

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

New York Transmission Owners

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Docket No. ER21-1647-000

**PREPARED SUPPLEMENTAL DIRECT TESTIMONY
OF JOSHUA C. NOWAK ON BEHALF OF
NEW YORK TRANSMISSION OWNERS**

July 8, 2021

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OF
Joshua C. Nowak**

I. INTRODUCTION AND SUMMARY

Q. Please state your name, affiliation, and business address.

A. My name is Joshua C. Nowak. I am employed by Concentric Energy Advisors, Inc. (“Concentric”) as an Assistant Vice President. My business address is 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

Q. Have you previously submitted Direct Testimony in this proceeding?

A. Yes. On April 9, 2021, I submitted Direct Testimony on behalf of Central Hudson Gas & Electric Corporation (“Central Hudson”), Consolidated Edison Company of New York, Inc. (“Con Edison” or “CECONY”), Niagara Mohawk Power Corporation d/b/a National Grid (“National Grid”), New York State Electric & Gas Corporation (“NYSEG”), Orange and Rockland Utilities, Inc. (“O&R”), and Rochester Gas and Electric Corporation (“RG&E”) collectively referred to as the “Transmission Owners,” “TOs,” or “Companies.” The purpose of my Direct Testimony was to present evidence of the uncompensated risks and nonprofit operations required of the TOs absent the approval of a means for them to fund and earn a return (“TO Funding”) for transmission System Upgrade Facilities and System Deliverability Upgrades (“SUFs/SDUs”) needed to reliably interconnect new

1 generation sources to the New York Transmission System. Under the existing approach,
2 Interconnection Customers pay the TOs upfront for the capital costs associated with
3 SUFs/SDUs caused by their generator interconnections but then the TOs are required to
4 own, operate, and maintain those SUFs/SDUs without being allowed to recover a return for
5 those assets (the “Existing Funding Approach”).

6 **Q. What is the purpose of your Supplemental Direct Testimony?**

7 A. On June 8, 2021, the Federal Energy Regulatory Commission (“FERC”) issued a
8 deficiency letter (“Deficiency Letter”) requiring additional information to process the TOs’
9 filing. My Supplemental Direct Testimony provides additional information that is
10 responsive to the Deficiency Letter on issues raised in my Direct Testimony. Capitalized
11 terms used, but not defined, herein shall have the meanings set forth in my Direct
12 Testimony.

13 **II. RESPONSIVE INFORMATION ON ISSUES RAISED IN THE DEFICIENCY**
14 **LETTER**

15 **Q. What are the issues raised in the Deficiency Letter that you are addressing in your**
16 **Supplemental Direct Testimony?**

17 A. This testimony does not represent a comprehensive response to the issues raised in the
18 Deficiency Letter. Rather, I am providing supplemental information on issues identified in
19 the Deficiency Letter that are related to topics addressed in my Direct Testimony.
20 Specifically, I am providing evidence to address the following items from the Deficiency
21 Letter:

- 1 • 3.b. Also, provide support that the NYTOs' approved retail and transmission rates
2 have not already incorporated the risk of owning, maintaining, and operating the
3 transmission system with the System Upgrade additions. Please describe the
4 conditions under which transmission owners may not recover some or all their
5 operations and maintenance costs, including costs associated with System Upgrades.
- 6 • 4.a. Considering that the capital for System Upgrades is currently required to be
7 provided by the interconnection customers, please explain if there are concerns
8 specifically related to attracting capital to fund System Upgrades. If so, please
9 explain how the capital attraction concerns arise.
- 10 • 7.a. Please explain whether there is any difference between the risks and costs
11 associated with the modification or replacement of existing transmission facilities
12 versus the addition of new transmission facilities.

13 I provide evidence on each of these topics below.

14 **A. The TOs' approved retail and transmission rates and the risk of owning,**
15 **maintaining, and operating the transmission system with SUFs/SDUs**

16 **Q. Do the TOs' approved retail and transmission rates incorporate the risks associated**
17 **with SUFs/SDUs?**

18 A. No, they do not. As I observed in my Direct Testimony, the weighted average cost of
19 capital is authorized on the basis of an investor's required return on rate base. While
20 utilities raise capital on an enterprise-wide basis, the determination of the authorized return
21 is set by reference to the risks associated with investing in the rate base. In this way,
22 capital may be efficiently allocated, with each business segment earning a return based on

1 its own unique set of risks and business characteristics. Since SUFs/SDUs are not included
2 in rate base, the return authorized for retail rates or transmission rates does not account for
3 risks associated with SUFs/SDUs.

