Transmission Owner Funding of Interconnection Upgrades

New York Transmission Owners

March 1, 2021 TPAS Meeting

Introduction

- **NYTO Stakeholder Outreach**
  - Started meeting with stakeholders in Q4 2020
  - Presented to ESPWG on February 23rd

- **Today's Agenda**
  - Review the proposal presented to ESPWG
  - Add details and respond to feedback received to date

Introduction (Continued)

- **The NYTOs support the clean energy goals in the CLCPA:**
  - Committed to working with the state to meet the goals
  - Local transmission upgrade proposals to integrate clean energy
  - Support Identification of Public Policy Transmission Needs
  - Energy storage solicitations
  - Advocacy for reforms to remove market barriers to new technologies

Introduction (Continued)

- **Meeting CLCPA goals means substantial growth in new renewable and storage projects.**
- **Complementary reforms to the NYISO interconnection upgrade funding mechanism are needed to accommodate growing number and scale of interconnection requests.**
  - CY 2019 had four to five times the number of projects in CY 2017.
  - Upgrades will represent growing parts of TO systems.
  - Changes are needed to properly align the costs of the risks associated with owning and operating interconnection upgrades while protecting TOs' ability to maintain affordable customer rates in the future.
  - We propose to achieve this without delay in the integration of new resources.

Background

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- **The NYTOs seek changes to the funding mechanism for Upgrades to align the process with recent judicial and FERC precedent.**
  - While the NYTOs ultimately own and bear the risks associated with owning, operating, and maintaining Upgrades, they currently do not earn a return on Upgrades.
  - Recent precedent in the D.C. Circuit (*Ameren*) affirms the right of a TO to earn a return on, and of, these Upgrades.
  - *Ameren* rejects forcing TOs to function as owners and operators of transmission facilities without recovering a return.

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Background (Continued)

Interconnection Upgrade Funding Today

- **This presentation and the Upgrade Funding Proposal apply to three types of interconnection facilities NYISO identifies in each Interconnection Class Year Facilities Study, which TOs own and operate on a non-profit basis under current rules:**
  - System Upgrade Facilities (SUF) are needed to maintain system reliability for all interconnections, including energy only (ERIS), interconnections.
  - System Deliverability Upgrades (SDU) are needed to provide for the simultaneous deliverability of all capacity resources to load and are required for only Capacity Resource Interconnection Service (CRIS).
  - Transmission Owner Attachment Facilities are needed to connect projects at the point of interconnection.
  - Collectively "Upgrades"

Background (Continued)

- **Today, each Developer that wishes to remain in the Class Year is required to fund 100% of the upgrade costs allocated to it shortly after it accepts its cost allocation.**
  - Once the Class Year Study is released, the Class Year Initial Decision Period begins, and each Developer must notify the NYISO if it accepts its cost allocation.
  - If any Developers reject their cost allocations, the NYISO reiterates the decision process until all Developers accept their cost allocations and post security for the full cost of the facilities for which the ISO determined the Developers are responsible.
  - Failure to post security results in a project losing its Class Year position.

Overview of Proposal

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- **TO Upgrade Funding Proposal would enable the TO, on an Upgrade-specific basis:**
  - To provide the initial funding for Upgrades;
  - To recover that investment,
    - with a return,
    - from the Developer,
    - over 20 years.

- **Each TO must notify the NYISO of any Upgrades the TO will fund prior to the start of the NYISO Class Year Initial Decision Period.**
  - Developer will have this information prior to accepting its cost allocation and posting security.
  - TO funding will **not** alter timing of Class Year process.

