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

Exhibit “A”
Customer Comments

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December 20, 2013

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-42-13-00007-P – Rates for the Sale of Power and Energy

Dear Ms. Delince:

Enclosed please find the Comments of the City of New York on the New York Power Authority's proposal to decrease the Fixed Costs component of the production rates for its New York City Governmental Customers for 2014. These comments are submitted in response to the notice published in the State Register on October 16, 2013.

We note that NYPA provided some additional information to the City on December 18, 2013. Given the timing, the City only has briefly reviewed the information but has determined that the information provided does not resolve concerns raised in the comments. We note that this problem further demonstrates the need for modifications to the fixed cost review and comment process.

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

Sincerely,

COUCH WHITE, LLP

Kevin M. Lang slg

Kevin M. Lang

KML:slg
Enclosure (via e-mail and U.S. Mail)
cc: Hon. Edna Wells Handy, Commissioner, DCAS
Mr. Mitch Gipson, First Deputy Commissioner, DCAS
Ms. Sally Renfro, Chief of Staff, DCAS
Ms. Kristin Barbato, Deputy Commissioner and Chief Energy Management Officer, DCAS Energy Management

Ms. Susan Cohen, Assistant Commissioner, DCAS Energy Management
Dr. Sergej Mahnovski, Director, NYC Office of Long Term Planning and Sustainability
Gail Rubin, Esq., Chief, Affirmative Litigation, NYC Law Department

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**POWER AUTHORITY
OF THE STATE OF NEW YORK**

Rates for the Sale of Power and Energy	**SAPA No. PAS-42-13-00007-P**

COMMENTS OF THE CITY OF NEW YORK

December 20, 2013

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PRELIMINARY STATEMENT

While some progress was made in 2013, and additional steps have been taken for 2014, to moderate the energy rates charged by the New York Power Authority ("NYPA") to the City of New York, ("City"), more effort is needed. NYPA's financial health is tied to the Long Term Agreements ("LTA") between it and the City and the revenues provided by the City. Published reports have indicated that the City and other downstate customers account for about two-thirds of NYPA's revenues. As discussed herein, the City has numerous concerns with the level of costs that NYPA includes in the Cost-of-Service and with the process for determining the production rates. Given the importance of the City to NYPA, the City respectfully requests that the NYPA Board of Trustees ("Board") continue to focus on controlling and reducing NYPA's fixed costs.

In considering the proposed 2014 Cost-of-Service for the City at the September 24, 2013 Board meeting, no member of the Board raised any questions regarding the level of the fixed costs, nor was there discussion of the proposal. Rather, after summarily adopting NYPA's Staff's recommendation to issue the proposal for public comment, the Chairman commented that the Board could then "focus our time, effort, and energies where it really matters."[1] The City respectfully submits that the decision to charge the City and other New York City Governmental Customers ("NYCGCs") almost $800 million in production costs for 2014 is worthy of the Board's time and attention.

While the City appreciates the efforts taken to date to reduce the fixed costs for 2014, additional reductions should be made. The City respectfully urges the Board to carefully scrutinize the proposal before it and make the further adjustments discussed in these comments.

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1 http://streaming1.expeditevcs.com:8080/NYPA/NYPA092413-003.htm.

PROCEDURAL SETTING

In accordance with the LTAs, on May 23, 2013, NYPA distributed its *"Preliminary Staff Report – New York City Governmental Customers Annual Planning and Pricing Process Analysis, Including: Preliminary 2014 Cost-of-Service"* ("Preliminary Report") to the NYCGCs. At the time the Preliminary Report was issued, NYPA advised the NYCGCs that its 2014 budget had not yet been developed, and that some of the costs were "placeholders" that simply reflected increases compared to the 2013 fixed costs.

Discovery on the Preliminary Report ensued. Between June 2013 and September 2013, the City sought additional information on and clarifications of the information in the Preliminary Report. At its September 24, 2013 meeting, the Board summarily approved the issuance of a notice of proposed rulemaking for the 2014 Cost-of-Service. On October 16, 2013, a notice of proposed rulemaking associated with the 2014 Cost-of-Service was published in the State Register ("October 16 Notice"). Pursuant to § 202 of the State Administrative Procedure Act ("SAPA"), the City submit these comments in response to that Notice.

