COMMENTS OF THE METROPOLITAN TRANSPORTATION AUTHORITY AND THE PORT AUTHORITY OF NEW YORK AND NEW JERSEY ON THE NEW YORK POWER AUTHORITY PRELIMINARY STAFF REPORT AND NEW YORK CITY GOVERNMENTAL CUSTOMER ANNUAL PROCESS ANALYSIS INCLUDING THE 2006 COST-OF-SERVICE

INTRODUCTION

The Port Authority of New York and New Jersey (Port Authority) and the Metropolitan Transportation Authority (MTA) jointly submit these comments on the New York Power Authority's (NYPA) Preliminary Staff Report and New York City Governmental Customer Annual Process Analysis including the 2006 (2006 SENY Rate Plan). For Rate Year 2006, NYPA proposes to increase its production rates by 7.23% for its Southeast New York governmental customers (SENY Customers) which, in or about March 2005, signed Long Term Agreements (LTA) supplementing their NYPA power contracts. Both the MTA and the Port Authority (PA/MTA) are SENY Customers. The LTA provide for a consultative Annual Planning and Pricing Process (Annual Process) between NYPA and SENY Customers leading to the setting of rates for the next rate year.

As laid out in the 2006 SENY Rate Plan, revised most recently on November 4, 2005, the rate increase will capture changes in both the fixed and base variable cost components of the 2006 Cost-of-Service (COS). The notice (I.D. No. PAS-43-05-00002-P) to revise rates to account for the changes in the fixed cost component was published in the New York State Register dated October 26, 2005. The revision of rates to account for the changes in the variable cost component will be based on the Annual Process review of the projected 2006 COS as agreed upon in the LTA. These PA/MTA joint comments address the increases in both the fixed and variable cost components.

After analysis of the 2006 SENY Rate Plan, and various meetings and discussions among NYPA, the City of New York, MTA and Port Authority staff and our respective consultants, the PA/MTA has concluded that NYPA has not provided sufficient justification for the total proposed 7.23% increase to its 2006 production rates. This increase follows SENY Customer production rate increases of 22% in January 2005 and 6.5% in April 2004. The PA/MTA has identified several 2006 COS components that should be reduced.

As of December 6, 2005, based on the most recent discussions in the Annual Process, NYPA has proposed a $5.2 million reduction in the $47.4 million proposed increase in fixed and variable costs, which is a step in the right direction. This is a strong positive indication that NYPA and the SENY Customers have begun to establish a collaborative relationship in this process.

This is the first year during which NYPA and the SENY Customers jointly participated in the Annual Planning and Pricing Process contemplated in the LTA. All parties made significant and good faith efforts to engage in the process in the spirit intended. As always, a maiden voyage highlights areas for improvements, and the PA/MTA has included recommendations for improving the process to produce additional efficiencies.

PRELIMINARY COMMENT

RECOMMENDATIONS FOR IMPROVEMENT OF ANNUAL PROCESS

The first-time implementation of the LTA has been a challenge to the SENY Customers and the NYPA Staff. A significant effort has been made by both sides to implement this agreement in the spirit intended when it was executed. However, the first-time implementation of such agreements inevitably identifies situations and consequences that were unanticipated when the original agreement was drafted.

The PA/MTA requests that the NYPA Board and Staff commit to work with the SENY Customers to identify areas where process changes can be implemented within the existing agreement, leading ultimately to the joint issuance of a clarification document effective for the Year 2007 and thereafter. If required, the LTA should be modified. We hope these changes can rectify the unanticipated shortcomings of the current Annual Process and capture the intent of the original negotiations.

Following are changes that in our opinion would facilitate the annual implementation of the LTA and would be mutually beneficial to NYPA and SENY Customers alike:

(1) Allow SENY Customers to be privy to, and provide input into, the assumptions used in the creation of the revenue requirements and associated modeling of market prices that begins in March of each year. As part of this initiative, NYPA should develop a COS study manual that documents the process, key assumptions and sensitivities.

(2) After the SENY Customers have selected their risk management option (on or about July 1st of each year), SENY Customers should be updated on a regular basis on the planned execution of customer-selected hedge strategies and the ultimate impact on the revenue requirement. The SENY Customers should have the option to provide input on the implementation of the hedge strategy. An expansion of hedge positions to cover longer time periods, or the purchase of "strips" of energy when market conditions suggest benefits from doing so are examples of strategies that might be discussed. In exchange, the SENY Customers would bear the potential increase or decrease in the cost of accelerating or delaying the implementation of the strategy and purchase/sale of the hedge instruments. The unusual events of the 2005 energy markets coincided with the timing of purchases of these instruments resulting in the unintended consequence of potentially increasing the variable costs to the SENY Customers. The SENY Customers discovered this economic impact after the instruments had been purchased. A more measured strategy with respect to the timing of purchases might have lowered purchase costs.

