

FERC's Treatment of Generator Leads: A Policy at Cross Purposes with Competition and Renewable Power

Contributed by: Jay Matson, Richard Lorenzo, Ted Duver, Loeb & Loeb LLP

The United States, by many accounts, is on the cusp of building significant amounts of renewable generation. However, areas with the most wind, sun and geothermal activity are often in remote areas, not only distant from load, but tens or even hundreds of miles from the existing transmission infrastructure needed to reach the marketplace and consumers. To the extent transmission owners do not proactively expand the integrated grid into these regions in time for projects under development or at all, developers will be forced to consider interconnection solutions that involve construction of substantial facilities, most notably a lengthy generator lead.

Under the traditional development model, a generator approaches a transmission provider and requests interconnection service—i.e., the ability to "plug in" to the grid. The transmission provider then follows the processes incorporated into its open access transmission tariff (OATT), which is based on model procedures and agreements adopted by the Federal Energy Regulatory Commission (FERC), to construct the facilities needed to connect the renewable generation source to the grid. For various reasons the transmission provider may not be able to construct the interconnection in time to meet the developer's needs, and the cost of a utility-constructed interconnection may undermine the economics of the project. In the end, even though the developer pays for the facilities, they are owned and operated by the transmission provider.

In light of these considerations, developers are opting to construct interconnection facilities themselves. Some projects already exist where developers have successfully pursued this approach. But it is not without risk. If a third party seeks service over a generator lead, FERC has taken the position that the generator lead morphs into a transmission line and the developer is transformed into a transmission provider. As a result, the developer must adopt an OATT and provide the requested service, thereby subjecting itself (at least in part) to FERC's regulatory oversight as a transmission provider.

FERC's treatment of interconnection facilities is grounded in a rationale, now over a decade old, that assumes only utilities with monopolistic franchise service territories own

transmission assets. Applying this policy, based on this rationale, to pure-play generation makes little sense. While it is unclear whether a generator lead is properly considered "generation" or "transmission" under the Federal Power Act (FPA), as a practical matter, FERC's insistence on regulating developer constructed generator leads is at odds with its policy of promoting a competitive marketplace because the possibility of being regulated as a transmission provider may cause a developer to forgo an otherwise desirable project. That undermines the goal of promoting clean renewable sources of power and robust competition among power suppliers. It also contradicts the concepts of functional unbundling and divestiture.

To promote competitive electricity markets and the increased use of renewables, FERC should disclaim jurisdiction over developer constructed generator leads. If FERC on its own is not willing to pursue such a policy, it should be mandated by Congressional action.

Competition, Promoting New Generation and The Evolution of a Standardized Interconnection Process

Developing "independent" sources of power—generation owned by non-utilities—had been a goal since Congress enacted the Public Utility Regulatory Policy Act (PURPA) in 1978.¹ But it was open access and the associated movements to deregulate the industry at the federal level in 1996, and in many states shortly thereafter, that led to widespread development of power plants by companies other than utilities themselves.

Deregulation is premised on the belief that generation is not a natural monopoly; it is economically feasible for new generation to be built and compete against the incumbent generation. The resulting competition will drive down energy prices. However, for competition to work, enough suppliers are needed in the market to limit any one supplier's market power. Since the advent of open access, FERC has been committed to adopting rules and regulations that foster robust competition.² In recent years, FERC has also embraced development of renewable generation.³

Among the policies that FERC implemented to promote generation development was the standardization of the interconnection process. In the late 1990s, the choice for new generation was often natural gas. Since the transportation infrastructure for natural gas was fairly extensive, developers enjoyed flexibility as to where these plants could be sited. Each case was unique; the specific terms of service were driven by the wants, needs and negotiating ability of the interconnecting utility and the developer. It was a flawed interconnection process, but projects were completed and interconnected.⁴ That was almost certainly helped by the fact that the distance from the power plant to the existing

transmission (or in some cases, distribution) infrastructure was relatively short. Short interconnections are faster to build and a relatively small component of a project's overall costs, so any disputes between the transmission provider and the developer were less severe in nature.

Determined to resolve the flaws and bring certainty to the interconnection process, and thereby facilitate the development and interconnection of new generation, FERC adopted standardized processes and agreements in Order Nos. 2003 and 2006.⁵ Under these processes, still in effect today, a developer approaches the transmission provider to request an interconnection. Depending on where the project is located, the transmission provider could be a regional transmission organization (RTO) or a utility in whose service territory the project interconnects. The developer then takes a number and waits in the queue for its turn. After as many as three separate studies, the transmission provider and the developer sign a Large or Small Generator Interconnection Agreement or go to FERC to work out an agreement via settlement or litigation.

