

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on June 24, 1999

COMMISSIONERS PRESENT:

Maureen O. Helmer, Chairman
Thomas J. Dunleavy
James D. Bennett
Leonard A. Weiss

CASE 96-E-0900 - In the Matter of Orange and Rockland
Utilities, Inc.'s Plans for Electric
Rate/Restructuring Pursuant to Opinion No.
96-12. JOINT PETITION FOR AUTHORITY TO
TRANSFER GENERATING ASSETS.

CASE 96-E-0897 - In the Matter of Consolidated Edison Company
Of New York, Inc.'s Plans for (1) Electric
Rate/Restructuring Pursuant to Opinion No.
96-12; and (2) the Formation of a Holding
Company Pursuant to PSL, Section 70, Section
108, and Section 110, and Certain Related
Transactions.

ORDER APPROVING TRANSFER OF GENERATING FACILITIES
AND MAKING OTHER FINDINGS

(Issued and Effective June 24, 1999)

BY THE COMMISSION:

BACKGROUND

One feature of Orange and Rockland Utilities, Inc.'s
(Orange and Rockland) Rate and Restructuring Plan adopted in
Opinion No. 97-20 is the auctioning of Orange and Rockland's
generating facilities.^{1/} Consolidated Edison Company of New
York, Inc.'s (Con Edison) Rate and Restructuring Plan, adopted in
Opinion No. 97-16, also provides for the auctioning of its
generating facilities, including its two-thirds share of the

^{1/} Case 96-E-0900, Orange and Rockland Utilities, Inc. - Plans
for Electric Rates and Restructuring, Opinion No. 97-20
(issued December 31, 1997).

Bowline Point Generating Station (Bowline).^{1/} Orange and Rockland filed a Final Divestiture Plan on February 3, 1998, which was approved, with modifications, in the Auction Plan Order.^{2/}

In a petition dated February 26, 1999, Orange and Rockland, Con Edison and Southern Energy, Inc. (Southern) jointly request authority under Public Service Law (PSL) § 70 to transfer all of Orange and Rockland's generating assets and Con Edison's two-thirds share of Bowline to affiliates of Southern for \$476.29 million, subject to adjustments at the closing of the transaction. Southern was the winning bidder for these facilities in Orange and Rockland's auction.

The Auction Plan Order

Subsequent to filing its Final Divestiture Plan, Orange and Rockland reached agreement with Con Edison to jointly sell both utilities' interests in Bowline. In the Auction Plan Order, this agreement was rejected because the proposed revenue sharing arrangement gave Con Edison a premium payment, to the detriment of Orange and Rockland's ratepayers. A revised agreement changing the sharing mechanism was approved in the Auction Compliance Order.^{3/}

The Auction Plan Order approved Orange and Rockland's proposal to conduct a two-phase auction. Initially, Orange and Rockland would solicit non-binding preliminary bids in Phase I. These bids would be evaluated, with a reduced number of bidders selected to participate in Phase II, the binding bid round. If more than one of the Phase II bids clustered around a particular

^{1/} Case 96-E-0897, Consolidated Edison Company of New York, Inc. - Plans for Electric Rates and Restructuring, Opinion No. 97-16 (issued November 3, 1997).

^{2/} Case 96-E-0900, supra, Order Authorizing The Process for Auctioning of Generating Plant and Rejecting Joint Agreement (issued April 16, 1998).

^{3/} Case 96-E-0900, supra, Order on Bowline Joint Agreement Compliance Filing (issued May 26, 1998).

price, the clustered bidders would compete against each other in a multiple-round ascending bid process. The winning bidder was to be selected by Orange and Rockland, in consultation with its financial and legal advisors and Con Edison.

During Phase I of the auction, bidders would be allowed to submit separate bids on Bowline, a 98 acre vacant parcel of property adjoining Bowline (Bowline adjacent property), the Lovett Generating Station (Lovett), the hydroelectric facilities as a group,^{1/} and the gas turbines as a group.^{2/} Bids would also be invited for all the assets as a single package. The Phase I bids would be evaluated on price and non-price criteria, including the perceived sincerity of the bid, ability to successfully finance and close, assumption of environmental and other liabilities, the ability to properly operate the plants, a commitment to retain plant personnel, and the certainty of receiving requisite regulatory approvals. These criteria would also be employed in selecting the winning bidder.

Orange and Rockland was required to implement horizontal and vertical market power guidelines. Horizontal market power occurs if one or a small number of generation entities own a percentage share of generation supply large enough to improperly raise prices above competitive market levels. The horizontal market power guidelines, which generally track federal precedents, were incorporated in the Auction Plan Order.

Vertical market power occurs when an entity exercises market power at one stage of a production process and leverages that power to gain advantage over its competition in a different stage of the production process. The Auction Plan Order suggested that the potential for vertical market power had been ameliorated. However, additional guidelines were subsequently

^{1/} Orange and Rockland owns four hydroelectric generating stations--Grahamsville, Mongaup, Rio and Swinging Bridge.

^{2/} There are two gas turbine facilities--Hillburn and Shoemaker.

adopted for circumstances where utility affiliates own both generation and transmission in the same region.^{1/}

Load pocket market power^{2/} was addressed by the proposed use of call contracts within the two load pockets denominated as the Eastern pocket and Western pocket. Load pocket conditions occur in the Eastern pocket (where Lovett is located) in both the summer and winter approximately 22% of each year; in the Western pocket (where the hydros and gas turbines are located), load pocket conditions occur during the summer only, and for approximately 10% of the year.

Labor and environmental issues were also addressed in the Auction Plan Order. Orange and Rockland planned to require the purchaser(s) of its generating assets to honor its collective bargaining agreement and assume responsibility for all past, present and future environmental liabilities. To ensure that other environmental considerations were satisfied, a Final Supplemental Generic Environmental Impact Statement (FSGEIS) was issued June 18, 1998 in this proceeding. In the FSGEIS, potential environmental, social, and economic impacts arising out of the divestiture process were evaluated. It was decided that the potential for discontinuance of informal land use agreements at some of the generation sites was a potential adverse impact, beyond those addressed in the Final Generic Environmental Impact Statement (FGEIS) issued in conjunction with Opinion No. 96-12.^{3/} Moreover, the effect of divestiture on the value of the

^{1/} Cases 96-E-0900, et al., Generation Plant Auctions, Statement of Policy Regarding Vertical Market Power (issued July 17, 1998).

^{2/} A "load pocket" is a portion of a utility's service territory in which load levels, at certain times, will exceed the transfer capability into the area, and so local generators must serve some of the load. Depending on the specific circumstances present in the load pocket, the local generators may or may not possess market power.

^{3/} Case 94-E-0952, In the Matter of Competitive Opportunities For Electric Service, Opinion No. 96-12 (issued May 20, 1996).

real property tax base in local communities was considered, and it was determined additional mitigation was warranted.

The new owner(s) of the plants were encouraged to continue all reasonable informal land use arrangements and to negotiate gradual, rather than immediate, changes in assessments for the plants. A voluntary mediation program to facilitate resolution of assessment disputes between the new owner(s) and host communities was established, with our Staff as the mediator.

Under Orange and Rockland's proposed schedule for the auction, it would begin soliciting interest in early June 1998, with final binding bids due in September 1998. Closing, subject to regulatory approvals, was anticipated to occur in May 1999, at the latest.

THE JOINT PETITION

The Joint Petitioners describe the assets to be transferred, Southern's ability to manage the facilities, the contracts that were executed between the parties, and the process that was actually undertaken to auction the facilities. They ask that we:

1. find that the transfer is in the public interest pursuant to PSL § 70;
2. approve the transaction contracts;
3. find that Southern is in compliance with our vertical and horizontal market power guidelines such that the transfers present no issue with respect to vertical or horizontal market power;
4. find that the auctioned assets are "eligible facilities" pursuant to Section 32 of the Public Utility Holding Company Act (PUHCA), enabling Southern to secure exempt wholesale generator (EWG) status from the Federal Energy Regulatory Commission (FERC);
5. approve the Orange and Rockland Transition Power Sales Agreement, the Con Edison Transition Capacity Sales Agreement and the Amendment, the Eastern Load Pocket Agreement, and the Western Load Pocket Agreement;

6. approve Orange and Rockland's and Con Edison's proposed accounting for these transactions;
7. approve the rate treatment of the net gain from the sale of Orange and Rockland's Purchased Assets and find that it is in compliance with the Restructuring Plan; and
8. find that the rate treatment of the net loss from the sale of Con Edison's interest in Bowline is in accord with Opinion No. 97-16 and is approved.

