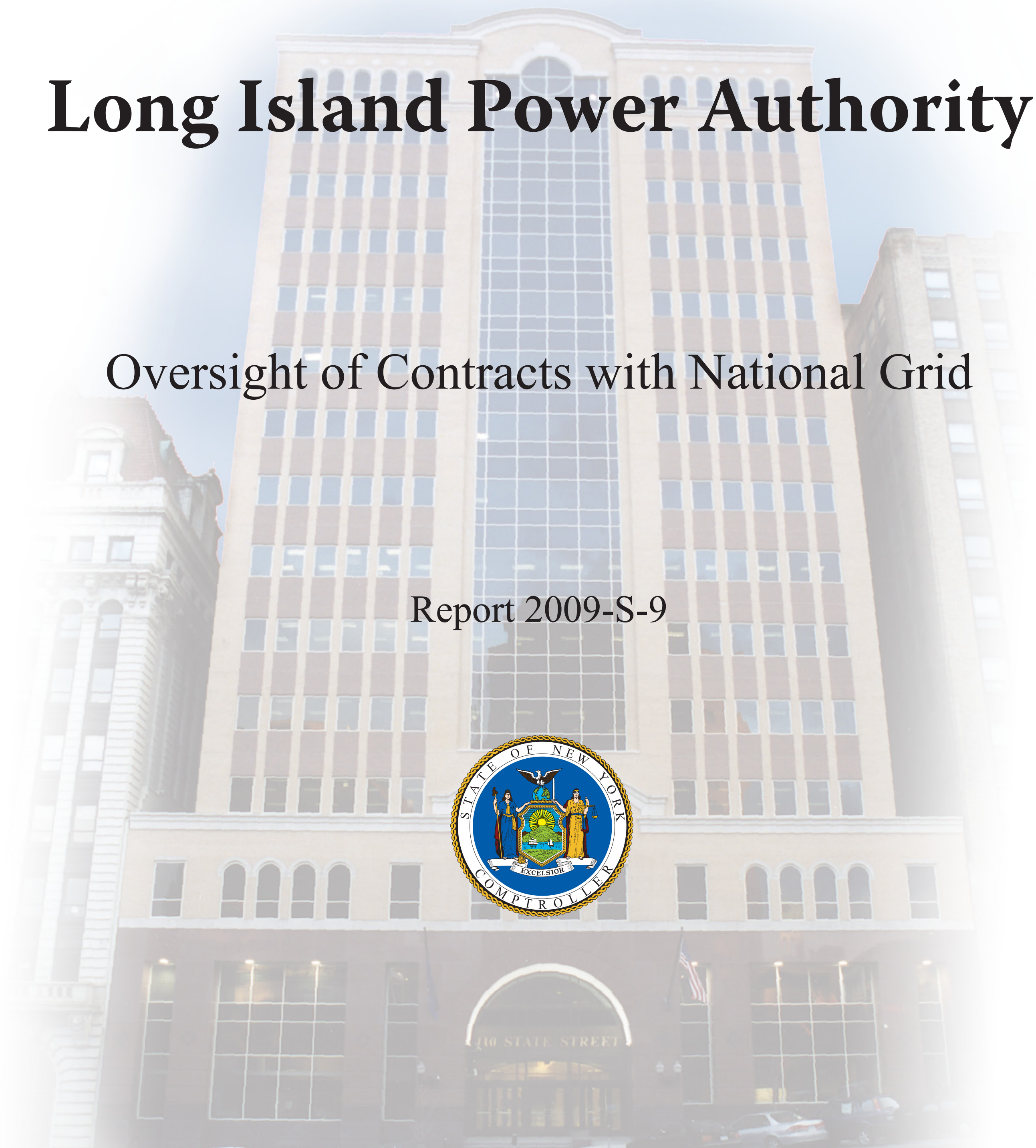
Office of the New York State Comptroller

Division of State Government Accountability

Long Island Power Authority

Oversight of Contracts with National Grid

Report 2009-S-9



Thomas P. DiNapoli

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State of New York
Office of the State Comptroller

Division of State Government Accountability

July 22, 2010

Kevin S. Law
President and Chief Executive Officer
Long Island Power Authority
333 Earle Ovington Boulevard
Uniondale, NY 11553-3606

Dear Mr. Law:

The Office of the State Comptroller is committed to helping State agencies, public authorities and local government agencies manage government resources efficiently and effectively and, by so doing, providing accountability for tax dollars spent to support government operations. The Comptroller oversees the fiscal affairs of State agencies, public authorities and local government agencies, as well as their compliance with relevant statutes and their observance of good business practices. This fiscal oversight is accomplished, in part, through our audits, which identify opportunities for improving operations. Audits can also identify strategies for reducing costs and strengthening controls that are intended to safeguard assets.

