New York Power Authority

Staff Analysis of Public Comments and Recommendations

Rate Modification Plan – Rate Years 2011 to 2014

Including:

Revised Cost of Service

Appendix A

November 2011

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Part I: Introduction

This Staff Analysis of Public Comments and Recommendations ("Staff Analysis") is being issued by the New York Power Authority ("Authority" or "NYPA") in November 2011 to analyze the comments received in the Authority's hydroelectric preference rate proceeding for the 2011 to 2014 Rate Years, and to support the final rates requested to be approved by the Authority's Trustees. Part I of this Staff Analysis provides background on the July 2011 proposed rulemaking, the public comment period and the proposed final rates. Part II contains the Authority staff's analysis and disposition of the issues raised in the public comments.

A. Background

1. July 2011 Proposed Rulemaking

At their meeting of July 26, 2011, the Trustees authorized a notice of proposed rulemaking ("NOPR") for a 3½-year rate plan to increase the rates for hydroelectricity applicable to preference power customers. The Authority proposed new rates to cover the period from November 1, 2011 to April 30, 2015. The proposed rate plan was prepared by the Authority staff and explained in its "Preliminary Staff Report, Hydroelectric Production Rates, Rate Modification Plan – Rate Years 2011 to 2014" ("Preliminary Staff Report"). Preference power is the hydroelectricity sold from the Authority's Niagara Project and St. Lawrence Project (collectively, the "Hydro Projects") for "domestic and rural" use as defined under New York Public Authorities Law § 1005(5) ("PAL") and the Niagara Redevelopment Act, 18 U.S.C. § 836(b)(1) (2011) ("NRA"). NYPA's sales of hydroelectricity at the preference power rate apply to forty-seven in-state municipal electric systems and four rural electric cooperatives (collectively, "NY Munis & Coops"), three upstate investor-owned utilities ("IOUs"),[1] the

[1] Until August 1, 2011 the residential customers served by the three upstate IOUs received 455 MW of firm preference power. These allocations were withdrawn in accordance with New York State law that redirects such power and energy for the Recharge New York power program. These IOUs, however, will continue to receive their allocations of "firm peaking" preference power.

neighboring states customers ("NS Customers")[2] and the Niagara Project Relicensing Host Communities ("Host Communities") and other entities who received hydropower allocations as part of the Niagara Project relicensing process (collectively, with the Host Communities, the "Relicensing Customers").[3]

2. Ratemaking Principles

The Hydroelectric Cost-of-Service ("Hydro CoS" or "CoS") in the Preliminary Staff Report is based on an update of the cost elements using the same ratemaking principles and methodologies employed by the Authority when setting preference power rates in 2003 and included in the January 2003 Report on Hydroelectric Production Rates ("January 2003 Report"). Subsequent to the 2003 rate action, such principles and methodologies were later agreed to by all the NY Munis & Coops, the bargaining agents for the NS Customers and the Relicensing Customers. Each of these customers agreed through either a long-term contract or settlement agreement with the Authority that it would not object to those ratemaking principles and methodologies in subsequent Authority rate increases for the term of their contracts or settlement agreements.

In 2007, the Authority proposed, and later adopted, a preference rate increase based on updated cost information and the ratemaking principles that had already been agreed to by the aforementioned customers.

The key agreed-upon principles and methodologies from the January 2003 Report include:

i. The principles set forth in the March 5, 1986 Settlement Agreement (Appendix B to this Agreement) settling *Auer v. Dyson*, No. 81-124 (Sup. Ct. Oswego

[2] The NS Customers are certain municipal utility systems in the seven neighboring states of Connecticut, Massachusetts, New Jersey, Ohio, Pennsylvania, Rhode Island and Vermont.

[3] The Host Communities consist of the City of Niagara Falls, NY; Lewiston Porter Central School District; Niagara County; School District of the City of Niagara Falls, NY; Niagara Wheaton Central School District; Town of Lewiston, NY; and Town of Niagara, NY. The two other Relicensing Customers are Niagara University and the Tuscarora Nation.

Co.), *Auer v. Power Authority*, Index No. 11999-84 (Sup. Ct. N.Y. Co.) and *Delaware County Electric Cooperative, Inc. v. Power Authority*, 82 Civ. 7256 (S.D.N.Y.) (the "*Auer* Settlement").

ii. Recovery of capital costs using Trended Original Cost and Original Cost methodologies.

iii. Treatment of sales to third parties, including the New York Independent System Operator ("NYISO").

iv. Allocation of Indirect Overheads.

v. Melding of costs of the Niagara Power Project and St. Lawrence-FDR Power Project for ratemaking.

vi. Post-employment benefits other than pensions (*i.e.*, retiree health benefits and now referred to as Other Postemployment Benefits, or OPEBs).

vii. Rate Stabilization Reserve ("RSR") methodology.

3. Proposed Rates

To set the rates for the four future rate periods, staff used projected calendar year data. The Preliminary Staff Report proposed the following rates:

Rate Year[4]	**Demand Rate $/kW-month**	**Energy Rate $/MW-hour**	**RSR-related Surcharge $/MW-hour**	**Effective Rate**[5] **$/MW-hour**
2011	3.32	4.92	-	11.42
2012	3.70	4.92	-	12.16
2013	4.12	4.92	-	12.98
2014	4.32	4.92	0.50	13.87

The Preliminary Staff Report included a CoS study which set out the calculations supporting the proposed rates and explained the additional costs of production of hydroelectricity at the Hydro Projects. These costs include: (1) the Authority's capital

[4] Except for 2011, the preference power rate year runs from May 1 of the calendar year indicated to April 30 of the following year. Because of the timing of the initial proposal, the Authority had proposed that the 2011 rate year of the period would be from November 1, 2011 to April 30, 2012.

[5] Effective rate at 70% load factor.

costs including upgrades and life extension and modernization costs at both Hydro Projects; (2) the Authority's costs related to Federal Energy Regulatory Commission ("FERC") relicensing for the Hydro Projects; (3) operation and maintenance ("O&M") costs for the Hydro Projects; and (4) indirect overhead costs.

B. Public Comment Period

Written notice and a copy of the Preliminary Staff Report were mailed to all affected customers on or about July 26, 2011. The written notice stated that customers could contact the Authority for further information, for answers to questions concerning the rate proposal or to meet with NYPA staff to discuss details of the proposal. The notice also informed customers of three separate public forums on the proposed rates for the purpose of obtaining the views of interested persons: September 19, 2011 in Syracuse, New York; September 20, 2011 in Niagara Falls, New York; and September 22, 2011 in Massena, New York. Notice of the proposed rulemaking was published in the *New York State Register* ("*State Register*") on August 17, 2011. Such notice also announced the dates and locations of the public forums. The *State Register* notice also established an October 3, 2011 deadline to submit written comments on the proposed rulemaking.[6] The public comment period end date was subsequently extended three weeks, from October 3, 2011 to October 24, 2011, based on customers' feedback.

Following the Trustees' action on July 26, 2011, Authority staff made itself available to affected customers and their organizations on a number of occasions for the purpose of answering questions about the proposed rate revisions. The Authority staff held meetings with representatives of the Municipal Electric Utilities Association ("MEUA"), which represents 40 municipal utility systems in New York State; the New York Association of Public Power ("NYAPP"), which represents a total of thirteen municipal utility systems and rural electric cooperative systems; the NS Customers; and with a number of elected officials.

[6] The October 3, 2011 deadline was in accordance with the 45-day comment period for rulemakings required by the New York State Administrative Procedure Act.

Interested parties submitted voluminous and substantive data requests concerning the Preliminary Staff Report. Staff responded to a total of 128 data requests: 35 from MEUA, 64 from NYAPP, and 29 from the NS Customers. Many of these data requests had multiple subparts, so these numbers understate the amount of material staff provided. Many data requests sought the workpapers in support of the calculations underlying the proposal.

The three public forums were conducted in accordance with the terms of the "Policy and Procedures – Public Forums on Rate Proposals" adopted by the Authority's Trustees in November 1990. Such Policy and Procedure provides for the holding of public forums on all proposed Authority production and transmission rate increases of two percent or more.