4 **Q. How is this concept applied in practice?**

5 A. The TOs have utility operations that are New York Public Service Commission-
6 (“NYPSC”) regulation and FERC regulation. Each jurisdiction establishes rates based on
7 an underlying rate of return, which is established based on the risks associated with the
8 jurisdictional rate base. Since SUFs/SDUs are not included in either NYPSC or FERC rate
9 base, the authorized rates of return for the TOs have not been adjusted to reflect the risks
10 associated with SUFs/SDUs. Therefore, the approved retail and transmission rates have
11 not been established with a risk-adjusted rate of return that incorporates the risk of owning,
12 maintaining, and operating SUFs/SDUs.

13 **B. The conditions under which transmission owners may not recover some or**
14 **all their operations and maintenance costs, including costs associated with**
15 **SUFs/SDUs**

16 **Q. Have the TOs historically recovered all their operations and maintenance costs?**

17 A. No, they have not. As shown in Figure 1 of my Direct Testimony five of the six TOs have
18 consistently underearned relative to their allowed ROEs for the period 2015 through 2019.
19 This indicates that they have not recovered all their costs. There are a number of factors
20 that can contribute to utilities under-recovering their costs, so it is not possible to isolate a
21 single variable such as operations and maintenance costs (especially a single component of
22 such as operations and maintenance costs associated with SUFs/SDUs) without making

1 several assumptions. Nonetheless, the consistent pattern of underearning demonstrated by
2 five of the six TOs indicates that the TOs are not fully recovering their actual cost of
3 service.

4 **Q. How does the New York regulatory structure affect the TOs' ability to recover their**
5 **costs associated with SUFs/SDUs through retail rates?**

6 A. The TOs are all operating under multi-year rate plans authorized by the NYPSC. These
7 rate plans are typically three-year terms with revenue escalation set based on forecasts of
8 sales, property taxes, depreciation expenses, operations and maintenance expenses, and
9 plant in service (as well as earnings sharing mechanisms in the event of earning above the
10 authorized return). Since the multi-year rate plans rely on forecasts, utilities have no
11 assurance of a dollar-for-dollar recovery as actual costs vary from forecasted costs, except
12 where specific reconciliations are established. I am not aware of any of the TOs having a
13 reconciliation account for operations and maintenance expenses associated with
14 SUFs/SDUs. While a rate case every three years allows utilities to reset their costs and
15 develop updated forecasts, each of the utilities completed a rate case over the course of the
16 five-year period included in Figure 1 of my Direct Testimony. Nonetheless, five of the six
17 utilities consistently underearned their authorized ROEs. Therefore, *any* incremental cost
18 is an unrecovered cost when utilities are persistently underearning. Since operations and
19 maintenance expenses for SUFs/SDUs are included in multi-year rate plans, SUFs/SDUs
20 have contributed to the TOs underearning their allowed ROEs and failing to recover their
21 full cost of service. To the extent the TOs experience financial losses from SUFs/SDUs
22 due to the regulatory, reliability, cybersecurity, environmental, operational, or other risks

(as discussed in Section IV of my Direct Testimony), this would place incremental pressure on the TOs to underearn their allowed ROEs and under-recover their cost of service.

C. Concerns specifically related to attracting capital

Q. Please describe the concerns related to raising capital related to SUFs/SDUs.

A. As described in my Direct Testimony, without an ability to earn a return on SUFs/SDUs, and the potential for financial loss due to uncompensated risks associated with SUFs/SDUs, there is no benefit to investors – there are only downside risks. By owning the facilities, and servicing the facilities, the facilities represent a nonprofit portion of the Companies’ overall enterprises. Given the potential for financial loss created by these nonprofit operations, currently SUFs/SDUs represent a downside-only proposition to the TOs, and investors in the TOs. As recognized in the recent *Ameren* decision with regard to upgrades comparable to SUFs/SDUs, investors do not expect “to underwrite the prospect of potentially large non-profit appendages with no compensatory incremental return.”¹ With the Companies’ requirement to maintain a nonprofit segment within the overall enterprise under the Existing Funding Approach, and no potential for a compensatory incremental return, the TOs’ ability to raise capital is inhibited.

