



FERC Order 1000 Process Security

RPPTF September 19, 2013

Current security language as described

- In the OA filing:
 - “...a letter of credit as determined by the Office of Interconnection to cover the incremental costs of construction resulting from reassignment of the project”

- Protect ratepayers from increased costs should a Designated Entity abandon a project or default on its obligation
- As previously explained in PJM filings, in the event of a default there could be extra costs, including:
 - (i) purchase the right of way from the original developer;
 - (ii) engineer into the replacement Designated Entity's plans of the partially built facilities; or
 - (iii) purchase new easements as a result of the expiration of options that had expired.

Concepts in implementing security

- Security must be determined prior to project award
- Security must be provided before project award is final
- Methodology should be workable for reliability and market efficiency projects
- Methodology should be designed to address the anticipated risks
- Methodology of calculation should be transparent

Additional Concepts in implementing security

- Security provides a ready means to address immediate costs to cure the default—allows new entity assurance to recover costs to move forward quickly without having to await lengthy litigation or proof of full level of damages

Additional Considerations in Implementing Security

- Nothing in the PJM proposal would limit the potential liability of the defaulting entity to the newly designated entity but would provide some security that a reasonable proxy of those costs is recoverable while other collection efforts might be pursued.

Additional Concepts in Implementing Security

- Amount of security determined through determination of a reasonable proxy for known costs
- Legal principles of “cost to cure” set the framework for security in the event of default

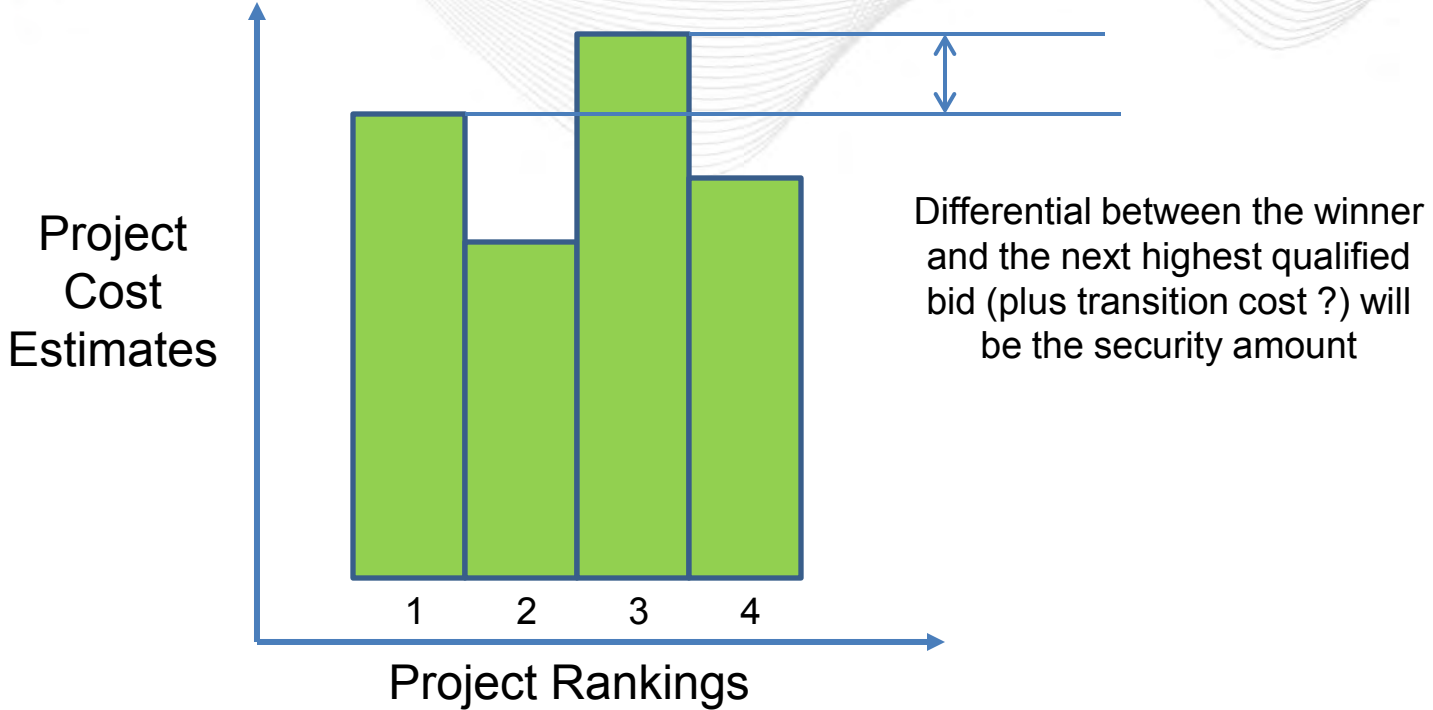


Alternatives for Consideration:

- Alternative A: Cost Difference between selected proposal and next highest proposal as best proxy of incremental cost at time security is to be posted
- Alternative B: Percentage of the total cost of the selected proposal as set forth in developer's proposal

Alternative A: Details and Issues

Example - cost difference as proxy



Calculation based on cost difference proxy

<u>Description</u>	<u>Project Cost (\$M)</u>	<u>Cost of next highest project (\$M)</u>	<u>Security Amount (\$M)</u>
Scenario A – Cost Difference > proj cost	200	500	300
Scenario B – Cost Difference is very small	600	625	25
Scenario C – Only one solution is viable/proposed	100	-	?

