

**Iberdrola USA, Inc.**  
**Consolidated Financial Statements**  
**For the Years Ended December 31, 2009 and 2008**

**Iberdrola USA, Inc.**

**Index**

**Page(s)**

**Management's Report on Internal Control Over Financial Reporting**

**Consolidated Financial Statements for the Years Ended December 31, 2009 and 2008**

Report of Independent Auditors	
Consolidated Statements of Income .....	1
Consolidated Statements of Comprehensive Income .....	1
Consolidated Balance Sheets .....	2 – 3
Consolidated Statements of Cash Flows .....	4
Consolidated Statements of Changes in Equity.....	5
Notes to Consolidated Financial Statements .....	6 – 44

## **Management's Report on Internal Control Over Financial Reporting**

Iberdrola USA, Inc.'s (the company) internal control over financial reporting is a process affected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Management is responsible for establishing and maintaining effective internal control over financial reporting. Management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2009, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based on that assessment, management concluded that, as of December 31, 2009, the company's internal control over financial reporting is effective based on the criteria established in *Internal Control—Integrated Framework*. The effectiveness of the company's internal control over financial reporting as of December 31, 2009, has been audited by PricewaterhouseCoopers LLP, an independent public accounting firm, as stated in their report which appears herein.

Iberdrola USA, Inc.  
February 18, 2010

## Report of Independent Auditors

To the Shareholder and Board of Directors of Iberdrola USA, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of comprehensive income, of cash flows and of changes in equity present fairly, in all material respects, the financial position of Iberdrola USA, Inc. and its subsidiaries (collectively, the "Company") at December 31, 2009 and 2008, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assertion of the effectiveness of internal control over financial reporting, included in *Management's Report on Internal Control Over Financial Reporting* dated February 18, 2010, listed in the accompanying Index to the Iberdrola USA, Inc. Consolidated Financial Statements for the Years Ended December 31, 2009 and 2008. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits of the financial statements in accordance with auditing standards generally accepted in the United States of America and our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for noncontrolling interests effective January 1, 2009.

A company's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the

company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and those charged with governance; and (iii) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers LLP  
February 18, 2010

**Iberdrola USA, Inc.**  
**Consolidated Statements of Income**

Year ended December 31,	2009	2008 As Adjusted (Note 1)
(Thousands)		
<b>Operating Revenues</b>		
Utility	\$3,937,086	\$4,535,051
Other	424,555	533,995
<b>Total Operating Revenues</b>	<b>4,361,641</b>	<b>5,069,046</b>
<b>Operating Expenses</b>		
Electricity purchased and fuel used in generation		
Utility	983,495	1,260,776
Other	299,123	375,191
Natural gas purchased		
Utility	880,975	1,204,683
Other	64,308	86,560
Other operating expenses	980,280	847,692
Merger costs	-	30,227
Positive benefit adjustments	-	275,000
Maintenance	215,978	180,251
Depreciation and amortization	282,081	271,683
Other taxes	263,647	265,133
<b>Total Operating Expenses</b>	<b>3,969,887</b>	<b>4,797,196</b>
<b>Operating Income</b>	<b>391,754</b>	<b>271,850</b>
<b>Other (Income)</b>	<b>(30,422)</b>	<b>(33,689)</b>
<b>Other Deductions</b>	<b>5,226</b>	<b>22,025</b>
<b>Interest Charges, Net</b>	<b>308,276</b>	<b>282,487</b>
<b>Income Before Income Taxes</b>	<b>108,674</b>	<b>1,027</b>
<b>Income Taxes</b>	<b>(3,991)</b>	<b>(46,559)</b>
<b>Net Income</b>	<b>112,665</b>	<b>47,586</b>
<b>Less:</b>		
<b>Preferred Stock Dividends of Subsidiaries, Noncontrolling Interests</b>	<b>1,113</b>	<b>1,140</b>
<b>Net Income Attributable to Other Noncontrolling Interests</b>	<b>1,624</b>	<b>1,272</b>
<b>Net Income Attributable to Iberdrola USA</b>	<b>\$109,928</b>	<b>\$45,174</b>

The notes on pages 6 through 44 are an integral part of our consolidated financial statements.

**Iberdrola USA, Inc.**  
**Consolidated Statements of Comprehensive Income**

Year ended December 31,	2009	2008 As Adjusted (Note 1)
(Thousands)		
<b>Net Income</b>	<b>\$112,665</b>	<b>\$47,586</b>
<b>Other Comprehensive Income (Loss), Net of Tax</b>	<b>43,624</b>	<b>(147,959)</b>
<b>Comprehensive Income (Loss)</b>	<b>156,289</b>	<b>(100,373)</b>
<b>Less:</b>		
<b>Preferred Stock Dividends of Subsidiaries, Noncontrolling Interests</b>	<b>1,113</b>	<b>1,140</b>
<b>Comprehensive Income Attributable to Other Noncontrolling Interests</b>	<b>1,624</b>	<b>1,272</b>
<b>Comprehensive Income (Loss) Attributable to Iberdrola USA</b>	<b>\$153,552</b>	<b>\$(102,785)</b>

The notes on pages 6 through 44 are an integral part of our consolidated financial statements.

**Iberdrola USA, Inc.**  
**Consolidated Balance Sheets**

December 31, (Thousands)	2009	2008 As Adjusted (Note 1)
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$113,504	\$71,892
Accounts receivable and unbilled revenues, net	775,274	916,513
Fuel and natural gas in storage, at average cost	226,768	364,406
Materials and supplies, at average cost	30,147	34,286
Deferred income taxes	37,500	58,887
Derivative assets	5,145	366
Prepaid income taxes	129,223	118,105
Broker margin account	15,383	85,781
Prepayments and other current assets	123,236	102,459
<b>Total Current Assets</b>	<b>1,456,180</b>	<b>1,752,695</b>
<b>Utility Plant, at Original Cost</b>		
Electric	6,201,951	5,994,022
Natural gas	2,843,127	2,792,134
Common	607,776	630,054
	<b>9,652,854</b>	<b>9,416,210</b>
Less accumulated depreciation	3,345,411	3,149,351
<b>Net Utility Plant in Service</b>	<b>6,307,443</b>	<b>6,266,859</b>
Construction work in progress	188,540	161,263
<b>Total Utility Plant</b>	<b>6,495,983</b>	<b>6,428,122</b>
<b>Other Property and Investments</b>		
Other property and investments	217,806	228,627
Investment in wind farms	304,821	-
<b>Total Other Property and Investments</b>	<b>522,627</b>	<b>228,627</b>
<b>Regulatory and Other Assets</b>		
Regulatory assets		
Nuclear plant obligations	109,896	149,846
Unfunded future income taxes	481,525	395,172
Environmental remediation costs	269,230	236,882
Unamortized loss on debt reacquisitions	49,150	55,196
Nonutility generator termination agreements	45,355	54,577
Natural gas hedges	9,652	66,741
Pension and other postretirement benefits	1,031,962	1,197,515
Other	427,595	386,654
<b>Total regulatory assets</b>	<b>2,424,365</b>	<b>2,542,583</b>
Other assets		
Goodwill	1,526,580	1,526,598
Prepaid pension benefits	145,723	27,062
Derivative assets	442	28,334
Other	101,302	131,989
<b>Total other assets</b>	<b>1,774,047</b>	<b>1,713,983</b>
<b>Total Regulatory and Other Assets</b>	<b>4,198,412</b>	<b>4,256,566</b>
<b>Total Assets</b>	<b>\$12,673,202</b>	<b>\$12,666,010</b>

The notes on pages 6 through 44 are an integral part of our consolidated financial statements.

**Iberdrola USA, Inc.**  
**Consolidated Balance Sheets**

<b>December 31,</b>	<b>2009</b>	<b>2008</b> <b>As Adjusted</b> <b>(Note 1)</b>
<b>(Thousands, except shares)</b>		
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Current portion of long-term debt	<b>\$233,502</b>	\$331,020
Notes payable	<b>118,950</b>	623,988
Accounts payable and accrued liabilities	<b>195,697</b>	255,105
Accounts payable, electricity purchased	<b>91,975</b>	105,800
Accounts payable, natural gas purchased	<b>90,672</b>	139,712
Interest accrued	<b>36,515</b>	56,396
Interest accrued on debt to affiliates	<b>19,116</b>	-
Taxes accrued	<b>74,095</b>	75,034
Derivative liabilities	<b>9,608</b>	104,877
Environmental remediation costs	<b>40,028</b>	42,107
Other	<b>246,944</b>	201,305
<b>Total Current Liabilities</b>	<b>1,157,102</b>	1,935,344
<b>Regulatory and Other Liabilities</b>		
Regulatory liabilities		
Accrued removal obligations	<b>931,964</b>	914,671
Deferred income taxes	<b>367,764</b>	428,643
Gain on sale of generation assets	<b>22,860</b>	76,027
Pension benefits	<b>71,141</b>	72,474
Positive benefit adjustments	<b>297,938</b>	280,010
Other	<b>198,236</b>	174,866
<b>Total regulatory liabilities</b>	<b>1,889,903</b>	1,946,691
Other liabilities		
Deferred income taxes	<b>1,153,694</b>	917,826
Nuclear plant obligations	<b>150,279</b>	158,672
Pension and other postretirement benefits	<b>603,309</b>	651,641
Environmental remediation costs	<b>177,322</b>	170,547
Derivative liabilities	<b>493</b>	117,264
Other	<b>215,563</b>	218,781
<b>Total other liabilities</b>	<b>2,300,660</b>	2,234,731
<b>Total Regulatory and Other Liabilities</b>	<b>4,190,563</b>	4,181,422
<b>Long-Term Debt</b>		
Other long-term debt	<b>2,598,933</b>	3,576,937
Long-term debt owed to affiliates	<b>1,350,000</b>	-
<b>Total Long-Term Debt</b>	<b>3,948,933</b>	3,576,937
<b>Total Liabilities</b>	<b>9,296,598</b>	9,693,703
<b>Commitments and Contingencies</b>		
<b>Preferred Stock of Subsidiaries</b>		
Redeemable preferred stock, noncontrolling interests	<b>24,545</b>	24,549
<b>Iberdrola USA Common Stock Equity</b>		
Common stock (\$.01 par value, 100 shares authorized and outstanding at December 31, 2009 and 2008)	-	-
Capital in excess of par value	<b>2,009,101</b>	1,759,101
Retained earnings	<b>1,424,361</b>	1,314,433
Accumulated other comprehensive loss	<b>(96,726)</b>	(140,350)
<b>Total Iberdrola USA Common Stock Equity</b>	<b>3,336,736</b>	2,933,184
<b>Other Noncontrolling Interests</b>	<b>15,323</b>	14,574
<b>Total Equity</b>	<b>3,352,059</b>	2,947,758
<b>Total Liabilities and Equity</b>	<b>\$12,673,202</b>	\$12,666,010

The notes on pages 6 through 44 are an integral part of our consolidated financial statements.

**Iberdrola USA, Inc.**  
**Consolidated Statements of Cash Flows**

Year Ended December 31, (Thousands)	2009	2008 As Adjusted (Note 1)
<b>Operating Activities</b>		
Net income	\$112,665	\$47,586
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	281,562	287,302
Amortization of regulatory and other assets and liabilities	68,917	70,509
Deferred income taxes and investment tax credits, net	147,878	23,218
Bridgeport pipeline contract impairment	7,312	-
Pension income	(4,962)	(59,000)
Positive benefit adjustments including carrying costs	17,928	280,010
Changes in current operating assets and liabilities		
Accounts receivable and unbilled revenues, net	141,627	70,340
Broker margin accounts	70,398	(52,779)
Environmental remediation costs	(26,269)	(9,395)
Inventory	141,778	(111,799)
Prepayments and other current assets	(36,193)	(89,376)
Accounts payable and accrued liabilities	(119,097)	15,869
Interest accrued on debt to affiliates	19,116	-
Interest accrued	(19,831)	(2,286)
Taxes accrued	(240)	(85,778)
Other current liabilities	41,199	6,939
Pension and other postretirement benefits contributions	(12,615)	(53,500)
Changes in other assets		
Preliminary survey costs, Maine Power Reliability Program	(31,156)	(14,206)
Other	(112,026)	(29,268)
Changes in other liabilities	(4,051)	(49,490)
<b>Net Cash Provided by Operating Activities</b>	<b>683,940</b>	<b>244,896</b>
<b>Investing Activities</b>		
Utility plant additions	(324,022)	(515,850)
Proceeds from sale of Capitol Area System	10,624	-
Other property additions	(1,012)	(15,521)
Other property sold	1,440	-
Investment in wind farms	(304,821)	-
Maturities of current investments available for sale	-	357,445
Purchases of current investments available for sale	-	(180,400)
Investments available for sale	18,957	(43,732)
<b>Net Cash Used in Investing Activities</b>	<b>(598,834)</b>	<b>(398,058)</b>
<b>Financing Activities</b>		
Equity contribution from parent	250,000	-
Repurchase of common stock	-	(7,151)
Repayment of first mortgage bonds and preferred stock of subsidiaries, including net premiums	(4)	(35,038)
Derivative activity	(23,631)	(100,413)
Long-term note issuances, debt owed to affiliates	1,350,000	-
Long-term note issuances	354,800	200,000
Long-term note repayments	(1,467,633)	(237,441)
Notes payable three months or less, net	(505,038)	486,272
Dividends to other noncontrolling interests	(875)	(757)
Dividends paid on preferred stock of subsidiaries, noncontrolling interests	(1,113)	(1,140)
Dividends paid on common stock	-	(176,344)
<b>Net Cash (Used in) Provided by Financing Activities</b>	<b>(43,494)</b>	<b>127,988</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>41,612</b>	<b>(25,174)</b>
<b>Cash and Cash Equivalents, Beginning of Year</b>	<b>71,892</b>	<b>97,066</b>
<b>Cash and Cash Equivalents, End of Year</b>	<b>\$113,504</b>	<b>\$71,892</b>

The notes on pages 6 through 44 are an integral part of our consolidated financial statements.

**Iberdrola USA, Inc.**  
**Consolidated Statements of Changes in Equity**

As Adjusted (Note 1)  (Thousands, except per share amounts)	Iberdrola USA Shareholder							Compre- hensive Income (Loss)*	Total
	Common Stock Outstanding \$ .01 Par Value		Capital in Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Other Noncontrolling Interests		
	Shares	Amount							
<b>Balance, January 1, 2008</b>	158,279	\$1,583	\$1,752,465	\$1,447,889	\$7,609	\$(2,453)	\$13,817	\$3,220,910	
Net income*				45,174			1,272	\$46,446	46,446
Other comprehensive (loss), net of tax Comprehensive (loss)*					(147,959)			(147,959)	(147,959)
Cumulative-effect adjustment, change in accounting for collateral assignment split- dollar life insurance				(2,286)					(2,286)
Common stock dividends declared (\$1.11 per share)				(176,344)					(176,344)
Dividends to other noncontrolling interests							(515)		(515)
Common stock repurchased	(297)					(7,151)			(7,151)
Common stock issued, restricted stock plan	382		(9,817)			9,817			-
Amortization of restricted stock plan grants			15,320						15,320
Acquisition by Iberdrola	(158,364)	(1,583)	1,133			(213)			(663)
<b>Balance, December 31, 2008</b>	-	-	1,759,101	1,314,433	(140,350)	-	14,574		2,947,758
Net income*				109,928			1,624	\$111,552	111,552
Other comprehensive income, net of tax Comprehensive income*					43,624			43,624	43,624
Equity contribution from parent			250,000					\$155,176	155,176
Dividends to other noncontrolling interests							(875)		(875)
<b>Balance, December 31, 2009</b>	-	-	\$2,009,101	\$1,424,361	\$(96,726)	-	\$15,323		\$3,352,059

The notes on pages 6 through 44 are an integral part of our consolidated financial statements.

