DEPARTMENT OF CITYWIDE ADMINISTRATIVE SERVICES
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Martha K. Hirst
Commissioner

Citywide Personnel Services

Facilities Management & Construction

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December 7, 2005

VIA E-MAIL AND EXPRESS MAIL

Angela D. Graves, Deputy Secretary
Power Authority of the State of New York
123 Main Street
White Plains, NY 10601

Re: New York State Register ID No. PAS-43-05-00002-P, Rates for the Sale of Certain Power and Energy

Dear Secretary Graves:

The City of New York ("City") hereby submits an original and five (5) copies of the "Comments of the City of New York."

Sincerely,

Martha Hirst

Martha K. Hirst

Enclosures

C: Lewis S. Finkelman
Donald Brosen
Susan Cohen

POWER AUTHORITY OF THE STATE OF NEW YORK

New York State Register ID No. PAS-43-05-00002-P,
Rates for the Sale of Certain Power and Energy

COMMENTS OF THE CITY OF NEW YORK

DATED: December 7, 2005

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PRELIMINARY STATEMENT

Pursuant to the provisions of the State Administrative Procedures Act ("SAPA"), the City of New York ("City") hereby submits these comments on the New York Power Authority's ("NYPA") proposal to increase the "Fixed Costs" component of its overall rates ("2006 SENY Rate Plan"). The Fixed Cost increase was noticed for public comment in the October 26, 2005 edition of the *New York State Register* ("Notice").

The City currently contracts with NYPA for the purchase of full requirements electric supply service. The electricity purchased by the City is used to provide or support critical public services (e.g., schools, housing, health care, transportation) and for economic development purposes. It is estimated that the City will purchase over 1,000 megawatts ("MW") of electric capacity from NYPA in 2006 and pay NYPA approximately $370 million for that power.

BACKGROUND INFORMATION

In 1976, NYPA became a party with several major Southeastern New York customers ("SENY Customers") to an Application for Electric Service ("Applications for Service") under which NYPA furnishes capacity and energy to certain major SENY Customer facilities in New York State. These Applications for Service have been supplemented and amended from time to time pursuant to agreements executed by the SENY Customers and NYPA (collectively, the "Parties").

Pursuant to a Long Term Agreement entered into by the Parties as of March 18, 2005 ("LTA"), the rates that NYPA charges New York City Governmental Customers ("NYC Governmental Customers"), including the City, were increased to collect an additional $105 million in 2005.

The LTA also provides for a rate-setting process for 2006 and beyond. The rate-setting process requires that all costs be based on NYPA's cost of providing service. However, the LTA designates different treatment for Fixed Costs and Variable Costs, as those terms are defined in the LTA. Fixed Cost increases are required to be set consistent with accepted regulatory [cost-of-service] methodologies, and can be changed only through a rate case filing in accordance with SAPA. Variable Costs, on the other hand, are subject to a contract-based annual rate-setting process ("Annual Process") that provides for the filing of estimated Variable Costs for the succeeding year ("Base Variable Costs"). The Annual Process also provides the NYC Governmental Customers with pricing options (these are cost recovery mechanisms for NYPA) for the Variable Costs, and some of those options include hedging opportunities.

The transition to more market-based pricing options under the LTA has been a difficult one, and it is ongoing. Options with hedging opportunities were desired by the NYC Governmental Customers as a transition to more market-based pricing. The logic of treating Fixed and Variable Costs differently for review purposes was due in large part to the fact that the LTA includes a true-up process to reconcile payments attributable to Variable Costs with actual Variable Costs incurred.[1]

SUMMARY OF POSITION

In the Notice, NYPA proposes to increase the "Fixed Costs" component of the overall (production and delivery) rates by 1.1 percent on average for LTA customers. That, however, is somewhat misleading. In the 2006 cost of service study, Fixed Costs are identified as increasing by $10.3 million, or 7.6 percent.[2] Moreover, for the reasons set forth below, the City submits that Fixed Costs are significantly overstated and requests that the overall rate increase for NYC Governmental Customers be reduced.

In addition, the City will use this opportunity to recommend that NYPA's rates be restructured to reflect the NYPA cost structure. The problem stems from the fact that current demand and energy charges are not set to recover Fixed Costs and Variable Costs, respectively. For example, using 2005 billing determinants, NYPA's demand charges will generate $200.8 million of revenues, while 2005 Fixed Costs were set at $136.3 million. This means that the demand

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[1] The 2006 SENY Rate Plan, which included projected Base Variable Costs, was submitted on or about June 1, 2005, and Base Variable Costs were established in early July, 2005. Base Variable Costs were updated in a transmittal from NYPA to the NYC Governmental Customers dated November 4, 2005, and as late as December 6, 2005. The updated Base Variable Costs are significantly higher than those submitted with the 2006 SENY Rate Plan presented in June 2005. The City's position is that some of the November 4th updates were not appropriate under the LTA and that others must be revised. The City hereby reserves its contractual rights with respect to the setting of the 2006 Variable Costs.

