

Competitive Transmission Development Technical Conference

**Panel 1: Cost Containment Provisions in Competitive
Transmission Development Processes; and**

**Panel 2: Commission Consideration of Rates That Contain
Cost Containment Provisions and Result from Competitive
Transmission Development Processes**

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PJM appreciates the opportunity to address the thoughtful questions raised by the Commission for consideration by Panels One and Two. My name is Craig Glazer, and I serve as PJM's Vice President of Federal Government Policy. I have been around the issues that the Commission raises in this panel for most of my professional life---first as a litigator representing municipalities and ultimate consumers in rate cases before this Commission and state commissions, second as Chairman of the Public Utilities Commission of Ohio and Ohio Power Siting Board during the formation of RTOs, and, more recently, working with my colleagues at PJM on key aspects of developing, tariffing and implementing our Order 1000 processes.

COST CAPS: THE "RAGGED EDGE" WHERE PLANNING AND REGULATION MEET.

At its heart, cost caps submitted in Order 1000 competitive solicitations represent the intersection of two closely related but distinctly different tasks --- namely:

1. the planning function performed by RTOs as one of their core responsibilities; and
2. the setting of rates--- one of the Commission's core responsibilities.

Clearly each of us needs to understand and reflect each entity's important role. But our "bottom line" message today is a plea that in examining our respective roles, we do not blur any further what already are overly blurry lines separating the planning function from the ratemaking function.

The analysis and selection of a cost commitment can inform the rate setting process but should not be a substitute for it. And, as my colleague Steve Herling will note tomorrow, the planning process should not become laden with additional processes and tariffing requirements that severely limit the exercise of discretion and judgment, which is so important to the planning process. We fully support the need for transparency in planning, which is, in our view, at the heart of Order 1000. But, we remain concerned that one unintended consequence of the level of tariff specificity that is being sought will turn the RTO planning processes into a "litigation mill," if not a compliance trap, for well-intentioned RTO planners. In short, if we understand and appropriately define our respective roles, I firmly believe we can extract the best of both of our processes to ensure fair outcomes for consumers.

THE UNIQUE CHALLENGES THAT COST CAP PROPOSALS PRESENT FOR THE RTO.

Before proposing specific solutions, PJM would like to step back and define the exact challenge associated with cost cap provisions.

As noted above, by definition cost cap evaluations (and as equally important the terms and conditions associated with exceptions to a cost cap) represent the "ragged edges" between the appropriate role of the RTO in selecting among submitted projects and FERC's regulatory responsibility to set just and reasonable rates. In approaching a question such as this, I always urge the RTO community to put ourselves in your shoes --- the Commission and its staff --- so as to understand your objectives and determine how they can best be met.

At the same time, we urge you to recognize the sometimes awkward and ill-fitting position we find ourselves in when we are being asked to essentially balance the interests of load versus the project

investor by evaluating and ranking the allocation of that risk as defined through a cost cap provision. To me, the allocation of risk is at the heart of the regulatory process and has been a space appropriately reserved to the Commission since its inception. As we move into the world of choosing among competing proposals, some of which contain cost caps, there clearly is a balance that needs to be struck between the RTOs' role and the Commission's role. Moreover, in examining this question, we would urge the Commission to recognize that the RTOs' true expertise lies in planning. We are not regulators, general contractors or judges, nor do we have a field staff to police project development. And, calling "balls and strikes" on risk allocation associated with rates has never been an RTO function.

The Benefits but Added Complexity of the Sponsorship Model.

The sponsorship model that PJM has adopted is not like bidding out the construction of a pre-determined project as is the practice utilized in some other RTOs, most notably the California ISO ("CAISO"). Rather, our process opens the door for the submittal of innovative ideas to solve identified reliability, market efficiency or public policy needs. Under the PJM sponsorship model, the "competition" between resources is not a typical competitive bidding process where cost, qualifications and timeliness of construction are the key items to evaluate. Rather, each proposal is compared to others, first and foremost, as to whether they solve the need and can be timely sited and approved. After this threshold determination, PJM determines which of the projects that make the first cut, are the more efficient and cost effective in terms of cost, qualifications and timeliness of construction. As a result, overall project comparisons are challenging and 'side by side' comparisons of cost commitments for vastly different projects can be even more challenging.