Following is a report of our audit of the Long Island Power Authority's Oversight of Contracts with National Grid PLC. This audit was performed pursuant to the State Comptroller's authority under Article X, Section 5 of the State Constitution and Section 2803 of the Public Authorities Law.

This audit's results and recommendation are resources for you to use in effectively managing your operations and in meeting the expectations of taxpayers. If you have any questions about this report, please feel free to contact us.

Respectfully submitted,

Office of the State Comptroller
Division of State Government Accountability

State of New York
Office of the State Comptroller

EXECUTIVE SUMMARY

Audit Objective

Our objective was to determine whether the Long Island Power Authority (LIPA) adequately monitors National Grid's performance in implementing contracts for the supply of electricity to LIPA; the operation of LIPA's electrical distribution system; and the provision of customer, financial, engineering and other services to LIPA.

Audit Results - Summary

LIPA is the primary supplier of electricity on Long Island. Most of its day-to-day operations are performed by a private utility, National Grid PLC (National Grid), under three 15-year contracts with LIPA set to expire in 2013. The Management Service, Power Supply and Energy Management agreements were initially developed between LIPA and Keyspan. The Management Service Agreement was amended in 2007 when Keyspan was acquired by National Grid. LIPA is responsible for monitoring National Grid's implementation of these contracts, and its net payments to National Grid may be increased or decreased depending on National Grid's performance in various areas of the contracts. In 2008, LIPA paid National Grid a total of about $1.8 billion under the contracts: $906 million for electricity and the fuel used in generating that electricity; $274 million for capital projects; and $666 million for other services.

We found that LIPA adequately monitors National Grid's performance in implementing the three contracts. LIPA receives monthly reports from National Grid describing various aspects of its performance, verifies the information in these reports against independent sources of such information, and takes appropriate follow-up actions when National Grid fails to meet the performance targets specified in the contracts. LIPA also contracts with outside consultants for assistance in monitoring National Grid's performance, and has staff with offices on-site at National Grid facilities to oversee the utility's operations.

In each of the performance areas we tested, LIPA appropriately increased or decreased its net payments to National Grid on the basis of National Grid's performance in those areas. For example, when National Grid did not meet the minimum annual performance standard for customer satisfaction in 2006 and 2007, LIPA appropriately assessed monetary penalties of $1 million in each year. Conversely, when National Grid exceeded the targeted capacity in its power plants supplying LIPA with electricity in 2007, 2008 and 2009, LIPA appropriately increased its payments to National Grid by $1 million in each year.

In addition, we verified that LIPA was receiving certain payments from National Grid in accordance with the agreement that was executed when National Grid acquired the utility (Keyspan) originally responsible for the three contracts. However, improvements are needed in LIPA's monitoring of National Grid's sales of emission credits from its power plants. Contrary to contract requirements, National Grid did not report to LIPA the receipt of cash from credits sold through EPA auctions, and as a result, LIPA did not receive its share ($309,878) of the proceeds from these sales until we made LIPA officials aware of the issue. While the failure to report the sales appeared to be an oversight on the part of National Grid, LIPA needs to improve its monitoring to prevent such errors in the future and ensure that it receives its full share of the proceeds from such sales.

Our report contains a recommendation to improve monitoring of National Grid's emission credit sales. LIPA officials agreed with our recommendation and, in responding to our draft report, indicated they had already taken action to implement it.

This report, dated July 22, 2010, is available on our website at: http://www.osc.state.ny.us.Add or update your mailing list address by contacting us at: (518) 474-3271 or
Office of the State Comptroller
Division of State Government Accountability
110 State Street, 11th Floor
Albany, NY 12236

Introduction

Background

The Long Island Power Authority (LIPA) is the primary supplier of electricity on Long Island, providing power to approximately 1.1 million customers. Most of LIPA's day-to-day operations are performed by a private utility, National Grid PLC (National Grid), under the following three contractual agreements:

- Under the Management Service Agreement, National Grid operates and maintains LIPA's electric transmission and distribution system; reads customers' electric meters; bills and collects payments from customers; provides other customer services; provides financial and operational reports to LIPA; and provides planning and engineering services to LIPA.
- Under the Power Supply Agreement, National Grid supplies LIPA with power by providing for the sale and delivery of electric capacity and energy from its generating plants on Long Island.
- Under the Energy Management Agreement, National Grid manages the fuel supplies for its power-generating plants. It also used to manage the scheduling, bidding, buying and selling of power on LIPA's behalf in various power markets, but certain other companies assumed this responsibility in new contracts that began in January 2010.

