February 26, 2013

MEMORANDUM TO THE TRUSTEES

FROM THE PRESIDENT and CHIEF EXECUTIVE OFFICER

SUBJECT: Decrease in New York City Governmental Customer Fixed Cost Component – Notice of Adoption

SUMMARY

The Trustees are requested to take final action to approve a decrease in the Fixed Cost component of the production rates by $5.4 million or 3.4%, not including Astoria Energy II ("AE II") plant expenses, to be charged in 2013 to the New York City Governmental Customers ("Customers"). The decrease would be effective with the March 2013 billing period.

BACKGROUND

At their September 24, 2012 meeting, the Trustees directed the publication in the *New York State Register* (*"State Register"*) of a notice that the Authority proposed to increase the Fixed Costs component of the production rates to be charged in 2013 to the Customers. The *State Register* notice was published on October 10, 2012 in accordance with the State Administrative Procedure Act ("SAPA"). The public comment period was due to expire on November 26, 2012, but was extended through December 28, 2012 by NYPA via written notice to the Customers in order to accommodate possible Customer time constraints caused by Hurricane Sandy. The City of New York ("City"), Metropolitan Transportation Authority ("MTA"), New York City Housing Authority, New York State Office of General Services, and Port Authority of New York and New Jersey, of the eleven SENY Customers, filed formal written comments on December 17, 2012.

As indicated in the September 24th memorandum to the Trustees, under the Customers' Long Term Agreements ("LTAs"), the Authority must establish Fixed Costs based on cost-of-service ("COS") principles and may make changes only under a SAPA proceeding with the approval of the Trustees. As the memorandum also indicated, the LTAs establish two distinct cost categories: Fixed Costs and Variable Costs. Fixed Costs include Operation and Maintenance ("O&M"), Shared Services, Capital Cost, Other Expenses (i.e., certain directly assignable costs) and a credit for investment and other income.

DISCUSSION

Based on Customer comments received and staff's analysis, the final decrease in Fixed Costs sought by this action is $5.4 million. This represents a $9.2 million decrease from the proposed Fixed Costs estimate discussed at the September 24, 2012 Trustee meeting. Under the LTAs, Customers' concerns must be considered in a confidential process prior to presenting any proposed changes to the Fixed Costs to the Trustees or issuing them for public comment. Numerous Customer data requests were presented to staff, and in all cases responses to relevant questions were provided to the Customers.

In addition, as part of the SAPA process, the New York City Governmental Customers ("NYCGCs") submitted formal written comments to NYPA, which are attached as Exhibit "A." In their comments, the NYCGCs took the position that the 2013 Fixed Costs are "overstated" and "the period of time over which the fixed costs are collected from the NYCGCs should be lengthened." The NYCGCs are requesting that the 2013 Fixed Cost be reduced by some $54.5 million.

1. Staff Analysis of Public Comments on Fixed Costs and Recommendations

Below is staff's analysis and recommendations addressing the public comments received on the Fixed Costs proposal, which are included in Exhibit "A."

First, staff provides a review of the recently concluded annual process with the NYCGCs that led to the proposed 2013 Fixed Costs and the Final 2013 COS. Second, staff provides its analysis and recommendations regarding six issues raised by the NYCGCs in their comments filed on December 17, 2012.

<u>Staff Review of the 2013 LTA Annual Process:</u> During this cycle of the LTA's annual process, NYPA staff has provided the Customers with abundant verifying information via the issuance of a comprehensive Preliminary 2013 COS and its' accompanying, explanative, staff report and by responding to numerous data requests made during the discovery process.

After distribution of the Preliminary 2013 COS on June 1, 2012, the City and the MTA submitted numerous discovery requests. There were 40 discovery requests put forth by the City, many of which contained multiple parts resulting in a total of 85 responses and analysis being provided to the City. The MTA issued 6 data requests that were answered. All responses and analyses were provided over various points during July and August.

In addition to the formal data discovery, NYPA staff conducted conference calls with the NYCGCs and their consultants on various COS issues. On August 23, 2012, pursuant to the terms of the LTA, NYPA and the NYCGCs teleconferenced on Fixed Costs. Particular focus was placed on the O&M and Shared Services expenses with the NYCGCs voicing concerns over the level of Fixed Costs, the payback period of certain non-recurring costs, and the amortization of certain debt service expenditures. The NYCGCs also voiced concerns about NYPA's inability to provide them with final budget numbers or detailed back-up to the preliminary estimates. Minutes were taken at this meeting and subsequently distributed to all attendees for feedback and concurrence. An additional 16 data requests were generated from this meeting and responded to by NYPA staff through three informational memoranda dated September 14, 2012, September 21, 2012 and October 17, 2012.

The following is a summary of the NYCGCs comments filed under SAPA proceedings and NYPA's responses.

<u>Issue 1: Final COS Budget Data</u>

<u>Comments</u>: The NYCGCs commented that NYPA would be refining the proposed 2013 Fixed Cost figures over the summer of 2012 and presenting more accurate Fixed Cost information to the Board at is September 2012 meeting. They also indicated that NYPA was going to provide this updated information to the NYCGCs once it was reviewed with the Board. They also requested a reconciliation of the difference between the Fixed Costs increase included in the Preliminary COS

of $6.3 million versus the $3.9 million included in the SAPA notice.

Staff Analysis: There seems to be Customer confusion about the timing of the SAPA notice versus the timing of the approval of the Final Budget. As communicated in an e-mail to the NYCGCs on August 29, 2012 and explained further in the September 14, 2012 informational memorandum, the SAPA notice, which is based on the Preliminary COS, was approved by the Trustees at the September 24, 2012 Board Meeting. The final proposed budget, however, was to be reviewed by the Trustees beginning late November and would be approved at the December Board meeting. They were also advised that the Fixed Cost component of the 2013 COS would be adjusted as soon as those numbers were available. As staff has explained to the Customers, the Authority's annual budget cycle, which is finalized near the end of the year, is not "in sync" with the rate-making and discovery process that occurs in accordance with the requirements of the LTA, which takes place mid-year. As a result, NYPA can only provide preliminary budget estimates during the discovery process since NYPA's budget process for the upcoming fiscal year begins after the Preliminary COS is finalized in May. The Fixed Costs included in the Preliminary COS are estimates of what NYPA expects in the upcoming fiscal year based on known events, historical spending patterns and inflationary factors. Since SAPA rules dictate that total Fixed Costs cannot increase beyond what was included in the original SAPA notice, the NYCGCs are assured that total Fixed Costs in the Final COS will not be higher than these estimates and have historically been significantly lower. This procedure is similar to prior years, has been discussed with Customers in prior years, and was again discussed with the Customers during the August 23, 2012 LTA teleconference and reiterated in an e-mail correspondence of August 29, 2012 and informational memorandum dated September 14, 2012.

The difference between the Fixed Cost increase included in the Preliminary COS of $6.3 million and the SAPA notice of $3.9 million was a change resulting from comments received from the NYCGCs during the August 23, 2012 LTA teleconference. At that meeting the Customers had requested that NYPA recover certain Hurricane Irene costs over multiple years similar to what was done for the Rate Study costs and other non-recurring Fixed Cost items. In response to this, NYPA adjusted the Fixed Costs totals contained in the SAPA notice to reflect the amortization of Hurricane Irene Costs over three years, without interest, rather than one year as originally proposed in the 2013 Preliminary COS. This change, and the fact that it was being reflected in the SAPA notice, was relayed to the Customers in an e-mail dated August 29, 2012 and an informational memorandum dated September 21, 2012. Since that time, NYPA has reduced these costs even further, crediting the Customers in the 2013 Final COS with $.6 million in Federal Emergency Management Assistance ("FEMA") reimbursements received and anticipated for Hurricane Irene.

Recommendation: Since all of the requested information has been provided, and the current year process was consistent with past practice, there are no recommendations for this issue.

Issue 2: Poletti Related Expenses

Comment: The anticipated cost of decommissioning and dismantling the Poletti Project ("Poletti"), which served these Customers' needs since the Project's in-service date in 1977, is being amortized over a number of years at a level of $3.9 million per year. The NYCGCs assert that the annual contribution of $3.9 million should be removed from the COS due to the recent contract award of $20.6 million as recently approved by the Board of Trustees. They indicate that this, together with the $12.2 million that has been previously spent, will bring the total decommissioning costs to $32.78 million, which is less than the $37 million collected. The

Customers also questioned whether they have been credited with the $1.3 million in salvage value related to the decommissioning of the plant. Lastly, they questioned why the $1.33 million for inventory costs amortization was not charged to the asset retirement fund.

Staff Analysis: The current estimate for the Poletti Decommissioning Program including the Demineralized Water Plant is $45.9 million which includes all awarded and anticipated contracts required to implement and complete the program including contingencies and net of any salvage value to be credited to this project including the $1.3 million referenced in the NYCGCs comments. As relayed to the NYCGCs during the August 23, 2012 LTA teleconference and in the informational memoranda of September 14 and October 17, 2012, the contractors bids include a credit for recoverable salvage value. The $32.78 million referenced in the NYCGCs comments refers to the total projected spending in 2012 for this project together with the bid award of $20.6 million which was considered by the Trustees at their September 2012 Trustee meeting for Poletti Power House deconstruction. As of December 31, 2012, NYPA has collected $37.3 million from the NYCGCs, resulting in an outstanding balance to project completion of $8.6 million. In honoring the Authority's previous commitment to lower the annual contribution if actual costs were lower than initial projections, the remaining balance of $8.6 million has been amortized over the next five years resulting in a reduced annual payment of $1.8 million from the current of $3.9 million. The annual savings to the NYCGCs is $2.1 million and has been reflected in the 2013 Final COS. This item will continue to be revisited and adjusted as the decommissioning project continues.