Cost and cost caps are clearly factors to be evaluated in the review of submitted proposals. I am cognizant that there are certain commentators who argue that cost estimates should not be a factor in the selection process. Although this sounds facially attractive, we do not believe it is realistic in practice, at least not in the PJM region. I would not want to be a witness for PJM at a state siting proceeding and have to testify that we never looked at the relative costs of two project proposals, each of which could solve the identified need. In short, those who argue that costs should only be considered later in the regulatory process, ignore the simple realities of what it takes to get a project sited under a state siting process in today's highly charged siting environment. Just ignoring the evaluation of costs and cost caps is not a realistic option.

Specifying the Issues for Commission Consideration.

As a result, there really are two separate issues for the Commission's consideration:

1. Before considering the question of evaluating a cost cap proposal, assuming that the estimate costs of competing projects is a relevant factor in the Order 1000 process, the following questions should be considered and answered:
 - What consideration and weight should the RTO give in its selection process to cost estimates in general?
 - Should we heavily discount cost estimates as simply a "best guess"?
 - Should we accept cost estimates on face value?

- Or should we set aside the developer's cost estimates and have the RTO undertake its own cost estimate? To date, PJM has undertaken its own cost estimates to facilitate its evaluation of similar projects to avoid the "low balling" problem leading to inaccurate results.¹
2. Assuming that a cost cap is proposed, another set of issues are triggered:
- To the extent cost commitments are proposed by some developers and not others, should the RTO give a cost cap special weight?
 - How can the RTO evaluate "revenue requirement" caps when comparing them to other proposals without such caps? Would the RTO have to prognosticate on the potential ROE, capital structure and revenue stream the Commission would award the alternative proposal in order to undertake a true "side by side" comparison?
 - How do we compare competing cost caps given the inevitable list of exclusions that accompany them?

PROPOSED REFORMS FOR COMMISSION CONSIDERATION.

Through the end of 2015, out of approximately 280 greenfield proposals submitted in proposal windows, 100 of those proposals contained some type of cost cap proposal. Based on this experience and the attendant challenges these submittals have created,² we suggest the following potential reforms to the Commission's processes for addressing cost caps and their relationship both to the Order 1000 process as well as the Commission's ratemaking processes.

a) **Commission Guidance on Consideration of Cost Commitments in the Context of the Order 1000 Processes.**

Commission guidance, through a policy statement or other means,³ that clarifies the type of costs that can be considered in a cost cap and the relationship of the cost cap to the ratemaking process is needed. PJM has thought about - but does not think it is feasible - to develop either a nationwide or RTO-wide pro forma cost cap. Although seemingly attractive, a Commission written 'force majeure' clause or list of exclusions probably frustrates the kind of innovative allocation of project risks and rewards that represents the best of Order 1000. On the other hand, RTOs should not be required to "choose" between an all-in cost cap, which includes ROE (effectively a revenue requirement cap), against some calculation of what the annual revenue requirement might be for another project. As a result, the Commission should clarify that any cost commitment that is

¹ This process has not been without its challenges as we have been reluctant, up to now, to discuss with the incumbent transmission owner its cost proposal to ensure that the costs of tying into existing facilities is reasonable. We clearly need to find additional ways to open discussion and verify our own cost estimates without running the risk of giving the incumbent transmission owner an edge in challenging the cost estimates of its competitor.

² This number does not include the Artificial Island proposal window conducted between April 29 through June 28, 2013.

³ See Commission's Policy Statement on Promoting Transmission Investment through Pricing Reform, Docket No. RM11-26-000 (Nov. 15, 2012).

expected to be evaluated through an Order 1000 competitive solicitation process should be focused on going forward out-of-pocket costs associated with permitting, siting and constructing the project. “All- in” cost commitments which seek to also cap return move the RTO into a space that is best addressed through the regulatory process.⁴

b) Avoiding Thrusting the RTO Into Solving Risk Allocation Issues.

