NewGen Strategies & Solutions

225 Union Boulevard
Suite 450
Lakewood, CO 80228
Phone: (720) 633-9514

September 8, 2023
via email

Senator Kevin Thomas, Co-Chair
Assembly Member Fred W. Thiele, Jr., Co-Chair
NYS Legislative Commission on the Future of LIPA
1979 Marcus Avenue, Suite 210
Lake Success, NY 11042

Subject: Review of LIPA Public Power Model Savings and Customer Rate Impacts

Dear Senator Thomas and Assembly Member Thiele:

NewGen Strategies and Solutions, LLC (NewGen) was retained by the New York State Legislative Commission on the Future of the Long Island Power Authority (Commission) to (1) conduct an independent review of the reasonableness of the projected financial savings identified by the Commission as associated with transitioning Long Island Power Authority (LIPA) to a "true publicly owned" power authority from its current structure utilizing a third-party service contractor, PSEG Long Island LLC (PSEG-LI), and (2) analyze the transition's potential rate impact on LIPA's customers.

Our analysis confirms that the projected financial savings associated with transitioning LIPA to a public power authority identified by the Commission are reasonable, and that the impact will be to lower rates for LIPA's customers if LIPA's Board of Trustees chooses to use the financial savings for that purpose.

The Commission's objective is to provide more competitive and reliable service to LIPA's customers by transitioning to a public power model that will improve operational and management efficiencies at LIPA, utilizing the existing workforce engaged directly in LIPA delivery and customer-related operations currently employed by the Long Island Electric Utility ServCo LLC (ServCo), a subsidiary of PSEG-LI. To support this effort, the Commission prepared the Draft Report on Establishment of a Public Power Model for the Operation of the Long Island Power Authority (Draft Report) dated April 17, 2023. The Draft Report provides an assessment of various aspects, benefits, and savings of establishing a public power model for LIPA. This public power model includes eliminating the third-party service contract of PSEG-LI and LIPA directly managing the ServCo and utility operations.

The Draft Report identifies, quantifies, and communicates the operational, financial, technical, and other aspects of the proposed transition for LIPA. The Draft Report contains two cost savings analyses: 1) LIPA Options Analysis developed by LIPA and 2) the "Conservative Viewpoint" developed by GDS Associates, Inc. (GDS), which was previously retained by the Commission to conduct such an independent analysis. The Draft Report identifies approximately $48 million (Conservative Viewpoint) to $78 million (LIPA Options Analysis) per year in cost savings from LIPA directly managing the operation of its electric system. The Commission recognizes that the application of any benefits from reductions in LIPA's costs resulting from the changes in its operational contract will ultimately be decided by the LIPA Board of Trustees. This letter report by NewGen reviews the estimated savings, calculates expected rate impacts, and discusses other considerations or recommendations regarding the implementation of the public power model for LIPA.

After our review of the Draft Report and supporting documents, NewGen concludes that if LIPA transitions to a public power organizational structure, then:

- The total annual cost savings estimates of $48 million (Conservative Viewpoint) to $78 million (LIPA Options Analysis) are reasonable.
- The total annual cost savings are likely to be closer to the LIPA Options Analysis of $78 million.
- These savings will allow LIPA's Board of Trustees to reduce electric bills for its customers and increase reinvestment in the utility system infrastructure.
    - Of the $48.0 million to $78.0 million in cost savings, approximately $23.7 million to $49.9 million will be available for customer bill reductions.
    - The remaining $24.3 million to $28.1 million will be available for increased reinvestment in the utility system infrastructure.

Review and Evaluation of LIPA and Draft Report Estimated Savings

NewGen completed a targeted review and evaluation of the estimated savings related to LIPA's transition to a public power model. This review focused on the ongoing savings estimates generated by operating as a public power utility and did not integrate the one-time transition-related costs. The transition costs are a one-time expense ranging from $16 million (LIPA Option Analysis) to $59 million (Conservative Viewpoint).[1] With one-time transition costs estimated by LIPA, LIPA customers will see cost savings in year 1 and larger cost savings in years 2 and beyond. With the one-time transition costs in the Conservative Viewpoint, customers may not see a decrease in year one, but will see costs decrease in years 2 and beyond.

