



**Date:** September 27, 2016

**To:** THE TRUSTEES

**From:** THE PRESIDENT and CHIEF EXECUTIVE OFFICER

**Subject:** Increase in New York City Governmental Customer Fixed Costs – Notice of Proposed Rulemaking

SUMMARY

The Trustees are requested to authorize a Notice of Proposed Rulemaking (“NOPR”) to increase the Fixed Costs component of the production rates by \$16.6 million or 12.7%, excluding Astoria Energy II (“AE II”) plant expenses to be charged in 2017 to the New York City Governmental Customers (“Customers”). AE II plant expenses, although part of the Cost of Service (“COS”), 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 2017 COS.

In addition, the Trustees are requested to direct the Corporate Secretary to file the 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”). This year, the Customers requested that the Authority issue updated Fixed Cost figures at the end of November 2016, along with backup information, that are to be included in the Authority’s 2017 budget. The Customers will comment on the updated Fixed Costs component as it is made available per the mutually agreed-upon timeline. Barring any material changes to the Preliminary 2017 Fixed Costs, the 45-day statutory comment period concerning this proposed rate action will close December 5, 2016. If there are any material changes to the originally proposed Fixed Costs, the Authority agreed to extend the public comment period to December 16, 2016, to allow the Customers more time to review the updated Fixed Costs. Upon closure of the aforementioned comment period, Authority staff will take into consideration any concerns raised and return to the Trustees at their January 2017 meeting to seek final adoption of this proposal.

Further, since the proposed Fixed Costs increase exceeds 2.0%, a public forum will be held in accordance with the Authority’s policy. A public forum allows the Customers an additional opportunity to voice their concerns regarding the increase in the 2017 Fixed Costs component. Trustee authorization is also requested to direct the Corporate Secretary to provide all appropriate notice for such public forum.

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-1900s 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 a collaborative process for acquiring resources, managing risks 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. This year, the Customers have requested that they receive an update to the Fixed Costs proposal closer to the time of the Authority’s development of its 2017 budget. Staff has agreed to share updated preliminary 2017 Fixed Costs figures with the Customers by the end of November 2016. At that time, if there are any material changes from the currently proposed O&M and Shared Services Fixed Costs, the Authority will extend the public comment period to December 16, 2016, giving the Customers more time to understand and analyze the revised proposal and to submit comments on the modified Fixed Costs, if warranted.

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 the Authority 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 the Authority 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 the Authority 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, the Authority may use a true-up mechanism to assess charges for under-recovery and apply credits for over-recovery of costs. The 2017 costs related to the AE II service are \$142.9 million and have been included in the Preliminary 2017 COS but are not subject to this NOPR proceeding and therefore do not require further approval.

In the rate-setting process for the 2017 rate year, the Customers selected an “Energy Charge Adjustment (“ECA”) with Hedging” option as the cost-recovery mechanism. Under this mechanism, all Variable Costs are passed on to the Customers. In other words, the charges for electric service during the rate year are subject to an adjustment based on the difference between the Variable Costs actually incurred to serve the Customers and the Variable Costs recovered by the Authority under its tariffs in the rate year. Costs associated with hedging activities for the purpose of reducing volatility are normally assigned to the Variable Costs upon the Customers’ selection of a hedging strategy.

## DISCUSSION

Based on the Preliminary 2017 COS, the increase in Fixed Costs is \$16.6 million, or 12.7% higher than the Fixed Costs included in the Final 2016 COS. These Fixed Costs are subject to review under this SAPA proceeding. Contributing to the 12.7% increase in Fixed Costs is a projected \$6.9 million increase in O&M, a \$5.3 million increase in Other Expenses, a \$3.3 million increase in Capital Cost, and a \$1.1 million increase in Shared Services as compared to those levels in the Final 2016 COS.

The increase in O&M is mainly driven by a planned increase in work at the Small Hydro facilities, of which the major projects are the continuation of tainter gate painting and concrete repair at Crescent, roof replacement at the Crescent and Vischer Ferry plants, and rebuilding Unit #1 at Jarvis.

