

Attachment I

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

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| <p>New York Independent System Operator, Inc.</p> |))) | Docket No. ER20-____-000 |
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AFFIDAVIT OF LORENZO P. SEIRUP

Mr. Lorenzo P. Seirup declares:

1. I have personal knowledge of the facts and opinions herein and if called to testify could and would testify competently hereto.

Background and Introduction

2. I am the Supervisor of Market Mitigation and Analysis – Installed Capacity for the New York Independent System Operator, Inc. (“NYISO”). My business address is 10 Krey Boulevard, Rensselaer, NY 12144.
3. My current responsibilities include supervising and coordinating operation of ICAP Mitigation staff and activities; ensuring administration, implementation and enforcement of the applicable Installed Capacity¹ (“ICAP”) market provisions of the Market Monitoring Plan,² administering the NYISO’s supplier-side and buyer-side capacity market power mitigation measures, which are set forth in Services Tariff Section 23; conducting market power analyses; and reviewing market data to determine whether market performance is consistent with a competitive market. Apart from capacity market mitigation administration, I assist in the development of new (and revisions to existing) market rules. My work in this capacity is predominantly focused on economic and financial matters; in particular, those relating to market efficiency, capacity markets, the retirement of existing electrical facilities, and the development of new energy projects. In short, I have participated on the NYISO team that develops filings and responds to Commission Orders

¹ Capitalized terms not otherwise defined herein shall have the meaning specified in Attachment Y of the OATT, and, if not defined therein, in the OATT or the Market Administration and Control Area Services Tariff (“Services Tariff”).

² Section 30 of the NYISO Services Tariff.

in the NYISO proceedings before the Commission that involve these matters from 2012 to the present. I hold a Bachelor of Science degree in Mathematics from Rensselaer Polytechnic Institute.

4. I submit this affidavit in support of the NYISO's Federal Power Act³ Section 205 filing that proposes revisions to Attachment Y and Rate Schedule 10 of its Open Access Transmission Tariff ("OATT") to establish cost containment requirements for its Public Policy Transmission Planning Process ("Public Policy Process").
5. I participated in the stakeholder process that led to the NYISO proposal, particularly in the development of the proposed rules relating to the allowable forms of Cost Containment (*e.g.*, either a "hard" Cost Cap or a "soft" Cost Cap), and in the development of the NYISO's assessment of Cost Caps in its selection process. I presented to stakeholders on these topics and led stakeholder discussions on issues relating to them. My work and work performed under my direction forms the basis for the rules in proposed Open Access Transmission Tariff ("OATT") Section 31.4.5.1.8.
6. In my opinion, as a subject matter expert in energy economics and rule design, the proposed changes are appropriate and necessary to help protect consumers by reducing the possibility of, and financial exposure to, excessive cost overruns that might occur in the development of transmission solutions selected in the NYISO's Public Policy Process.

Soft Cost Cap and Required Minimum Developer Shareholder Cost Overrun Sharing

7. The NYISO's proposed rules allow, but do not require, a Developer to include a Cost Cap as part of its proposed transmission solution in the Public Policy Process. A Developer that elects to submit a Cost Cap may do so in either the form of a hard Cost Cap or a soft Cost Cap.⁴

³ 16 U.S.C. § 824d (2014).

⁴ Proposed OATT Section 31.4.5.1.8.3.

8. If a Developer elects to propose a hard Cost Cap for its Included Capital Costs,⁵ the Developer will not be eligible to recover from ratepayers a dollar amount for the Included Capital Costs above the capped amount.⁶
9. If a Developer elects to propose a soft Cost Cap for its Included Capital Costs, the Developer will share with ratepayers the Included Capital Costs above the capped amount based on a defined percentage.⁷ However, Developers are limited to proposing soft Cost Caps with a percentage of cost sharing of at least twenty (20) percent (“20%”).⁸
10. This limitation is designed to preclude proposals that are unlikely to be effective at containing costs from being included in proposed transmission solutions.
11. In order for a cost containment proposal to provide effective consumer protection and to be effective at containing costs, it should provide for the minimization of cost overruns. Economic theory provides that a Developer, in its capacity as a rational actor, will strive to minimize cost overruns when it has a profit motive to do so. This ‘alignment’ between the Developer’s profit motive and the minimization of cost overruns (which can be thought of as the consumer’s ‘profit motive’) occurs when incremental costs in excess of the agreed-upon Cost Cap are accompanied by a financial loss on the part of the Developer, and thus a decrease in the overall value of the project to the Developer’s shareholders.
12. It is clear that this is always the case in the context of a proposed Hard Cap, where the Developer is financially liable for every dollar incremental to the amount defined by the Hard Cap. In the context of a Soft Cap, however, it is possible for a risk sharing arrangement to transfer insufficient financial liability to the Developer to align its profit motive with the minimization of cost overruns. This occurs when the unrecoverable portion of a cost overrun is not sufficient to outweigh the incremental value of the Developer’s return on the recoverable portion of that cost overrun.
13. In support of the development of the NYISO’s proposed rules, I performed an analysis to determine the minimum amount of cost sharing necessary to ensure that profit motive