A panel of Authority representatives was available at the public forums to explain the basis for the proposed rate revisions and to listen to issues raised by concerned members of the public. The Authority had invited parties to submit written comments at the public forums. Various customer groups, as well as elected officials and residents of New York State, attended. Customers included representatives from the NS Customers, MEUA, NYAPP, the Niagara Power Coalition, Inc. ("NPC," an organization representing the Host Communities), Jamestown Board of Public Utilities, Town of Massena Electric Department and the Plattsburgh Municipal Lighting Department. Elected officials included Assemblyman John D. Ceretto, William L. Ross, Chairman of the Niagara County Legislature (and also NPC Chairman), and Renae Kimble, Niagara County Legislator. Mr. Charlie McGrath, a St. Lawrence Project-area citizen, also commented. In addition to oral or written comments delivered at the public forums, written comments were received through October 24, 2011, the end of the public comment period.

NYPA received written comments from MEUA,[7] NYAPP,[8] the NS Customers, and NPC as well as numerous letters from elected officials and other parties concerning the rate proposal. All such written comments and letters submitted in the proceeding, as well as the transcripts from the three public forums, are included in the accompanying Appendix C. All of the public comments received were evaluated by Authority staff. A detailed description of the issues raised and the proposed disposition of each are contained in Part II of this Staff Analysis.

C. Summary of Final Proposed Rates

Based on our analysis of the written comments and other information received, Authority staff recommends a series of adjustments which results in proposed rates representing a decrease from the initial proposal. The major driver in the rate adjustments is the introduction of a forward looking capacity credit as part of the Hydro CoS computation. This capacity credit, which is based on NYPA's unforced capacity sales into the NYISO market, has always been incorporated in the annual Rate Stabilization Reserve ("RSR"), a contractual mechanism that reconciles actual costs and with tariff-based revenues. By estimating and incorporating the NYISO capacity sales as part of the CoS, the customers will receive the up-front rate-reducing effect of these sales. The reasons for the various adjustments are explained fully in Part II of this Staff Analysis. The revised rates, which represent a phase-in to fully cost-based rates, are as follows:

[7] MEUA's comments also included the affidavit and exhibits of Frank W. Radigan. Page references to these comments will be designated as "MEUA at [page #]"; references to Mr. Radigan's affidavit will be designated as "Radigan at [page #]."

[8] NYAPP's comments also included the affidavit of Whitfield A. Russell. Page references to these comments will be designated as "NYAPP at [page #]"; references to Mr. Russell's affidavit will be designated as "Russell at ¶ [#]."

Rate Year[9]	Demand Rate $/kW-month	Energy Rate $/MW-hour	RSR-related Surcharge $/MW-hour	Effective Rate[10] $/MW-hour
2011	3.26	4.92	-	11.30
2012	3.57	4.92	-	11.91
2013	3.91	4.92	-	12.57
2014	4.07	4.92	up to 0.40	13.28

These rates reflect a 6 cents/kW-month reduction in the demand rate for the 2011 rate year, a 13 cents/kW-month reduction for the 2012 rate year, a 21 cents/kW-month reduction for the 2013 rate year and a 25 cents/kW-month reduction for the 2014 rate year. For 2014, the RSR-related surcharge was adjusted downward, and would be no higher than $0.40/MWh. Based on the above, rates for a typical municipal system residential customer would increase by less than 60 cents per month for each year of the phase-in period, which is less than 1% of their total electric bill, and by less than 5 cents per month for each year of the phase-in period for a typical residential customer of the IOUs, which is also well below 1% of their total electric bill.

In addition, the RSR will be adjusted to produce a year-end 2010 balance of negative $24.5 million for reasons explained fully in Part II of this Staff Analysis.

Exhibit A contains the revised Hydro CoS, and the Exhibit B shows a summary of bill impacts, both of which are attached to this Staff Analysis. Also attached are revised Tables 1 through 5 supporting the cost-based credit associated with the production of ancillary services.

9 As a result of the extended comment period granted by the Authority, the 2011 rate year will commence on December 1, 2011, rather than November 1, 2011 as originally proposed. The other rate years will extend from May 1 of the calendar year indicated to April 30 of the following year.

10 Effective rate at 70% load factor.

Part II: Public Comments, Staff Analysis and Recommendations

A. Issue: Requests to Delay Implementation Date and Extend Review Period

Public Comments:

Several commenters, including the NS Customers and NYAPP, requested that NYPA delay implementation of the new rates until May 1, 2012. NYAPP (at 2) stated that NYPA's "fiscal integrity" will be "unaffected" by such delay. Senators Young, *et al.* and Senator Fuschillo also requested a May 1, 2012 effective date. MEUA requested that the review time for future NYPA rate proceedings be extended to allow for at least four months between publication of the *State Register* notice and the comment due date. Many parties cited the need for more time to consider responses to data requests. NPC criticized NYPA's rate-setting process as not allowing it or any other party to "test" the proposed rates.

Staff Analysis:

The current rate implementation defers the rate increase that NYPA staff had expected to implement effective May 1, 2011. Further delays of this action would only compress the time period in which the phase-in of a rate increase can occur. Following the initial rate increase on December 1, 2011, subsequent increases will be effective on May 1, 2012, 2013 and 2014.

NYAPP is incorrect to suggest that this rate matter should be based on an evaluation of NYPA's current fiscal condition. Rather, NYPA's obligation is to ensure that the preference rate is based on cost, which is the focus of this proceeding.

Subsequent to the July 26, 2011 Trustee action, the Authority promptly sent copies to its customers of the Preliminary Staff Report, filed all appropriate notices in the *State Register*, and made staff available to the customers and/or their representatives on a number of occasions to answer questions regarding the proposed rate revisions. The proposed rate action employs the same principles and methodologies agreed to by the customers and adopted by the Trustees in the 2003 rate action. Meetings and telephone calls were held with representatives from MEUA, NYAPP, the NS Customers, NPC and a number of elected officials to discuss the proposal. Staff responded to a total of 128 data requests, many of which contained multiple sub-parts.

Based on letters and comments received at the public forums, NYPA agreed to extend the comment period an additional three weeks, until October 24, 2011. Such extension was unprecedented for NYPA hydro rate proceedings. It is important to note that the Authority held three public forums (instead of one, as in past proceedings) throughout New York State in order to better engage stakeholders during the present rate case.

The time initially allotted for review and comment on the proposed rate action follows the timetable the Authority used for the 1992, 2003 and 2007 rate actions, and meets the standard set forth for rulemakings under the State Administrative Procedure Act ("SAPA"). Extending the review time to at least four months between publication of the NOPR and comment due date would result in an unprecedented six-month time period between the notice of the rate action and its final implementation.

Staff acknowledges the complexity of the data and issues involved in this proceeding, but also understands that affected parties always desire more time to review data in rate proceedings. Moreover, based on the extensive amount of data shared with customers and the meetings held in this case, which included multiple technical conferences, staff believes that there was sufficient time to review the proposed rate action.

Recommendation:

By operation of the extended due date granted for the filing of comments, the Authority has consented to delay the implementation date for new rates, which was originally scheduled to become effective on November 1, 2011. The proposed rates should be implemented one month later than originally proposed, to be effective December 1, 2011. NYPA recommends no changes regarding the review period for future hydro rate proposals.

B. Issue: Proposed Preference Rates and their Conformance With the "Lowest Possible Rate" Standard

Public Comments:

MEUA, NYAPP and the NS Customers all argue that the Authority staff's proposed rates do not conform with the statutory standard that preference customers be served at the "lowest possible rate" as set forth in PAL § 1005(5). The federal Niagara Redevelopment Act ("NRA") provides for similar rate treatment, as it prescribes that the preference power shall be made available at the "lowest rates reasonably possible." 18 U.S.C. § 836(b)(1) (2011).

These parties claim that various adjustments to NYPA's proposed rate plan are needed in order to make NYPA's rates consistent with this standard. The adjustments requested include the following:

(1) Enlarging the allocator used to derive the demand charge to include all sales from the Hydro Projects, not merely those made to firm contract customers. *See, e.g.,* MEUA at 9-10, NYAPP at 3-4; NS Customers at 5-6. Under this theory, it would be appropriate for NYPA to allocate costs to non-firm customers who are not able to receive electricity at the preference rate and whose purchases are uncertain, rather than to perform the traditional allocation costs based on sales to firm contract customers.

(2) That NYPA's estimates of its capacity or "UCAP"[11] sales credits should be used to directly lower the Hydro CoS, rather than employed in the RSR reconciliation process. NS Customers at 11-12.

[11] In New York State, UCAP or "unforced capacity" refers to electric capacity that is needed to meet the reliability needs of customers as required under the NYISO tariff. In the context of this proceeding, NYPA's UCAP sales refers to capacity sold into the NYISO capacity markets or capacity internally transferred to non-hydroelectric customers at the NYISO UCAP rate. These UCAP transactions (which form the basis for the UCAP credit) are above the capacity needs of NYPA's firm hydroelectric power contract customers who receive this capacity product as part of the bilateral transaction between NYPA and the customer.

