

# Cost Containment Metric for Transmission Project Evaluation in Public Policy Process

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ESPWG/TPAS

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# Objective

- The NYISO proposes to amend the Public Policy Transmission Planning Process in the OATT to establish the treatment of cost containment in the project proposal, evaluation and selection, and Development Agreement processes.
- Assuming a positive stakeholder vote and Board approval, the NYISO plans to make a Section 205 filing so that the cost containment provisions will be accepted or approved by FERC in its tariff for Developers to use in proposing projects as solutions to any Public Policy Transmission Needs that are identified by the New York State Public Service Commission in the current and future transmission planning cycles.
- The NYISO will address cost containment for the reliability and economic planning processes as part of the Comprehensive System Planning Process project that will continue later this year.

# Cost containment discussions to date

- NYISO discussed additional cost containment metric in WNY Transmission “lessons learned” process. Written comments received from interested parties in May 2018.
- Opinions have ranged from favoring NYISO consideration of all cost containment proposals for total project costs, to limited consideration of cost containment for capital costs only, to opposition to further tariff metrics evaluating cost containment.
- NYISO presented a straw proposal on voluntary cost containment for transmission project capital costs in November 2018.
- NYISO proposed to consider cost containment in quantitative metrics based on a developer’s not-to-exceed capital cost cap. In the absence of cost containment, the NYISO proposed to continue using its independent consultant’s (“IC”) capital cost estimates .
- Stakeholders provided written comments.

# Capital Cost Evaluation Method

- **NYISO position continues to be:**
  - Cost containment considered in Public Policy Process will be limited to capital costs only
  - Evaluation methodology must be feasible for NYISO implementation
  - Consistency across projects must be maintained
  - Consideration of cost containment must not add to evaluation time and lengthen Public Policy Process that stakeholders have agreed already takes too long to complete
- **NYISO is proposing an evaluation methodology for capital cost containment that meets the objectives in time for use in the current Public Policy Process**
- **Open question on how to address cost containment for upgrades.**
  - The NYISO has heard a lot of feedback on application of cost containment to upgrades to existing transmission facilities that Transmission Owners elect to build.
  - The NYISO is considering this feedback and will address this issue with stakeholders in June.

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# Capital Cost Containment Proposals

Developer may voluntarily propose cost containment for defined categories of capital costs. Developers may propose either a hard cap or a soft cap, as defined below:

- **Hard cap:** A hard cap for capital costs is defined as an amount (the cap) over which the Developer agrees not to recover capital costs from ratepayers
- **Soft cap:** A soft cap for capital costs is defined as an amount (the cap) above which excess capital costs are shared between shareholders and ratepayers based on a defined percentage; Developers would define the percentage of risk sharing as part of their cost containment proposal

# Cost Containment—Evaluation Overview

The NYISO will consider cost containment proposals in both a quantitative and qualitative manner:

- **Use in Quantitative Cost Metrics:** Depending on several factors, the NYISO will use the proposed cap for contained capital cost elements (included capital costs) to calculate the total capital cost of the project that is used in existing quantitative cost metrics.
- **Qualitative Evaluation:** In addition, the NYISO will assess any proposed cap qualitatively through a new metric. The additional metric is intended to factor in cost containment as one metric among a host of metrics the NYISO may consider to evaluate, rank and select the more efficient or cost effective transmission project to meet a Public Policy Transmission Need.

# Quantitative Factors – Hard Cap

- A hard cap for capital costs is defined as an amount (the cap) over which the Developer agrees not to recover costs from ratepayers for contained capital costs
- If the Developer's cost cap is below the IC cost estimate, the NYISO will use the Developer's cost cap as the estimate for contained costs plus its independent consultant's estimate of the Developer's excluded capital costs to calculate a total project capital costs.
- The NYISO will use the total capital cost to compare project costs to benefits under the quantitative cost metrics in its tariffs, including capital cost and cost per MW.

