Revised Straw Proposal for Treatment of Capital Costs in Proposed Public Policy Transmission Projects

I. Introduction

- The NYISO proposes to amend the Public Policy Transmission Planning Process in OATT Attachment Y 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 will 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 transmission projects as solutions to any Public Policy Transmission Needs that are identified by the New York State Public Service Commission beginning in the 2018-2019 transmission planning cycle.

- The NYISO will address cost containment for upgrades proposed by Developers to existing Transmission Owner transmission facilities in its tariffs after the rights of Developers and Transmission Owners concerning upgrades are addressed separately.

- The NYISO plans to address cost containment for the reliability and economic planning processes as part of the Comprehensive System Planning Process review project.

II. Cost Containment Treatment

- A Developer may voluntarily propose cost containment for defined categories of capital costs, as set forth below. Developers may propose either a hard or soft cap for contained capital costs, as described below. Depending on several factors, the proposed cap may be used in the existing quantitative cost metrics.

- 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.

A. Quantitative Factors

1) Hard Cap: A hard cap for capital costs is defined as an amount (the cap) over which the Develop agrees not to recover costs from ratepayers.
   a) If the Developer's cost cap is below the independent consultant ("IC") cost estimate, the NYISO will use the Developer's cost cap as the estimate for contained costs plus its IC estimate of the Developer's excluded capital costs in the quantitative cost metrics in its tariffs (*e.g.*, cost per MW of transfer capability, net production cost savings, capacity cost savings, overall cost/benefit ratio).
   b) If the Developer's cost cap is above the IC cost estimate, the NYISO will use the Developer's cost cap for included capital costs in quantitative cost metrics in its tariffs.

2) 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.
   a) If the Developer's cost cap is below the IC cost estimate, the NYISO will calculate an adjusted estimate for contained capital costs for use in the quantitative cost metrics.
      i) The adjusted estimate will be based upon the amount of financial risk that the Developer proposes to assume. One possible methodology to calculate the adjusted estimate for contained capital costs would be 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 that amount to the Developer's cost cap.
      ii) The NYISO will use the adjusted estimate for contained capital costs plus its IC estimate of the Developer's excluded capital costs to evaluate the quantitative metrics in its tariffs (capital cost and cost per MW of transfer capability; capital cost is also used as input into calculation of net production cost savings, capacity cost savings, and cost/benefit ratio).
      iii) The NYISO is examining a potential approach to consider how effective the proposed cost containment will be in containing costs (*i.e.*, how strong is the incentive) and reflect that in the estimated capital costs for use in the quantitative cost metrics.
   b) If the Developer's cost cap is above the IC cost estimate, the NYISO will use the Developer's cost cap for contained capital costs to evaluate the quantitative cost metrics in its tariffs.

c) Some Developers wish to be able to propose a soft cap that would be considered by the NYISO, as described above, but with the Developer retaining the flexibility to propose alternative equivalent rate adjustments to FERC (such as reductions in return on equity and/or foregone incentives under Commission transmission rate incentives policy). The NYISO is considering this proposal.

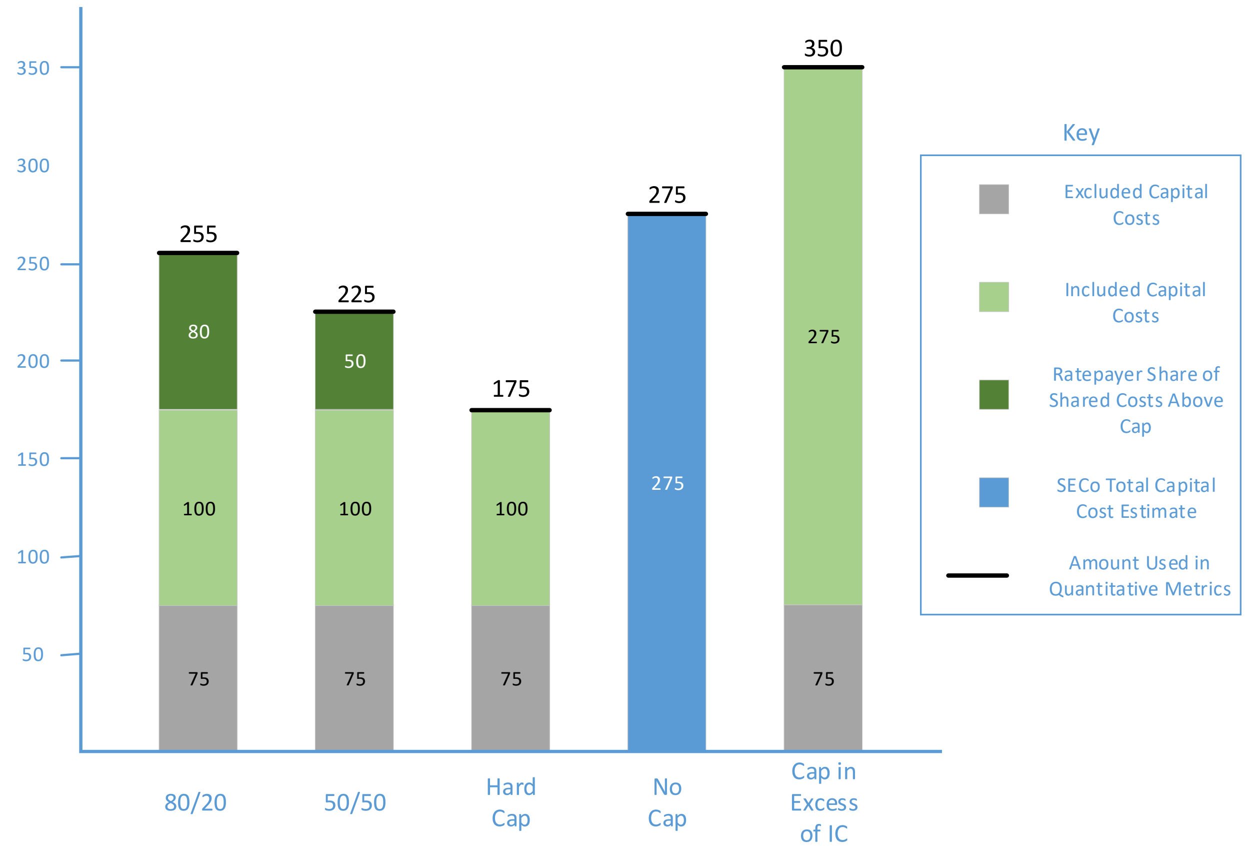
Notes on Capital Cost Caps:

