

**GOVERNOR'S PROGRAM BILL
2013**

MEMORANDUM

AN ACT to amend the public service law, the public authorities law and the executive law, in relation to the powers and duties of the department of public service and the Long Island power authority, and to repeal subdivision (u) of section 1020-f of the public authorities law relating to general powers of the authority (Part A); in relation to the issuance of securitized restructuring debt of the Long Island power authority (Part B)

Purpose:

This bill would bring accountability and transparency to the delivery of electricity on Long Island and the Rockaway Peninsula in Queens ("service area") by: (i) authorizing the reformulation of the relationship between the Long Island Power Authority (LIPA) and its service provider so that the service provider takes over control of utility operations in the service area and LIPA's role is minimized consistent with its fiduciary, financial and related obligations; (ii) creating a new Long Island-based office in the Department of Public Service (DPS) to oversee the core utility operations of the service provider; and (iii) authorizing the refinancing of a significant portion of LIPA's outstanding debt at lower interest rates and capping or eliminating certain categories of payments in lieu of taxes (PILOTs), with the savings passed onto ratepayers.

Summary of Provisions:

Section 1 of the bill would provide a blueprint for separating the bill into two parts.

PART A

Section 1 would delete a provision under Public Service Law (PSL) § 3 related to DPS undertaking a management and operational audit, which would be added to a new § 3-b.

Section 2 would add a new PSL § 3-b that would establish a new office within DPS to review and make recommendations to LIPA and its service provider related to core utility functions.

Section 3 would amend PSL § 18-a to create a funding mechanism for DPS's new office, without increasing the amount LIPA currently pays in 18-a assessments.

Sections 4 and 5 would reconstitute LIPA's board of trustees and create new eligibility criteria, effective January 1, 2014.

Section 6 would repeal Public Authorities Law (PAL) § 1020-f(u).

Section 7 would amend PAL § 1020-f by requiring LIPA and its service provider to comply with new or amended standards and procedures commensurate with DPS's new authority under PSL § 3-b.

Section 8 would: (i) eliminate the franchise tax paid to the State based on gross receipts and related taxes; and (ii) starting in calendar year 2015, cap at 2% per year any increases in PILOTs related to property owned by LIPA.

Section 9 would amend PAL § 1020-s to ensure consistency with PSL § 3-b.

Section 10 would amend PAL § 1020-w to conform requirements associated with LIPA's annual audit to those of other public authorities.

Section 11 would amend PAL § 1020-cc to eliminate certain approval and related requirements associated with LIPA's procurement and letting of contracts.

Section 12 would amend Executive Law (EL) § 94-a to empower the Utility Intervention Unit (UIU), within the Department of State, to participate in rate proceedings under PSL § 3-b and hold regular forums in each of the service areas of the six investor-owned utilities and LIPA.

Section 13 would allow LIPA to amend the operating service agreement entered into with PSEG, without having to obtain any additional approvals.

Section 14 would supersede a condition established in a resolution issued by the Public Authorities Control Board (PACB) related to the implementation of certain rate increases.

Section 15 would make Part A of the bill effective on January 1, 2014, except that section 12 would take effect on April 1, 2014 and sections 5, 10, 11, 13 and 14 would take effect immediately.

PART B

Section 1 of Part B of the bill would make legislative findings.

Section 2 would provide definitions of key terms.

Section 3 would authorize LIPA to issue a financing order with respect to refinancing an amount of outstanding debt by issuing restructuring bonds based upon a specified legal standard and expedited process to be followed by LIPA and the courts.¹ This section would also establish

¹ The Long Island Lighting Company or "LILCO" still exists as a subsidiary of the Long Island Power Authority (referred to in Part B of the bill as the "Authority"). The brand name "LIPA" is the d/b/a of LILCO. Although the LIPA name is used with respect to most public references associated with electricity delivery in the service area, the

that charges to ratepayers related to paying off such restructuring bonds would be irrevocable, and that neither the State nor LIPA would take or permit any action to reduce, impact, postpone or terminate such charges. This section would also require that the proceeds of the restructuring bonds be used to pay upfront financing costs and other approved costs related to refinancing LIPA's debt.

