

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

**Exhibit “A”  
Customer Comments**

February 23, 2015

**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-01-15-00012-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 increase the Fixed Costs component of the production rates for its New York City Governmental Customers for 2015. These comments are submitted in response to the notice published in the New York State Register on January 7, 2015.

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

Sincerely,

COUCH WHITE, LLP

  
Kevin M. Lang

Enclosure

cc: Hon. Stacey Cumberbatch, Commissioner, DCAS  
Ms. Sally Renfro, Chief of Staff, DCAS  
Ms. Ozgem Ornektekin, Deputy Commissioner – Energy Management, DCAS  
Suzanne M. Lynn, Esq., General Counsel, DCAS  
Ms. Susan Cohen, Assistant Commissioner – Energy Budget, Supply & Reporting, DCAS  
Gail Rubin, Esq., Chief, Affirmative Litigation, NYC Law Department  
Mr. Anthony Fiore, Interim Director of Energy Regulatory Policy, NYC Office of Sustainability

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

---

**Rates for the Sale of Power and Energy**

---

**SAPA No. PAS-01-15-00012-P**

**COMMENTS OF  
THE CITY OF NEW YORK**

**February 23, 2015**

**COUCH WHITE, LLP  
540 BROADWAY  
ALBANY, NEW YORK 12207  
Telephone: (518) 426-4600  
Telecopier: (518) 426-0376**

## TABLE OF CONTENTS

	<u>Page</u>
PRELIMINARY STATEMENT .....	1
PROCEDURAL SETTING .....	2
COMMENTS .....	3
POINT I .....	3
THE RATE OF INCREASE OF THE FIXED COSTS IS EXCESSIVE AND UNREASONABLE .....	3
A. NYPA Staff And The Board Of Trustees Are Not Properly Determining The Reasonableness Of The Fixed Costs .....	5
B. Personnel Costs Are Excessive .....	6
C. Greater Assessment And Scrutiny Of Capital Investments In The Small Hydros Are Needed .....	7
D. The Interest Rates Charged To The NYCGCs Are Not Consistent With The Requirements Of The Long-Term Agreement .....	9
E. The Use Of Consultants And Contractors Should Be Reduced.....	10
F. Vehicle-Related Costs Are Unjustified And Excessive.....	12
G. The Black Start Charges Must Be Reviewed.....	13
H. The Treatment Of Spare Parts Is Inconsistent .....	13
POINT II .....	14
NYPA SHOULD EXTEND THE RECOVERY PERIOD FOR THE 500 MW UNIT’S FIXED RATE DEBT SERVICE EXPENSE .....	14
POINT III.....	18
THE DSM CHARGE SHOULD BE ELIMINATED .....	18
POINT IV .....	19
RESEARCH AND DEVELOPMENT COSTS SHOULD NOT BE ALLOCATED VIA LABOR RATIOS.....	19
POINT V.....	20

POLETTI DECOMMISSIONING COSTS CONTINUE TO BE A CONCERN.....	20
POINT VI .....	21
THE AMOUNTS CHARGED FOR DEPRECIATION SHOULD BE REVIEWED.....	21
POINT VII.....	23
NYPA SHOULD ENGAGE IN A COMPREHENSIVE REVIEW AND AUDIT OF ITS MANAGEMENT AND OPERATIONS.....	23
CONCLUSION.....	25

## **PRELIMINARY STATEMENT**

The City of New York (“City”) has reviewed the fixed cost portion of the projected 2015 Cost-of-Service for the New York City Governmental Customers (“NYCGCs”), as provided to it by the staff of the New York Power Authority (“NYPA”). The City respectfully requests that NYPA’s Board of Trustees reduce the fixed costs by \$11.2 million related to explicitly-identified items discussed herein, and that it make additional reductions to fixed cost items that are excessive but for which the City does not have enough information to quantify the size of the reductions. The City also respectfully requests that the Board of Trustees extend the recovery period for fixed-rate debt service for the 500 MW unit to match its service life, which is consistent with the manner in which most utility capital costs are recovered. The City estimates that this adjustment would further reduce the fixed costs by approximately \$20 million. In total, the adjustments discussed herein would reduce the fixed costs by more than 20% from the \$140.9 million level set forth in the preliminary 2015 Cost-of-Service, and by almost 4% on a total cost basis.

In addition to the adjustments discussed in these comments, the City believes that there are many other opportunities for NYPA to reduce the level of the Cost-of-Service while still covering the costs it incurs to serve the NYCGCs. A comprehensive audit will provide a plan for NYPA to do so. Similar comprehensive audits of regulated utilities by the New York State Public Service Commission (“PSC”) have resulted in hundreds of millions of dollars of savings for the utilities’ customers. The audits have also resulted in improvements and increasing efficiencies in the manner in which the utilities procure goods and services, plan and undertake construction activities, and operate their businesses. Accordingly, the City respectfully recommends that the Board of Trustees engage an independent consultant to conduct a full review of NYPA’s costs and processes via a management audit.

The Long-Term Agreement between the City and NYPA envisioned an annual process for setting the Cost-of-Service in which the City's concerns would be fairly and reasonably considered, and adjustments would be made as appropriate. Since 2005, the City has engaged in earnest reviews of the Cost-of-Service and in extensive discussions with NYPA Staff to understand the justification and rationale for the fixed cost items and cost levels. Where warranted, the City has raised concerns regarding the cost items in formal comments to the Board of Trustees. Despite the City's efforts, most of the City's concerns are generally not addressed and most of the costs that it has questioned have remained unchanged. From this perspective alone, the City looks forward to a future process that is more transparent and provides a better opportunity for setting rates that are fair and reasonable.

