MINUTES OF THE REGULAR MEETING
OF THE
POWER AUTHORITY OF THE STATE OF NEW YORK

January 28, 2003

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Minutes of the Regular Meeting of the Power Authority of the State of New York held at the Albany Office at 11:00 a.m.

Present: Louis P. Ciminelli, Chairman
Frank S. McCullough, Jr., Vice Chairman
Timothy S. Carey, Trustee
Gerard D. DiMarco, Trustee
Joseph J. Seymour, Trustee

Eugene W. Zeltmann	President and Chief Executive Officer
David E. Blabey	Executive Vice President, Secretary and General Counsel
Robert A. Hiney	Executive Vice President – Power Generation
Vincent C. Vesce	Executive Vice President – Business Services and Administration
Peter A. Barden	Senior Vice President – Public & Government Affairs
Louise M. Morman	Senior Vice President – Marketing, Economic Development and Supply Planning
Robert L. Tscherne	Senior Vice President – Energy Services and Technology
Carmine J. Clemente	Deputy Secretary and Deputy General Counsel
Arnold M. Bellis	Vice President – Controller
Thomas P. Antenucci	Vice President – Project Management
Robert Deasy	Vice President – Energy Resource Management & Fuels Operation
Anne Wagner-Findeisen	Vice President – Ethics & Regulatory Compliance and Deputy Secretary
John M. Hoff	Vice President – Procurement and Real Estate
Charles I. Lipsky	Vice President - Chief Engineer
Thomas H. Warmath	Vice President and Chief Risk Officer, Energy Risk Assessment and Control
James H. Yates	Vice President – Major Account Marketing & Economic Development
Dennis T. Eccleston	Chief Information Officer
Peter Scalici	Acting Inspector General
John J. Hahn	Temporary Deputy Inspector General
Michael Brady	Acting Treasurer
Joseph J. Carline	Assistant General Counsel – Power & Transmission
William Ernsthaft	Assistant General Counsel – Finance
Gary Paslow	Executive Director – Policy Development
John L. Osinski	Executive Director – Regulatory Affairs
Craig D. Banner	Director – Electric System Marketing & Customer Billing
Jordan Brandeis	Director – Supply Planning & Power Contracts
Arthur M. Brennan	Director – Internal Audit
John B. Hamor	Director – Intergovernmental Affairs
John L. Murphy	Director – Public Relations
Mark O'Connor	Director – Real Estate
Gary D. Levenson	Senior Attorney II
James F. Pasquale	Manager – Business Power Allocations & Compliance
Roger W. Busha Jr.	Security Specialist
Benjamin C. Wong	Project Engineer
Angela D. Graves	Assistant Secretary – Legal Affairs
Andrew J. McLaughlin	Assistant Secretary – Legal Affairs
Noelle M. Zandri	Secretary to General Counsel
Bonnie Fahey	Executive Assistant

Denise Baker	Financial Administrator
Joann Duffy	Performance Planning Consultant
Wayne Gowen	Senior Network Specialist
Andrea Phillips	Legislative Liaison

Chairman Ciminelli presided over the meeting. Executive Vice President, Secretary and General Counsel Blabey kept the Minutes.

1. Approval of the Minutes

The minutes of the regular meeting of December 17, 2002 were unanimously adopted.

2. **Financial Reports for the Year Ended December 31, 2002 (Preliminary)**

Mr. Bellis provided the Financial Reports for the twelve month period ending December 31, 2002.

3. Report from the President and Chief Executive Officer

President Zeltmann congratulated Mr. Scalici on the Inspector General's recent training and education initiatives, emphasizing that security is an area of critical importance to the Authority and noting that he was pleased with the effort of the entire staff team working on security issues.

At the request of President Zeltmann, Mr. Antenucci provided a report on the status of construction of the 500 MW Combined Cycle Project in Queens.

Chairman Ciminelli requested that the Trustees be provided with a one or two page chart or table which would present, at a summary level, the status of scheduled progress versus actual, planned budget expenditures versus actual, and the status of contingency allocation. He noted that this information would provide the Trustees with a valuable frame of reference to gauge Project progress.

4. Power Allocations under the Power for Jobs Program

The President and Chief Executive Officer submitted the following report:

SUMMARY

"The Trustees are requested to approve 30 allocations of available power under the Power for Jobs ('PFJ') program to the businesses listed in Exhibit '4-A' which have been recommended for such allocations by the Economic Development Power Allocation Board ('EDPAB').

BACKGROUND

"In July 1997, Governor George E. Pataki and the New York State Legislature approved a program to provide low-cost power to businesses and not-for-profit corporations that agree to retain or create jobs in New York State. In return for commitments to create or retain jobs, successful applicants receive three-year contracts for PFJ electricity.

"The Power for Jobs program originally made available 400 megawatts ('MW') of power. The program was to be phased in over three years, with approximately 133 MW being made available each year. In July 1998, as a result of the initial success of the program, Governor Pataki and the Legislature amended the PFJ statute to accelerate the distribution of the power, making of total of 267 MW available in Year One. The 1998 amendments also increased the size of the program to 450 MW, with 50 MW to become available in Year Three.

"In May 2000, legislation was enacted which authorized another 300 MW of power to be allocated under the PFJ program. The additional MWs were described in the statute as 'phase four' of the program. Customers who received allocations in Year One were authorized to apply for reallocations. Over 95% reapplied. The balance of the power was awarded to new applicants.

