

September 24, 2013

MEMORANDUM TO THE TRUSTEES

FROM THE PRESIDENT and CHIEF EXECUTIVE OFFICER

**SUBJECT: Decrease in New York City Governmental Customers
Fixed Costs – Notice of Proposed Rulemaking**

SUMMARY

The Trustees are requested to authorize a Notice of Proposed Rulemaking (“NOPR”) to decrease the Fixed Costs component of the production rates by \$8.1 million or 5.3%, not including Astoria Energy II (“AE II”) plant expenses to be charged in 2014 to the New York City Governmental Customers (“Customers”). AE II plant expenses, although part of the Fixed Costs component, are not subject to this NOPR proceeding as recovery of such costs has been agreed to by contract. The proposal is based on Authority staff’s Preliminary 2014 Cost-of-Service (“COS”).

In addition, the Trustees are requested to direct the Corporate Secretary to file a NOPR with the New York State Department of State for publication in the *New York State Register* in accordance with the requirements of the State Administrative Procedure Act (“SAPA”). Upon closure of the 45-day statutory comment period concerning this proposed rate action, Authority staff will take into consideration concerns that have been raised and return to the Trustees at their meeting on December 17, 2013, to seek final adoption of this proposal.

BACKGROUND

In 2005, the Authority and the Customers entered into supplemental agreements for the purchase of electric service through December 31, 2017. These agreements (the 2005 “Long-Term Agreements,” or “LTAs”) replaced prior agreements entered into during the mid-1990s with these Customers. The LTAs established a new relationship between the Authority and the Customers that reflects the costs of procuring electricity in the marketplace managed by the New York Independent System Operator (“NYISO”). The LTAs define specific cost categories with respect to providing electric service, and prescribe a collaborative process for acquiring resources, managing risk and selecting a cost-recovery mechanism.

The LTAs separate all costs into two distinct 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. Under the LTAs, the Authority must establish Fixed Costs based on COS principles and make changes based on a filing in accordance with SAPA requirements. In addition, the LTAs contemplate that year-to-year changes in Fixed Costs will be reviewed by the Customers in advance of the filing made under SAPA; Authority staff must consider the Customers’ concerns

before presenting any proposed changes to the Fixed Costs to the Trustees or issuing proposed changes for public comment.

Also, pursuant to the LTAs, the Authority develops the Variable Costs on an annual basis. These are costs the Authority expects to incur to serve the Customers in the upcoming Rate Year; specifically for fuel and purchased power, risk management, NYISO ancillary services and O&M reserve, less a credit for NYISO revenues from NYPA generation dedicated to these Customers. The Variable Costs are subject to the Customers' review and comment. The cost-recovery mechanisms for the upcoming year's Variable Costs are selected by the Customers from among the choices set forth in the LTAs. These cost-recovery mechanisms were previously approved by the Trustees and therefore do not require further approval.

On July 10, 2008, the Authority and the Customers entered into an agreement ("Agreement") that implemented Article XI of the LTAs concerning the acquisition of long-term resources under a request for proposal ("RFP") process. The RFP resulted in NYPA contracting with Astoria Energy II LLC for the full product toll of a 500 MW combined-cycle unit over a twenty-year period. The full product toll allows NYPA to capture all energy, capacity and ancillary services output of the generating unit for the benefit of the Customers. Under the Agreement, the costs incurred by NYPA are to be included as part of the COS based rate, and in order to ensure full recovery of all costs related to the full product toll, NYPA may use a true-up mechanism to assess charges for under-recovery and apply credits for over-recovery of costs. The 2014 costs related to the AE II service are \$139.2 million and have been included in the Fixed Costs component of the Preliminary 2014 COS.

DISCUSSION

Based on the Preliminary 2014 COS, the decreases in Fixed Costs are \$8.1 million, or 5.3% lower than the Fixed Costs included in the Final 2013 COS. These Fixed Costs are the subject of review under this SAPA proceeding. Although AE II costs are included in the Preliminary 2014 COS, they are outside this NOPR because recovery of NYPA's AE II costs has been separately agreed to through contracts between NYPA and the Customers. Contributing to the reduction in Fixed Costs of 5.3% is a projected decrease in Capital Cost of \$15.6 million. The reduction in Capital Costs is largely due to the retirement of the Poletti debt in 2013.

Variable Costs are projected to increase by a total of \$17.8 million, or 3.4% compared to the Final 2013 COS. Based on preliminary analyses, Authority staff projects that the 2014 production rate, combining the Fixed and Variable Costs, will increase by about 1.7% compared to the Final 2013 COS.

Under the LTAs, any change in the Fixed Costs component of the Customers' production rates must be done in accordance with a SAPA proceeding. Thus, the Customers will have an opportunity to file comments upon the issuance of the NOPR. After closure of the 45-day statutory comment period concerning the proposal, Authority staff will take into consideration the concerns raised and will return to the Trustees at their meeting on December 17, 2013 to seek final adoption of an appropriate Fixed Costs rate. Subsequent to such final adoption, staff will incorporate the approved Fixed Costs and the final Variable Costs that are determined in the rate-

setting process with the Customers into new production rates to become effective with the January 2014 billing period.

FISCAL INFORMATION

The adoption of this proposal concerning the decrease in Fixed Costs applicable to the Customers under the LTAs would result in the Authority continuing to recover the appropriate Fixed Costs associated with serving these Customers.

RECOMMENDATION

The Director – Market Analysis and Administration recommends that the Trustees authorize the Corporate Secretary to file a Notice of Proposed Rulemaking in the *New York State Register* for the adoption of a decrease in the Fixed Costs component of the production rates (comprising non-AE II costs) by \$8.1 million to be charged in 2014 to the New York City Governmental Customers.

It is also recommended that the Senior Vice President – Economic Development and Energy Efficiency, or his designee, be authorized to issue written notice of the proposed action to the affected Customers under the provisions of the Authority’s tariffs.

For the reasons stated above, 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.
NYC Customers-NOPR

RESOLUTION

RESOLVED, That the Authority projects a decrease in the Fixed Costs of serving the New York City Governmental Customers when comparing those costs contained in current rates to 2014 projected costs; and be it further

RESOLVED, That the Authority has entered into supplemental Long-Term Agreements with the New York City Governmental Customers and those agreements provide for the recovery of additional Fixed Costs through a rate filing under the State Administrative Procedure Act; and be it further

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 proposed 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 Secretary 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 proposed 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.