All three agreements became effective in 1998 and are scheduled to expire in 2013. The agreements were originally between LIPA and another private utility, Keyspan. However, Keyspan was acquired by National Grid in August 2007, and the Management Service Agreement was amended to make National Grid responsible for performing these functions.

LIPA is responsible for monitoring National Grid's implementation of the agreements. The agreements include various metrics that are to be used by LIPA to assess National Grid's performance. If this performance does not meet certain minimum standards, as specified by the metrics, National Grid is to be assessed certain monetary penalties. To facilitate LIPA's monitoring, National Grid is required to provide LIPA with certain monthly reports of its performance. LIPA also contracts with a number of outside consultants that are responsible for monitoring various aspects of National Grid's performance. In addition, LIPA has staff with offices on-site at National Grid facilities to oversee the day-to-day operations and planning related to the agreements.

In 2008, LIPA paid National Grid a total of about $1.8 billion under the three agreements. About $906 million of this amount was for power and fuel, $274 million was for capital projects, and $666 million was for the other functions specified in the agreements.

LIPA was created by the State Legislature in 1986 as a corporate municipal instrumentality of New York State to acquire and close the Shoreham nuclear power plant. In 1998, by merging with the Long Island Lighting Company (LILCO), LIPA became the region's public utility and owner of the electric transmission and distribution system, including electrical substations. It is governed by a Board of Trustees whose members are appointed by the Governor and State Legislature.

Audit Scope and Methodology

We audited the actions taken by LIPA in monitoring National Grid's performance under the contractual agreements to determine whether LIPA has established an adequate system for such monitoring. Our audit covered the period August 23, 2007 through January 27, 2010.

To accomplish our objective, we interviewed LIPA officials to confirm and enhance our understanding of the three major contractual agreements between LIPA and National Grid, as well as an additional agreement that was executed in August 2007 as a result of the merger between Keyspan and National Grid (the Merger Agreement and Waiver). In addition, we examined selected aspects of National Grid's reported performance under these agreements and the actions taken by LIPA when National Grid either did not meet minimum performance standards or did not comply with contractual requirements.

We also reviewed relevant policies and procedures; analyzed selected monthly system operating reports and customer service reports; and reviewed LIPA's emergency procedures and capital construction budgets. In addition, we reviewed documents relating to the three major contractual agreements and the Merger Agreement and Waiver.

We conducted our performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these functions do not affect our ability to conduct independent audits of program performance.

Authority

The audit was performed pursuant to the State Comptroller's authority as set forth in Article X, Section 5 of the State Constitution and Section 2803 of the Public Authorities Law.

Reporting Requirements

A draft copy of this report was provided to LIPA officials for their review and comment. Their comments were considered in preparing this report, and are included at the end of the report.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the Chairman of the Long Island Power Authority shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendation contained herein, and if the recommendation was not implemented, the reason why.

Contributors to the Report

Major contributors to this report were Frank Houston, John Buyce, Myron Goldmeer, Diane Gustard, Dana Bitterman, Carole LeMieux and Dana Newhouse.

Audit Findings and Recommendation

Management Service Agreement

We found that LIPA officials adequately monitored National Grid's performance under the Management Service Agreement, and took appropriate action when National Grid did not meet minimum performance standards.

Performance Metrics

Under the Management Service Agreement, National Grid operates and maintains LIPA's electric transmission and distribution system, and provides LIPA with various customer, financial, engineering and other services. The agreement contains a total of 19 performance metrics, and National Grid is required to submit detailed monthly reports to LIPA describing its performance against these standards.

Certain designated LIPA officials are responsible for reviewing these monthly reports. In addition, LIPA contracts with Virchow Krause, an independent accounting and advisory firm, to assist with the monitoring. Annually, Virchow Krause audits National Grid's performance against the 19 performance metrics and makes a determination about the accuracy of the monthly reports.