\*Amounts do not include Preferred Stock Dividends of Subsidiaries, Noncontrolling Interests of \$1,140 for 2008 and \$1,113 for 2009.

## **Notes to Consolidated Financial Statements**

### **Note 1. Significant Accounting Policies**

**Background:** Iberdrola USA, Inc. (Iberdrola USA, the company, we, our, us) is a public utility holding company operating under the Public Utility Holding Company Act of 2005. We are a super-regional energy services and delivery company with operations in New York, Connecticut, Massachusetts, Maine and New Hampshire. Our wholly-owned subsidiaries, and their principal operating utilities, include: Berkshire Energy Resources – The Berkshire Gas Company (Berkshire Gas); CMP Group, Inc. – Central Maine Power Company (CMP); Connecticut Energy Corporation – The Southern Connecticut Gas Company (SCG); CTG Resources, Inc. – Connecticut Natural Gas Corporation (CNG); and RGS Energy Group, Inc. – New York State Electric & Gas Corporation (NYSEG) and Rochester Gas and Electric Corporation (RG&E).

We have evaluated events or transactions that occurred after December 31, 2009, for inclusion in these financial statements through February 17, 2010, which is the date these financial statements were available to be issued. (See “New accounting standards adopted,” “Subsequent events,” below.)

Effective September 16, 2008, Energy East Corporation (Energy East) became a wholly-owned subsidiary of Iberdrola, S.A. (Iberdrola), a corporation organized under the laws of the Kingdom of Spain. The merger was completed through the acquisition by a subsidiary of Iberdrola, of all the outstanding common stock of Energy East. Subsequent to the consummation of the merger, Energy East cancelled all previously existing shares of common stock, including treasury stock, and issued 100 shares of common stock with a total par value of \$1. As of December 31, 2008, we had recorded merger costs of \$30.2 million, primarily consisting of advisors’ fees. We also incurred premiums totaling \$12.7 million on the early retirement of debt due to special redemption on put options in the event of a change in control. The effects of the merger required for accounting purposes, including any allocation of goodwill, were not pushed down to Energy East. The accompanying consolidated financial statements have not been adjusted to reflect Iberdrola’s basis in Energy East. On December 1, 2009, Energy East changed its legal and operating name to Iberdrola USA, Inc.

Under the merger order prescribed by the New York State Public Service Commission (NYSPSC), NYSEG and RG&E customers will receive \$275 million in positive benefit adjustments (PBAs). Those benefits will, over time, be used to either reduce rates or moderate requested rate increases. Conditions were also established to ensure that ratepayers receive a portion of any added benefits associated with synergy savings and efficiency gains produced by the transaction. The PBAs were recorded in September 2008, in accordance with the merger order, as a regulatory liability with an offsetting charge to income, and will accrue a carrying cost until used for the customer’s benefit. Carrying costs, which are included in interest expense, were \$18 million in 2009 and \$5 million in 2008.

As part of an effort to reduce costs and increase efficiency, we have undertaken various measures to reduce workforce levels in 2010. On January 29, 2010, workforce levels were reduced by 140 through an involuntary separation. An additional reduction of approximately 55 employees has been announced in Connecticut. On February 12, 2010, we offered a voluntary early retirement program to approximately 500 employees. Eligible employees who accept the offer will receive a pension that is enhanced by the annuity value of one week’s pay for every full year of service and not reduced by the normal early retirement factors.

**Accounts receivable:** Accounts receivable at December 31 include unbilled revenues of \$209 million for 2009 and \$242 million for 2008, and are shown net of an allowance for doubtful accounts at December 31 of \$42 million for 2009 and \$51 million for 2008. Accounts receivable

## **Notes to Consolidated Financial Statements**

do not bear interest, although late fees may be assessed. Bad debt expense was \$76 million in 2009 and \$91 million in 2008.

Unbilled revenues represent estimates of receivables for energy provided but not yet billed. The estimates are determined based on various assumptions, such as current month energy load requirements, billing rates by customer classification and delivery loss factors. Changes in those assumptions could significantly affect the estimates of unbilled revenues.

The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing accounts receivable, determined based on experience for each service region and operating segment and other economic data. Each month the operating companies review their allowance for doubtful accounts and past due accounts over 90 days and/or above a specified amount, and review all other balances on a pooled basis by age and type of receivable. When an operating company believes that a receivable will not be recovered, it charges off the account balance against the allowance. Changes in assumptions about input factors such as economic conditions and customer receivables, which are inherently uncertain and susceptible to change from period to period, could significantly affect the allowance for doubtful accounts estimates.

**Asset retirement obligations:** We record the fair value of the liability for an asset retirement obligation (ARO) and/or a conditional ARO in the period in which it is incurred and capitalize the cost by increasing the carrying amount of the related long-lived asset. We adjust the liability to its present value periodically over time, and depreciate the capitalized cost over the useful life of the related asset. Upon settlement we will either settle the obligation at its recorded amount or incur a gain or a loss. Our regulated utilities defer any timing differences between rate recovery and depreciation expense as either a regulatory asset or a regulatory liability.

The term conditional ARO refers to an entity's legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. If an entity has sufficient information to reasonably estimate the fair value of the liability for a conditional ARO, it must recognize that liability at the time the liability is incurred.

Our ARO at December 31, including our conditional ARO, was \$51 million for 2009 and 2008. The ARO primarily consists of obligations related to removal or retirement of: asbestos, PCB-contaminated equipment, gas pipeline and cast iron gas mains. The long-lived assets associated with our AROs are generation property, gas storage property, distribution property and other property.

The following table reconciles the beginning and ending aggregate carrying amount of the ARO for the years ended December 31, 2009 and 2008.

<b>Year ended December 31,</b>	<b>2009</b>	<b>2008</b>
<b>(Thousands)</b>		
ARO, beginning of year	<b>\$50,788</b>	\$49,670
Liabilities incurred during the year	-	62
Liabilities settled during the year	<b>(2,309)</b>	(2,407)
Accretion expense	<b>2,140</b>	2,504
Revisions in estimated cash flows	<b>334</b>	959
ARO, end of year	<b>\$50,953</b>	\$50,788

We have AROs for which we have not recognized a liability because the fair value cannot be reasonably estimated due to indeterminate settlement dates, including: the removal of hydroelectric dams due to structural inadequacy or for decommissioning; the removal of

## **Notes to Consolidated Financial Statements**

property upon termination of an easement, right-of-way or franchise; and costs for abandonment of certain types of gas mains.

**Accrued removal obligations:** Our regulated utilities meet the requirements concerning accounting for regulated operations, and recognize a regulatory liability, for financial reporting purposes only, for the difference between removal costs collected in rates and actual costs incurred. We classify those amounts as accrued removal obligations.

**Consolidated statements of cash flows:** We consider all highly liquid investments with a maturity date of three months or less when acquired to be cash equivalents and those investments are included in cash and cash equivalents.

<b>Supplemental Disclosure of Cash Flows Information</b>	<b>2009</b>	<b>2008</b>
(Thousands)		
Cash paid (received) during the year ended December 31:		
Interest, net of amounts capitalized	<b>\$255,014</b>	\$251,726
Income taxes, net of benefits received	<b>\$(150,374)</b>	\$25,128

Interest capitalized was \$1 million in 2009 and \$4 million in 2008.

**Construction work in progress:** As of December 31, 2009, we included \$53 million of preliminary survey costs for CMP's Maine Power Reliability Program in Construction work in progress on our balance sheet. Consolidated preliminary survey costs included in Other assets at December 31 totaled approximately \$16 million for 2009 and \$31 million for 2008. Preliminary survey costs represent expenditures incurred for the purpose of determining the feasibility of utility projects under contemplation. When construction begins on such projects, the amounts are moved to Construction work in progress, and then eventually to Utility plant when construction is completed and the asset is placed in service. If a project is abandoned, the costs incurred for that project are charged to an appropriate expense account, and included in future rates.

**Depreciation and amortization:** We determine depreciation expense substantially using the straight-line method, based on the average service lives of groups of depreciable property, which include estimated cost of removal, in service at each operating company. The weighted-average service lives of certain classifications of property are: transmission property - 55 years, distribution property - 52 years, generation property - 48 years, gas production property - 32 years, gas storage property - 39 years, and other property - 34 years. Our depreciation accruals were equivalent to 2.8% of average depreciable property for 2009 and 2008.

We charge repairs and minor replacements to operating expense, and capitalize renewals and betterments, including certain indirect costs. We charge the original cost of utility plant retired or otherwise disposed of to accumulated depreciation.

**Bridgeport pipeline contract impairment:** In 1998 CNE Energy Services Group, Inc. (CNE Energy), a subsidiary of Connecticut Energy Corporation, provided the funds for the construction of an 11.5 mile long pipeline in Bridgeport, Connecticut, which is subject to a 20 year gas transmission agreement (Agreement) with an unrelated entity. CNE Energy recorded the \$12.8 million total cost of construction of the pipeline as an intangible asset (contract interest) on its balance sheet, which it then began to amortize over the 20 year life of the project. SCG constructed the pipeline and has owned and operated it since its completion. In addition to funding the pipeline construction costs, CNE Energy has paid all operating and maintenance costs related to the pipeline project. As a result of Energy East's acquisition of SCG and CNE Energy in February 2000, the value of the investment in the pipeline was assessed and CNE Energy recorded a valuation adjustment/additional intangible asset of \$2.4

## **Notes to Consolidated Financial Statements**

million. CNE Energy has been amortizing the valuation adjustment over the remaining term of the Agreement, since February 2000.

In February 1998 the Connecticut Department of Public Utility Control (DPUC) issued a decision concerning the allocation of revenues during the first 10 years of the Agreement, allocating a portion to SCG for the benefit of its ratepayers with the remaining portion retained by CNE Energy. The original DPUC decision required SCG to petition the DPUC by July 1, 2008, for an adjustment to the allocation of revenues for the second 10 years of the Agreement. The DPUC issued a decision on April 1, 2009, reducing the annual revenue allocation to CNE Energy for the remaining term of the Agreement. Based on its estimate of undiscounted cash flows for the remaining years, CNE Energy determined that the combined \$7.1 million carrying amount of the contract interest and valuation adjustment was not recoverable, and impaired the entire net carrying amount. In addition, because substantially all of its economic activity is derived from the Bridgeport contract, CNE Energy also impaired \$0.2 million of net goodwill in 2009. The combined pretax impairments totaling approximately \$7.3 million are included in depreciation and amortization on the income statement. The total after-tax effect of the impairments is approximately \$4.7 million.

**Goodwill:** We are required to perform an annual goodwill impairment test at the same time each year and, accordingly, we perform our annual impairment testing of goodwill during the third quarter of each year. We update the test between annual tests if events or circumstances occur that would more likely than not reduce the fair value of a reporting unit below its carrying value. The annual analysis of the potential impairment of goodwill requires a two step process. Step one of the impairment test involves comparing the fair values of reporting units with their aggregate carrying values, including goodwill. If the carrying amount of a reporting unit exceeds the reporting unit's fair value, step two must be performed to determine the amount, if any, of the goodwill impairment loss. If the carrying amount is less than fair value, further testing of goodwill impairment is not performed.

Step two of the goodwill impairment test involves comparing the implied fair value of the reporting unit's goodwill against the carrying value of the goodwill. Under step two, determining the implied fair value of goodwill requires the valuation of a reporting unit's identifiable tangible and intangible assets and liabilities as if the reporting unit had been acquired in a business combination on the testing date. The difference between the fair value of the entire reporting unit as determined in step one and the net fair value of all identifiable assets and liabilities represents the implied fair value of goodwill. A goodwill impairment charge, if any, would be the difference between the carrying amount of goodwill and the implied fair value of goodwill upon the completion of step two.

For purposes of the step one analyses, we base the determination of the fair value of Iberdrola USA's reporting units on the income approach, which estimates fair value based on discounted future cash flows. Based on the completion of step one of the annual impairment analysis, management determined that the fair values of all reporting units were greater than their respective carrying values. (See Note 2.)

We may be required to recognize an impairment of goodwill in the future due to market conditions or other factors related to our performance. Those market events could include a decline in the forecasted results in our business plan, significant adverse rate case results, changes in capital investment budgets or changes in interest rates that could permanently impair the fair value of a reporting unit. Recognition of impairments of a significant portion of goodwill would negatively affect our reported results of operations and total capitalization, the

## **Notes to Consolidated Financial Statements**

effect of which could be material and could make it more difficult to maintain our credit ratings, secure financing on attractive terms, maintain compliance with debt covenants and meet expectations of our regulators.

***New accounting standards adopted:*** We have adopted new accounting standards issued by the Financial Accounting Standards Board (FASB) as explained below.

***Collateral assignment split-dollar life insurance:*** Effective January 1, 2008, we began applying a new accounting standard, ratified by the FASB in late March 2007, that requires an employer to recognize a liability for a postretirement benefit related to a collateral assignment split-dollar life insurance arrangement. In such an arrangement, the employee, versus the employer, owns and controls the insurance policy. The new standard also requires that an employer recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. CNG is the only Iberdrola USA subsidiary with collateral assignment split-dollar life insurance arrangements. We elected to recognize the effects of the change in accounting principle through a cumulative-effect adjustment that resulted in a decrease in retained earnings of \$2.3 million. The change did not affect our results of operation or cash flows.

***Disclosures about derivative instruments and hedging activities:*** In March 2008 the FASB issued a new standard that requires enhanced disclosures about an entity's derivative instruments and hedging activities to enable investors to better understand their effects on the entity's financial position, financial performance and cash flows. The enhanced disclosures are intended to improve transparency about the location and amounts of derivative instruments in an entity's financial statements and how the entity accounts for derivative instruments and related hedged items. Requirements include: disclosure of fair values of derivative instruments and their gains and losses in a tabular format, disclosure of derivative features that are credit risk-related, and cross-referencing within the notes to enable financial statement users to locate important information about derivative instruments. The new standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. In years after initial adoption, comparative disclosures are required only for periods subsequent to initial adoption. Our adoption of the new requirements effective for our financial statements issued for fiscal years and interim periods beginning on or after January 1, 2009, did not affect our financial position, results of operation or cash flows. (See Note 10.)

***Fair value measurements:*** The FASB has issued a number of new standards related to fair value measurements. The initial new standard was issued in September 2006, which we adopted effective January 1, 2008, for our fair value measurements of financial assets and financial liabilities. Changes as a result of the application of the new standard relate to the definition of fair value, the methods used to measure fair value, and expanded disclosures about fair value measurements. The new standard applies under other accounting pronouncements that require or permit fair value measurements in which the FASB previously concluded that fair value is the relevant measurement attribute, but does not require any new fair value measurements.