The inventory dollar amount in question represents purchases of inventory items that were anticipated to be needed during the time of the Poletti's operation, but which still remained after the project's closing and could not be liquidated. The inventory costs incurred were operational in nature. Conversely, the Asset Retirement Obligations Fund was set up for costs related to the decommissioning of the physical building and not for recovery of costs incurred during the operating life of the plant. Since the inventory purchases were made for anticipated operational needs, NYPA has correctly not utilized the Asset Retirement Obligations Fund for their recovery.

Recommendation: Staff recommends that, due to the lower estimates for the decommissioning of Poletti, the NYCGCs annual contribution be reduced to $1.8 million from the current $3.9 million in the 2013 Final COS, and that the inventory costs amortization of $1.33 million remain as a separate cost component since the purchases were legitimately incurred to facilitate Poletti's operation when the plant was still active.

Issue 3: Fixed Costs for the 500MW

A. Level of Expenses at the 500 MW

Comment: The NYCGCs comment that Fixed Cost levels associated with the 500 MW facility have been increasing over the past several years while the net sales and revenues associated with the facility have been decreasing. Based on the analysis presented, the NYCGCs are projecting losses of $11 million in 2013 for the 500 MW facility. The Customers indicate that this will be greatly improved if "NYPA…extends the recovery period of the debt service associated with the 500 MW facility to match its projected service life, the annual Fixed Costs to the Customers would be reduced significantly and the economics would improve dramatically." The NYCGCs indicate that the savings to the COS in 2013 would be approximately $31-37 million depending on the amortization schedule used.

Staff Analysis: It is not a valid argument to look at the profitability of one generating unit against near-term spot market prices to determine its economic feasibility. These generating units are a hedge against the total cost of serving the energy needs of the NYCGCs and cannot be evaluated in the isolate. Moreover, the existence of the 500 MW combined cycle unit in 2006 has had a dampening effect on energy and capacity market prices and without this facility the prices to supply electricity to NYCGCs would have been significantly higher.

It is also important to recognize that amortizing the principal and interest payments over more years than the current life of the bonds does not make a facility more "profitable" in a given year since the debt will still need to be paid by NYPA in accordance with the existing schedule. At this time, NYPA bears a certain amount of risk on these bonds since they currently mature in 2021-2025, which is well past the expiration of the LTA in 2017. What the Customers are asking is for NYPA to further defer recovery of a significant amount of the actual debt service payments until after the expiration of the current LTA, thereby causing the Authority to take on even greater risk on approximately $30 million each year until the expiration of the LTA. If the Customers would like NYPA to extend the existing repayment period beyond the current amortization schedule, this can certainly be discussed during any prospective contract negotiations for the renewal of the current LTA.

In addressing the Customers' proposal, the Final COS includes amortization of the variable rate portion of the 500 MW debt over 25 years versus the 20-year assumption included in the Preliminary COS and in prior years. Unlike the outstanding fixed rated debt (see discussion in Staff Analysis below), the schedule of retirement of principal on Variable Rate Debt can be adjusted and extended by the Authority. In this manner, the rate recoveries will continue to match the cash costs incurred by the Authority. This represents a $6.8 million cost reduction to the Customers in 2013 and has been reflected in the 2013 Final COS.

B. Refinancing of 500 MW Fixed Rate Debt

Comment: The Customers requested that NYPA evaluate the possibility of refinancing the outstanding fixed rate bonds Series 2002A, 2007C and 2011A for the 500 MW facility. Although, the Customers recognize that these bonds have been previously refunded and are therefore not eligible for further refinancing, they requested that NYPA still explore this possibility given the "realities of the marketplace."

Staff Analysis: The majority of the Series 2002A bonds were refunded in October 2007 (Series 2007C bonds) and in October 2011 (Series 2011A bonds). The combined refundings resulted in gross savings of approximately $14.9 million and net present value savings (at the date of issue) of approximately $11.3 million, which are already being passed on to the Customers. In accordance with Federal Tax Regulations, the refunding issues (Series 2007C and 2011A bonds) are no longer eligible for advanced refunding. The only remaining Series 2002A bonds mature in November 2013.

C. Decommissioning Costs

Comment: The NYCGCs commented on the level of costs currently estimated for the eventual decommissioning of the 500 MW facility. At this time, they are contributing $3.8 million towards a decommissioning cost that was estimated at $60 million in expected costs in 2000 dollars. They indicate that "given the amount of the contract the Board recently approved for the deconstruction of Poletti, it is likely that NYPA's estimate for decommissioning the 500 MW facility is overstated. It is their opinion that "due to the modern construction method used for the 500 MW, the costs of decommissioning should be equal or less than that of Poletti."

Staff Analysis: Due to the high volatility of such costs it is difficult to predict with certainty what the actual costs will be at the time of the 500 MW's decommissioning. Although the current estimate for the decommissioning of the Poletti site is $45.9 million, these quotes were obtained in a very soft construction market and the 500 MW decommissioning is approximately 20 or more years away. As with Poletti, if the costs to decommission the 500 MW site come in lower than those currently being projected, the collection period of these monies will either be truncated or the annual Customer contribution reduced, depending on the monies needed at the time.

D. GE Litigation Expenses

Comment: The Customers have claimed that NYPA has not provided the requested information regarding the expenses related to the GE litigation. They assert that the legal fees associated with the case equates to approximately 3,460 to 5,200 hours of work.

Staff Analysis: In the December 2011 Trustee item, NYPA staff committed to providing the Customer with the billing rates and any other disclosable information on the costs of the GE litigation as soon as possible. This requested information was sent to the NYCGCs on January 27, 2012 and again on November 2, 2012 in response to an October 31, 2012 e-mail received from one of the NYCGCs consultants. Inexplicably, the Customers failed to reflect the receipt of this information in their filed comments. This information included law firm billing rates, consultant costs of DMJM-Harris and URS Corp., and an accompanying response letter to the City describing the back-up information being provided. The issues involved in the GE litigation were technical in nature and the law firm handling the case needed significant assistance from engineering and construction consultants to perform the necessary analyses. As indicated in this back-up documentation, of the $2.6 million in total costs for the GE litigation, 63% represented engineering consultant costs that were needed to substantiate NYPA's claim against GE and its subcontractors, and were not for legal fees.

Recommendation: In response to the NYCGCs request, staff recommends that the amortization of the variable rate debt on the 500 MW be extended an additional five years for a $6.8 million savings to the 2013 COS. Staff does not recommend any further changes to the costs related to the 500 MW for the reasons stated above.

Issue 4: Non-recurring costs

A. Amortization of Certain Costs

Comment: NYCGCs have cited $6.5 million in non-recurring costs that are included in the 2013 Preliminary COS that they believe are "capital" and not "operating" and should therefore be paid back over the life of the asset rather than a one-year period as included in the 2013 Preliminary COS.

Staff Analysis: During staff's August 23, 2012 LTA teleconference and in a follow-up informational memorandum dated September 14, 2012 NYPA explained that whether an expense is considered "capital" or "operating" is determined by NYPA's accounting classifications and in accordance with that, these costs were determined to be "operating." NYPA maintains its books and records in accordance with generally accepted accounting principles and its annual financial statements are audited by independent public accountants. NYPA follows utility accounting practice when determining whether an expenditure is a “capital” or “maintenance” expense. Costs incurred in connection with additions or replacements of minor items of property are accounted for as “maintenance” and therefore included in the operating budget, recoverable in one year.

However, as in past years, staff indicated that the Authority would be willing to consider spreading the payback of some of these costs over a multiple-year period as requested by the Customers. NYPA staff reviewed this issue and in an informational memorandum sent to the Customers on September 21, 2012, relayed to the Customers that “NYPA has agreed to amortize Hurricane Irene costs over three years and will be reflecting this change in the SAPA notice.” In addition, NYPA agreed to forgo charging the Customers any interest that would normally accrue with such an amortization. This change represented $4.5 million of the $6.5 million being questioned. The remaining $2 million, although for non-recurring items, would not yield any savings to the Customers since these amounts are in line with what NYPA typically includes in the COS each year, and, over the long-term, would only result in the Customers paying this annual amount plus interest.

B. Request to “True-up” Storm Related Expenses

Comment: Related to this, the NYCGCs expressed concern that there was no “true-up” for storm related expenses when they are included in the COS before the work is done.

Staff Analysis: Since NYPA has agreed to spread the costs related to Storm Irene over three years, payments from the Customers can easily be adjusted next year if actual costs are less than the original estimates. In addition, NYPA has credited the Customers with $.6 million from FEMA reimbursements received for anticipated costs for Hurricane Irene. These reimbursements are for work already done and not previously included in prior years’ COS.