⁵ Proposed OATT Section 31.4.5.1.8.1.

⁶ Proposed OATT Section 31.4.5.1.8.3.

⁷ Proposed OATT Section 31.4.5.1.8.3.

⁸ Proposed OATT Section 31.4.5.1.8.3.

alignment is achieved. This analysis forms the basis and rationale for the NYISO's proposed limitation of Soft Caps to those with a percentage cost sharing of at least 20%.

14. In order to arrive at 20% as the minimum necessary cost sharing amount, I calculated the Net Present Value of an incremental cost overrun to a hypothetical Developer under a variety of cost sharing amounts using generic financing and cost of capital assumptions. This analysis showed that, for the hypothetical Developer I had studied, the "breakeven" point at which the Developer was financially indifferent to an incremental cost overrun was just slightly above 20%. As cost-sharing levels rose above 20%, the Developer had an increasing strong profit motive to avoid cost overruns. Below 20%, the Developer earned additional profit with a cost overrun, even though it forwent recovery of a portion of that overrun. On August 6, 2019, I presented this analysis to stakeholders and led discussions regarding the assumptions, results, and conclusions.
15. This analysis does not show, and does not seek to show, that all cost containment proposals with at least cost sharing of at least 20% achieve profit motive alignment, nor does it show that proposals with less than 20% cost sharing fail to achieve profit motive alignment. The breakeven amount depends on the cost of capital and capital structure of the project. As a result, this amount will vary between Developers, and could even differ between projects proposed by the same Developer.
16. The NYISO's proposal does not contemplate an accurate determination of profit motive alignment for each proposed transmission solution, as the necessary financial parameters to determine a minimum cost sharing amount on a project-by-project basis will not be available to the NYISO, and may not even be known to the Developer, at the time the NYISO is performing its selection process.
17. Recognition of this inherent inaccuracy is one of the reasons that the quantitative and qualitative metrics included in the NYISO's proposed changes are necessary components of the NYISO's evaluation and selection process, not only to compare the relative effectiveness of proposals, but also to identify cost containment proposals that are at risk of being ineffective or marginally effective at containing costs.

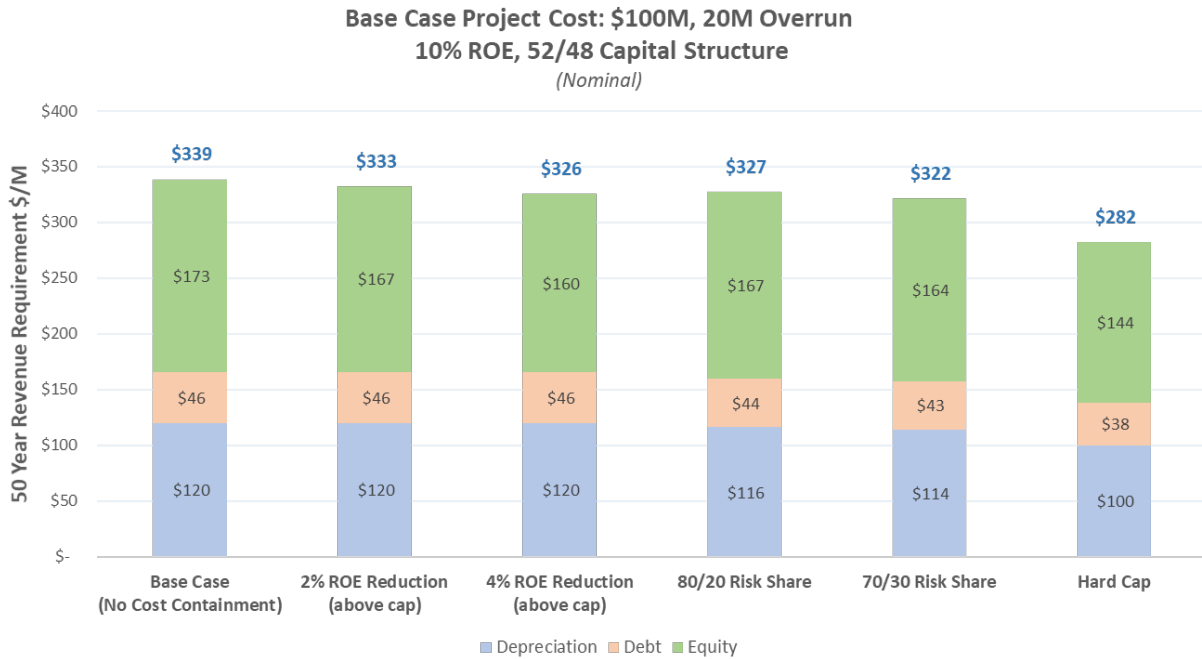
18. The NYISO’s proposed limitation on soft Cost Caps actually enhances the application of the proposed quantitative and qualitative metrics. It does so by “shifting the starting line” from which the effectiveness of each cost containment proposal is measured to a point that better represents the “conceptual zero”⁹ of effectiveness in incenting Developers to avoid cost overruns. That is, by requiring a minimum of 20% cost sharing – which my analysis estimates to be the minimum amount to result in cost sharing. In addition, the proposed limitation on soft Cost Caps provides for greater confidence in “apples-to-apples” comparisons between transmission solutions by precluding cost containment proposals with cost sharing amounts that are likely to be ineffective.