The FASB issued a related new standard in February 2008 that was effective upon issuance. It delayed the effective date of the initial fair value measurement standard for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in an entity's financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. It also requires additional disclosures concerning application of the provisions of the initial fair value measurement standard.

## **Notes to Consolidated Financial Statements**

In April 2009 the FASB issued two new standards related to fair value measurements, which we began applying effective April 1, 2009:

- One of the new standards provides guidance for determining fair value when the volume and level of activity for an asset or liability have significantly decreased and for identifying transactions that are not orderly. It provides additional guidance to entities for estimating fair value in accordance with existing requirements when the volume and level of activity for an asset or a liability has significantly decreased. Even in those circumstances, and without considering the valuation technique(s) used, the intention of fair value measurement does not change. The new standard also provides guidance for identifying circumstances that indicate a transaction is not orderly. In addition, it amends the disclosures in connection with fair value measurements to require disclosure in interim and annual periods about the inputs and valuation techniques used to measure fair value as well as a discussion of any changes in them during the period; and to require disclosures concerning debt and equity securities according to major security types. The new standard is effective for interim and annual reporting periods ending after June 15, 2009, and must be applied prospectively.

As a result of the revised guidance and continued illiquidity in the auction rate securities market, we reassessed the fair value of our \$3.85 million investment in auction rate securities. We have held the investment for over a year as a result of several failed auctions. In 2009 we reduced the carrying value of our investment to \$2.7 million; the writedown of \$1.1 million is included in Other Deductions on the income statement.

- The other new standard provides amended guidance concerning the recognition and presentation of other-than-temporary impairments. It amends the guidance in U.S. generally accepted accounting principles for other-than-temporary impairment of debt securities (but not equity securities) to make it more operational and to improve the financial statement presentation and disclosure of other-than-temporary impairments on debt and equity securities. The amended guidance is effective for interim and annual reporting periods ending after June 15, 2009.

In August 2009 the FASB issued an accounting standards update to provide amended guidance concerning the fair value measurement of liabilities. The key provisions of the amendments include clarification about valuation techniques that are to be used in circumstances in which a quoted price in an active market for the identical liability is not available and that a reporting entity is not to include a separate input or adjustments to other inputs to reflect the existence of a restriction that prevents the transfer of a liability. The amended guidance is effective for an entity's first reporting period (including interim periods) beginning after issuance of the update. We initially began applying the guidance effective October 1, 2009.

Except for the reduction in the carrying value of our investment in auction rate securities, our adoption of the various new standards related to fair value measurements had no effect on our financial position, results of operation or cash flows.

**Noncontrolling interests:** In December 2007 the FASB issued a new accounting standard concerning noncontrolling interests in consolidated financial statements. The new standard is the result of a joint project between the FASB and the International Accounting Standards Board, and is intended "to improve the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements" about noncontrolling (sometimes called minority) interests. Earnings attributable to noncontrolling interests will no longer be excluded from net income as a result of applying the new standard, which is effective for fiscal years (including interim periods) beginning on or after December 15, 2008. Earlier adoption is prohibited and prospective application is required, except that the presentation and disclosure requirements are to be applied retrospectively for all periods

## **Notes to Consolidated Financial Statements**

presented. See “Reclassifications,” below, concerning reclassifications of prior period amounts with respect to our adoption of this standard. Our application of the new standard did not materially affect our financial position, results of operation or cash flows.

**Postretirement benefit plan assets disclosures:** In December 2008 the FASB issued a new standard that amends the disclosures an employer is required to provide about its pensions and other postretirement benefits, to improve disclosures about postretirement benefit plan assets. The improved disclosures include objectives and other information concerning fair value measurements of plan assets, and must be provided for fiscal years ending after December 15, 2009. Our application of the new standard beginning with the annual reporting period ending December 31, 2009, did not affect our financial position, results of operation or cash flows. (See Note 13.)

**Subsequent events:** In May 2009 the FASB issued a new standard to establish principles and requirements concerning accounting for and disclosure of subsequent events – events that occur after the balance sheet date but before the financial statements are issued or available to be issued. The new accounting standard is based on the same principles as in the existing auditing standard, with new terminology as to the evaluation of subsequent events either as of the date the financial statements are “issued” or “available to be issued”. We adopted the new standard as of June 30, 2009, and it had no effect on our financial position, results of operation or cash flows. (See “Background,” above, for the required disclosure.)

**New accounting standards issued but not yet adopted:** New accounting standards issued by the FASB that we have not yet adopted in these financial statements are as explained below.

**Variable interest entities:** In June 2009 the FASB issued amendments to its revised interpretation concerning consolidation of variable interest entities (VIEs). The amendments clarify, but do not significantly change, the criteria for determining whether an entity meets the definition of a VIE, and change existing consolidation guidance so that qualifying special purpose entities are no longer exempt from consolidation. The amendments require an enterprise to perform ongoing assessments as to whether an entity is a VIE and whether the enterprise is the primary beneficiary of a VIE. Previously such assessments were required only when specified events occurred. The amended standard will alter how an enterprise determines when an entity that is not sufficiently capitalized or not controlled through voting should be consolidated. An enterprise will also be required to perform a qualitative analysis to determine whether it should provide consolidated reporting of an entity based upon the entity’s purpose and design and the enterprise’s ability to direct the entity’s actions. The amended standard also requires enhanced disclosures to provide more transparent information about an enterprise’s involvement in a VIE, and any significant changes in its risk exposure due to that involvement. The amendments are effective at the start of a company’s first fiscal year beginning after November 15, 2009, including interim periods. Earlier application is prohibited. We expect that our adoption of the amendments effective January 1, 2010, will not affect our results of operation, financial position or cash flows.

**Disclosures about fair value measurements:** In January 2010 the FASB issued amendments to improve disclosures about fair value measurements. New disclosures that will be required include: 1) details of transfers in and out of Levels 1 and Level 2 of the fair value measurement hierarchy, and 2) gross presentation of roll forward activity within Level 3 – separate presentation of information about purchases, sales, issuances and settlements. Entities will also have to provide fair value measurement disclosures for each class of assets and liabilities, as well as disclosures about inputs and valuation techniques for both recurring and nonrecurring Level 2 and Level 3 fair value measurements. The amendments are effective for interim and annual reporting periods beginning after December 15, 2009, except that the disclosures about

## **Notes to Consolidated Financial Statements**

Level 3 roll forward activity are effective for fiscal years beginning after December 15, 2010, and interim periods within those fiscal years. Our adoption of the amendments as they become effective will not affect our results of operation, financial position or cash flows.

### ***Other (Income) and Other Deductions:***

<b>Year Ended December 31,</b>	<b>2009</b>	<b>2008</b>
<b>(Thousands)</b>		
Interest and dividend income	<b>\$(3,148)</b>	\$(16,585)
Allowance for funds used during construction	<b>(1,152)</b>	(5,267)
Earnings from equity investments	<b>(3,825)</b>	(3,740)
Carrying costs on regulatory assets	<b>(20,193)</b>	(5,704)
Miscellaneous	<b>(2,104)</b>	(2,393)
<b>Total other (income)</b>	<b>\$(30,422)</b>	\$(33,689)
Early retirement of debt	<b>\$1,137</b>	\$12,704
Losses on energy risk contracts	<b>443</b>	620
Civic donations	<b>1,307</b>	3,231
Impairment of auction rate security investment	<b>1,115</b>	-
Miscellaneous	<b>1,224</b>	5,470
<b>Total other deductions</b>	<b>\$5,226</b>	\$22,025

***Early retirement of debt:*** In October 2008 SCG paid premiums of \$11.1 million in connection with the early retirement of \$25 million of long-term debt that was subject to special redemption or put options in the event of a change in control. Energy East's merger with Iberdrola in 2008 qualified for such a change in control. SCG is not allowed rate recovery for such losses on reacquired debt. In addition, in October 2008 TEN Companies, Inc. (TEN Cos.), a subsidiary of CTG Resources, Inc., paid premiums of \$1.6 million in connection with the early retirement of a total of \$22.5 million of long-term debt that was subject to similar put options in the event of a change in control. All of the put options were accounted for as embedded derivatives prior to the debt retirement. We did not assign any value to the put options prior to the merger as we believed that any fair value attributable to the put options would have been negligible because of significant uncertainty as to whether the merger would take place. In May 2009 TEN Cos., in conjunction with the sale of the Capitol Area System to the state of Connecticut, extinguished its \$14.9 million Industrial Revenue Demand Bonds issued by the Connecticut Development Authority. TEN Cos. no longer has any debt.

***Principles of consolidation:*** These financial statements consolidate our majority-owned subsidiaries after eliminating intercompany transactions, except variable interest entities for which we are not the primary beneficiary.

***Reclassifications:*** Certain amounts have been reclassified in our consolidated financial statements to conform to the 2009 presentation.

We have also reclassified certain prior-period amounts in accordance with a new accounting standard concerning noncontrolling interests, which we adopted effective January 1, 2009. (See "New accounting standards adopted," "Noncontrolling interests," above.) We have retrospectively applied the presentation and disclosure requirements to our noncontrolling interests for all periods within these financial statements.

- ***Balance sheets:*** The redeemable preferred stocks of subsidiaries are noncontrolling interests, but continue to be presented in a manner consistent with temporary equity because they contain a feature that allows the holders to elect a majority of the subsidiary's board of directors if preferred stock dividends are in default in an amount equivalent to four full quarterly dividends. Such a potential redemption-triggering event is not solely within the control of the subsidiary.

## **Notes to Consolidated Financial Statements**

Other Noncontrolling Interests that were previously included in Other liabilities, Other are reclassified to equity.

- *Statements of Income and Statements of Comprehensive Income:* Net Income and Comprehensive Income are revised to include Preferred Stock Dividends of Subsidiaries, now identified as noncontrolling interests; and Net Income Attributable to Other Noncontrolling Interests, previously included in Other (Income); which are then deducted to arrive at Net Income/Comprehensive Income Attributable to Iberdrola USA.
- *Statements of Cash Flows:* Net Income now includes Preferred Stock Dividends of Subsidiaries and Net Income Attributable to Other Noncontrolling Interests. In the Financing Activities section – Amounts for Dividends to other noncontrolling interests, and Dividends paid on preferred stock of subsidiaries, noncontrolling interests are added.
- *Statements of Changes in Equity:* Net Income and Comprehensive income now include Net Income Attributable to Other Noncontrolling Interests. An amount for Dividends to other noncontrolling interests, and columns for Other Noncontrolling Interests and Comprehensive Income are added.

**Regulatory assets and regulatory liabilities:** Our public utility subsidiaries currently meet the requirements concerning accounting for regulated operations for their electric and natural gas operations in New York, Maine, Connecticut and Massachusetts; however, we cannot predict what effect the competitive market or future actions of regulatory entities would have on their ability to continue to do so. If our public utility subsidiaries were to no longer meet the requirements concerning accounting for regulated operations for all or a separable part of their operations, they may have to record certain regulatory assets and regulatory liabilities as an expense or as revenue, or include them in accumulated other comprehensive income.

Pursuant to the requirements concerning accounting for regulated operations our utilities capitalize, as regulatory assets, incurred and accrued costs that are probable of recovery in future electric and natural gas rates. Substantially all regulatory assets for which funds have been expended are either included in rate base or are accruing carrying costs. Our operating utilities also record, as regulatory liabilities, obligations to refund previously collected revenue or to spend revenue collected from customers on future costs.

Unfunded future income taxes and deferred income taxes are amortized as the related temporary differences reverse. Unamortized loss on debt reacquisitions is amortized over the lives of the related debt issues. Nuclear plant obligations, demand side management program costs, gain on sale of generation assets, other regulatory assets and other regulatory liabilities are amortized over various periods in accordance with each operating utility's current rate plans. Amortization of total regulatory assets net of amortization of total regulatory liabilities was \$49 million in 2009 and \$54 million in 2008.

In 2009 we recorded reserves totaling \$48.2 million on existing regulatory assets to reflect management's assessment of risk and increased uncertainty about the ultimate recovery for certain issues that have not been resolved with our regulators. Those amounts include \$30 million for NYSEG and \$10 million for RG&E related to ongoing disputes about earnings sharing accruals (see Note 8) and \$5.5 million for CMP related to deferred storm costs. The resulting charge increased other operating expenses for the period.

## **Notes to Consolidated Financial Statements**

Other regulatory assets and other regulatory liabilities consisted of:

<b>December 31,</b>	<b>2009</b>	<b>2008</b>
<b>(Thousands)</b>		
Other postretirement benefits	<b>\$31,320</b>	\$37,973
Customer Hardship Arrearage Forgiveness and related programs	<b>47,550</b>	39,953
Loss on sale of RG&E Oswego generating unit	<b>22,467</b>	28,943
Asset retirement obligation	<b>25,986</b>	26,578
Deferred storm costs	<b>103,744</b>	79,168
Deferred pension costs	<b>44,600</b>	38,161
Stranded cost reconciliation	<b>8,501</b>	13,725
Deferred natural gas costs	<b>40,356</b>	23,175
Nonbypassable wires charge	<b>19,324</b>	20,131
Incremental assessment	<b>20,681</b>	-
Other	<b>63,066</b>	78,847
<b>Total other regulatory assets</b>	<b>\$427,595</b>	\$386,654
Deferred natural gas costs	<b>\$22,643</b>	\$13,378
Asset retirement obligation	<b>12,246</b>	11,023
Nonfirm margin sharing	<b>12,478</b>	27,332
Economic development	<b>21,657</b>	4,936
Pension	<b>27,237</b>	34,006
Nuclear decommissioning	<b>17,320</b>	15,509
Accrued earnings sharing	-	14,245
Tennessee gas pipeline settlement	<b>10,408</b>	-
Other	<b>74,247</b>	54,437
<b>Total other regulatory liabilities</b>	<b>\$198,236</b>	\$174,866

### ***Regulatory proceedings:***

***CNG overearnings and rate filing:*** In June 2008 CNG filed its monthly financial report with the DPUC showing that it exceeded its allowed return on equity (ROE) by more than 100 basis points for the sixth consecutive monthly period. As a result, the DPUC initiated an overearnings investigation. In August 2008 the DPUC issued a decision ordering CNG to implement a rate decrease of \$15 million effective August 6, 2008, and the filing of a rate case by January 1, 2009.

In January 2009 CNG filed an application for a delivery rate increase of \$16.2 million or approximately 4.4% over the revenues produced from its existing rate schedules. The DPUC issued CNG's rate order on July 23, 2009, requiring a rate reduction of 4.2% effective July 31, 2009. CNG appealed the order and the application of new tariffs prescribed by the rate order was temporarily suspended by the court. On January 6, 2010, the Connecticut Superior Court entered a ruling against CNG's appeal. On January 21, 2010, CNG filed for a continuation of the temporary stay while it pursues an appeal of that decision in the Appellate Court.