The Purchaser

Southern is a leading global energy company competing in all sectors of the electricity business and, increasingly, in the marketing of natural gas and other energy related products and services. Through direct and indirect subsidiaries, Southern designs, builds, owns and operates power production facilities and provides a broad range of energy-related services in Asia, Europe, Latin America and North America. Southern had total consolidated assets of \$11 billion for the year ending December 31, 1997.

Southern has created a number of affiliates to purchase and operate the generating facilities. Southern Energy Bowline, LLC was incorporated to purchase Bowline; Southern Energy Lovett, LLC was incorporated to purchase Lovett; and, Southern Energy NY-Gen, LLC was incorporated to purchase the hydros and gas turbines (collectively, the Southern Affiliates).

The Auction Process

Orange and Rockland asserts it conducted the auction in conformance with the requirements of the Auction Plan Order. Donaldson, Lufkin and Jenrette Securities Corporation (DLJ) served as Orange and Rockland's financial advisor as well as the auction administrator. Skadden, Arps, Slate, Meagher & Flom LLP served as the company's legal advisor.

DLJ began the auction process in early June 1998 by soliciting expressions of interest in the auction from approximately 175 interested entities. Potential bidders with

both the ability to close the transaction in a timely manner and the qualifications to operate the plants reliably were identified. Those that signed confidentiality agreements received the detailed Confidential Information Memorandum as well as CD-ROMs containing data and documents relating to the facilities and term sheets describing the material terms and conditions that would be set forth in the transaction agreements.

DLJ invited qualified bidders to participate in Phase I and submit non-binding initial bids for all, any, or any combination of the assets. All bids for Bowline, even if included as part of a bid for multiple assets, were required to be separately identified and specified.

DLJ received non-binding bids from Phase I bidders on or before August 3, 1998. Upon DLJ's and Skadden's recommendations, Orange and Rockland invited a select group of bidders to participate in Phase II. Orange and Rockland and DLJ assembled and made available to all Phase II bidders a significant amount of additional information about the generating facilities, including answers to hundreds of specific inquiries. Additionally, the company's management gave oral presentations and conducted tours of the plants. Orange and Rockland asserts that the identity of the Phase II bidders were kept confidential.

All Phase II bidders were simultaneously sent the formal texts of each transaction agreement to be executed in connection with the transfer of the generating facilities. DLJ invited each Phase II bidder to identify in writing the principal objections or suggested changes, if any, it required in order to execute the transaction agreements.

DLJ received Phase II bids on October 23, 1998. Subsequently, after a period of negotiations, Orange and Rockland, Con Edison and the Southern Affiliates executed final contracts for Southern's purchase of all of the generating assets (the Purchased Assets) on November 24, 1998. Orange and Rockland claims it has complied fully with the Auction Plan Order by consulting with Staff on each of the critical steps in the auction process such as review of (a) the Confidential

Information Memorandum; (b) the transaction agreements; (c) the Phase I bid evaluation; and (d) the Phase II bid evaluation.

The Transaction Contracts

Asset Sales Agreements

The Joint Petitioners have entered into a number of transaction contracts. The central agreements are the Asset Sales Agreements (ASA). Separate agreements were executed with each Southern Affiliate identified above. Each ASA delineates all the conditions of the sale including purchase price and allocation of assets by the parties prior to and after closing. Specific areas of note in the ASAs are the provisions relating to environmental liabilities, labor, pension benefits, property tax issues, and miscellaneous adjustments to the purchase price.

Environmental Liabilities - Each ASA provides that the Southern Affiliate will assume, with limited exceptions, all known and unknown on-site environmental liabilities arising from the ownership or operation of the facility(ies) purchased. However, the Southern Affiliate will not assume environmental liabilities related to off-site disposal of hazardous substances prior to the closing date.

Labor Provisions - Each ASA calls for the Southern Affiliates to honor the collective bargaining agreement and offer employment to the union-represented employees to begin as of the closing date. The Southern Affiliates will not assume sponsorship or any other obligation under any Orange and Rockland benefit plan in connection with the assumption of the collective bargaining agreement or in connection with hiring any of the hourly employees. All benefits accrued under any Orange and Rockland benefit plan(s) and all benefits currently payable as of the closing date will remain the obligation of Orange and Rockland.

Further, the ASAs call for the Southern Affiliates to determine which Orange and Rockland management employees they wish to offer employment. All such employees will be given credit for all service with Orange and Rockland under all

Southern employee benefit plans in which they become participants for purposes of eligibility, vesting and determination of level of benefits.

Pension Benefits - The ASAs call for Orange and Rockland to pay the Southern Affiliates, at closing, \$10 million. Although the payment is not earmarked for any particular purpose, the parties acknowledge that the payment was negotiated to compensate Southern for the additional liability it assumed by agreeing to maintain the level of retirement benefits to transferred employees while giving credit for years of service with Orange and Rockland.

Property Tax Issues - The ASAs require the Southern Affiliates to abide by all currently existing property tax settlements. With respect to the pending tax certiorari proceedings involving Bowline, Orange and Rockland agreed to cede all of its rights to Southern Energy Bowline, LLC, including any and all property tax refunds that may be achieved.

Assumed Liabilities - Each ASA sets forth the liabilities to be assumed by the Southern Affiliate after closing. In a "catch-all" provision pertaining to specifically unidentified liabilities, there is a cap on the assumption of \$3 million, over which Orange and Rockland continues to be liable.

Miscellaneous Adjustments - The purchase price is also subject to adjustment to reflect the level of fuel inventory levels, vehicle lease values, customary proration of any applicable prepaid taxes, rents and/or fees, and maintenance and capital expenditures, from the date the ASAs were executed to the date of closing.

Interconnection and Site Agreements

The Joint Petitioners executed Continuing Site/Interconnection Agreements providing for continued access to each other's facilities and for interconnection services to Orange and Rockland's transmission system. Each agreement requires the parties to grant the easements necessary to enable each other to maintain their respective facilities and equipment.

Such operating easements will be prepared by the parties prior to closing. Amendments to these agreements were filed May 17, 1999 to specify the points of demarcation between the parties' facilities.

Load Pocket Agreements

Orange and Rockland entered into two Load Pocket Agreements to address the Eastern and Western load pockets in its territory. The Eastern Load Pocket Agreement allows Orange and Rockland to call on Lovett and have it dispatched when it is not otherwise being dispatched, in order to ensure the reliability of the Eastern load pocket. The Western Load Pocket Agreement allows Orange and Rockland to call on and have dispatched the Shoemaker Gas Turbine and the Mongaup, Rio and Swinging Bridge hydroelectric facilities, when such facilities are not otherwise being dispatched, in order to ensure the reliability of the Western load pocket.

Each Load Pocket Agreement has an initial term of one year. Orange and Rockland may, in its sole discretion, extend the term of each agreement for a maximum of four additional consecutive one year terms. The company claims that the payments made by Orange and Rockland under the Load Pocket Agreements are not duplicative of the payments made by Orange and Rockland under the Transition Power Sales Agreement. The company also claims that the penalty provisions contained in these agreements are sufficient to prevent any breaches by Southern.

Transition Power Sales Agreements

The Transition Power Sales Agreement (TPSA) calls for Southern to provide Orange and Rockland with installed capacity and energy at specified amounts and prices from the closing date through October 31, 2000. The Auction Plan Order did not contain any provision for such a contract as it was anticipated that the New York Independent System Operator (ISO) and a liquid wholesale capacity market would be open and fully operational by May 1, 1999. By September 1998, Orange and Rockland concluded that this

would not be the case and filed a proposal to allow it to solicit short-term transition contracts. On October 7, 1998 we approved such a modification to the Auction Plan Order and deferred any determination regarding the terms and pricing of these transition contracts until consideration of the Section 70 petition.^{1/}

Con Edison entered into a Transition Capacity Sales Agreement (TCSA) with Southern, giving it the option of purchasing up to 810 MW of installed capacity from Bowline for the Summer 1999 capability period, by providing Southern Energy Bowline, LLC notice of such amount by December 4, 1998. The TCSA also gave Con Edison the option of purchasing any amount of capacity, up to 810 MW, for the Winter 1999-2000 capability period by providing notice of such amount by September 1, 1999.