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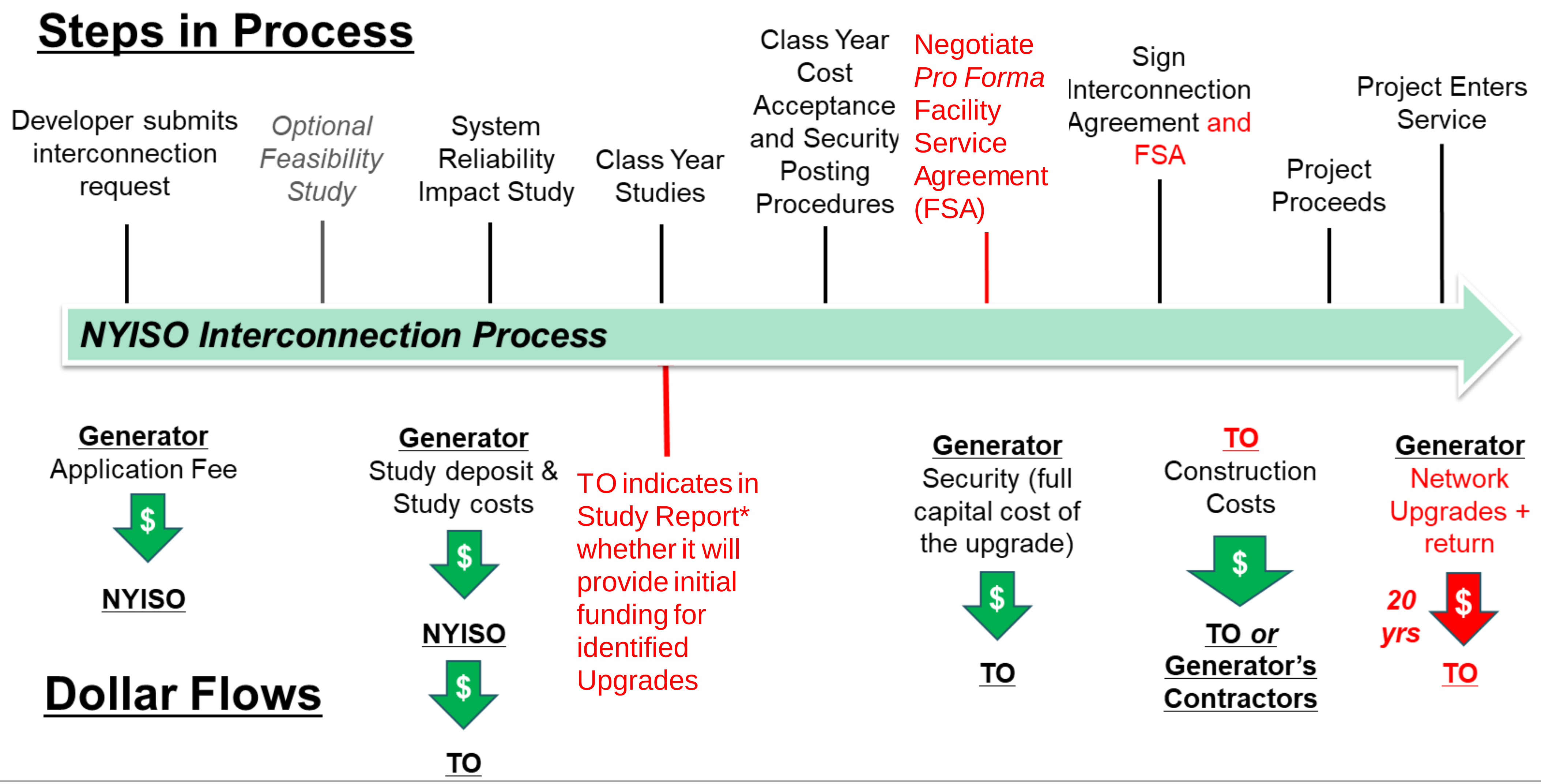
Overview of Proposal (Continued)

- **TO will pay the costs of the Upgrades it is funding during construction, rather than the Developer.**

- **Developers repay these costs to the TO over twenty (20) years.**
  - Developer security posting required on a declining basis until costs are fully paid.
  - A new *pro forma* Facility Service Agreement (FSA) will govern these payments.
    - Modeled on the MISO FSA which FERC accepted.
  - FSA to be handled in tandem with IA.

Proposal Timeline



*Either Class Year Study Report or Additional SDU Report

Response to Stakeholder Questions

Impacts of Proposal

- **TOs do not believe this change will have significant cost impacts.**
  - Proposal replaces the Developer's cost of capital with TO's cost of capital on transmission interconnection facilities only, typically a small percentage of overall project costs.
  - For example, "Proposed NYISO Installed Capacity Demand Curves for the 2021-2022 Capability Year and Annual Update Methodology and Inputs for the 2022-2023, 2023-2024, 2024-2025 Capability Years" – August 2020:
    - The weighted average cost of capital (WACC) used to develop the localized levelized embedded gross CONE should reflect a capital structure of 55 percent debt and 45 percent equity; a 6.7 percent cost of debt; and a 13.0 percent return on equity, for a WACC of 9.54 percent.
  - This is much higher than authorized cost of capital for the NYTOs.

Impacts (Continued)

- **The proposal provides reasonable TO compensation for the risks associated with owning, operating, and maintaining transmission facilities that are expected to be a growing part of their systems.**
  - There is greater opportunity for liabilities to be incurred due to an increase in the total number of transmission assets and the commensurate increased complexity in management, monitoring, and compliance of their transmission system.
  - Increased complexity equals increased responsibility/risk.

- **Recovery of O&M expenses does not include a utility's return on equity or the return it must earn to reward investors for assuming the risks of the investment.**
  - Rather, a return for investors (whether shareholders or bondholders) is designed to reward investors for making the investment and assuming the risks of the business. The business is an entire system.