Recommendation: Staff recommends that, in response to the NYCGCs comments, Hurricane Irene costs be amortized over three years without interest. As part of this amortization, NYPA will adjust any future payments towards Hurricane Irene costs to reflect actual expenditures once they are fully known.

Issue 5: Small Hydro - Operations & Maintenance Expenses

Comment: The NYCGCs comment on the expenses of NYPA’s Small Hydro facilities claim that they perform poorly from an economic perspective as compared to the 500 MW Project. They also request that NYPA conduct an audit of these facilities to see whether there are any cost savings measures that can improve their profitability. Lastly, they request that the Kensico facility be removed from the 2013 Final COS in light of its recent closure.

Staff Analysis: The comparison of NYPA’s Small Hydro facilities to the 500 MW is a difficult one since the 500 MW is a single natural-gas fired unit while the Small Hydro Facilities are five water-level dependent plants dispersed throughout the State. There are many factors, unique to each of the facilities, which must be considered before such comparisons can be considered.

NYPA’s O&M facility budgets reflect the resources deemed necessary to reliably operate and maintain each plant in a given year. The Small Hydro Facilities are remotely operated facilities with the day-to-day maintenance and repair work routinely performed by personnel from other NYPA facilities. There is a wide array of inspection, monitoring, testing, maintaining and repairing of equipment and structures at each of the facilities, as well as other jobs that ensure regulatory compliance and reliable operations. A sampling of the work includes overhauling gear boxes, scaffolding, battery testing and replacement, wicket gate inspection and repairs, oil analysis, work on pumps, seals and motors, testing, calibrating and maintaining monitoring equipment, flashboard installation and removal, etc. In addition, there are general facility expenses such as trash removal, communications, electricity, snow removal, facility upkeep, and insurance. The level of expenditures for a given year is determined in a budget process with a budget being presented to the Board of Trustees for approval that balances financial and operational requirements.

Most of the expenditures for this work are NYPA labor costs which include travel time to and from the home facility. Materials and supplies are also needed. NYPA employs outside contractors to do specialized work if this proves more cost effective than assigning in-house staff. During 2012, the Small Hydro facilities came in within $100,000 of budget, which is evidence to the appropriateness of the resources being allocated.

In response to the Customer's inquiry regarding the Kensico facility these costs have since been removed from the 2013 Final COS. At the time of the Preliminary COS, it had not been determined that Kensico would be closing. Upon learning of its closure, NYPA removed all costs related to the operation of this facility from the Final COS with the exception of insurance which represents insurance for all of the Small Hydro facilities. Beginning in 2014, these costs will need to be reclassified to another budget line. As mentioned earlier, NYPA has included the cost of decommissioning Kensico amortized over five years through 2017 recognizing that this facility has been closed and is now ready for decommissioning.

<u>Recommendation</u>: Staff recommends that due to the recent closure of Kensico, the operating expenses associated with it be removed from the COS and has reflected this in the 2013 Final COS. Along with this, staff recommends that the current projected costs to decommission Kensico be added to the Final COS, amortized over five years. Given the due diligence that was put into developing the Small Hydro budgets and that these are approved budgets that balance the needs of these facilities with available resources, staff does not recommend any further changes to Small Hydro operating costs in the 2013 Final COS.

<u>Issue 6: Excess Revenues Should Be Returned to the Customers</u>

<u>Comments</u>: The NYCGCs have commented that NYPA has been over collecting on its Fixed Costs each year and needs to return this money to the Customers.

<u>Staff Analysis</u>: Per the terms of the LTA Agreement, there is no "true-up" on the Fixed Cost portion of the COS. Through the SAPA process, Fixed Costs are determined and approved by the Board of Trustees. Once the accompanying rate is determined, except for a modest 5% contingency that, if unused, is returned to Customers, NYPA accepts all risks and must absorb any and all costs that exceed that amount.

<u>Recommendation</u>: Since the terms of the LTA do not allow for a "true-up" of Fixed Costs, NYPA staff finds this claim to be without merit.

2. Final Recommendation on 2013 Fixed Costs

Based on Customer comments received and further staff analysis, staff recommends the withdrawal of the originally proposed Fixed Costs increase and the approval of a Fixed Costs decrease in 2013 over 2012 rates. The Fixed Costs for 2013 would decline $5.4 million from the 2012 COS to $154.3 million. This is a $9.2 million decline from the costs discussed at the September 24, 2012 Trustee meeting and included in the October 10, 2012 SAPA notice. A breakdown of the changes in 2013 Fixed Costs as compared to 2012 are as follows: Operations and Maintenance, an increase of $1.2 million; Shared Services, an increase of $1.3 million; Capital Costs, a decrease of $6.7 million and Other Expenses, a decrease of $1.2 million. This change will take effect beginning March 1, 2013. When taken into consideration with AEII costs which are outside of the SAPA process and this Notice of Adoption, the total 2013 Fixed Costs component of the production rates are $287.6 million.

3. For Trustee Information: Description of Final 2013 COS and Customer Rates

Because the Variable Costs component (i.e., fuel and purchased power, risk management, New York Independent System Operator ("NYISO") ancillary services and O&M reserve, less a credit for NYISO revenues from Customer-dedicated generation) is developed in collaboration with the Customers in accordance with the provisions of the LTAs previously approved by the Trustees, staff is not requesting the Trustees' approval of the Variable Costs component of the production rates for 2013. Additionally, the Authority passes all Variable Costs to the Customers by way of the "Energy Charge Adjustment ("ECA") with Hedging" cost recovery mechanism which the Customers collectively selected for 2013. This cost recovery mechanism offered under the LTA employs a monthly charge or credit that reflects the difference between the projected Variable Costs of electricity (i.e., the Variable Costs recovered under the Customers' tariffs) and the monthly actual Variable Costs incurred by the Authority to serve the Customers.

For the Trustees' information, the projected Variable Costs are expected to decrease 9.5% from 2012 levels and, in combination with the recommended Fixed Costs decrease and AEII costs, results in a final projected 2013 COS of $808.2 million. At existing rates, revenues of $860.7 million would be produced, resulting in an over-recovery of $52.5 million. As a result, staff is recommending that rates be revised downward by 6.1%.

The current 2012 Customer rates and recommended 2013 Customer rates with the 6.1% overall decrease are shown in Exhibit "B."

FISCAL INFOMATION

The adoption of the Fixed Costs decrease would result in an estimated $5.4 million reduction in revenue to the Authority which is offset by the forecasted reduction in costs. The Energy Charge Adjustment mechanism will protect NYPA's net revenues from the effects of movements in variable costs above those projected.

RECOMMENDATION

The Director – Market Analysis and Tariff Administration recommends that the Trustees authorize the Corporate Secretary to file a Notice of Adoption with the New York State Department of State for publication in the *New York State Register* for a decrease in Fixed Costs applicable to the New York City Governmental Customers under the Long-Term Agreements.

It is also recommended that the Corporate Secretary be authorized to publish a Notice of Adoption of the Notice of Proposed Rulemaking, consistent with the discussion herein, in the State Register.

The Trustees are also requested to authorize the Senior Vice President – Economic Development and Energy Efficiency, or his designee, to issue written notice of adoption and the revised tariff leaves, as necessary, to the affected Customers.

For the reasons stated, I recommend the approval of the above-requested action by adoption of a resolution in the form of the attached draft resolution.

Gil C. Quiniones
President and Chief Executive Officer

Att.
Decrease in NYC Govt'l Cust Rates

RESOLUTION

RESOLVED, That the Senior Vice President – Economic Development and Energy Efficiency or his designee be, and hereby is, authorized to issue written notice of this final action by the Trustees to the affected Customers; and be it further

RESOLVED, That the Corporate Secretary of the Authority be, and hereby is, directed to file such notices as may be required with the New York State Department of State for publication in the *New York State Register* and to submit such other notice as may be required by statute or regulation concerning the rate decrease; and be it further

RESOLVED, That the Chairman, the Vice Chairman, the President and Chief Executive Officer, the Chief Operating Officer and all other officers of the Authority are, and each of them hereby is, authorized on behalf of the Authority to do any and all things, take any and all actions and execute and deliver any and all certificates, agreements and other documents to effectuate the foregoing resolution, subject to the approval of the form thereof by the Executive Vice President and General Counsel.

Decrease in New York City Governmental Customer Fixed Cost Component – Notice of Adoption

Exhibit “A”
Customer Comments

COUCH WHITE
COUNSELORS AND ATTORNEYS AT LAW

Couch White, LLP
540 Broadway
P.O. Box 22222
Albany, New York 12201-2222
(518) 426-4600

Kevin M. Lang
Partner

Direct Dial: (518) 320-3421
Telecopier: (518) 426-0376
email: klang@couchwhite.com

December 17, 2012

VIA E-MAIL AND OVERNIGHT DELIVERY

Ms. Karen Delince
Corporate Secretary
New York Power Authority
123 Main Street, 11-P
White Plains, New York 10601

Re: SAPA No. PAS-41-12-00009-P – Rates for the Sale of Power and Energy

Dear Ms. Delince:

Enclosed please find the Comments of the City of New York, Metropolitan Transportation Authority, New York City Housing Authority, New York State Office of General Services, and Port Authority of New York and New Jersey on the New York Power Authority's proposal to increase the Fixed Costs component of the production rates for New York City Governmental Customers for 2013. These comments are submitted in response to the notice published in the State Register on October 10, 2012.