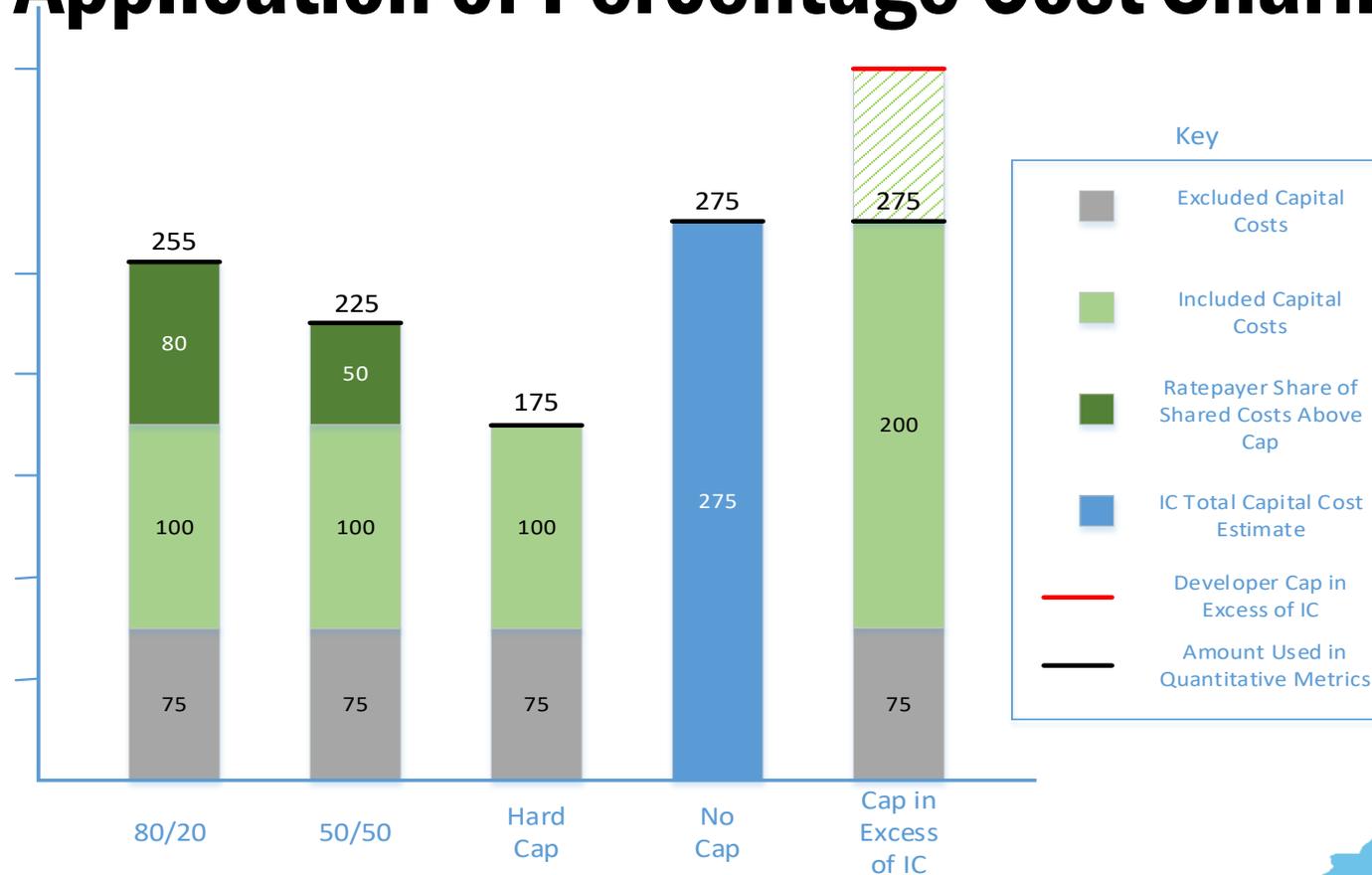
# Quantitative Factors – Soft Cap

- **Soft cap:** A soft cap for capital costs is defined as an amount (the cap) above which excess costs are shared between shareholders and ratepayers based on a defined percentage
  - If the Developer's cost cap is below the IC costs estimate, the NYISO will calculate an adjusted estimate for contained capital costs for use in the quantitative cost metrics
    - The adjusted estimate will be based upon the amount of financial risk that the Developer proposes to assume [*From NextEra comments May 9, 2018*]
    - The adjusted estimate for contained capital costs will be calculated by multiplying the difference between the Developer's capital cost cap and the IC estimate (for the same facilities) by the risk percentage assumed by ratepayers
    - The NYISO will add the ratepayer risk exposure amount to the Developer's cost cap, plus excluded capital costs, and use the total for its quantitative metrics
- **Alternatively, the NYISO is examining a potential adjustment to the expected capital cost of a project that will consider how effective the proposed cap will be in containing capital costs (*i.e.*, how strong is the incentive to the Developer not to exceed the proposed cap).**

# Example of Percentage Cost Sharing

	80/20 Risk Share		50/50 Risk Share		0/100 Risk Share	
	Contained Costs	Excluded Costs	Contained Costs	Excluded Costs	Contained Costs	Excluded Costs
Developer Proposal	100	75	100	75	100	75
Independent Estimate	200	75	200	75	200	75
Adjusted Estimate	180	75	150	75	100	75
<b>Total Capital Costs for Evaluation</b>	255		225		175	

# Application of Percentage Cost Sharing



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# Quantitative Factors – Cost Cap Above IC

- Consider whether to use the independent consultant's cost estimate if a Developer's cost cap is above the independent cost estimate. Unlikely to occur due to Developers' incentives to proposing a cost cap below the independent estimate.
  - *E.g.*, all cost estimates in AC Transmission were below IC's estimate
- A developer proposal to cap their costs above the independent consultant's estimate may have little value in protecting ratepayers from cost overruns.