***SCG overearnings and rate filing:*** In July 2008 SCG filed its monthly financial report with the DPUC showing that it exceeded its allowed ROE by more than 100 basis points for the sixth consecutive monthly period. As a result, the DPUC initiated an overearnings investigation. In October 2008 the DPUC issued a decision ordering SCG to implement a rate decrease of \$15 million effective October 24, 2008, and to file pro forma adjustments for the purpose of a surcharge for the period beginning October 24, 2008, through June 30, 2009.

## **Notes to Consolidated Financial Statements**

In January 2009 SCG filed an application for a delivery rate increase of \$50.1 million or approximately 15.2% over the revenues produced from its existing rate schedules. The DPUC issued SCG's rate order on July 2, 2009, requiring a rate reduction of 3.2% effective August 19, 2009. SCG appealed the order and the application of new tariffs prescribed by the rate order was temporarily suspended by the Court until it makes a final decision on the appeal. On December 17, 2009, the Court issued an order requiring the DPUC to provide its reasoning for several findings in its decision within 90 days. The timing for a decision is early March 2010.

***NYSEG and RG&E rate filings:*** On September 17, 2009, NYSEG and RG&E filed rate cases for their electric and natural gas businesses with the NYPSC. The rate cases request approval to increase the rates the companies charge to deliver electricity and natural gas by a total of \$383 million. If approved, the proposed rates would ensure that the companies can meet their increasing cost of service and achieve an adequate return on investment. The increases would be the first for the companies since the mid-1990s.

Under the proposed delivery rates, the typical NYSEG total residential electricity bill would increase approximately 18.6% and the typical NYSEG total residential natural gas heating bill would increase approximately 17.4%. The typical RG&E total residential electricity bill would increase approximately 16.1% and the typical RG&E total residential natural gas heating bill would increase approximately 15.2%. The rate filings request an 11.43% ROE and a 48% equity ratio.

On January 22, 2010, the NYPSC Staff filed its testimony and exhibits related to the NYSEG and RG&E rate filings. Staff's testimony recommended a \$38 million or 2.8% delivery, net rate increase for the companies' four rate filings. Staff's proposal included ROEs of 9.6% for NYSEG and 9.8% for RG&E, and accepted the companies' proposed 48% equity ratio. The NYPSC Staff also proposed one-time charges of \$107 million related to historical annual compliance filings and accounting for certain software costs. In addition, the NYSPC Staff proposes that NYSEG electric not be allowed to collect \$25.8 million of deferred storm costs. On February 12, 2010, the companies filed their rebuttal testimony and revised the requested rate increases to a total of \$282 million. Settlement discussions are to occur from February 16 to February 26, 2010. If no settlement is reached, then hearings will begin on March 8, 2010. A decision by the NYPSC is expected in the summer of 2010.

***Revenue recognition:*** We recognize revenues upon delivery of energy and energy-related products and services to our customers.

Pursuant to a Maine state law, CMP is prohibited from selling power to its retail customers. CMP does not enter into purchase or sales arrangements for power with ISO New England Inc., the New England Power Pool, or any other independent system operator or similar entity. CMP sells all of its power entitlements under its nonutility generator (NUG) and other purchase power contracts to unrelated third parties under bilateral contracts.

NYSEG and RG&E enter into power purchase and sales transactions with the New York Independent System Operator (NYISO). When NYSEG and RG&E sell electricity from owned generation to the NYISO, and subsequently repurchase electricity from the NYISO to serve their customers, they record the transactions on a net basis in their statements of income. NYSEG and RG&E net their purchase and sale transactions with the NYISO on an hourly basis.

***Share-based compensation:*** As of September 16, 2008, our two share-based compensation plans, the 2000 Stock Option Plan and the Restricted Stock Plan, ceased as a result of our merger with Iberdrola. All stock options immediately vested upon consummation of Energy East's merger with Iberdrola and the holders received an amount in cash equal to the excess of

## **Notes to Consolidated Financial Statements**

the merger consideration per share over the exercise price per share. In addition, all shares of restricted stock vested upon consummation of the merger and became entitled to receive the merger consideration. We recognized in income for the year ended December 31, 2008, total compensation cost of \$16.9 million and total income tax benefit of \$6.7 million for the two share-based compensation plans. The cash paid by Iberdrola for restricted stock is included in capital in excess of par value in shareholder equity.

**Taxes:** We file a consolidated federal income tax return and allocate income taxes among Iberdrola USA and its subsidiaries in proportion to their contribution to consolidated taxable income. The determination and allocation of our income tax provision and its components are outlined and agreed to in the tax sharing agreements among Iberdrola USA and its subsidiaries.

Deferred income taxes reflect the effect of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and the amount recognized for tax purposes. We amortize investment tax credits over the estimated lives of the related assets.

We account for sales tax collected from customers and remitted to taxing authorities on a net basis.

We classify all interest and penalties related to uncertain tax positions as income tax expense.

**Use of estimates and assumptions:** The preparation of our consolidated financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. Significant estimates and assumptions are used for, but not limited to: (1) allowance for doubtful accounts and unbilled revenues; (2) asset impairments, including goodwill; (3) depreciable lives of assets; (4) income tax valuation allowances; (5) uncertain tax positions; (6) reserves for professional, workers' compensation, and comprehensive general insurance liability risks; (7) contingency and litigation reserves; and (8) earnings sharing mechanism (ESM), nonbypassable wires charges and environmental remediation liability. Future events and their effects cannot be predicted with certainty; accordingly, our accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as our operating environment changes. We evaluate and update our assumptions and estimates on an ongoing basis and may employ outside experts to assist in our evaluation, as considered necessary. Actual results could differ from those estimates.

### **Note 2. Goodwill**

We do not amortize goodwill, but test it for impairment at least annually. Impairment testing includes various assumptions, primarily the discount rate, which is based on an estimate of our marginal, weighted-average cost of capital, and forecasted cash flows. We test the reasonableness of the conclusions of our impairment testing using a range of discount rates and a range of assumptions for long-term cash flows. We had no impairment of goodwill in 2009 or 2008 as a result of our impairment testing. No impairment was indicated within any of the ranges of assumptions analyzed for our New York, Maine or nonutility reporting units. For our New England gas reporting unit, which includes CNG, SCG and Berkshire Gas, our discounted cash flow analysis included some points at the low end of the range where the fair value approximated the carrying value. As a result, management performed more detailed analysis, including scenario

## **Notes to Consolidated Financial Statements**

analysis. Management determined that the fair value of this reporting unit was greater than its carrying value. Goodwill allocated to the New England gas reporting unit totaled \$543 million at December 31, 2009.

The carrying amount of goodwill as of December 31, 2008 and 2009, is shown in the following table. Goodwill has not been adjusted to reflect Iberdrola's purchase of Energy East.

	<b>2009</b>	<b>2008</b>
<b>(Thousands)</b>		
Balance as of January 1		
Goodwill	<b>\$1,526,598</b>	\$1,526,048
Accumulated impairment losses	-	-
	<b>1,526,598</b>	1,526,048
Preacquisition income tax adjustments	<b>838</b>	550
Goodwill related to the sale of a business unit	<b>(614)</b>	-
Impairment for Bridgeport	<b>(242)</b>	-
Balance as of December 31		
Goodwill	<b>1,526,822</b>	1,526,598
Accumulated impairment losses	<b>(242)</b>	-
	<b>\$1,526,580</b>	\$1,526,598

### **Note 3. Income Taxes**

<b>Year Ended December 31,</b>	<b>2009</b>	<b>2008</b>
<b>(Thousands)</b>		
Current		
Federal	<b>\$(146,715)</b>	\$(60,513)
State	<b>(5,155)</b>	(9,076)
Current taxes charged to expense	<b>(151,870)</b>	(69,589)
Deferred		
Federal	<b>155,400</b>	41,214
State	<b>(4,890)</b>	(15,156)
Deferred taxes charged to expense	<b>150,510</b>	26,058
Investment tax credit adjustments	<b>(2,631)</b>	(3,028)
<b>Total</b>	<b>\$(3,991)</b>	\$(46,559)

The significant decrease in current income tax expense in 2009 as compared to 2008 is driven primarily by the effect of filing our 2008 federal and state income tax returns in September 2009. Those filings included a significant one-time tax deduction related to previously capitalized repair costs. The one-time deduction is a temporary difference between book and tax expense and requires normalization for all subsidiaries other than CMP, resulting in an offsetting deferred tax expense, which is the primary driver of the significant increase in deferred income tax expense in 2009 as compared to 2008.

## Notes to Consolidated Financial Statements

Our tax expense differed from the expense at the statutory rate of 35% due to the following:

<b>Year Ended December 31,</b>	<b>2009</b>	<b>2008</b>
<b>(Thousands)</b>		
Tax expense at statutory rate	<b>\$37,467</b>	\$(85)
Depreciation and amortization not normalized	<b>9,672</b>	(1,481)
Investment tax credit amortization	<b>(2,631)</b>	(3,028)
Removal costs	<b>(7,445)</b>	(5,853)
Medicare subsidy	<b>(3,922)</b>	(4,687)
Tax return and audit adjustments	<b>(15,445)</b>	(14,343)
Production Tax Credits	<b>(14,543)</b>	-
State taxes, net of federal benefit	<b>(6,529)</b>	(15,751)
Other, net	<b>(615)</b>	(1,331)
<b>Total</b>	<b>\$(3,991)</b>	\$(46,559)

Income taxes were \$41.5 million less in 2009 than they would have been at the federal statutory rate of 35% and \$46.5 million less in 2008. The 2009 effective tax rate was less than the statutory rate primarily due to the recording of a deferred tax asset related to production tax credits generated as a result of our investment in wind farms (see Note 7) and the flow-through effect of the tax deduction related to previously capitalized repair costs taken for CMP on the 2008 return filed in 2009. The 2008 effective tax rate was less than the statutory rate primarily due to the reversal of reserves resulting from the favorable resolution of federal and state tax audits, benefits related to the early retirement of assets and tax deductibility of repairs resulting from filing the 2007 return in 2008 and the flow-through effect of a book depreciation rate change for CMP effective July 1, 2008. The effective tax rate is not a meaningful value in 2008 due to the level of pretax income (a loss of \$245 thousand).

Our consolidated deferred tax assets and liabilities consisted of:

<b>December 31,</b>	<b>2009</b>	<b>2008</b>
<b>(Thousands)</b>		
<b>Current Deferred Income Tax Assets</b>		
Derivative assets	<b>\$3,648</b>	\$23,489
Other	<b>33,852</b>	35,398
<b>Total Current Deferred Income Tax Assets</b>	<b>\$37,500</b>	\$58,887
<b>Noncurrent Deferred Income Tax Liabilities (Assets)</b>		
Property related	<b>\$1,377,569</b>	\$1,148,952
Pension	<b>243,737</b>	211,211
Unfunded future income taxes	<b>150,306</b>	157,159
Deferred (gain) on sale of generation assets	<b>38,248</b>	20,555
Accumulated deferred investment tax credits	<b>26,805</b>	33,774
Federal and state net operating loss carryforwards	<b>(80,382)</b>	-
Other postretirement benefits	<b>(101,966)</b>	(109,124)
PBA merger order	<b>(118,028)</b>	(110,926)
Other	<b>(14,831)</b>	(5,132)
<b>Total Noncurrent Deferred Income Tax Liabilities</b>	<b>1,521,458</b>	1,346,469
Valuation allowance	-	-
Less amounts classified as regulatory liabilities		
Deferred income taxes	<b>367,764</b>	428,643
<b>Noncurrent Deferred Income Tax Liabilities</b>	<b>\$1,153,694</b>	\$917,826
Deferred tax assets	<b>\$352,707</b>	\$284,069
Deferred tax liabilities	<b>1,836,665</b>	1,571,651
<b>Net Accumulated Deferred Income Tax Liabilities</b>	<b>\$1,483,958</b>	\$1,287,582

## **Notes to Consolidated Financial Statements**

Iberdrola USA and its subsidiaries have the following loss carryforward amounts: federal - \$66 million, state of New York - \$627 million, Maine - \$47 million, and Connecticut - \$71 million, which expire between 2027 and 2029. We have not recorded a valuation allowance because we believe we will be able to fully utilize the loss carryforwards.

<b>Reconciliation of Gross Income Tax Reserves</b>	<b>2009</b>	<b>2008</b>
<b>(Thousands)</b>		
Balance as of January 1	<b>\$4,702</b>	\$17,991
Increases for tax positions related to prior years	<b>38,142</b>	748
Reductions for tax positions related to prior years	<b>(3,346)</b>	-
Decreases for positions related to settlements with taxing authority	-	(14,037)
Balance as of December 31	<b>\$39,498</b>	\$4,702

The total gross unrecognized tax benefits as of December 31, 2009, were \$40.7 million, including gross income tax reserves of \$39.5 million and interest of \$1.2 million. Including interest and penalty, \$5.2 million of the total gross unrecognized tax benefits would affect the effective tax rate, if recognized. Gross income tax reserves increased \$38.1 million in 2009 primarily due to accelerated deductions taken on the 2008 federal and state tax returns. Gross income tax reserves decreased \$3.3 million in 2009 primarily due to the expiration of state statutes.

We have been audited through 2005 for federal income taxes. The statute of limitations in all state jurisdictions has expired for all years through 2005. Our federal returns for 2006 through 2008 are currently under review. We anticipate that the reviews will be completed in 2011. We cannot predict the ultimate outcome of the reviews.