Feasibility and Enforceability of Alternative Rate Mechanism

19. The NYISO’s proposed rules also allow for an alternative rate mechanism. During the stakeholder process, some stakeholders requested that the NYISO consider an alternative mechanism for a Developer to effectuate a cost containment commitment. This alternative mechanism would achieve the cost containment commitment by reducing rate recovery for cost overruns through an adjustment to the project’s rate of return rather than through the denial of rate recovery for the unrecoverable portion of cost overruns. I evaluated cost recovery reductions achieved through lower returns on equity applied to amounts in excess of a cap. Based upon this analysis, I determined that Developers could potentially absorb the amount of a capital cost overrun through a lower return on equity on the capital cost overrun amount over the useful life of the asset. That is, I determined that in some circumstances, the total long-term revenue reduction for a transmission project could be achieved either through directly foregoing recovery of the Developer’s share of the overrun amounts, or through a lower rate of return applied to the overrun amounts. It is not always possible, however, and it must therefore be verified on a case-by-case basis. The following example illustrates the NYISO’s analysis.

⁹ The “conceptual zero” being the point at which a Developer is financially indifferent to an incremental cost overrun. That is, cost sharing amounts above this point provide a financial incentive for the Developer to minimize cost overruns, while cost sharing amounts below this point do not, or may even have the opposite effect.

Illustrative Example: Revenue Requirement Comparison



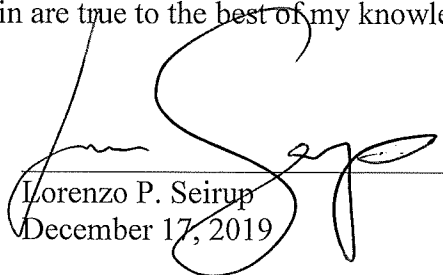
For purposes of example above, I have compared different revenue requirements for a hypothetical project that has a \$100 million project cost, \$20 million cost overrun, 10% return on equity, and 52/48 capital structure. The example demonstrates that, in this scenario, a 4% return on equity reduction would achieve a long-term revenue reduction that is slightly greater than the revenue reduction achieved using an 80/20 risk share.

20. The NYISO's proposed rules therefore allow the use of an alternative rate mechanism to achieve a cost containment commitment, but require that the alternative rate mechanism achieve a rate recovery reduction that is equal to, or better for ratepayers than, the approach based on the percentage cost sharing that the Developer first proposed to the NYISO.¹⁰
21. This concludes my affidavit.

¹⁰ Proposed OATT Section 6.10.6.3.

ATTESTATION

I am the witness identified in the foregoing affidavit. I have read the affidavit and am familiar with its contents. The facts set forth therein are true to the best of my knowledge, information, and belief.


Lorenzo P. Seirup
December 17, 2019

Subscribed and sworn to before me
this 17th day of December, 2019


Notary Public

My commission expires: 02 / 12 / 2022

CARL F. PATKA
Notary Public - State of New York
No. 4962209
Qualified in Albany County
My Commission Expires Feb. 12, 2022