In September 1998, Con Edison issued a request for proposals (RFP) for capacity. Pending receipt of responses, not due until after the divestiture bids were due, it proposed to inform bidders that it reserved the option, at its discretion, to enter into a short-term transition contract with the new owner of Bowline for the purchase of up to Con Edison's full two-thirds share of the Bowline capacity. In our October 7, 1998 Order, we also approved Con Edison's proposal but deferred consideration of the reasonableness of the purchase price until our review of the Section 70 Petition.

Southern Guaranties

Southern executed parent guaranties in favor of Orange and Rockland and Con Edison to secure the performance of the Southern Affiliates, including payment of the purchase price and indemnification of the utilities against claims assumed by the Southern Affiliates under the ASAs.

^{1/} Case 96-E-0900, supra, Order Approving Modification To Divestiture Plan (issued October 7, 1998).

Agency Agreement

Orange and Rockland has agreed to act as Southern's agent to the New York Power Pool (NYPP). The Agency Agreement allows Southern to engage in wholesale power sales and sales of ancillary services to Orange and Rockland and other electric wholesale market participants before the ISO becomes operational. Thus, the term of this agreement extends until the ISO commences operation.

As Southern's agent to the NYPP, Orange and Rockland has the obligation to perform the activities necessary to ensure that Southern meets its obligations set forth in the NYPP Operating Manual. Southern will pay a fee of \$41,666.67 per month to Orange and Rockland as compensation for the agency arrangement. This payment equates to 50 percent of Orange and Rockland's monthly NYPP membership fees.

Incremental Energy Sales Agreement

The Incremental Energy Sales Agreement between Orange and Rockland and Southern is a full-requirements agreement which allows Orange and Rockland to meet its responsibilities to furnish electricity as the provider of last resort to customers in its service territory. Southern will provide both energy and ancillary services to Orange and Rockland. The term of the agreement begins the day after the closing and terminates on the earlier of (a) the first day of operation of the ISO, or (b) May 1, 2000. The energy payment to Southern for delivered energy is based on a fuel index, a heat rate and a predefined adder.

Energy Sales Agreement

Con Edison and Southern have entered into an Energy Sales Agreement which begins the day after the closing and terminates the first day of September 1999. The agreement is for firm delivery of 500 MWhs of energy during on-peak hours. The energy payment to Southern for delivered energy is based on a fuel index, a heat rate and a predefined adder.

The Public Interest

Orange and Rockland and Con Edison affirm that they have complied with the Auction Plan Order, and maintain that the transfer of the Purchased Assets to the Southern Affiliates is in the public interest. The companies claim:

1. Orange and Rockland will remain subject to our jurisdiction and will remain obligated to perform its obligations under its Rate and Restructuring Plan;
2. the operation of Orange and Rockland's transmission and distribution business will in no way be inhibited or impaired as a result of the transaction;
3. upon closing, there will be no competitive transition charge in the Orange and Rockland service territory;
4. the purchase price compares favorably to those in other generation auctions;
5. divestiture of generation is in the public interest;
6. the labor and environmental provisions of the ASAs are in the public interest;
7. Southern is financially able to close the transactions and is qualified to operate the facilities;
8. Southern currently complies, and is required to comply through closing, with the horizontal and vertical market power guidelines; and
9. the transaction will not have any significant impact on the environment, for purposes of the New York State Environmental Quality Review Act.

Market Power

The Joint Petitioners assert that the transfer of the Purchased Assets to the Southern Affiliates will not create vertical or horizontal market power concerns. Through the utilities' consultant, Putnam, Hayes & Bartlett, Inc. (PHB), the Joint Petitioners attempt to demonstrate that Southern presently is, and through the closing will continue to be, in compliance

with all applicable market power guidelines. PHB explains that Southern's acquisition of the Purchased Assets will generally have a positive effect on competition based on its study, which applies the FERC's Merger Policy Statement guidelines for evaluating the effects of mergers on competition in the electric utility industry, as modified to reflect features of the restructured markets in New York.

With regard to horizontal market power, the PHB study concludes that the transfer will either decrease or have a negligible impact on market concentration in all relevant markets. The analysis examines the effect on competition of the transfer for each of the relevant product markets: total capacity, uncommitted capacity, economic capacity, and available economic capacity, in each of the two relevant geographic markets, N.Y. West and N.Y. East.

PHB also concludes that the transfer will have no effect on the potential exercise of vertical market power. PHB explains that Southern does not currently own any transmission facilities in New York and will not acquire any transmission facilities other than those that are part of the Purchased Assets and incidental to the operation of the generating facilities. As a result, Southern will not be able to use such facilities to control access by others to the transmission grid or to otherwise engage in anti-competitive behavior through vertical control.

Accounting and Taxes

Gross proceeds from the sale of the Purchased Assets will be \$476,290,000, subject to the adjustments set forth in the ASAs.^{1/} Of this total, Orange and Rockland will receive gross proceeds of \$343,056,700 and Con Edison will receive gross proceeds of \$133,233,000 (i.e., two-thirds of the purchase price for Bowline).

^{1/} The purchase price is allocated as follows: Bowline - \$199,850,000; Bowline adjacent property - \$12,500,000, Lovett - \$243,500,000; hydros and gas turbines - \$20,440,000.

Orange and Rockland estimates an after-tax net gain applicable to New York operations of \$7.4 million. This estimate is based on an allocation of 67 percent of gross proceeds to New York operations.^{1/} Because Orange and Rockland selected a winning bidder prior to May 1, 1999, the company proposes to share the New York portion of the gain 75 percent to ratepayers and 25 percent to shareholders. The ratepayer share of the estimated after-tax New York net gain is approximately \$5.6 million or \$8.5 million before Federal Income Taxes (FIT). The estimated gain is subject to update to reflect actual costs of the sale.

Con Edison estimates a net after-tax loss of \$13,594,000, which was calculated by subtracting the net book cost of its share of Bowline, the book cost of its share of materials and supplies and the FIT payable in connection with the sale, net of previously deferred income taxes for depreciation, from its share of the gross proceeds. This estimated loss is also subject to update to reflect actual costs of the sale.

Both Orange and Rockland and Con Edison have excluded from the FIT calculation previously deferred income taxes for depreciation above the current statutory rate and the reversal of the deferred Investment Tax Credit (ITC) balances related to the Purchased Assets. The utilities claim that this treatment is necessary to meet Internal Revenue Service normalization requirements.

Ratemaking Treatment

As stated above, Orange and Rockland proposes to allocate the net proceeds 75 percent to customers and 25 percent to shareholders. Under Opinion No. 97-20, the company is

^{1/} The allocation percentages are based on a composite factor developed from a history of the Demand Ratio and Energy Ratio as defined in the Power Supply Agreements between Orange and Rockland and its New Jersey and Pennsylvania utility subsidiaries, Rockland Electric Company and Pike County Light and Power Company, respectively.

required to file a plan for the disposition of the ratepayers' share of the net proceeds, which is to be determined consistent with the principle of maintaining rate stability.

Opinion No. 97-20 requires the benefits of the net proceeds to be provided first to customers other than the "Large Industrial Customers" who have been placed in Service Classification No. 22. These customers are to receive the divestiture benefits up to the annual equivalent of an additional 2.91 percent rate reduction. The potential additional 2.91 percent, when combined with the previous rate reductions totaling 2.09 percent as specified in company's Rate and Restructuring Plan, has the potential to provide the annual equivalent of a five percent rate reduction.

Orange and Rockland proposes to return the customers' share by means of a Divestiture Gain Credit (DGC) that would operate over the final two rate years covered by the Rate and Restructuring Plan (i.e., December 1, 1999 through November 30, 2001). The credit would be applied to each eligible customer class such that the equivalent percent impact on revenue responsibility would be uniform. If the two year credit, as Orange and Rockland currently estimates, is \$9.8 million, the impact would be equivalent to a uniform 1.8 percent reduction in revenue. This percentage reduction is subject to update to reflect the actual costs of the sale and the transfer date.