## Notes to Consolidated Financial Statements

### Note 4. Long-term Debt

At December 31, 2009 and 2008, our consolidated long-term debt was:

Company		Interest Rates	Maturity	Amount (Thousands)	
				2009	2008
<b>First mortgage bonds <sup>(1)</sup></b>					
RG&E	Series B, TT, WW, VV, XX & YY	5.90% - 8.00%	2009 - 2033	\$636,000	\$586,000
RG&E	PCN 2009	4.75%	2032	10,500	2,750
RG&E	PCN 2004 Series B	5.375%	2032	50,000	50,000
RG&E	PCN Series C	5.00%	2032	29,350	-
CMP	Series A	5.70%	2019	150,000	-
SCG	Medium Term Notes I, II, III & IV	5.772% - 7.95%	2010 - 2037	234,000	234,000
Berkshire Gas	Series P	10.06%	2019	10,000	10,000
Total first mortgage bonds				1,119,850	882,750
<b>Unsecured pollution control notes (PCNs), fixed</b>					
NYSEG	1985 Series A, B & D	4.00% - 4.10%	2015	132,000	132,000
NYSEG	2004 Series B & C	3.245% - 5.35%	2028 - 2034	170,000	170,000
RG&E	1998 Series A	5.95%	2033	25,500	25,500
CMP	Industrial Development Authority of the state of New Hampshire Notes	5.375%	2014	19,500	19,500
Total unsecured pollution control notes, fixed				347,000	347,000
<b>Unsecured PCNs, variable</b>					
NYSEG	2006 Series A	.27%	2024	12,000	12,000
NYSEG	2005 Series A	.25%	2026	1,550	6,975
NYSEG	2004 Series A	.32%	2027	175	3,475
NYSEG	1994 Series B, C, D1 & D2	.17% - .24%	2029	175,000	175,000
RG&E	1997 Series A, B & C	.60% - .75%	2032	68,000	70,150
TEN Cos.	Industrial Revenue Variable Rate Demand Bonds	1.465%	2025 - 2030	-	14,900
Total unsecured pollution control notes, variable				256,725	282,500
<b>Various long-term debt</b>					
Energy East	Unsecured Note	8.05%	2010	-	200,000
Energy East	Unsecured Note	6.75%	2012	-	400,000
Energy East	Unsecured Note	6.75%	2033	-	200,000
Energy East	Unsecured Notes	6.75%	2036	-	500,000
NYSEG	Unsecured Notes	5.50% - 6.15%	2012 - 2023	600,000	600,000
CMP	Series E & F Medium Term Notes	5.10% - 7.00%	2009 - 2037	293,200	330,700
CNG	Medium Term Notes Series A, B, C & D	5.63% - 9.10%	2012 - 2037	150,000	130,000
Berkshire Gas	Unsecured Notes	4.76% - 9.60%	2011 - 2021	30,000	33,000
NORVARCO	Promissory and Senior Notes	7.05% - 10.48%	2020	12,823	14,007
Total various long-term debt				1,086,023	2,407,707
Obligations under capital leases				18,897	21,297
Unamortized premium (discount) on debt, net				3,940	(33,297)
				2,832,435	3,907,957
Less debt due within one year, included in current liabilities				233,502	331,020
Total Other long-term debt				2,598,933	3,576,937
<b>Long-term debt owed to affiliates</b>					
Iberdrola USA	Unsecured Notes	5.90%	2013	300,000	-
Iberdrola USA	Unsecured Notes	7.08%	2019	1,050,000	-
Total Long-term debt owed to affiliates				1,350,000	-
<b>Total Long-Term Debt</b>				<b>\$3,948,933</b>	<b>\$3,576,937</b>

<sup>(1)</sup> The first mortgage bonds are secured by liens on substantially all of the respective utility's properties.

## **Notes to Consolidated Financial Statements**

On April 8, 2009, the obligor on Energy East's \$1.3 billion of outstanding unsecured debt was transferred to Iberdrola International, a subsidiary of Iberdrola S.A. In exchange Energy East entered into a debt agreement with Scottish Power, Limited, another subsidiary of Iberdrola S.A., for \$1.05 billion and received an equity infusion of \$250 million from Iberdrola S.A. On May 26, 2009, Energy East borrowed an additional \$300 million from Scottish Power, Limited. Those funds were used to invest in wind farms. (See Note 7.)

There are federal and state regulatory restrictions on our ability to borrow funds from our utility subsidiaries. While we may be able to borrow funds from our utility subsidiaries by obtaining regulatory approvals and meeting certain conditions, we do not expect to seek such loans. Iberdrola USA has no secured indebtedness and none of its assets are mortgaged, pledged or otherwise subject to lien. None of Iberdrola USA's debt obligations are guaranteed or secured by its subsidiaries.

As of December 31, 2009, NYSEG and RG&E had outstanding \$674 million of tax-exempt pollution control notes (PCNs), of which \$277 million have coupons fixed to maturity, \$40 million are notes with a mandatory redemption date in 2016, \$100 million are auction rate notes under a special rate period where the rate is fixed until January 2010, \$187 million are weekly variable rate demand notes (VRDNs), \$2 million are 7-day auction rate notes and \$68 million are 35-day auction rate notes.

As of December 31, 2008, NYSEG and RG&E had outstanding \$775.9 million of tax-exempt PCNs, of which \$277.5 million had coupons fixed to maturity, \$100 million were auction rate notes under a special rate period where the rate was fixed until January 2010, \$187 million were weekly VRDNs, \$109.5 million were 7-day auction rate notes and \$101.9 million were 35-day auction rate notes.

In response to market disruptions triggered by downgrades of bond insurers that began in the first quarter of 2008, NYSEG and RG&E began in August 2008 to place orders for their own accounts in the auctions for \$143.4 million of auction rate notes. NYSEG and RG&E bid at each auction for 100% of the outstanding securities at the greater of the one-month London Interbank Offer Rate (LIBOR) or the Securities Industry and Financial Markets index. As of December 31, 2008, NYSEG and RG&E held a total of \$130.5 million which have been accounted for as a redemption of long-term debt including: NYSEG PCN 2004 Series A and NYSEG PCN 2005 Series A. The securities held by RG&E pursuant to this program were remarketed as mandatory tender bonds in August 2009. During 2009 NYSEG continued to bid on \$99 million of its auction rate notes. As of December 31, 2009, it held a total of \$97 million of those securities.

In August 2009 RG&E converted PCN 1997 Series C and PCN 2004 Series A from auction rate to mandatory tender bonds, with 2016 tender dates. Those two series had been subject to the program described above wherein RG&E was bidding for the securities at auction. At the time of the conversion, RG&E held \$33 million of PCN 1997 Series C bonds and \$11 million of PCN 2004 Series A bonds. Also at the time of conversion, \$4.6 million of PCN 1997 Series C bonds were retired in connection with the closing of Russell Station. After the conversion, there were \$29 million of PCN 1997 Series C bonds and \$11 million of PCN 2004 Series A bonds outstanding.

## **Notes to Consolidated Financial Statements**

As of February 11, 2010, NYSEG and RG&E were:

- Paying rates averaging 0.50% on the remaining \$68 million of auction rate notes for which they are not placing orders at auction.
- Paying rates averaging 0.17% on the \$99 million of auction rates notes on which they are placing orders at auction. The \$99 million includes \$98.8 million of notes being held on account that have been accounted for as a redemption of long-term debt.
- Paying rates averaging 0.17% on the \$187 million weekly VRDNs.

Beginning in May 2006 RG&E entered into a series of derivative transactions – forward starting swaps – intended to hedge \$150 million of financing transactions in December 2008 and \$100 million in October 2009. The hedges that settled in December 2008, at a loss of \$100.4 million, were in connection with the pricing of RG&E's Series XX 8.00% Bonds due December 15, 2033. RG&E's inability to issue the Series XX Bonds prior to receiving authorization from the NYPSC and the sharp decline in treasury yields and swap rates in November and December 2008 contributed to the magnitude of the loss on the hedges.

In June 2009 RG&E issued \$150 million Series YY first mortgage bonds bearing a coupon of 5.9% and with a maturity date of July 15, 2019. The proceeds of the issuance funded the redemption at maturity of \$100 million of Series B Medium Term Notes in October 2009. The remainder of the funds were used to reduce short-term debt and for general corporate purposes. RG&E settled its October 2009 hedge in June 2009 at a loss of \$20.9 million in connection with the pricing of those Series YY Bonds.

In May 2009 CMP issued \$150 million Series A first mortgage bonds bearing a coupon of 5.7% and with a maturity date of June 1, 2019. The proceeds of the issuance were used to reduce short-term debt and for general corporate purposes. CMP had entered into two derivative transactions – forward starting swaps – to hedge that financing transaction. CMP settled the hedges in May 2009 at a loss of \$19.9 million.

The above hedge losses are included in other comprehensive income and are being amortized to interest expense over the term of the related new debt that was issued.

At December 31, 2009, long-term debt, including sinking fund obligations and capital lease payments (in thousands) that will become due during the next five years is:

<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
\$233,502	\$223,525	\$162,027	\$380,292	\$29,163

**Cross-default provisions:** Iberdrola USA has a provision in its revolving credit facility, which provides that its default with respect to any other debt in excess of \$50 million will be considered a default under its revolving credit facility.

## **Notes to Consolidated Financial Statements**

### **Note 5. Bank Loans and Other Borrowings**

Iberdrola USA is the sole borrower in a revolving credit facility providing maximum borrowings of up to \$300 million. Our operating utilities are joint borrowers in a revolving credit facility providing maximum borrowings of up to \$475 million in aggregate. Sublimits that total to the aggregate limit apply to each joint borrower and can be altered within the constraints imposed by maximum limits that apply to each joint borrower. Both facilities have expiration dates in 2012 and require fees on undrawn borrowing capacity. Two of our operating utilities have uncommitted bilateral credit agreements for a total of \$10 million. The two revolving credit facilities and the two bilateral credit agreements provided for consolidated maximum borrowings of \$785 million at December 31, 2009 and 2008. Iberdrola USA pays a facility fee of 6 basis points annually on its \$300 million revolver and each joint borrower pays a facility fee on its revolver sublimit, ranging from 6 to 10 basis points annually depending on the rating of its unsecured debt.

We use drawings on our credit facilities to finance working capital needs, to finance temporarily certain refundings and for other corporate purposes. Drawings on Iberdrola USA's revolving credit facility are used to provide financing to its nonregulated subsidiaries and can be used to provide additional financing to its operating utilities. There was \$119 million of such short-term debt outstanding at December 31, 2009, and \$624 million outstanding at December 31, 2008. The weighted-average interest rate on short-term debt was 0.5% at December 31, 2009, and 1.4% at December 31, 2008. At February 11, 2010, there was \$85 million of such debt outstanding.

In our revolving credit facility we covenant not to permit, without the consent of the lender, our ratio of consolidated indebtedness to consolidated total capitalization to exceed 0.65 to 1.00 at any time. For purposes of calculating the maximum ratio of consolidated indebtedness to consolidated total capitalization, the facility excludes from consolidated net worth the balance of Accumulated other comprehensive income (loss) as it appears on the consolidated balance sheet. The facility contains various other covenants, including a restriction on the amount of secured indebtedness Iberdrola USA may maintain. Continued unremedied failure to comply with those covenants for 15 days after written notice of such failure from the lender constitutes an event of default and would result in acceleration of maturity. Our ratio of consolidated indebtedness to consolidated total capitalization pursuant to the revolving credit facility was 0.55 to 1.00 at December 31, 2009. We are not in default as of December 31, 2009.

In the revolving credit facility in which our operating utilities are joint borrowers, each joint borrower covenants not to permit, without the consent of the lender, its ratio of total indebtedness to total capitalization to exceed 0.65 to 1.00 at any time. For purposes of calculating the maximum ratio of consolidated indebtedness to total capitalization, the facility excludes from consolidated net worth the balance of Accumulated other comprehensive income (loss) as it appears on the consolidated balance sheet. The facility contains various other covenants, including a restriction on the amount of secured indebtedness each borrower may maintain. Continued unremedied failure to comply with those covenants for five business days after written notice of such failure from the lender constitutes an event of default and would result in acceleration of maturity for the party in default. We are not in default as of December 31, 2009.

## Notes to Consolidated Financial Statements

### **Note 6. Redeemable Preferred Stock of Subsidiaries, Noncontrolling Interests**

The redeemable preferred stock of subsidiaries are noncontrolling interests because they contain a feature that allows the holders to elect a majority of the subsidiary's board of directors if preferred stock dividends are in default in an amount equivalent to four full quarterly dividends. Such a potential redemption-triggering event is not solely within the control of the subsidiary.

At December 31, 2009 and 2008, our consolidated redeemable preferred stock, noncontrolling interests was:

Subsidiary and Series	Par Value per Share	Redemption Price per Share	Shares Authorized and Outstanding <sup>(1)</sup>	Amount (Thousands)	
				2009	2008
CMP, 6% Noncallable	\$100	-	5,180	<b>\$518</b>	\$518
CMP, 4.60%	100	101.00	30,000	<b>3,000</b>	3,000
CMP, 4.75%	100	101.00	50,000	<b>5,000</b>	5,000
CMP, 5.25%	100	102.00	50,000	<b>5,000</b>	5,000
NYSEG, 3.75%	100	104.00	78,379	<b>7,838</b>	7,838
NYSEG, 4.50% (1949)	100	103.75	11,800	<b>1,180</b>	1,180
NYSEG, 4.40%	100	102.00	7,093	<b>709</b>	709
NYSEG, 4.15% (1954)	100	102.00	4,317	<b>432</b>	432
NYSEG, Limited Voting Junior	1	-	1	-	-
RG&E, Limited Voting Junior	1	-	1	-	-
Berkshire Gas, 4.80%	100	100.00	1,180	<b>118</b>	122
CNG, 6.00%	100	110.00	4,104	<b>410</b>	410
CNG, 8.00% Noncallable	3.125	-	108,706	<b>340</b>	340
<b>Total</b>				<b>\$24,545</b>	\$24,549

<sup>(1)</sup> At December 31, 2009, Iberdrola USA and its subsidiaries had 16,732,193 shares of \$100 par value preferred stock, 16,800,000 shares of \$25 par value preferred stock, 775,609 shares of \$3.125 par value preferred stock, 600,000 shares of \$1 par value preferred stock, 1,000,000 shares of \$100 par value preference stock and 6,000,000 shares of \$1 par value preference stock authorized but unissued.

On January 28, 2010, CMP Group, Inc. made a tender offer to purchase any and all of the following outstanding shares of CMP's cumulative preferred stock: at par – the 6% Noncallable; at a discount – the 4.60%, 4.75% and 5.25%. The tender offer expires on March 3, 2010, unless extended.

### **Note 7. Investment in Wind Farms**

In April 2009 Iberdrola USA, through its subsidiary CNE Energy, acquired an interest in various wind farms owned by Aeolus Wind Power V LLC (Aeolus V) in exchange for \$305.4 million in cash. CNE Energy purchased its membership interest in Aeolus V from PPM Wind Energy LLC (PPM), an affiliate, which contributed its 100% ownership of the wind farms to Aeolus V.

The main characteristics of the investment are as follows:

- PPM retains day-to-day management of the wind farms. Defined major decisions require consent from CNE Energy.
- As a minority shareholder, CNE Energy has the right to a substantial portion of the profits and tax credits generated by the wind farms up to the return level established at the beginning of the investment contract.
- CNE Energy initially holds a 50% interest in Aeolus V until it achieves a stipulated 7.5% return, after which it is entitled to maintain a 5% ownership interest.
- PPM has the option to purchase, at fair market value, CNE Energy's remaining residual equity interest, which is exercisable after CNE Energy achieves its agreed upon return.

## Notes to Consolidated Financial Statements

- Whether or not CNE Energy obtains the agreed upon return depends on the economic performance of the wind farms. While PPM is bound to operate and maintain the facilities in an efficient manner and maintain appropriate insurance, it is not obligated to deliver cash to CNE Energy over and above the aforementioned profits and tax credits.

CNE Energy uses an equity method referred to as Hypothetical Liquidation at Book Value (HLBV) to account for its investment in Aeolus V. The application of that method results in CNE Energy recording a gain or loss on its investment based on the cash implications of a liquidation at book value, with a corresponding adjustment to the investment account. In addition, the HLBV method requires the tax effects related to Production Tax Credits and taxable income (loss) to be recorded in income taxes on the income statement. Finally, the HLBV method requires a credit to accumulated deferred income taxes on the balance sheet and a debit to income taxes on the income statement for an amount representing the statutory rate applied to the difference between the tax basis and the book basis of the investment.