We reviewed the annual audit reports that were prepared by Virchow Krause for 2007 and 2008. At the time of our audit, the annual report for 2009 had yet to be completed. We found that Virchow Krause identified no material issues with the manner in which National Grid calculated and reported on its performance for the two years.

In addition, we reviewed National Grid's monthly performance reports for the period August 2007 through September 2009, examining all the reports relating to all 19 performance metrics. We found that the reports appeared to be sufficiently detailed and LIPA took appropriate action when National Grid did not meet the minimum performance standards.

For example, the Management Service Agreement provides that National Grid and an independent consultant will each periodically conduct surveys to gauge general customer satisfaction. The surveys do not identify specific problem areas, but rather result in an overall composite score that is compared against established benchmarks which increase for each year of the contract. National Grid did not meet the minimum performance standard for customer satisfaction in 2006, 2007 and 2008. Although National Grid's satisfaction scores improved each year, ranging from 73 to 77 points, they did not keep pace with increases in the minimum benchmarks, which rose from 75 to 78.

According to the agreement, for each year this standard is not met, National Grid is to be assessed a penalty of $1 million and, if the standard is not met for three consecutive years, it can be deemed to be in default of the agreement. We verified that LIPA assessed and collected the $1 million penalties in 2006 and 2007. In addition, after National Grid again failed to meet the minimum benchmarks for customer service in 2008, LIPA declared National Grid to be in default, which would have allowed LIPA the option of cancelling the contract. National Grid contested the default and the parties negotiated a settlement plan in February 2010, which increases the annual penalty for unsatisfactory customer satisfaction to $2 million. The settlement also requires National Grid to take several key actions designed to improve customer service, including: improving staffing on Long Island, establishing an Employee Culture Improvement Plan for Customer Service, conducting a best practices review of areas impacting customer service, and linking executive and management compensation directly to improved customer satisfaction. Although these new requirements are very recent, they are critical to improving customer service. LIPA officials recognize the importance of these actions and have committed to monitoring National Grid's progress in fulfilling the requirements. Officials also reported that National Grid's customer satisfaction scores have now exceeded the performance criteria for 2009.

We also noted the following:

- For the metric related to system performance, reliability and customer outages, LIPA officials continuously interact with National Grid's staff and review the relevant monthly reports. The monthly reports we reviewed showed that National Grid was performing within the established target range for this metric.
- When we reviewed the monthly reports for seven metrics for particular customer-related services (such as meter reading, billing accuracy, payment arrears, and responsiveness to customer calls), we found that the reports appeared to be sufficiently detailed and otherwise adequate, and for six of the seven metrics, National Grid was performing either within the established target or within the offset range (a range in which the penalty for that metric may be offset by a favorable performance on a related metric). On the seventh metric (relating to overdue customer payments), the commercial arrears were excessive, but this was due mainly to an issue LIPA officials believed was beyond the control of National Grid, as it related to a

disagreement between LIPA and the Long Island Rail Road regarding the discounted rates the Rail Road was to pay for its electricity and the discounted rent LIPA was to pay for its use of Rail Road lands. As a result, LIPA did not assess National Grid with the penalty for this metric.

- When we reviewed the monthly reports for ten metrics related to various operational matters (such as work plan completion, capital costs per customer, storm outages, worker safety, substation maintenance, and cable failures), we found that the reports appeared to be sufficiently detailed and otherwise adequate, and for all ten metrics, National Grid was performing either within the established target or within an offset range.

Emergency Preparedness

To ensure that power is promptly restored in the event of a storm or other emergency, LIPA and National Grid are required by the Management Service Agreement to have appropriate policies and procedures in place. We verified that LIPA has established appropriate emergency policies that include procedures to notify local officials and the general public through various means in the event of an emergency, and to keep them informed about recovery efforts and progress. LIPA officials also told us that they have a system set up, so that in the event of emergencies, emails are automatically sent to relevant LIPA and National Grid officials. We selected three dates in 2009 when a storm occurred in LIPA's service area. We found that LIPA does monitor weather-related and other emergencies through the implementation of these procedures. Our review showed National Grid met the required service recovery benchmarks for each of the three calendar years 2007 through 2009.

Capital Construction

According to the Management Service Agreement, National Grid is responsible for making capital improvements to LIPA's transmission and distribution system with LIPA's approval. National Grid provides LIPA with a list of proposed capital projects annually. LIPA officials and an engineering consultant, Navigant Consulting Inc., review the proposed capital projects, select the ones they deem most significant, and give approval for the projects they want completed. The final list is approved by LIPA's Board of Trustees.