Q. Are the concerns related to capital attraction associated with attracting capital for the purpose of funding SUFs/SDUs?

A. The capital attraction concerns are not related to attracting capital for the funding of SUFs/SDUs under the Existing Funding Approach. As noted in the Deficiency Letter

¹ *Ameren Servs. Co. v. FERC*, 880 F.3d 571, at 581 (D.C. Cir. 2018) (“*Ameren*”).

1 under the Existing Funding Approach, “the capital for [SUFs/SDUs] is currently required
2 to be provided by the interconnection customers.” Therefore, the TOs are not raising
3 capital for the purpose of funding of SUFs/SDUs. Rather, the concerns related to capital
4 attraction are associated with each TO’s ability to raise capital to fund its overall utility
5 operations. The TOs generally raise capital on an enterprise-wide basis. As such, investors
6 are not typically able to limit their investments to specific assets – they invest in the entire
7 enterprise. Under the Existing Funding Approach, an investment in the TOs requires an
8 investment in an enterprise that owns a nonprofit segment associated with SUFs/SDUs.
9 This nonprofit segment contains no potential for a compensatory incremental return
10 associated with SUFs/SDUs, and instead is burdened by the potential for financial loss. Put
11 in the framework of the *Ameren* decision, the Existing Funding Approach requires
12 investors to underwrite a nonprofit appendage with no compensatory return. Therefore, the
13 presence of a nonprofit segment associated with SUFs/SDUs inhibits the TOs’ ability to
14 attract capital for an investment in their *overall enterprises*.

15 **Q. How do the TOs compare to other utilities under the Existing Funding Approach?**

16 A. Under the Existing Funding Approach, the TOs are not able to earn a return on
17 SUFs/SDUs. This regulatory treatment of the TOs is in diametric opposition to the other
18 transmission owners that are expressly permitted, as determined in the *Ameren* decision, to
19 seek the option to self-fund system upgrades comparable to the SUFs/SDUs. Therefore, on
20 a relative basis, the TOs are required to maintain nonprofit segments that contain no
21 potential for a compensatory incremental return, and are instead burdened by the potential
22 for financial losses; transmission owners with the option to self-fund system upgrades do

1 not have the same burden. As a practical matter, several of the transmission owners
2 permitted to seek the option to self-fund system upgrades are held by companies that are
3 typically considered peers, or proxy companies for the TOs. These companies include:

- 4 • ALLETE, Inc.
- 5 • Ameren Corporation
- 6 • American Electric Power Company, Inc.
- 7 • CenterPoint Energy, Inc.
- 8 • Duke Energy Corporation
- 9 • Entergy Corporation
- 10 • Otter Tail Corporation
- 11 • Xcel Energy Inc.

12 Other companies have also expressed their intent to seek permission for the option to self-
13 fund system upgrades, with the transmission owners in the PJM Interconnection, L.L.C.
14 having filed on June 30, 2021 in Docket No. ER21-2282 to do so. To the extent the TOs
15 are required to maintain nonprofit segments, but the other transmission owners are not, they
16 may no longer be considered suitable peers as they do not have the same uncompensated
17 risks. Therefore, on a relative basis, the TOs would be exposed to an incremental risk that
18 would inhibit their ability to raise capital relative to other transmission owners that would
19 otherwise be considered peers. Significantly, the incremental risk is not related to the
20 nature of underlying utility assets themselves, but rather the funding model and associated
21 allowed returns.