### **PROCEDURAL SETTING**

In 2014, with the concurrence from the NYCGCs, NYPA modified the process for development of the 2015 Cost-of-Service. A *“Preliminary Staff Report – New York City Governmental Customers Annual Planning and Pricing Process Analysis, Including: Preliminary 2015 Cost-of-Service (Base Variable Cost)”* was provided to the NYCGCs on July 7, 2014. As its name implies, that Report addressed only the variable cost aspects of the 2015 Cost-of-Service. It was used to assist NYPA and the NYCGCs in formulating their procurement plans for energy, capacity, and ancillary services for 2015.

On October 23, 2014, NYPA shared with the NYCGCs some of the figures that comprise the fixed cost portion of the 2015 Cost-of-Service. That information was updated on November 21, 2014. Then, on December 19, 2014, NYPA provided a *“Staff Report New York City Governmental Customers Annual Planning and Pricing Process Analysis, Including the Preliminary 2015 Cost-of-Service”* (“Preliminary Report”) to the NYCGCs. Discovery on the

fixed cost information began shortly after the figures were provided in late October and continued through the end of January.

Additionally, NYPA revised the presentation of certain fixed cost information to match other publicly available NYPA documents, such as its Operating Budget. These changes allowed the City to directly compare the Cost-of-Service information to the budget information presented to the Board of Trustees. Overall, this approach was an improvement to the process compared to prior years.

On December 16, 2014, the Board of Trustees approved a 2015 Operating Budget for NYPA and issuance of the Preliminary Report. A Notice of Proposed Rulemaking related to the 2015 Cost-of-Service was published in the January 7, 2015 edition of the New York State Register, making the deadline for public comments February 23, 2015.

Pursuant to the notice and the procedure set forth in the Long-Term Agreement between the City and NYPA, the City submits these comments on the fixed cost portion of the 2015 Cost-of-Service.

## **COMMENTS**

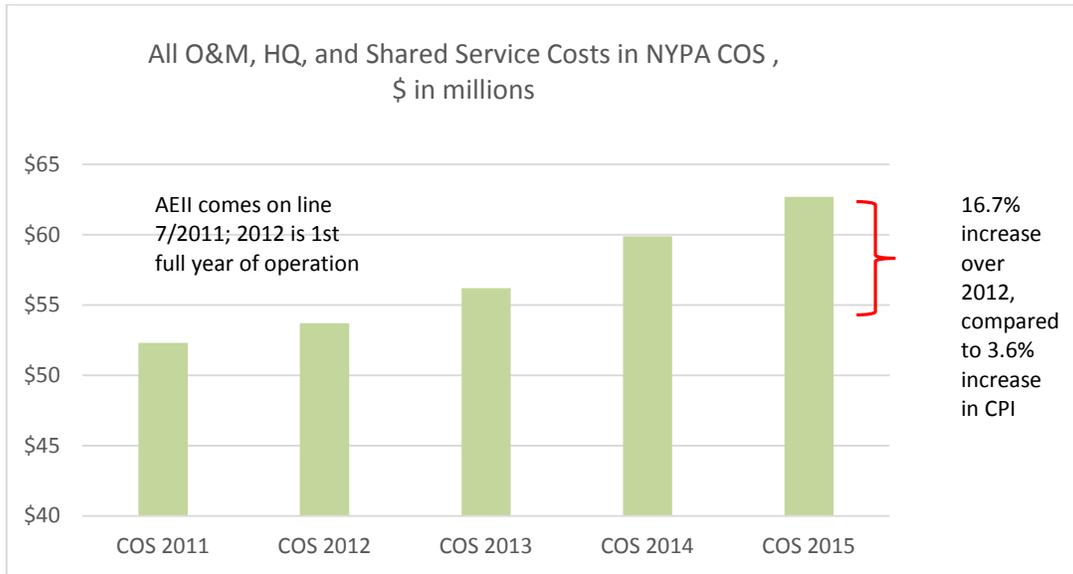
### **POINT I**

#### **THE RATE OF INCREASE OF THE FIXED COSTS IS EXCESSIVE AND UNREASONABLE**

Over the past few years, the City and other NYCGCs have had productive discussions with NYPA Staff regarding the management of the NYCGCs' supply portfolio and risk mitigation/hedging activities. These efforts, combined with lower natural gas and energy prices, have led to significant declines in the variable cost portion of the NYCGCs' Cost-of-Service. However, the same cannot be said for the portion of fixed costs of the NYCGCs' Cost-of-Service under the direct control of NYPA. As shown in Table 1, that part of NYPA's fixed costs have

grown considerably over the past five years – more than 4.5 times greater than the Consumer Price Index over the same period.

**Table 1**  
**Growth in Fixed Costs for NYCGCs**



The information provided by NYPA over the past few months does not support or justify these rate increases. Indeed, in many instances, the information primarily raises more questions than it answers. Although not a large dollar amount, a glaring example of the deficiency of the process pertains to the charge for demand side management. NYPA offered multiple justifications for this charge, but none have merit. The City believes that there are many items included in the Cost-of-Service that similarly cannot be justified as incurred to serve the NYCGCs. The inclusion of such items has inappropriately inflated the Cost-of-Service.