(3) All UCAP sales into the NYISO markets should be credited to the preference customers by lowering the energy charges collected under RSR rather than to the reconciled Hydro CoS used in the RSR calculation. NYAPP at 7, 9. Under this theory, UCAP sales into the NYISO would be a benefit realized exclusively by preference power customers, rather than attributed to the Hydro Projects as a whole.

(4) UCAP credits should be made at cost, even if the NYISO market price for NYPA's UCAP sales is below NYPA's cost. NYAPP at 8; Russell at ¶¶ 23-24; Radigan at 30. Under this proposed reform, NYPA's sales into short-term NYISO capacity markets would somehow be recognized as containing the same benefits as long-term firm sales to contract customers.

(5) NYPA's UCAP credit should be enlarged to include all capacity sales above the actual capacity demands from the Hydro Projects, rather than using the sales that exceed the "base level" of demand that NYPA uses to determine the demand rate. Radigan at 26-28; NYAPP at 24; Russell at ¶ 25.

Staff Analysis:

The requested rate adjustments noted in (1) – (5) above are discussed separately on their merits (see the Staff Analysis of Issues C, D and E, below), but first we addresses the notion, raised by some customers, that if a proposed modification reduces the rate, NYPA is *required* to adopt it in order to satisfy the "lowest possible rate" standard found in PAL §1005(5). That notion, however, is not mandated by law and, equally important, is inconsistent with specific rate methodologies agreed to by the customers in their long-term contracts and settlement agreements with NYPA.

Both the law and the customers have long recognized NYPA's "[b]road discretion . . . to determine the components of its costs" and that NYPA is not required or authorized to set the preference rate at "less than cost." *Auer v. Dyson*, 110 Misc. 2d 943, 948-49 (Sup. Ct. Oswego Co. 1981) ("*Auer*"). In fact, the preference customers have agreed to abide by the principles set out in the *Auer* cases and the *Auer* Settlement ending those litigations.

In subsequent long-term contracts and settlement agreements those principles have been further defined to include specific agreed-upon methodologies. Those methodologies include the recovery of capital costs, the treatment of sales of ancillary services or surplus energy to third parties and the creation and administration of the RSR. In addition, the application of these agreed-upon methodologies was fully explained and illustrated in the January 2003 Report, made available to all customers and specifically referenced in later contractual arrangements.

The truth is that some of the now-challenged methodologies are virtually identical to the methodologies adopted by the Trustees in 2003 and again in 2007 when the last preference rate increase was adopted. By way of example, NYPA's calculation of the demand allocation, the UCAP credit and the RSR adjustments in the July 2011 proposal are thoroughly consistent with these methods, which were expressly agreed to by customers.

Two final points are worth noting. First, the customers' reliance on the *Bergen* case is misplaced. *Village of Bergen v. Power Auth. of State of N.Y.*, 249 A.D.2d 902 (4th Dep't 1998), *appeal den'd,* 97 N.Y.2d 606 (2001). The issue there – NYPA's method for allocating indirect overheads – was not specifically covered by any agreement between NYPA and the customers. Here, however, the now-criticized methodologies concerning such items as UCAP crediting and RSR adjustments were previously employed in the January 2003 Report and consistent with the principles and methodologies contained in the customer agreements.

Second, the claim that NYPA *must* accept any customer suggestion which yields a lower rate is totally at odds with NYPA's acknowledged "broad discretion" in determining its costs. To accept that argument, NYPA would effectively cede all discretion to any customers who could suggest a cost calculation that yields a lower rate.

Recommendation:

Although the Authority is not mandated to accept any particular customer proposal, we have always been receptive to reasonable suggestions concerning the development of the preference rate. In this case, the customers have raised some valid considerations. Accordingly, NYPA will, as described further below, adopt certain adjustments which should address the customers’ concerns.

C. Issue: Requests to Increase the Demand Allocator

Public Comments:

NYAPP argues that denominator used to set the demand rate should be based on the MW-months of NYPA's contract demand plus the MW-months of the Authority's average UCAP sales from the Hydro Projects. In other words, the demand rate must be calculated using billing demands of 41,000 MW-months rather than the lower 34,000 to 36,000 MW-months the Authority has proposed to use in 2011-2014 based on estimated firm customer contract demands. NYAPP at 2-4. NYAPP states that this adjustment is necessary to achieve the lowest possible rate. *Id.* at 5-6. MEUA makes a similar claim. Though Mr. Radigan (MEUA's consultant) states that he does not take issue with NYPA's proposed revenue requirement, he believes that the rate design does not result in the lowest possible rate because it ignores "critical" billing determinants in the calculation of the demand rate. Radigan at 19. Mr. Radigan objects to NYPA not calculating the demand rate by spreading the cost over "all users" of the Hydro Projects' capacity. *Id.* at 22.

The NS Customers raise the demand allocator issue in a slightly different context. They first argue that NYPA's non-preference energy sales into the NYISO markets justify a customer credit based on the capacity costs associated with such sales. NS Customers at 5. But, the NS Customers further state that they would be happy with an alternative form of relief obtained by increasing the denominator used to calculate the demand charge. *Id.* at 5-6.

Staff Analysis:

The billing determinant methodology used for the proposed 2011-2014 hydroelectric production rates is the same methodology used in both the 2003 and 2007 production rates proposals and is entirely consistent with the contracts and settlements reached with various preference power customers.

According to standard ratemaking principles, the firm power contract customers are responsible for the cost recovery of the assets developed to serve them. NYPA adheres to this principle when it undertakes its cost recovery through production rates that are developed by using the total *firm* demands of its hydroelectric customers.

These customers incorrectly equate NYPA's month-to-month and capability period-to-capability period sales of excess hydroelectric capacity into the NYISO market with long-term firm demand that is used in the derivation of the demand rate. To base the demand rate on the full capacity sales from the Hydro Projects pre-supposes that the clearing price of the NYISO UCAP market will always at least equal or exceed the cost-based demand rate developed with the increased billing determinants. Otherwise, NYPA would be at risk of adopting a rate recovery approach that leads to the under-recovery of its costs. In fact, the NYISO UCAP Rest of State clearing price has often been lower than the demand rate that would result from the customers' proposed method. The customers' proposed approach would very likely lead to the application of a less than cost-based rate.

The conventional method of developing a demand charge is to spread the fixed costs of a project to the firm users of the project and then to provide firm users with a demand credit from the non-firm use of the project's excess capacity. This is just the approach NYPA uses when it provides a UCAP credit in the annual RSR calculation. Through the UCAP credit computation the preference customers receive their allocated share of the Hydro Projects' UCAP sales as a credit to the actual cost of service. In its review of its Hydro CoS, staff recognizes that it can enhance the UCAP credit in a manner consistent with the rate methodologies in the January 2003 Report. In particular, and consistent with the NS Customers' suggestion (at 11-12), staff finds that it would be appropriate to provide the preference customers with the direct CoS benefit of forecasted UCAP sales, rather than incorporating the credit solely at the time of the RSR reconciliation process.

Recommendation:

NYPA does not find compelling the argument to increase the denominator used to calculate the demand charge. As shown, there is risk that NYPA would not recover its costs. However, to provide the preference customers with the timing benefits of the

UCAP sales, staff proposes to build a UCAP credit, based on NYPA's projected NYISO capacity sales revenue, into the annual rate development for each of the 2011-2014 rate years. Any differences in the estimated UCAP credit and actual UCAP sales would be reconciled in future annual RSR computations. By making this adjustment, NYPA would reduce the Hydro CoS by $1.6 million in Rate Year ("RY") 2011, $3.7 million in RY 2012, $5.1 million in RY 2013 and $6.5 million in RY 2014.

D. Issue: Requests that the RSR Should Reflect a UCAP Credit Based on Cost and Be Applied to the RSR Balance Directly

Public Comments:

As noted in Issue C, *supra*, the annual RSR reconciliation process contains a UCAP Credit which is designed as a credit to the preference power customers to account for market sales of capacity from the Hydro Projects that is above the needs of NYPA's contract hydropower customers. Both NYAPP and MEUA request that prior RSR annual calculations be revised to reflect the use of the cost-based rate for the UCAP credits. NYAPP at 7; Radigan at 30.