With any cost cap, the devil is in the details. The language of the various exclusions clearly matter and this makes comparisons that much more challenging. We have seen exception language in which the costs and timing of siting processes are expressly excluded and pitted against other proposals where they are included. The submitted “exceptions” clauses with any cost cap, in effect, represent the allocation of risk that each developer is proposing to split with the load. The evaluation of the reasonableness of such allocations are the types of decisions the Commission makes every day for non-market assets, such as transmission and for which this Commission has a host of trial staff, administrative law judges and advisory staff. Assigning those decisions to the RTO thrusts PJM into a quasi-regulatory role which we are ill-fitted to handle and which is clearly far afield from the traditional planning process that Order No. 1000 assigned to RTOs.

c) Recognizing the Trade-Offs Associated with Binding Cost Caps.

Some may urge the Commission to adopt a rule effectively saying “developer, you live by your accepted cost cap no matter what”. But we would be kidding ourselves if we think this would be cost-free. Such a rule may just invite a cost cap proposal where the stated exceptions swallow the commitment provisions themselves. Or if they don’t, they would impose a heavy risk premium on all submitted proposals --- a risk premium that may be driven as much by the regulator’s insistence on making the cost cap “binding” as anything else.

d) Ensuring an Avenue for the RTO To Receive Commission Guidance After Public Input, Relative to a Specific Cost Cap Proposal.

Finally, we have found that one cannot simply lift proposed cost cap language verbatim in the final designated entity agreement (“DEA”). Between the time the proposal is submitted through a proposal window to the actual finalization of the DEA, many refinements are likely to be made to the project, as proposed. But we have found ourselves being challenged for even minor changes in the wording of the cost cap to fit revised in-service dates, new termination points or other necessary project changes that only came to light after the submittal of the original proposal and the evaluation of the projects submitted. In those instances, the RTO is essentially negotiating the details of the cost cap on behalf of load interests - another anomalous place for the RTO to be in when load is otherwise capable, under a traditional regulatory model without a cost cap, of bringing its concerns directly to the FERC.

⁴ The tenor of some of the questions in the notice for Panel One suggest a possible Commission directive to the RTO to somehow lay out and tariff the criteria it will evaluate in reviewing cost cap proposals. This would be, in our view, an unworkable shifting of regulatory responsibility from the Commission to the RTO and inevitably set up yet more rounds of compliance filings and degrees of specificity that would weigh down the planning process. Because cost caps are so intertwined with the allocation of risk between project investors and ratepayers, we believe the Commission would be ill-advised to require the RTO to get even deeper into this area by now having to meet a pre-determined list of RTO analytics associated with RTO reviews of cost caps.

For these reasons, we think one answer would be for the Commission to make available an option for the RTO (or other affected parties) to adjudicate the reasonableness of competing cost caps before the RTO has to, on its own, commit to a particular cost cap proposal. Because the cost cap itself is so bound up in the ratemaking process, RTOs, rather than having to address this issue on their own, should be able to certify to the Commission a review of closely competing cost cap proposals and allow all interested stakeholders to “weigh in” before the Commission on the reasonableness of the cost cap and, in particular, its exclusion clauses as weighed against another alternative (or consideration of a project with no cost cap at all). This would be akin to seeking a declaratory judgment ruling from the Commission but would be a more bounded process to ensure an expeditious determination so the RTO can proceed with project designation. PJM does not anticipate that this option would be needed for most projects. However, it would be available to provide due process, before the RTO is too far down the road with a particular developer, for parties to opine and receive Commission guidance on two or more competing cost cap proposals, especially in those cases where the terms of those cost caps essentially represent the “tie breaker” between competing proposals.

Our recommendation is informed by Commission precedent in *Artificial Island*.⁵ PJM filed the fully executed pro forma Designated Entity Agreement between PJM and Northeast Transmission Development, LLC (“NTD”) for construction and designation of a portion of the Artificial Island Project because the accepted proposal included a non-standard provision creating a cap on construction costs.⁶ In its *Artificial Island* Order, the Commission addressed the challenges to the justness and reasonableness of the terms and conditions of the cost cap and found that the arguments pertaining to PJM’s RTEP process or generic policy on evaluating competitive transmission proposals were beyond the scope of that docket.⁷ Nonetheless, while the Commission emphasized that although a cost cap is not required, it found that the submitted cost cap “would add an additional level of protection for ratepayers by limiting the costs associated with the Project that NTD will recover through its Annual Transmission Revenue Requirement.”⁸