If you have any questions regarding these comments, please feel free to contact me.

Sincerely,

COUCH WHITE, LLP

Kevin M. Lang

Enclosure
cc: Edna Wells Handy, Commissioner, DCAS
Mitch Gipson, Chief of Staff, DCAS
Ellen Ryan, Acting Deputy Commissioner, DCAS Energy Management
Susan Cohen, Assistant Commissioner, DCAS Energy Management
Sergej Mahnovski, Director, OLTPS
James Pasquale, Senior Vice President Marketing/Economic Development, NYPA
L. Helle Maide, Director - Key Accounts, NYPA
Keith Hayes, Manager - Key Accounts, NYPA

Vincent Gil, Account Executive
David E. Keller, Senior Deputy Budget Director, MTA
James Henly, Esq., General Counsel, MTA
Rory Christian, Director – Energy, Finance, & Sustainability Management - NYCHA
Andreas Spitzer, Chief Financial Officer, NYCHA
Stephen Starowicz, Director - Energy Planning & Procurement, OGS
Franklin Hecht, Chief Financial Officer, OGS
Christine Weydig, Deputy Director - Office of Environmental & Energy Programs, PANYNJ
Christopher Zeppie, Director - Office of Environmental & Energy Programs, PANYNJ

S:\DATA\Client3 11400-11824\11636\Corres\2013 fixed cost comments.lt.docx

POWER AUTHORITY
OF THE STATE OF NEW YORK

Rates for the Sale of Power and Energy	SAPA No. PAS-41-12-00009-P

COMMENTS OF
THE CITY OF NEW YORK, METROPOLITAN TRANSPORTATION AUTHORITY, NEW YORK CITY HOUSING AUTHORITY, NEW YORK STATE OFFICE OF GENERAL SERVICES, AND PORT AUTHORITY OF NEW YORK AND NEW JERSEY

December 17, 2012

COUCH WHITE, LLP
540 BROADWAY
ALBANY, NEW YORK 12207
Telephone: (518) 426-4600
Telecopier: (518) 426-0376

PRELIMINARY STATEMENT

On June 1, 2012, the New York Power Authority ("NYPA") distributed its *"Preliminary Staff Report – New York City Governmental Customers Annual Planning and Pricing Process Analysis, Including: Preliminary 2013 Cost-of-Service"* ("Preliminary Report") to the New York City Governmental Customers. On October 10, 2012, NYPA issued a notice of proposed rulemaking in the State Register, stating that it was considering increasing the fixed cost component of the production rates it charges its Governmental Customers by 2.4 percent compared to the rates adopted for 2012.[1]

Pursuant to § 202 of the State Administrative Procedure Act ("SAPA"), the City of New York ("City"), Metropolitan Transportation Authority, New York City Housing Authority, New York State Office of General Services, and Port Authority of New York and New Jersey (for purposes of these comments, "NYCGCs") hereby submit these comments in response to the notice of proposed rulemaking. The NYCGCs have a number of concerns with the proposed 2013 rate year fixed cost increase. In some instances, the proposed fixed costs are overstated; in others, the period of time over which the fixed costs are collected from the NYCGCs should be lengthened. The NYCGCs respectfully urge the NYPA Board of the Trustees ("Board") to modify the proposed fixed costs as described, and for the reasons, set forth herein. If the changes set forth below are accepted, instead of increasing, 2013 fixed costs would be reduced from NYPA's proposed 2013 levels by $54.5 million, or 32.8 percent.

---

[1] Although the comment period was due to expire on November 26, 2012, NYPA advised the New York City Governmental Customers via email on November 14, 2012 that the comment period was extended through December 28, 2012.

PROCEDURAL SETTING

In accordance with the provisions of the Long Term Agreements ("LTAs") between the NYCGCs and NYPA, earlier this year NYPA prepared the Preliminary Report, which identifies and briefly describes NYPA's proposed fixed and variable costs for the 2013 Cost-of-Service. On June 1, NYPA distributed the Preliminary Report to the NYCGCs. Starting on June 20, 2012, the City submitted discovery requests to NYPA related to the Preliminary Report and 2013 Cost-of-Service.

In order to comply with the requirements of the LTAs, NYPA must provide preliminary fixed cost estimates to the NYCGCs long before it engages in its planning and budgeting processes for the ensuing year, resulting in a timing mismatch.[2] Based on the discovery responses provided by NYPA, it appears that some fixed cost categories reflected increases that were not based on actual analysis or factual foundation, and the proposed levels failed to recognize that NYPA's actual fixed costs have been less than the figures contained in the prior years' Costs-of-Service. Indeed, for at least a few years, NYPA's experience has been that its actual costs levels have been millions of dollars less than its final projected fixed cost levels, resulting in cost over-recoveries that heretofore have not been returned to the NYCGCs.

This year, NYPA advised the NYCGCs that it would be refining the proposed 2013 fixed cost figures over the summer of 2012 and presenting more accurate information to the Board at its September 2012 meeting. NYPA committed to provide that updated information to the NYCGCs once it was reviewed with the Board. That did not happen. The NYCGCs recognize that Hurricane Sandy recently caused many disruptions to the ordinary course of

[2] Although outside the scope of this matter, the NYCGCs urge the Board to consider changes to this process to make it more meaningful. The provision of vague and unreliable cost information does not serve any party's interest, and the NYCGCs would be willing to explore with NYPA ways to improve the process by which rates are set for the upcoming year.

business, but present circumstances do not explain why the updated information was not provided to the NYCGCs shortly after the September meeting, and weeks before the Hurricane.

Because the NYCGCs do not have updated information regarding changes made to the Preliminary Report and accepted by the Board at its September meeting, these comments are based on the information presented in the Preliminary Report and through the discovery responses provided by NYPA to the NYCGCs. However, the relatively small difference between the change in the level of fixed costs contained in the Preliminary Report and in the October 10 notice of proposed rulemaking lead the NYCGCs to conclude that the overall structure and components of the forecasted 2013 fixed cost levels have not changed materially.

SUMMARY OF POSITION

The Preliminary Report indicated that NYPA intended to increase the fixed cost component of the production rates it charges the NYCGCs by 3.9 percent, or $6.3 million, compared to the fixed cost levels included in the final 2012 Cost-of-Service. According to the October 10, 2012 notice of proposed rulemaking, the size of the increase was reduced to 2.4 percent, or approximately $3.8 million. However, the notice did not provide any details regarding the adjustments made to the figures in the Preliminary Report, and NYPA inexplicably has not yet otherwise provided such information to the NYCGCs.

Certain components of the estimated 2013 fixed costs are overstated or otherwise should be adjusted. Accordingly, the NYCGCs request that NYPA's 2013 fixed costs be reduced by $54.5 million, or 32.8 percent, as shown in Appendix I. The largest component of the reduction is associated with their request to adjust the debt service period for the 500 MW facility to correspond with the plant's projected service life. Additional adjustments relate to NYPA's amortization of storm and other non-recurring costs, asset retirement funds for the 500

MW facility and Charles A. Poletti Generating Station ("Poletti"), Poletti inventory costs, General Electric ("GE") litigation costs, and recurring operations and maintenance ("O&M") expense levels for the small hydroelectric facilities operated by NYPA for the benefit of the NYCGCs ("Small Hydros"). The NYCGCs dispute these increases on the basis of generally accepted cost recovery principles and the fact that that NYPA's plans are inconsistent with Governor Cuomo's persistent statements that government must take the lead by trimming spending and learning to make do with less.

The NYCGCs respectfully urge the Board not to "rubberstamp" the 2013 fixed cost proposal developed by NYPA management. The Board should exercise its fiscal responsibility to the NYCGCs and make the adjustments discussed herein.

DISCUSSION

THE PROPOSED LEVELS OF FIXED COSTS SHOULD BE ADJUSTED DOWNWARD

The Preliminary Report indicates that NYPA is seeking to increase the NYCGCs' contribution to its O&M and shared services expense categories, while slightly reducing the amounts it collects for recovery of its capital costs and for miscellaneous other expenses.[3] For the reasons set forth below, the NYCGCs respectfully submit that certain of the fixed cost line items are overstated or otherwise should be adjusted. Most significantly, the NYCGCs urge the Board to re-examine and revise the manner in which NYPA recovers the debt service expense associated with its 500 MW facility. Extending the debt service repayment period to coincide with the projected service life of the facility, an accounting practice that is routinely employed

[3] Because the NYCGCs did not receive any details regarding the Board's action in September, or how the projected fixed cost levels changed as set forth in the notice of proposed rulemaking, they are unable to comment on the exact fixed cost changes. The NYCGCs therefore reserve the right to submit supplemental comments once the updated 2013 fixed cost projections are provided by NYPA.

by electric utility companies and electric utility regulatory commissions, would reduce 2013 fixed cost levels by about $37.7 million.