[2] The 1.1 percent increase is derived by dividing the $10.3 million increase by the total of all projected production and delivery revenues.

charges are recovering significant amounts of Variable Costs. Because the LTA places a great deal of importance on being able to track and reconcile Variable Costs recovered to Variable Costs incurred, the rate design should be restructured so that projected Fixed Costs are recovered through demand charges and projected Base Variable Costs are recovered through energy charges.

POINT I

FIXED COSTS IN THE 2006 SENY RATE PLAN ARE OVERSTATED

The City's review of the increase to Fixed Costs in the 2006 SENY Rate Plan revealed that Fixed Costs are overstated by $8.6 million. Accordingly, the City requests that NYPA's 2006 revenue requirement be reduced by that amount.[3]

A. Poletti Payroll & Benefits

Poletti plant O&M costs are included in Fixed Costs. Poletti Payroll & Benefits are part of the Poletti O&M. As set forth below, Poletti Payroll & Benefits are overstated by approximately $4.7 million.

[3] In addition, the Fixed Costs presented to the NYC Governmental Customers assume a commercial operation date of January 1, 2006, for the 500 MW Poletti combined cycle unit ("Poletti CC"). If Poletti CC is not in commercial operation on January 1, 2006, it would not be "used and useful," which is the accepted regulatory standard for the inclusion of utility assets in rate base. Accordingly, to the extent that Poletti CC is delayed, Fixed Costs associated with the plant for the period January 1, 2006 through the commercial operation date should be prorated and returned to customers in the 2007 rate plan.

Poletti Payroll & Benefits are projected to increase by $1.8 million, from $12.3 million to $14.1 million, or 14.6 percent, from 2005 to 2006. By way of contrast, the annual changes in Poletti Payroll & Benefits for the three years beginning with the change from 2002 to 2003 were 2.6, 5.1 and -.8 percent, respectively. The marked increase for Poletti Payroll & Benefits for 2006 is inexplicable, particularly for a plant that is scheduled to be taken out of service as early as 2008, and no later than 2011.

The projected Poletti Payroll & Benefits cost for 2006 clearly is inconsistent with recent history and not justifiable when compared to a peer group. The peer group consists of generating units that are comparable in age and technology. Poletti's non-fuel O&M expense and number of employees is nearly twice as large as that of its peer group. Although some of the increase in Poletti Payroll and Benefits expense may be attributable to higher wages and 9/11 security-related costs, it is inconceivable that these items account for the extremely high levels of Poletti Payroll and Benefits expense as compared to similar units. Because the Poletti Payroll and Benefits expense proposed for 2006 cannot be justified based on recent history or by comparison to expenses incurred by similar units, the City requests that it be reduced by one-third. This would reduce the Poletti Payroll and Benefits expense from $14.1 million to $9.4 million, or by $4.7 million.

B. Shared Services Expense

Fixed Costs in the 2006 SENY Rate Plan include an allocation of NYPA's projected 2006 expenses for its headquarters. Specifically, the Rate Plan allocates 16.47 percent of a total budget of $94.8 million, or $15.6 million, to the SENY Customers as Shared Services Expense. For the reasons set forth below, the City requests that this expense be reduced by $2.1 million.

In 2003, the actual headquarters expense was $75.5 million. Thus, the projected 2006 expense represents a 25.6 percent increase over the 2003 actual expense. This increase is far in excess of inflation indices for the period and cannot be justified.

The LTA anticipates that Fixed Costs will be increased or decreased based on cost of service principles typically used to determine utility rates. Utility ratemaking does not guarantee recovery of all costs. Rather, there must be an assessment of whether the increase that is sought is reasonable. Here, a reasonable increase in headquarters overhead should be based on an accepted inflationary index.

If we apply the consumer price indices for 2004, 2005 and 2006 (2.7 percent, 3.2 percent and 2.6 percent, respectively) to the actual 2003 headquarters expense, the 2006 budget for this expense should be reduced from $94.8 million to $82.1 million, or by $12.7 million. Inasmuch as the NYC Governmental Customers represent 16.47 percent of the total Shared Service Expense, the amount included as Fixed Costs in the 2006 SENY Rate Plan should be reduced by $2.1 million (16.47 percent of $12.7 million). This adjustment will ensure that a more rational increase from 2003 actual costs is included in the 2006 rates for NYC Governmental Customers.