Section 4 would create a special purpose corporate municipal instrumentality of the State to issue the restructuring bonds and pledge the restructuring property, including the ratepayer charges and money collected from ratepayer charges, as security for such bonds. This section would also establish such special purpose entity's governance requirements, list the activities that it would be allowed to undertake and provide that it cannot file for bankruptcy.

Section 5 would establish the required content of the financing order to be issued by LIPA, and requirements and procedures related to periodic reporting and the mechanism needed to make periodic adjustments to ratepayer charges to ensure the adequacy of funds for repayment of principal and interest on the associated restructuring bonds and other ongoing financing costs. This section would also make the final financing order irrevocable, and ratepayer charges non-by-passable.

Section 6 would set the attributes of the restructuring bonds, so that such bonds would be without recourse to the credit or any assets of LIPA, would be tax exempt, would not constitute debt of the state and would constitute legal investments.

Section 7 would establish the attributes of the "restructuring property" – the cash flow related to the restructuring bonds and other ongoing financing costs – including that such property constitutes an existing present property right not subject to setoff or defense and may be pledged to create a perfected security interest or sold to create a true sale.

Section 8 would establish the duties and limit the rights of LIPA and any successor owner of LIPA's assets while restructuring bonds are outstanding.

Section 9 would establish the State pledge to holders of restructuring bonds.

Sections 10 through 16 would establish additional requirements related to choice of law, conflicts, severability, duration, standing and third-party billing.

Section 17 would make Part B of the bill effective immediately.

Section 2 of the bill would provide a severability clause.

Section 3 of the bill would make the bill effective as specified in the effective date associated with each of the two parts of the bill.

actual parent entity and the entity that maintains statutory authority on matters related to such electricity delivery is the Authority. To avoid confusion, this memorandum refers simply to LIPA.

Existing Law:

PSL § 3 establishes the powers of DPS and PAL Article 5, Title 1-a establishes the requirements and powers associated with LIPA. PSL § 18-a establishes, among other things, the mechanism by which DPS is funded. EL § 94-a(4)(b) establishes the powers of the UIU. PACB's Resolution No. 97-LI-1, dated July 16, 1997, established requirements related to LIPA's acquisition of certain assets.

Justification:

This bill would significantly revamp LIPA's role with respect to the delivery of electricity and its relationship to customers in the service area, and bring much-needed accountability and transparency to all matters related to electrical service in the service area. Since 1998, when it acquired LILCO's capital stock and affiliated assets, LIPA has never been directly responsible for operating the T&D system assets or providing electricity to its customers; instead it has contracted out virtually all of the operations and service responsibilities to other companies. That arrangement, and the fact that the LIPA-service provider structure has never been subject to any type of State utility oversight, has proved to be unworkable.

On November 13, 2012, Governor Andrew M. Cuomo established a Commission under the Moreland Act to, among other things, investigate LIPA's response to and preparations for Hurricanes Irene and Sandy. The Commission's interim report, issued January 7, 2013, found that LIPA and its current service provider – National Grid – struggled in the context of both storms to ensure adequate storm preparation, efficient storm response and effective restoration of customer service. The Commission found that the LIPA-National Grid management structure contributed to these problems. The Commission also found that in the context of the provision of electric service during normal conditions, LIPA and National Grid have personnel with overlapping responsibilities related to communications with customers and elected officials, determination of basic policies and overall management and operations of the system. The usage of the "LIPA" brand name with respect to all matter related to the service area, as well as the overlapping responsibilities between LIPA and National Grid, create confusion with respect to which entity is in charge of service, operations and management, and contribute to broken customer relationships, limited accountability and disconnected management, planning and operational processes.