NewGen reviewed and consulted the following documents supplied by the Commission, LIPA, the prior consultant's evaluations used in the Draft Report, and publicly available information. The source documents reviewed and consulted included:

- Second Amended and Restated Operations Service Agreement with PSEG-LI (Second A&R OSA)
- LIPA Financial Statements
- LIPA Bond Official Statements
- 2021-DPS-Management-and-Operations-Audit-Annual-Report-November-17-2021
- Draft Report to the Legislative Commission on the Future of LIPA, dated April 17, 2023 (Draft Report)
- GDS Associates, Inc. Microsoft Excel model supporting Draft Report results
- LIPA 2023 Operating Budget
- LIPA Cost of Service and Rate Models
- LIPA Fact Sheet on Public Power Model, 2023
- Lazard Report on Privatization and Public Power Models, February 2023

The reductions in costs identified with a transition to a public power model were associated with the elimination of the PSEG-LI service agreement or Second A&R OSA. PSEG-LI serves as the third-party

[1] Draft Report page 63, Table 2.

management contractor for LIPA and manages the ServCo staff operating the utility system. PSEG-LI's Second A&R OSA is set to expire at the end of 2025 and defines three service areas or fees as shown below.

- **PSEG-LI Management Fee** (currently $78 million): This cost includes the 19 contracted director-level staff to manage the operations of the ServCo and the profit, fee, and incentives which PSEG-LI receives as the third-party contractor.
- **IT/Affiliate** (currently $24 million): These are pass-through costs of the broader PSEG corporation which provides information technology (IT), human resources, procurement, and other functional administrative support.
- **Energy Management Fee** (currently $19 million): These are pass-through costs for the management of the power supply function such as bidding for all generation assets under contract to LIPA into the market, scheduling outages and tests of contract assets, and managing forward energy hedges and fuel commodity purchases.

PSEG-LI Management Fee

The primary source of savings identified by eliminating the PSEG-LI service contract was associated with the PSEG-LI Management Fee. Based on LIPA's Options Analysis evaluation of the savings, LIPA can provide similar services to the Management Fee for approximately $5 million per year. Based on the prior consultant's evaluation (Conservative Viewpoint), LIPA can provide similar services to the Management Fee for approximately $15 million per year. Whether the LIPA Options Analysis or Conservative Viewpoint cost estimate is utilized, this change will result in $63 to $73 million a year in cost savings as shown in Table 1.

These estimates of costs for LIPA to replace the staff, expertise, and responsibilities in the PSEG-LI Management Fee were based on LIPA's Options Analysis that between 6 and 12 new LIPA staff are required to replace the 19 contracted PSEG-LI positions. This estimate was based on LIPA's leadership identifying significant overlap of roles and responsibilities for eight of its existing employees with the PSEG-LI Management Fee directors and five existing ServCo managers performing the roles of the contracted directors. Thus, a minimum of six additional staff are required to perform the same tasks, roles, and responsibilities as the contracted 19 PSEG-LI staff included in the Management Fee.[2] To ensure the new staffing cost estimate is sufficient, a budget for up to 12 new staff was used in the LIPA Options Analysis. As a result, the $5 million per year is labor-related costs to provide the equivalent management of the 19 contracted positions within PSEG-LI. Should LIPA become a public power utility, it will not recover additional fees, profits, or further incentive compensation that make up the majority of the $78 million Management Fee from PSEG-LI.[3]

IT/Affiliate and Energy Management Fees

There were other adjustments in expected operating and management costs by transitioning to the public power model; however, these adjustments were minor compared to the elimination of the Management Fee. Other minor adjustments to the expected operating costs of the public power model by LIPA and the Draft Report included the pass-through costs from PSEG-LI. The purpose of a pass-through cost is to

[2] Draft Report, page 119.
[3] Second Amended and Restated Operating and Service Agreement, Section 5.1 and Appendix 4.2 (D).

recover the costs of the services and operations. Thus, LIPA did not expect these costs to change substantially as they were transitioned to LIPA direct costs and operations; these changes are listed below.