We verified that National Grid was providing LIPA with a monthly variance report which monitors the cost of each project and determines whether there have been cost overruns. In addition, we were informed by LIPA officials that they also monitor National Grid's capital construction work by getting status updates during weekly meetings with National Grid officials.

Power Supply Agreement

We found that, overall, LIPA officials adequately monitored National Grid's performance under the Power Supply Agreement. However, improvements are needed in LIPA's monitoring of one of the activities covered by the agreement (National Grid's sale of power-generating plant emission credits). National Grid failed to report to LIPA the receipt of cash from certain sales made through auctions; as a result, LIPA did not receive its share ($309,878) of the proceeds from the sales.

Performance Incentives

National Grid supplies LIPA with electricity that is generated at its power plants. The Power Supply Agreement sets forth the terms and conditions for the sale and delivery of this electricity. The agreement includes three primary performance incentives for National Grid. If National Grid exceeds the performance targets specified by each incentive, it receives additional payments from LIPA. If National Grid fails to reach the targets, it is to make certain penalty payments to LIPA.

The three incentives relate to the efficiency, availability and capacity of National Grid's power plants. National Grid is to provide LIPA with monthly (efficiency), semi-annual (capacity), and annual (availability) reports about its performance in each of these three areas, and LIPA is to verify the reliability of these reports by comparing the information in the reports to other independent sources of such information.

We reviewed the monthly/semi-annual/annual reports for the three incentives in 2007, 2008 and 2009. We found that National Grid's performance exceeded the targets in all three years. In addition, for all three years reviewed, we found that LIPA officials took appropriate measures to ensure that the performance levels reported by National Grid, and the incentives paid, were accurate.

For example, according to the Power Supply Agreement, National Grid's power plants are to maintain a total combined capacity of between 3,933 and 3,973 megawatts. The capacity is to be measured twice a year, once for the summer months and once for the winter months. National Grid is to send LIPA semi-annual reports of these measurements, and LIPA is to verify the accuracy of these reports by comparing the information to information maintained by the New York Independent System Operator, an independent not-for-profit entity that oversees power plants located in New York State.

We reviewed the semi-annual reports for 2007, 2008 and 2009 and found that National Grid exceeded the target capacity in all three years. Moreover, because National Grid exceeded the target by a certain amount in each year, it was eligible to receive the maximum incentive payment of $1 million a year. We verified that this was the amount paid by LIPA in 2009.

Sale of Emission Credits

Power plants typically emit certain pollutants into the air. The amount of each pollutant is limited by laws and regulations. If a plant emits fewer pollutants than allowed for a given period, it gets a certain number of "credits" for the shortfall, and may sell these credits to buyers who may use the credits to offset excessive amounts of pollutants in their emissions.

According to the Power Supply Agreement, National Grid is to send a notification letter to LIPA whenever it intends to sell its emission credits and offer LIPA the first right to purchase certain of the excess credits. If LIPA refuses the offer and National Grid sells the credits, LIPA should receive 67 percent of the proceeds from the sale. The credits are sold either through agreements with private buyers or auctions conducted by the U.S. Environmental Protection Agency (EPA). Certain officials at LIPA are responsible for monitoring the sales, and they receive reports from National Grid showing the total credits allocated to National Grid and the number used for the year.

LIPA reported that for 2007, 2008 and 2009, National Grid sold emission credits valued at approximately $29.4 million. LIPA's share of these sales totaled about $19.3 million. We verified that LIPA received the required payments, with one exception. For 2008 and 2009, LIPA's share of the sales from agreements with private buyers totaled $4.48 million, while its share of the sales from EPA auctions totaled $309,878. We verified that LIPA received the $4.48 million from National Grid; however, we determined that LIPA did not receive the $309,878 in auction proceeds. When we brought this to the attention of LIPA officials, they did not know why the auction proceeds were not received from National Grid.

Subsequently, in their response to our preliminary audit findings, LIPA officials stated that, because of an apparent oversight, National Grid did not notify LIPA when these auction sales were finalized and when they received the cash, and as a result, never initiated the wire transfer process that is used to remit the funds to LIPA. After being made aware of our audit findings, LIPA officials contacted National Grid and obtained the funds, providing us with documentation of the receipt. We recommend

LIPA improve its monitoring of National Grid's emission credit sales to prevent such errors in the future.