A. ADJUSTING THE 500 MW FACILITY'S DEBT SERVICE COLLECTION PERIOD WOULD IMPROVE THE FACILITY'S ECONOMICS WHILE REDUCING THE COST BURDEN ON THE NYCGCS

Over the past few years, the City has presented information to the Board regarding rising fixed cost levels and continued losses associated with the 500 MW facility and the Small Hydros. With respect to the former, a significant portion of the reported losses are due to unnecessarily high levels of debt service repayment costs associated with NYPA's accelerated cost recovery method. If NYPA follows generally accepted cost-recovery principles and extends the recovery period of the debt service expense associated with the 500 MW facility to match its projected service life, the annual fixed costs charged to the NYCGCs would be reduced significantly and the economics of the facility would improve dramatically.

1. Continuation Of The Current Financial Trend Is Not Acceptable

The fixed cost levels associated with the 500 MW facility have been increasing over the past several years while the net sales and revenues associated with the facility have been decreasing. Examining this troubling trend provides valuable information regarding NYPA's operation of the 500 MW facility. Table 1 demonstrates that the inclusion of the 500 MW facility in the NYCGCs' supply portfolio has resulted in a positive net cost position in the annual Cost-of-Service in each of the past few years, and that this trend will continue in 2013. If this facility was privately owned, its owner presumably would be examining ways to reverse the continued financial loss trend and improve the economics of the facility. The Board should be doing the same – the operations and financial structure of the 500 MW facility should be thoroughly examined to identify and implement measures to improve its economics.

Table 1 **500 MW Facility Actual/Projected Annual Net Costs/(Benefits)** **($ Millions)**			
Year	**Revenues & Capacity Value**	**Fuel & Fixed Costs**	**Net Cost/(Benefit)**
2010 (Actual)	(227.4)	232.8	5.4
2011 (Actual)	(209.7)	229.1	19.4
2012 (Projected)	(177.1)	230.2	53.1
2013 (Projected)	(203.9)	214.9	11.0

The Board should not be satisfied with the recent financial performance of the 500 MW facility. The NYCGCs have carefully reviewed the information in the Preliminary Report, and other information provided by NYPA over the past few years, to determine changes that could be made to improve the economics of the 500 MW facility. Aside from operational changes,[4] the NYCGCs have determined that one critical change – extending the debt repayment terms to the projected service life of the 500 MW facility – is not only consistent with industry standard but would materially benefit the economic performance of the facility.

2. The Board Should Adjust The Debt Service Repayment Terms Of The 500 MW Facility To Match Its Projected Service Life

One of the most common depreciation methods used throughout the industry, and by NYPA, for calculating depreciation expense is the straight-line depreciation method. In support of its recent request to the Federal Energy Regulatory Commission ("FERC") for an

[4] The NYCGCs continue to believe that cycling the plant to better follow market demand would improve the economics of the facility substantially.

increase in its transmission revenue requirement,[5] NYPA submitted sworn direct testimony of Thomas A. Davis, its Vice President of Financial Planning & Budgets. At page 12, line 7 of his testimony, Mr. Davis stated without qualification or limitation that "NYPA uses the straight line method of depreciation expense."

It is a generally accepted principle of utility ratemaking that when using the straight-line depreciation method, an asset's capital costs are amortized over the asset's projected service life. *See, e.g.*, Bonbright, *et al.*, Principles of Public Utility Rates, 2d Ed., Public Utilities Reports, Inc., 1988, pp. 276-277; Phillips, The Regulation of Public Utilities, Public Utilities Reports, Inc., 1993, pp. 271-272; *Federal Power Commn. v. Memphis Light, Gas & Water Div.*, 411 U.S. 458, fn 1 (1973) ("Under the straight-line method, the depreciation allowance for an asset remains equal over its useful life"); *Lindheimer v. Ill. Bell Tel. Co.*, 292 U.S. 151, 168 (1934) (Under the straight-line method of depreciation, "the annual depreciation charge is obtained by dividing the estimated service value by the number of years of estimated service life"); *R.J. Reynolds Tobacco Co. v. City of New York Dept. of Finance*, 237 A.D.2d 6, 7-8 (1st Dep't 1997) ("straight-line depreciation correlates with a pro rata depreciation over the useful life of the asset; the deduction is calculated by an equation that divides the asset's value, after a reduction for a postulated salvage value, by its useful life").

While NYPA appears to adhere to this principle for purposes of its transmission revenue requirement, as demonstrated by Mr. Davis' testimony and work papers, it is not doing so when calculating the recovery of the 500 MW facility debt service costs from the NYCGCs under the LTAs. Rather, for the NYCGCs, NYPA uses an accelerated depreciation approach, depreciating the 500 MW facility over a much shorter period of time. Figure 5B of the

---

[5] *New York Independent System Operator, Inc.*, Docket No. ER12-2317, "NYPA Revised Transmission Revenue Requirement" (dated July 27, 2012).

Preliminary Report indicates that the 500 MW facility has a projected service life of at least 25 years, with an "estimated retirement date" of May 1, 2030. However, Figures 4B through 4E of the Preliminary Report reveal that NYPA is recovering its debt service expense for the 500 MW facility from the NYCGCs over substantially shorter periods, ranging from 16 to 20 years. The last bond matures in 2025, well short of the asserted retirement date of the facility.

When questioned about this matter, NYPA claimed that it takes "a conservative approach with respect to the structure (tenor) of debt issued to support major generation and transmission assets."[6] The NYCGCs calculate that if NYPA acted in accordance with generally accepted depreciation principles, as upheld by the United States Supreme Court and New York courts, the debt service costs associated with the 500 MW facility would decrease by between \$31.5 million and \$37.7 million in 2013, depending on the service life used (discussed below).[7] Further, the use of straight line depreciation over an asset's entire service life – the approach NYPA uses for its transmission assets – assures intergeneration equity (*i.e.*, that future customers pay their fair share of the debt service costs associated with the 500 MW facility).[8] Accordingly, the NYCGCs strongly urge the Board to direct NYPA to revise the accounting methodology for recovery of the debt service expense associated with the 500 MW facility to apply straight-line depreciation over the entire projected service life associated with the facility.

As the Board considers this matter, the NYCGCs also request that the Board extend the projected service life, and the amortization period, applicable to the 500 MW facility

---

6 NYPA Response to City Request 31a, dated July 26, 2012.

7 While the NYCGCs continue to disagree with NYPA's imposition of a lost opportunity cost rate on unrecovered costs over time, the NYCGCs included a 3.5 percent opportunity cost rate in its straight line depreciation calculation.

8 NYPA's assertion that its approach results in interest rate savings is irrelevant because of intergeneration equity issue. Even with such savings, the NYCGCs are being subjected to more than their fair share of the costs of the 500 MW facility.

from 25 years to a minimum of 30 years. Such an extension is consistent with generally accepted practices within the electric industry and NYPA's submissions in its FERC transmission rate case.

The NYCGCs have researched publicly available information on projected service lives of natural gas-fired combined cycle generating facilities, similar to the 500 MW facility, and found no support for use of a 25-year service life. Rather, service lives of 30 to 40 years for such facilities are commonly used for many purposes (including depreciation). For example, in its development of the demand curves for the capacity markets, the New York Independent System Operator, Inc.'s expert consultants used a 30-year capital recovery period for all of the technologies it considered, including a Frame 7F unit.[9]

Moreover, a 30-year service life for the 500 MW facility is consistent with what NYPA presented in its pending FERC transmission rate case. Specifically, the information set forth in WP-2 to Mr. Davis' sworn testimony to the FERC indicates that NYPA is using a 30-year service life for the following accounts: boiler plant equipment (acct. 312), turbo generator units (acct. 314), fuel holders, producers, and accessory equipment (acct. 342), accessory electric equipment (acct. 345), and miscellaneous power plant equipment (acct. 346). In establishing the NYCGCs' Cost-of-Service, the NYCGCs are not aware of any legitimate reason for using different service lives for the same asset. The NYCGCs respectfully urge the Board to adopt the use of the same 30-year service life, and amortization period, for the 500 MW facility that NYPA has presented in its FERC transmission rate proceeding.

[9] *New York Independent System Operator, Inc.*, Docket No. ER11-2224, NYISO Tariff Filing, dated November 30, 2010, Attachment 2 – "Independent Study to Establish Parameters of the ICAP Demand Curve for the New York Independent System Operator", dated November 15, 2010, p. 59.

NYPA's primary purpose for using a shorter service life appears to be to expedite the recovery of the 500 MW facility's capital costs from the NYCGCs and ensure that, no matter what happens after 2017, NYPA will have recovered a vast majority of its debt service costs. This approach contradicts the ratemaking principle that the entire service life of an asset is the basis for the time period over which asset costs are recovered. Furthermore, it unnecessarily increases the costs and burdens imposed on the NYCGCs by tens of millions of dollars each year, funds that could otherwise be used to serve the important public functions carried out by those entities. The additional costs associated with the expedited debt service recovery also negatively impacts the economics of the 500 MW facility.

For all of the foregoing reasons, the Board should: (i) align the debt service costs with the entire projected service life of the 500 MW facility; and (ii) adopt a service life of no less than 30 years for the 500 MW facility. In summary, extending the debt service expense recovery period to the current projected service life of the 500 MW facility would reduce the 2013 Cost-of-Service by $31.5 million, or 19.0 percent, and extending the projected service life from 25 years to 30 years would further reduce the 2013 Cost-of-Service by $6.2 million, or 3.7 percent. These adjustments are shown in Appendix 1, and Appendix II shows the calculations supporting them.