NYAPP refers to the "Global Settlement Agreement"[12] concerning the application of the UCAP credit, noting that it is explicit in the determination of the MW-months of capacity above a base level of capacity sales, but does not indicate the method for converting MW-months to a dollar credit, nor whether that dollar credit is to be spread to all contract customers or be applied only to the preference customers. Russell at ¶ 21. NYAPP contends that NYPA is incorrectly crediting UCAP sales based on the lower of market prices or costs and that revising the calculation to use a cost-based UCAP is necessary under the Global Settlement and applicable precedents.

Staff Analysis:

Consistent with the staff determination that the proposed rates for 2011-2014 should not be recalculated based on billing determinants that have been expanded to include estimated short-term UCAP sales, staff similarly disagrees with the NYAPP's proposal that the UCAP credit in prior annual RSR computations be re-valued at cost. Staff does not agree that its current approach of crediting the RSR for UCAP sales based on market prices conflicts with the Global Settlement Agreement and applicable precedents.

[12] The Global Settlement Agreements are long-term contract extensions entered into between NYPA and all NY Munis & Coops in 2003 which set forth the RSR crediting methodology and all other rate setting principles and methodologies regarding preference rates that were adopted by the Trustees in 2003.

There is no sound basis to equate the UCAP sales NYPA makes to NYISO customers as being the equivalent firm power service that the contract customers receive through the application of a rate that is at the lowest possible cost. By paying their rates, NYPA's firm contract customers are receiving long-term firm electric power and energy that is among the least expensive in the country. In contrast, the NYISO customers that purchase short-term UCAP from NYPA in a competitive market are merely meeting the unforced capacity requirements on a month-to-month or a capability period-to-capability period basis that are set for reliability purposes by the NYISO. As these NYISO customers are not receiving the same product, service or benefits as NYPA's firm contract customers, it does not make sense to apply the same cost of service rate to these transactions.

Rates are designed based upon the cost of providing service with the cost causer being the cost payer. NYPA correctly assigns this cost of service to its firm contract customers and correctly credits their cost of service through an application of a UCAP credit. However, NYPA will make a slight modification to its UCAP crediting practices to include in RSR balances the actual sales revenues it receives, rather than the lower of market revenues or cost. The market cost more properly reflects the service that the UCAP purchaser receives, and this change ensures that the preference customers will get that benefit when the market price exceeds the cost-based price for capacity.

Additionally, NYPA rejects the proposal that UCAP credit should be applied to the RSR balances only rather than deducted from the Hydro CoS, as suggested by NYAPP. Because the UCAP credit derives from the operation of Hydro Projects as a whole, it is appropriate for staff to continue to deduct these dollars from the actual Hydro CoS and not apply it to the preference power customers only. (Of course, consistent with NYPA's recommendation in Issue C, the UCAP credit applied to the CoS in the RSR process would consist of the reconciliation between the forecasted and actual UCAP sales.) This is consistent with the NYPA's rate methodologies that it has employed since 2003.

Recommendation:

Staff believes its dollar valuation of the UCAP credit at market prices is appropriate and should be retained, and that the UCAP credit made in the RSR calculation should be applied to the Hydro CoS.

E. Issue: NYPA's UCAP Credit Calculation Applied to the RSR and Claims that Preference Customers Cross-Subsidize Non-Preference Customers

Public Comments:

NYAPP states that a flaw in NYPA's UCAP calculation used in the RSR causes MW-months of actual capacity sales to be understated because NYPA's UCAP sales crediting methodology leaves the difference between the forecasted demand (the "base level" of approximately 36,000 MW-months) and the actual demands (ranging from 32,000-35,000 MW-months in recent years) out of the equation. Preference customers are charged for the costs of those MW-months but cannot use them. Nevertheless, preference customers are not granted a dollar credit when NYPA sells these MW-months, either in the UCAP credit to the RSR or in the calculation of the demand rate. Russell at ¶ 25.

MEUA argues that cross-subsidization can occur between the rates charged to preference customers and non-preference customers. In view of 2010 data, MEUA points out that actual billed demand of 32,711 MW is 10% less than the amount used in development of the current demand charge. They pinpoint the cause of the differential as being that the former Reynolds Metals (*i.e.*, now ALCOA's East Plant) saw its demand of 2,568 MW-months in 2007 reduced to 0 MW-months in 2010. ALCOA is a non-preference customer and its inclusion in the RSR calculation can cause cross-subsidization because the demand from the industrial customers can vary from year to year, while the demand of the preference power customers is more stable. If demand from the non-preference customers is down, the demand revenues collected go down, and the amount of money that needs to be collected in the RSR's energy charge goes up. Radigan at 26-28.

Staff Analysis:

Staff finds a certain level of merit in the public comments concerning the cross-subsidization issue and has reconsidered its UCAP sales credit methodology.

Beginning with the 2005 RSR calculation, the UCAP credit has been based on:

1) actual demand of Hydro Project contract customers;
2) plus UCAP sales to others in the NYISO market (= total sales of capacity);
3) minus the base level of capacity used to develop the demand rate;
4) equals the net amount of capacity used for the UCAP credit calculation.

In general, when actual demand was consistent with forecasted demand, the RSR calculation produced reasonable and expected UCAP credit results. However, in 2009 and 2010 ALCOA's East Plant was out of service for significant periods due to prevailing economic conditions. NYPA's base level of capacity approach did not leave the flexibility to account for the capacity reduction and did not make allowance for the greater amount of UCAP market sales that resulted with the absence of the East Plant's capacity needs.

Since the firm contract customers are paying for the embedded and operating costs of the hydroelectric projects, it is in accordance with traditional ratemaking standards that they be provided with the value produced by the UCAP sales made for each year from the time the UCAP credit was first implemented via the Global Settlement Agreement in 2003. Staff finds that such a methodological change can substantially remedy the problem of any cross-subsidization between the preference and non-preference customers that might have resulted in the RSR calculation as the increased UCAP sales will mitigate lost non-preference customer (*i.e.*, ALCOA) demand revenues.

Recommendation:

Staff recommends that the actual UCAP sales be used in the annual RSR calculations for 2005 through 2010. The dollar effect of the change is a $13.5 million positive movement in the 2010 RSR negative balance.

F. Issue: Treatment of the 455 MW Redirected to the Recharge New York Power Program

Public Comments:

NYAPP stated that the 455 MW withdrawn from the rural and domestic ("R&D") customers of the three upstate IOUs to implement the Recharge New York Power Program enacted into law in 2011 must remain in the billed demands used to calculate the demand rate. NPC registered the similar concern that its members not pay for RSR balances related to withdrawn preference power. NS Customers noted that the Authority should confirm its plan to reduce the RSR balance by a historical ratio of MWh usage of the utilities' R&D customers to the total preference power customers' MWh usage.

Staff Analysis:

The Preliminary Staff Report noted that the RSR balance might need to be altered as a result of the reduction in the portion of the hydropower sales made at preference power rates resulting from the newly created Recharge New York Power Program. Staff reviewed the billing determinants and contributions to the RSR balance for several years to determine an appropriate reduction in the cumulative RSR balance.

Recommendation:

Staff recommends that the 455 MW withdrawn from the R&D customers of the IOUs continue to be included in the billing demands used in the Hydro CoS. The withdrawn power, however, would no longer be classified as preference power and would be excluded from the calculation of the annual contribution to the RSR. Staff also recommends that the RSR balance as of December 31, 2010 (as adjusted) be reduced by 30.17%. This percentage represents the average MWh for these R&D customers out of the total preference MWh for the period 2008 through 2010 (see table below).

Year	IOU residential firm MWh	Total Preference MWh	IOU / Total
2008	2,981,500	9,980,801	29.87%
2009	2,964,533	9,759,304	30.38%
2010	2,982,171	9,848,105	30.28%
Total	8,928,204	29,588,210	30.17%

Using this 30.17% ratio results in a $10.5 million positive movement in the 2010 RSR negative balance.

G. Issue: Annual RSR Report Procedures

Public Comments:

MEUA points out that the RSR is a “full, after the fact reconciliation of NYPA’s rate year costs and revenues.” Though it concedes that the RSR process is a “mutually agreed upon” revenue requirement reconciliation set out in the preference customers’ contracts with NYPA, MEUA requests the right to review the annual RSR calculations and the establishment of a public process, with an opportunity for information sharing, discovery and comment. MEUA at 4-5. While other customers did not provide written comments on the specific issue of RSR review, NYAPP and the NS Customers made this concern known to NYPA staff at in-person meetings.

