Why we support a balanced approach to cost capping in the PJM competitive process

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Transource Energy is AEP's Competitive Affiliate

- Transource is the affiliate of AEP that participates in Order 1000 competitive processes
- Transource actively participated in nearly all competitive transmission processes
  - PJM: Participant in all windows, finalist in Artificial Island and designated entity for two competitive projects
  - SPP: Bidder on Walkemeyer, submitted numerous DPPs
  - MISO: Bidder on Duff-Coleman, active participant in planning process, led establishment of Transmission Developer sector
  - NYISO: Pre-Order 1000 project proponent, active stakeholder, preparing to propose projects in upcoming windows
  - CAISO: Joint bidder on two competitive projects

  * AEP has also participated in the competitive processes in Alberta, Canada

Transource Supports Balanced Approach to Cost Caps

Our Perspective : Transource supports consideration of voluntary caps on upfront capital cost in the PJM competitive process, without creating rigid bright-line tests or complicated forms and scoring that could would limit flexibility and undermines PJM’s ability to balancing customer benefit and risk when selecting of the best solution

1. Focusing commitments on upfront capital cost achieves the largest value to customers and balances the complexity, effort and risks compared to cost caps on other aspects of lifetime costs

2. Appropriate developer risk assumption varies by project and the evaluation process must retain room for PJM judgement

3. This approach maintains the existing, well-functioning and appropriate roles of FERC and all other stakeholders in setting and enforcing transmission rates

4. Provides stakeholders clarity and transparency without compromising confidentiality that can skew project delivery (ROW and material procurement)

Transource Does Not Support the LS Power Motion

Our Perspective : Complicating cost caps in PJM to include all aspects of lifetime cost and increasing the influence of cost caps on project selection through rigid forms is not in customers' long-term interest because:

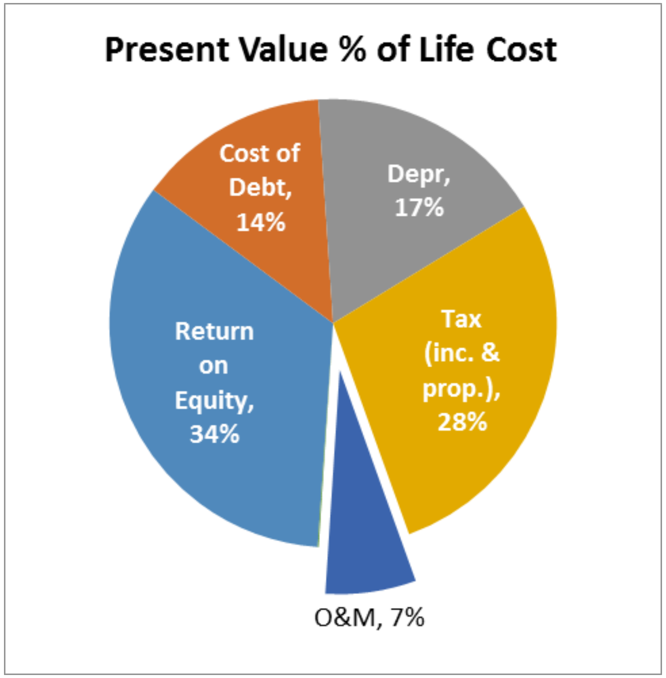
1. It shifts developers' resources away from finding the best planning solution, which is proven to deliver overwhelmingly the most benefits to customers in the sponsorship model

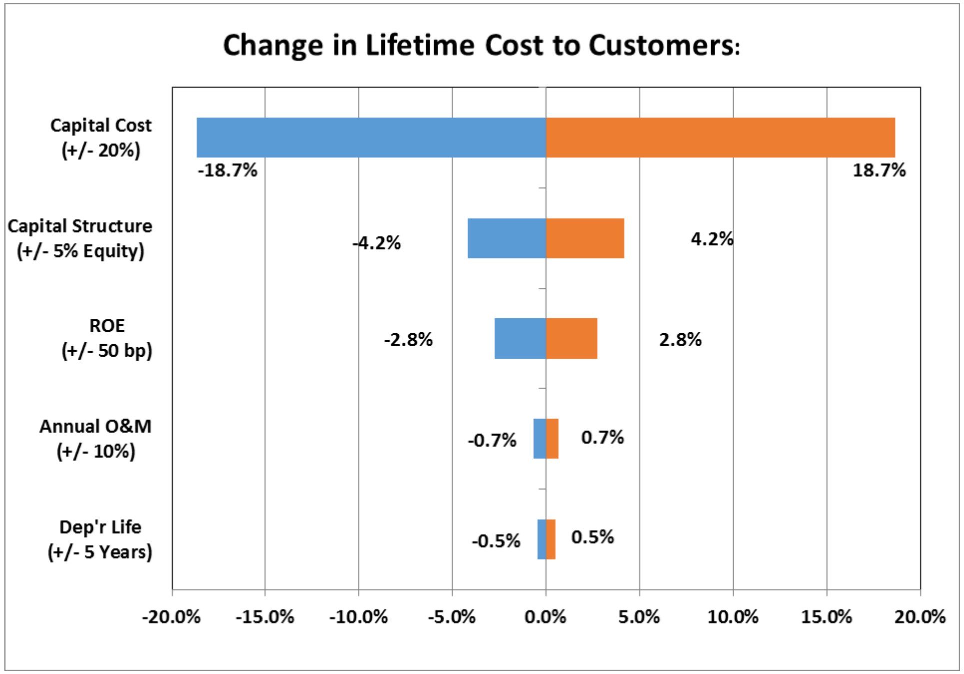
2. May lead to serious unintended consequences; risk assumption is not free and developers will expect to either be compensated or aggressively limit exposure
   - *The idea that project costs can both go down while developer risk assumption can go up significantly – with no other consequence - sounds too good to be true because it is*