3. <u>NYPA Should Evaluate The Possibility of Refinancing Its Debt Given Current Market Conditions</u>

According to the Preliminary Report and other information provided by NYPA, there are three sets of fixed rate revenue bonds outstanding related to the 500 MW facility – Series 2002A, 2007C, and 2011A. In response to a City question about NYPA's actions to refinance this debt, NYPA stated that it had advance refunded portions of the 2002A bonds with the 2007C and 2011A bonds, and that the balance of the 2002A bonds matures in 2013.[10]

While it may not be prudent to refinance the balance of the 2002A bonds given their impending maturity date, the NYCGCs recommend that the Board investigate whether cost savings could be achieved from refinancing the 2007C and/or 2011A bonds. Although both bond series are not advance refundable, the former are not callable until 2017, and the latter are not callable, the realities of the marketplace suggest that these bond provisions do not constitute insurmountable impediments to refinancing. Given current low finance rates, it is at least worth investigating the potential savings that could be achieved via refinancing, and whether the costs of refinancing would be justified by the savings.

B. CERTAIN NON-RECURRING EXPENSES SHOULD BE RECOVERED OVER A LONGER PERIOD OF TIME

The NYCGCs' review of the supporting documentation provided by NYPA for the 2013 fixed costs revealed that NYPA does not always follow standard or typical utility accounting practices for differentiating between capital costs and O&M expenses, and in some cases seeks to recover costs its expends on an annual basis that should be spread out and recovered over multiple years. The NYCGCs recognize that there are differences between NYPA and regulated, investor-owned utilities, and that NYPA does not maintain its books in precisely the same way as other utilities. Nevertheless, NYPA does treat capital costs differently from O&M expenses – the former is typically recovered over a period of years while the latter is recovered in the current or subsequent year.

When major storms occur and damage utility infrastructure, the New York Public Service Commission ("PSC") directs its regulated utilities to maintain separate accounting of the

[10] NYPA Response to City Request 32, dated July 26, 2012.

capital costs and O&M expenses associated with storm recovery efforts. After reviewing the prudence of the utilities' actions and activities, the PSC typically allows the utilities to recover the prudently incurred expenses over a period of years (the number depends on the magnitude of the expenses) and add the capital costs to their rate bases, where they are recovered via straight-line depreciation over the entire service lives of the assets. In contrast, according to the Preliminary Report, NYPA is seeking to recover 100 percent of its Hurricane Irene-related costs, including both capital costs and O&M expenses, from the NYCGCs in 2013, and there is no opportunity for any review of the prudence of NYPA's actions or the reasonableness of NYPA's actual storm-related expenditures.

NYPA identified that Hurricane Irene caused substantial damage to some of its hydroelectric facilities and required portions of some dams to be rebuilt. In total, NYPA included non-recurring Hurricane Irene costs of $4.5 million in its preliminary 2013 fixed costs. For a regulated utility, the cost associated with rebuilding a dam would be considered a capital cost that is put into rate base and recovered from the utility's customers over the remaining service life of the asset. However, NYPA inexplicably is seeking to recover the entire cost of the project from the NYCGCs in 2013. The NYCGCs attempted to seek an understanding and documentation from NYPA as to how it classifies and recovers such expenditures, but NYPA declined to provide any details, stating that its accounting department makes such decisions.

NYPA has proposed similar treatment for some other non-recurring costs that are non-storm-related. In response to information requests by the City, NYPA identified $2.0

million of projects associated with the 500 MW facility that it calls "non-recurring" and which the NYCGCs and most others in the utility industry would consider to be capital projects.[11]

For both storm-related costs and non-recurring projects that are capital in nature (*e.g.*, dam reconstruction at the Small Hydros and roof replacement of the 500 MW facility), the NYCGCs respectfully urge the Board to change the recovery period from one year to the remaining projected service lives of the assets. If the Board declines to accept this approach, it should at least direct NYPA to amortize these costs over a three-year period.[12] In this instance, amortizing the $6.5 million of non-recurring storm and capital related costs over a period of three years reduces NYPA's 2013 fixed cost estimate by $4.3 million or 2.6 percent.

C. THE BOARD SHOULD ADJUST ITS STORM-RELATED COST RECOVERY PROCEDURES TO PREVENT OVERPAYMENTS

In analyzing the issue discussed above, the NYCGCs identified a corollary concern. At present, NYPA has not completed its storm-recovery work from Hurricane Irene, and, in some cases, has not even started certain projects. In response to questions posed by the NYCGCs regarding the storm costs, NYPA stated that for some projects, it has only estimates, and it lacks certainty regarding the actual costs it will incur. It appears to the NYCGCs that

[11] While the amounts at issue for the 2013 Cost-of-Service are relatively small, NYPA has advised the NYCGCs that it considers the replacement of the roof of the 500 MW facility, which it reports will cost millions of dollars, "to be an operating cost and not a capital expense." Informational Memorandum from NYPA to the NYCGCs, dated September 14, 2012, unnumbered page 3. The NYCGCs respectfully submit that for any other utility, the replacement of an entire roof would be considered a capital project, not a maintenance item, and the costs would be recovered from customers over time, not in one year. Accordingly, there is significant reason for the Board to comprehensively reconsider NYPA's approach to recovery for capital-type non-recurring costs.

[12] In its Informational Memoranda to the NYCGCs, NYPA indicated that it would amortize the Hurricane Irene-related costs over three years. NYPA also stated that it "will be reflecting this change in the SAPA Notice." The notice issued in the State Register makes no reference to this change, and it is not known whether some or all of the $2.5 million difference in the level of the fixed costs for 2013 stated in the Preliminary Report and that notice pertain to this matter.

many of these estimates are overstated. Nevertheless, NYPA has included those cost estimates in the 2013 fixed costs. The problem is that there is no reconciliation mechanism; in the event that actual costs incurred are less than estimates, NYPA will be overcollecting these costs from the NYCGCs.

This method of recovering costs is neither fair nor reasonable and should be changed.[13] Two appropriate alternate approaches are: (i) NYPA waits to recover the costs until it has completed the work and knows how much was actually spent; or (ii) NYPA includes the projected costs in the subsequent year(s)' fixed costs, but those costs are subject to reconciliation once the work is completed and the actual amounts spent are known. Both alternatives, which are consistent with generally accepted utility ratemaking practices, would ensure that NYPA is made whole for the costs it incurs, and that the NYCGCs are not overpaying for the work performed.

The NYCGCs urge the Board to reconsider its approach to recovery of non-recurring storm-related costs, especially considering recent events and the potential for similar large-scale storms to affect the downstate region in the future. The NYCGCs should be charged only for the costs incurred to serve them, and no more.

D. POLETTI-RELATED COSTS SHOULD BE REMOVED FROM THE COST-OF-SERVICE

1. Contributions to the Asset Retirement Fund Should Cease

The Preliminary Report includes multiple categories of fixed costs associated with the now-closed Poletti, including an annual charge of $3.9 million for its asset retirement fund. Last year, the City argued that all going-forward costs related to Poletti should come from the

---

[13] As discussed below, there is no lawful basis for NYPA to retain amounts that it concedes are in excess of its actual costs.

asset retirement fund, and therefore be excluded from the development of future fixed cost levels. Based on recent information, the NYCGCs now jointly request that even the $3.9 million collected from the NYCGCs for the asset retirement fund be terminated.

NYPA advised the NYCGCs that it initially projected the cost of dismantling Poletti would be in excess of $50 million. Based on this estimate, NYPA began charging the NYCGCs $3.9 million per year for the asset retirement fund. According to NYPA's Informational Memorandum to the NYCGCs dated August 23, 2012, and repeated in three subsequent Informational Memoranda (dated September 14, 2012; September 21, 2012; and October 17, 2012), NYPA will have collected $38 million from the NYCGCs as of December 31, 2012.

At its September 24, 2012 meeting, the Board approved a contract with LVI Demolition Services, Inc. to dismantle the Poletti facility for $20,580,921.[14] In its presentation on that matter, NYPA management reported that $33.4 million has been collected from the NYCGCs, and $12.2 million has been expended on decommissioning activities at Poletti.[15]

Also at the September 24 meeting, NYPA management advised the Board that it intends to continue collections for the asset retirement fund through 2014. Regardless of whether the $38 million figure or $33.4 million figure is correct, both figures are greater than the total stated cost of demolition - $32.78 million. Given these facts, there is no basis to continue any contribution to the asset retirement fund as part of the fixed costs. In fact, in response to the City's concerns regarding the asset retirement fund last year, Staff reported to the Board: "[i]f

---

[14] Informational Memorandum from NYPA to the NYCGCs, dated October 17, 2012, unnumbered page 2, and web cast from the September 24 meeting, available at http://streaming1.expeditevcs.com:8080/NYPA/NYPA092412-003.htm.

[15] The discrepancy between the numbers presented to the NYCGCs ($38 million) and the Board ($33.4 million) is not explained by NYPA.

the decommissioning costs are lower than those that have been forecasted for COS purposes, the Customers will either have the period of collection truncated or the annual assessed cost lowered."[16] Accordingly, the NYCGCs respectfully request that the Board adhere to the position it adopted last year and remove this item from the 2013 Cost-of-Service. Removing the Poletti asset retirement charge figure from the calculation of 2013 fixed cost levels reduces NYPA's 2013 fixed cost estimate by 2.3 percent.