Staff Analysis:

NYPA staff agrees that transparency in the Hydro CoS process, including the annual RSR computation, is a worthwhile goal. NYPA staff has regularly provided the annual RSR computation and supporting documentation to customers, but this process has not been done at consistent intervals. The receipt of customer comments and other formal procedures (as in a SAPA-style rulemaking proceeding) are unnecessary, however, as NYPA’s administration of the RSR computation is already provided for as a matter of contract. Staff believes that the distribution of the RSR computation on an annual basis will allow for critical detailed information to be provided to preference customers and, coupled with follow-up meetings or conference calls, this should provide adequate opportunity for the customers to better understand the expenses and revenues that form the basis of the annual RSR computation. Such a process would be mutually beneficial to both NYPA and its preference customers.

Recommendation:

NYPA staff agrees to provide the preference customers with the annual reconciliation to the RSR by June 1st of each year and to meet over the ensuing few months to discuss relevant issues and provide needed data to customers. In light of NYPA’s contractual rights and obligations concerning the RSR, no formal public process is necessary.

H. Issue: Increased Ancillary Services Credit

Public Comments:

NS Customers assert that the preference customers' current cost-based ancillary services credit used in the development of the Hydro CoS is insufficient, as it only credits the costs associated with the amount of regulation service necessary for contract loads, and not the actual regulation service sales. They refer to their contract to claim that they are entitled to receive an ancillary services credit based not on their contract demands, but rather based on the total amount of Authority ancillary services sales on the NYISO markets. NS Customers at 7-10.

Staff Analysis:

The NS Customers' claim is inconsistent with their Authority contracts and settlements. In their contracts with the Authority for preference power, their members agreed that certain methodologies and principles adopted by the Authority in 2003 could continue to be used without objection when the Authority sets future hydro rates.[13] One of those principles is "(iii) Treatment of sales to third parties, including the New York Independent System Operator." Although NS Customers interpret this provision as requiring *all* sales to third parties be used in the Hydro CoS crediting mechanism, they completely ignore the portion of Article X[14] of their preference power contract, which states that the customer waives any challenges to the methodologies and principles employed by the Authority in 2003 that are used to set new rates.

Thus, under the terms of their preference contracts, the NS Customers have already consented to the continued use of the 2003 methodology, and their claims to

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[13] Each of NS Customers agreed to these methodologies and principles in their long-term contracts with the Authority executed in 2006.

[14] NS Customers have quoted a provision from Article X of their contract, entitled "Agreement for the Sale of Niagara Project Power and Energy," but have mistakenly referred to the "Relicensing Settlement Agreement Addressing Allocation of Niagara Project Power and Energy to Neighboring States" from 2005. No specific rate provisions are included in that document.

enlarge the “cost-based” production credit in the derivation of the base hydro rate and to reduce the Hydro CoS accordingly have no merit.

Recommendation:

Because there is no basis to accept customer claims that the cost-based credit should be increased, staff does not recommend this adjustment. However, for other reasons staff does recommend an increase in the cost-based credit for rate years 2011-14. Due to an upward adjustment to the 2009 test year billing determinants to reflect average annual usage for the ALCOA East plant (which happened to be shut down for much of that year), the ancillary services credit of $61.9 million shown in the preliminary CoS is proposed to be increased by a total of $2.2 million over the proposed rate plan. This is reflected in the revised Hydro CoS in Exhibit A.

I. Issue: Request for Credits Based on Authority Investment Income

Public Comments:

The NS Customers argue that they should receive a credit for investment income in the CoS since much of the Authority's investment income is generated from the operations at the Hydro Projects. They state that the failure to provide such credits is tantamount to including tax payments in the CoS, but failing to recognize tax refunds. NS Customers at 10-11.

Staff Analysis:

The NS Customers' tax refund analogy runs counter to the ratemaking principles established in the preference customer contracts. The preference rates are cost-based where no working capital charge is included and no real rate of return is earned. A portion of the Authority's investment income is derived from the Hydro Projects, but the Authority's investments are not analogous to tax refunds for which interest must be credited to the preference customers. As the *Auer* Settlement instructs, after the cost-based rate is established, revenues from the Hydro Projects can go into NYPA's general revenue fund. *Auer* Settlement ¶ 10. A claim for a share of the Authority's investment income would produce preference rates that are below cost and in violation of *Auer* Settlement principles. Yet, that is exactly the result if investment income derived from such excess revenues is used as a credit to the CoS.

Recommendation:

Staff recommends that no credits be provided to the Hydro CoS for investment income.

J. Issue: 2009-10 Deferred Rate Increases

Public Comments:

NYAPP asserts that the Authority's uncollected costs associated with the rate increases previously proposed for RYs 2009 and 2010 should not be allocated to ratepayers because that rate proceeding was cancelled by the Trustees in March 2009. NYAPP bases its argument on a March 24, 2009 Press Release issued by the Authority that announced the cancellation of the 2009 proposed rate, as well as the March 31, 2009 Trustees' decision to "withdraw" the proposed rates and "extend" the rates in effect in 2008. NYAPP claims that it had no "notice" that 2009-10 costs would be deferred and recovered through the RSR mechanism, and expected those costs to be forgiven. NYAPP also claims that the Authority's proposal in this regard demonstrates a lack of "transparency." NYAPP at 9-11.

Staff Analysis:

The contractually agreed-upon RSR mechanism is used to make annual calculations of the RSR balance, regardless of whether the Trustees decide to suspend any applicable RSR-related surcharge in addition to withdrawing a preference rate increase proposal. In essence, it is *always* appropriate for the Authority to record under-recovery of costs (as well as over-recoveries) through the RSR pursuant to customer contracts.

The 2009 suspension of the RSR surcharge did not indicate that prospective RSR calculations would be abandoned nor its balance forgiven; rather, it solely indicates that the costs accrued (including any potential surcharges) would be deferred until such date when the Trustees authorize the Authority to make such recoveries.

Moreover, the March 31, 2009 Memorandum to the Trustees gave clear notice that 2009 and 2010 costs would be deferred, not forgiven. The Memorandum states the following:

> The expected revenue increase resulting from the 2009 Rate Year Increase was nearly $10 million. *Those revenues will be deferred and recovered over appropriate, subsequent year(s). By deferring*

> *the collection of revenues, the Authority will comply with the requirement that preference rates be established on the basis of costs.* (emphasis supplied)

As shown above, the Authority correctly and openly stated that 2009-2010 rate year costs would not lapse, but rather that recovery would be postponed.

It is important to note that 2009-10 rate year costs would not be recovered until the rate year 2014 under the rate plan proposal. Based on the adjustments to the RSR balance now being recommended to the Trustees, an RSR-related surcharge to collect 2009-10 costs would be capped at $0.40/MWh in RY 2014. Authority staff will continue to monitor the RSR balance annually in order to evaluate the necessity of including 2009-10 costs within the preference rate.

Recommendation:

Staff does not recommend any changes to the RSR mechanism that would fail to recognize the cost deferrals related to the 2009 and 2010 rate years.

K. Issue: Contributions to New York State Treasury

Public Comments:

Certain parties raised concerns regarding NYPA's voluntary contributions to the State, but such comments were not uniformly critical. At the public forums, numerous parties remarked that it was inappropriate for NYPA to request a preference power rate increase in light of the large contributions to the State Treasury that the Authority has made in recent years.[15]

However, MEUA commented that it has reviewed the materials provided during the discovery process in this proceeding and concludes that NYPA's expenditures used to make contributions to the State Treasury have been "properly excluded" from the Hydro CoS. MEUA at 5-6.

NYAPP noted the size of the voluntary transfers and requested that the Authority adopt "detailed metrics" for measuring its creditworthiness at the time it considers making voluntary contributions to the State. NYAPP at 13-14. NYAPP is concerned that NYPA maintain its financial strength, particularly in light of "planned and needed upgrades of the hydro Projects" and that NYPA not become subject to "more stringent covenants in future lending agreements" that may require NYPA to increase hydroelectric rates in greater amounts than would otherwise be needed. Russell at ¶ 39.

Finally, NPC commented that the Authority should redirect the funds it would contribute to the State and instead use such "surplus funds" to offset the "entire proposed rate increase." NPC at 9-11.

Staff Analysis:

Despite the concerns raised, no party has argued that the Authority included the expenditures related to NYPA's contributions to the State in the Hydro CoS. Indeed, as

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[15] *See* Statement of Assemblyman John D. Ceretto at 1-2; Statement of William L. Ross on behalf of NPC at 7-8; Statement of Niagara County Legislator Renae Kimble at 2-3 (all dated September 20, 2011, Niagara Falls public forum); Comments of Mr. Charlie McGrath, Tr. 17 (September 22, 2011, Massena public forum).