(3) The LTA calls for a Risk Management Audit with the participation of the SENY Customers. The SENY Customers must be convinced that NYPA's risk management practices and programs are serving their collective desires for safe, reliable and low cost electric generation services. The only way the SENY Customers can receive this assurance is through regular, ongoing participation in the process to review the risk plan, policy and status of risk positions, and probable base variable cost variance.

The PA/MTA also wishes to express our concern regarding the commercial operation status of the new Combined Cycle Unit. This unit was due to be in service in mid-2005. Although we have repeatedly received reports that the unit is on schedule to be in service, contingency plans need to be put in place that minimize the cost burden on customers if this unit is not commercially available on January 1, 2006. Customers should be held harmless for the economic consequences of any delay in a commercial operation commencement date beyond January 1, 2006.

COMMENTS –FIXED COSTS

THE FIXED COST COMPONENT OF THE 2006 SENY COST OF SERVICE SHOULD BE REDUCED BY AT LEAST $8.3 MILLION

The PA/MTA review of the proposed increase to Fixed Costs in the 2006 SENY Rate Plan revealed that Fixed Costs are overstated by at least $8.3 million. Accordingly, we request that NYPA reduce the fixed costs of the old Poletti Plant by $6.2 million and the shared services fixed costs by $ 2.1 million. NYPA should revisit its calculation of the asset retirement obligations included in the "Other Expenses" component for "Site Demolition and Restoration" and make the appropriate adjustments. In addition, if the new Combined-Cycle Unit is not in commercial operation on January 1, 2006, all fixed costs embedded in 2006 rates from January 1, 2006 through the actual commercial in-service date should be prorated and returned to customers in the 2007 Rate Year Plan.

Operations and Maintenance – Old Poletti Plant

The PA/MTA provided NYPA Staff with a benchmarking analysis prepared by our consultant, Science Applications International Corporation (SAIC), comparing the costs of the old Poletti Plant to other similar facilities. This analysis compared the historical operating costs of the old Poletti Plant to those of a peer group of other similar facilities based upon data filed with various federal agencies. Benchmarking studies of this type are routinely used to provide a measure of the reasonableness of the total cost. The consultant's report concluded that the fixed costs of the Poletti Unit could be reduced by $6.2 million.

The benchmarking study's results demonstrated that Poletti has the highest operating costs in the peer group across a broad number of measures of plant performance. In addition, the old Poletti Plant is scheduled to be shut down in 2008 in accordance with the stipulation agreement signed by NYPA and other parties, and its non-fuel O&M expenses should be decreasing significantly. Furthermore, NYPA has indicated that the new Combined-Cycle Unit adjacent to the Poletti Plant will permit the sharing of staff between the two facilities during the phase-out of the old Poletti Plant. This provides NYPA with increased opportunity for significant economies for the operation of both facilities, which is not evident in the costs contained in the current 2006 Rate Year COS.

NYPA staff indicated their intention to propose a $3.6 million reduction in the fixed operation and maintenance costs for the old Poletti Plant with the main drivers for this decrease being "a reduction in labor due to attrition and a reduction in the level of non-essential maintenance required … in anticipation of the 2008 shutdown of the Poletti Plant."

While the $3.6 million reduction in fixed O&M for the old Poletti Plant is a move in the right direction, the PA/MTA continues to recommend a total decrease of $6.2 million and continues to maintain that additional economies can and must be realized at that facility. NYPA staff should immediately move to identify additional cost reductions to attain the $6.2 million figure.

Shared Services

The PA/MTA has analyzed the increases in costs related to Shared Services and has concluded that costs are far greater than what would be expected using a Consumer Price Index benchmark. This is especially true give the political environment of fiscal restraint in which all the SENY Customers are operating. As a result, NYPA should decrease the Shared Services line item by $2.1 million to bring those costs in line with inflationary increases.

Other Expenses – Site Demolition and Restoration

The "Other Expenses" line item in the 2006 SENY Rate Plan contains $4.8 million to cover annual annuity payments for Site Demolition and Restoration ("SD&R Costs") costs at the old Poletti Plant ($4.1 million) and at the new Combined Cycle unit ($0.7 million). NYPA indicated in the notes to the Financial Statements in its 2003 Annual Report that it began implementing FAS No. 143, "Accounting for Asset Retirement Obligations" effective January 1, 2003.

Estimates of demolition costs for the old Poletti Plant/Demineralizer existed at least as far back as July 2000.