Further, since acquiring LILCO's assets in 1998, LIPA's ratemaking process has been far too opaque. Confusion related to ratemaking persists because of a provision of the LIPA Act that exempts LIPA from having to obtain approval from the PSC with regard to rates and charges (PAL § 1020-s), and a contrary resolution adopted by the PACB in 1997 that requires LIPA to obtain the approval of the PSC prior to implementing an increase in average customer rates exceeding 2.5%. Many ratepayers and public officials are skeptical of LIPA's ratemaking process and see it as a way to obscure rate increases that arguably would be subject to PSC review and approval pursuant to the PACB resolution. Additionally, LIPA's excessive \$7 billion in debt contributes to high electric rates and affects LIPA's ability to capitalize its system in the same manner as investor-owned utilities.

Notwithstanding the operational and management problems associated with the LIPA-National Grid structure, public ownership of LIPA's assets does provide several important benefits, including the ability of LIPA to obtain tax-exempt financing and reimbursement from the Federal Emergency Management Agency associated with storm damages. Accordingly, this bill would maximize the benefits of public ownership of the T&D system by creating a more workable and effective relationship between LIPA and its service provider, under the oversight of a newly created Long Island-based office of DPS.

A. Maintaining Public Ownership of T&D Assets under DPS Oversight

A fundamental concern with respect to LIPA is its lack of transparency and the lack of oversight in fixing rates and budgeting, in contrast to the regulatory oversight of investment-owned utilities on these matters. To address these concerns, the bill would establish a new office within DPS to review and make recommendations to LIPA and/or its service provider related to core utility functions. The establishment of this new office would be timed to coincide with LIPA's transition on January 1, 2014 to a new service provider. In this regard, LIPA entered into an Operations Service Agreement (OSA), dated December 28, 2011, with PSEG Long Island, LLC (PSEG), to create a new entity – called "Servco"² – to take over responsibilities from National Grid to operate and manage LIPA's T&D assets. The new PSL § 3-b would authorize DPS to oversee Servco's operations.

For example, the DPS rate review process envisioned under Part A of the bill would maximize the transparency of and maintain the public's confidence in LIPA's ability to fix rates at the lowest level, while balancing LIPA's existing obligations to its bondholders. Rate review proceedings would be undertaken in a manner consistent with proceedings associated with rate proposals made by investor-owned utilities; *i.e.*, Servco would make the primary rate filings, an evidentiary hearing would be held before an administrative law judge, intervenors would be allowed to participate, briefs would be filed and a final recommended decision issued. At that point, the final decision on rates would be made by the LIPA board pursuant to the same public process established with respect to management and operational audits. *C.f.* L. 2012, ch. 8, § 3. The bill would amend PAL § 1020-f to require that, in early 2015, a proceeding would be commenced to review a 3-year rate proposal for 2016-18. Rate proposals after 2018 would be reviewed if they seek to increase revenues by 2.5% or more – the same triggering mechanism for investor-owned utilities. Importantly, the rate review process would be undertaken in a manner that would not delay LIPA's existing budget schedule.

Additionally, the bill would require Servco to prepare an emergency response plan in early 2014 that must meet the same requirements recently imposed on investor owned utilities under PSL § 66(21), with the initial storm plan being subject to a rigorous public review process. Servco would be required to undertake at least one drill per year to implement procedures to practice its emergency response plan and include participation of appropriate municipal emergency responders and officials. Servco would also be required to file for DPS review a report that evaluates its performance during any major storm event. These requirements would assure that Servco is better situated to address major storms in the future.

² Servco is the name specified in the OSA as the new service provider, although it may be provided with a different name upon taking over operations from a National Grid on January 1, 2014.

Other key provisions include requiring Servco to submit to DPS for review its annual capital expenditure plans. DPS would take over the role – currently with the UIU – of investigating and mediating customer complaints, consistent with the role it plays in resolving complaints made by customers of investor-owned utilities. The existing requirement related to management and operational audits would be amended to be consistent with PSL § 3-b and require the next audit to be undertaken no later than December 15, 2016 to better align the timing of the audit with the three-year rate plan to be fixed by January 1, 2016. DPS would review any proposal made by Servco related to distributed generation or other related programs. The bill would also require LIPA to take certain measures to ensure that future staffing is kept at minimum levels, consistent with meeting its contractual, fiduciary and statutory obligations. Because of the more focused role of LIPA management, the size of LIPA board would be reduced, with a new smaller board reconstituted on January 1, 2014 at the same time that Servco takes over operations in the service area.