The following table shows the effects of The investment on our consolidated income statement and balance sheet:

Income statement for the year ended December 31, (Thousands)	<b>2009</b>
Other income (loss), earnings from equity investment	\$(579)
Income tax benefit	14,746
Total income statement benefit	\$14,167
Balance sheet at December 31, (Thousands)	
Investment in wind farms	\$304,821
Deferred tax liabilities, noncurrent	(32,964)
Prepaid income taxes	\$47,709

The following table provides summary financial information for Aeolus V:

Income statement for the year ended December 31, (Thousands)	<b>2009</b>
Revenues, including PTCs	\$51,070
Operating income	13,564
Net Income	\$(1,048)
Balance sheet at December 31, (Thousands)	
Total Assets	\$686,386
Total Equity	\$674,948

### **Note 8. Commitments and Contingencies**

***Alleged overcharges by TEN Companies:*** The state of Connecticut (State) filed suit in February 2007 against Energy East and its subsidiaries TEN Cos., CNG and CTG Resources, Inc. for an alleged \$14 million overcharge for heating and cooling services supplied to state buildings since 1992. Subsequently, the State provided an expert's report that claims the overcharges amounted to \$30 million.

In May 2008 TEN Cos. and the State signed a memorandum of understanding (MOU) to allow the parties to finalize an agreement for the State's purchase of certain heating and cooling equipment that serves certain state buildings (Capitol Area System) at a specified purchase

## **Notes to Consolidated Financial Statements**

price of \$10.6 million, along with other terms specified in the MOU. TEN Cos. entered into an Asset Purchase Agreement (Agreement) contemplated in the MOU with the State in November 2008. All lawsuits have been withdrawn with prejudice and mutual releases have been exchanged. The State passed legislation authorizing the Agreement and the sale was completed on June 1, 2009.

**Capital spending:** We have commitments in connection with our capital spending program. We plan to invest approximately \$5.5 billion in our energy delivery infrastructure during the next five years, including amounts dedicated to electric reliability. We expect that about one-half of our capital spending will be paid for with internally generated funds and the remainder through the issuance of a combination of debt and equity securities. The program is subject to periodic review and revision. Our capital spending will be primarily for the extension of energy delivery service, increased transmission capacity, necessary improvements to existing facilities and compliance with environmental requirements and governmental mandates.

CMP has received initial approval for a grant from the U.S. Department of Energy (DOE) of \$96 million for the deployment of Advanced Metering Infrastructure (AMI) throughout CMP's service territory, to serve all of its approximately 600,000 residential, commercial and industrial customers. The total estimated cost of the AMI project is \$166 million.

NYSEG has received initial approval for a grant from the DOE of approximately \$30 million for an Advanced Compressed Air Energy Storage Demonstration plant using a salt storage cavern. The total estimated cost of that project is \$125 million.

**Staff allegations concerning earnings sharing calculations:** The New York Department of Public Service Staff (Staff) in its testimony and briefs in the merger proceeding alleged that NYSEG did not properly compute the amount due to customers under the electric ESM in NYSEG's electric rate plan that was in effect from 2002 through 2006. The Staff claimed that its preliminary analysis showed an additional \$67 million, including interest, that should have been allocated to customers. The Staff also raised issues with regard to the ESM under the RG&E electric rate plan currently in effect, but had not completed its analysis.

In its January 22, 2010, testimony, the NYPSC provided a detailed analysis of those issues. The Staff proposed a one-time charge of \$107 million relating to the companies' annual compliance filings including the calculation of the ESM and accounting for certain software costs. The companies vigorously dispute Staff's claims, but cannot predict how the matters will be resolved. The companies have reduced their regulatory assets by \$40 million as a result of the uncertainty related to this proceeding.

**Homer City:** In June 2008 NYSEG received a letter from subsidiaries of Edison Mission Energy regarding a notice of violation (NOV) from the U. S. Environmental Protection Agency (EPA) claiming that certain modifications to the Homer City Electric Generation Station (Homer City) during the time it was owned by NYSEG and Pennsylvania Electric Company (Penelec) were done in violation of EPA's new source review (NSR) regulations. Homer City was sold in 1999 to Edison Mission Energy by NYSEG and Penelec. Edison Mission Energy asserts that it is entitled to indemnification for certain fines, penalties and costs arising out of the violations alleged in the NOV under the terms of the Asset Purchase Agreement for Homer City. That appears to be the same claim Edison Mission Energy made to NYSEG in October 2000. NYSEG continues to believe that the costs sought by Edison Mission Energy are not liabilities of NYSEG and therefore did not retain liability for those material claims.

In September 2008 NYSEG, Penelec and Edison Mission Energy met with the EPA for a required NOV conference. EPA indicated at the meeting that it seeks a system-wide NSR

## **Notes to Consolidated Financial Statements**

settlement covering Edison Mission Energy's entire generation fleet, including a number of plants in Illinois, and would require installation of scrubbers on Homer City Units 1 and 2 as part of the settlement. In April 2009 EPA sent Edison Mission Energy a settlement proposal that included those controls, along with specified emissions caps, operational controls, improvement projects and fines. To our knowledge, Edison Mission Energy has not yet formally responded to EPA's proposal. While the EPA's settlement proposal substantially increases the potential value of the claim, NYSEG believes it has sound contractual defenses under the Asset Purchase Agreement. NYSEG estimates that its most likely cost exposure over the next several years will be primarily for legal defense costs and, potentially, a proportionate share of fines EPA may assess against Edison Mission Energy. NYSEG cannot predict the nature or amounts of any potential fines or penalties.

***Nonutility generator power purchase contracts:*** We expensed approximately \$218 million for NUG power in 2009 and \$403 million in 2008. We estimate that our NUG power purchases will total \$71 million in 2010, \$72 million in 2011, \$67 million in 2012, \$63 million in 2013 and \$62 million in 2014.

***Nuclear entitlement power purchase contracts:*** In connection with our sales of nuclear generating assets in 2001 and 2004, we entered into four entitlement contracts under which we purchase electricity at a fixed contract price. We expensed approximately \$290 million for nuclear entitlement power in 2009 and \$274 million in 2008. We estimate that our nuclear entitlement power purchases will be \$297 million in 2010, \$282 million in 2011, \$184 million in 2012, \$195 million in 2013 and \$83 million in 2014.

***South Glens Falls Energy, LLC (SGF) bankruptcy proceeding:*** In January 2008 the trustee in the SGF Chapter 7 bankruptcy proceeding brought adversarial proceedings seeking repayment of alleged preferential payments made in the one-year period preceding the bankruptcy filing to SGF affiliates in amounts totaling \$14 million. We evaluated the claims and filed responsive pleadings in April 2008. The Iberdrola USA defendants filed a motion for summary judgment on the claims. Oral argument on the summary judgment motion was held in October 2008. On October 13, 2009, the Iberdrola USA defendants entered into a settlement agreement with the trustee resolving the remaining issues. The settlement provided for a \$1 million payment by Cayuga Energy, Inc., and the claims against the other Iberdrola USA affiliates were dismissed.

### **Note 9. Environmental Liability**

From time to time environmental laws, regulations and compliance programs may require changes in our operations and facilities and may increase the cost of electric and natural gas service.

The EPA and various state environmental agencies, as appropriate, have notified us that we are among the potentially responsible parties who may be liable for costs incurred to remediate certain hazardous substances at 25 waste sites. The 25 sites do not include sites where gas was manufactured in the past, which are discussed below. With respect to the 25 sites, 15 sites are included in the New York State Registry of Inactive Hazardous Waste Disposal Sites, four are included in Maine's Uncontrolled Sites Program, one is included on the Massachusetts Non-Priority Confirmed Disposal Site list and nine sites are also included on the National Priorities list.

Any liability may be joint and several for certain of those sites. We have recorded an estimated liability of \$1 million related to 12 of the 25 sites. We have paid remediation costs related to the remaining 13 sites, and do not expect to incur any additional liability. We have recorded an

## **Notes to Consolidated Financial Statements**

estimated liability of \$3.1 million related to another 12 sites where we believe it is probable that we will incur remediation costs and/or monitoring costs, although we have not been notified that we are among the potentially responsible parties. The ultimate cost to remediate the sites may be significantly more than the accrued amount. Factors affecting the estimated remediation amount include the remedial action plan selected, the extent of site contamination and the portion attributed to us.

We have a program to investigate and perform necessary remediation at our 61 sites where gas was manufactured in the past. Eight sites are included in the New York State Registry, eight sites are included in the New York Voluntary Cleanup Program, three sites are part of Maine's Voluntary Response Action Program and those three sites are part of Maine's Uncontrolled Sites Program, three sites are included in the Connecticut Inventory of Hazardous Waste Sites, and three sites are on the Massachusetts Department of Environmental Protection's list of confirmed disposal sites. We have entered into consent orders with various environmental agencies to investigate and, where necessary, remediate 47 of the 61 sites.

Our estimate for all costs related to investigation and remediation of the 61 sites ranges from \$213 million to \$429 million at December 31, 2009. Our estimate could change materially based on facts and circumstances derived from site investigations, changes in required remedial action, changes in technology relating to remedial alternatives and changes to current laws and regulations.

The liability to investigate and perform remediation, as necessary, at the known inactive gas manufacturing sites was \$213 million at December 31, 2009, and \$204 million at December 31, 2008. We recorded a corresponding regulatory asset, net of insurance recoveries, because we expect to recover the net costs in rates.

Our environmental liabilities are recorded on an undiscounted basis unless payments are fixed and determinable. Nearly all of our environmental liability accruals, which are expected to be paid through the year 2030, have been established on an undiscounted basis. Some of our operating utility subsidiaries have received insurance settlements during the last two years, which they generally accounted for as reductions to their related regulatory assets.

### **Note 10. Accounting for Derivative Instruments and Hedging Activities**

We are exposed to certain risks relating to our ongoing business operations. The primary risk we manage by using derivative instruments is commodity price risk. In accordance with the accounting requirements concerning derivative instruments and hedging activities, we recognize all derivative instruments as either assets or liabilities at fair value on our balance sheet.

The financial instruments we hold or issue are not for trading or speculative purposes.

**Commodity price risk:** Commodity price risk, due to volatility experienced in the wholesale energy markets, is a significant issue for the electric and natural gas utility industries. We manage this risk through a combination of regulatory mechanisms, such as the pass-through of the market price of electricity and natural gas to customers, and through comprehensive risk management processes. Those measures mitigate our commodity price exposure, but do not completely eliminate it.

We have electricity commodity purchases and sales contracts for both capacity and energy (physical contracts) that have been designated and qualify for the normal purchases and normal sales exception in the accounting requirements concerning derivative instruments and hedging activities.

## **Notes to Consolidated Financial Statements**

Effective January 1, 2010, NYSEG and RG&E will no longer offer fixed price service to their customers. They currently have a nonbypassable wires charge adjustment that allows them to pass through rates any changes in the market price of electricity. They use electricity contracts, both physical and financial, to manage fluctuations in electricity commodity prices in order to provide price stability to customers. We include the cost or benefit of those contracts in the amount expensed for electricity purchased when the related electricity is sold. We record changes in the fair value of electric hedge contracts to derivative assets and/or liabilities with an offset to regulatory assets and/or regulatory liabilities in accordance with the requirements concerning accounting for regulated operations. At December 31, 2009, the loss recognized in regulatory assets was \$0.1 million for electricity derivatives. For the year ended December 31, 2009, the loss reclassified from regulatory assets into income was \$6.9 million, which is included in electricity purchased.

Owned electric generation and long-term supply contracts reduce our exposure to market fluctuations.

All of our natural gas utilities have purchased gas adjustment clauses that allow them to recover through rates any changes in the market price of purchased natural gas, substantially eliminating their exposure to natural gas price risk. NYSEG and RG&E use natural gas futures and forwards to manage fluctuations in natural gas commodity prices in order to provide price stability to customers. We include the cost or benefit of natural gas futures and forwards in the commodity cost that is passed on to customers when the related sales commitments are fulfilled. We record changes in the fair value of natural gas hedge contracts to derivative assets and/or liabilities with an offset to regulatory assets and/or regulatory liabilities in accordance with the requirements concerning accounting for regulated operations. At December 31, 2009, the loss recognized in regulatory assets was \$9.5 million for natural gas hedges. For the year ended December 31, 2009, the loss reclassified from regulatory assets into income was \$50.1 million, which is included in natural gas purchased.

Energetix, Inc. and NYSEG Solutions, Inc. offer retail electric and natural gas service to customers in New York state and actively hedge the load required to serve customers that have chosen them as their commodity supplier. As of January 26, 2010, the energy marketing subsidiaries' expected fixed price loads were 97% hedged for 2010. A fluctuation of \$1.00 per Megawatt-hour in the average price of electricity would change earnings less than \$100,000 in 2010. The percentage of hedged load for the energy marketing subsidiaries is based on load forecasts, which include certain assumptions such as historical weather patterns. Actual results could differ as a result of changes in the load compared to the load forecast.

Financial electricity contracts for those two companies are designated as cash flow hedging instruments. We record changes in the fair value of the cash flow hedging instruments in other comprehensive income (OCI), to the extent they are considered effective, and reclassify those gains or losses into earnings in the same period or periods during which the hedged transactions affect earnings. We record the ineffective portion of any change in fair value of cash flow hedges to the income statement as either Other (Income) or Other Deductions, as appropriate.

Our derivative volumes by commodity type that are expected to settle each year are:

<b>As of December 31, 2009</b>	<b>Electricity Contracts</b>	<b>Natural Gas Contracts</b>	<b>Other Fuel Contracts</b>
<b>Year to settle</b>	<b>Financial Mwhs</b>	<b>Financial Dths</b>	<b>Financial Gals</b>
2010	3,158,334	17,249,762	3,743,000
2011	192,469	1,648,254	-

## Notes to Consolidated Financial Statements

The location and amounts of derivative fair values in the balance sheet are:

As of December 31, 2009 (Thousands)	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<b>Derivatives designated as hedging instruments</b>				
Commodity contracts:				
Electricity derivatives:				
Current	Current assets	\$4,383	Current liabilities	\$(321)
Long term	Other assets	431	Other liabilities	(184)
Natural gas derivatives:				
Current	Current assets	129	Current liabilities	(9,271)
Long term	Other assets	11	Other liabilities	(309)
Other contracts:	Current assets	633	Current Liabilities	(16)
<b>Total derivatives designated as hedging instruments</b>		<b>\$5,587</b>		<b>\$(10,101)</b>

The effect of hedging instruments on OCI and income was:

Period Ended December 31, 2009	Gain (Loss) Recognized in OCI on Derivatives	Location of Gain (Loss) Reclassified from Accumulated OCI into Income	Gain (Loss) Reclassified from Accumulated OCI into Income	Location of Gain (Loss) Recognized in Income on Derivatives	Gain (Loss) Recognized in Income on Derivatives
Derivatives in Cash Flow Hedging Relationships	Effective Portion <sup>(1)</sup>	Effective Portion <sup>(1)</sup>		Ineffective Portion and Amount Excluded from Effectiveness Testing <sup>(2)</sup>	
<b>(Thousands)</b>					
Interest rate contracts	\$(86,359)	Interest expense	\$(6,149)	Interest expense	-
Commodity contracts:					
Electricity derivatives	16,946	Electricity purchased	(56,497)	Other (Income)/ Other Deductions	\$104
Other	(1,748)	Other direct costs	(3,974)		-
<b>Total</b>	<b>\$(71,161)</b>		<b>\$(66,620)</b>		<b>\$104</b>

<sup>(1)</sup> Changes in OCI are reported in after-tax dollars.