PJM’s proposal outline herein has a slight, but important, timing difference from the tariff process followed for the *Artificial Island* solicitation. In *Artificial Island*, PJM submitted the cost containment provision it accepted through a fully executed DEA filed with the Commission. Such an “after designation by the RTO” approach effectively forces load interests (or unsuccessful bidders) to have to mount a campaign against the RTO Board’s decision on a matter that is far more closely tied to ratemaking (a FERC function) rather than planning (an RTO’s function). Given that the burden of proof appropriately lies with the developer seeking rate recovery within the cost cap, PJM believes a more balanced approach would be for the Commission process to allow for adjudication of the various issues before final designation, if in fact the cost cap becomes the tie breaker between competing projects. This option would provide the kind of forum that would allow for a thorough review of the cost cap and, more importantly, the reasonableness of

⁵ *PJM Interconnection, L.L.C.*, 154 FERC ¶ 61,054 (Jan. 29, 2016) (“*Artificial Island* Order”)

⁶ *PJM Interconnection, L.L.C.*, Original Designated Entity Agreement - SA No. 4310, DEA at Schedule E, Docket No. ER16-429-000 (Nov. 30, 2015).

⁷ Unfortunately, the Commission declined PJM’s request for guidance on how the Commission perceives its role in reviewing cost containment provisions offered by developers as an outgrowth of the Order 1000 competitive solicitation process. *Artificial Island* Order at P 27.

⁸ *Artificial Island* Order at n. 44. The Commission “emphasize[d] that [it was] not determining the justness and reasonableness of NTD’s transmission rates in this proceeding.”

exceptions clauses. Moreover, going forward, such an option would provide a fuller record to set expectations of all concerned as the RTO moves forward with a given proposal.⁹ As a result, with an optional process, we believe this step, although adding some litigation on the front end, will avoid the uncertainty (and potential creation of contested stranded cost claims) on the back end.

In short, our suggestion is to restore the balance by allowing for fair but timely processes for Commission review of unexecuted cost cap agreements, rather than thrusting the RTO into the middle of judging what are essentially ratemaking questions that are key to project selection. As noted above, this does not put PJM in the “don’t consider costs in the planning process” arena but it does try to save the RTO from having to interpret, years later, a particular exclusion clause or explain its rationale for the inclusion or exclusion of a given set of costs from a cost cap. By restoring a more balanced approach, with more involvement by the Commission at the front end when it is obvious that Commission guidance is needed, PJM believes we can get back to fulfilling our respective missions without inadvertently encroaching on each other’s role.

Enforcement of Cost Cap Provisions: Another Area Requiring Clear Identification of Roles

The Commission’s notice also implies that some kind of verification and enforcement process potentially be included in “the transmission planning process”.¹⁰ Like the cost cap issue, this idea could easily cause a further blurring of lines between the regulatory and the planning processes. PJM has no problem requiring the developer to report to stakeholders its ongoing costs of the project or any particular challenges the developer is facing, including the impact of those factors on the project budget and the cost cap. And, although the RTO can serve as a vehicle for the posting of that information and for hosting an explanation by the developer to stakeholders through the RTOs stakeholder process, the actual enforcement of the cost cap must come through the regulatory process by way of the filing of a complaint by load or a state public utility commission or examination of those cost overruns through the formula rate process.¹¹

In this area, as in the above area, we urge the Commission to resist the temptation to “layer” another set of responsibilities on the RTO that, we would respectfully argue, are better addressed through the existing regulatory processes employed in this building. We appreciate the Commission’s consideration and look forward to further refining these proposals through this Technical Conference.

⁹ We have set forth this process as optional, similar to a declaratory judgment request, so as to allow the RTO to “take its chances” and move forward, in the interest of proceeding expeditiously, without seeking this up-front guidance, if need be.

¹⁰ Competitive Transmission Development Technical Conference, Supplemental Notice of Technical Conference and Request for Speakers, Docket No. AD16-18-000, Preliminary Agenda at 2 (May 10, 2016).

¹¹ And although our tariff reserves authority to the PJM Board to withdraw its approval for a project, that provision was designed to ensure that the original reliability violation or other driver is being timely addressed. See PJM Amended and Restated Operating Agreement, Schedule 6 § 1.5.8(k). It was never meant as a substitute for the Commission ruling on the reasonableness of cost recovery for a project which has exceeded its original cost estimates.