

Another Complex Hurdle: Interconnecting New Generation Projects

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Many new electrical generation projects face a major stumbling block in the form of interconnection to the incumbent utility-owned transmission grid. This problem exists with regard to new greenfield projects, transfers of divested utility generating assets, and qualifying facilities in the current U.S. marketplace.

BACKGROUND

In Order No. 888 and its progeny, the Federal Energy Regulatory Commission (“FERC”) provided for open access to the Nation’s public utility-owned transmission grid. Open access to the grid encompasses the concept of non-discriminatory interconnection of new generation to that grid. This was confirmed recently by the FERC in *Tennessee Power Company*, 90 FERC ¶ 61,238 at 61,761 (2000) (“*Tennessee Power*”), where the FERC found that “[i]nterconnection is an element of transmission service and is... required to be provided under [the] *pro forma* tariff.”

Unfortunately, some of the incumbent utility transmission owners have used their continuing ownership and control over monopoly transmission facilities to hinder the interconnection of nonutility generation facilities to the benefit of their own, or their affiliates’, generation businesses.

Moreover, major portions of the United States' transmission grid is owned and operated by federal power marketing agencies, such as the Tennessee Valley Authority, and municipal and cooperatively-owned utilities (effectively removing one third of the national transmission grid from FERC regulation). These utilities are not even subject to the FERC's open access rules, nor are they subject to the FERC's recent regional transmission organization requirements found in Order No. 2000.

The bottom line for independent power project developers and the users they wish to serve is that some incumbent utilities and others have been able to exercise their monopoly power over the grid to make the interconnection of new generation an expensive, confusing, and time-consuming process. Interconnection negotiations in the 1990's have become the battleground similar to power purchase negotiations (under PURPA from the 1980's). This has in some instances caused otherwise promising projects to be uneconomic.

Importantly, where they exist, Independent System Operators ("ISOs") have not protected independent developers, as incumbent utilities continue to dominate ISO decision-making in this volatile time of transition. Following is a discussion of some of the significant, and potential deal-killing interconnection problems that independent power project developers are facing today.

THE INTERCONNECTION PROCESS

Today, even where ISOs exist, the incumbent utilities perform interconnection studies, which provide estimates of the cost and technological feasibility of interconnecting a new generation project to the grid. These same utilities, or their affiliates, may also be developing their own projects for interconnection to the same grid. In many cases, the estimated cost for the interconnection is unduly high in an effort to make an independent developer's project seem too costly to pursue.

In other cases, the estimates are wildly inaccurate, making it extremely difficult to properly plan a budget for development and financing of a project. In one such case, for example, the actual interconnection cost claimed by the utility exceeded the original cost estimate by 50%, resulting in close to \$2 million of interconnection cost overruns for the project pro formas.

Not only do incumbent utilities control the interconnection study

process, but they are also largely responsible for carrying out the construction of the physical interconnection facilities, such as generator leads and transformers. In fact, some utilities insist, on dubious reliability grounds, that they must construct and own all interconnection facilities.

Once wrapped in the safety and reliability blanket, some utilities have effectively sought to goldplate their transmission networks with state of the art fiber optic systems, telemetry and other improvements, none of which benefit interconnecting generators who are billed for these improvements without any real operating justification.

Moreover, some utilities overcharge for legitimate interconnection facilities that they themselves provide, in many cases charging an automatic markup for incumbent utility-provided equipment and services. For nonincumbent utility provided equipment and services, the incumbent utilities often forgo competitive bidding resulting in dramatically higher costs for construction and installation.

Some utilities have even attempted to charge exorbitant ongoing operating and maintenance fees for services that are either not provided or do not result from the interconnection of the new generator. Lastly, because the incumbent utilities directly control the interconnection study and construction process, the interconnection of new generation has become extremely time-consuming, as some utilities often delay projects on spurious grounds.

INCUMBENT UTILITY ATTEMPTS TO PLACE INTERCONNECTING GENERATORS UNDER THEIR TRANSMISSION TARIFFS

In an attempt to maintain control over the operations of new generators, some incumbent utilities have sought to place generators under their open access transmission tariffs, even though the generators do not require transmission service in order to export power to the grid. For example, in the New England region, at least one utility has attempted to impose its local open access transmission tariff on generators that interconnect directly with ISO-controlled pool-level transmission facilities and not the utility's lower voltage local system.

In so doing, some utilities have attempted to charge generators for transmission or ancillary services that are not actually provided, in an

attempt to inappropriately shift costs from retail ratepayers to generators. The incumbent utilities have done so without providing any cost justification for these charges, essentially claiming that it is administratively unfeasible to separate out the costs for the services allegedly provided to generators.