"In July 2002, legislation was signed into law by Governor Pataki, which authorized another 183 megawatts of power to be allocated under the program. The additional MW are described in the statute as 'phase five' of the program. Customers who received allocations in Year Two or Year Three will be given priority to reapply for the program. Any remaining power will be made available to new applicants.

"Approved allocations will entitle the customer to receive the power from the Authority pursuant to a sale for resale agreement with the customer's local utility. A separate allocation contract between the customer and the Authority will contain job commitments enforceable by the Authority.

"The program is designed to assist New York State enterprises that are at risk of reducing or closing their operations or moving out of State or are willing to expand job opportunities. Successful applicants are required to create or maintain a specific number of jobs in order to qualify for an allocation. At various meetings from December 1997 through December 2002, the Trustee's approved allocations to 1,159 employers under the PFJ program. Currently, the program is linked to some 300,000 jobs at manufacturing facilities, small businesses, hospitals, colleges and cultural institutions across the state.

DISCUSSION

"Completed applications were reviewed by EDPAB and recommendations were made based on a number of competitive factors including the number of jobs retained or created, the amount of capital investment in New York State and whether a business is at a competitive disadvantage in New York. 30 applications were deemed highly qualified and presented to the EDPAB for its review on January 28, 2003.

"As a result of its meeting, the EDPAB recommended that the Authority's Trustees *{approve}* the allocations to the 30 businesses listed in Exhibit '4-A'. Exhibit '4-A' lists those businesses that were recommended to have their existing allocation extended under phase five of the program. Collectively, these organizations have agreed to create or retain over 9,500 jobs in New York State in exchange for allocations totaling 11.78 MW. The allocation contracts will be for a period of up to three years. The power will be wheeled by the investor-owned utilities as indicated in the exhibits. The basis for EDPAB's recommendations is also included in the exhibits.

RECOMMENDATION

"The Manager – Business Power Allocations and Compliance recommends that the Trustees approve the allocations of power under the Power for Jobs program to the companies listed in Exhibit '4-A'.

"The Executive Vice President, Secretary and General Counsel, the Senior Vice President – Marketing, Economic Development and Supply Planning, the Vice President – Major Account Marketing and Economic Development and I concur in the recommendation."

The following resolution, as submitted by the President and Chief Executive Officer, was unanimously adopted.

WHEREAS, the Economic Development Power Allocation Board has recommended that the Authority approve an aggregate 11.78 MW of allocations of Power for Jobs power to the companies listed in Exhibit "4-A";

NOW THEREFORE BE IT RESOLVED, That to implement such Economic Development Power Allocation Board recommendations, the Authority hereby approves allocations of Power for Jobs power to the companies listed in Exhibit "4-A" (the "Customers"), as submitted to this meeting, and that the Authority finds that such allocations are in all respects reasonable, consistent with the requirements of the Power for Jobs program and in the public interest; and be it further

RESOLVED, That a total of 11.78 MW of power purchased by the Authority for Power for Jobs be sold to the utilities that serve such Customers for resale to them for a period of up to three years under the terms of both the Authority's Power for Jobs sale for resale contracts with the utilities and separate allocation contracts between the Authority and such Customers; and be it further

RESOLVED, That the Senior Vice President - Marketing and Economic Development or her designee be, and hereby is, authorized to negotiate, subject to approval of the form thereof by the Executive Vice President, Secretary and General Counsel, to execute any and all documents necessary or desirable to effectuate the foregoing.

5. Municipal and Rural Cooperative Economic Development Program – Allocation to the Village of Green Island

The President and Chief Executive Officer submitted the following report:

SUMMARY

"The Trustees are requested to approve an allocation of power under the Municipal and Rural Cooperative Economic Development Program ('Program') to the Village of Green Island ('Green Island').

BACKGROUND

"The 1991 amendment to the power sales agreement between the Authority and the Municipal and Rural Cooperative Systems reserved 108,000 kW of power for economic development in the systems. As of September 17, 2002, 31,350 kW have been allocated.

"Power from this block can be allocated to individual systems to meet the increased electric load resulting from eligible new or expanding businesses in their service area. Under the guidelines established for the Program, an allocation to a system should meet a target number of new jobs per megawatt ('MW'). The guidelines provide that for businesses new to a system, the jobs per megawatt ratio is considered on a case-by-case basis. For projects involving existing businesses, the number of jobs per MW is the number of new jobs as compared to the level of employment prior to the expansion. Specifically, for companies employing 100 or less, the target ratio is 25 jobs per MW; for companies employing between 101 and 250, the ratio is 50; for companies employing between 251 and 500, the ratio is 75; and for companies employing over 500, the ratio is 100 jobs per MW.

"Green Island has submitted an application for power under the Program for consideration by the Trustees.

DISCUSSION

"An application has been submitted by Green Island on behalf of the Sealy Corporation ('Sealy'). Sealy is the largest bedding manufacturer in North America. Sealy, a privately held corporation, has been in business since 1881. Sealy produces a diversified line of mattress and bedding foundation products including many of the component parts and all of its proprietary and patented mattress innerspring requirements. Brand names include Sealy, Stearns and Foster, and Bassett. Sealy operates over 30 plants in 20 states and around the world and employs over 6,000 people. Sealy products are sold to 3,200 customers in over 7,000 retail outlets. Customers include furniture stores, leading department stores, sleep shops, and mass merchandisers. Sealy is also a leading supplier to the hospitality industry.