Initially, the DGC will be based on the company's projected monthly sales over the two year period for which the credits will be applied. The company proposes to monitor monthly the DGC credits and reconcile the amounts to be credited based on actual sales.

Exempt Wholesale Generator Status

The Joint Petitioners interpret PUHCA as requiring a finding that new ownership of a generation facility will benefit customers, is in the public interest, and does not violate state law, before the Southern Affiliates can be afforded EWG status for the Purchased Assets. Southern seeks EWG status for its

affiliates so they may operate the Purchased Assets free of burdensome federal regulation intended for monopoly utilities.

Southern asserts that its affiliates will participate in a wholesale competitive market for the sale of electricity. Consumers will benefit from increased competition in the marketplace which will set the price the Southern Affiliates may charge, thus making state rate regulation unnecessary. The EWG findings have been made in similar circumstances in other states,^{1/} and for the purchasers of the plants in New York State Electric & Gas Corporation's auction.^{2/}

PARTY COMMENTS

Notice of the petition was published in the State Register on March 17, 1999. In addition, Orange and Rockland served notice of the petition on the active parties in Cases 96-E-0900 and 96-E-0897. A meeting among Orange and Rockland, Con Edison, Southern, Staff and interested parties was held in Suffern, New York on March 19, 1999 to discuss the Joint Petition. A Notice Soliciting Comments was issued March 10, 1999 in this proceeding, establishing a comment filing deadline of April 21, 1999. The deadline was subsequently extended to May 14, 1999 by a Notice Extending Time For Comments issued May 5, 1999. Comments have been received from the Industrial Energy Users Association (IEUA), IBEW Local 503, Town of Stony Point, Rockland County, Sullivan County, the New York State Consumer Protection Board (CPB), the New York State Attorney General's Office (AG), Sullivan County, and the City of New York (City).

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

^{2/} Case 96-E-0891, New York State Electric & Gas Corporation - Plans for Electric Rates and Restructuring, Order Approving Transfer of Electric Generation Facilities, Approving Contracts Upon a Condition, and Making Other Findings (issued December 3, 1998).

The Multi-Party Petition

On or about March 29, 1999, IEUA, IBEW Local 503, Town of Stony Point, Rockland County, and Sullivan County (MP-Petitioners) filed a Multi-Party Petition (MPP) for the Appointment of an Administrative Law Judge (ALJ) to Supervise Discovery and Establish a Hearing Schedule in connection with the Joint Petition. CPB and AG expressed support for the MPP; the Joint Petitioners opposed it. Deferring consideration of the MPP, we directed our Staff to conduct a complete and thorough investigation of the auction process and apprise the MP-Petitioners, CPB and AG of the progress and results of that effort.^{1/}

Comments on the Joint Petition

Attorney General's Office

The AG reiterates its concerns that it raised in its April 6, 1999 letter commenting on the MPP. The AG believes that Orange and Rockland's and Con Edison's customers should receive appropriate compensation for the Purchased Assets. In a June 23, 1999 letter, the AG acknowledges the utilities' agreement to resolve outstanding issues. However, it claims it cannot render an opinion on the resolution at this time. Therefore, the AG states that it is reserving the right to address these matters once more details are known.

City of New York

While the City does not oppose the sale, it requests that the transfer to Southern of Con Edison's claim to real property tax refunds related to Bowline was improper and should be rejected. The City contends that this refund claim belongs to the ratepayers (except for the 14 percent management incentive provided to Con Edison) because ratepayers paid these taxes.

^{1/} Case 96-E-0900, supra, Order on Investigation of Orange and Rockland's Auction Process and Extending Time for Comments (issued April 26, 1999) (April 26 Order)

Therefore, the City suggests that Southern should be ordered to report the amount of any property tax refund it receives. 86 percent of two-thirds of that amount (i.e., Con Edison's share of the refund) should be imputed as a reduction to Con Edison's rates at the next available opportunity.

Consumer Protection Board

In a May 14, 1999 letter, CPB states that it remains concerned with the potential impact that the matters in controversy may have for Orange and Rockland's ratepayers if this sale occurs without some equitable resolution of the issues raised. CPB also notes that no formal Staff recommendation has been presented that resolves the concerns raised in the MPP. Thus, CPB states that its position remains as set forth in its letter supporting the MPP.

CPB also asserts that until the matters of the auction process, pension liability payment, and property tax refunds are properly resolved, it has no basis to conclude that this sale is in the public interest. Therefore, CPB urges a complete resolution of the Staff investigation, circulation of Staff's results to the parties for review and discussion, and an agreed upon settlement by all concerned that we can consider. CPB avers that an acceptable alternative could be a Staff report circulated for comments by the parties. Finally, CPB reserves its right to comment further upon receipt of the results of Staff's investigation.

In a June 22, 1999 letter, CPB amends its comments based on information reported to it by Staff. In this letter, CPB reiterates its concerns with the proposed transaction and describes its understanding of the resolution of Staff's investigation, noting the provision of additional benefits by Orange and Rockland and Con Edison to the utilities' ratepayers. Although CPB had not seen any written documentation reflecting this agreement by the utilities at the time it submitted its comments, its states that based on the information provided by Staff, its concerns appear to have been resolved. Therefore, CPB

does not object to the approval of the Joint Petition, as modified by the additional payment for the benefit of ratepayers.

In addition, CPB expresses concern with as-yet unresolved union issues. It encourages the union and Southern to amicably resolve these issues in a manner that protects all parties' interests.

IBEW Local 503

IBEW Local 503 explains that it has held several meetings with the Joint Petitioners to resolve a number of outstanding union issues, primarily related to pension benefits, medical benefits and the employees' 401K program. Initially, the union expressed concerns that approval of the Joint Petition could impact its negotiations. By letter dated June 23, 1999, however, the union reports that Southern has agreed to resolve the 401K and pension vesting issues. Separately, the union advised Staff that the medical benefits issue has also been resolved.

Because of its agreement with Southern, the union advises that it withdraws its objections and fully supports the Joint Petition.

Industry Energy Users Association

In a May 14, 1999 letter, IEUA requests that Orange and Rockland and Southern be held to the evidentiary standard that they have the burden of proof to demonstrate why the proposed sale is in the public interest. IEUA contends that the comparison provided in the Joint Petition as to the reasonableness of the price received for the Purchased Assets is unpersuasive on its face and not conclusive. Accordingly, IEUA states that because the auction price falls at the bottom of a very wide range, it cannot conclude that the price received by Orange and Rockland is in the public interest.

IEUA continues by stating that Orange and Rockland's inclusion of materials and spare parts inventory as part of the sale price was not prudent and is detrimental to ratepayers.

IEUA states that it has several concerns associated with this component of the transaction with Southern. First, the fact that the Southern bid was conditioned on the inclusion of the spare parts inventory in and of itself represents a non-conforming bid based on the Offering Memorandum. Second, IEUA asserts that it is hard-pressed to understand why Orange and Rockland would provide, free of charge, \$14.7 million of inventory when the parts included in inventory are not only valuable in their own right, but are needed and required for the maintenance and operation of the Purchased Assets.

IEUA reiterates its concerns on the property tax issues and believes that monies are due to customers. Also, IEUA reiterates its concerns regarding the auction process and states that it was flawed and the cost of conducting the auction must not be borne by ratepayers. Finally, IEUA urges that ratepayers not be liable for any advisory and legal fees and other closing costs associated with this transaction.

Subsequently, in a June 22, 1999 letter, IEUA amends its comments based on its conversations with Staff regarding Staff's investigation. Because IEUA had not seen any written documentation of the utilities' agreement to provide an additional benefit to ratepayers, it claims it cannot render an opinion as to the appropriateness of the amount of the benefit. Rather, IEUA raises a few technical issues that it believes should be implemented to ensure that post-divestiture electric rates are correct. IEUA notes a series of adjustments and corrections that should be made to the Joint Petition. These include: 1) assignment of 100% of the gain of the Bowline adjacent property to New York operations; 2) correction of the composite allocation factor for New York from 67 percent to 67.7 percent; and 3) adjustment of the gain calculation to reflect incremental depreciation expense through June 30, 1999.