Moreover, because a generator's negotiated interconnection agreement with the incumbent utility is designed to provide all of the rates, terms, and conditions associated with the interconnection, the transmission service agreements generators are required to enter into may actually contradict the terms of the interconnection agreement. Not only does this create ambiguity, and extraordinary cost inefficiencies, but it also requires the generator to constantly monitor the incumbent utility's FERC filings affecting its tariff, resulting in an unnecessary administrative and legal cost burden on the project.

INTERCONNECTION POLICY UNCERTAINTY

While Order No. 888 allows for non-discriminatory interconnection, there is no uniform interconnection policy. As a result, interconnection policy varies utility by utility in those areas without operating ISOs, and ISO by ISO in those areas where they exist. The confusion caused by the lack of a clearly-defined interconnection policy at FERC is exacerbated by federal/state jurisdictional concerns.

For example, though *Western Massachusetts Electric Company v. FERC*, 165 F. 3d 922 (DC Cir. 1999) makes clear that FERC has jurisdiction over interconnection, the movement by many states to retail electricity competition has necessitated revisions to utility open access tariffs that may have the effect of imposing inappropriate charges on interconnecting generators.

This has resulted in the misapplication of wholesale concepts, such as denying credits for behind-the-meter (or self-provided) generation, to generators taking station service as retail customers to restart their plants in the event of outages. Moreover, generators have been faced with a variety of generator imbalance charge proposals by some utilities, each of which attempts to wring more revenues from generators in the competitive marketplace.

A major policy debate concerns the rights an interconnection agreement affords a given generator to deliver its power on the grid. In

Entergy Services, Inc., 91 FERC ¶ 61,149 (2000), the FERC clarified that there are no transmission delivery rights, beyond the receipt point, conveyed by an interconnection.

This is consistent with the *Tennessee Power* case where the FERC earlier found that an interconnection customer must make a separate application under the *pro forma* tariff for the delivery component of transmission service since interconnection alone conveys no right to delivery service.

Related to this issue, the FERC has pending before it a complaint by a generator located in Florida, in which the generator claims the utility is discriminatorily denying transmission service even though the generator has executed an interconnection agreement with the utility. The generator claims that the utility inappropriately allowed its own generating affiliates to reserve all the existing capacity in the system, making the generator responsible for significant upgrades and delaying potential transmission into key markets for up to eight years.

It is extremely difficult for developers to deal with shifting interconnection policies around the Nation. Additionally, because many utilities do not have a model interconnection agreement, each interconnection agreement is different, raising concerns over disparate treatment of generators by the incumbent utility. This is of particular concern where the incumbent utility has sold its generating assets to another entity in a divestiture auction, where preferential interconnection may have been negotiated along with the purchase of the generating assets.

While several large utilities and power pools, such as Entergy, the Southern Company, Commonwealth Edison, and the Southwest Power Pool, have developed interconnection procedures as amendments to their *pro forma* tariff, these efforts are not uniform and are evaluated and approved on a case-by-case basis at the FERC. Even within ISO's, interconnection policy uncertainty has caused severe problems for generators seeking to interconnect with the ISO-controlled grid.

For example, in one such case, an independent generating project was assigned an advantageous interconnection position only to see it later taken away by the ISO because an incumbent utility sought interconnection for one of its own projects at the same area on the grid.

For more information on the proliferation of generator interconnection problems in the US, contact Michael Zimmer, Jonathan W. Gottlieb or John Cohen at the address given below.

ABOUT THE AUTHOR

Michael J. Zimmer is a partner in the Washington, DC, office of Baker & McKenzie. He specializes in U.S. banking, finance, and major projects. He has represented energy concerns for over 20 years in matters before the Department of Energy, the FERC, the SEC and Congress. He has represented domestic and international industrial and manufacturing companies, electric utilities and their unregulated subsidiaries, energy project developers, natural gas pipeline and distribution companies, trade associations, financial institutions, universities, and embassies in over 30 states and 15 foreign countries.

Since 1977, he has been an invited witness on various energy tax proposals before Congressional committees, various federal departments and agencies, and state commissions and agencies. Mr. Zimmer has been involved in several mergers, acquisitions and project financings in the IPP industry including some of the largest undertakings in the United States. He has also been responsible for major precedents before the FERC involving issues under the Federal Power Act, PURPA, the Natural Gas Policy Act and PUHCA.

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