<sup>(2)</sup> Ineffective portion of long-term power supply contracts that are designated as cash flow hedges.

The amounts in other comprehensive income (OCI) related to previously settled treasury lock contracts, after tax and accumulated amortization, at December 31 is a net (loss) of \$(140.9) million for 2009 and \$(107.4) million for 2008.

As of December 31, 2009, we reported \$(60.5) million in net derivative gains/(losses) related to discontinued cash flow hedges. At December 31, 2009, \$0.4 million in gains/(losses) are reported in OCI because the forecasted transaction is considered to be probable. We expect that \$0.4 million of gains/(losses) in OCI will be reclassified into earnings within the next 12 months.

As of December 31, 2009, the maximum length of time over which we are hedging our exposure to the variability in future cash flows for forecasted energy transactions was 16 months –

## Notes to Consolidated Financial Statements

through April 2011. We estimate that approximately \$4 million in losses will be reclassified from accumulated other comprehensive income into earnings during 2010, as the underlying transactions occur.

NYSEG, RG&E and our unregulated energy marketing subsidiaries Energetix, Inc. and NYSEG Solutions, Inc., face risks related to counterparty performance on hedging contracts due to counterparty credit default. We have developed a matrix of unsecured credit thresholds that are dependent on a counterparty's or the counterparty guarantor's applicable credit rating (normally Moody's or S&P). When our exposure to risk for a counterparty exceeds the unsecured credit threshold, the counterparty is required to post additional collateral or we will no longer transact with the counterparty until the exposure drops below the unsecured credit threshold.

We have various master netting arrangements in the form of multiple contracts with various single counterparties that are subject to contractual agreements that provide for the net settlement of all contracts through a single payment. Those arrangements reduce our exposure to a counterparty in the event of default on or termination of any one contract. For financial statement presentation, we do not offset fair value amounts recognized for derivative instruments and fair value amounts recognized for the right to reclaim or the obligation to return cash collateral arising from derivative instruments executed with the same counterparty under a master netting arrangement. Under the master netting arrangements our obligation to return cash collateral was \$1.7 million at December 31, 2009, and our right to reclaim cash collateral was \$19.3 million at December 31, 2008.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade credit rating on our debt from each of the major credit rating agencies. If our debt were to fall below investment grade, it would be in violation of those provisions, and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a liability position on December 31, 2009, is \$9.7 million for which we have posted collateral of \$6.2 million in the normal course of business. If the credit-risk-related contingent features underlying those agreements were triggered on December 31, 2009, we would be required to post an additional \$3.5 million of collateral to our counterparties.

### **Note 11. Fair Value of Financial Instruments and Fair Value Measurements**

The carrying amounts and estimated fair values of our financial instruments are shown in the following table.

<b>December 31,</b>	<b>2009</b>		<b>2008</b>	
	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>	<b>Carrying Amount</b>	<b>Estimated Fair Value</b>
<b>(Thousands)</b>				
First mortgage bonds	\$1,121,921	\$1,180,627	\$881,920	\$899,492
Pollution control notes, fixed	\$351,811	\$350,573	\$347,000	\$319,671
Pollution control notes, variable	\$256,725	\$247,903	\$282,500	\$282,500
Various long-term debt	\$1,083,081	\$1,083,945	\$2,375,240	\$2,156,465
Long-term debt owed to affiliates	\$1,350,000	\$1,481,946	-	-

The carrying amounts for cash and cash equivalents, accounts receivable, notes payable and interest accrued approximate their estimated fair values.

We value all fixed rate long-term debt, whether unsecured or secured by a first mortgage lien, taxable or tax-exempt, by assigning a market-based yield for each security and then deriving the

## Notes to Consolidated Financial Statements

price from the yield. Market-based yields are determined by observing secondary market trading levels for debt of similar maturity, rating, tax and structural characteristics. We value all variable rate debt at par as it approximates fair value, except for the auction rate securities issued by RG&E, which do not have an active market.

### ***Assets and liabilities measured at fair value on a recurring basis***

Description	Total	Fair Value Measurements at December 31, Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>2009</b>				
<b>Assets</b>				
Noncurrent investments available for sale, auction rate securities	\$2,735	-	-	\$2,735
Noncurrent investments available for sale, other	114,706	\$114,706	-	-
Derivatives	5,587	141	-	5,446
Total	\$123,028	\$114,847	-	\$8,181
<b>Liabilities</b>				
Derivatives	\$10,101	\$9,580	-	\$521
Total	\$10,101	\$9,580	-	\$521
<b>2008</b>				
<b>Assets</b>				
Noncurrent investments available for sale, auction rate securities	\$3,850	-	-	\$3,850
Noncurrent investments available for sale, other	119,214	\$119,214	-	-
Derivatives	28,700	-	-	28,700
Total	\$151,764	\$119,214	-	\$32,550
<b>Liabilities</b>				
Derivatives	\$222,141	\$62,699	-	\$159,442
Total	\$222,141	\$62,699	-	\$159,442

**Valuation techniques:** At December 31, 2008, we valued our noncurrent investments available for sale, auction rate securities at par due to the variable rate earned on the investments. At January 1, 2008, we included the fair value of those investments in Level 1. As a result of the continued illiquidity in the auction rate securities market, we included the fair value of those investments in Level 3 at December 31, 2008. During 2009 we reassessed our valuation of this investment in accordance with guidance related to decreased market activity. (See Note 1.) At December 31, 2009, we estimated the fair value based on the estimated probabilities of when the auction rate markets would return to historic interest rate levels.

We measure the fair value of our noncurrent investments available for sale, other using quoted market prices in active markets for identical assets and include the measurements in Level 1. The investments primarily consist of money market funds, but also include some fixed income and equity investments.

## **Notes to Consolidated Financial Statements**

We determine the fair value of our various derivative assets and liabilities utilizing market approach valuation techniques:

- NYSEG, RG&E and our energy marketing subsidiaries enter into electric energy derivative contracts to hedge the forecasted purchases required to serve their electric load obligations. Those companies hedge their electric load obligations using derivative contracts that are settled based upon Locational Based Marginal Pricing published by the NYISO. Forward market price quotes for some NYISO locations are not actively traded and not readily available outright from market dealers. We derive forward market prices for some locations based on the historical relationship of prices in those locations to prices in locations where an active market exists. The resulting value represents the derived forward market price for each location, which we use to value the open derivative contracts. Because we adjust quoted market prices for our own load characteristics, we include those fair value measurements in Level 3.
- NYSEG, RG&E and our energy marketing subsidiaries enter into natural gas derivative contracts to hedge the forecasted purchases required to serve their natural gas load obligations. The forward market prices used to value our open natural gas derivative contracts are exchange-based prices for the identical derivative contracts traded actively on the New York Mercantile Exchange. Because we use prices quoted in an active market, we include those fair value measurements in Level 1.
- We enter into treasury-related derivative contracts to hedge the forecasted issuance of debt, to manage the risk of changes in interest rates associated with existing debt, and to maintain desired fixed-to-floating rate ratios. We value those derivatives based on indicative values provided by transaction counterparties and calculated based upon proprietary models that use well-recognized financial principles and reasonable, market-based estimates of relevant future market conditions. We assess the reasonableness of the transaction counterparty valuations utilizing a model that constructs forward LIBOR rates from a spot LIBOR curve, applies the forward rates to construct pro forma cash flows and discounts the pro forma cash flows to the present using forward rates. Because the valuations provided by the counterparties are only indicative and do not represent prices at which the counterparties would be willing to transact, we include those fair value measurements in Level 3. We had no treasury-related derivative contracts at December 31, 2009.

## Notes to Consolidated Financial Statements

### *Instruments measured at fair value on a recurring basis using significant unobservable inputs*

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Auction Rate Securities	Derivatives, Net	Total
<b>Balance, January 1, 2008</b>	-	\$19,885	\$19,885
Total (losses) (realized/unrealized)			
Included in earnings	-	(34,283)	(34,283)
Included in other comprehensive income	-	(50,498)	(50,498)
Included in regulatory liabilities	-	(54,044)	(54,044)
Purchases, issuances and settlements	\$(16,075)	(24,506)	(40,581)
Transfers into Level 3	19,925	12,704	32,629
<b>Balance, December 31, 2008</b>	3,850	(130,742)	(126,892)
Total (losses) (realized/unrealized)			
Included in earnings	(1,115)	128,994	127,879
Included in other comprehensive income	-	(91,604)	(91,604)
Included in regulatory liabilities	-	57,089	57,089
Purchases, issuances and settlements	-	41,188	41,188
Transfers into Level 3	-	-	-
<b>Balance, December 31, 2009</b>	\$2,735	\$4,925	\$7,660
Total gains for the period included in earnings attributable to the change in unrealized gains relating to assets still held at December 31,			
2008	-	\$19,925	\$19,925
2009	-	\$90	\$90

The amounts of realized and unrealized gains and losses included in earnings for the period (above), which are reported in the various categories indicated are:

	Electricity purchased	Other operating expense	Other Income	Other Deductions	Interest expense
<b>(Thousands)</b>					
Total gains (losses) included in earnings for year ended December 31,					
2008	\$(18,277)	\$(3,017)	\$288	\$(13,324)	\$47
2009	\$103,088	\$19,667	\$90	\$(1,115)	\$6,149
Change in unrealized gains (losses) relating to assets still held at December 31,					
2008	\$(18,916)	\$(1,297)	\$288	\$(620)	-
2009	-	-	-	-	-

## Notes to Consolidated Financial Statements

### **Note 12. Accumulated Other Comprehensive Income (Loss)**

	Balance January 1, 2008	2008 Change	Balance December 31, 2008	2009 Change	Balance December 31, 2009
<b>(Thousands)</b>					
Net unrealized holding (losses) gains on investments, net of income tax benefit (expense) of \$1,741 for 2008 and \$(749) for 2009	\$1,498	\$(2,622)	\$(1,124)	\$1,124	-
Amortization of pension cost for nonqualified plans, net of income tax (expense) benefit of \$(1,702) for 2008 and \$319 for 2009	(11,901)	2,473	(9,428)	(567)	\$(9,995)
Unrealized (losses) gains on derivatives qualified as hedges:					
Unrealized (losses) gains during period on derivatives qualified as hedges, net of income tax benefit (expense) of \$55,990 for 2008 and \$(28,529) for 2009		(84,566)		42,631	
Reclassification adjustment for (gains) losses included in net income, net of income tax expense (benefit) of \$1,557 for 2008 and \$(23,969) for 2009		(2,374)		36,502	
Net unrecognized (losses) on settled cash flow treasury hedges, net of income tax benefit of \$39,582 for 2008 and \$24,554 for 2009		(60,870)		(36,066)	
Net unrealized (losses) gains on derivatives qualified as hedges	18,012	(147,810)	(129,798)	43,067	(86,731)
<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>\$7,609</b>	<b>\$(147,959)</b>	<b>\$(140,350)</b>	<b>\$43,624</b>	<b>\$(96,726)</b>

No Accumulated Other Comprehensive Income (Loss) is attributable to the noncontrolling interests for any of the above periods.

## Notes to Consolidated Financial Statements

### Note 13. Retirement Benefits

We have funded noncontributory defined benefit pension plans that cover substantially all of our employees. The plans provide defined benefits based on years of service and final average salary. We also have other postretirement health care benefit plans covering substantially all of our employees. The health care plans are contributory with participants' contributions adjusted annually.

#### ***Obligations and funded status:***

	Pension Benefits		Postretirement Benefits	
	2009	2008	2009	2008
<b>(Thousands)</b>				
<b>Change in benefit obligation</b>				
Benefit obligation at January 1	\$2,240,741	\$2,247,808	\$497,995	\$519,858
Service cost	32,664	32,520	5,414	5,305
Interest cost	134,325	134,080	29,528	30,467
Plan participants' contributions	-	-	9,424	9,457
Plan amendments	125	232	-	(977)
Actuarial loss (gain)	66,046	(23,887)	29,084	(24,787)
Benefits paid	(140,354)	(150,012)	(44,534)	(44,041)
Federal subsidy on benefits paid	-	-	3,034	2,713
Benefit obligation at December 31	\$2,333,547	\$2,240,741	\$529,945	\$497,995
<b>Change in plan assets</b>				
Fair value of plan assets at January 1	\$1,995,905	\$2,905,948	\$112,433	\$102,618
Actual return on plan assets	396,287	(761,531)	27,094	(37,709)
Employer contributions	1,915	1,500	49,913	56,883
Plan participants' contributions	-	-	1,403	4,213
Benefits paid	(140,354)	(150,012)	(44,534)	(13,572)
Fair value of plan assets at December 31	\$2,253,753	\$1,995,905	\$146,309	\$112,433
Funded status at December 31	\$(79,794)	\$(244,836)	\$(383,636)	\$(385,562)

Amounts recognized in the balance sheet December 31,	Pension Benefits		Postretirement Benefits	
	2009	2008	2009	2008
<b>(Thousands)</b>				
Noncurrent assets	\$145,723	\$27,062	-	-
Current liabilities	-	-	\$(6,391)	\$(5,819)
Noncurrent liabilities	(225,517)	(271,898)	(377,245)	(379,743)
	\$(79,794)	\$(244,836)	\$(383,636)	\$(385,562)

We have determined that all of our operating companies are allowed to defer as regulatory assets or regulatory liabilities items that would otherwise be recorded in accumulated other comprehensive income pursuant to the accounting requirements concerning defined benefit pension and other postretirement plans. Amounts recognized as regulatory assets or regulatory liabilities consist of:

December 31,	Pension Benefits		Postretirement Benefits	
	2009	2008	2009	2008
<b>(Thousands)</b>				
Net loss	\$943,802	\$1,098,091	\$50,653	\$48,357
Prior service cost (credit)	\$26,044	\$29,920	\$(7,689)	\$(14,842)
Transition obligation	-	-	\$20,400	\$27,200

Our accumulated benefit obligation for all defined benefit pension plans was \$2.2 billion at December 31, 2009, and \$2.1 billion at December 31, 2008.

## Notes to Consolidated Financial Statements

CMP's, CNG's, NYSEG's and SCG's postretirement benefits were partially funded at December 31, 2009 and 2008.

The projected benefit obligation exceeded the fair value of pension plan assets for the CMP, CNG, SCG, RG&E and Berkshire Gas plans as of December 31, 2009, and 2008. The accumulated benefit obligation exceeded the fair value of pension plan assets for the CMP, CNG and SCG plans as of December 31, 2009, and for the CMP, CNG, SCG, RG&E and Berkshire Gas plans as of December 31, 2008. The following table shows the aggregate projected and accumulated benefit obligations and the fair value of plan assets for those companies' plans for the relevant periods.