"Sealy is planning a proposed expansion that will involve the construction of a new 257,000 square-foot facility, housing manufacturing and some back-office space. Total project cost estimate is approximately $20 million dollars and will be located in the Village of Green Island Industrial Park. Sealy's current manufacturing facility is located in Albany where they employ 230 people.

"Sealy, attracted by an economic stimulus package, had made what it had considered a final decision to re-locate and expand in Clarion, PA when it was approached by the Green Island Industrial Development Association. It was determined that, with the prospect of less expensive power in conjunction with incentives from Empire State Development, the Green Island site would be the most economical. Empire State Development has confirmed that the power allocation is essential to keeping Sealy in New York State and that there is no option of keeping the load at its current location in New York.

"In addition to the retention of 230 jobs in the Albany area, the expansion at Green Island will provide for approximately 230 new jobs over the next three years, adding significant revenue to the local economy. The electrical load of the new facility is estimated to be approximately 750 kW which includes an expansion of 500 kW above the 250 kW load at the existing facility. It is recommended that the

Trustees approve an allocation of 500 kW to the Green Island under the Program on behalf of Sealy Corporation.

"The Municipal Electric Utilities Association Executive Committee supports the recommended allocation to Green Island.

"The recommended allocations under the Program comprise half hydropower and half incremental power. In accordance with the Authority's marketing arrangement with the municipal and cooperative customers, the hydropower will be added to the recipient system's contract demand at the time a project becomes operational. The hydropower earmarked for this Program is presently sold to the municipal and cooperative customers on a withdrawable basis. As a partial-requirements customer, Green Island may purchase the incremental power from the Authority or an alternate supplier.

RECOMMENDATION

"The Senior Vice President – Marketing, Economic Development & Supply Planning recommends that the Trustees approve the allocations of power under the Municipal and Rural Cooperative Economic Development Program to the Village of Green Island in accordance with the above memorandum of the President and Chief Executive Officer.

"The Executive Vice President – Power Generation, the Executive Vice President, Secretary and General Counsel, and I concur in the recommendation."

Mr. Banner presented the highlights of staff's recommendations to the Trustees.

Responding to questions from Trustee Seymour, Messrs. Hiney and Banner explained the details of the proposed allocation.

The following resolution, as submitted by the President and Chief Executive Officer, was unanimously adopted.

RESOLVED, That the allocation of power to the Village of Green Island under the Municipal and Rural Cooperative Economic Development Program is hereby approved as set forth in the forgoing report of the President and Chief Executive Officer; and be it further

RESOLVED, That the Senior Vice President – Marketing, Economic Development & Supply Planning or her designee be, and hereby is, authorized to execute any and all documents necessary or desirable, subject to approval of the form thereof by the Executive Vice President, Secretary and General Counsel, to effectuate the aforesaid allocation.

6. Quarterly Review of Power for Jobs Employment Commitments

The President and Chief Executive Officer submitted the following report:

SUMMARY

"The Trustees are requested to authorize a one year extension of the current moratorium on enforcement action against Power for Jobs ('PFJ') customers whose employment levels fall short of their agreed-upon commitments.

BACKGROUND

"Each year, the Authority initiates a review of all PFJ customers' performance against agreed upon job commitments. All of the PFJ contracts contain a commitment to retain or add a specific number of jobs. If the actual job levels fall below 90% of the customer's commitment, the Authority may reduce that customer's power allocation proportionately.

"At their meeting on March 26, 2002, the Trustees authorized a one year moratorium against taking job commitment enforcement action against PFJ customers. Customers were having difficulty meeting their commitments as a result of the national economic downturn. The Trustees approved the moratorium retroactive to January 1, 2002 and directed staff to report back to the Trustees at their meeting in January 2003 on whether the moratorium should be continued, modified or terminated.

DISCUSSION

"Recent reviews of customer job commitments show that the customers are continuing to feel the effects of the national economic downturn and most failures to meet job commitments may be attributed to overall economic conditions.

"Analysis of employment volatility by the Federal Reserve Bank of New York indicates that a significant portion of changes in New York State's employment relate to national economic conditions. The regional economies of New York State may be more or less sensitive to national economic trends (71% of Buffalo area employment volatility may be explained by national changes, compared to 37% of Albany area employment volatility.). However, for New York State as a whole, about 65% of change in employment levels is attributable to fluctuations in the national economy.

"Following the release of New York State's most recent employment data on January 23, 2003, New York State Chief Economist, Stephen Kagann, reported: 'Due to the lingering effects of the national recession, seasonally adjusted private employment in New York fell 6,800 or 0.1% in December 2002 from the previous month, equal to the national rate of decline of 0.1%. From December 2001 to December 2002, New York private employment declined 44,600 or 0.6%. A large share of the job losses was concentrated in New York City, which endured both the direct effects of September 11th and the reverberations from the national recession.'

"Consistent with overall national and state employment trends, approximately two-thirds of PFJ customers reported lower jobs in their current period than they had previously reported. Reducing their allocations would only continue to add to their financial distress.