- IT/Affiliate Services Fee adjusted from $24 million to $23 million in the LIPA Options Analysis with a Conservative Viewpoint estimated at $33 million.
- Energy Management Fee adjusted from $19 million to $15 million in the LIPA Options Analysis with a Conservative Viewpoint estimated at $25 million.

As the IT/Affiliate and Energy Management costs are simply pass-through costs of PSEG-LI operations, it is expected that LIPA will have similar costs when these operations are fully transitioned in-house. LIPA's Options Analysis estimated a $1 million savings as the IT costs are transitioned in-house. The effort is already underway as of September 2022 and will bring the existing IT services from PSEG-LI in New Jersey to LIPA.

While the IT/Affiliate and Energy Management costs could remain stable as projected by LIPA, the Draft Report identified a Conservative Viewpoint related to risks in transitioning to the standalone structure, and IT systems implementation efforts often face schedule delays and unforeseen costs. Based on these concerns, a cost increase of $9 million was included in the Conservative Viewpoint.

Similar to this approach with the IT/Affiliate Services, LIPA expects the Energy Management costs to remain relatively stable in the public power model; however, the LIPA Options Analysis estimated a savings of $4 million from the current $19 million per year for the pass-through services. NewGen did not have access to backup data supporting the $4 million reduction in costs in the public power model; however, the LIPA Options Analysis assumed that there would be improved efficiencies and potential cost reductions with likely overlap with existing LIPA staff and bringing operations in-house. The Draft Report identified a Conservative Viewpoint related to risks in transitioning the Energy Management operations in-house and potential loss of economies of scale that PSEG likely experiences with a larger utility operation. Based on this concern, a cost increase of $6 million was included in the Conservative Viewpoint.

The Current Costs, LIPA Options Analysis estimated costs, and Conservative Viewpoint costs are summarized in Table 1 and taken directly from the Draft Report.[4]

[4] https://nylipa.gov/storage/20230417_draft_report.pdf Table 1, page 57.

Table 1
LIPA Pro Forma Cost Components – Potential for Change

PSEG-LI Fee Item	Current Costs ($000)	LIPA Options Analysis ($000)	Conservative Scenario ($000)
PSEG-LI Management Fee – Operating Expense	$48,000	$3,100	$9,300
PSEG-LI Management Fee – Capitalized Expense(1)	$30,000	$1,900	$5,700
PSEG-LI Management Fee Subtotal	$78,000	$5,000	$15,000
PSEG-LI IT/Affiliate Services Fee	$24,000	$23,000	$33,000
PSEG-LI Energy Management Fee	$19,000	$15,000	$25,000
Total Annual Costs	$121,000	$43,000	$73,000
Savings compared to Current Costs		($78,000)	($48,000)

(1) The capitalized portion of labor does not show up as an expense as suggested within this table.

Reasonableness of Estimated Savings

NewGen also reviewed the cost savings estimates made in the Draft Report (Table 1) to assess if they meet a "reasonable" standard in the industry. For this effort, NewGen performed a high-level evaluation of the methodology and approach to estimating the cost savings from the proposed operational changes. In reviewing the largest source of cost savings, the Management Fee, it is reasonable to eliminate the majority of the costs PSEG-LI currently recovers for the fee from LIPA customers.