Rockland County

Rockland County states that the approval of the transfer must be conditioned upon Southern's willingness to

resolve the property tax issues involving Bowline through a reasonable prospective phase-down. The County contends that the "public interest" requires such a phase-down and that Southern should hold an acceptable phase-down offer open for a reasonable period of time. Rockland also states that issues of fact exist with respect to property tax matters requiring hearings and the appointment of an ALJ.

Rockland County also contends that the transfer of Excess Deferred Income Tax (EDIT) and Unamortized Investment Tax Credit (UITC) balances to shareholders is contrary to equity, regulation and normalization. It states that EDITs and UITCs represent federal tax expenses that Orange and Rockland recovered from ratepayers in excess of FIT that never were, or never will become, due and payable. The County asserts that under continued rate regulation, Orange and Rockland would have flowed these EDITs and UITCs back to ratepayers ratably, over the regulatory life of the Purchased Assets. In support of this position, Rockland County submitted a copy of testimony, submitted by David M. Wise of WiseEnergy, Inc. to the Maine Public Utilities Commission, arguing that retention of EDITs and UITCs is permissible and consistent with the intent of the IRS tax normalization requirements.

By letter dated June 22, 1999, Rockland County amends its comments. First, it notes that significant progress has been made by Southern and the local community to resolve the Bowline property tax dispute. The County believes that the pendency of this proceeding and our FSGEIS has facilitated the resolution of this matter. To ensure the progress continues, Rockland County requests that Southern be required to hold open its last settlement offer for a period of time. Second, the County asks that certain specified federal income tax benefits associated with the divestiture inure to the benefit of ratepayers.

Sullivan County

Sullivan County states that the potentially large impact on the real property tax base of many counties, towns,

villages, cities and schools has not been adequately addressed in the Joint Petition. Sullivan County suggests that we should require Orange and Rockland and Southern to address the property tax concerns.

Subsequently, Sullivan County amended its comments to indicate that it had met with Southern representatives and received assurances that Southern would work with the County to address the needs of the local residents. As a result of this meeting, Sullivan County reports, it is more comfortable with the transaction.

DISCUSSION

Except as noted below, Orange and Rockland conducted the auction in substantial conformance with the Auction Plan Order and other prior Orders. The auction process which led to the sale of the Purchased Assets was designed to maximize auction proceeds. The \$476.29 million purchase price was the highest bid received.

Southern is an entity with the requisite financial and operational backing to be capable of properly managing the Purchased Assets in a competitive environment. Moreover, Southern meets the tests for determining that, as a new entrant into the wholesale electric marketplace, it will not be able to exercise horizontal or vertical market power. As a result, the transfer of the Purchased Assets to the Southern Affiliates is in the public interest and is approved subject to the conditions and understandings discussed below.

The Auction Process

In the Auction Plan Order, Orange and Rockland was authorized to proceed with the approach it had proposed for conducting the auction of its generating facilities, subject to some modifications. Staff engaged in a detailed examination of all facets of the auction process. Staff also reviewed issues noted in the MPP, specifically relating to: 1) the auction process itself; 2) a \$10 million payment from Orange and Rockland

to Southern; and 3) the disposition of the tax certiorari proceedings related to Bowline.

The company generally implemented its divestiture plan in compliance with the Auction Plan Order. Contrary to the utilities' assertions, however, Staff was not provided full details during the auction process.

There is no concern with the selection of potential bidders at the outset of the auction process. In fact, there was significant interest expressed in the generating facilities. Based on the preliminary bids received in Phase I, Orange and Rockland's bundling of the facilities was reasonable.

A number of bidders were selected for Phase II, based on DLJ's recommendations. After a reasonable period for the bidders to conduct due diligence, Phase II bids were received in late October 1998. Southern was determined to be the winning bidder and negotiations ensued over the next few weeks, resulting in the execution of the ASAs and related agreements.

With respect to the \$10 million payment to Southern, the Joint Petitioners adequately demonstrated that this amount was roughly equal to the additional liability to be incurred by Southern as a result of assuming the pension benefits of the transferred employees with full credit for years of service at Orange and Rockland.

With respect to the tax certiorari claims, Staff's investigation concluded that Orange and Rockland received no remuneration for ceding its rights to the claims to Southern. However, Orange and Rockland asserted that the claims had little or no value and therefore this action was of no consequence. Based on information gathered by Staff, it appears that the tax claims may have some value, primarily as a means of assisting Southern in resolving future property tax and assessment issues.

Another area of concern in the MPP was related to local property tax impacts resulting from divestiture. As discussed in the FSGEIS, property tax issues are, to some extent, beyond our jurisdiction. However, Southern has advised us it will comply with the property tax mitigation measures discussed in the FSGEIS

and will work closely with all of the host communities to resolve future local concerns.

Finally, concerns were raised regarding labor issues. Staff conducted a number of meetings with union representatives and the Joint Petitioners. As a result of these meetings and of direct negotiations between the union and the Joint Petitioners, the vast majority of the union concerns were resolved. As noted above, the union and Southern have entered into an agreement that resolves almost all of the remaining issues. Therefore, the union supports the Joint Petition and the few open issues do not pose any impediment to our approving the sale.

Resolution of Parties' Concerns

To resolve the concerns raised by the parties and noted by Staff during its investigation, Staff engaged in a series of discussions with Orange and Rockland and Con Edison to determine how best to address these concerns. As a result of these discussions, the utilities agreed to provide additional benefits to their ratepayers in the total amount of \$10 million (pre-tax). Orange and Rockland agreed to give its New York ratepayers its shareholders' portion of the net proceeds (approximately \$5 million), to make an approximate \$2 million positive adjustment to the net proceeds attributable to the Bowline adjacent property and to reduce deferred debits currently carried on Orange and Rockland's books of account by \$1 million.^{1/} In addition, Con Edison agreed to a \$2 million imputation to its share of the net proceeds, which will have the effect of reducing its net after-tax loss on the sale of its two-thirds interest in Bowline.

The total benefit to the utilities' ratepayers will encompass all price and process concerns raised in the MPP and all concerns identified during the investigation. Based on the parties' comments and Staff's investigation, we conclude this

^{1/} The final breakdown of the \$8 million payment to Orange and Rockland's New York ratepayers among the above-described categories of payments will be determined by the actual proceeds received at closing.

adjustment, when added to the net proceeds received from Southern, constitutes a fair and reasonable result for the auction.

Market Power

Horizontal Market Power

The Joint Petitioners' performed a horizontal market power analysis using the Herfindahl-Hirschman Index (HHI). Their analysis indicated that no horizontal market power concerns will arise as a result of the sale. Southern's market share in the energy market is projected to be in the 2% to 5% range, depending on the market definition and time of year. This is clearly not a market power problem. Southern's market share in the capacity market ranges from 7% to 16%, depending on the market definition and assumptions used. This is in an acceptable range, and is not a barrier to approval of the transfer.

Vertical Market Power

Southern's assertion that this transaction does not create any vertical market power concerns is correct. Southern and its affiliates do not own any electric transmission or distribution facilities in New York State. As a result of the sale, the only such facilities it will own are those that are incidental to the generating facilities. Ownership of these dedicated T&D facilities will not give Southern any opportunity to inhibit the ability of any other generator in the State to access the transmission grid.

The Transaction Agreements

The Sales Contracts

In the ASAs and Continuing Site/Interconnection Agreements, Orange and Rockland has preserved its authority to operate the transmission system and respond to system emergencies. The contracts compel the Southern Affiliates to conform to good utility practice and reliably operate the plants. As a result, the sale should not adversely affect system

reliability. The Continuing Site/Interconnection Agreements provide that Southern will operate the Purchased Assets in parallel with Orange and Rockland's transmission system, in compliance with standards that meet or exceed Orange and Rockland's existing procedures.

The contracts capture the real property and assets, including ash disposal sites, that will be transferred to the Southern Affiliates. Reservations have been made for assets excluded from the sale, such as electric substations, disconnect switches and other electric interface equipment. Should any of the schedules provided with the contracts be modified, or further modified as the case may be, Orange and Rockland is directed to file all revised schedules upon their completion.

Safety - Safety has been properly considered. Because the Southern Affiliates will be electric corporations under the Public Service Law, they must continue to meet the safety requirements in our regulations, including 16 NYCRR Part 125.