C. Other Expenses – Site Demolition and Restoration

The 2006 SENY Rate Plan includes a request for $4.8 million for Site Demolition and Restoration ("SD&R") as part of the Fixed Cost component. These costs are associated with Poletti ($4.1 million) and the 500 MW CCU ($0.7 million). This is only the second time that such costs have been included in NYPA's revenue requirement.[4]

Initially, workpapers and documents provided by NYPA in response to requests by the City indicate that the SD&R cost estimates are based on estimates from 2000. Apparently, no updates have been conducted despite the fact that no SD&R costs were included in the SENY cost of service until 2005.

The lack of any updates raises concerns about the underlying SD&R analysis, including the assumptions utilized. For example, according to workpapers provided by NYPA, the SD&R estimates assume a 3.5 percent inflation factor. However, the Annual Energy Outlook for 2005, published by the Energy Information Administration, a section of the U.S. Department of Energy, estimates that the annual rate of inflation for the period 2003-2025 will be approximately 2.5 percent. Utilizing this, more current estimate of long-term inflation, the SD&R cost estimate should be reduced by approximately 25 percent.

In addition, the SD&R estimate for the 500 MW Poletti combined cycle unit ("Poletti CC") assumes that the generating plant will be "totally dismantled and all foundations removed" and that the cooling tower, substation, and fuel piping and

[4] NYPA's 2003 Annual Report stated that NYPA began to comply with FAS 143 on January 1, 2003.

associated equipment will be dismantled in 2030. Given the in-City need for electric generating capacity and the general lack of acceptable sites for new generation, it is unreasonable to assume that the Poletti site will not still be utilized as a generation site in 2030 (indeed, it may not be reasonable to assume that Poletti CC will be retired in 2030). However, even if the site is not used for generating electricity post-2030, and all of the dismantling occurs, there will be some value to the restored property. The study allocates no residual value to the land, either as an ongoing generating site or a restored, non-generating site. Although it is difficult to estimate the future value, it cannot simply be ignored. The City recommends that, until NYPA can produce a decommissioning study that includes a realistic appraisal of the value of the land in 2030, an additional 10 percent of the SD&R costs be disallowed.

Based on the above analysis, the SD&R cost estimate included in Fixed Costs should be reduced by 35 percent. In addition, the calculation of the SD&R costs appears to be incorrect and requires an adjustment. The 2006 SENY Rate Plan includes $4.8 million for SD&R costs. However, the workpapers provided by NYPA show that actual funding for SD&R costs is equal to $4.644 million as follows:

Plant	Estimated SD&R Costs (in millions)
850 MW Poletti	$3.743
Demineralizer	0.195
500 MW CC	0.706
Total	$4.644

Clearly, the Fixed Costs included in the 2006 SENY Rate Plan should be reduced by $156,000 for this error. Reducing the adjusted SD&R costs of $4.644 million by 35 percent reduces the Fixed Costs an additional $1.625 million, for a total reduction $1.8 million.

POINT II

NYPA SHOULD CHANGE ITS RATE DESIGN TO REALIGN RATES WITH APPROPRIATE COSTS

NYPA should use this opportunity to correct a rate design anomaly that is likely to become more problematic given the ability of the SENY Customers to choose hedging strategies under the LTA. Specifically, the current rates overcollect demand revenues and undercollect energy revenues.

As a general principle of rate design, demand charges should be designed to recover Fixed Costs and energy charges should be designed to recover Variable Costs. A review of the customer revenues at 2005 standard tariff offering rates (Figure 13 of the SENY Rate Plan) indicates that the 2005 billing determinants generate demand revenues of $200.8 million and energy revenues of $454.7 million. As previously indicated, NYPA indicates on Figure 1 that the total Fixed Costs are $146.6 million and the Variable Costs are $516.1 million. Ignoring the revenue shortfall of approximately $7.2 million, the current rates overcollect demand revenues, and undercollect energy revenues (see attached Appendix I).

Under the LTA options, there often will be a reconciliation performed that will compare the Variable Costs that NYPA actually incurs with the revenues that it is to collect associated with those costs. In order to properly perform any type of reconciliation, the Fixed Costs and Variable Costs should be easily identifiable. The current rate design does not permit this.

Attached Appendix II shows an alternative rate design for both the demand and energy revenues. The total revenues collected are the same, but demand revenues are reduced to $146.6 million and the energy revenues are increased to $508.9 million.[5] For the reasons stated, the City supports a rate design that reflects demand charges designed to achieve fixed cost recovery and energy charges designed to achieve variable cost recovery.