Transmission Owner Risks of Owning and Operating Upgrades

- **At last week's ESPWG/TPAS meeting, we identified several risks associated with owning and operating Upgrades and explained that Upgrades are no different in this regard than the rest of a TO's transmission system.**

- **The same liabilities that could be incurred as a result of traditional transmission ownership and operation also apply to Upgrades. These include risks associated with:**
  - NERC, NPCC, FERC, OSHA, EPA, PSC, DEC, vegetation management and other compliance
  - Storm and outage recovery

Transmission Owner Risks (Continued)

Because there is no return for this increased exposure to risks, there are uncompensated costs.

- **Some of these risks include the potential to be subject to a disallowance in cost recovery or to be subject to fines or punitive measures not recoverable in rates if there was a compliance issue.**
  - Consumer interests expressed concerns that utilities should not be rewarded for imprudent costs or compliance failures.
  - The proposal does not provide for the recovery of costs that a regulator disallows.
  - Rather, reasonable investors consider the risk of this type of under-recovery of costs when deciding whether to invest in a utility. This type of risk is one of many that gives rise to a need to compensate investors through a return on investment.

Implementation

Facilities Service Agreement

- **Revisions to Adopt a new *Pro Forma* Facilities Service Agreement to Provide a Standardized Contractual Mechanism for the Exercise of a TO Election to Fund**
  - Based on the MISO *pro forma* FSA accepted for filing (ER20-359)
  - Recovery over 20-year term
  - Security for capital costs only
  - For boiler plate terms and conditions, would use NYISO-specific provisions from the NYISO LGIA rather than those in the MISO *pro forma* FSA

Implementation – Developer Rights

- **Developer's Option to Build Would Remain Intact**
  - Today, Developers have the right to build Stand Alone Upgrades.
  - TO Upgrade funding will not interfere with the Developer's right to build Stand Alone Upgrades, consistent with FERC's treatment of MISO's compliance filing to Order No. 845 (ER19-1960).
  - If a TO funds a Standalone Upgrade, the Developer can still build the Upgrade, and the TO would provide the funding.
  - Consistent with Upgrade Funding, with cost recovery from the Developer/project company would occur via a Facilities Service Agreement.

Implementation – Developer Rights (Continued)

- **Buyer Side Mitigation Rules:**
  - The FSA would be added to the list of contracts that shall not constitute a "non-Qualifying contractual relationship" in the Services Tariff.
    - We believe this is appropriate treatment.
  - Calculation of unit-specific Net CONE would continue as it is done today based on the best available information the ISO has when it performs the Part A and Part B exemption analysis.
    - Would occur before the TO funding declaration
    - Generally does not affect a significant amount of projects' overall costs
    - Generally does not have a significant impact on the Net CONE of Developers
    - Will facilitate smooth and timely administration of Class Year

Implementation – Developer Rights (Continued)

- **Incremental TCCs**
  - Today, Developers that fund Upgrades that result in incremental transfer capability have the right to obtain Incremental Transmission Congestion Contracts (TCC).
  - Under TO Upgrade Funding, we propose no changes to Incremental TCC rights.
  - Today, Developers must pay for the Upgrades up front.
  - With TO Funding, the Developer will not pay for the upgrades upfront, but should still receive the Incremental TCCs on the same schedule and under the same terms as the current NYISO OATT because the Developer must post adequate security to cover payments due to the TO.

Implementation – Developer Rights (Continued)

- **Headroom Payments**
  - No changes proposed to current treatment
  - Headroom refers to incremental capability to interconnect additional capacity or energy to the system in excess of the Developer that funds the Upgrade giving rise to the Headroom.
  - Today, when a Developer funds facilities which create Headroom, any lower queued project which utilizes within 10 years the Headroom funded by the earlier project, must make a lump sum Headroom payment to the earlier project.
  - Headroom payments are due at the time of posting security to cover Class Year cost allocations.
  - This treatment of Headroom payments would continue. The earlier queued projects may not have fully repaid the TO for the Upgrades, but they will have posted adequate security.
  - Accordingly, it is appropriate to continue with the current practice.

OATT Revisions

- **Cross Default Provisions Established in the FSA and LGIA/SGIA**
  - These provisions would provide that a default in either the FSA or LGIA/SGIA would constitute a default in both the FSA and LGIA/SGIA.

- **Other Implementing Changes**
  - Forfeiture of Security: If the TO elects to fund, a security requirement applies in declining amounts for the term of the resulting FSA.
  - Final Invoicing; Billings, Payment, Final Payment: If the TO elects to fund, payment for the Upgrades will be addressed in the resulting FSA.

Next Steps

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- **Targeted implementation of the TO Funding Mechanism for Class Year 2021**
- **The NYTOs are seeking stakeholder feedback on the proposal:**
  - Send comments/feedback to Stu Caplan and Kat O’Konski of Troutman Pepper (stuart.caplan@troutman.com and katherine.okonski@troutman.com)