Guaranteed Synergy Savings

When companies merge, they often expect to realize certain synergy savings (i.e., reduced costs and/or increased revenues) as a result of their merger. In 1998, when Keyspan was created by merging Brooklyn Union Gas and the gas and generation businesses of LILCO, a portion of the expected synergy savings were to be shared with LIPA and its customers over a ten-year period. These guaranteed synergy savings were treated as a reduction to the capacity charge LIPA paid to Keyspan (now National Grid).

We reviewed the documentation relating to these monthly credits. We also tested the invoice for December 2008 and verified that the appropriate synergy savings had been credited to LIPA for that month.

Recommendation

Improve the monitoring of National Grid's emission credit sales to ensure that LIPA receives its full share of the proceeds from these sales.

Energy Management Agreement

We found that LIPA officials adequately monitored National Grid's performance under the Energy Management Agreement.

Cost of Fuel at Power Plants

Under the Energy Management Agreement, National Grid is responsible for the procurement, delivery, storage and management of fuel for its power generating plants. In addition, prior to January 2010, National Grid was also responsible for the scheduling, bidding, buying and selling of power on LIPA's behalf in various power markets.

The Energy Management Agreement includes two primary performance incentives for National Grid. One of the incentives, relating to the purchase of power from out-of-State suppliers, was discontinued in 1999 when the New York Independent System Operator was created. The other incentive, which is still active, relates to the price of fuel for National Grid's power plants. If National Grid obtains this fuel (natural gas and oil) at a price that is lower than the target price in a given month, it receives an incentive payment from LIPA that month (i.e., LIPA and National Grid share the savings). If National Grid obtains this fuel at a price that is higher than the target price, it must make "disincentive" payments to LIPA (i.e., LIPA and National Grid share the additional costs). The total incentive/disincentive payments may not exceed $5 million annually.

National Grid provides LIPA with monthly reports showing the amount of fuel purchased and the price at which the fuel was purchased, and LIPA verifies the accuracy of the reported fuel prices by comparing them to the prices published in certain industry reports. We reviewed the fuel purchase summary reports submitted by National Grid for January through September 2009, and found that the reported fuel prices were consistent with the published industry prices.

In addition, for 2009, LIPA reported that National Grid received a total of about $2.3 million in incentives for obtaining fuel for less than the monthly target fuel prices. We reviewed the documentation relating to these incentive payments. We also verified the accuracy of the incentive payment for December 2009 and found that the claimed fuel price incentive of $480,000 for that month was consistent with National Grid's performance that month.

LIPA is also required by the Energy Management Agreement to pay for the cost of the fuel at National Grid's power plants. LIPA officials reported that, before these monthly payments are made, they review the invoices and supporting documentation submitted by National Grid to verify the accuracy of the payments, and compare National Grid's prices to the prices in industry publications. We reviewed an invoice for the oil used in October 2009 and found that both the total amount of oil used and the prices paid for that oil were adequately supported. We also reviewed the June 2009 invoices for natural gas and found that there was adequate supporting evidence for the claimed payments of $21 million and evidence of LIPA's oversight.

Guaranteed Synergy Savings

Under the Energy Management Agreement, LIPA was to receive about $24 million in synergy savings over a ten-year period commencing in 1998 and ending in May 2008. LIPA was to receive these payments in the form of a monthly credit to certain invoices from the contracted utility (initially Keyspan and later National Grid). We reviewed the documentation relating to these monthly credits during our audit period. We also tested the invoice for the final credit in May 2008 and verified that the appropriate synergy savings ($141,700) had been credited to LIPA for that month.

Merger Agreement and Waiver

When Keyspan was acquired by National Grid in August 2007, an additional agreement (the Merger Agreement and Waiver) was executed. This agreement guaranteed LIPA synergy savings in an amount equivalent to $69.1 million on a net present value basis using a discount rate of 7.8

percent. The savings were to be paid annually over a period of seven years, with the final payment to be made in 2013.

LIPA receives the payments, via wire transfer, on September 1 of each year. We reviewed the relevant wire transfer and bank documentation for 2007 and 2008 and confirmed that LIPA received the correct payment amounts for those two years ($5.34 million and $9.09 million, respectively).