A. NYPA Staff And The Board Of Trustees Are Not Properly Determining The Reasonableness Of The Fixed Costs

Each year, the City submits comments to the Board of Trustees raising concerns with the level of fixed costs included in the Cost-of-Service. The analysis of the City's arguments, as set forth in the minutes from the Board of Trustees meetings at which the comments are considered, often only tangentially respond to the specific issues raised. In many instances, the analysis contains only a statement of the overall benefits provided by NYPA, or a comparison to the rates the NYCGCs would otherwise pay as full-service customers of Consolidated Edison Company of New York, Inc., rather than a response to the City's concerns or a justification of the disputed cost item. The failure to properly consider and address the City's concerns diminishes the validity of the Cost-of-Service process, and it demonstrates that the current structure must be substantially revised.

The Cost-of-Service process is akin to a regulated utility ratemaking process but with one substantial difference. In a rate case, a utility develops its cost projections for the rate year(s) at issue, presents those costs and the corresponding rates to the PSC and interested parties, there is a review process of the costs, and the PSC makes a final decision as to the level of the costs to be recovered from the utility's customers. Here, the intent of the Cost-of-Service process, as set forth in the Long-Term Agreement, is the same.<sup>1</sup>

NYPA is required to develop its cost projections for the subsequent year, present its costs to the NYCGCs, allow for review of and comment on the costs, and the Board of Trustees makes the final decision. The one substantial difference in this process is that the same NYPA Staff

---

<sup>1</sup> See, e.g., Section II.B.1.a of the Long-Term Agreement, which provides, in part “[f]ixed costs will include only those costs justified on the basis of cost causation principles, shall be consistent with accepted regulatory COS methodologies, and can be changed only through a rate case filing in accordance with SAPA.”

who initially develop the costs also review the City's comments and recommend what the final costs should be.<sup>2</sup>

In both the rate case and the Cost-of-Service process, the development of the cost projections and rates are performed on a bottoms-up basis. That is, costs are developed on a line-item basis, then grouped into different categories, then summed to determine the total revenue requirement. Thus, in determining the final Cost-of-Service, the relevant consideration is whether the costs are properly justified, reasonable, and appropriate.

Turning to the overall level of fixed costs proposed for 2015, the City respectfully submits that the continual year-over-year increases, at more than four times the rate consumer prices are increasing in general, for the non-debt-service portion of fixed costs, is not reasonable or justifiable. The excessive costs charged to the NYCGCs include the following.

B. Personnel Costs Are Excessive

Figure 2 of the Preliminary Report includes a cost of \$4.1 million in site payroll for the "Project" category "SENY," which NYPA has explained means personnel who are assigned to work on SENY matters.<sup>3</sup> In total, there are 30 full-time equivalent positions assigned to "SENY." Although the City asked for details regarding what the assigned individuals do, such information was never provided. The NYCGCs are also charged \$1.0 million for consultants and contracted services for "SENY." In addition, the NYCGCs are charged \$17.8 million as an allocated share of NYPA's headquarters costs, which costs presumably include some allocation

---

<sup>2</sup> While the final decision is made by the Board of Trustees, the minutes from the Board meetings demonstrate that the Board defers completely to NYPA Staff on this matter. *See, e.g.,* Minutes of the Regular Meeting of the Power Authority of the State of New York, dated January 28, 2014 ("2014 Minutes").

<sup>3</sup> Of this amount, \$3.9 million is charged to the NYCGCs.

of NYPA headquarters staff who provide services to the NYCGCs,<sup>4</sup> and \$2.1 million for site payroll, consultants, and NYPA headquarters staff for the Project category “AEII.” Managing the non-plant aspects of a supply portfolio and performing customer service and billing and accounting functions, without need to read meters, should not require 30 full-time equivalents plus an unstated number of allocated headquarters staff, consultants, and contractors.

Figure 2 of the Preliminary Report also includes a cost of \$4.5 million in site payroll plus \$1.7 million for consultants and contracted services for four small hydroelectric facilities (“small hydros”).<sup>5</sup> In total, there are 31 full-time equivalent people assigned to the small hydros. NYPA has confirmed that none of the four small hydros are staffed on a full-time basis. While there are both routine and non-recurring maintenance activities required at each hydro, NYPA has also explained that an unspecified percentage of such tasks are performed by consultants and contractors. Therefore, it defies credulity that NYPA needs 31 people to partially maintain four small hydros on a periodic basis. As with the SENY category, NYPA has not provided any information to the NYCGCs to justify the reasonableness of these labor and consultant costs.

C. Greater Assessment And Scrutiny Of Capital Investments In The Small Hydros Are Needed

The concerns with the excessive labor costs for the small hydros are exacerbated by the fact that such facilities cost the NYCGCs more to operate each year than the revenues they produce. Last year, the City disputed the reasonableness of spending hundreds of thousands of dollars to rebuild the Jarvis facility, a project that continues into 2015. In response, NYPA Staff

---

<sup>4</sup> As noted in footnote 1, the Long-Term Agreement requires the fixed costs to be limited to those costs incurred by NYPA to provide service to the NYCGCs. In the event the headquarters cost allocation does not reflect staff costs incurred to serve the NYCGCs, the inclusion of such costs is improper.

<sup>5</sup> The small hydros include Ashokan (4.75 MW), Crescent (9.95 MW), Jarvis (9.0 MW), and Vischer Ferry (9.95 MW).

acknowledged that the facilities are not economic, but that it has a responsibility to maintain the facilities as part of the NYCGCs' supply portfolio.<sup>6</sup>

Even though NYPA recognizes that the small hydros are uneconomic, it has never approached the NYCGCs to determine whether they want NYPA to continue to maintain the facilities. Such a discussion should occur, and all of the costs and benefits of the small hydros should be evaluated, before further capital investments are made in these facilities.