- Cost caps used by the NYISO only cap the defined cost contained elements of project cost included within the cap.
- NYISO does 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 consultant expects to use in its capital cost estimates.

Illustrative Example:

	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
Total Capital Costs for Evaluation	255		225		175	

NYISO Quantitative Evaluation of Illustrative Example:



B. Qualitative Factors for use in the Cost Containment Metric:

a) In addition to the above, the NYISO will assess any proposed capital cost cap on a qualitative basis. The new metric will be additive to quantitative cost metrics and other evaluation metrics. This new metric will consider:

- Did the Developer propose cost containment?
- How effective is the proposed cap in providing an incentive to the Developer to contain capital costs at or below the cap?
- How effective is the proposed cap in protecting ratepayers from capital cost overruns and providing an incentive to Developers to contain capital costs?

i) Considerations if cost cap is below IC estimate:

- 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.

ii) Considerations if Developer cost cap is above 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?
- The NYISO may request, under current tariff provisions, additional project and Developer financial qualification information that the NYISO would consider under this metric.

C. Capital Costs Subject to Containment and Excluded from Containment

a. *Proposed capital cost elements subject to cost containment:*
   1. Development costs (*e.g.,* project management, engineering, legal, insurance, permitting, bond costs, and taxes – a detailed definition to be developed).
   2. Equipment and construction costs (*e.g.,* the Developer's and its contractor's bulk power and related non-bulk power transmission system equipment and construction costs – a detailed definition to be developed in tariff language).
   3. Rights-of-Way costs and land lease costs for new rights-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).
   4. Expected environmental site remediation and environmental impact mitigation costs.

b. *Proposed capital cost elements excluded from cost containment:*
   1. System upgrades determined by the NYISO in one of its interconnection processes.

2. 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).
3. 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.
4. Unforeseeable environmental remediation and environmental impact mitigation costs.
5. Non-capital costs; *e.g.*, operation & maintenance, total revenue requirement.

c. *Proposed excusing conditions:*
   1. 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.
   2. *Force Majeure* events (as defined in interconnection).
   3. Changes in laws or regulations (*e.g.* – taxes).
   4. Material modifications to scope or routing (*e.g.* – pursuant to PSC Article VII and/or local siting processes).
   5. Actions or inactions of regulatory or governmental entities, and court orders.

III. Cost Containment Filing & Enforcement

- The NYISO will memorialize the capital cost containment bid and excusing provisions in amendments to the *pro forma* Development Agreement in its tariff. The NYISO will fill in the capital cost containment amount(s) in the *pro forma* Development Agreement that it enters into with the Developer of the selected project. The Development Agreement will state that the Developer will file rates at FERC for cost recovery through the NYISO Tariff that include the cost containment commitments proposed by the Developer to the NYISO. See Section 2(c) above.
  - If the capital costs filed by a Developer in Commission rate proceedings differ from the capital costs containment submitted to the NYISO by the

Developer with its project proposal and agreed to in the Development Agreement for the proposed project, the NYISO will file at the Commission for its consideration the capital cost containment proposed by the Developer and agreed to in the Development Agreement.

- Capital cost containment included in project proposals and agreed to in the Development Agreement will be addressed in proceedings at the Commission.
- Other rate issues, including return on equity, allowance for funds used during construction ("AFUDC"), capital structure, depreciation and incentives, and operation and maintenance, will be determined in rate proceedings by the Commission.

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