"Moreover, the Power for Jobs statute does not authorize reallocation of power recovered by employment commitment enforcement action. Consequently, any power made available by reducing current Power for Jobs allocations could not be used to help retain or create jobs with new allocations.

"In consideration of all these factors, the moratorium should be continued and the customers who are not in compliance with their job commitments should be allowed to retain their allocations until their contracts expire or such time as the Trustees end the moratorium.

"The moratorium would be retroactive to January 1, 2003 and cover four PFJ quarterly commitment reviews. Each of these job commitment reviews will be conducted on the normal schedule and the Trustees will receive informational reports during 2003 following approval of the attached resolution.

RECOMMENDATION

"The Manager – Business Power Allocations and Compliance recommends that the Trustees approve a one year extension of the current moratorium on enforcement action against Power for Jobs ('PFJ') customers whose employment levels fall short of their agreed-upon commitments. The extension would be for one year, retroactive to January 1, 2003.

"The Executive Vice President, Secretary and General Counsel, the Senior Vice President – Marketing, Economic Development and Supply Planning, the Vice President – Major Accounts Marketing and Economic Development, and I concur in the recommendation."

Mr. Pasquale presented the highlights of staff's recommendations to the Trustees.

Chairman Ciminelli noted that the effects of 9/11/01 and the decrease in national economic activity had adversely affected industry in the state and made this moratorium necessary. Vice Chairman McCullough and Trustee Carey agreed with the Chairman and stated that they were in support of the proposed extension of the moratorium on enforcement actions.

The following resolution, as submitted by the President and Chief Executive Officer, was unanimously adopted.

RESOLVED, That the Authority hereby approves a one year extension retroactive to January 1, 2003, of the current moratorium on enforcement action against Power for Jobs customers whose employment levels fall short of their agreed-upon commitments; and be it further

RESOLVED, That the Manager – Business Power Allocations and Compliance will submit informational reports on Power for Jobs customers performance against agreed upon employment commitments to the Trustees on a regularly scheduled basis.

7. <u>Motion to Conduct Executive Session</u>

The President and Chief Executive Officer submitted the following report:

"Mr. Chairman, I move that the Authority conduct an executive session in connection with: (i) potential administrative litigation relating to particular persons and corporations, and (ii) the security of Authority facilities."

On motion duly made and seconded, an Executive Session was held at approximately 11:16 a.m. in connection with (i) potential administrative litigation relating to particular persons and corporations, and (ii) the security of Authority facilities.

8. <u>Motion to Resume Meeting in Open Session</u>

"Mr. Chairman, I move to resume the meeting in Open Session."

On motion duly made and seconded, the meeting resumed in open session at approximately 12:07 p.m.

9. Hydroelectric Preference Rates

The President and Chief Executive Officer submitted the following report:

SUMMARY

"The Trustees are requested to approve revisions to the hydroelectric preference power rate. Such revised rate would be placed in effect retroactive to December 18, 2001. A four-year rate plan is also proposed commencing May 1, 2003. This item also requests the Trustees to authorize the Secretary to file notice for publication in the State Register of this proposed action. Finally, the Trustees are requested to authorize the Secretary to schedule a public forum for the purpose of obtaining the views of interested parties concerning the Authority's proposed adjustment in the hydroelectric preference rates.

BACKGROUND

"At their meeting of April 28, 1992, the Trustees adopted the hydroelectric rates in effect today. Current preference rates are $1.00/kW-month for demand and $4.92/MW-hour for energy. These rates are in effect for all preference power sold to municipal, cooperative and investor-owned utilities, as well as out-of-state customers, served from the Niagara and St. Lawrence hydroelectric projects.

"Following Trustee adoption of the current rates in 1992, a group of 13 municipal electric utility customers ('plaintiffs') sought review of three aspects of the cost-of-service study supporting the rate. The plaintiffs filed two challenges to this rate: one in state court; and the other at the Federal Energy Regulatory Commission ('FERC'). They first pursued their claims at FERC which dismissed the plaintiffs' complaint for lack of jurisdiction over the Authority's preference power rate. Thereafter, eight of the 13 original plaintiffs reactivated their state court lawsuit (the *Bergen* litigation) and challenged the method used by the Authority to allocate its indirect overhead costs.

"After protracted litigation, in June 2000, the New York State Supreme Court ordered the Authority to issue refunds to the eight plaintiffs based on a revised and reduced rate calculated by use of plaintiffs' 'labor ratio' method of allocating indirect overhead costs. Pursuant to the court's decision, which was affirmed by the Appellate Division, Fourth Department, with leave denied to the Court of Appeals, the refund amounted to about $15 million and was based upon a revised rate which left the demand charge at one dollar per kW-month and reduced the energy charges in effect from May 1, 1992 through April 30, 1999 as follows:

		($/MW-hour)
Effective Period	Original Rate	Reduced Rate
5/1/1992 to 4/30/1993	3.82	2.57
5/1/1993 to 4/30/1994	4.35	3.07
5/1/1994 to 4/30/1999	4.92	3.61

"The plaintiffs were issued refunds (including interest) based upon (a) the court's decision covering their power purchases from the Authority during that period, and (b) a settlement of the plaintiffs' claims for the period May 1, 1999 to December 17, 2001.