The Management Fee primarily represents the profit, performance incentives, and fees that a for-profit company and investor-owned utility would recover for its services. Transitioning to a public power model eliminates most, if not all, of these profit-related and incentive costs. The costs that remain for the public power model would be the remaining labor costs in the Management Fee related to the roles and responsibilities of the 19 budgeted management staff and directors. The LIPA Options Analysis estimate for new staff at LIPA to ensure the existing roles and responsibilities are properly included in-house at LIPA is reasonable and likely conservative. The Conservative Viewpoint increased the number of staff from LIPA's Options Analysis, resulting in a cost estimate of $15 million annually to perform the same functions as the PSEG-LI 19 director positions. In reviewing the LIPA Options Analysis, the labor costs assumed are already conservative to provide the level of service LIPA is currently paying in the Management Fee. The Conservative Scenario seems overly conservative; therefore, we believe that the LIPA Options Analysis estimate is more than adequate and the more likely outcome.

Please note that the PSEG-LI Management Fee is separated into operating and capitalized expenses based on information in the Draft Report and from LIPA staff. Currently, some of the PSEG-LI Management Fee and staff time is associated with and allocated to capital projects and management. This split between operating and capital expenses is important when the savings are translated into LIPA customer billing impacts.

The remaining cost reductions or changes estimated in the LIPA Options Analysis are minor and related to the pass-through operational costs for IT, administrative, and energy management services at PSEG-LI on behalf of LIPA. As these appear to simply pass through direct costs, it is reasonable to expect similar costs for the LIPA public power model as they will perform the same activities as PSEG-LI currently provides. The LIPA Options Analysis and Conservative Viewpoint costs for the PSEG-LI fees are summarized in Table 1 and were taken directly from the Draft Report.

In our opinion, the LIPA Options Analysis costs appear reasonable, and the Conservative Viewpoint costs appear to be overly conservative. LIPA's total annual costs should decrease by at least $48 million and up to $78 million per year based on the information contained in the Draft Report. It is important to note that our review focused on the reasonableness of the aggregate savings and methodology. We do not opine on the accuracy of more detailed calculations in the supporting LIPA or GDS financial models, and we do not make any warranties or guarantees of the savings projected and used in the prior LIPA Options Analysis.

Operating Expenses and Capitalization of Expenses

While the total cost savings are projected to be $78 million in the LIPA Options Analysis for the transition to a public power model, those amounts do not directly translate dollar for dollar into LIPA customer bill reductions. It is important to note that the cost reductions will be split between operational savings and capital savings. The reduction in the operating expense portion of the Management Fee (from $48 million to $3.1 million), not the capitalized expense reduction (from $30 million to $1.9 million), will directly reduce customer bills.

Operating expenses are recovered on a "one to one" basis each year in the rates from customers. The capitalized expense reduction ($30 million to $1.9 million) can be used for additional support of high priority capital needs such as additional storm hardening. Table 2 summarizes the annual customer savings of operating and capitalized expense savings from Table 1.

Table 2
Projected Annual Cost Savings for LIPA

PSEG-LI Fee Item	LIPA Options Analysis Savings per Year ($000)	Conservative Viewpoint Savings per Year ($000)
PSEG-LI Management Fee – Operating Expense	$44,900	$38,700
PSEG-LI IT/Affiliate Services Fee	$1,000	($9,000)
PSEG-LI Energy Management Fee	$4,000	($6,000)
Total Cost Savings on Customer Bills	$49,900	$23,700
Total Cost Savings to Invest in Infrastructure	$28,100	$24,300
Total Annual Cost Savings	$78,000	$48,000

This treatment of the PSEG-LI Management Fee in our analysis differs from that in the Draft Report, which was offered for illustrative purposes. In the Draft Report, it appears the total capitalized expense savings ($28.1 million for LIPA Options Analysis or $24.3 million Conservative Viewpoint) were subtracted from the annual debt service expense to estimate a total annual LIPA operating cost reduction and eventual reduction in customer's bills.