The original deadline for submitting comments was December 2, 2013. On November 26, 2013, NYPA extended the comment deadline to December 20, 2013. On or about December 6, 2013, NYPA posted to its website revised figures for the 2014 Cost-of-Service. On December 12, 2013, NYPA provided some support for the revised figures. While the City acknowledges that the revised figures represent an overall reduction in the 2014 Cost-of-Service and appreciates the additional supporting documents, the latter raised additional questions and the City has not had sufficient time to properly analyze the changes and the information provided.

COMMENTS

POINT I

THE PROPOSED LEVEL OF OPERATIONS AND MAINTENANCE EXPENSES SHOULD BE REDUCED

On a total basis, the fixed costs in the 2014 Cost-of-Service are expected to be 9.8 percent lower than the fixed costs incorporated into 2013 rates. However, the Board must take note of the fact that the reduction is largely due to NYPA's partial restructuring of debt service to match the underlying life of assets, and to the end of the amortization of the Poletti debt expense. Within the overall Fixed Cost category, the operations and maintenance ("O&M") expenses are increasing by $3.9 million, or 11.5 percent. While this amount may not seem large compared to the entire Fixed Costs, the increase has not been justified and the City's concerns should not be ignored.

One area of concern is the costs associated with the small hydroelectric facilities ("small hydros"). While the documentation provided on December 12 indicates that the O&M expenses for the small hydros has gone down compared to 2013, there is no basis to determine whether the amount proposed to be spent is reasonable. Indeed, the fact that the small hydros lose money each year calls into question the propriety of the expenditure level.

In particular, NYPA's plans for the Jarvis hydro warrant further consideration. NYPA explained to the NYCGCs earlier this year that Jarvis Unit #2 suffered some type of failure on June 29, 2012, and the turbine must be rebuilt at a cost now projected at $339,400. As noted above, the small hydros are not economic even when fully operational. However, it appears that NYPA conducted no analysis to determine whether rebuilding this unit is cost-justified. Compounding this concern, NYPA revealed for the first time in the December 12 documentation that it now plans to rebuild Jarvis Unit #1, presumably at a similar cost. Again, NYPA appears to have conducted no analysis to determine whether the rebuild makes economic sense.

In addition to the lack of justification, the recent information provided raises questions as to the manner in which NYPA intends to proceed. The original equipment was apparently of European design, and NYPA claims that it needs to reverse engineer the equipment in order to fabricate replacements. There is no explanation as to whether NYPA considered procuring replacement parts from the original equipment manufacturer, and the information also raises a question as to the prudence of NYPA's original actions and whether the NYCGCs should be responsible for the associated costs. Finally, the act of rebuilding a turbine is not a routine maintenance item; based on the description provided by NYPA, this work appears to be a major capital investment in the plant. As such, the costs of the work should be amortized over time.[2]

Before the Board approves the rebuild of either Jarvis Unit, it should require NYPA to prepare and present a cost-benefit analysis to the City and other NYCGCs. The decision to proceed should not occur until that analysis is completed and the City and other NYCGCs are given the opportunity to provide meaningful input into the matter.

Another specific concern pertains to NYPA's use of consultants, the costs of which are included in the O&M expenses. Specific inquiry was made regarding the nature and role of the consultants, and this matter was discussed during the August 19, 2013 meeting between the NYCGCs and NYPA. At that meeting, NYPA could not provide details regarding

[2] This has been a continuing concern to the NYCGCs. Capital investments should be distinguished from O&M expenses and recovered over the life of the equipment. This is standard practice in the utility industry. NYPA, however, refuses to separate capital investments from O&M expenses and improperly recovers the entire capital cost of projects from the NYCGCs when the projects are undertaken.

the consultants and agreed to circulate information at a later date. Again, while the amounts are not large compared to the entire Fixed Costs, the City's questions as to the services consultants are allegedly providing, how the sharing percentages were determined, and why repairs and maintenance work cannot be performed by NYPA employees have not been answered. The City's concerns should be addressed.[3]

