

## *Special Planning Committee Session:*

# **PJM Review of Cost Cap Submittals---Issues, Challenges and Going Forward Principles**

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## **Objective**

Evaluate the need for and, if appropriate, develop guiding principles for PJM to consider in evaluation cost commitment provisions offered by proposing entities within the Order 1000 competitive solicitation process.



## **Presentation Overview:**

- What We've Said in the Past: PJM Presentations to FERC, OPSI et al.
- Review of Key Issues
- Proposed Principles for Discussion
- Next Steps

## PJM Presentation to OPSI:

### ***Cost Containment Issues aka “The Game Show” ...***





***PJM Productions Presents:***

## **“Who Does What?”**

**...an exciting new game show for regulators!!**



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OPSI Annual Meeting-October, 2016

**The RTO has received 3 different cost cap proposals:**

- **One caps total cost including ROE**
- **Second has lower capital structure but only caps construction costs with exclusions for siting changes**
- **Third has capped lowest construction cost but broader set of exclusions for siting, construction delays etc.**



## Who Decides the Best Cost Cap?

1. The RTO which assumes various ROE levels to ensure apples to apples comparison?
2. The FERC in a rate proceeding where the bidder seeks recovery of incentive rates?
3. The state PUC in reviewing alternatives in the siting process?
4. The U.N. Security Council in an emergency meeting



- The project includes **both** (a) a competitive new build and (b) upgrades required of the incumbent T.O. to connect the new line to the existing grid.
- The incumbent transmission owner's **cost of upgrades** to interconnect the new project substantially increase above original estimates.
- The new cost estimates potentially impact the **overall choice** of which is the lowest cost project as between the incumbent's proposal and the new entrant's proposal.



## Who Decides How to Handle the Rising Cost of the Incumbent's Upgrades needed to accommodate the new project?

1. The RTO which tries to substitute its opinion of the upgrade costs for the incumbent transmission owner?
2. The FERC when the incumbent seeks to recover those costs through formula rates and the state or consumer advocates "find" the costs in that formula rate case?
3. The state which hauls in the incumbent to question its proposed costs?
4. The public through a Doodle Poll?



SurveyMonkey®

The project is under construction but due to rising costs, the cap is exceeded.



## Who enforces the cap on the transmission developer?

1. The RTO who hires a team of field police at each construction site?
2. The FERC in response to a complaint from consumer advocates to disallow cost increases?
3. The developer who walks off the job if it can't recover its costs?
4. The Mob using its usual enforcement





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# **“Who Does What?”**

## **...an exciting new game show for regulators!!**

### **Now in its Second Year!!!!**



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April 2017

- After an analysis of the competing proposals and the ROEs under each, the RTO has chosen an “all-in” life of the asset cost cap.
- The PUC and the Consumer Advocate think the ROE estimate from the RTO is way too high.



## Who decides whether the RTO should adopt that project based on the RTOs' ROE analysis?

1. The RTO that says “states you got it wrong...”
2. The FERC which decides to defer to the RTOs' analysis
3. The FERC which undertakes its own review after litigation
4. The Developer who says “too much uncertainty, I’m taking a hike...”
5. President Trump in an early morning tweet...



- The incumbent's uncapped upgrade work makes it difficult to determine the overall cost of the project and the least cost alternative.
- The RTO is forced to estimate but cannot assure the public that its decision will turn out to be the lowest cost decision



## Who decides what to do next?

1. The RTO Board using its best judgment but with recognition that costs could increase and ultimately change which was the least cost project?
2. The PUC which tries to strong-arm the incumbent to cap its portion of the project costs?
3. The FERC, which, not knowing what to do, sets the matter for hearing?
4. Sumo wrestlers who are appointed to represent each side...



*Where Do We Go From Here???*

## **Proposed Principles and Analytical Approach**



## Four Key Time Periods

- **Stage One: The Submittal Process:**
  - Consistency in Presentation: Ensuring apples to apples comparisons without stifling innovation in design of cost cap proposals
- **Stage Two: The RTO Evaluation Process:**
  - Consideration to be given the cost cap in overall project evaluation
  - Evaluation of exclusions
  - Impact of Upgrade Costs on Project Selection

- **Stage Three: The RTO/FERC Approval Process:**
  - Rights of parties to challenge the non-standard terms of the DEA that contain cost cap commitment
  - Interrelationship between DEA approval and rate submittals
- **Stage Four: Project Construction Tracking and Enforcement:**
  - Reporting and tracking of costs
  - Triggering events for exclusions
  - Enforcement: Role of the Board
  - Enforcement: Role of FERC