While this process is still flawed, with further refinement it can work reasonably well when the interconnection is relatively small and the fuel source is more established. The best sources of renewable fuel resources, however, are often a significant distance from the grid—tens, if not hundreds, of miles. And renewables are particularly sensitive to the need to complete projects and begin selling power as soon as possible once construction is under way. Delays associated with the development of a 50 or 100 mile generator lead can undermine the viability of a renewable project. The cost to plan and construct the generator lead can be prohibitive as well. Often, the best approach would be for the developer to build and own the generator lead itself. As discussed below, FERC's decision to regulate such developer-built facilities, whereby a pure generator can become a regulated transmission provider, will cause developers to think twice before taking this approach.

Regulation of Generator Leads and The Slippery Slope Leading to FERC Regulation

Legally, nothing in the Federal Power Act requires regulation of generator leads. The FPA explicitly bestows upon FERC the authority to regulate transmission in interstate commerce.⁶ It also prohibits FERC from regulating generation.⁷ But does a generator lead support the generation function or is it properly considered a conduit for transmission service? FERC suggests (though it does not explicitly state) that the movement of power over a wire from a generating unit to the integrated transmission system is not generation, but transmission, even if the facility over which it moves is a generator lead owned by a generation company engaged strictly in the production of power. Consequently, FERC claims

the authority to regulate it. To date, FERC has chosen to do so only when a potential customer asks the generator to provide service over the generator lead.⁸

Intentional or not, by using the service request as the triggering event for implementing regulation, FERC has side-stepped the thorny problem of requiring all generators to become transmission providers. After all, every generator has some sort of generator lead facilities that it uses to access the grid. However, this triggering event is also discriminatory. While renewable generators typically employ lengthy generator leads, thereby subjecting themselves to potential service requests, fossil and nuclear plants typically have shorter generator leads. Fossil and nuclear plants will likely never be asked to provide service over their generator leads.

For a generator, becoming a public utility has severe consequences. Most immediately and fundamentally, its business is no longer generation only. It is generation and transmission. FERC imposes numerous requirements to ensure transmission services are provided on a basis that is just and reasonable and not unduly discriminatory, consistent with its mandate under the FPA. Among the obligations are: (1) adopting an OATT; (2) upgrading facilities to provide service to customers; and (3) instituting measures to comply with the standards of conduct, including functional unbundling and maintenance of an Open Access Same-Time Information System ("OASIS").

FERC has indicated that it would not impose the traditional regulatory burdens on generators that are only transmission providers because of their generator leads.⁹ Inherent in this decision is a recognition that pure-play generators are not like traditional utilities, and that the level of concern over a generator's activity does not rise to the same level as a utility's. That being the case, regulation is not warranted. Nonetheless, FERC requires generators-turned-transmission providers to adopt an OATT based on the same "pro forma" model with which all other transmission providers must start.¹⁰ Deviations are allowed, but only if FERC is convinced that they are "consistent with or superior to" the pro forma's provisions.¹¹

FERC approval of a deviation to an OATT is not a sure thing, and the repercussions can be significant. In a recent case, generators that, through a partnership, collectively owned a single generator lead that they all used, asked FERC to accept deviations to their OATT. While FERC accepted some modifications, it rejected others. For example, FERC permitted the partners to "grandfather" the transmission service agreements that already existed among themselves, so that the generation owners would not have to take service under the

same OATT as third parties. However, FERC did not permit the partners to waive the requirement to establish and maintain an OASIS.¹²

Even if the requirement to provide service to third parties and the limited regulatory requirements were tolerable, there will be an on-going risk that FERC will apply additional regulatory requirements in the future. For example, one can easily envision a reliability incident attributable to a generator lead issue leading FERC to the conclusion that NERC's transmission-related reliability requirements should apply to generator leads. Indeed, in the case of the partnership discussed above, explicitly requiring an OASIS seems to be an expansion of the regulatory requirements as compared to previous decisions, which made no mention of that requirement, and suggested that the only regulatory requirement to be imposed would be adoption of an OATT.¹³ Ultimately, such uncertainty impairs the ability of developers to attract capital on reasonable terms so that they can pursue additional pure-play generation projects.