As a result of the new DPS oversight role, the review and approval requirements associated with contracts greater than \$50,000, and associated contract letting requirements would become redundant and unnecessary. Accordingly, PAL § 1020-cc would be amended to eliminate these requirements. Similarly, because PSL § 3-b would require DPS review of rate increases of 2.5% or greater, the fifth project condition established under the 1997 PACB resolution would become redundant and thus superseded by enactment of § 3-b into law. The bill would also authorize LIPA to amend the OSA with PSEG, consistent with increasing Servco's responsibilities and accountability, and to address the new DPS oversight authority under PSL § 3-b. Because the amended OSA would need to be approved in an expedited manner to ensure a smooth transition to Servco, only LIPA board approval would be required to effectuate the contract amendments.

Finally, LIPA pays a franchise tax of about \$26 million per year to the State based on gross receipts, despite the fact that a provision of the Tax Law requiring investor-owned utilities to pay the same tax was repealed in 2000. Additionally, a review of LIPA's annual budget shows that PILOTs assessed by municipalities with respect to LIPA's T&D-related property are growing at a rapid rate. Both the gross receipts tax paid to the State and the PILOTs assessed by municipalities are passed on directly to LIPA's customers and paid as part of the utility bill. To reduce the effect of these taxes, the bill would eliminate entirely the gross receipts tax imposed by the State and, starting in calendar year 2015, cap the property-related PILOTs at 2% per year.

In sum, DPS oversight and the associated public participation requirements established under the bill would shed light on and bring accountability to the rate-making and storm planning processes, educate ratepayers and public officials with respect to utility practices in the service area, and make the oversight of Servco-LIPA more consistent with the oversight of investor-owned utilities.

B. Refinancing LIPA's Debt

Part B of the bill would authorize provide LIPA to refinance a significant portion of its debt in a manner that would provide much needed relief to ratepayers in the service area. LIPA has approximately \$7 billion in outstanding debt, a substantial portion of which was issued to

refinance debt associated with construction of the now abandoned Shoreham nuclear power plant. Incredibly, LIPA maintains basically the same amount of debt today as it did in 1998 when it acquired LILCO's assets. The annual debt service associated with such debt – over \$300 million per year – puts pressure on LIPA's customer rates. LIPA customers pay a portion of that debt through the delivery charge on their utility bills.

Part B of the bill would create a special purpose entity authorized pursuant to an expedited public process to issue restructuring bonds to refinance some of LIPA's existing debt. The debt would be secured by a new charge on customer bills, although the total delivery charge paid by each customer would be reduced by an amount greater than the new charge. The bill would provide the special purpose entity and the new charge on the bill with certain attributes that would enable the debt to be issued at lower interest rates than the interest rates on the bonds that would be redeemed or defeased. Like other bonds issued by State authorities, the restructuring bonds would be tied to a statutory pledge and agreement that the State would not in any way take or permit any action to revoke, modify, impair, postpone, terminate or amend the provision of the bill in any manner that would be materially adverse to the owners of such bonds.

Along with other cost-saving measures to be taken in the bill and the amended agreement with PSEG, authorizing LIPA to refinance its debt in the manner considered here would start the process of reducing the overall debt burden borne by LIPA's ratepayers.

Legislative History:

This is a new bill.

Budget Implications:

Starting in fiscal year 2014-15, all costs and expenses of DPS related to responsibilities under PSL § 3-b would amount to an offset of funds to be provided as a temporary state energy and utility service conservation assessment under PSL § 18-a(6), until such assessment expires by operation of law. The elimination of the State tax on gross receipts paid by LIPA pursuant to PAL § 1020-q(2) would result in a fiscal plan impact of approximately \$26 million per year.

Effective Date:

The effective dates of Parts A and B of the bill are as specified in the last section of each of the individual parts.