The stated increase in Other Expenses is \$5.3 million in the Preliminary 2017 COS as compared to the Final 2016 COS. However, in the 2016 Final COS, a total one-time \$5.4 million credit to correct historical cost accounting related to Demand Side Management and Load Research Studies was recorded under Other Expenses and issued to the Customers. Not including the one-time \$5.4 million credit recorded last year, Other Expenses were \$8.6 million, indicating a decrease by approximately \$100,000, or 1.2%, in Other Expenses (\$8.5 million) in the Preliminary 2017 COS.

The \$3.3 million increase in Capital Cost is mainly attributable to increases in both fixed and variable debt payments, specifically scheduled principal re-payments, for the 500 MW CCU.

The \$1.1 million increase in Shared Services is due to an overall projected increase in the Authority's Headquarters and Research and Development ("R&D") costs.

Variable Costs are projected to increase by a total of \$67.6 million, or 19.1%, as compared to the Final 2016 COS. Although Variable Costs are not subject to this NOPR, for the Trustees' information, Authority staff has included two new cost elements, the Clean Energy Standard ("CES") charge and the New York Transco cost recovery, within the Preliminary 2017 Variable Costs. The CES charge consists of a Zero Emission Credit ("ZEC") and a Renewable Energy Credit ("REC") charges. These charges have been developed by the New York Public Service Commission to support the adoption of Clean Energy Standard. The CES implements the clean energy goals of the New York State Energy Plan. ZECs are payments made to nuclear plants to support the preservation of existing at risk nuclear zero emissions attributes. Procurement of RECs is based on an obligation to invest in renewable generation resources to serve the Load Serving Entity's retail customers. It is estimated to cost the Customers approximately \$23.3 million to purchase ZECs and RECs for their load in 2017. New York Transco costs are allocated to the Authority as a Load Serving Entity as part of the NYISO charges in accordance with the New York Transco settlement agreement approved by the Federal Energy Regulatory Commission. The New York Transco Costs for the Customers are estimated to be approximately \$4.0 million in 2017. In addition, it is projected that fuel expenses for Astoria Energy II and the 500 MW CCU will increase by \$29.9 million.

Based on preliminary analyses, Authority staff projects that the overall 2017 production COS, combining the Fixed and Variable Costs, will increase by \$86.4 million, or 13.8%, as compared to the Final 2016 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. After closure of the comment period concerning the revised proposal, Authority staff will take into consideration any concerns raised and will return to the Trustees to seek final adoption of an appropriate Fixed Costs rate at their January 2017 meeting. Subsequent to such final adoption, staff will incorporate the approved final 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 2017 billing period.

### FISCAL INFORMATION

The adoption of this proposal would result in the Authority recovering the Fixed Costs incurred with the service of these Customers in 2017.

## RECOMMENDATION

The Manager – Pricing & Energy Market Analysis and the Vice President – Finance recommend that the Trustees authorize the Corporate Secretary to file a Notice of Proposed Rulemaking in the New York State Register for the adoption of an increase in the Fixed Costs component of the production rates (comprising non-AE II costs) by \$16.6 million to be charged in 2017 to the New York City Governmental Customers.

It is also recommended that the Vice President – Finance, 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, I recommend the approval of the above-requested action by adoption of the resolution below.

Gil C. Quiniones  
President and Chief Executive Officer

## **RESOLUTION**

RESOLVED, That the Vice President – Finance, or his designee, be, and hereby is, authorized to issue written notice to the affected Customers of this proposed action by the Trustees for a projected \$16.6 million, or 12.7%, increase in the Fixed Costs of serving the New York City Governmental Customers when comparing those costs contained in current rates to 2017 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 Fixed Costs through a rate filing under the State Administrative Procedure Act; 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 increase, including those notices required for a public forum, and proposed tariff modification; 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 agreements, certificates and other documents to effectuate the foregoing resolution, subject to the approval of the form thereof by the Executive Vice President and General Counsel.