It is unclear why NYPA's recognition of these old Poletti Plant retirement obligations did not occur at least at the same time as the recognition of the FAS No. 143 retirement obligations for the Small Clean Power Plants in New York City. NYPA should rightly have begun expensing the liability related to the old Poletti Plant/Demineralizer at least in 2003. The PA/MTA recommends that NYPA adjust its schedule to reflect annual annuity payments into the Sinking Fund for the old Poletti Plant/Demineralizer beginning January 1, 2003 instead of July 1, 2005.

<u>Fixed Costs - New Combined-Cycle Unit</u>

There has been quite a bit of slippage in the commercial in-service date of the new Combined-Cycle Unit. NYPA indicates that the current commercial operation date for the unit is January 1, 2006. If the new Combined-Cycle Unit is not in commercial operation on January 1, 2006, all fixed costs associated with this unit for the period between January 1, 2006 and the actual commercial in-service date should be prorated and returned to customers in the 2007 Rate Year Plan. The PA/MTA makes the following arguments to support this request:

(1) Servicing the debt on a generation unit typically does not begin until the unit is fully commercially operational;

(2) Any pre-commercial non-fuel O&M for the plant is typically capitalized and recovered in the cost of the plant over the unit's useful life through depreciation; and

(3) The allocation of overhead costs between SENY and other NYPA Customers is based upon a labor allocator that should be recalculated to reflect the delayed in-service date of the unit.

COMMENTS –BASE VARIABLE COSTS

THE BASE VARIABLE COST COMPONENT OF THE 2006 COST OF SERVICE SHOULD BE REDUCED BY AT LEAST $9.6 MILLION

The November 4, 2005 increases of $5.2 million in the 2006 COS related to a decrease in the forecast of small hydro production and of $4.4 million related to an increase in the estimated distribution loss factor should be eliminated. In addition, if the new Combined-Cycle Unit is not commercially operational on January 1, 2006, the SENY Customers should not be responsible for base variable costs until the Combined-Cycle Unit becomes fully commercially operational.

Small Hydro Production Forecast and Distribution Losses

NYPA and the SENY Customers agreed to "refresh" the 2006 COS to account for hedges procured by NYPA after the initial June 2005 issue of the 2006 SENY Rate Plan. The SENY Customers expected that the only updates to the 2006 COS would relate to the price of energy. However, NYPA used that opportunity to not only make cost adjustments related to the hedges, but to also change other cost components.

The PA/MTA take strong exception to changes in two of those components: the reduction in the megawatt hours dispatched from the small hydroelectric generating units in the SENY portfolio, and an increase in the distribution loss factor. Both changes are arbitrary and in the opinion of the PA/MTA, they are not the known or accepted changes for which this limited reopening of the 2006 COS was intended. In addition, there is a short turnaround time between NYPA's handover to customers of the refreshed 2006 COS and the deadlines for customer submission of comments. The turnaround time does not allow customers the opportunity to properly investigate changes in assumptions underlying the line items other than those that are "based in fact."

The PA/MTA therefore offers for consideration, as NYPA and the SENY Customers review the Annual Planning Process with a view to improvement, special treatment in the 2006 COS for certain items that may be difficult to forecast or that are outside NYPA's control. These items can be segregated in the 2006 COS to receive balancing account treatment.

In the case of the two items under discussion, the proposed mechanism would allow for the forecast of the small hydroelectric production and the distribution loss factors to be "trued-up" to the actual observed quantity after the close of the Rate Year. For the small hydroelectric plant output, the actual quantities (MWh) generated would be adjusted to the actual MWh dispatch of the plant. No adjustment would be made to the prices faced by the plants. Any over-or under-forecast of the output of these plants would be quantified based upon the prevailing prices and included in the next cost of service. This mechanism would be applied to the loss factors through the application of the actual loss factor percentages. The debate between NYPA staff and the SENY Customers has centered on defining the historic time period to estimate this loss factor percentage. The balancing account method may be a reasonable way of settling this issue.

Commercial Operation of the New Combined-Cycle Unit

If the new Combined-Cycle Unit is not commercially operational on January 1, 2006, a significant probability exists that the variable costs will be higher than forecast in the variable cost portion of the revenue requirement. Given that the SENY Customers have chosen the default sharing option, this may have adverse economic consequences for the SENY Customers.

NYPA staff has repeatedly assured the SENY Customers that the new Combined-Cycle Unit will be fully commercially operational on January 1, 2006. The SENY Customers should be insulated from any responsibility for any additional costs associated with any delay in the commercial availability of the new Combined-Cycle Unit beyond January 1, 2006.

CONCLUSION

For the reasons discussed in these comments, the PA/MTA recommends that the proposed production rates for the 2006 Rate Year should be decreased to reflect the adjustments in the 2006 COS set forth in these comments.