Environmental Issues - The ASA addresses environmental issues. Applicable environmental and non-environmental permits are listed and transferred. Emissions allowances associated with the operation of the Purchased Assets accompany their transfer. Southern will assume all environmental liabilities associated with the facilities, including off-site impacts, except that Orange and Rockland will remain responsible for pre-closing off-site liabilities and certain identified items.

While these arrangements are generally acceptable, two exceptions are noted. First, ratepayers shall not be responsible for any portion of the remediation costs, reported to be approximately \$200,000, associated with the Hillburn Gas Turbine site. Further, ratepayers shall not be liable for any of the costs of any environmental insurance premiums, as described in Article VII of the ASAs. Such insurance is related to liabilities arising primarily from Hazardous Substances released at the Purchased Assets. Ratepayers are typically not responsible for costs associated with such releases, a general rule that will not be abrogated as a result of this transaction.

Labor Issues - As to labor issues, the Southern Affiliates anticipate hiring all of the Orange and Rockland production-related union employees and approximately half of the production-related management employees. The existing collective bargaining agreement will be continued for union employees, while management employees hired by the Southern Affiliates will receive total compensation and benefits at least comparable to those they currently receive from Orange and Rockland. As discussed above, the vast majority of the labor concerns have been resolved by Orange and Rockland and/or Southern, and the union fully supports the Joint Petition.

Pension Issues - During final negotiations between Orange and Rockland and Southern, an issue arose regarding certain future retiree-related liabilities. Ultimately, Southern agreed to assume all such liabilities in exchange for a \$10 million payment at closing by Orange and Rockland. This \$10 million payment was a negotiated value, based on the companies' respective actuarial analyses regarding the extent of the future liabilities. Orange and Rockland's treatment for the \$10 million payment will be consistent with Orange and Rockland's discharge of the outstanding liability to pay certain pension and other post-retirement medical benefits for those employees hired by Southern.

With regard to both union and management employees transferring to Southern, all benefits accrued and currently payable as of the closing date are and remain the obligation of Orange and Rockland. At closing, Southern will assume the terms and conditions of the employee benefit plans covering hourly employees. Under the ASAs, Southern is required to count years of service with Orange and Rockland in determining benefit accruals (pension and post-retirement medical and life insurance benefits) for hourly employees. Management employees hired by Southern shall also be given credit for all service, to the same extent as such service was credited for such purpose by Orange and Rockland under all employee benefit plans, programs and fringe benefits of the Buyer in which they become participants

for purposes of eligibility, vesting and determination of benefits.

These provisions in the ASAs adequately protect the transferred employees. Moreover, they protect Orange and Rockland's customers by reducing the company's future employee benefit obligations. For these reasons, we find that the \$10 million payment and the treatment of employee benefit issues is reasonable.

Property Taxes - The Bowline ASA contains a provision whereby Orange and Rockland and Con Edison will cede all of their rights in the pending tax certiorari proceedings to Southern Energy Bowline, LLC. As discussed above, Orange and Rockland has agreed to pay its shareholders' entire share of the net gain from the sale to the New York ratepayers, an action that adequately addresses the commentors' concerns about the differences between the sharing allocations for the property tax refunds and for the net proceeds from the sale.

There are no pending property tax disputes associated with any of the other Purchased Assets. However, there are existing property tax agreements associated with some of them. Southern reports that it fully intends to honor these agreements. We affirm that Southern is required to do so and direct Southern to take no actions that are in conflict with any of the terms of these agreements.

Year 2000 Issues - Orange and Rockland has taken reasonable steps to confront Year 2000 computer programming issues outside the context of the ASAs. In conformance with our Year 2000 Orders,^{1/} Orange and Rockland is expected to complete all Year 2000 readiness activities at the generating facilities by July 1, 1999. The company reports substantial progress towards that goal. To the extent any exceptions to this deadline

^{1/} Case 98-M-1432, Utility Year 2000 Readiness, Order (issued October 30, 1998); Case 98-M-1432, supra, Order (issued February 17, 1999).

arise, Orange and Rockland is expected to clearly identify them, and report to us.

In order to ensure that planning for Year 2000 is not disrupted, the parties shall take the following steps. If the plant transfer takes place prior to July 1, 1999, Southern and its affiliates will assume responsibility for Year 2000 compliance. If the plant transfer takes place after July 1, 1999, Orange and Rockland will provide its Year 2000 compliance plan to Southern and its affiliates, which must then either accept the plan or file their own plan within 30 days after the closing. If the closing takes place after October 1, 1999, however, we require that Southern and its affiliates accept Orange and Rockland's plan.

Assumed Liabilities - In each of the ASAs, there is a catch-all assumption of liabilities provision in which Southern agrees to assume all liabilities associated with the Purchased Assets other than those treated elsewhere or expressly retained by Orange and Rockland. These provisions limit the Southern Affiliates' liability to \$3 million. In the New York State Electric & Gas Corporation, Niagara Mohawk Power Corporation and Con Edison in-City auctions, the buyers agreed to assume all liabilities (unless expressly retained by the sellers) without any similar cap.

Information was requested of the Joint Petitioners regarding the potential liabilities covered by this provision, the possible exposure to Orange and Rockland and Con Edison, and the basis for the \$3 million cap amount. Responsive information was not provided, so no analysis of the impact of this provision is possible. Therefore, to ensure both utilities' ratepayers are protected against any future risks arising as a result of the utilities' agreement to cap Southern's assumption of liabilities, we find that this provision is not in the public interest. Accordingly, any and all such liabilities incurred by Orange and Rockland and/or Con Edison shall be borne entirely by the companies' shareholders.

Transition Power Contracts

Orange and Rockland will purchase capacity through October 2000 and energy through April 2000 under its Transition Power Sales Agreement (TPSA) with Southern. While the capacity price appears somewhat high (\$130 per MW-day), it is offset by the energy price (set at \$25.50 to \$26 per MWh). Since 76% of the energy is scheduled for on-peak hours and, given the expected trend of the market price of energy for on-peak hours over the next year, the benefit provided by the energy price appears to justify the capacity payment.

Because Southern did not provide bids with and without the TPSA, we cannot determine the exact impact it had on Southern's price. Reductions in transition power purchase prices, however, may suggest reductions in overall bid prices. Under the circumstances here, we will accept the TPSA for filing.

Con Edison will purchase capacity only, from Southern under a Transition Capacity Sales Agreement (TCSA). For the Summer 1999 capability period, the capacity price is \$130/MW-day for the first 315 MW and \$99/MW-day for an additional 300 MW. This differential in purchase price was the result of negotiations between Con Edison and Southern and was based on Southern matching an independent offer Con Edison had received through a request for proposals it circulated in September 1998. For the Winter 1999 capability period, Con Edison has the right, at its sole discretion, to purchase between 315 and 810 MW from Southern at \$130/MW-day. If, by September 1, 1999, Con Edison decides not to purchase any capacity from Southern at that price, Southern has the right to match the lowest price offered by third parties to Con Edison for any capacity purchases. For the foregoing reasons, the TCSA is accepted for filing as well.

Load Pocket Agreements

The Eastern and Western Load Pocket Call Option Agreements are designed to prevent Southern from exercising market power within the load pockets, when the generation inside the pocket is necessary to serve the load pocket area. The

agreements obligate Southern to have the specified plants available during requested load pocket hours. The agreements establish appropriate availability and energy payments for this service. The payment that Orange and Rockland will make to Southern for energy required during load pocket hours is a function of historical generation characteristics, fuel price indices, and market revenues.

The penalties and legal provisions of the agreements, which are meant to ensure that reliability will be safeguarded, are reasonable and appear to adequately protect system reliability. For these reasons, the Load Pocket Call Option Agreements are accepted for filing.

Energy Sales Agreements

The energy price derivations contained in the Incremental Energy Sales Agreement between Orange and Rockland and Southern and in the Energy Sales Agreement between Con Edison and Southern are reasonable. Further, the energy prices contained in these agreements are reasonable as compared to the market price of electric futures. As is our standard practice under PSL § 110(4), these agreements are accepted for filing.