- Calculation of security considers the cost of selecting an alternate proposal in the future
- Calculation of security is based on project costs from proposers
- Calculation of security is dependent on having reviewed costs from competing project proposals (already reviewed in evaluation process)

Alternative A Issues:

- Calculation of security can vary widely depending on costs of next highest bid: zero dollars to an amount that exceeds the estimated cost of the selected project:
 - *Solution:* Cap security at no higher than estimated project cost?
Zero dollar security shows very little incremental costs for project A vs. project B:

Alternative A Issues:

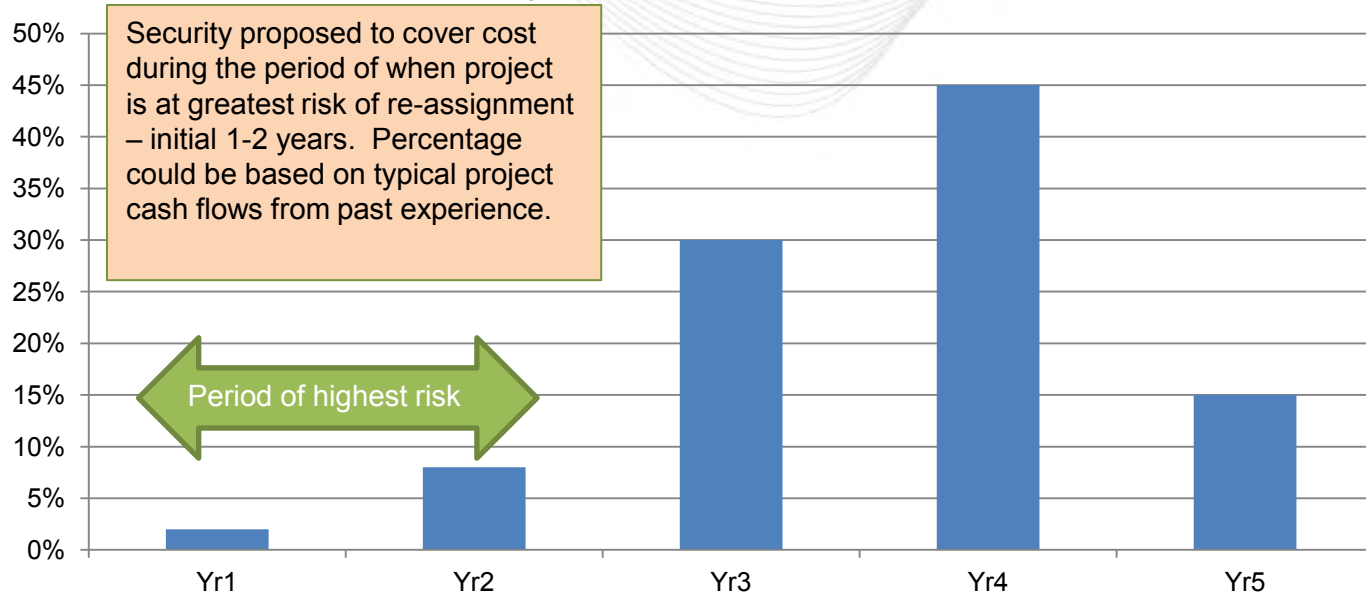
- Letter of Credit reflects that litigation processes may not be effective against bankrupt entities---security based on “market position” not applicable
- Security is in the nature of promoting performance by entities

Alternative A Issues:

- **Timing Challenge Under Alternative A:**
 - Due to need to post LOC at time of award, proxy may not reflect actual costs to cover/complete project, which could be higher (or lower) than LOC amount: Litigation for damages must address any delta
- **Potential for Gaming:**
 - “High” bids merely to increase costs of project

Alternative B: Proxy Based on Percentage of Project Cost

Project A - Cash Flow



- *Calculation based on cost percentage proxy (use 10% for illustration)*

<u>Description</u>	<u>Cost (\$M)</u>	<u>Security Amount (\$M)</u>
Scenario A	200	20
Scenario B	600	60
Scenario C	100	10

- Calculation of security is based on project cost developed by the proposing entity
- Calculation of security is based on a percentage of cost assumes a typical cash flow of large regional project.
- Calculation of security applies consistently to all projects and does not differentiate in risk profile of projects
- Calculation of security does not consider variation of alternative proposals and varied risk

- **Timing Challenge Under Alternative B:**
 - Due to need to post LOC at time of award, proxy may not reflect actual costs to cover/complete project which could be higher (or lower) than LOC amount: Litigation for damages must address any delta
- **Potential for Gaming:**
 - “Low” bids to limit security required but do not reflect the actual costs of project

Issues re: Alternative B:

- Does the defaulting entity owe a percentage of the total project costs to the new entity even if the defaulting entity never recovered those costs from ratepayers?
- Does this constitute a windfall to the new designee and its ratepayers at the expense of the original designee?