MEUA has verified during the discovery process, NYPA's documentary support for the production costs of the Hydro Projects indicates that no costs related to such contributions are included in NYPA's rate development. This is appropriate because such expenditures are unrelated to the costs of the operation of the Hydro Projects.

To address NYAPP's concerns, as demonstrated in the discovery phase of this proceeding, NYPA currently has existing metrics and engages in an in-depth review process to determine whether any transfer of surplus funds to the State is feasible and advisable. As shown in NYPA's responses to, *e.g.,* Data Requests MEUA 26 and NYAPP 1-23, the Trustees have set forth their criteria to determine whether these transfers were feasible and advisable.

Before a transfer can be considered it must (1) be authorized by the Legislature; (2) be approved by the Trustees "as feasible and advisable" and (3) satisfy the requirements of the Authority's General Resolution Authorizing Revenue Obligations dated February 24, 1998, as amended and supplemented ("Bond Resolution"). The Bond Resolution's requirements to withdraw monies "free and clear of the lien and pledge created by the [Bond] Resolution" are as follows: such withdrawals (a) must be for a "lawful corporate purpose as determined by the Authority," and (b) the Authority must determine, taking into account among other considerations anticipated future receipt of revenues or other moneys constituting part of the Trust Estate, that the funds to be so withdrawn are not needed for (i) payment of reasonable and necessary operating expenses, (ii) an Operating Fund reserve for working capital, emergency repairs or replacements, major renewals or for retirement from service, decommissioning or disposal of facilities, (iii) payment of, or accumulation of a reserve for payment of, interest and principal on senior debt or (iv) payment of interest and principal on subordinate debt.

Before any such transfer is made, a full review of the Authority's finances is conducted, and may include meetings and extensive communication with the Authority's financial advisor, bond counsel, and the rating agencies. The Authority reviews the effects that these transfers will have considering its current and future financial obligations, and before the actual transfer is made, it is reaffirmed by the Trustees utilizing the most recent updated financial information available. The Trustees have developed a process to ensure that these any such transfers are “feasible and advisable” and will not result in preference power rate increases beyond those necessary to provide power at cost. Moreover, at their meeting on May 24, 2011, the Trustees adopted a Policy Statement establishing a “2.0 times debt service” coverage ratio shall be used as a reference point in considering any such transfer.

Lastly, NPC’s insistence that NYPA is obligated to redirect funds it has contributed (or will contribute in the future) to the State to lower the preference rate was firmly rejected in a recent decision of the Appellate Division, Fourth Department. The court concluded that as long as NYPA has based the preference rate on cost “there is nothing in the Public Authorities Law prohibiting [NYPA] from contributing surplus funds to the State.” *Niagara County v. Power Auth. of N.Y.*, 82 A.D.3d 1597, 1601 (4th Dep’t), *appeal den’d*, 17 N.Y.3d 838 (2011).

Recommendation:

Staff has reviewed the Trustees’ decision making criteria regarding contributions to the State Treasury and recommends no changes. Further, staff confirms that expenditures related to such contributions are unrelated to, and not included in, the Hydro CoS.

L. Issue: Relicensing Settlement Agreement with Host Communities

Public Comments:

NPC posits that the proposed rate increase will “diminish the value” of the allocations to its Host Community members obtained as part of its relicensing settlement with NYPA. NPC further states that it understood that the “value of the overall transaction would increase,” and that the NYPA proposal “violates the spirit” of that settlement agreement because the allocations “could readily become worthless” from the rate increase. NPC at 5-6.

Staff Analysis:

The sale of hydropower at preference rates to the Host Communities, whose allocations now total 28 MW, began in 2007 under long-term contracts extending through September 1, 2025 as a result of the “Host Community Relicensing Settlement Agreement Addressing Non-License Terms and Conditions” executed on June 27, 2005. Before these allocations were made, the Host Communities paid the market price for all of their electricity. As a result of their hydro allocations, they receive some of the least expensive electricity in the United States for a portion of their loads.

NPC incorrectly implies that NYPA has somehow failed to live up to its settlement agreement commitments by making this rate proposal. However, Section 6.2(d) of the settlement agreement sets forth that the Host Communities shall pay NYPA the same cost-based rate for Niagara Project power that is paid by preference customers. NYPA never committed to freeze the preference rate, and parties understood that NYPA makes preference rate adjustments from time to time.

Recommendation:

Staff rejects NPC’s complaints as unfounded and maintains that this rate proposal is completely consistent with the settlement agreement. Accordingly, staff makes no specific recommendations to the proposed rate plan to address NPC’s complaints. Staff points out, however, that the rate adjustments recommended in this Staff Analysis should address some of NPC’s concerns.

M. Issue: Shared Services, Charitable Contributions and Other Post-Employment Benefits Expenses

Public Comments:

NYAPP indicated that the Authority has not provided sufficient information as to what is included in Shared Services within the CoS and requests additional information regarding this category of expenses.

MEUA requested that charitable contributions not directly assignable to the Hydro Projects be removed from the CoS, as they do not direct benefit Hydro Project operations. MEUA takes no issue with CoS inclusions of charitable contributions that directly benefit the Hydro Projects, and which are directly assigned.

Staff Analysis:

During the discovery process, the Authority responded to several data requests regarding the allocation of Shared Services costs, including requests MEUA 8, 12, 29 and 31, NYAPP 1-5 and 3-5, and NS 14 and 28. Staff received no further inquiries regarding Shared Services expenses.

To provide further clarity regarding the responses previously provided, costs included in the Shared Services category are in support of NYPA-wide initiatives that are not directly chargeable to any specific project or facility. These costs include such items as general overhead to maintain NYPA operations, programs and facilities, including headquarters payroll, employee benefits, contractor and consultant support, information technology expenses, corporate finance and controller expenditures, corporate support including the maintenance of all facilities, equipment and grounds, marketing costs, general law department expenditures, Energy Resource Management and Energy Risk Management.

Shared Services expenses are allocated based on labor ratios, which, in turn, is based on the percent of total direct costs charged to each facility.

Concerning charitable contributions, staff's analysis indicates that all charitable contributions and sponsorships should be removed from the Hydro CoS. These include both directly assigned charitable contributions, as well as those included in Shared Services. The total value of the cost proposed to be removed for RYs 2011-14 is $483,000. Because this amount is *de minimis*, it will have little impact on the preference rate and will not affect the safe and reliable operation of the Hydro Projects.

Staff points out that its analysis resulted in an adjustment to its Other Post-Employment Benefits ("OPEB") expense which, though not part of Shared Services, is allocated in the same manner. Certain overhead cost-cutting measures undertaken by staff in the last few months, including an approximate $5 million reduction for RY 2012-2014 resulting from the Trustees' approval of a revised funding plan for the OPEB Trust at their October 2011 meeting, will lower the Hydro CoS.

Recommendation:

Staff recommends that any prospective charitable contributions or sponsorships be removed from the Hydro CoS. This would remove $483,000 for the 2011-14 rate years and lower, to some extent, the Shared Services component. Staff also recommends a $5 million downward adjustment to the OPEB expense be reflected in the Hydro CoS.

N. Issue: Recovery of Costs for Parks Near the St. Lawrence Power Project

Public Comments:

NYAPP seeks clarification concerning payments made to the Robert Moses and Coles Creek State Parks located in the direct vicinity to the St. Lawrence Power Project.

Staff Analysis:

In the Preliminary Staff Report, the Authority discussed its assumption of responsibility for operations at the New York State Robert Moses and Coles Creek Parks. The Authority developed these parks as part of the St. Lawrence Project, and through a series of agreements with state officials, assigned O&M responsibilities for these parks to the New York State Office of Parks, Recreation and Historic Preservation ("OPRHP"). The FERC license issued for the St. Lawrence Project on October 23, 2003 incorporates these facilities as project recreational facilities and, under the terms of the license, the Authority has the ultimate responsibility to fund the O&M costs of both parks. However, as part of a 2009 Memorandum of Understanding between the State of New York and the Authority, the Authority was relieved of these annual payments to OPRHP for the state fiscal years 2011 through 2017. Therefore, the Authority included no parks-related expenses within the CoS beyond the rate year 2010.

In reviewing accounting data for past years in response to customer data requests, staff discovered that in 2008, $8 million charged to the Miscellaneous and General Expenses Account for the Niagara and St. Lawrence Projects for Parks reimbursement had not been backed out of financial information used in the 2008 actual Hydro CoS used in the RSR calculation for that year. The CoS did include a separate entry for $800,000 attributable to the Parks.