To ensure that there is no confusion about the City's position on the Jarvis rebuild, the City renews its comments from last year. As happened last year, this year NYPA again failed to justify why it needs to reverse engineer the equipment in order to fabricate replacements or why it could not procure replacement parts from the original equipment manufacturer. Further, 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.

Last year, NYPA Staff responded to the City's comments by claiming that "NYPA follows standard accounting and utility practice when determining whether an expenditure is a 'capital' or 'maintenance' expense."<sup>7</sup> That assertion was not correct. In New York and elsewhere, utilities follow the Uniform System of Accounts; NYPA does not. Under the Uniform System of Accounts, the reconstruction of the Jarvis facility's equipment would not be classified as a maintenance expense. For these reasons, NYPA is not following standard utility accounting practices.

---

<sup>6</sup> 2014 Minutes, pp. 41-42. The comment about the value of the entire portfolio in no way justifies continuation of these uneconomic units. Indeed, the portfolio would be more valuable without them.

<sup>7</sup> 2014 Minutes, p. 42.

For 2015, the City notes as well that there is a project to repaint and, as necessary, replace the tainter gates at the Crescent facility.<sup>8</sup> While the repainting is properly considered a maintenance expense, the replacement of the gate is not – that would be a capital investment under the Uniform System of Accounts. NYPA did not provide a breakdown of the costs for each aspect of this project, so the City cannot identify the amount by which the 2015 Cost-of-Service should be reduced. For both the Jarvis and Crescent projects, the Board of Trustees should direct NYPA Staff to determine and make the requisite adjustments to the fixed costs.

More importantly, before the Board of Trustees approves either project, it should require NYPA Staff to prepare and present cost-benefit analyses for the projects. The decision to proceed should not occur until the analyses are completed, the broader evaluation discussed above is conducted, and the NYCGCs are given the opportunity to provide meaningful input into the matter.

D. The Interest Rates Charged To The NYCGCs Are Not Consistent With The Requirements Of The Long-Term Agreement

The interest rates NYPA charges to the NYCGCs are excessive and inappropriate. These include alleged “lost opportunity” costs and the variable debt service expenses, including the commercial paper interest rate. According to NYPA’s “*2015-2018 Approved Budget and Financial Plan*,” its assumed interest rate on commercial paper in 2015 is only 0.75% (and only 1.00% for 2016). However, NYPA is charging the NYCGCs between 4.5% and 6.5% for commercial paper debt service expense.

Last year, the City objected to these interest rates charged by NYPA. In response, NYPA Staff asserted that such rates were essentially locked-in when the Long-Term Agreement was

---

<sup>8</sup> See “2015 Non-Recurring Tasks” document, provided by NYPA on November 21, 2014, p. 2.

executed in 2005. NYPA Staff offered no citation to any provision in the Long-Term Agreement or other factual basis to support that assertion. The City submits that NYPA Staff's position is without merit as there is no contractual or factual basis for it. The Long-Term Agreement did not freeze short-term variable interest rates at their 2005 levels. In fact, NYPA Staff's position is inconsistent with the express terms of the Long-Term Agreement – when NYPA's commercial paper interest rate is only 0.75%, inclusion of interest rates that are above NYPA's actual rate cannot be costs "reasonably incurred to provide service to the [NYCGCs]," as required by Section II.B.1.a of the Long-Term Agreement.

The City acknowledges that NYPA uses a variety of debt instruments, and their interest rates vary and can be higher than the commercial paper rate. Accordingly, the City has recalculated the fixed costs using interest rates of 2% and 3% for those items for which interest was included, other than fixed debt instruments. The result is a reduction in the overall fixed costs of \$6.02 million at the 2% rate and \$4.00 million at the 3% rate. For 2015, the City therefore asserts that the fixed costs should be reduced by \$6 million, but not less than \$4 million, to reflect the actual costs that will be incurred by NYPA in 2015.

E. The Use Of Consultants And Contractors Should Be Reduced

Absent clear justification, the increase in the use of consultants and contracted services is unjustified and should be rejected. The City has raised numerous concerns over the past few years regarding these cost categories. For 2015, the costs for these two categories have increased dramatically. Compared to 2014, the costs for contracted services are higher by more than 35% and the cost for consultants is higher by almost 82%. Compared to the average over the prior four years, the increases are about 46% and 66%, respectively. In the same manner that Con

Edison, other utilities, and many businesses in New York and across the nation have become more efficient and reduced spending, so too must NYPA.

Moreover, NYPA's attempted justification for the use of contractors and consultants was inadequate. For example, NYPA stated that it retains both contractors and consultants to perform recurring maintenance work.<sup>9</sup> However, NYPA did not provide any explanation as to why it could not perform such maintenance work with the 31 full-time equivalents assigned to the small hydros or the 1,075 NYPA employees assigned to operations, and it did not explain why it needs both contractors and consultants to perform maintenance work. Over \$8 million is included in the fixed costs for these tasks, but there is nothing in the Preliminary Report, discovery responses, or other information provided by NYPA to the NYCGCs to justify this level of spending.

More broadly, NYPA has not justified the overall expenses for these cost categories, or why the level of expenses has increased so substantially.<sup>10</sup> Because the City was not given a complete breakdown of these costs, it was not able to properly review the composition of these cost items and cannot offer comments on the merits of any particular consultant or contractor expense. Given the lack of justification, at a minimum, the overall costs should be reduced to be in line with prior years. Doing so results in a reduction in contracted services costs of \$4 million and in consultant costs of \$800,000.

---

<sup>9</sup> NYPA responses to NYC IRs 29a and 30b.