On a corollary point, NYPA reported to the Board that in 2011, some unidentified Poletti assets were sold for $1.3 million. Because the plant was retired at that time, those sales should have been considered part of the salvage value of the plant and the revenues should have been credited to the NYCGCs. The NYCGCs have reviewed the records provided by NYPA since 2011, and they have not found any accounting entry crediting the $1.3 million of net proceeds. It would be unfair and unreasonable for NYPA to charge the entire cost of the dismantling Poletti to the NYCGCs but keep all, or even a portion, of the salvage value. Accordingly, the Board should credit the $1.3 million to the NYCGCs immediately.

2. <u>Recovery Of Materials And Supplies Inventory Costs Should Come From The Asset Retirement Fund</u>

The City has objected to NYPA's recovery of obsolete Materials and Supplies Inventory from Poletti for years. Last year, NYPA management incorrectly characterized the City's objections in its presentation to the Board, claiming that the City had not questioned any specific costs. To ensure that there is no confusion regarding the City's objection, which is joined by the other NYCGCs, the NYCGCs state that they object to <u>all</u> of the Poletti-related Inventory costs NYPA proposes to include in the 2013 Cost-of-Service (approximately $1.3 million). None of those costs should be included in the 2013 Cost-of-Service because all of the

[16] December 15 Minutes, p. 40.

costs should be recovered from the asset retirement fund. Additionally, the NYCGCs object to the application of a 4.25 percent lost opportunity cost to the principal amount of the Inventory.

In support of this position, the NYCGCs assert that there is no provision in the LTAs that permits the addition of the lost opportunity cost to the recovery of the principal amount. Further, because the inventory was purchased long ago, NYPA's claim that it has experienced or will experience any lost opportunity costs by continuing to maintain the Inventory on its books until it is written off lacks merit. Indeed, NYPA has offered no documentation or other support that it experienced any negative financial effects as a result of carrying the Inventory on its books over that last few decades. Finally, the NYCGCs are not aware of any generally accepted accounting practice in the utility industry that provides for the inclusion of lost opportunity costs on a write-off of obsolete inventory, and NYPA has not pointed to any authority for its action.

The NYCGCs note that while the City raised these concerns last year, and NYPA management apparently advised the Board that it disagreed with the City's arguments, the Board did not offer any explanation of the basis of its decision to reject those arguments. This year, as part of its discovery on the Preliminary Report, the City pursued NYPA management's rationale for its position. In response, NYPA stated that "[t]he Poletti Asset Retirement Fund was established for the retirement of the physical building. The inventory is equipment that has no salvageable value."[17]

The NYCGCs respectfully submit that this response is not responsive to the prior objections and cannot form any basis for the Board to reject the NYCGCs' request that these costs be removed from the Cost-of-Service. The asset retirement fund will be used to cover the

[17] NYPA Response to City Request 33b, dated July 26, 2012.

cost of far more than just the power plant building because the act of demolition includes far more than just taking down the building.[18] Moreover, whether the Inventory has any salvageable value is irrelevant to whether this cost should be recovered via the asset retirement fund.

For the foregoing reasons, the $1.3 million charge should be eliminated from the 2013 fixed cost estimate and the inventory costs recovered from the asset retirement fund. If this request is denied, the Board of Trustees should at least remove the opportunity cost adjustment as being improperly imposed. Removing the Poletti inventory costs figure from the calculation of 2013 fixed cost levels reduces NYPA's 2013 fixed cost estimate by 0.8 percent.

E. CERTAIN FIXED COSTS ASSOCIATED WITH THE 500 MW UNIT SHOULD BE ADJUSTED DOWNWARD

1. Decommissioning Costs

NYPA is charging the NYCGCs $3.8 million each year as a contribution to the decommissioning/asset retirement fund for the 500 MW facility; as of July 1, 2012, NYPA will have collected $21.942 million.[19] This charge is based on an estimated decommissioning cost of $60 million in 2000 dollars. That cost was not based on a decommissioning study or other similar analysis.[20] Given the amount of the contract the Board recently approved for the deconstruction of Poletti, discussed above, it is likely that NYPA's estimate for decommissioning the 500 MW facility is overstated.

Considering that the 500 MW facility was built using modern construction methods that likely will make its deconstruction easier, and absent information to the contrary, it

---

18 *See* NYPA Request for Quotations, dated February 27, 2012, provided in response to City Request 35c.

19 Preliminary Report, Figure 5B.

20 In response to City Request 37, NYPA stated that it has no decommissioning plan for the 500 MW unit and no documentation on the estimated cost of the decommissioning and deconstruction of the unit.

is reasonable to project that the cost to deconstruct the 500 MW unit should be about the same, or less, than the cost to deconstruct Poletti. Therefore, the total decommissioning cost for the 500 MW facility should be adjusted downward to $33 million in 2012 dollars, an amount approximately equivalent to the cost of decommissioning Poletti.[21] Recalculating Figure 5B using $33 million in 2012 dollars instead of $60 million in 2000 dollars reveals that the amount already collected will exceed the amount needed in 2036, the projected retirement date assuming a 30-year service life (discussed above).

Accordingly, there is no reason for the NYCGCs to make any additional contributions to the asset retirement fund for the 500 MW facility. The Board should therefore direct NYPA to remove these fixed costs from the 2013 Cost-of-Service. This adjustment reduces the 2013 fixed costs by 2.3 percent.[22]

2. GE Litigation Expenses

In each of the past few years, the City has disputed the GE litigation expense line item. Last year, the Board expressly directed NYPA to provide certain information to the NYCGCs related to this matter,[23] but the NYCGCs have never received that information. More importantly, neither NYPA nor the Board addressed the specific concerns raised by the City, particularly the assertions that the total amount of legal fees was unreasonable.

---

[21] As discussed in the City's comments last year, NYPA proceeded with decommissioning activities at Poletti before completing a decommissioning plan. Had NYPA completed the plan before commenced any deconstruction activities and better coordinated deconstruction activities (*e.g.*, avoiding multiple mobilizations and demobilizations), the total costs likely would have been lower.

[22] The recalculated Figure 5B is included as Appendix III.

[23] December 15 Minutes, p. 42.

The NYCGCs continue to assert that the legal fees associated with this matter are excessive, equating to approximately 3,460 to 5,200 hours of work.[24] Due to the absence of any support for the expenditures, the Board should not allow their continued inclusion in the fixed costs. Removing all GE litigation expenses further reduces NYPA's 2013 fixed cost estimate by $0.4 million or 0.2 percent.

F. FIXED COSTS ASSOCIATED WITH THE SMALL HYDROS SHOULD BE ADJUSTED DOWNWARD

1. The Board Should Investigate Steps To Make The Facilities Economic

Like the 500 MW facility, the Small Hydros have performed poorly from a financial perspective. However, their poor economics cannot be solved by adjusting the recovery period for their debt service expenses. Table 2 below shows the historical and projected total revenues and costs associated with the Small Hydros (as allocated to the NYCGCs).

Table 2

Small Hydros Actual/Projected Annual Net Costs/(Benefits)

($ Millions)

Year	Revenues & Capacity Value	Fixed Costs	Net Cost/(Benefits)
2010 (Actual)	(6.1)	11.9	5.8
2011 (Actual)	(6.4)	14.3	7.9
2012 (Projected)	(7.2)	16.5	9.3
2013 (Projected)	(6.1)	19.8	13.7

[24] This estimate is based on an hourly rate of $500 to $750.

In light of these numbers, the Board should conduct an audit of the operations of the Small Hydros to determine whether and what cost-savings measures could and should be implemented to improve their economics. If the economics cannot be improved, the Board should direct NYPA management to develop a list of options for the future of these facilities so that the NYCGCs can make an informed decision whether to continue to support the operation of, and additional capital investments in, these facilities.

In addition to performing an audit, the Board should take immediate action to reduce expenditures at these facilities. This action should include adoption of the following recommendations.

2. <u>The Costs Related To The Kensico Hydroelectric Facility Should Be Removed From The 2013 Cost-Of-Service</u>

One of the Small Hydros, the costs of which are included in the Preliminary Report, is the Kensico Project, a three-unit, 3 MW facility located in Westchester County. In 2012, the Kensico Project ceased operations. Therefore, all costs associated with that Project should be removed from the 2013 Cost-of-Service.

Upon information and belief, NYPA's expenditures at that location have been limited to matters specifically related to the operation of the hydroelectric facility, itself. Because the Kensico Dam and Reservoir, including the stilling pool, tailrace and surrounding lands, are part of the City's water supply system, they have been, and will continue to be, actively maintained by the City's Department of Environmental Protection ("DEP"). With the cessation of electricity production at the Kensico Project, NYPA should not have any continuing responsibility at that site. Therefore, there should be no need for NYPA to retain contractors or consultants to provide services at that site, make any future capital improvements at or purchases for that facility, or incur any other expenses related to it. However, it does not appear that

NYPA has made any downward adjustment to the fixed costs associated with the Small Hydros to account for this closure.[25]

The NYCGCs respectfully request that the Board instruct NYPA to remove all costs associated with the Kensico Project. If there is any cost that cannot be removed, NYPA and/or the Board should explain the reason for continuation of any such cost.