December 31,	Projected Benefit Obligation Exceeds Fair Value of Plan Assets		Accumulated Benefit Obligation Exceeds Fair Value of Plan Assets	
	2009	2008	2009	2008
(Thousands)				
Projected benefit obligation	\$1,049,408	\$1,013,034	\$594,083	\$1,013,034
Accumulated benefit obligation	\$971,240	\$935,335	\$544,709	\$935,335
Fair value of plan assets	\$823,891	\$741,136	\$387,141	\$741,136

### *Components of net periodic benefit cost and other amounts recognized in regulatory assets and regulatory liabilities:*

Years ended December 31,	Pension Benefits		Postretirement Benefits	
	2009	2008	2009	2008
(Thousands)				
<b>Net periodic benefit cost</b>				
Service cost	\$32,664	\$32,520	\$5,415	\$5,305
Interest cost	134,325	134,080	29,528	30,467
Expected return on plan assets	(223,979)	(241,615)	(6,231)	(7,993)
Amortization of prior service cost (benefit)	4,001	4,300	(7,152)	(7,425)
Amortization of net loss	48,027	11,715	5,925	4,582
Amortization of transition obligation	-	-	6,800	6,800
Net periodic benefit cost	<b>\$(4,962)</b>	\$(59,000)	<b>\$34,285</b>	\$31,736
<b>Other changes in plan assets and benefit obligations recognized in regulatory assets and regulatory liabilities</b>				
Net (gain) loss	<b>\$(106,262)</b>	\$979,259	<b>\$8,221</b>	\$20,915
Prior service cost	125	232	-	(977)
Amortization of net (loss)	(48,027)	(11,715)	(5,925)	(4,582)
Amortization of prior service (cost) credit	(4,001)	(4,300)	7,152	7,425
Amortization of transition obligation	-	-	(6,800)	(6,800)
Total recognized in regulatory assets and regulatory liabilities	<b>(158,165)</b>	963,476	<b>2,648</b>	15,981
Total recognized in net periodic benefit cost and regulatory assets and regulatory liabilities	<b>\$(163,127)</b>	\$904,476	<b>\$36,933</b>	\$47,717

## **Notes to Consolidated Financial Statements**

We include the net periodic benefit cost in other operating expenses. The net periodic benefit cost for postretirement benefits represents the amount expensed for providing health care benefits to retirees and their eligible dependents. The amount of postretirement benefit cost deferred at December 31 was \$31 million for 2009 and \$38 million for 2008. We expect to recover any deferred postretirement costs by 2012. We are amortizing over 20 years the transition obligation for postretirement benefits that resulted from our adoption in 1992 of the accounting requirements concerning employers' accounting for postretirement benefits other than pensions.

### **Amounts expected to be amortized from regulatory assets or regulatory liabilities into net periodic benefit cost for the fiscal year ending**

<b>December 31, 2010</b>	<b>Pension Benefits</b>	<b>Postretirement Benefits</b>
<b>(Thousands)</b>		
Estimated net loss	\$77,674	\$6,147
Estimated prior service cost (credit)	\$3,531	\$(5,201)
Estimated transition obligation	-	\$6,800

We expect that no pension benefit or postretirement benefit plan assets will be returned to us during the fiscal year ended December 31, 2010.

<b>Weighted-average assumptions used to determine benefit obligations at December 31,</b>	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Discount rate	<b>5.80%</b>	6.10%	<b>5.80%</b>	6.10%
Rate of compensation increase	<b>4.00%</b>	4.00%	<b>4.00%</b>	4.00%

As of December 31, 2009, we decreased our discount rate from 6.10% to 5.80%. The discount rate is the rate at which the benefit obligations could presently be effectively settled. We determined the discount rate by developing a yield curve derived from a portfolio of high grade noncallable bonds that closely matches the duration of the expected cash flows of our benefit obligations.

<b>Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31,</b>	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Discount rate	<b>6.10%</b>	6.00%	<b>6.10%</b>	6.00%
Expected long-term return on plan assets	<b>8.75%</b>	8.75%	-	-
Expected long-term return on plan assets - nontaxable trust	-	-	<b>8.00%</b>	8.00%
Expected long-term return on plan assets - taxable trust	-	-	<b>4.80%</b>	4.80%
Rate of compensation increase	<b>4.00%</b>	4.00%	<b>4.00%</b>	4.00%

We developed our expected long-term rate of return on plan assets assumption based on a review of long-term historical returns for the major asset classes, the target asset allocations and the effect of rebalancing of plan assets discussed below. That analysis considered current capital market conditions and projected conditions. The operating companies amortize unrecognized actuarial gains and losses either over 10 years from the time they are incurred or using the standard amortization methodology, under which amounts in excess of 10% of the greater of the projected benefit obligation or market-related value are amortized over the plan participants' average remaining service to retirement.

## Notes to Consolidated Financial Statements

### **Assumed health care cost trend rates to determine benefit obligations at December 31,**

	<b>2009</b>	<b>2008</b>
Health care cost trend rate assumed for next year	<b>8.0%</b>	8.0%
Rate to which cost trend rate is assumed to decline (the ultimate trend rate)	<b>4.5%</b>	5.0%
Year that the rate reaches the ultimate trend rate	<b>2028</b>	2014

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	<b>1% Increase</b>	<b>1% Decrease</b>
<b>(Thousands)</b>		
Effect on total of service and interest cost	\$1,535	\$(1,285)
Effect on postretirement benefit obligation	\$23,487	\$(20,133)

**Plan assets:** Our pension benefits plan assets are held in a master trust providing for a single trustee/custodian, a uniform investment manager lineup, and an efficient, cost-effective means of allocating expenses and investment performance to each plan under the master trust. Our primary investment objective is to ensure that current and future benefits obligations are adequately funded and with volatility commensurate with our tolerance for risk. Preservation of capital and achievement of sufficient total return to fund accrued and future benefits obligations are of highest concern. Our primary means for achieving capital preservation is through diversification of the trust's investments while avoiding significant concentrations of risk in any one area of the securities markets. Within each asset group, further diversification is achieved through utilizing multiple asset managers and systematic allocation to various asset classes; providing broad exposure to different segments of the equity, fixed-income and alternative investment markets.

Our asset allocation policy is the most important consideration in achieving our objective of superior investment returns while minimizing risk. We have established a target asset allocation policy within allowable ranges for our pension benefits plan assets of 58% equity securities, 27% fixed income and 15% for all other types of investments. The target allocations within allowable ranges are further diversified into 30% large cap domestic equities, 10% medium and small cap domestic equities and 18% international equity securities. Fixed income investment targets and ranges are segregated into core fixed income at 5%, long dated corporate securities 6%, annuity contracts 13% and high yield fixed income 3%. All fixed income investments are in domestic securities. Other, alternative investment targets are 5% each for real estate, absolute return and strategic markets. Systematic rebalancing within the target ranges, should any asset categories drift outside their specified ranges, increases the probability that the annualized return on the investments will be enhanced, while realizing lower overall risk.

## Notes to Consolidated Financial Statements

The fair values of our pension benefits plan assets at December 31, 2009, by asset category are:

Asset Category (Thousands)	Total	Fair Value Measurements at December 31, 2009, Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	\$38,248	\$927	\$37,321	-
U.S. government securities	49,619	49,619	-	-
Common stocks	1,000,311	997,495	2,816	-
Registered investment companies	119,155	119,155	-	-
Corporate bonds	364,243	-	364,243	-
Preferred stocks	6,916	6,916	-	-
Common/collective trusts	358,201	-	62,557	\$295,644
Partnership/joint venture interests	93,269	-	-	93,269
Real estate investments	40,618	-	-	40,618
Other investments, principally annuity and fixed income	183,173	20,784	31,265	131,124
<b>Total</b>	<b>\$2,253,753</b>	<b>\$1,194,896</b>	<b>\$498,202</b>	<b>\$560,655</b>

Valuation techniques: We value our pension benefits plan assets as follows:

- Cash and cash equivalents – Level 1: at cost, plus accrued interest, which approximates fair value. Level 2: proprietary cash associated with other investments, based on yields currently available on comparable securities of issuers with similar credit ratings.
- U.S. government securities, Common stocks and Registered investment companies - at the closing price reported in the active market in which the security is traded.
- Corporate bonds – based on yields currently available on comparable securities of issuers with similar credit ratings.
- Preferred stocks – at the closing price reported in the active market in which the individual investment is traded.
- Common/collective trusts and Partnership/joint ventures – using the Net Asset Value (NAV) provided by the administrator of the fund. The NAV is based on the value of the underlying assets owned by the fund, minus its liabilities, and then divided by the number of shares outstanding. The NAV is classified as Level 2 if the plan has the ability to redeem the investment with the investee at NAV per share at the measurement date. Redemption restrictions or adjustments to NAV based on unobservable inputs result in the fair value measurement being classified as a Level 3 measurement if those inputs are significant to the overall fair value measurement.
- Real estate investments – based on a discounted cash flow approach that includes the projected future rental receipts, expenses and residual values because the highest and best use of the real estate from a market participant view is as rental property.
- Other investments, principally annuity and fixed income - Level 1: at the closing price reported in the active market in which the individual investment is traded. Level 2: based on yields currently available on comparable securities of issuers with similar credit ratings. Level 3: when quoted prices are not available for identical or similar instruments, under a discounted cash flows approach that maximizes observable inputs such as current yields of similar instruments but includes adjustments for certain risks that may not be observable such as credit and liquidity risks.

## Notes to Consolidated Financial Statements

(Thousands)	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)					Total
	Corporate Bonds	Common/Collective Trusts	Partnership/Joint Venture Interests	Real Estate Investments	Other Investments	
<b>Balance, December 31, 2008</b>	\$112	\$432,918	\$106,819	\$58,687	\$156,149	\$754,685
Actual return on plan assets:						
Relating to assets still held at the reporting date	-	2,557	2,565	-	-	5,122
Relating to assets sold during the year	-	112,364	3,869	(19,345)	-	96,888
Purchases, sales and settlements	(112)	(252,195)	(19,984)	1,276	(25,025)	(296,040)
Transfers into and/or out of Level 3	-	-	-	-	-	-
<b>Balance, December 31, 2009</b>	-	\$295,644	\$93,269	\$40,618	\$131,124	\$560,655

Our postretirement benefits plan assets are held with two trustees in multiple voluntary employees' beneficiary association (VEBA) and 401(h) arrangements and are invested among and within various asset classes in order to achieve sufficient diversification in accordance with our risk tolerance. This is achieved for our postretirement benefits plan assets through the utilization of multiple institutional mutual and money market funds, providing exposure to different segments of the fixed income, equity and short-term cash markets. Approximately 20% of the postretirement benefits plan assets are invested in VEBA and 401(h) arrangements that are not subject to income taxes. The remainder is invested in arrangements subject to income taxes.

We have established a target asset allocation policy within allowable ranges for our postretirement benefits plan assets of 56% equity securities, 37% fixed income and 7% for all other types of investments. The target allocations within allowable ranges are further diversified into 30% large cap domestic equities, 7% medium and small cap domestic equities, 13% international developed market and 6% emerging market equity securities. Fixed income investment targets and ranges are segregated into core fixed income at 30%, global high yield fixed income 4% and international developed market debt 3%. Other, alternative investment targets are 4% for real estate and 3% absolute return. Systematic rebalancing within target ranges, should any asset categories drift outside their specified ranges, increases the probability that the annualized return on the investments will be enhanced, while realizing lower overall risk.

## Notes to Consolidated Financial Statements

The fair values of our other postretirement benefits plan assets at December 31, 2009, by asset category are:

Asset Category (Thousands)	Total	Fair Value Measurements at December 31, 2009, Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market funds	\$4,214	\$4,214	-	-
Mutual funds, fixed	51,061	51,061	-	-
Mutual funds, equity	82,089	82,089	-	-
Other investments	3,109	1,865	\$774	\$470
Total assets measured at fair value	\$140,473	\$139,229	\$774	\$470
Whole life insurance contract	5,836			
Total postretirement benefits plan assets	\$146,309			

**Valuation techniques:** We value our postretirement benefits plan assets as follows:

- Money market funds and Mutual funds, fixed and equity – based upon quoted market prices, which represent the NAV of the shares held.
- Other investments – these are primarily 401(h) investments that are an allocation of pension Master Trust investments.

The whole life insurance contract is presented at the contract value, which is not a fair value measurement.

Diversified equity securities did not include any Iberdrola common stock at December 31, 2009.

### Cash Flows

**Contributions:** In accordance with our funding policy we make annual contributions of not less than the minimum required by applicable regulations. We expect to contribute \$22.9 million to our pension benefit plans and \$43.1 million to our other postretirement benefit plans in 2010.

**Estimated future benefit payments:** Our expected benefit payments and expected Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act) subsidy receipts, which reflect expected future service, as appropriate, are:

(Thousands)	Pension Benefits	Postretirement Benefits	Medicare Act Subsidy Receipts
2010	\$145,629	\$43,447	\$3,363
2011	\$155,495	\$46,079	\$3,630
2012	\$161,789	\$46,240	\$3,992
2013	\$169,316	\$47,378	\$4,349
2014	\$173,939	\$48,236	\$4,673
2015 - 2019	\$905,792	\$241,602	\$27,693

## **Notes to Consolidated Financial Statements**

### **Note 14. Sale of NYSEG's Seneca Lake Storage Facility**

On January 9, 2010, NYSEG entered into an agreement to sell its Seneca Lake Storage facility and related assets for \$65 million. The carrying amount of the facility assets is approximately \$33 million, and the assets are included in natural gas storage property at December 31, 2009. The sale of the facility is contingent on receiving appropriate regulatory approvals from the NYPSC and the Federal Energy Regulatory Commission, but is expected to close in the second half of 2010. NYSEG and other petitioners are in the process of preparing regulatory filings, with such filings to be submitted within 60 days of the date of the purchase agreement.

### **Note 15. Sale of Fossil Fuel Generation Assets**

Iberdrola, in connection with receiving authorization from the NYPSC in September 2008 to acquire Energy East, agreed to sell certain fossil fuel generation assets owned by either RG&E or Cayuga Energy, Inc. (Cayuga). In its order authorizing the acquisition, the NYPSC directed Iberdrola and the other petitioners in the acquisition proceeding to develop, in collaboration with interested parties, a divestiture plan for the fossil fuel generation assets. Iberdrola and Energy East filed the divestiture plan with the NYPSC in November 2008. The NYPSC issued an order approving the divestiture plan as filed, effective November 17, 2009.

The generation assets are to be sold at auction, in a two-stage process. Extensive consultation with the NYPSC Staff concerning the auction process is required and is currently ongoing. The auction process would be suspended, but not terminated, if bids obtained are priced at less than the current net book value of the assets (approximately \$14 million at December 31, 2009). Iberdrola/RG&E would then petition the NYPSC for guidance on the next steps to be taken. RG&E will be allowed to retain 10% of the net proceeds realized from the auction of its fossil fuel generation assets, up to a maximum pretax ceiling of \$5 million. Cayuga is a competitive subsidiary of Iberdrola USA that operates in wholesale electric markets. Cayuga's plant is a merchant facility and because its costs have never been reflected in regulated utility rates, the divestiture plan provides for separate accounting for the proceeds related to its sale.

We have determined that all of the criteria are not yet met in order to classify the assets as held for sale. In addition, the net book value of the assets is immaterial to our balance sheet.