# Notes on Capital Costs

- Cost caps used by the NYISO only cap the defined cost contained elements of project cost included within the cap. *See Appendix* on included/excluded costs.
- NYISO will not add to the Developer's cap any additional contingency to the elements subject to the cap
  - Developer decides whether to include any contingency/escalation when considering what cap to propose
- **IC estimates used will include appropriate contingency/escalation factors**
  - To the extent practicable, the NYISO will provide to Developers in advance of a project solicitation any contingency and escalation percentages its independent consultant expects to use in its capital cost estimates

# Proposed Cost Containment Metric

- A new, separate metric will consider cost containment proposals on a qualitative basis
- This new metric will consider:
  - Did the Developer propose cost containment?
  - Does the cost containment proposal limit total exposure to ratepayers?
  - How effective is the proposed cap in protecting ratepayers from capital cost overruns?
  - How effective is the proposed cap in providing an incentive to the Developer to contain capital costs at or below the cap?

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# Qualitative Factors - Dev. Cost Cap < IC

- **Considerations if cost cap is below IC estimate (and, as a result, cost cap is used in the qualitative metrics):**
  - How much risk is the Developer assuming in the event that costs exceed the cost cap?
    - While the percentage of Developer-assumed risk is included in the adjusted estimate of contained capital costs up to the IC estimate, as described above, the NYISO will consider the portion of contained capital costs for which the Developer is at risk in the event that actual costs exceed the IC estimate.
  - How close is the cost cap to the IC estimate? Is the cost cap so significantly below the cost estimates to cause concern?
    - The concern could be that it is not credible that the Developer could construct the project at a cost at or below the cap, raising the risk of the Developer not completing project or requesting relief from the cap from FERC.