<sup>10</sup> For example, in response to a request by the City for justification of the contracted services expenses, NYPA did not provide a complete explanation for the increase in those expenses. NYPA response to NYC IR 29a. A mere reference to a "majority" of the increase is unduly vague as 51% could constitute a majority of expense, leaving 49% of the increase unjustified. Because NYPA provided no allocation of the expenses to different projects or facilities, the response is insufficient to satisfy the justification requirement of the Long-Term Agreement.

It is possible that deeper reductions would be appropriate. The City urges the Board of Trustees to carefully examine these costs before approving the 2015 Cost-of-Service.

F. Vehicle-Related Costs Are Unjustified And Excessive

In order to better understand why the fixed costs are increasing at such a high level, the City this year attempted to engage in a fuller assessment of capital costs recovered from the NYCGCs than it had in past years. NYPA explained that it segregates the capital investments for the 500 MW unit into five categories – other, vehicle, forklift, spare transformers, and summer 2008 outage. While most of the capital costs are in the “other” category, costs in the “vehicle” category stood out. The documentation provided by NYPA in support of its response to NYC IR 14 reveals that since 2006, NYPA has purchased 17 vehicles other than forklifts for the 500 MW unit and Poletti.<sup>11</sup> Considering that Poletti ceased operating in 2008, presumably NYPA is not continuing to make capital investments in a closed facility (if it is, that raises a separate set of concerns). Inasmuch as the 500 MW unit is a single, fixed location facility, 17 vehicles to operate that site seems excessive.

As noted above, the Long-Term Agreement requires that the fixed costs in the Cost-of-Service must encompass only those costs reasonably needed to provide service to the NYCGCs. NYPA has not justified the need for 17 vehicles at the 500 MW unit. Therefore, these costs, which amount to over \$777,000, should be removed from the Cost-of-Service, or the amount included should be substantially reduced to encompass only one or two vehicles.<sup>12</sup>

---

<sup>11</sup> The inventory includes four cars, six trucks, six sport utility vehicles, and one van.

<sup>12</sup> Because the cost of the vehicles is capitalized and recovered over five year periods, the Cost-of-Service reflects only a portion of the total capital cost. The Board of Trustees should direct NYPA Staff to calculate the total amount charged to the NYCGCs in the 2015 Cost-of-Service and remove that amount from the fixed costs. Going forward, these capital costs should be removed from the development of the fixed costs altogether.

G. The Black Start Charges Must Be Reviewed

The same documentation discussed above also shows that the NYCGCs have been charged a total of \$726,785 for black start equipment at the 500 MW unit since 2008. These charges are curious because the 500 MW unit does not possess black start capability.

If the 500 MW unit has such capability, it should have been participating in the NYISO's black start program and receiving revenues under the NYISO's Rate Schedule 5. However, none of the figures that comprise the 2015 Cost-of-Service (or any of the other Costs-of-Service since 2008) show any black start revenues as being received from the NYISO. Moreover, the City has been very active in discussions at the NYISO regarding the black start program in New York City, and one of the program participants' complaints has been that none of the recent entrants, including the 500 MW unit, have black start capability. NYPA has also participated in these discussions, but it never refuted these complaints or otherwise asserted that the 500 MW unit has black start capability.

Unless NYPA can demonstrate that these charges relate definitely to near-term black start capability at the 500 MW unit, the costs should be removed.<sup>13</sup>

H. The Treatment Of Spare Parts Is Inconsistent

Over the past few years, the City has objected to the inclusion of a charge in the fixed costs related to obsolete materials and supplies acquired for, but never used at, Poletti. NYPA claimed that it was carrying the costs of such parts and supplies on its books, that the NYCGCs would be charged such costs when the parts were placed into service, and that the NYCGCs

---

<sup>13</sup> As with the vehicle costs, the carrying charges should be subtracted from the 2015 Cost-of-Service, and the capital costs should be removed from the development of future years' Costs-of-Service.

therefore should compensate NYPA for the costs of such parts. Implicit in that explanation is that the NYCGCs were not being charged when NYPA acquired the inventory.

However, at the 500 MW unit, it appears that NYPA is not following the same procedure. As noted above, one of the categories of capital costs charged to the NYCGCs pertains to spare transformers. Since 2008, NYPA has incurred capital costs of over \$4.5 million for these presumably (as the category name indicates) spare parts. These costs are being depreciated over either 21 or 20 years, with the annual carrying charge included in the fixed costs.

NYPA has not provided any justification for the disparate treatment of these spare parts compared to the spare parts from Poletti, and the City cannot discern any reason for the inconsistent approaches. Therefore, the carrying costs for the spare transformers should be removed from the 2015 Cost-of-Service, and those capital costs should be removed from the development of future years' Costs-of-Service. Conversely, if the treatment of the costs of these spare parts is consistent with NYPA's accounting practices, then NYPA has been double-charging the NYCGCs for the Poletti materials and supplies inventory, and all historical and current charges for such inventory must be reversed and the NYCGCs credited for those improper charges.

## **POINT II**

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

For the last two years, the City has asked the Board of Trustees to improve the economics of the 500 MW unit by restructuring the unit's 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 additional adjustments are warranted.

As noted above, NYPA Staff has asserted that it adheres to standard utility accounting practices. Under standard utility accounting practices, the capital investment in a facility is recovered over its entire life, commencing with the date it commences operation. Here, NYPA will recover much of its investment in a power plant over a period of up to 17 years even though its life span is expected to be 30 years or more. This expedited recovery is demonstrated by the schedules in the Preliminary Report; other information suggests that NYPA will recover its entire investment over this condensed time period.<sup>14</sup>

In response to the City's previous comments on this subject, neither NYPA Staff nor the Board of Trustees has offered any reason why recovery over a compressed time period of about one-half of the 500 MW unit's expected service life is reasonable or required. This year as well, the Preliminary Report contains no explanation as to the reason for the expedited recovery.