Potential Rate Impacts from Estimated Savings

In addition to our review of the Draft Report and supporting financial model, NewGen conducted an analysis of the potential retail rate impacts from the estimated cost savings to LIPA residential customers. To accomplish this task, the Commission provided NewGen with a copy of LIPA's functional cost-of-service and rate models as well as staff resources at LIPA for any questions or clarifications regarding the rate making process and strategy for the utility. LIPA's rates primarily include two components: the Power Supply Charge and the Delivery Charge.

Based on a review of the cost of service model and discussions with LIPA staff, NewGen determined the PSEG-LI costs from the Management Fee and IT/Affiliate Fee are included in the Delivery Charge portion of LIPA's rates. Thus, the majority of the savings generated from transitioning to a public power model will eventually reduce the Delivery Charges in LIPA's tariffs. Furthermore, the Energy Management Fee is recovered in the Power Supply Charge. Thus, the changes in costs for transitioning costs from PSEG-LI to the public power model would affect both the Delivery and Power Supply Charges for LIPA customers. LIPA's 2023 total revenue projections and breakdown by charge type are included in Table 3.

Table 3
2023 Projected Revenues

Description	2023 Revenue ($000s)	Portion
Delivery Charge	$1,873,619	45%
Merchant Function Charge	$26,193	1%
Power Supply Charge	$2,072,186	49%
Energy Efficiency and Renewable Energy (DER)	$79,800	2%
Taxes, PILOTs, Miscellaneous Revenues	$151,336	4%
Total Revenues	$4,203,134	100%

Based on the 2023 projected revenues in Table 3, the Delivery Charge represents 45% of the total revenue or $1.9 billion and the Power Supply Charge represents 49% or $2.1 billion. As shown in Table 2, the projected annualized savings for LIPA from transitioning to a public power model range from $23.7 to $49.9 million based on the LIPA Options Analysis and the Conservative Viewpoint in the Draft Report. The impacts of the projected savings to the Delivery Charge, Power Supply Charge, and Total Bills are included in Table 4.

Table 4
Public Power Savings Impacts to Bills

Description	Current Rate Revenues ($000)	LIPA Options Analysis ($000)	As a Percent of Current Rate	Conservative Viewpoint ($000)	As a Percent of Current Rate
Delivery Charge	$1,873,619	($45,900)	(2.4%)	($29,700)	(1.6%)
Power Supply Charge	$2,072,186	($4,000)	(0.2%)	$6,000	0.3%
All other charges, taxes	$257,329	$-	0.0%	$-	0.0%
Total	$4,203,134	($49,900)	(1.2%)	($23,700)	(0.6%)

The LIPA Options Analysis forecasted costs result in decreases in rates including a 2.4% reduction to the Delivery Charge, a 0.2% reduction to the Power Supply Charge, and an overall decrease of 1.2% to the total retail rates. The Conservative Viewpoint results in a 1.6% decrease to the Delivery Charge, a 0.3% increase to the Power Supply Charge, and an overall decrease of 0.6% to the total retail rates, including taxes.

LIPA historically follows a rate making policy of equal rate changes for all classes and related charges within each customer class. For example, if LIPA implemented a 2.5% rate increase, all classes' rates would increase at 2.5% and each charge (e.g., Customer Service and Delivery) would increase at that same rate. Based on this rate making policy, NewGen recreated an average residential customer's monthly bill using the LIPA Options Analysis and Conservative Viewpoint savings results. Table 5 summarizes an average residential customer's monthly bill after applying the Conservative Viewpoint and the LIPA Options Analysis savings.