Agency Agreement

As a generator in New York, Southern would be required to join the NYPP or to make other arrangements to permit it to engage in wholesale power sales and sales of ancillary services to Orange and Rockland and other electric wholesale market participants. Rather than joining the NYPP, Southern requested Orange and Rockland to act as its NYPP agent for all purposes. The agency fee and terms of the agreement are reasonable and the agreement is approved. Although not addressed in the Agency Agreement, because the company's NYPP fees are recovered from ratepayers, the fees received from Southern shall be flowed back to the benefit of ratepayers.

Comparison to Other Auctions

A large number of generation auctions have been completed to date. It is difficult to make direct comparisons between this auction and any other auction because the characteristics of the assets available for sale (age, state of repair, location, regional market prices, fuel source, etc.) and the particular transaction details (transition contracts, regulatory requirements, etc.) for each auction are unique. However, once these unique characteristics of each auction are recognized, we can consider comparing the auctions based on price per megawatt and price to book ratios.

Overall, generation auctions for all types of assets have seen prices averaging \$319 per kW. This auction resulted in an average price of \$268 per kW, which is acceptable given the operating characteristics of the Purchased Assets. Orange and Rockland will receive approximately 1.25 times its \$274,955,812 book value for these assets (pre-tax); Con Edison will receive approximately 1.00 times its \$133,481,000 book value (pre-tax). It is estimated that the other auctions nationwide have yielded sales prices that vary significantly, from 0.2 times book to 5.9 times book. While price to book relationships give an indication of the effects of the transaction on rates, it is not an indication of fair value; with the adjustments discussed above, the utilities' ratepayers have received fair and reasonable value for the Purchased Assets.

The Public Interest

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

Southern, with its extensive worldwide experience, and expertise in all sectors of the electricity business, and with

the hiring of all Orange and Rockland union employees and half of the company's management employees, is fully qualified to operate the Purchased Assets. It has adequate financial resources to close the proposed transaction. Moreover, the Southern Affiliates will be capable of operating these facilities safely and reliably.

In combination with the adjustments discussed above, the price paid for the Purchased Assets satisfies the public interest. None of the details of this transaction countermands this conclusion. As noted above, ratepayers have received fair value for the assets. Moreover, the divestiture contributes to the creation of a fully-functional wholesale market for electricity where none of the participants should be able to exercise market power. Accordingly, the proposed transfer is approved as in the public interest.

Accounting Issues

Orange and Rockland estimates an after-FIT net gain applicable to its New York operations of \$7.4 million. The New York customers' share of the estimated net book gain is \$5.6 million. Con Edison estimates a net after-FIT loss of \$13.594 million on the sale of its two-thirds interest in Bowline. Neither of these estimates reflects the offset of auction costs, investigation-related adjustments, other adjustments to purchase price to occur at closing or revised depreciation deductions. Accurate calculations are not possible until the closing has occurred and all proceeds, costs and expenses can be ascertained.

Orange and Rockland Allocation Issues

Orange and Rockland's allocation of the proceeds, costs and tax effects to its New York operations is based on a composite factor developed from a history of the Demand Ratio and Energy Ratio as defined in the Power Supply Agreements between Orange and Rockland and its utility subsidiaries in New Jersey and Pennsylvania. Orange and Rockland reports the New York factor as 67 percent. Staff has reviewed the development of this

composite factor and has determined that 67.7 percent is a more accurate New York factor.

Additionally, in the Joint Petition, Orange and Rockland allocated the net proceeds for the Bowline adjacent property between all of its utility subsidiaries. At Staff's request, the company investigated the source of the investment in this property and determined, based on a review of the Power Supply Billings between the subsidiaries, that the New York ratepayers funded all of its investment costs. Given this treatment of the property's costs, a recalculation of the New York portion is required to reflect 100 percent of the net gain applicable to this property.

Federal Income Tax Issues

Both Orange and Rockland and Con Edison have excluded from their FIT calculations previously deferred income taxes on depreciation claimed when the tax rate was above the current statutory rate and the reversal of the deferred ITC balances related to the Purchased Assets. The utilities believe that this treatment is necessary to meet Internal Revenue Service tax normalization requirements. Moreover, both companies assert that failure to follow the requirements of tax normalization rules will result in the loss of accelerated depreciation deductions and/or investment tax credits. The companies assert their desire to avoid violating IRS normalization rules prevent them from passing back to ratepayers any of the "excess tax reserves" and Accumulated Deferred Investment Tax Credits in connection with the sale.

As noted by Rockland County, under continued rate regulation, these tax balances would have flowed back to ratepayers ratably over the regulatory lives of the Purchased Assets. However, the sale abruptly truncates the systematic passback to ratepayers of the excess deferred federal income taxes (DFIT) and the sharing of ITC. The companies' treatment of these tax credits is based on a narrow and self-serving reading of the Federal Tax Code. The Code says nothing about assigning

these tax credits to the utilities as their property in the event the systematic amortization is truncated. They should be treated as ratepayer credits and entitlements, based on the overpayment of them in rates. The ITC circumstances are different because the Tax Code provides for a sharing between the utilities and their ratepayers.

For the foregoing reasons, all or a portion of the tax effects should ultimately inure to the benefit of the utilities' ratepayers. However, these tax issues need not be resolved now, but will be addressed in the filing discussed below.

Post-Closing Filings

Orange and Rockland

Because the accounting issues discussed in the preceding section cannot be fully resolved until all details of the transaction are finalized, Orange and Rockland is directed to make a filing within 30 days of the date of closing. The company is further directed to include the following items in the filing:

1. an itemization of the final proceeds and costs figures related to the auction;
2. a reallocation of proceeds, costs and after-tax net gains between New York, New Jersey and Pennsylvania operations using a revised composite factor for New York operations of 67.7 percent;
3. a recalculation of the New York share of the net gains associated with the Bowline adjacent property based on a 100 percent allocation to New York operations;
4. a proposal for the fair disposition of the ITC and resolution of the other federal tax issues noted above;
5. the actuarial reports and calculations supporting the proposed accounting for the transfer of the employee benefit obligations to Southern and for the payment of the \$10 million;
6. the journal entries reflecting the \$1 million adjustment-related adjustment that will be used to reduce deferred debits carried on Orange And

Rockland's books of account with related charges against income;

7. a revised plan for the disposition of the New York ratepayers' share of the net book gain from the sale, including the \$7 million investigation-related adjustment, through the Divestiture Gain Credit mechanism to each eligible service class; and
8. the projected impact on customer bills by service class.

In the Joint Petition, Orange and Rockland proposes returning the ratepayers' share of the net gains over the final two rate years of its Rate and Restructuring Plan (i.e., December 1, 1999 through November 30, 2001). While this proposal appears to be consistent with the ratemaking objective of promptly returning customer revenue, while at the same time maintaining an appropriate degree of rate stability, it must be reconsidered given the additional net gains of \$8 million attributable to the investigation-related adjustment. Additionally, the mechanism for returning the net gains to ratepayers must be specified.

Of course, for all of the items listed above, Orange and Rockland should include with the filing all supporting workpapers, including detailed calculations and explanations that are sufficient to allow Staff to fully review the company's proposals.

Con Edison

In our Order approving the sale of two of Con Edison's three in-City asset bundles, we established a collaborative proceeding, to commence upon the Secretary's receipt of Con Edison's filing (i.e., 60 days after the closing on the last of its in-City and Bowline sales transactions), to examine the issues concerning the allocation of net proceeds for the benefit

of ratepayers.^{1/} Con Edison is directed to include in its filing required under that Order all of the accounting and ratemaking issues associated with the sale of its two-thirds interest in Bowline, including, but not limited to, treatment of: 1) FIT issues; 2) stranded cost determinations; and 3) the \$2 million investigation-related adjustment.

Treatment of Multi-Party Petition

In the MPP, the MP-Petitioners requested: 1) access to bid information; 2) appointment of an ALJ to oversee formal discovery of the issues raised in the MPP; 3) establishment of a hearing schedule if the parties are unable to settle their concerns; and 4) public statement hearings in Rockland County to address sale-related issues. In our April 26 Order, we deferred consideration of the MPP pending the conclusion of Staff's investigation.