The economics of the 500 MW unit would be enhanced if the fixed rate debt service expense is restructured 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.<sup>15</sup>

NYPA Staff's analysis of this request last year was limited to a statement that the request would increase NYPA's risks.<sup>16</sup> NYPA Staff did not provide any details regarding the extent to

---

<sup>14</sup> The 500 MW unit commenced commercial operations in 2006. One ratings agency, Moody's, has reported that NYPA will retire its debt related to the 500 MW unit by 2017. See "Moody's affirms P-1 short-term rating on the New York State Power Authority's commercial paper notes," dated December 6, 2013, p. 2. Based on information in the Preliminary Report, the City estimates that NYPA will have recovered more than 75% of the original cost by 2017 – an amount that is far larger than what any regulated utility in New York would have recovered over the same time period.

<sup>15</sup> Copies of the relevant pages from the 2012 comments are included in Appendix A.

<sup>16</sup> 2014 Minutes, p. 43.

which it believed NYPA's risks would increase, nor did it provide any justification for the accelerated cost recovery that now exists.

Regardless of what happens after the Long-Term Agreement expires in 2017, NYPA will continue to own the 500 MW unit, and it can bid the plant's output into the NYISO's wholesale markets. NYPA will receive energy, capacity, and ancillary service revenues for that output. Thus, NYPA's risk will be no greater than the risk experienced by other suppliers in the NYISO's in-City wholesale markets, and any claim that NYPA would be unable to recover its costs would be baseless.

Indeed, NYPA Staff's claim is disproven by an examination of the market prices it would receive for the sale of the 500 MW unit's output. The City conducted an analysis of the potential impacts of its proposal, and whether NYPA would experience any real risk of not recovering its investment in the 500 MW unit. That analysis revealed that NYPA would need capacity revenues of between \$4/kW-month and \$8/kW-month to fully recover its costs over the expected life of the 500 MW unit. The winter spot market price for in-City installed capacity is above \$8/kW-month, and the summer prices have been more than double the \$8/kW-month level. Even with new supply projects that are proposed for New York City, future clearing prices are not projected to decline to levels that would prevent NYPA from recovering its costs. Thus, the facts demonstrate that there is little to no risk of NYPA not recovering its costs if the City's requested relief were to be granted.

In contrast, the savings to the NYCGCs associated with matching the debt service to the service life of the 500 MW unit would yield annual savings to the Cost-of-Service of approximately \$20 million per year. This value estimate was derived largely from the difference between the interest rates applicable to the existing Series C 2007 and Series A 2011 bonds and

the interest rates available to NYPA at present. Based on prior discovery responses, the City understands that the outstanding bonds cannot be refinanced, and the City is not proposing that they be refinanced. However, NYPA has multiple available methods of extending the investment recovery period without adversely impacting these fixed debt instruments. Put another way, there is no reason why NYPA needs to tie the charges to the NYCGCs for cost recovery for the 500 MW unit directly to the costs NYPA incurs under these two bond issuances.

With the exceptionally low interest rate market, a defeasance would be particularly worthwhile as it would result in substantial interest rate savings. To develop its savings estimate, the City assumed that the defeasance would be funded by a new municipal bond issuance with the proceeds invested in U.S. Treasury securities. As those securities mature, they would produce annual cash flows sufficient to pay the annual debt service on the existing bonds. The Cost-of-Service savings are derived from the difference in the annual debt service on the new issuance and the debt service on the Series C and A bonds.

The Long-Term Agreement does not require the NYCGCs to shield NYPA from all risk or to fully compensate NYPA for all of its capital investments within the term of the Agreement, and it is unreasonable for NYPA to inflate the fixed cost portion of the Cost-of-Service to eliminate all of its risk and to so expeditiously recover those investments. For all of the foregoing reasons, the City respectfully requests that, consistent with standard utility accounting principles, the Board of Trustees extend the recovery period for the fixed rate debt service expense to no less than 30 years and reduce the 2015 Cost-of-Service by \$20 million.

### **POINT III**

#### **THE DSM CHARGE SHOULD BE ELIMINATED**

While the City does not usually file Comments objecting to smaller fixed cost items, the circumstances surrounding the Demand Side Management (“DSM”) charge warrant specific mention. Since at least 2007, and possibly earlier, one of the items of “Other Expense” charged to the NYCGCs was a DSM charge of either \$400,000 or \$500,000. In the 2007 Cost-of-Service, the DSM charge was included in Figure 11. Since 2008, it has been included on Figure 5.

The City believed that at one time, DSM charges derived from NYPA’s Peak Load program costs. This year, the City inquired about the purpose of this charge. NYPA provided two different sets of answers, neither of which is meritorious.<sup>17</sup> NYPA’s current claim is that the costs are an allocation of costs for renewable energy and clean energy project charges (neither of which can be considered DSM-related). In support of this claim, NYPA provided an itemization of past projects; the largest in 2014 was Build Smart New York, which is for state buildings. Most of the projects on the list are location-specific and should be paid for by the customers who directly benefit from them.