Another part of the information provided on October 7 pertained to the derivation of the allocation percentages used for Shared Services Expense. That explanation indicated that the "HQ Managed O&M – 2014 Forecast" is $208.6 million and that overheads are allocated based on labor ratios. No information was provided to show the derivation of the labor ratios, and the information shown is difficult to understand and track. The explanation suggests that only $99.2 million of the $208.6 million could be allocated directly to particular facilities. This suggests that almost 50 percent of the O&M costs represent administrative and general expenses – an unreasonably high percentage.[4]

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[3] On October 7, 2013, NYPA provided the following statements in apparent response to the City's request. Neither response is responsive to the question asked.

For AEII: "3. Listing of jobs/functions that consultants are involved with on behalf of City (shown at $140k): *The consulting costs represent a share of the projected expenditures for developing and implementing hedge strategies and hedge effectiveness testing, as well as support for emerging issues impacting NYPA fuel supply.*"

For the small hydros: "6. Small hydros – list of consultants and descriptions of what function(s) they perform: *The projects that consultants were projected to work on at the time of the 2014 Preliminary COS preparation are as follows: Crescent Fish Guidance System, Crescent Tainter Gate Painting, Restoration of Crests on Dams A & B at Crescent, Transmission Tower repair at Vischer Ferry and Restoration of Crests on Dams D, E & F at Vischer Ferry.*" [Source: *2014 City Cost Of Service – Fixed Cost Follow-Up Items*, Email from Michael Quinn to the City, dated October 7, 2013.]

[4] To try to better understand the information provided, the City reviewed the annual operating budgets approved by the Board. Doing so reinforced the City's concerns. The 2013 Operating Budget approved by the Board at is December 18, 2012 meeting shows a total budget of $366.7 million, exclusive of AEII and HTP lease costs. The breakdown included on page 4 of 5 of the budget shows headquarters expenses, inclusive of research and

NYPA's proposal to add a new line item to the Cost-of-Service and separately charge for AEII direct support and shared services also raised a number of concerns. The derivation of the AEII direct support and shared services costs of $2.1 million remains unexplained. NYPA could not provide any documentary support showing the legitimacy of the proposal, and its responses to information requests on this topic were contradictory and opaque. For example, in response to the City's information request 23, NYPA stated that it "absorbed these [the AEII] costs internally," but in the attachment to that response NYPA stated that the AEII costs "were either charged to the 500 MW [sic] or absorbed by other facilities." Thus, the

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development costs, being about 31 percent of the total budget, not 50 percent. The breakdown also shows different allocations from those provided on October 7, raising a question as to why total O&M costs are allocated based on labor ratios for the Cost-of-Service when the budget reflects a different allocation of O&M costs. For example, the 2013 budget shows SENY costs at 1.94 percent of the total budget, but the October 7 document shows an allocation of 3.88 percent. Also, from comparing the two documents, it is impossible to discern what constitutes "HQ Managed O&M" – nothing in the 2013 budget supports such an allocation of the total budget.

The costs shown in the two documents should be reconcilable, and the inability to reconcile them raises a concern about the propriety of the fixed costs included in the Cost-of-Service. According to reports provided by NYPA to the City each year, NYPA has overcollected its fixed costs on a total basis in two of the last three years; no information is given on a facility or line item basis, making it impossible to know where overspending or underspending may be occurring. In contrast to the dearth of details provided by NYPA, Consolidated Edison Company of New York, Inc. provides extensive, project-by-project details on its budgeted and actual expenditures as part of its rate cases. NYPA should consider providing a similar level of detail to the NYCGCs.

The information provided by NYPA on December 12, 2013 buttresses these concerns. The 2014 budget information provided does not distinguish between O&M expenses and shared services, nor do the labor allocations. Moreover, the information indicates two separate categories of "SENY" costs but with no explanation for the different categories. There are no labor costs assigned to SENY with or without a "WBS" code, yet $4.46 million of labor costs were assigned to SENY. The labor ratios also show duplicative allocations to the small hydros (under the "B" and "C" cost centers). While the information shows some decreases in 2014 compared to 2013, NYPA has not provided enough information to allow the City to reconcile the figures and ensure that costs are being properly allocated among NYPA's facilities.

