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. NYPA Should Evaluate The Possibility of Refinancing Its Debt Given Current Market Conditions

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. The Costs Related To The Kensico Hydroelectric Facility Should Be Removed From The 2013 Cost-Of-Service

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