3. Recurring O&M Costs Must Be Reduced

According to the information provided by NYPA in Figure 2 to the Preliminary Report and in response to City Request 23, in 2013 NYPA is projected to spend over $1 million on contractors, consultants, direct purchases, and stores for the Small Hydros. These costs are in addition to the $3.5 million for on-site employees. This level of expenditures is excessive and unjustified and should be reduced substantially.

To put these expenditures in perspective, Table 3 compares the recurring expenses for the Small Hydros and 500 MW facility. Whether viewed in terms of the size of the facilities or their electrical output, the Small Hydros are tiny relative to the 500 MW facility. But, on a unitized cost basis, the table shows that the level of recurring O&M expenses are substantially greater for the Small Hydros. The NYCGCs submit that the expense levels are too high and should be reduced.

[25] The cost information for these facilities in the Preliminary Report is consolidated, preventing the NYCGCs from discerning the costs associated with any individual facility.

Table 3 Comparison of Recurring O&M Expenses					
	Small Hydros		500 MW Facility		Ratio*
Projected 2013 Sales (MWh)	142,211		2,931,360		5%
	Total Expense	$/MWh	Total Expense	$/MWh	Ratio ($/MWh)*
Total Site Payroll	$3,541,101	24.90	$11,258,839	3.84	648%
Direct Purchases	$213,006	1.50	$966,396	0.33	454%
Store Issues	$77,168	0.54	$471,494	0.16	337%
Fees & Dues	$5,051	0.04	$233,495	0.08	50%
Office & Station	$187,556	1.32	$572,680	0.20	660%
Contracted Services	$691,451	4.86	$6,657,028	2.27	214%
Consultants	$129,759	0.91	$129,308	0.04	2275%
Total	$4,845,093	34.07	$20,289,240	6.92	492%

*Small Hydros Relative to 500 MW Facility

The City asked NYPA for the details on many of these categories of recurring expenses, but they were not provided. Instead, NYPA offered single sentence descriptions of each category. For example, the contracted services category is described as providing "servicing and repair of equipment, facility maintenance services, flashboard installation and removal and property and liability insurance."[26] The consultants category is described as "technical support for environmental and operational issues and compliance."[27] These descriptions do not respond to the City's questions. In fact, the tasks included in the descriptions already appear to be included in the 2013 fixed costs through charges for site employees and the allocated charges for headquarters.

[26] September 21, 2012 Informational Memorandum from NYPA to the NYCGCs, unnumbered page 3.

[27] *Id.*

Because of the lack of information regarding these recurring expenses, there is no way to determine their legitimacy or reasonableness. The NYCGCs can accept that NYPA may need some specialized assistance with certain aspects of regulatory compliance issues at the Small Hydros, but not at the cost levels proposed. Moreover, it is commonplace in the utility industry for utilities to benchmark their costs against those of other similarly-situated companies. The City asked NYPA if it has compared its O&M expense levels to industry averages to determine whether its costs are in line with industry norms. NYPA responded that it has not.[28] Unless and until NYPA substantiates these O&M expenses, the charges should be reduced to levels commensurate with the levels spent on the 500 MW facility, as follows.[29]

Table 4

Proposed Recurring O&M Expense Reductions for Small Hydros

Category	$/MW	Proposed Expense	Revised Expense
Total Site Payroll	3.84	$3,541,101	$546,232
Direct Purchases	0.33	$213,006	$46,930
Store Issues	0.16	$77,168	$22,896
Fees & Dues	0.04	$5,051	$5,051
Office & Station	0.20	$187,556	$27,731
Contracted Services	2.27	$691,451	$322,961
Consultants	0.04	$129,759	$6,257
Total		$4,845,093	$978,059

Adjusting NYPA's projected Small Hydro recurring O&M expense levels to levels commensurate with the identified recurring O&M levels for the 500 MW facility reduces NYPA's 2013 fixed cost estimate by $3.9 million or 2.3 percent.

---

28 NYPA Response to City Request 25b, dated July 26, 2012.

29 The "Fees & Dues" category was not changed as it was already lower for the Small Hydros than for the 500 MW facility.

G. NYPA SHOULD RETURN ITS EXCESS REVENUES TO THE NYCGCS

In response to questions posed by the NYCGCs during the August 23 teleconference with NYPA, NYPA provided two spreadsheets to the NYCGCs that compared the fixed costs it charged them in 2010 and 2011 to the fixed costs it actually incurred in serving them.[30] These spreadsheets show that NYPA overcollected fixed costs by $5,928,177 in 2010 and by $2,753,127 in 2011. Figures for 2012 are not yet known. These amounts represent profits – amounts received over and above the costs NYPA incurred to provide service to the NYCGCs. While NYPA should be able to recover its prudently incurred and legitimate costs and expenses of providing electric service to the NYCGCs, NYPA should not be profiting at their expense. Indeed, no provision of law permits NYPA to earn profits over and above recovery of its costs and expenses. The NYCGCs therefore request that NYPA refund these fixed cost overcollections to the NYCGCs or use them as a credit to offset 2013 Cost-of-Service.

[30] Informational Memorandum from NYPA to the NYCGCs, dated October 17, 2012.

CONCLUSION

The NYCGCs respectfully request that the NYPA Board of Trustees adjust the level of fixed costs for the 2013 Cost-of-Service in accordance with the discussion and recommendations set forth herein and identified on Appendix 1.

Dated: December 17, 2011
Albany, New York

Respectfully submitted,

Kevin M. Lang, Esq.
Couch White, LLP
540 Broadway
P.O. Box 22222
Albany, New York 12201-2222
Tel: 518-426-4600
Email: klang@couchwhite.com

Decrease in New York City Governmental Customer Fixed Cost Component – Notice of Adoption

Exhibit "B"

Current 2012 and Proposed 2013 Customer Production Rates

NEW YORK CITY GOVERNMENTAL CUSTOMERS

EXHIBIT "B"

Service Tariff No. 100 Rate Comparison (Current vs. Proposed)

	Demand ($/kW)		ENERGY (¢/kWh)											
			SUMMER		SUMMER ON PEAK		SUMMER OFF PEAK		WINTER		WINTER ON PEAK		WINTER OFF PEAK	
Service Classification	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**
SC 62 Conventional	$0.00	$0.00	8.347	7.746					7.804	7.267				
SC 65 Conventional	$10.69	$8.15	6.458	6.051					5.926	5.581				
SC 66 Conventional	$0.00	$0.00	6.576	5.937					6.576	5.937				
SC 68 Conventional	$17.02	$17.56	6.028	5.637					5.486	5.158				
SC 68 TOD	$18.74	$18.42			7.075	6.782	4.429	4.688			6.120	5.702	4.574	4.668
SC 69 Conventional	$12.50	$12.50	6.344	5.869					5.803	5.391				
SC 69 TOD	$12.88	$13.23			7.595	6.935	5.006	4.887			6.661	5.878	5.148	4.866
SC 69 KIAC TOD	$12.88	$13.23			6.494	5.125	3.906	3.077			5.560	4.068	4.048	3.057
SC 80 Conventional	$1.73	$1.72	6.088	5.461					6.088	5.461				
SC 82 Conventional	$11.82	$11.88	6.362	5.898					5.820	5.418				
SC 85 Conventional	$13.94	$11.36	6.441	6.043					5.915	5.577				
SC 91 Conventional	$10.69	$11.44	6.553	5.988					6.011	5.509				
SC 91 TOD	$14.51	$14.60			7.602	6.985	4.957	4.892			6.647	5.906	5.102	4.872
SC 93 Conventional	$8.26	$7.94	6.527	6.013					5.991	5.539				
SC 98 Conventional	$4.58	$5.42	6.444	5.845					5.902	5.366				
SC 98 TOD	$13.80	$10.21			7.580	6.994	4.979	4.936			6.641	5.932	5.122	4.916

Service Tariff No. 100 Demand Standby Rate Comparison (Current vs. Proposed)

	CONTRACT DEMAND ($/KW per month)				AS USED DEMAND ($/KW per day)			
	High Tension		Low Tension		High Tension		Low Tension	
Service Class	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**
SC68 TOD	$1.412	$1.388	$1.499	$1.473	$0.534	$0.525	$0.567	$0.557
SC69 TOD	$0.988	$1.014	$1.031	$1.059	$0.373	$0.384	$0.390	$0.400
SC91 TOD	$1.093	$1.100	$1.160	$1.168	$0.413	$0.416	$0.439	$0.442
SC98 TOD	$1.058	$0.782	$1.104	$0.817	$0.400	$0.296	$0.417	$0.309

Service Tariff No. 100 Energy Credit Standby Rate Comparison (Current vs. Proposed)

	ENERGY CREDIT (¢/kWh)							
	SUMMER ON PEAK		SUMMER OFF PEAK		WINTER ON PEAK		WINTER OFF PEAK	
Tension	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**	**2012**	**2013**
High Tension	5.988	5.575	4.014	3.565	5.725	5.134	4.359	3.978
Low Tension	5.692	5.298	3.815	3.388	5.441	4.880	4.143	3.781