City does not know what costs they were actually charged in the past, and it has no basis to determine whether the proposed costs are reasonable or appropriate.

In sum, NYPA has not properly justified its proposed O&M expense levels for the 2014 Cost-of-Service, and the City was not given sufficient information to confirm the reasonableness of the figures in the Preliminary Report. Moreover, the nature of this process is such that the City is not given the opportunity to comment on certain actual proposed spending levels when they replace earlier rough estimates that are primarily fixed percentage increases of the levels approved for the 2013 Cost-of-Service. Because of the insufficiency of the information provided, the City cannot opine on the reasonableness of the proposed O&M expenses. It is possible that further reductions to the allocations to the NYCGCs would be appropriate. Accordingly, the Board should require NYPA to provide more detailed explanations and justifications of the costs to it and to the NYCGCs, and it should ensure that the costs being properly allocated to the NYCGCs.

POINT II

NYPA SHOULD EXTEND THE RECOVERY PERIOD FOR THE 500 MW UNIT'S FIXED RATE DEBT SERVICE EXPENSE

Last year, the City asked the Board to improve the economics of the 500 MW unit by restructuring the unit's fixed and variable rate debt service expense to more closely reflect the expected life of the unit. The City appreciates that the Board favorably considered a part of this request and extended the recovery period for the variable rate debt service expense. That action helped, but it is not sufficient.

The economics of the 500 MW unit continue to be challenging and would be enhanced if the fixed rate debt service expense is restructured in a similar fashion to match the life of the plant. The detailed justification for doing so was provided by the City in the

December 17, 2012 comments submitted jointly with the other NYCGCs on the 2013 Cost-of-Service. That justification remains equally relevant this year, and in the interests of brevity, it is incorporated herein by reference.[5] The City respectfully requests that the Board extend the recovery period for the fixed rate debt service expense to no less than 30 years.

POINT III

THE VARIABLE DEBT RATES CHARGED TO THE NYCGCS ARE EXCESSIVE AND UNREASONABLE

Based on publicly available information, it appears that the interest rates charged by NYPA for the variable rate debt for the 500 MW unit and the small hydroelectric facilities is an order of magnitude higher than NYPA's actual cost. The use of such rates is unjust and capricious.

The 2014 Cost-of-Service uses the following interest rates for the variable rate debt.

TABLE 1
Variable Debt Interest Rates per 2014 Cost-of-Service

Figure	Title	Interest Rate
4E	500MW CCU – Variable Debt Service Expense Adjustable Rate Notes – Series 3 and 4	4.500 %
4F	500MW CCU - Variable Debt Commercial Paper Debt Service Expense	5.33 %
4I	Small Hydro - Variable Rate Debt Service Expense	4.94 % (weighted rate)

[5] Copies of the relevant pages from the 2012 comments are included in Appendix A.

However, NYPA's financial statements report the following as its actual interest rates.

TABLE 2 **NYPA's Variable Debt Interest Rates**	
Instrument	Interest Rate
Adjustable Rate Tender Notes – 2016	0.19 %
Adjustable Rate Tender Notes – 2020	0.19 %
Commercial Paper – EMCP (Series 1)	0.18 %
Commercial Paper – CP (Series 2)	0.16 %
Commercial Paper – CP (Series 3)	0.22 %
Source: NYPA Financial Statements, attached as Exhibit 3-A to the Minutes of the Regular Meeting of the Audit Committee on March 21, 2013	
Tax Exempt Commercial Paper – 1/1/14-12/31/14	0.25 % (assumed)
Taxable Commercial Paper – 1/1/14-12/31/14	0.50 % (assumed)
Tax Exempt Commercial Paper – 1/1/15-12/31/15	0.50 % (assumed)
Taxable Commercial Paper – 1/1/15-12/31/15	0.75 % (assumed)
Source: NYPA 2014-2017 Proposed Budget and Financial Plan[6]	

A comparison of Table 2 and Table 3 reveals order of magnitude differences between the rates charged to the NYCGCs and NYPA's actual interest rates for variable rate debt. The interest rates included in the 2014 Cost-of-Service should be consistent with the NYPA's actual borrowing costs. Accordingly, the Board should direct NYPA to recalculate and reduce the variable rate debt expenses included in the Cost-of-Service.