Section II.B.1.a of the Long Term Agreement provides that the fixed costs “must be justified as reasonably incurred to provide service to the [NYCGCs].” Clearly, the costs of renewable energy projects undertaken for municipalities and other NYPA customers outside of the New York City area could not have been incurred to provide service to the NYCGCs, nor can they be considered DSM costs. As such, even under NYPA’s new rationale, the costs are not properly included in the NYCGCs’ Cost-of-Service.

---

<sup>17</sup> See NYPA response to NYC IR 17b, provided December 10, 2014 and January 5, 2015, and Action Items for Jan. 7, 2015 COS Meeting – update 013015, response to NYC IR 17.

Accordingly, the Board of Trustees should (i) remove the \$400,000 DSM charge from the 2015 Cost-of-Service, and (ii) provide a credit to the NYCGCs equal to the total DSM charge included in past years' Costs-of-Service.

#### **POINT IV**

#### **RESEARCH AND DEVELOPMENT COSTS SHOULD NOT BE ALLOCATED VIA LABOR RATIOS**

As part of its review of the fixed costs, the City inquired about the research and development (“R&D”) programs that comprise the \$8.8 million amount included on Figure 3 of the Preliminary Report. NYPA explained that the R&D costs generally comprise three categories – membership dues to the Electric Power Research Institute, payments to the New York State Energy Research and Development Authority, and R&D projects undertaken by NYPA – and are allocated amongst its operating organizations on a labor ratio basis.<sup>18</sup> NYPA also provided a brief summary of the general types of its R&D projects.<sup>19</sup>

A review of this summary reveals that it is improper to allocate the R&D costs on a labor ratio basis. The summary makes clear that the R&D projects are specifically related to individual operating organizations and can easily be allocated to those organizations. Moreover, a labor ratio-based allocation is inconsistent with the requirement in the Long-Term Agreement that the fixed costs must be “reasonably incurred to provide service to the [NYCGCs].” Many of the R&D projects have no direct relationship to NYPA’s responsibilities under the Long-Term Agreement. For those projects, NYPA therefore has no valid basis to allocate their costs, in whole or in part, to the NYCGCs.

---

<sup>18</sup> NYPA response to NYC IR 22b and 22d.

<sup>19</sup> Action Items for Jan. 7, 2015 COS Meeting – update 013015, response to NYC IR 22b.

Because NYPA did not provide the costs associated with each project or type of project, the City cannot provide a calculation of the amount it is being overcharged. Inasmuch as NYPA Staff has, or should have, such information, the Board of Trustees should direct NYPA Staff to revise the allocation to be consistent with the Long-Term Agreement and adjust the fixed costs correspondingly.

#### **POINT V**

#### **POLETTI DECOMMISSIONING COSTS CONTINUE TO BE A CONCERN**

In prior years, the City has submitted extensive comments regarding the decommissioning costs for Poletti. For the most part, NYPA Staff and the Board of Trustees have disregarded these comments. Last year, NYPA Staff advised the Board of Trustees that the decommissioning budget was \$47 million, and some “slight movement” was to be expected.<sup>20</sup> In response to the City’s claim that the decommissioning charge for the 500 MW unit was too high and unsubstantiated, NYPA Staff observed that the decommissioning estimate was developed, reviewed, and adjusted by NYPA’s Cost Estimation group, “which has decades of valuation experience with NYPA generation and transmission assets.”<sup>21</sup>

In 2014, NYPA advised the NYCGCs that the Poletti decommissioning costs were escalating substantially, that it had already exceeded its contingency budget by \$2.7 million, and that it was adding another \$11.3 million of costs to the project.<sup>22</sup> While the City recognizes that some changes to pre-established plans can arise when those plans are executed, the magnitude of the changes appear to support the City’s continued assertions that NYPA did not properly or

---

<sup>20</sup> 2014 Minutes, p. 44.

<sup>21</sup> *Id.*

<sup>22</sup> “*Poletti Project Decommissioning Cost Update*,” provided on November 21, 2014.

prudently plan the decommissioning of Poletti, and that had it prepared a complete decommissioning plan *before* commencing the work, at least some of these additional costs could have been avoided. Further, given the decades of experience of the group responsible for developing the decommissioning costs, it is reasonable to assume that the group should have been better able to forecast the decommissioning costs and needs and more accurately plan the decommissioning process.

The City was not given sufficient information to perform a proper engineering review of the initial plans, the reason for the changes, or the reasonableness of NYPA's assumptions. Whether and to what extent the additional charges could have been avoided is not known. Therefore, under the circumstances, the City believes that NYPA should accept some of the responsibility for these changes and absorb a portion of the cost overruns. An equal division of those additional costs would be fair, resulting in a reduction in the decommissioning costs of \$8 million.<sup>23</sup>

## **POINT VI**

### **THE AMOUNTS CHARGED FOR DEPRECIATION SHOULD BE REVIEWED**

As part of its review of the fixed costs this year, the City examined into the manner in which NYPA recovers its capital investments. The City now has a better understanding of NYPA's approach, but its review raised a few questions that warrant further analysis by NYPA.

First, as a result of the City's questions, NYPA reviewed its capital additional summary for Poletti and the 500 MW unit. That review resulted in a series of adjustments. In explaining

---

<sup>23</sup> Inasmuch as NYPA charges the NYCGCs a fixed amount each year for the decommissioning expense, this adjustment would reduce the total amount owed, but not necessarily the annual charge.

this matter to the NYCGCs, NYPA asserted that it had been undercollecting its depreciation expenses.<sup>24</sup> However, the information supporting this statement, provided in the fourth sheet of the same document, indicates that NYPA was slightly overcollecting its depreciation expenses. The City could not reconcile the information provided and respectfully requests that the Board of Trustees direct NYPA Staff to review its calculations and ensure that the NYCGCs are not overcharged.