3. Creating a formulaic evaluation approach limits flexibility for PJM to consider what conditions are best for a specific project – just assumes more cost containment is always better and all project aspects can be fit into a box

4. Creates jurisdictional and ongoing enforcement issues for PJM and developers

Caps on Capital Cost provides most value to customers





- This graph shows the make up of the present value of the revenue requirement over the life of a typical project
- Changes to capital cost also directly affects ROE, depreciation and taxes
- As such, changes to capital cost has the greatest impact on lifetime cost to customers
- Focusing cost caps in PJM to upfront capital costs provides significant value to customers

Competitive Bidding Process Risk Assessment

- In Competitive Bidding regions (MISO, SPP, CAISO), competitive projects are selected upfront with limited incentive for developers to meaningfully participate in the planning process

- Developers then have 9-12+ months to analyze a competitive project (end of planning process plus the RFP window)

- Developers, knowing that cost certainty is most valued, are incentivized to put its resources into <u>analyzing and mitigating unknown project risks</u> that can impact the cost of the project through activities like accelerated project design and procurement.
  - This typically accelerates a significant portion of the up-front project development work at significant cost to developers

- Based on this detailed analysis of project risks, developers can make <u>highly informed decisions on risk assumption</u> for cost containment in proposals; the details of the proposal and the RTO’s evaluation are kept mostly confidential
  - Risk transfer from customers to the developer is not “free”, but the significant investment in upfront work may “de-risk” the project and allow for an aggressive bid

PJM sponsorship model emphasizes the best project

- PJM sponsorship model is different and incentivizes developers to put significant resources into finding the most cost effective projects (most benefits for customers at the lowest cost)
- Windows are much shorter (2 or 4 months), includes submission of planning data, with modeling data available at the start and periodically updated during the window
- Active developers may propose 10+ projects in single window and project ideas it is not uncommon for the best idea to emerge only days before the closing of the window
- Cost estimates are based on desktop analyses and historical data, with no opportunity to accelerate project design and procurement activities, however they are validated by PJM's third party process
- There is insufficient time for the months-long, detailed up-front development work performed in competitive bidding processes

PJM Sponsorship Model Works for Customers

- Competitive bidding can yield moderate cost savings versus initial planning estimates
  - Offset by the costs of the process (RTO, developers, evaluators, etc.) that are mostly paid by customers
  - The winning Duff-Coleman bid was ~$11M less than initial estimates, while MISO spent $1.5M in the evaluation, plus the millions likely spent by developers
- In contrast, the PJM sponsorship model has produced *hundreds of millions* in overall benefits to customers:
  - Artificial Island options were *hundreds of millions* less than previously identified options
  - Project 9A from the 2014-2015 Market Efficiency Window generated *hundreds of millions* more benefits than other options
  - The BG&E upgrade solutions identified in the 2016-2017 Market Efficiency Window clearly demonstrate the most customer value
- <u>***It is not in the interest of customers to erode the value of the sponsorship model to gain lesser marginal value from some additional cost certainty***</u>

How could we aggressively take risk in PJM?

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We see several likely impacts that stakeholders should seriously evaluate before making dramatic changes to the PJM competitive process such as the LS Power proposal:

- Developers limit proposal submissions to focus on risk mitigation through up-front development work
  - *Outcome: PJM customers lose benefits from finding best project ($100s of millions)*

- Developers blindly take risks based on limited analysis and “price the risk” at a cost point above initial planning estimates
  - *Outcome: distorts selection of the most cost effective project*

- Developers blindly takes risks based on limited analysis at a “competitive” cost point below initial planning estimates
  - *Outcome (positive): if the project goes smoothly everyone wins*

  - *Outcome (negative): if the project goes poorly, developer will aggressively limit their exposure, transferring the risk/cost to PJM and customers – more on next slide*

Developers will limit risk exposure

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- PJM and customers will assume the following risks and associated costs:
  - *Litigating force majeure language, potentially over the life of the project – even clear, enforceable language is subject to dispute forcing PJM to fight in courts to hold entities accountable with costs paid by customers*
  - *Potentially cutting corners to keep costs down; especially O&M*
  - *Taking aggressive, rather than collaborative, positions with land owners, permitting/environmental agencies*
  - *Abandoning challenging projects held in "bankruptcy remote" project companies, leaving PJM to pick up the pieces*

Developer Risk Assumption	**INCREASE** →
Customer Cost Certainty	**INCREASE** →
Developer Non-Performance Risks (Unintended Consequences)	**INCREASE** →

- Rather than being innovative, it could be very damaging for our nation's critical energy infrastructure
- There is very little consequence to developers for non-performance with only 3% collateral posted, no other liability for damages to the Transmission Provider and no impact on pre-qualification status
- Recovering from a single instance of any of these unwanted behaviors would likely cost customers substantially more than the combined cost saving benefit generated from adding cost containment for competitive proposals

Jurisdictional and Enforcement Issues

- Customers benefit from the ability to track/monitor/enforce cost caps and those that are related to ROE, equity structure and revenue requirement through FERC’s existing processes
  - These can change over time
  - Language in the DEA agreement does not limit parties’ rights to make FERC 205/206 filings seeking changes to rates after the in-service date

- FERC is the ratemaking authority - Transource’s own experience shows that cost containment details are negotiated at FERC with input from various stakeholders – is there a presumption that the presence – or lack of – cost commitments will be rubber stamped at FERC?

- PJM is not in best position to evaluate ongoing and complex costs caps - PJM is a planner and operator - the expertise to do this is in the FERC forums where there is decades of expertise developed to analyze and adjudicate costs and PJM should not create a duplicative, parallel process