Recommendation:

Based on the analysis above, staff recommends that the $800,000 cost for the Robert Moses and Coles Creek Parks not be included in either the RSR true-up or the Hydro CoS for RYs 2011-2014 covered under this proposed rate plan. The removal of the $8 million charge from the CoS results in a positive adjustment to the cumulative RSR of about $3 million.

O. Issue: Lewiston Pump Generation Project Life Extension and Modernization Program Costs

Public Comments:

Niagara County Legislator Renae Kimble questioned the “feasibility of the $460 million dollar Life Expectancy Project upgrade” at the Lewiston Pump Generation Plant (“LPGP”) at the Niagara Project, and its consequent effect on preference power rates. She claimed that this expense is unwarranted, and that it should not be included in the current rate modification plan.

Staff Analysis:

The Niagara Project has been operating for over 50 years, mostly with original equipment. Life extension and modernization (“LEM”) work is entirely prudent. The Authority's staff participates in industry research organizations from which we obtain a broader understanding of how plant systems degrade and when replacement is prudent, and consequently, the Authority has conducted overhauls to maintain the equipment and to replace or repair components as needed. Those overhauls provided the Authority's engineering and maintenance staff with the information to develop an understanding as to how components and systems were aging, and how long they could reasonably be expected to operate with the reliability needed at this critical project. It is important to note, however, that the basic control systems, including, but not limited to, wiring, hydraulic systems, breakers, transformers, exciters, governors and motor-generators are original.

While the cost of the LPGP LEM program may appear high, it must be viewed in the context of work over a nine year period. This is due to both an allowance for associated escalation risks, and work taking place one unit at a time so that NYPA can continue to meet its power commitments. The LEM project is necessary for the Authority to continue to meet its customers’ electricity demand both currently and prospectively.

In the alternative, a choice to retire the LPGP rather than upgrade it would cause a reduction in the firm power capability of the Niagara Project on the order of several hundred megawatts, which would cause a significant reduction in sales to all hydropower customers.

Recommendation:

Based on the analysis stated, staff does not recommend any changes to the Hydro CoS relating to expenses associated with the LPGP LEM project.

P. Issue: Control Systems at the Niagara Facility

Public Comments:

Legislator Kimble made two claims concerning the safety of the Niagara Project's control systems. First, she alleged that the replacement of the Project's original analog gauges with current industry-standard digital gauges poses a risk both to the operation of the Project, as well as to the electricity grid itself. Also, she alleged that the newer gauges represent excessive spending, as she claims they will not last as long as the original equipment. Second, Legislator Kimble alleges that the replacement of the analog gauge system with a digital system might pose a cyber security risk, and potentially subject the Niagara Project to a malicious attack by "hackers."

Staff Analysis:

Safety of Digital Gauges

Many of the gauges and associated components in the plant have been replaced or re-built as part of normal maintenance over the past 50 years. There is no evidence to show that new systems will not last as long as the originals, and periodic replacement of gauges and other components is routine. Making a change to digital equipment is undertaken cautiously, and the risk of lack of availability of analog equipment and the industry expertise to maintain such systems is itself a driver in moving to modern digital systems.

Safety of the Power Projects' Cyber Network

The North American Energy Reliability Corporation provides for extensive cyber-security procedures, to which all utilities, including the Authority, must adhere and be subject to audit. Further, control systems at the Hydro Projects are not part of a conventional business network, but rather are a secure closed network.

Recommendation:

Based on the analysis stated, staff does not recommend any changes to the Niagara Project's program of control system modernization.

Q. Issue: Sale of Capacity on the NYISO Market

Public Comments:

Legislator Kimble claims that the Authority sales of excess capacity are violative of the Authority's mandate to provide electricity at the "lowest possible rate" to its customers. She alleges that the sale of such electricity on the NYISO market enriches the Authority at the expense of the preference power customers.

Staff Analysis:

As directed by statute and case law, the Authority provides electricity to its preference power customers at the lowest possible rate. The preference power rate is cost-based, and the Authority charges preference customers only as much as it costs the Authority to produce. Further, the NYISO market clearing price has no bearing whatsoever on the preference customer rate, which is set by contract.

Recommendation:

Staff does not recommend any changes in response to this comment.

Exhibits and Tables

NEW YORK POWER AUTHORITY
HYDROELECTRIC PROJECTS
FINAL PRODUCTION COST OF SERVICE

($000)

Line	Description	(Per 2007 CoS) 2008	2011	2012	2013	2014	Difference 2011 vs 2008 *
	Operations & Maintenance/Administrative & General						
1	Operations & Maintenance/A&G	61,941	71,655	72,063	74,540	76,238	9,714
2	Amortized Roadwork	2,983	212	-	-	-	(2,771)
3	Subtotal O&M/A&G (line 1 + line 2)	64,924	71,866	72,063	74,540	76,238	6,942
	Indirect Overheads						
4	Shared Services	41,329	44,888	45,829	46,555	47,226	3,559
5	Research & Development	3,780	2,523	2,598	2,650	2,703	(1,257)
6	Project Study Debt Service	846	-	-	-	-	(846)
7	Y2K Debt Service	2,874	237	237	237	237	(2,637)
8	Subtotal Indirect Overheads (sum lines 4-7)	48,829	47,648	48,664	49,442	50,166	(1,181)
9	**St. Law. Relicensing, amortization**	2,000	2,000	2,000	2,000	2,000	-
10	**Niagara Relicensing, amortization**	12,000	12,700	12,700	12,700	12,700	700
11	**Other Post -Employment Benefits (OPEB)**	13,608	10,348	9,532	9,388	9,234	(3,261)
12	**O&M Cost of Service** (sum lines 3,8, 9, 10,11)	**141,361**	**144,562**	**144,959**	**148,070**	**150,338**	**3,201**
	Capital Costs						
13	Total Depreciation	35,350	40,984	43,422	45,309	47,204	5,634
14	Interest on Debt	21,453	30,322	33,205	35,104	37,386	8,869
15	Inflation Compensation	21,521	28,697	30,428	32,182	34,069	7,176
16	Subtotal Capital Costs (sum lines 13-15)	78,324	100,003	107,055	112,595	118,659	21,679
17	**Total Cost of Service** (line 12 +line 16)	**219,685**	**244,565**	**252,014**	**260,665**	**268,997**	**24,880**

* 2008 data is from 2007 CoS and was based on data and projections available at that time.

NEW YORK POWER AUTHORITY
HYDROELECTRIC PROJECTS
FINAL PRODUCTION COST OF SERVICE
($000)

Line	Description		(Per 2007 CoS) 2008	2011	2012	2013	2014	Difference 2011 vs 2008 *
1	**Total Cost of Service**	**($000)**	**219,685**	**244,565**	**252,014**	**260,665**	**268,997**	**24,880**
2	**Credits for ancillary services**	($000)						
3	Black Start, O&M		81	69	72	74	76	(12)
4	Voltage Support, O&M		332	213	219	225	232	(119)
5	Remaining O&M		140,948	144,280	144,668	147,771	150,030	3,332
	(page 1, line 12 - (line 3+line 4)							
6	Operating Reserves, O&M		4.82%	4.62%	4.60%	4.55%	4.52%	
7	Regulation, O&M		0.57%	0.57%	0.57%	0.56%	0.56%	
8	Subtotal OR, Reg. O&M		5.39%	5.19%	5.17%	5.11%	5.08%	
9	Op. Res.+ Reg. O&M credit	($000)	7,597	7,488	7,479	7,551	7,622	(109)
	(line 8 * line 5)							
10	**Capital Reductions**							
11	All ancillary services		6.85%	6.92%	6.98%	6.99%	7.03%	
12	Subtotal capital reductions	($000)	5,365	6,920	7,472	7,870	8,342	1,555
	(page 1, line 16 * line 11)							
13	Total Ancillary Credits	($000)	13,375	14,690	15,243	15,721	16,271	1,315
	(sum lines 3,4,9,12)							
14	UCAP Credit	($000)		1,554	3,741	5,094	6,493	1,554
15	**Adjusted Cost of Service**	**($000)**	**206,310**	**228,321**	**233,030**	**239,851**	**246,233**	**22,011**
	(line 1 - (line 13 + line 14))							
16	Billing Demand	MW	36,137	34,086	35,035	35,871	36,100	(2,051)
17	Billing Demand Allocated Costs	($000)	106,822	128,858	133,567	140,388	146,770	22,035
	(line 15 - line 22)							
18	Billed Demand Rate	$/kW/mo	2.96	3.78	3.81	3.91	4.07	
	(line 17 / line 16)							
19	LTA Generation	GWh	20,221	20,216	20,216	20,216	20,216	(5)
20	Annual Generation	GWh	20,012	20,456	20,148	20,409	20,435	444
21	Billing Energy Rate	$/MWh	4.92	4.92	4.92	4.92	4.92	
22	Costs Allocated to Energy Rate	$/MWh	99,487	99,463	99,463	99,463	99,463	(25)
	(line 19 * line 21)							

* 2008 data is from 2007 CoS and was based on data and projections available at that time.