LIPA officials told us that the payment for September 1, 2009 ($13.02 million) has not been made because of an unresolved issue with National Grid relating to the company's request to be reimbursed for certain refunds issued to customers for items such as returned deposits and overpayments. LIPA officials indicated they were not satisfied with some of the information reported and controls in place over such refunds. As a result, LIPA withheld reimbursement of about $17 million pending clarification and additional independent audit work. In response, National Grid withheld the $13.02-million synergy payment for 2009. According to LIPA officials, as soon as the refund issue is resolved, the synergy payment for 2009 will be made.

Agency Comments

LIPA
Long Island Power Authority

333 Earle Ovington Boulevard, Suite 403
Uniondale, NY 11553
(516) 719-9898 • Fax (516) 396-5735
klaw@lipower.org

Kevin S. Law
President & Chief Executive Officer

July 2, 2010

Mr. Frank J. Houston
Audit Director
Office of the State Comptroller
Division of State Government Accountability
123 William Street – 21st Floor
New York, NY 10038

Re: OSC Report 2009-S-9

Dear Mr. Houston:

The attached document details our response to your audit on the Long Island Power Authority's Oversight of Contracts with National Grid (Report 2009-S-9). I am pleased that the results of your audit determined that LIPA's oversight of its contracts with National Grid is meaningful and appropriate. Rest assured that I have taken swift action to remediate the one area in which you reported the need for improvement.

Since your team identified the issue regarding the untimely payment of a portion of EPA emissions credit cash receipts due to LIPA from 2008 and 2009, LIPA has acted to ensure receipt of those monies from National Grid. In addition, LIPA has enhanced its internal procedures to ensure that all future EPA auction proceeds are received from National Grid in a timely manner. LIPA has also instructed National Grid to improve its internal procedures surrounding the EPA emissions credit auctions to ensure that National Grid promptly notifies LIPA that the cash proceeds have been received and that all of LIPA's share is promptly remitted to LIPA.

I note that LIPA's share of the 2010 EPA emissions auctions proceeds were received by LIPA in a prompt and timely fashion on April 16, 2010 demonstrating that the enhancements to the controls at both LIPA and National Grid are working effectively.

I want to personally thank you and the members of the audit team that worked here at LIPA for the professionalism and courtesy that was extended to the staff here at LIPA. Your review, coupled with our own internal measures, serve to benefit the ratepayers of Long Island.

Sincerely,

Kevin S. Law

LIPA
Long Island Power Authority

Response of the Long Island Power Authority ("LIPA")
to
Oversight of Contracts with National Grid
Report 2009-S-9
(the "Report")
Office of the State Comptroller ("OSC")
June 2010

General Observations/Comments

LIPA has carefully reviewed the Report, and notes that the Report does not identify any significant flaws in LIPA's Oversight of Contracts with National Grid. Instead, the Report reflects that LIPA has fulfilled its oversight role with respect to the contracts with National Grid in a proper and meaningful manner, to the benefit of LIPA's customers. The Report provides one specific recommendation to enhance LIPA's oversight practices, which LIPA has specifically commented on below. LIPA will, as always, continue to meet its obligations with respect to the oversight of National Grid's performance under its contracts to ensure the continuation of high quality service to LIPA's customers.

OSC Recommendation
Improve the monitoring of National Grid's emission credit sales to ensure that LIPA receives its full share of the proceeds from these sales.

LIPA Response:

LIPA makes every effort to ensure full and timely receipt of its share of proceeds from National Grid's sale of emissions credits, including through EPA auctions. From 2007 through 2009, National Grid sold emission credits totaling $29.4 million, two-thirds of which was to be remitted to LIPA from National Grid upon receipt. By the end of 2009, LIPA received $19.0 million of its $19.3 million share of these sales; however, the remaining amount, $309,878, resulting from EPA auction sales in 2008 and 2009, had not been forwarded by National Grid to LIPA in a timely manner, as required. LIPA did not receive these monies due to an oversight by National Grid and lack of adequate communication and follow-up internally at LIPA. Subsequent to identification of this issue, LIPA contacted National Grid and on March 18, 2010, LIPA secured full payment of the $309,878.

To further ensure that LIPA receives its full share of the proceeds from the sales of emissions credits in a more timely manner going forward, LIPA has enhanced its procedures to facilitate better coordination and communication between its internal departments and with National Grid. LIPA has also instructed National Grid to enhance its internal procedures to ensure that they promptly remit to LIPA its share of all emission credit sales, including EPA auctions.

Concerning the current year, LIPA notes that its share of the 2010 EPA auction sales proceeds was received from National Grid on April 16, 2010. This provides some early indication that the improvements are working.