# Qualitative Factors – Dev. Cost Cap > IC

- **Considerations if cost cap is above the IC estimate:**
  - How close is the cost cap to the IC estimate?
  - Is the cost cap significantly above the IC estimate so that it is unlikely to bind and provide benefit to ratepayers?
  - Does the cost cap exceed the IC estimate only by a small amount, meaning that the cost cap could provide a benefit to ratepayers in the event that the Developer's costs exceed the IC estimate?

# Potential Soft Cap Alternatives to Percentage Capital Cost Sharing

- IOUs have suggested use of ROE and incentives as financial adjustments to a cost cap. Such a method would examine total transmission project revenue requirement over the life of the asset using reduced ROE and/or incentives when cap exceeded, rather than foregoing recovery of capital costs. -Reduced ROE/incentives were included in TransCo and NextEra approved rates
- Not clear how NYISO would apply reduced ROE/incentives in absence of FERC order accepting/approving these items in advance of project solicitation
- The NYISO remains open to considering alternatives to achieve cost containment

# Next Steps

- The NYISO plans on returning to the ESPWG/TPAS in June for further discussion
- Please submit any additional questions or comments to [PublicPolicyPlanningMailBox@nyiso.com](mailto:PublicPolicyPlanningMailBox@nyiso.com)

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# **Appendix**

## **Proposed Capital Costs Included/Excluded, and Filing & Enforcement**

### **Updated since November 2018**

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# Cost Containment: Proposed Included Elements

- Development costs (*e.g.*, project management, engineering, legal, insurance, permitting, financing/bond costs – a detailed definition to be developed)
- Equipment and construction costs (*e.g.*, the Developer's and its EPC contractor's bulk power and related non-bulk power transmission system equipment and construction costs – a detailed definition to be developed in tariff language)
- Upgrades to existing transmission facilities proposed by the Developer that are not elected to be constructed by the Transmission Owner of those facilities, and that are assigned to the Developer by the NYISO in the Public Policy Transmission Planning Process, as provided in the NYISO's tariffs.
- Rights-of-Way costs and land lease costs for new right of way. Developers may choose to include real estate costs for existing rights-of-way that are part of the proposed transmission project but not owned by the Developer (*e.g.*, existing utility rights-of-way).

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# Cost Containment: Proposed Excluded Elements

- System upgrades determined by the NYISO in one of its interconnection processes.
- Upgrades to existing transmission facilities proposed by the Developer that are elected to be constructed by the Transmission Owner of those facilities and that are assigned to the Transmission Owner by the NYISO in the Public Policy Transmission Planning Process; process to be set forth in the NYISO's tariffs.
- Developers may choose to exclude Rights-of -Way costs and land lease costs for rights-of-way that are part of the proposed transmission project but not owned by the Developer (*e.g.*, existing utility rights-of-way).
- Allowance for funds used during construction ("AFUDC") or other representations of the cost of financing the transmission project during the construction timeframe that may be included as part of the capital cost of the project when it enters into service or as otherwise determined by FERC.
- Non-capital costs: O&M costs or total annual revenue requirements will not be considered in the selection process.

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# Cost Containment:

## Proposed Excusing Conditions

- Project changes or delays that are due to the actions or omissions of the NYISO, Connecting Transmission Owner, Interconnecting Transmission Owner, or Affected Transmission Owner
- *Force Majeure* events (as defined in interconnection)
- Changes in laws or regulations (*e.g.* – taxes).
- Material modifications to scope or routing (*e.g.* – pursuant to PSC Article VII and/or local siting processes)
- Actions or inactions of regulatory or governmental entities, court orders

# Questions?

# The Mission of the New York Independent System Operator, in collaboration with its stakeholders, is to serve the public interest and provide benefits to consumers by:

- Maintaining and enhancing regional reliability
- Operating open, fair and competitive wholesale electricity markets
- Planning the power system for the future
- Providing factual information to policy makers, stakeholders and investors in the power system



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