

December 16, 2014

**MEMORANDUM 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 \$2.6 million or 1.9%, not including Astoria Energy II (“AE II”) plant expenses to be charged in 2015 to the New York City Governmental Customers (“Customers”). AE II plant expenses, although part of the Fixed Costs component, are not subject to this NOPR proceeding as recovery of such costs has been agreed to by contract. The proposal is based on Authority staff’s Preliminary 2015 Cost of Service (“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 have requested a modification in the 2015 COS process for the Authority to issue updated Fixed Costs component values once they are firmed up. As a result, the Authority delayed the reporting of the proposed fixed costs to the Customers until they were firmed up and is initiating the SAPA process with this Trustee approval. Upon closure of the 45-day statutory comment period concerning this proposed rate action, Authority staff will take into consideration concerns that have been raised and return to the Trustees at their March 2015 meeting, to seek final adoption of this proposal.

**BACKGROUND**

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

The LTAs separate all costs into two distinct categories: Fixed Costs and Variable Costs. Fixed Costs include Operation and Maintenance (“O&M”), Shared Services, Capital Cost, Other Expenses (*i.e.*, certain directly assignable costs) and a credit for investment and other income. Under the LTAs, the Authority must establish Fixed Costs based on cost-of-service principles

and make changes based on a filing in accordance with SAPA requirements. In addition, the LTAs contemplate that year-to-year changes in Fixed Costs will be reviewed by the Customers in advance of the filing made under SAPA. This year, the Customers requested to receive an update to the Fixed Costs proposal closer to the time of NYPA's development of its 2015 budget. As a result, Authority staff provided updated proposed Fixed Costs to the Customers in two steps. Modifications to all the non-O&M costs were issued by October 23, 2014; and modifications to the O&M fixed costs were issued by November 21, 2014. The Customers will review the proposed fixed costs and may submit comments on the Fixed Costs if warranted.

The Authority's policies and procedures call for a public forum if the Fixed Costs component of the proposed rate increase exceeds 2.0%. Since the proposed 2015 Fixed Costs component is increasing by 1.9% as compared to the Fixed Costs included in the Final 2014 COS, in accordance with the Authority's policies and procedures, no public forum will be held.

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

In the rate-setting process for the 2015 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 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 potential volatility are assigned to the Variable Costs.

On July 10, 2008, the Authority and the Customers entered into an agreement ("Agreement") that implemented Article XI of the LTAs concerning the acquisition of long-term resources under a request for proposal ("RFP") process. The RFP resulted in NYPA contracting with Astoria Energy II LLC for the full product toll of a 500 MW combined-cycle unit over a twenty-year period. The full product toll allows NYPA to capture all energy, capacity and ancillary services output of the generating unit for the benefit of the Customers. Under the Agreement, the costs incurred by NYPA are to be included as part of the COS based rate, and in order to ensure full recovery of all costs related to the full product toll, NYPA may use a true-up mechanism to assess charges for under-recovery and apply credits for over-recovery of costs. The 2015 costs related to the AE II service are \$139.3 million and have been included in the Fixed Costs component of the Preliminary 2015 COS but are not subject to this NOPR proceeding and not part of the proposed 1.9% increase.

## DISCUSSION

Based on the Preliminary 2015 COS, the increases in Fixed Costs are \$2.6 million, or 1.9% higher than the Fixed Costs included in the Final 2014 COS. Per Customer request, the SENY direct charges were moved from Shared Services to O&M. As such the 2014 COS numbers were adjusted with the same modification to provide an appropriate year-over-year comparison. With this modification, contributors to the Fixed Costs increase are \$2.6 million in additional direct site O&M and headquarters O&M (“Shared Services”) as well as \$0.6 million increase in Capital Costs due to higher working capital carrying charges for inventory and oil. The increase in O&M largely stems from projected costs in non-recurring work needed at the 500 MW Combined-Cycle Unit (“CCU”) and Small Hydro Facilities.

Variable Costs are projected to decrease by a total of \$64.8 million, or 12.6% compared to the Final 2014 COS. Based on preliminary analyses, Authority staff projects that the 2015 production rate, combining the Fixed and Variable Costs, will decrease by about 5.9% compared to the Final 2014 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. Following the closure of the 45-day statutory comment period concerning the proposal, Authority staff will take into consideration the concerns raised and will return to the Trustees at their meeting in March 2015, to seek final adoption of an appropriate Fixed Costs rate. Subsequent to such final adoption, staff will incorporate the approved Fixed Costs and the final Variable Costs that are determined in the rate-setting process with the Customers into new production rates to become effective with the March 2015 billing period.

## FISCAL INFORMATION

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

## RECOMMENDATION

The Manager – Pricing and Energy Market Analysis and the Vice President – Financial Planning 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 \$2.6 million to be charged in 2015 to the New York City Governmental Customers.

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

For the reasons stated above, I recommend the approval of the above-requested action by adoption of the resolution below.

Gil C. Quiniones  
President and Chief Executive Officer

## RESOLUTION

RESOLVED, That the Authority projects an increase in the Fixed Costs of serving the New York City Governmental Customers when comparing those costs contained in current rates to 2015 projected costs; and be it further

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

RESOLVED, That the Senior Vice President – Economic Development and Energy Efficiency, or his designee, be, and hereby is, authorized to issue written notice of this proposed action by the Trustees to the affected customers; and be it further

RESOLVED, That the Corporate Secretary of the Authority be, and hereby is, directed to file such notices as may be required with the Secretary of State for publication in the *New York State Register*; and be it further

RESOLVED, That the Chairman, the Vice Chair, the President and Chief Executive Officer, the Chief Operating Officer and all other officers of the Authority are, and each of them hereby is, authorized on behalf of the Authority to do any and all things, take any and all actions and execute and deliver any and all certificates, agreements and other documents to effectuate the foregoing resolution, subject to the approval of the form thereof by the Executive Vice President and General Counsel.