[5] It should be noted that Rate SC 62 does not have a demand charge and only provides for 0.4% of the total revenues; therefore, we have not included any demand component in this rate.

CONCLUSION

For the reasons set forth herein, the Fixed Costs included in the 2006 SENY Rate Plan should be reduced as set forth herein. In addition, the SENY Customer rates should be redesigned to more closely track cost incurrence.

Dated: December 7, 2005

Martha K Hirst

Martha K. Hirst
Commissioner
Department of Citywide
Administrative Services

New York Power Authority

Rates and Costs at 2005 Standard Tariff Offer

Demand Revenues:

Total Government	Projected 2006 Demand KW (1)	2006 Demand Charge $/KW (2)	Pro Forma 2006 Fixed Costs ($000) (3)
SC 62	49,219	$ -	$0
SC 64	694,480	$ 11.38	7,903
SC 65	2,355,097	$ 8.40	19,783
SC 66	0	$ -	0
SC 68/82	2,317,190	$ 10.05	23,288
SC 69	3,130,212	$ 8.30	25,981
SC 80	900,119	$ 9.15	8,236
SC 85	4,384,512	$ 9.36	41,039
SC 91/93/98	8,957,461	$ 8.48	75,959
Total Before Credits/Rider	22,788,289		$202,189
ST. LAWRENCE MTA DEMAND CREDIT			($825)
PLM PAYMENT			(2,040)
SERVICE TARIFF RIDER "B" KIAC			1,500
Total Credits/Rider			($1,365)
Total			$200,824 *

Energy Revenues:

Total Government	Projected 2006 Energy MWh (1)	2006 Energy Charge $/MWh (2)	Pro Forma 2006 Variable Costs ($000) (3)
SC 62	28,414	$ 83.46	$2,371
SC 64	390,257	$ 42.96	16,765
SC 65	855,517	$ 49.58	42,417
SC 66	64,984	$ 70.16	4,559
SC 68/82	1,136,864	$ 44.32	50,386
SC 69	1,321,138	$ 46.42	61,327
SC 80	341,298	$ 44.19	15,082
SC 85	1,852,514	$ 45.65	84,567
SC 91/93/98	3,639,162	$ 49.12	178,756
Total Before Credits/Rider	9,630,149		$456,231
ST. LAWRENCE MTA DEMAND CREDIT			($1,567)
PLM PAYMENT			0
SERVICE TARIFF RIDER "B" KIAC			0
Total Credits/Rider			($1,567)
Total			$454,664
Total Revenues			$655,487

* Proposed fixed cost per June 1, 2005 cost of service was $146.6 million.

New York Power Authority

Rates and Costs at 2005 Standard Tarriff Offer

Demand Revenues at $146.6 Million - Energy Revenues at $508.9 Million

Demand Revenues:

Total Government	Projected 2006 Demand KW (1)	2006 Demand Charge $/KW (2)	Pro Forma 2006 Fixed Costs ($000) (3)
SC 62	49,219	$ -	$0
SC 64	694,480	$ 8.33	5,784
SC 65	2,355,097	$ 6.15	14,477
SC 66	0	$ -	0
SC 68/82	2,317,190	$ 7.35	17,042
SC 69	3,130,212	$ 6.07	19,013
SC 80	900,119	$ 6.70	6,027
SC 85	4,384,512	$ 6.85	30,033
SC 91/93/98	8,957,461	$ 6.21	55,588
Total Before Credits/Rider	22,788,289		**$147,965**
ST. LAWRENCE MTA DEMAND CREDIT			($825)
PLM PAYMENT			(2,040)
SERVICE TARIFF RIDER "B" KIAC			1,500
Total Credits/Rider			**($1,365)**
Total			**$146,600**

Energy Revenues:

Total Government	Projected 2006 Energy MWh (1)	2006 Energy Charge $/MWh (2)	Pro Forma 2006 Variable Costs ($000) (3)
SC 62	28,414	$ 93.38	$2,653
SC 64	390,257	$ 48.07	18,758
SC 65	855,517	$ 55.47	47,458
SC 66	64,984	$ 78.50	5,101
SC 68/82	1,136,864	$ 49.59	56,374
SC 69	1,321,138	$ 51.94	68,616
SC 80	341,298	$ 49.44	16,874
SC 85	1,852,514	$ 51.08	94,618
SC 91/93/98	3,639,162	$ 54.96	200,001
Total Before Credits/Rider	9,630,149		**$510,454**
ST. LAWRENCE MTA DEMAND CREDIT			($1,567)
PLM PAYMENT			0
SERVICE TARIFF RIDER "B" KIAC			0
Total Credits/Rider			**($1,567)**
Total			**$508,887**
Total Revenues			**$655,487**