## **Stage One: The Submittal Process**

- Focus on Construction Costs (implicitly includes financing costs)
- Consider allowing Caps for Individual Project Phases
- PJM Revisions to Greenfield Project Proposal Template
- Developer Presentation of Exclusions: Describe drivers and historic experience justifying exclusion
- Confidentiality of Submissions (Limiting redactions to ensure transparency)

## **Stage Two: The RTO Evaluation Process**

- Cost Caps are *One Component* of Overall Project Selection—Need to be evaluated concurrently but only one aspect of proposal review
- PJM Focus on *Construction Costs*
- *Exclusions* need to be evaluated with reference to both: (a) submitted material and (b) PJM judgement re: impact of exclusions on the cost cap's value
- *T.O. Upgrade Component*--Need for up-front review with the incumbent on upgrade costs associated with different proposals to ensure full consideration of total project cost ---need for appropriate protections and verifications

## **Stage Three: The RTO/FERC Approval Process**

- *PJM Vetting* of the proposed selection with stakeholders
- Clarity as to the *procedural vehicle* to challenge the cost cap
  - Protest to PJM-Filed DEA? (AI Precedent)
  - Rate Filing at FERC including incentive requests?
  - Complaint Filing only ripe if Cost Cap Exceeded?
    - Issue: Is FERC review at that time ‘de novo’ or just limited to whether cost cap was correctly applied?

## **Stage Four: Project Construction Tracking and Enforcement:**

- Reporting and tracking of costs
  - Should PJM revise standard reporting format?
  - Which details to be confidential vs. publicly presented?
- Reporting of triggering events for exclusions
  - Should PJM revise current reporting format?
- Enforcement: Role of the Board
- Enforcement: Role of FERC

PJM should focus its evaluation on capital (construction) cost and consideration of risks of exceeding estimate

- Project capital costs are a fundamental component of any project evaluation
- PJM OA requires PJM to identify the project cost in the RTEP and consider cost in determining the more effective or cost-effective enhancement
- The capital cost has the greatest sensitivity impact to overall NPV of a project relative to other rate factors for expected variations (discussed in previous Special PC meeting)

## **Proposed Principles**

- Cost cap proposals are voluntary
- Consideration of cost caps limited to cap on construction costs
- Cost cap is one factor in overall project review
- Confidentiality Requests limited to specific construction phase detail---still available to stakeholders thru NDAs
- Exclusions – Entities must submit rationale and supporting information to be provided by project developer
- Exclusions - PJM will consider the risk of excluded event and the potential cost impact of exclusions

## **Proposed Principles (cont'd)**

- Reporting---Err on the side of transparency in reporting
- Challenges to the Cost Cap---Comments and any Protests to be submitted to FERC prior to finalizing DEA Enforcement---
- Enforcement: Done exclusively through FERC ratemaking process  
Board reserves the right to reconsider projects that are not timely progressing

## **Next Steps**

- Agreement on Principles
- Development of Manual Language
- Review with MRC/MC
- Implementation for 2018 Planning Year

# APPENDIX

- Risks that may not be transferrable via cost commitment
  - Risk of abandonment when actual costs exceed threshold for TO/developer to continue with project under a cost commitment
  - Abandonment of project has a cost to re-evaluate and restart the project; security may not cover that cost fully
  - Risk of impact to quality of work as a result of cost cutting to meet the cost commitment
  - O&M Commitment can be a disincentive to perform appropriate maintenance

- Cost commitment by a proposer should be in the form of legally binding language.
- Some cost caps and cost commitments have been deemed stronger when considered in other ISO/RTO regions. Consider looking at what factors were part of that assessment.
- Concerns with how Stakeholders can participate in the process when PJM files the agreement and the developer/TO files the rate separately.
- Cost Commitment categories: What is the difference between an Adjustment and an Exclusion? Need to define more clearly. An Exclusion is an exclusion of certain and specific categories of costs from any cost commitment. An Adjustment is a predetermined cost adjustment factor or industry set index multiplier that would apply to predetermined specific category of cost(s).
- Endless permutations make comparison difficult, Can PJM consider standard terms and cost commitment form? There are examples of procurement models that can be helpful.
- Should PJM use fees to pay for analysis when necessary? For which proposals should PJM conduct such analysis
- Should PJM focus on capital costs or consider overall revenue requirement, which includes rate aspects

- Developers can only collect actual costs; lopsided scenario for developers, lopsided risk transfer because someone over performs on cost cap and does not get any benefit. If cost come in lower, consumers benefit and this is value of a cost commitment
- Should cost commitment be considered differently for reliability projects and market efficiency projects?
- Should there be categories of projects that should be excluded from cost commitment or specific provisions of cost commitment?