An added peril is the generator's loss of capacity over its own generator lead. If a developer constructs a generator lead that is larger than needed for its project and a third party wants to use the excess, the generator must provide it. This can be particularly problematic for renewable developers because projects are often financed, and built, in stages. FERC will grant the generator priority rights over the generator lead, but only to the extent the developer can demonstrate that it has specific plans, which can include steps taken toward the development of each stage, and a definitive timeline for completion of the project. FERC recently allowed a developer to retain 1,000 megawatts of priority rights over a generator lead line designed to serve 1,000 megawatts that was planned to be built over approximately 6 to 7 years.¹⁴ However, it also had to make any unused capacity available to others until the generator needs it.¹⁵

Open Access Was Not Intended For This Type of Facility

Applying open access principles to generator leads, contrary to its original intent, causes developers to forego generation, especially renewable, projects. When FERC adopted open access, the electric utility industry was composed largely of vertically integrated utilities, owners of the generation, transmission and distribution facilities necessary to serve customers in their respective franchise territories. They were monopolies, with the power to prevent competitors from luring away their customers. When FERC proposed open access, 15 years had elapsed since Congress enacted PURPA to promote the development of independent power producers. Independent power production was still very limited.

The open access policy is now encroaching on activities outside its original scope and purpose. In a recent case involving a different issue confronting the electric utility industry, U.S. Supreme Court Justice John Paul Stevens noted that "a reasonable principle, extended beyond its foundation, becomes bad law."¹⁶ The same can be said of FERC's decision to force certain generators into providing transmission service and then regulating it, thereby undermining their business model and the competitiveness necessary to succeed in the marketplace. As a consequence, there will be renewable generation projects that never get built. A policy designed to promote independent generation and competition, ironically, is now sometimes having the opposite effect.

To date, FERC has dismissed such arguments, effectively claiming there is no reason to believe that such a policy will impede future investment in generation projects. Generators should welcome the additional revenues paid by the users of the generator lead, so goes the thinking. Yet, a review of the leading developers of renewable generation suggests that none of them has adopted a business model designed to sell power and transmission service. Rather, the development of the generator lead is driven by the needs of the generation project. It is a secondary consideration, unless it undermines the project. The burden of turning the generator into a transmission provider, forcing it to adopt an OATT, subjecting it to the uncertainty of additional regulation in the future, and impairing its ability to raise capital, far outweigh the potential benefit of receiving modest revenues from providing transmission service.

Changing Course: Implementing a New Policy

To promote the development of new generation, especially renewable resources, FERC should treat generator leads as part of the generation plant and function. FERC should not force the generator to provide what it considers to be transmission service to third parties, or adopt any of the regulatory requirements applicable to transmission providers. Generators should be allowed to operate as pure-play generators. To help provide certainty to the industry, and the sources of capital considering investing in generation development, FERC should adopt a clear standard as to what will and will not be regulated, without condition. One potential line of demarcation would be the point where ownership of the facilities changes from the generator to another entity, presumably the transmission provider (that is actually in the business of being a transmission provider).¹⁷ This could be at the generator step up transformer, somewhere along the generator lead, or in the transmission provider's substation. The key is that with a clear standard a generator would be able to plan and develop its project with certainty as to what line of business it is and will continue to be in.

This could be accomplished if Congress were to modify the Federal Power Act to state explicitly that FERC does not have jurisdiction over generator leads. It would be more efficient, however, for FERC to adopt a new policy. FERC provided a forum for consideration of this policy when, on January 21, 2010, it issued a "Notice of Inquiry" in which it solicited comments on various regulatory barriers that hinder the development of renewable energy sources.¹⁸ FERC's stated goal is to remove "unnecessary barriers to transmission service and wholesale markets for [Variable Energy Resources]."¹⁹ In the Notice, FERC raised several specific questions for comment, none of which directly touch on the subject of generator interconnections. Nonetheless, the Notice broadly invites comments beyond the scope of those identified questions, and so provides a venue to address its generator lead policy, but that will happen only if parties intervene and raise it.²⁰ Comments must be filed with FERC by March 29, 2010.

Jay Matson is a Partner in the Washington DC office of Loeb & Loeb, focusing on energy and public utility issues. He has counseled generators, transmission owners and others on issues related to the development of transmission and interconnection facilities, particularly those needed to serve renewable resources.

Richard Lorenzo, a Partner based in the Washington DC and New York offices of Loeb & Loeb, has over 30 years of experience in the energy industry. Mr. Lorenzo has been actively involved in the development of numerous generation and transmission projects and represented them on the associated regulatory issues at the federal and state levels.

Ted Duver is Senior Counsel in the New York office of Loeb & Loeb, focusing principally on representation of energy and public utility companies in regulatory and complex commercial matters. He has litigated matters before courts, the Federal Energy Regulatory Commission and state commissions involving the development of transmission infrastructure and rate/cost issues.

¹ 16 U.S.C. §§ 2601–2645 (2006).