"As a result of the *Bergen* case decision, the Trustees at their meeting of December 18, 2001, adopted resolutions making the preference power rate as of that date temporary, subject to refund or surcharge, directing Staff to prepare a full hydroelectric cost-of-service study to determine the appropriate level of the preference power base rates taking into consideration changes in the Authority's hydroelectric costs of service since January 1, 1992, and directing staff to employ the labor ratio method for allocating indirect overheads for hydroelectric cost of service purposes.

DISCUSSION

"The attached Report to the Trustees on Cost of Service ('Report') sets forth in detail how the hydroelectric cost of service study was performed and the findings of that study. The key points of that

Report are summarized here. Also included as part of the Report are two presentations by consultants from the Brattle Group, who were retained to develop the updated cost of service for preference power rates.

"Allocation of Indirect Overheads. The proposed hydroelectric cost-of-service study in the Report allocates the production-related portion of indirect overhead based on labor ratios, consistent with the method approved by the *Bergen* decision and adopted by the Trustees in their resolution of December 18, 2001.

"Changes in Cost Structure of Niagara and St. Lawrence Projects. The hydroelectric cost-of-service study set forth in the Report also reflects the significant changes in the Authority's business and hydroelectric cost structure since 1992. The study sets forth the financial effects of the ongoing life extension modernization program at St. Lawrence, which has so far cost $54.2 million through October 31, 2002, with an additional $78.8 million worth of additional investment planned through 2006. For Niagara, $209.4 million has been spent on life extension and modernization through the end of October 2002**,** with an additional $85.5 million expected to be spent through 2006. Relicensing costs for the St. Lawrence Project consist of $39.5 spent through October 2002 and are estimated to total an additional $76.8 million through 2006 while the administrative costs of relicensing the Niagara Project total $20.5 million through October 2002 and are estimated to cost an additional $55.8 million through 2006. Changes in the cost of service study also reflect the amortization of the $66.3 million tax-exempt debt issuance made in 2000 as well as future expected debt issuances of $342 million through 2006.

"These changes in the Authority's cost structure at the hydroelectric projects were provided to the consultants from the Brattle Group that we retained. The consultants' reports are described later in this Memorandum.

"**Costs Relating to NYISO-Provided Ancillary Services**. Another significant change since 1992 has been the creation of an ancillary services market under the supervision of the electricity market operator in New York State, the New York Independent System Operator ('NYISO'). Due to the electricity restructuring of 1999, the NYISO now is the sole provider of generation-based ancillary services to Load Serving Entities in the New York market. The Authority provides certain of these services to the NYISO for resale by the NYISO in the market. Since the Authority only sells these services to the NYISO, it is not appropriate that the costs associated with these services be borne by the preference customers. Hence, the proposed rates reflect the removal of the cost of providing these ancillary services from the hydroelectric cost of service.

"The calculation of the total costs to be removed from the hydroelectric cost of service was performed by Frank C. Graves of the Brattle Group. His calculations result in a $8.9 million reduction for the retroactive rate period and an $11.6 million per year average reduction in the cost of service for the four subsequent years.

"**Accrual Accounting of Postretirement Benefits Other than Pensions.** The cost-of-service reflects the switch to an accrual accounting for retiree health benefits, resulting in an annual charge to the hydro projects of $10.6 million per year on average. Historically, the Authority has recorded benefits owed to existing retirees on a cash basis which means that the cost of health benefits expended during the year were recovered in rates. Under the accrual approach, the rates also reflect the cost of the health benefits that are accrued that year, *i.e.* those benefits earned by present employees and payable to them in the future. While use of the cash basis is currently acceptable for government entities, the Government Accounting Standards Board ('GASB') has permitted and actively recommends the accrual method to its members. GASB has issued a timetable indicating its intention to require the implementation of accrual accounting by its members in 2006. The Authority adopted the accrual approach on November 30, 2002 for calendar year 2002 and later. The Authority's proposal does not include this cost for the retroactive rate period. The hydroelectric cost of service will reflect this cost in the 2003 rate year.

"The switch to accrual accounting will provide more relevant and useful information of the Authority's costs. In essence, the Authority's rates will follow the generally accepted 'matching' principle of ratemaking, which states that customers should pay utility rates based on the cost of services provided by current employees, rather than the costs of employees' past service. The conversion to this method imposes a liability on the Authority (*i.e.* a 'make-up' provision) of approximately $271 million that will be amortized over twenty years. The $10.6 million per year is the share allocable to the hydro projects based on labor ratios.

"GASB has long favored the accrual approach. Commercial entities have been required to apply accrual accounting and regulated utilities have been permitted to recover these costs in rates since the early 1990s. This practice is currently followed by the investor-owned electric utilities in New York State and elsewhere.

"**Capital Cost Recovery**. The capital cost recovery methodology reflected in the cost of service was supplied by A. Lawrence Kolbe, Ph.D. of the Brattle Group. Dr. Kolbe developed a hybrid capital cost recovery method for the Authority which reflects a combination of older, equity-financed assets and its newer, debt-financed assets at the hydroelectric facilities.