1 **Q. Are the returns available to the TOs comparable to those of transmission owners with**
2 **the option to self-fund system upgrades?**

3 A. No, they are not. In my Direct Testimony, I summarize first principles articulated by the
4 Supreme Court in *Bluefield*, wherein the Court found that for a regulated enterprise is
5 entitled to earn a return equal to that earned on “other business undertakings which are
6 attended by corresponding, risks and uncertainties...”² The Court elaborated on this
7 requirement in its decision in *Hope*:

8 From the investor or company point of view it is important that there be
9 enough revenue not only for operating expenses but also for the capital costs
10 of the business. These include service on the debt and dividends on the stock...
11 By that standard the return to the equity owner should be commensurate with
12 returns on investments in other enterprises having corresponding risks. That
13 return, moreover, should be sufficient to assure confidence in the financial
14 integrity of the enterprise, so as to maintain its credit and to attract capital.³

15 Since other transmission owners possess the tariff right to self-fund system upgrades, and
16 the TOs are not able to do the same under the Existing Funding Approach, the other
17 transmission owners are able to earn an incremental return associated with system upgrades
18 while the TOs are required to maintain nonprofit segments of their business without a
19 compensatory return associated with system upgrades. As such, the returns available to the
20 other transmission owners are not equal to the returns available to the TOs that own and
21 operate similar assets with corresponding risks and uncertainties. This inhibits the TOs’
22 ability to raise capital on a relative basis to compared to enterprises with otherwise
23 corresponding risks.

² *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n*, 262 U.S. 679, at 692 (1923) (“*Bluefield*”).
³ *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, at 603 (1944) (“*Hope*”).

D. Modifications or replacements of existing transmission facilities compared to additions to the TOs' transmission system and associated risks

Q. Is there a difference in the risks associated with modifications or replacements of existing transmission facilities compared to risks associated with additions to the TOs' transmission system?

A. The costs and risks associated with the modification or replacement of existing transmission facilities versus the addition of new transmission facilities will depend on the specific application of the transmission equipment. Not all replacement transmission facilities carry the same risks. Similarly, not all new transmission facilities carry the same risks. The longevity, complexity, and technology can vary considerably depending upon the specific facility and its application, and these all have a more direct effect on the cost and risk associated with the facility. However, in aggregate, the risks between replacements of existing transmission facilities and the risks associated with additions can be expected to be largely similar since both categories contain the same range of underlying facilities.

Q. How do investors perceive risks in replacement transmission facilities versus new transmission facilities?

A. The distinction is largely irrelevant to investors. Investors would expect the utility to make economically efficient investments to provide safe and reliable service regardless of whether SUFs/SDUs are replacements of existing facilities or additions of new transmission facilities. Generally, utilities seek to raise capital to finance large, long-lived investments that are often recovered over decades. Therefore, over the life of the asset,

1 what was once considered a “new” facility, eventually becomes replaced or retired. And it
2 is over the life of the asset an investor expects to earn a return. As such, there is an
3 inherent temporal component in the distinction between replacement transmission facilities
4 versus new transmission facilities that is not relevant when assessing risks in the long run.

5 **III. SUMMARY AND CONCLUSIONS**

6 **Q. What are your conclusions?**

7 A. I have provided additional testimony in response to certain issues identified in the
8 Deficiency Letter that are related to topics addressed in my Direct Testimony. None of the
9 issues raised in the Deficiency Letter change my conclusions from my Direct Testimony. I
10 continue to conclude that under the Existing Funding Approach, without the ability to earn
11 a return on SUFs/SDUs, the TOs are exposed to uncompensated risks, which inhibit their
12 ability to raise capital on reasonable terms. In addition, the proposed TO Funding would
13 ensure that the TOs are allowed an opportunity to earn a return on SUFs/SDUs that the TOs
14 are required to own, operate, and maintain. This will allow the TOs to attract capital at
15 reasonable rates and on reasonable terms to enables them to provide safe, reliable utility
16 service while maintaining their financial integrity.

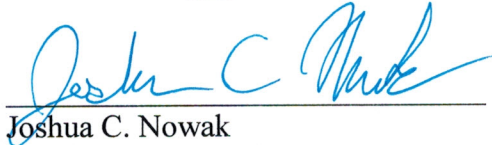
17 **Q. Does this conclude your Supplemental Direct Testimony?**

18 A. Yes, it does.

VERIFICATION

Pursuant to 28 U.S.C. § 1746, I state under penalty of perjury that the foregoing testimony is true and correct to the best of my knowledge, information, and belief.

Executed this 5 day of July, 2021.



Joshua C. Nowak
Assistant Vice President
Concentric Energy Advisors, Inc.