EXHIBIT "B"

NEW YORK POWER AUTHORITY
ESTIMATED AVERAGE ANNUAL CUSTOMER IMPACTS
Prices ($/MWh) include demand and energy components

		Current *	2011	2012	2013	2014
MUNIS/COOPS FULL REQUIREMENTS						
CURRENT HYDRO PRODUCTION RATES	$/MWh		10.36	10.42	10.41	10.41
PROPOSED HYDRO PRODUCTION RATES	$/MWh		10.91	11.55	12.17	12.87
INCREASES FROM CURRENT	$/MWh		0.55	1.13	1.76	2.46
END USE RESIDENTIAL IMPACTS						
SYSTEM RESIDENTIAL RATE	$/MWh	80.51	80.72	81.46	82.00	82.59
INCREASES FROM CURRENT	$/MWh		0.21	0.95	1.49	2.08
SYSTEM RESIDENTIAL AVG. BILL	$/mo	79.98	80.18	80.92	81.46	82.05
INCREASES FROM CURRENT	$/mo		0.21	0.94	1.48	2.07
MUNIS/COOPS PARTIAL REQUIREMENTS						
CURRENT HYDRO PRODUCTION RATES	$/MWh		10.61	10.69	10.68	10.68
PROPOSED HYDRO PRODUCTION RATES	$/MWh		11.18	11.88	12.53	13.24
INCREASES FROM CURRENT	$/MWh		0.58	1.19	1.85	2.56
END USE RESIDENTIAL IMPACTS						
SYSTEM RATE	$/MWh	59.27	59.51	60.38	61.01	61.69
INCREASES FROM CURRENT	$/MWh		0.24	1.12	1.74	2.42
SYSTEM RESIDENTIAL AVG. BILL	$/mo	64.87	65.14	66.09	66.78	67.52
INCREASES FROM CURRENT	$/mo		0.27	1.22	1.91	2.65
RESIDENTIAL UTILITY CUSTOMERS (PEAKING ONLY)						
END USE RESIDENTIAL IMPACTS						
SYSTEM RATE	$/MWh	135.58	135.61	135.71	135.79	135.83
INCREASES FROM CURRENT	$/MWh		0.03	0.13	0.21	0.25
SYSTEM RESIDENTIAL AVG. BILL	$/mo	88.94	88.96	89.03	89.07	89.10
INCREASES FROM CURRENT	$/mo		0.02	0.09	0.14	0.16

* Current is the most recent Energy Information Adminstration data, which is 2009.

Table 1
EMBEDDED COSTS FOR ANCILLARY SERVICES FOR NIAGARA AND ST. LAWRENCE

		2011	2012	2013	2014
Voltage Support O&M Cost Reduction ($)	[1]	212,522	218,897	225,464	232,228
Voltage Support Capital Share (%)	[2]	1.74%	1.85%	1.92%	1.98%
Black Start O&M Cost Reduction ($)	[3]	69,445	71,528	73,674	75,884
Black Start Capital Share (%)	[4]	0.074%	0.071%	0.069%	0.067%
Regulation O&M Share (%)	[5]	0.57%	0.57%	0.56%	0.56%
Regulation Capital Share (%)	[6]	0.57%	0.57%	0.56%	0.56%
Operating Reserve O&M Share (%)	[7]	4.62%	4.60%	4.55%	4.52%
Operating Reserve Capital Share (%)	[8]	4.62%	4.60%	4.55%	4.52%
Ancillary Service O&M Cost ($)	[9]	281,966	290,425	299,138	308,112
Ancillary Service O&M Share (%)	[10]	5.20%	5.17%	5.11%	5.09%
Ancillary Service Capital Share (%)	[11]	6.92%	6.98%	6.99%	7.03%

Notes and Sources:
[1]-[2]: Table 2.
[3]-[4]: Table 3.
[5]-[6]: Table 4.
[7]-[8]: Table 5.
[9]: [1] + [3]
[10]: [5] + [7]
[11]: 1 - { 1 - ([2]+[4]) } * { 1 - ([6]+[8]) }

Table 2
EMBEDDED COSTS FOR VOLTAGE SUPPORT FOR NIAGARA AND ST. LAWRENCE

		2011	2012	2013	2014
Voltage Fraction of Gross Capital (Niag. & St. L.)	[1]	**1.74%**	**1.85%**	**1.92%**	**1.98%**
Voltage O&M Expense : Niagara ($)	[2]	172,800	177,984	183,324	188,823
Voltage O&M Expense : St. Lawrence ($)	[3]	39,722	40,913	42,141	43,405
Total Voltage O&M Expense ($)	[4]	**212,522**	**218,897**	**225,464**	**232,228**

Notes and Sources:
[1]: From Workpaper 5.3. Fraction is Beginning-of-Year value (equal to End-of-Year value for previous year).
[2] and [3]: From Workpaper 2.2.
[4] = [2] + [3].

Table 3

EMBEDDED COSTS FOR BLACK START FOR NIAGARA AND ST. LAWRENCE

		2011	2012	2013	2014
Black Start Fraction of Gross Capital (Niag. & St. L.)	[1]	**0.074%**	**0.071%**	**0.069%**	**0.067%**
Inflation Factor	[2]	106.6%	103.0%	103.0%	103.0%
Black Start O&M Expense ($)	[3]	**69,445**	**71,528**	**73,674**	**75,884**

Notes and Sources:
[1]: From Workpaper 7. Fraction is Beginning-of-Year value (equal to End-of-Year value for previous year).
[2] = From Workpaper 1
[3]: Sum of Test Year Training costs for Niagara and St. Lawrence, plus O&M Cost allocated to Black Start from Workpaper 6 and adjusted by Inflation Factor in line [2].

Table 4
EMBEDDED COSTS FOR REGULATION FOR NIAGARA AND ST. LAWRENCE

		2011	2012	2013	2014
NYCA Peak Load	[1]	33,160	33,367	33,737	33,897
Total NYCA Regulation Requirement (MW)	[2]	223	223	223	223
Required regulation per MW of peak load (MW)	[3]	0.007	0.007	0.007	0.007
Peak load of all contract customers of Niagara and St. Lawrence (MW)	[4]	2,761	2,761	2,761	2,761
Required regulation for all contract customers of Niagara and St. Lawrence (MW)	[5]	19	18	18	18
Niagara & St. Lawrence Summer Generation Capacity (MW)	[6]	3,241	3,241	3,241	3,241
Share of regulation for all contract customers of Niagara and St. Lawrence in generation capacity (%)	[7]	0.57%	0.57%	0.56%	0.56%

Notes and Sources:
[1]: From Workpaper 8. Test year peak equals 2009 peak.
[2]: From Workpaper 8.
[3] = [2] / [1].
[4]: From Workpaper 8.
[5] = [3] * [4].
[6]: NYPA, "2009 Annual Report".
[7] = [5] / [6].

Table 5
EMBEDDED COSTS FOR OPERATING RESERVE FOR NIAGARA AND ST. LAWRENCE

		2011	2012	2013	2014
NYCA Peak Load	[1]	33,160	33,367	33,737	33,897
Total NYCA Reserve Requirement (MW)	[2]	1,800	1,800	1,800	1,800
Required reserve per MW of peak load (MW)	[3]	0.054	0.054	0.053	0.053
Peak load of all contract customers of Niagara and St. Lawrence (MW)	[4]	2,761	2,761	2,761	2,761
Required reserve for all contract customers of Niagara and St. Lawrence (MW)	[5]	150	149	147	147
Niagara & St. Lawrence Summer Generation Capacity (MW)	[6]	3,241	3,241	3,241	3,241
Share of required reserve for all contract customers of Niagara and St. Lawrence in generation capacity (%)	[7]	4.62%	4.60%	4.55%	4.52%

Notes and Sources:
[1]: From Workpaper 8. Test year peak equals 2009 peak.
[2]: From Workpaper 8.
[3] = [2] / [1].
[4]: From Workpaper 8.
[5] = [3] * [4].
[6]: NYPA, "2009 Annual Report".
[7] = [5] / [6].