"The Authority previously used the traditional Original Cost or OC methodology to set rates. As Dr. Kolbe explains, under OC, an asset or group of assets is depreciated over their useful lives on a straight-line basis (return of capital) and a return on capital is applied to the remaining value of the asset(s). This results in a cash flow pattern that is highest at the beginning of the asset life and decreases to zero at the end of the asset life. This cash flow pattern is a close match to the cash flow required for debt financing. The return on capital is comprised of an inflation compensation component and a real return component. The inflation compensation component compensates investors for the expected loss of purchasing power over time. The real return component is the return above inflation that investors require predicated on their perception of the risk level of the investment and alternative investments available.

"With the repayment of the original hydro bonds in 1982, the Authority adopted a version of the Trended Original Cost or TOC methodology. Under the TOC method adopted by the Authority, straight-line depreciation is charged, but the depreciation charge is increased for inflation and the capital account is increased by an inflation factor. However, the Authority does not collect a return *on* its capital investment, *i.e.* it does not receive a real rate of return on its capital. The Authority made this method part of the *Auer* Settlement, and has advised Dr. Kolbe that these principles still apply to the development of future rates.

"Compared to the OC methodology, the *Auer* TOC methodology defers capital cost recovery to the later years of the asset life. The *Auer* TOC method is applied only to that portion of the Hydro Facilities' capitalization financed with equity. With the addition of new debt as well as internally-generated funds (equity) to finance new investments in the Hydro Facilities, the Authority needs to adopt a hybrid capital cost recovery structure. Dr. Kolbe has calculated the costs of this hybrid capital structure, which provides for recovery of debt service costs associated with the debt-financed portion while continuing to recover costs associated with the portion financed with internally-generated funds through the *Auer* TOC method.

"Revised Rate Design. The Authority proposes a revised preference rate design for the 2003-2006 rate years such that the total proposed rate increases would be recovered through increases to the demand charge rather than through increases in the energy charge. This rate design change reflects the fact that cost increases at the projects are made up of fixed costs which do not vary with the production of energy. Unlike other generating facilities, there is no cost for the energy (*i.e.*, water) used to fuel hydroelectric facilities. Thus, increases in fixed plant related costs are more appropriately recovered through increases to the demand charge rather than to the energy charge.

"From their inception in 1958, the Authority's hydroelectric rates were designed with a $1/kW-month demand charge, which has remained unaltered. All subsequent rate increases were recovered through increases in the energy charge, which grew from $2.67/MW-hour in 1958 to $4.92/MW-hour in 1994 as part of the Authority's previous rate plan.

"The Authority's previous use of the energy charge to recover increased costs while keeping the demand charge constant introduced an undesirable uncertainty into the revenue recovery because energy sales vary according to hydrologic conditions. The proposed increase in the demand charge will bring the Authority's preference rate design more in keeping with traditional ratemaking methodologies of electric utilities in North America by more closely aligning the cost recovery with the nature of the Authority's costs, most of which are fixed. The effect of the rate increases and rate design change on the various types of preference customers is shown on the table in Attachment A.

"Normalized Water Flows. As in prior hydroelectric cost of service studies, normalized water flows are used in the calculation of the proposed preference rates for the future rate periods.

"The Proposed Multi-Year Rate Plan. The proposed rate plan consists of new base rates for five periods. For the first period, the rate will be made retroactive from December 18, 2001 to April 30, 2003 and is based on a cost-of-service test year composed of the last three months of 2001 and the first nine months of 2002. The revised energy charge applicable for the temporary rates period ($4.59/MW-hour) would result in a 4% effective rate decrease as compared to the temporary rate. This results in a refund of approximately $4.4 million for the initial rate period.
This assumes that the demand charge remains at $1/kW-month; the Authority does not propose to implement the rate design change discussed above until the 2003 rate year.

"For the remaining four periods, Staff has developed proposed rates for each of the four years starting May 1, 2003 and ending on April 30, 2007. Staff used projected calendar year data as forecasts to set the rate for each of these 12-month rate periods. These result in the proposed increases in base demand rates and effective rates for 70% load factor customers as set forth in the table below:

12-Month Period Commencing	Demand Rate $/kW-month	Energy Rate $/MW-hour	Effective Rate (70% LF customer) $/MW-hour	% Increase
5/1/2003	1.45	4.92	7.76	13
5/1/2004	1.71	4.92	8.27	7
5/1/2005	2.10	4.92	9.02	9
5/1/2006	2.39	4.92	9.59	6

"To the extent that actual rates generate revenues in excess or less than the cost of service for a particular 12-month period, the revenue excess or shortfall, as the case may be**,** will accumulate in the Revenue Stabilization Reserve ('RSR'). Consistent with the attached Report, Staff recommends that the range within which no surcharge or credit would be applied be reduced from +/-$25 million to +/-$15 million. Reducing the range will ensure that rates charged to customers more closely track the actual costs of service. In addition, the RSR balance has never approached the $25 million range. At year-end 2001, the RSR balance was negative $725,000.

FISCAL INFORMATION

"Implementation of the proposed schedule of rate increases would allow the Authority to recover its increased costs associated with preference hydroelectric sales. On an annual basis, the rates recover (in nominal dollars) cost increases of $7.0 million, $14.5 million, and $22.4 million and 30.0 million for calendar years 2003, 2004, 2005 and 2006, respectively.

RECOMMENDATION

"The Director – Supply Planning & Power Contracts recommends that the Trustees authorize the Secretary to: (1) file notice for publication in the State Register of proposed Authority action to adjust the hydroelectric preference power rates, and (2) schedule a public forum for the purpose of gathering the views of interested persons concerning the proposed adjustment of the hydroelectric preference power rates.