[6] The 2013-2016 Approved Budget and Financial Plan included similar interest rates as those shown above for the years in question.

POINT IV

THE COSTS FOR THE BLENHEIM-GILBOA PUMPED STORAGE FACILITY SHOULD BE REDUCED

Under the LTA, the NYCGCs' supply portfolio includes 250 MW from NYPA's Blenheim-Gilboa Pumped Storage Power Project ("Blenheim-Gilboa Facility"). As with the small hydros, the inclusion of the Blenheim-Gilboa Facility constitutes a net increase to the NYCGCs' production costs, whereas the initial purpose for including that output in the portfolio was to provide a benefit to the NYCGCs. The deficiency results from two factors.

First, NYPA has layered substantial transmission costs onto the costs of the Blenheim-Gilboa Facility. In recent years, the net revenues resulting from the sale of the Facility's output are insufficient to offset even the higher-than market capacity charge; adding these transmission costs only makes the economics worse for the City. The costs and revenues since the LTA was executed are shown in Table 3.

TABLE 3
Blenheim-Gilboa Costs and Revenues

Year	Gross Cost ($ millions)	NYISO Revenues ($ millions)	Net Cost/Revenues ($ millions)
2005	10.47	(3.44)	7.03
2006	10.47	(2.79)	7.68
2007	10.47	(3.28)	7.19
2008	10.47	(3.40)	7.07
2009	10.47	(1.05)	9.42
2010	10.47	(1.61)	8.86
2011	10.47	(1.66)	8.81
2012	10.47	(2.44)	8.03

Second, NYPA charges the NYCGCs a rate that is too high for the cost of capacity. The rate of $3.49/kW-month for the Blenheim-Gilboa Facility's capacity is reduced by offsetting energy revenues, for a net capacity cost of just under \$3.00/kW-month over the past few years. Yet Rest-of-State capacity prices have been as much as \$1.00/kW-month to \$2.00/kW-month less than this net over this period. Every \$1.00/kW-month is an additional \$3 million above market costs for Rest-of-State capacity charged to the NYCGCs. There is no justification for the higher than market charges, and the Board should direct NYPA to immediately change the formula. At no time should the effective rate charged be higher than the market price of capacity.[7]

POINT V

COLLECTIONS FOR POLETTI DECOMMISSIONING COSTS ARE UNSUPPORTED

Notwithstanding the fact that the Charles A. Poletti Generating Station ("Poletti") closed almost four years ago, NYPA continues to include Poletti-related costs in the Cost-of-Service. While some progress on this issue was made last year, the City's concerns have not been fully addressed.

The City voiced its concerns with the Poletti decommissioning cost estimate to NYPA during the discovery phase of the process, and NYPA agreed to provide a clearer breakdown of the actual and anticipated costs. NYPA provided a revised breakdown, but instead of providing greater clarity, it compounded the concerns. According to the documents provided, the amounts in five of the six cost categories changed between August and October, and the overall decommissioning cost increased by \$400,000. However, NYPA provided no explanation for the changes or cost increase. To resolve these concerns, the Board should require NYPA to prepare and provide a detailed, itemized list of all of the Poletti decommissioning costs, with

[7] The City is willing to discuss which market price should be used – strip, monthly, or spot.

references to supporting documents (*e.g.*, contracts, invoices, engineering plans) that justify each line item.

POINT VI

THE DECOMMISSIONING COST AND CORRESPONDING ANNUAL ASSET RETIREMENT CHARGE FOR THE 500 MW UNIT SHOULD BE ADJUSTED DOWNWARD

Very recently, NYPA advised the NYCGCs that adjustments had been made to annual asset retirement charge related to the decommissioning of the 500 MW unit. These adjustments lowered the charge by $1.5 million, which is a positive step, but that action does not fully address the unreasonableness of the charge. Indeed, although the annual charge was lowered, NYPA increased the decommissioning cost. For the reasons discussed below, the Board should reverse this increase, further reduce the cost estimate, and concomitantly reduce the annual asset retirement charge.