² *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats & Regs. ¶ 31,036 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), FERC Stats & Regs. ¶ 31,048 (1997), *order on reh'g*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998); *Promoting Undue Discrimination and Preference in Transmission Service*, Order No. 890, 72 Fed. Reg. 12,266 (March 15, 2007), FERC Stats & Regs. ¶ 31,241 (2007), *order on reh'g*, Order No. 890-A, 73 Fed. Reg. 2,984 (Jan. 16, 2008), FERC Stats & Regs. ¶ 31,261 (2007). *Order on reh'g*, Order No. 890-B, 73 Fed. Reg. 39,092 (July 8, 2008), 123 FERC ¶ 61,299 (2008).

³ *See, e.g., FERC, Statement of Acting Chairman Wellinghoff on Integrating Renewables into the Wholesale Electric Grid Technical Conference*, Mar. 2, 2009 (describing the steps

FERC has taken to facilitate renewable energy projects).

- ⁴ *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs. ¶ 31,146 at P 10 (2003).
- ⁵ *Standardization of Generator Interconnection Agreements and Procedures*, Order No. 2003, 68 Fed. Reg. 49,845 (Aug. 19, 2003), FERC Stats. & Regs. ¶ 31,146 (2003), *order on reh'g*, Order No. 2003-A, 69 Fed. Reg. 15,932 (Mar. 26, 2004), FERC Stats. & Regs. ¶ 31,160 (2004), *order on reh'g*, Order No. 2003-B, 70 Fed. Reg. 265 (Jan. 4, 2005), FERC Stats. & Regs. ¶ 31,171 (2005), *order on reh'g*, Order No. 2003-C, FERC Stats. & Regs. ¶ 31,190 (Jun. 16, 2005); *Standardization of Small Generator Interconnection Agreements and Procedures*, Order No. 2006, FERC Stats. & Regs. ¶ 31,180, *order on reh'g*, Order No. 2006-A, FERC Stats. & Regs. ¶ 31,196 (2005), *order on clarification*, Order No. 2006-B, FERC Stats. & Regs. ¶ 31,221 (2006).
- ⁶ See Federal Power Act, § 201, 16 U.S.C. 824(b)(1) (2006).
- ⁷ See Federal Power Act, § 201, 16 U.S.C. 824(b)(1) (2006).
- ⁸ See *Aero Energy, LLC*, 115 FERC ¶ 61,128 (2006), *order granting modification*, 116 FERC ¶ 61,149 (2006), *final order directing interconnection and transmission service*, 118 FERC ¶ 61,204 (2007), *order denying reh'g*, 120 FERC ¶ 61,188 (2007); *PSEG Energy Resources & Trade, Cross Hudson LLC*, 123 FERC ¶ 61,001 (2008), *reh'g denied*, 128 FERC ¶ 61,212 (2009).
- ⁹ See *Oxbow Power Marketing, Inc.*, 79 FERC ¶ 61,193 (May 19, 1997).
- ¹⁰ A generator can propose modifications to the OATT, perhaps to more narrowly tailor its terms to the generator's particular circumstances. Deviations from FERC's pro forma model can only become effective, however, if FERC finds them to be consistent with or superior to the pro forma provisions.
- ¹¹ See, e.g., Order No. 890-B, 123 FERC ¶ 61,299 at P 101 (2008).
- ¹² *Sagebrush, a California Partnership*, 130 FERC ¶ 61,093 at P 40 (2010).
- ¹³ See, e.g., *PSEG Energy Resources & Trade, PSEG Fossil LLC, Cross Hudson LLC*, 123 FERC ¶ 61,001, at P 26 (2008).
- ¹⁴ *Milford Wind Corridor, LLC*, 129 FERC ¶ 61,149 (2009).
- ¹⁵ *Id.* at P 23.
- ¹⁶ *NRG Power Marketing LLC v. Maine Pub. Util. Comm'n*, 558 U.S. _____, 130 S. Ct. 693 (2010).
- ¹⁷ FERC can refuse to exercise jurisdiction. See *New York v. FERC*, 535 U.S. 1 (2002) (in which the Supreme Court approved FERC's choice not to assert jurisdiction over bundled retail transmissions in a rulemaking proceeding, despite the fact that the FPA gave FERC the power to assert such jurisdiction).
- ¹⁸ Notice of Inquiry: Integration of Variable Energy Resources, FERC Docket No. RM-10-11 (Jan. 21, 2010).
- ¹⁹ *Id.* at P 9. The term "Variable Energy Resource" or "VER" refers to renewable energy sources that are variable beyond the control of the resource operator, such as wind, solar, and hydroelectric resources. *Id.* at n.1.
- ²⁰ *Id.* at P 13.