"The Executive Vice President – Power Generation, the Executive Vice President, Secretary and General Counsel, the Executive Vice President and Chief Financial Office, the Senior Vice President – Marketing, Economic Development and Supply Planning, the Vice President, Ethics & Regulatory Compliance and Deputy Secretary, and the Vice President – Controller and I concur in the recommendation."

Mr. Brandeis presented the highlights of staff's recommendations to the Trustees.

Responding to questions from Vice Chairman McCullough, Mr. Brandeis discussed the nature and significance of the approximately $4.4 million potential refund mentioned in the memorandum to the Trustees.

The following resolution, as submitted by the President and Chief Executive Officer, was unanimously adopted.

RESOLVED, That the Secretary of the Authority be, and hereby is, authorized to file notice with the Secretary of State for publication in the State Register of the Authority's proposed action to adjust the hydroelectric preference power rates, as set forth in the foregoing report of the President and Chief Executive Officer; and be it further

RESOLVED, That the Secretary of the Authority be, and hereby is, authorized to schedule a public forum for the purpose of obtaining the views of interested persons concerning the Authority's proposed action to adjust the hydroelectric preference power rates, as set forth in the attached memorandum of the President and Chief Executive Officer; and be it further

RESOLVED, That the Senior Vice President – Marketing, Economic Development and Supply Planning, or her designee be, and hereby is, authorized to provide written notice to affected customers of such proposed hydroelectric preference power rates action.

Exhibit '9-A'
January 28, 2003

NEW YORK POWER AUTHORITY
ESTIMATED AVERAGE ANNUAL CUSTOMER IMPACTS

Prices (cents/kWh) include demand and energy components

	Test Year (Oct 01-Sept. 02)	2003	2004	2005	2006
Full Requirements Customers					
PRODUCTION RATES (cents/kWh)	0.692	0.752	0.817	0.885	0.950
Change		0.06	0.06	0.07	0.06
Percent		8.7%	8.6%	8.4%	7.3%
SYSTEM RATES (cents/kWh)	3.60	3.66	3.72	3.79	3.85
Change		0.06	0.06	0.07	0.06
Percent		1.6%	1.7%	1.8%	1.6%
RESIDENTIAL RATES (cents/kWh)	4.62	4.68	4.74	4.81	4.87
Change		0.06	0.06	0.07	0.06
Percent		1.3%	1.3%	1.4%	1.3%
cents/month		62.83	67.90	71.32	67.37
Partial Requirements Customers					
PRODUCTION RATES (cents/kWh)	0.687	0.745	0.808	0.875	0.938
Change		0.06	0.06	0.07	0.06
Percent		8.5%	8.5%	8.2%	7.2%
SYSTEM RATES (cents/kWh)	4.35	4.41	4.46	4.53	4.58
Change		0.05	0.06	0.06	0.06
Percent		1.2%	1.3%	1.4%	1.3%
RESIDENTIAL RATES (cents/kWh)	4.72	4.77	4.83	4.89	4.95
Change		0.05	0.06	0.06	0.06
Percent		1.1%	1.2%	1.3%	1.2%
cents/month		51.66	55.83	58.64	55.39
Residential Utility Customers					
PRODUCTION RATES (cents/kWh)	0.781	0.868	0.962	1.061	1.155
Change		0.09	0.09	0.10	0.09
Percent		11%	11%	10%	9%
RESIDENTIAL RATES (cents/kWh)	12.46	12.48	12.50	12.53	12.55
Change		0.02	0.02	0.02	0.02
Percent		0.2%	0.2%	0.2%	0.2%
cents/month		11.54	12.47	13.10	12.37

10. Convertible Static Compensator Project –
<u>Expenditure Authorization – Additional Funding</u>

The President and Chief Executive Officer submitted the following report:

SUMMARY

"The Trustees are requested to authorize a $1.7 million increase in expenditure for the Convertible Static Compensator ('CSC') Project. This amount is required to incorporate scope of work changes to provide Sound Walls for the five CSC transformers and additional costs of internal Craft labor charges, direct and indirect charges associated with the completion of Phase II construction work. This amount will increase the Authority's commitment for the CSC Project from the previously authorized amount of $39.5 million to $41.2 million.

BACKGROUND

"The Trustees approved the commitment of $39.5 million for the engineering, procurement and installation of a CSC power device at the Marcy Substation using Flexible AC Transmission System ('FACTS') technology. Included in this amount is $7.55 million for engineering, craft labor and construction management which will be provided by Authority staff.

"The Authority teamed up with the Electric Power Research Institute ('EPRI') on the CSC Project. The Authority and EPRI jointly issued a Request for Proposal for the development, procurement and installation of the CSC. Siemens Power Transmission & Distribution, Inc. ('Siemens'), the lowest cost bidder, was also selected based on the technology proposed. EPRI executed a contract with Siemens to provide the associated power electronics technology. The Authority executed a corresponding agreement with EPRI to fund the development and turnkey installation of the CSC Project. The Authority has obtained significant industry support and co-funding for this project from EPRI, Siemens and many utilities throughout the country. The co-funding amount is expected to match the committed amount of $13,000,000.