The best evidence of the cost to decommission and dismantle the 500 MW unit would be a decommissioning study. The use of decommissioning studies has been long accepted in the utility industry. Recognizing that decommissioning costs can change over time, utilities review and update such studies periodically to ensure that that their decommissioning funds are sufficiently funded. For example, NYPA and every other nuclear plant operator conducted decommissioning studies for their nuclear units to determine the appropriate level of their annual trust fund contributions. When nuclear plants were sold, the decommissioning studies were updated and corresponding adjustments were made to the purchase price to reflect the over- or under-funding of the decommissioning trusts.

To the City's knowledge, NYPA has never commissioned a decommissioning study for the 500 MW unit, so it has no reasonable basis to assume that either of its $60 million estimate in 2000 dollars provided in the Preliminary 2014 COS, or its \$63.7 million estimate in 2013 dollars provided in the Final 2014 COS, are valid or reasonable. In the absence of such a study, the Board should look to empirical data. The decommissioning cost of Poletti of \$47.3 million in current dollars is a reasonable and more rational data point to use.

As the Board is aware, the Poletti building is a substantially more robust structure than the building housing the 500 MW unit. The design and size of the boiler, the structural steel supporting it and the building, and the size and location of the building in relation to other buildings and equipment that are still operating all influence the decommissioning cost. Taking these factors into account, NYPA has advised the NYCGCs that the total decommissioning cost will be approximately \$47 million. The design of the 500 MW unit, particularly the design of the building and the relative location of the plant, should make its dismantlement easier and less expensive than Poletti. Therefore, there is no reasonable basis for NYPA's assumption that it will cost approximately 35 percent more to decommission the 500 MW unit (*i.e.*, \$47.3 million in 2013 dollars compared to \$63.7 million in 2013 dollars).

Last year, based on the decommissioning costs for Poletti provided by NYPA, the NYCGCs argued that the assumed total cost and annual asset retirement charge for decommissioning the 500 MW unit were too high and should be reduced. In response to these assertions, NYPA claimed to the Board that there is high volatility in such costs, decommissioning would not occur for decades, and if the actual decommissioning costs are lower than projected, collections from the NYCGCs may be reduced in the future.[8] In its recent explanation of the changes made to the calculation of the annual charge, NYPA again asserted that the costs will be reconciled when the facility is decommissioned, and the NYCGCs will be

[8] Minutes from the February 26, 2013 Board meeting, p. 25.

responsible only for the actual costs once they are known. NYPA's assertions lack merit, and the Board should not accept it or allow the NYCGCs to be overcharged for this item.

The problem with NYPA's position is that it is not appropriate to over collect the decommissioning costs each year. Moreover, the plant is expected to continue to operate for at least two decades. The cost should be collected ratably over the period, not overcollected in earlier years, subject to potential refund at the end. Further, there is no certainty that the City and other NYCGCs will be NYPA customers when the 500 MW unit is retired. Therefore, it would be arbitrary and irrational for the Board to continue to overcharge the NYCGCs, and to refuse to consider adjusting the annual charge on the basis that the City possibly could be made whole 20 or more years from now.

The charges included in the 2014 Cost-of-Service for decommissioning the 500 MW unit are unjust, unreasonable, and unsupportable. Therefore, the Board should, at a minimum, set the total decommissioning cost at no more than $47.3 million in current dollars, and use that figure as the basis for annual asset retirement charges. Applying the same calculations used in Figure 5B of the Preliminary Report results in an annual asset retirement charge of $1.067 million.

CONCLUSION

The City respectfully requests that the NYPA Board of Trustees adjust the level of fixed costs for the 2014 Cost-of-Service and adopt other changes in accordance with the discussion and recommendations set forth herein.

Dated: December 20, 2013
Albany, New York

Respectfully submitted,

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