As discussed above, Orange and Rockland and Con Edison have agreed to increase ratepayers' net gains from the sale by a total of \$10 million. Staff reports it has generally discussed the results of its investigation and the basis for this \$10 million with the MP-Petitioners, CPB, AG and the City. Because these parties were only summarily briefed about the results of the investigation orally, they were unable to provide any substantive comments. However, other than the union, which had very specific employee concerns unrelated to the investigation, none of the other parties objected to our approval of the transfer.

In the April 26 Order, we noted the concerns with releasing the bid information. The concerns still exist and the information will not be released. Given Staff's review and consultation with the parties, formal discovery would not provide

^{1/} Case 96-E-0897, supra, Order Approving Transfers of Generating Facilities and Making Other Findings (issued June 8, 1999); Comprehensive Order Approving Transfers of Generating Facilities and Making Other Findings (issued June 17, 1999).

any additional meaningful information. Therefore, we see no need to appoint an ALJ or engage in a formal discovery process. Moreover, given the resolution of the process issues via the payment of the \$10 million by the utilities, we see no reason to engage in formal settlement negotiations or conduct hearings.

Public information meetings, however, may still be necessary. Therefore, Staff should contact the parties and determine whether and when to schedule such meetings. With the exception of this request for relief, the MPP is denied.

Analysis of Comments

Most of the comments received in response to our notices simply reiterated the concerns expressed in the MPP. As discussed in the preceding section, these concerns have been adequately resolved through the \$10 million payment from Orange and Rockland and Con Edison. The City's suggestion that a portion of any property tax refunds Southern receives be imputed to Con Edison's ratepayers is unnecessary. Because the estimated value of the tax certiorari proceedings to ratepayers is included in the \$10 million payment, the City's proposed imputation is rejected.

IEUA's technical concerns with the Joint Petition are well-founded. Orange and Rockland is required to make all of the suggested corrections. Similarly, Rockland County's comments about the treatment of EDITs and UITCs have merit and shall be addressed by Orange and Rockland in the ratemaking/accounting filing discussed above. Rockland County's request that Southern be required to keep open its last property tax settlement offer to the Bowline taxing entities is rejected. Southern and the local community report that they are working diligently to resolve their disputes and do not see any need for our involvement at this time. Therefore, there is no need for us to impose any conditions that would upset their negotiations. Sullivan County's property tax concerns have been adequately addressed in the FSGEIS.

Finally, Staff reports that it has been closely monitoring the situation involving the union, Orange and Rockland and Southern. The vast majority of the union concerns have been resolved, and, as noted previously, the union has withdrawn its objections to our approving the sale. While the remaining open issues will not impede us from approving the transaction, we strongly encourage Southern and Orange and Rockland to continue to work with the union to resolve these issues.

State Environmental Quality Review Act Compliance

Pursuant to the State Environmental Quality Review Act (SEQRA), approval of the Joint Petition constitutes a subsequent action to the policy determinations issued in Opinion Nos. 96-12 and 97-20 and in the Auction Plan Order. As discussed previously, the FSGEIS issued in this case analyzed all environmental, social and economic impacts associated with the proposed divestiture.

In conjunction with the Joint Petition, the Joint Petitioners filed an Environmental Assessment Form (EAF) evaluating the potential impacts associated specifically with the transfer to the Southern Affiliates. The EAF indicates that there are no further impacts beyond those addressed in the FSGEIS. That is, from the time the FSGEIS was issued to the present, the only element of the analysis that has changed is the identity of the new owner.

With respect to the impact on existing informal land use agreements or rights of access at property appurtenant to the auctioned facilities resulting from the change of ownership, the FSGEIS imposed the following mitigation:

1. Orange and Rockland should inform the new owner(s) of all informal land uses at each of its facilities;
2. The new owner(s) should perform a cost/benefit analysis for each land use identified and consider continuing every reasonable land use for which the benefits outweigh the costs; and,

3. Prior to changing or terminating any land uses, the new owner(s) should identify all affected individuals or communities, either directly or by publication, and provide a forum at which reasonable alternatives can be discussed.

Orange and Rockland advised Staff it has complied with the first condition listed above. By letter dated June 4, 1999, Southern indicated that its affiliates will comply with the second and third conditions. Southern and its affiliates are required to continue that compliance.

Regarding the potential impact divestiture may have on local tax bases and assessments, we are advised that Southern has already engaged in discussions with many of communities in which the Purchased Assets are located. Southern is encouraged to continue to work with these communities to minimize any potential impacts on their tax bases. We reaffirm the availability of our Staff to assist in these efforts, if necessary.

Based on the foregoing, we find that approval of the transfer is within the conditions and thresholds of the FSGEIS and that no additional conditions are needed. Accordingly, no further SEQRA action is required.

Federal and State Regulation

The Joint Petitioners ask that findings be made sufficient to justify a FERC decision that the Purchased Assets be awarded EWG status under federal law. Operating under that rubric, says Southern, will avoid unnecessary federal regulation and will permit more efficient participation in the wholesale electric market. Accordingly, in conformance with PUHCA and the FERC's regulations,^{1/} we find that allowing the Purchased Assets to become eligible facilities, with Southern owning the plants,

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

either indirectly through one or more affiliates as defined under federal law,^{1/} or directly: 1) will benefit New York consumers; 2) is in the public interest; and, 3) does not violate New York law.

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

While Southern will become both an electric and a gas corporation under New York law when it assumes ownership of the facilities, it is accorded lightened regulation in an Order Providing For Lightened Regulation issued today in Cases 99-G-0632 and 99-E-0633. This approach to regulation has been previously approved for generators that intend to participate entirely or primarily in the wholesale market.^{2/} Southern, however, will still be subject to State regulation with respect to matters such as enforcement, investigation, safety, reliability and system improvement.

The Commission orders:

1. Orange and Rockland Utilities, Inc.'s sale of its generating facilities, including Consolidated Edison Company of New York, Inc.'s two-thirds interest in the Bowline Point Generating Station, to Southern Energy, Inc. and its affiliates, Southern Energy Bowline, LLC, Southern Energy Lovett, LLC and

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

^{2/} Case 98-E-1670, Carr Street Generating Station, L.P. - Petition For Certification and Regulatory Regime, Order Providing For Lightened Regulation (issued April 23, 1999); Case 99-E-0148, AES Eastern Energy, L.P. and AES Creative Resources, L.P. - Petition For Lightened Regulation, Order Providing For Lightened Regulation (issued April 23, 1999).

Southern Energy NY-Gen, LLC, is approved, subject to the conditions discussed in the body of this Order.

2. The Asset Sales, Continuing Site/Interconnection and Agency Agreements that Orange and Rockland Utilities, Inc. and Consolidated Edison Company of New York, Inc. entered into with Southern Energy, Inc. and its affiliates are approved, subject to the discussion in the body of this Order.

3. The transition power sales agreements (including the Load Pocket Call Option Agreements) that Orange and Rockland Utilities, Inc. and Consolidated Edison Company of New York, Inc. entered into with Southern Energy, Inc. and its affiliates are accepted for filing.

4. Orange and Rockland Utilities, Inc., Consolidated Edison Company of New York, Inc. and Southern Energy, Inc. and its affiliates shall make the filings on Year 2000 issues described in the body of this Order.

5. All payments made by Southern Energy, Inc. and its affiliates to Orange and Rockland Utilities, Inc. pursuant to the Agency Agreement shall flow back to the benefit of the company's ratepayers.

6. Orange and Rockland Utilities, Inc. shall make the ratemaking/accounting filing discussed in the body of this Order, within 30 days of the closing of the sale.

7. Consolidated Edison Company of New York, Inc. shall include in its ratemaking/accounting filing, required as discussed in the body of this Order, the information described in the body of this Order.

8. The Multi-Party Petition is denied, with the exception of the request for public information meetings, which request shall be handled as described in the body of this Order.

9. The findings on exempt wholesale generator status under the Public Utility Holding Company Act described in the body of this Order are made.

10. The approval of the Joint Petition is within the conditions and thresholds of the Final Supplemental Generic Environmental Impact Statement prepared in this proceeding;

CASES 96-E-0900 and 96-E-0897

therefore, no further action under the State Environmental Quality Review Act is necessary.

11. These proceedings are continued.

By the Commission,

(SIGNED)

DEBRA RENNER
Acting Secretary