Table 5
Residential Customer Bill Impacts(1)

Description	Current Bill	LIPA Options Analysis Bill	Change From Current	Conservative Viewpoint Bill	Change From Current
Delivery Charge Total	$84.51	$82.44	(2.4%)	$83.17	(1.6%)
Power Supply Charge Total	$79.53	$79.38	(0.2%)	$79.76	0.3%
Total	$164.04	$161.81	(1.4%)	$162.93	(0.7%)
Change in Bill		($2.22)		($1.11)	

(1) Bill impact analysis assumes an average monthly usage of 723 kilowatt hours (kWh) at a Power Supply Charge of $0.11 per kWh. Does not include Revenue Decoupling Charge or Other Charges/Taxes.

As Table 5 shows, the reduction in an average residential bill could range from about $1 to $2 per month. It is important to note that this approach to applying the estimated savings generated by moving to a public power model used the historical LIPA rate strategy, not a cost of service model.

Other Considerations and Evaluations for the Transition to a Public Power Model

In addition to our review of the savings estimates provided, NewGen identified two other areas for consideration and potential further evaluation. As mentioned in the Draft Report, LIPA costs currently include $13 million per year in expenses for a dedicated department and staff at the New York Department of Public Service (DPS) for oversight of the utility. This oversight includes "review and recommendation" authority which is oversight of operations and terms and conditions of service, rates, and budgets established by LIPA and its service provider. This also includes DPS's review of, and essentially the authority to approve, any rate changes greater than 2.5%.

This level of annual oversight by a state DPS is atypical for public power utilities and options were discussed in the Draft Report for alternatives in the role and level of involvement of DPS with LIPA as a full public power utility. While it appears that legislation is required to limit, modify, or remove the requirement of annual DPS oversight of LIPA, if that were to happen and LIPA's operations align with other public power models, LIPA could save $13 million annually. This $13 million in annual cost savings would be in addition to the identified savings in the LIPA Options Analysis and Conservative Viewpoint.

The transition currently underway to bring IT services from PSEG-LI in-house to LIPA should also be monitored as it progresses. This process began in September 2022 and is expected to last through the end of 2024 or 2025 with the expiration of the current service agreement with PSEG-LI. Based on discussions with LIPA management, the critical IT infrastructure has already been transitioned to standalone systems and the remaining IT systems transition is in progress. The remaining IT systems transition efforts will be focused on more administrative types of IT systems, not utility operational or reliability-related systems. If there are additional costs for the broader IT transition effort, they should be integrated with and adjust the cost savings calculations included in this evaluation.

Summary and Conclusions

After our review of the Draft Report and supporting documents, NewGen concludes that should LIPA move to a public power organization structure, then:

- The total cost savings estimates of $48 million (Conservative Viewpoint) to $78 million (LIPA Options Analysis) are reasonable.
- The total cost savings are likely to be closer to the LIPA Options Analysis of $78 million.
- The largest driver of the cost savings is the elimination of the PSEG-LI Management Fee. The Management Fee is directly related to and almost solely driven by PSEG-LI profit and fees for managing LIPA. As a public power utility, these profit and fee-related costs will be eliminated.
- The second largest driver of the cost savings is the projected reduction in the number of staff LIPA would hire to replace the PSEG-LI staff.
- These savings would be realized by LIPA customers with reduced electric bills and increased reinvestment in the utility system infrastructure.
    - Of the $48 million to $78 million in cost savings, approximately $23.7 million to $49.9 million would translate to customer bill reductions.
    - The remaining $24.3 million to $28.1 million would translate to increased reinvestment in the utility system infrastructure.

We recognize that the LIPA Board of Trustees will have the ultimate responsibility in determining how any reduction in costs would be applied to LIPA's financial situation, including future rate revenues. With this said, if LIPA follows its historical rate making practices of applying level rate changes to all customer classes, these reductions in costs will result in a typical residential customer's bill decreasing by $1 to almost $2 per month, or 0.7% and 1.4%, respectively.

Sincerely,

NewGen Strategies and Solutions, LLC

DocuSigned by:
Jill Schuepbach
654E055C66394D8...
Jill Schuepbach
Principal

CC: The Honorable Rory Lancman, Executive Director