Second, the City requested information regarding the difference between minor additions and capital additions. NYPA explained that additions under \$750,000 are considered “minor” and additions over that amount are considered “capital.”<sup>25</sup> However, the City’s review of the documentation provided by NYPA revealed that this definition is not consistently applied.<sup>26</sup> The City could not discern the reason for the differences between the definitional distinction and the actual treatment of some investments (summing the costs of projects that spanned multiple years provided only a partial explanation). Because of the differences in the manner in which minor and capital additions are recovered, it is important that the definition be properly applied. Accordingly, the City respectfully requests that the Board of Trustees direct NYPA Staff to review this matter and ensure that the NYCGCs are not overcharged.

---

<sup>24</sup> See “Capital Recovery Charges,” first sheet, provided by NYPA on January 16, 2015 (the document was entitled “Explanations.xlsx”).

<sup>25</sup> NYPA response to NYC IR 14.

<sup>26</sup> See, e.g., “Customer Additions Customer Template,” sheets “Capital Additions” and “Minor Additions,” provided by NYPA on January 16, 2015.

## POINT VII

### **NYPA SHOULD ENGAGE IN A COMPREHENSIVE REVIEW AND AUDIT OF ITS MANAGEMENT AND OPERATIONS**

Under Public Service Law §66(19), the PSC is required to perform a comprehensive audit of the management and operations of each of the major electric and gas utilities at least once every five years. That law also requires the PSC to review the utilities' compliance with the recommendations from the audits every time the utilities seek new rates.

The PSC ceased performing such audits in the early 1990s, and utility rates rose dramatically over the next 15 or so years. Utility costs similarly grew, and many questions were raised about the efficiency of the utilities' procurement and construction practices and operations. Starting in 2008, the PSC resumed performing audits under Public Service Law §66(19). The results have been striking.

The first audit performed was of Con Edison.<sup>27</sup> The audit revealed extensive inefficiencies, mismanagement and poor management, sub-standard procurement practices, and other problems. The PSC directed Con Edison to implement the many recommendations in the audit. When the utility did so, it was able to reduce its capital spending and operations and maintenance expenses by hundreds of millions of dollars. These savings inured directly to the utility's customers. In part because of the audit, Con Edison's rates have been essentially flat since 2012.

In contrast, as shown in Table 1, the portion of NYPA's fixed costs excluding debt service for the NYCGCs have increased each year since 2012, in total by 16.7%. The Consumer Price Index over the same time period has grown by only 3.6%. As discussed herein, the

---

<sup>27</sup> See PSC Case 08-M-0152, Comprehensive Management Audit of Consolidated Edison Company of New York, Inc.

information provided by NYPA in support of the proposed 2015 fixed costs suggests many of the same problems and inefficiencies identified in the Con Edison Management Audit

The City recognizes that NYPA is not governed by Public Service Law §66(19) and is under no legal obligation to perform a management or operational audit. But, there is no prohibition under NYPA's enabling legislation in the Public Authorities Law against such audits, and the value of the utility audits performed to date are indisputable.

NYPA and its Board of Trustees should embrace the concept of a management audit, and they should commission one as soon as possible.<sup>28</sup> And like the audits performed by the PSC, it is essential that the audit be independent, and that the auditors be given the ability to review any and all records and access to all personnel and contractors. Given NYPA's public responsibilities and customer base, it should want to become more efficient and lower its operating costs.

The likely savings from the audit would more than justify the cost of the audit. Moreover, the audit would give the City, NYCGCs, and other NYPA customers confidence that the costs levied on them are reasonable and legitimate. For all of the foregoing reasons, the City respectfully urges the Board of Trustees to direct the performance of a management audit of NYPA's practices and operations.

---

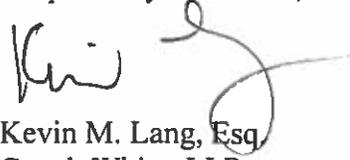
<sup>28</sup> The audits NYPA performs now, using both internal and external resources, are not the same as a management/operational audit, and they do not serve the same, or similar purposes.

**CONCLUSION**

The City respectfully requests that the NYPA Board of Trustees adjust the level of fixed costs for the 2015 Cost-of-Service and adopt other changes in accordance with the discussion and recommendations set forth herein.

Dated: February 23, 2015  
Albany, New York

Respectfully submitted,



Kevin M. Lang, Esq.  
Couch White, LLP  
*Counsel for the City of New York*  
540 Broadway  
P.O. Box 22222  
Albany, New York 12201-2222  
Tel: 518-426-4600  
Email: [klang@couchwhite.com](mailto:klang@couchwhite.com)

# **APPENDIX A**

**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**

<b>Table 1</b>			
<b><u>500 MW Facility Actual/Projected Annual Net Costs/(Benefits)</u></b>			
<b><u>(\$ Millions)</u></b>			
<b><u>Year</u></b>	<b><u>Revenues &amp; Capacity Value</u></b>	<b><u>Fuel &amp; Fixed Costs</u></b>	<b><u>Net Cost/(Benefit)</u></b>
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,<sup>4</sup> 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

---

<sup>4</sup> 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,<sup>5</sup> 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

---

<sup>5</sup> *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.”<sup>6</sup> 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).<sup>7</sup> 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).<sup>8</sup> 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

---

<sup>6</sup> NYPA Response to City Request 31a, dated July 26, 2012.

<sup>7</sup> 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.

<sup>8</sup> 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.<sup>9</sup>

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.

---

<sup>9</sup> *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.