"This major transmission system reinforcement includes the CSC, a power-electronics control device, and the related high voltage equipment at the Marcy 345kV substation as well as conventional 135 MVAR capacitor banks at substations in New York State. In its shunt configuration, it will provide dynamic voltage support at Marcy and Central New York. In its series configuration, the CSC will provide the capability to control power flow. The CSC can be used in both the shunt and series configurations simultaneously for both voltage support and power control. Of particular note is the CSC's capability to control power flow simultaneously on two different lines in the same substation by exchanging power between them and routing power from a heavily-loaded line to an underutilized one. This concept would be an industry 'first' and would result in advancing the state-of-the art FACTS technology to the fourth generation level.

"Once completed, this device is projected to reduce transmission line congestion in Central New York State, increasing the power transfer capability across the critical Utica/Albany transmission corridor known as Central-East ('C-E') by up to 120 MW and across the Total East ('T-E') interface by up to 240 MW. It would also improve the overall reliability and resiliency of the New York State grid.

DISCUSSION

"The +/- 200 MVA dynamic shunt compensation portion of the CSC in conjunction with a 135 MVAR Capacitor bank at New York State Electric & Gas's Oakdale substation ('Phase I') was completed successfully and placed in service in April 2001. It provided increased transmission capacity of 60 MW over the C-E Interface corridor and a total of 114 MW over all transmission corridors to Southeast New York.

"Work is in progress on the addition of the series hardware on the Utica-New Scotland and Utica-Coopers Corners lines plus a capacitor bank at Niagara Mohawk Power Corporation's ('NMPC') Edic substation ('Phase II'). The Edic Capacitor Bank is placed in service on June 17, 2002. The remaining Phase II work is planned to be completed by June 30, 2003, and is expected to provide additional increases in the C-E and T-E transfer limits.

"The Authority's Engineering and Real Estate Divisions have investigated the noise complaints of some neighbors south of the Marcy substation after the Phase I CSC was in service. The noise emission from the CSC has been studied and the critical noise sources were identified to be from the two intermediate transformers, one shunt transformer and potentially also from the two Series Transformers. The Article VII Certificate authorizing the original construction and expansion of the Marcy Substation requires the Authority to take all measures necessary to resolve expeditiously any and all audio noise problems caused by the transmission and substation facilities. An engineering solution is to provide Sound Wall Barriers to mitigate and reduce the noise level of the five CSC transformers. The Sound Wall Barrier design is a complicated challenge with the limited height of the walls due to the clearance required from the existing electrical busses and the elevation at the location of the complaining households (about 50 feet higher than the transformers' elevation); and the extreme quiet ambient noise level of the area.

"All major procurement and construction contracts for the Phase II work have been awarded. The additional cost associated with the completion of Phase II work are the added scope of work to design and install Sound Wall Barriers for the five transformers, additional craft labor cost for installation of overhead busses and electrical work by Marcy staff, additional tractor-type equipment rental cost by Marcy staff to safely install the equipment and overhead busses on the 10% grade design of the CSC yard area, associated engineering, and direct and indirect charges.

"This results in an increase in cost estimate of $1.7 million.

<u>FISCAL INFORMATION</u>

"Payment associated with this project will be made from the Capital Fund.

<u>RECOMMENDATION</u>

"The Senior Vice President – Energy Services and Technology, the Senior Vice President – Transmission, the Vice President – Project Management, the Vice President and Chief Engineer, the Director – Research and Technology and Development, and the Project Manager recommend that the Trustees authorize additional funding of $1.7 million for the Convertible Static Compensator Project.

"The Executive Vice President – Power Generation, the Executive Vice President, Secretary and General Counsel, the Senior Vice President – Chief Financial Officer and I concur in the recommendation."

Mr. Wong presented the highlights of staff's recommendations to the Trustees.

Responding to questions from Chairman Ciminelli, Mr. Wong explained that the expenses related to constructing the proposed Sound Wall Barriers are such that they could not have been anticipated and are a response to noise complaints from neighbors.

Mr. Hiney elaborated further, explaining that a challenge in designing the Sound Wall Barriers is the very low ambient noise levels around the CSC Project.

The following resolution, as submitted by the President and Chief Executive Officer, was unanimously adopted.

RESOLVED, That capital expenditures are hereby approved to be committed in accordance with the Authority's Expenditure Authorization Procedures for the Convertible Static Compensator Project, in the amount and for the purposes listed below:

Capital	Previous Expenditure Authorization	Current Expenditure Request	Total Expenditure Authorization
Equipment Procurement Rental and Installation	**$31,950,000**	**$1,055,000**	**$33,005,000**
Engineering, Craft Labor, Const. Management and Authority Direct/Indirect	**7,550,000**	**645,000**	**8,195,000**
	$39,500,000	**$1,700,000**	**$41,200,000**

11. <u>Next Meeting</u>

The next Regular Meeting of the Trustees will be held on **Tuesday, February 25, 2003, at 11:00 a.m., at the White Plains Office**, unless otherwise designated by the Chairman with the concurrence of the Trustees.

On motion duly made and seconded, the meeting was adjourned by the Chairman at approximately 12:13 p.m.

12. <u>Closing</u>

Upon motion duly made and seconded, the meeting was closed at 12:13 P.M.

David E. Blabey
Executive Vice President,
Secretary and General Counsel

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