

Financing increased interconnection costs in light of queue reform

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Interest in renewable and clean energy project development has skyrocketed in the U.S., resulting in longer interconnection wait times as more projects petition for interconnection rights. According to the Federal Energy Regulatory Commission (FERC), at the end of 2022, there were more than 2,000 gigawatts of generation and storage waiting in interconnection queues throughout the country, which is more than triple the total volume just five years ago. Projects faced an average wait time of up to five years to get connected to the grid.

To combat the logjam, the Federal Energy Regulatory Commission (FERC) adopted significant queue reform “to increase reliable, efficient access to the grid,” which should help limit premature or unfeasible interconnection requests but comes with a higher financial cost.

How to secure payment of high upfront costs has always been an issue for early-stage developers, but these new rules are bringing this issue to the forefront of developer discussions.

Queue reform

In proposing reforms to the generator interconnection process, FERC noted that the then-existing serial first-come, first-served process was adopted when most interconnection requests were for large traditional generating facilities that would use readily available transmission capacity. Transmission providers conducted a series of studies to identify any adverse impacts on the transmission providers’ system or any affected systems, determine the interconnection facilities and network upgrades needed to reliably interconnect the generating facility, and estimate the interconnection customer’s cost responsibility for the facilities.

Transmission providers were required to use “reasonable efforts” to complete the studies within established timeframes. The changes to the electric power industry and the evolving resource mix led to study delays and interconnection queue management issues, which hampered project developers’ ability to interconnect their facilities to the transmission system.

In July 2023, FERC issued a landmark order that adopted sweeping reforms to the generator interconnection process (Order No. 2023). These reforms aim to address the existing backlogs in the interconnection queues across the country and to improve certainty

in the interconnection process. The backlogs have been significant obstacles to the clean energy transition and to bringing online solar, wind, and storage projects, many of which have spent years in interconnection queues.

Order No. 2023 transitions the generator interconnection process from the serial first-come, first served study process to a cluster study process under which all interconnection requests received within a specified window will be studied together, eliminating the need for separate studies to be conducted for each interconnection request.

Transmission providers will also be required to make more information available that will allow a prospective interconnection customer to see certain estimates of a potential generating facility’s effect on a transmission provider’s transmission system and to make more informed decisions. More specifically, transmission providers will be required to publicly post an interactive visual representation of available interconnection capacity, known as a “heatmap,” as well as certain interconnection metrics.

Order No. 2023 also eliminates the “reasonable efforts” standard that previously applied to transmission providers and imposes per-business day penalties on transmission providers for delayed studies.

Prospective interconnection customers will also be subject to more stringent requirements, including increased financial commitments and readiness requirements. Order No. 2023 increased and accelerated the collection of the study deposits from prospective interconnection customers. Instead of collecting a study deposit at each phase of the interconnection process, prospective interconnection customers will be required to pay a single initial study deposit that is based on the size of the proposed generating facility at the time the interconnection request is submitted.

Size of proposed generating facility	Amount of deposit
> 20 MW < 80 MW	\$35,000 + \$1,000/MW
≥ 80 MW < 200 MW	\$150,000
≥ 200 MW	\$250,000

Source: Morgan Lewis

In addition to the new study deposit framework, prospective interconnection will be required to demonstrate 90% site control at the time of the interconnection request and 100% site control at the time of the facilities study and when executing or requesting unexecuted filing of the interconnection agreement. Prospective interconnection customers that withdraw after the cluster study begins may be subject to monetary penalties if the withdrawal has a material impact on the cost or timing of equal or lower-queued interconnection requests.

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These new requirements are intended to discourage premature or unfeasible interconnection requests from being submitted but are factors that developers should bear in mind as they pursue new projects. Transmission providers are required to submit compliance filings to incorporate the new requirements into their tariffs by April 3, 2024, and will implement the requirements once FERC approves the compliance filings.

Financing development costs

The more stringent requirements being imposed on interconnection requests create additional pressure for early-stage developers to identify sources of capital earlier in order to finance a project's development costs, which are generally the costs incurred prior to the issuance of a full notice to proceed (FNTP) under the construction contract.

Three common options, explored in further detail below, include (1) agreeing during the development phase to sell such project at or before FNTP, (2) securing a third-party equity investment and (3) securing a development loan facility.

Asset sales

It is common for an early-stage developer to sell a development asset before FNTP. If the developer seller has already posted credit support for a project (including any required interconnection deposits) prior to the project sale, the buyer entity will generally agree to replace that security at or shortly after closing.

With the increase in interconnection deposits being required early in the development phase of a project, some developers are finding it difficult to post the required security on their balance sheet and, as a result, are looking for buyers to post the interconnection deposits ahead of closing on the project sale.

To the extent buyers agree to these requests, they will include conditions in the purchase and sale agreement (PSA) to protect their investments. These conditions may include (1) diligence to the buyer's satisfaction as to whether the security deposits posted by the buyer will be fully (or partially) refundable, (2) granting buyer a security interest in the assets of the development project until closing, (3) if the interconnection deposits are refundable, giving the buyer sufficient controls under the PSA to step in and cause such deposit to be refunded to buyer upon the occurrence of certain specified triggers (e.g., a determination by buyer that the development project is not economically viable upon receipt of certain information) and (4) if the deposits are non-refundable, putting a portion of the purchase price in escrow until construction is complete.

Equity investments

Developers may seek an investor to make equity investments in a pipeline of development assets. In these circumstances, parties may agree to form a joint venture and establish guidelines around the types of development opportunities that can be pursued and the conditions that must be satisfied before the investor funds any given development asset.

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Developers will generally want to maintain control over development of the project and look to minimize the equity investor's day-to-day involvement, whereas the equity investor will want to ensure that sufficient controls are in place to protect its investment (such as delineating the types of decisions that require the equity investor's input and the circumstances under which the equity investor can remove the developer from its manager role). The parties may also agree that the joint venture will sell the asset to the developer, equity investor or a third party at FNTP at a specified purchase price.

Development loan facilities

A developer can also enter into a loan facility to finance a project's development costs. From the perspective of a lender, there is higher risk associated with financing a development asset since there is less certainty that a development asset will be economically viable and there are fewer project assets available to be taken as collateral security. As a result, while commercial banks do offer development loan facilities, they are often more costly than a construction loan facility and not always available to smaller developers with less credit.

Developers can find other sources of financing such as loans from its corporate investors, funds or other banking institutions that do not traditionally offer construction loan facilities. Given the higher risks associated with development assets, these loan facilities often

have higher interest risks and more restrictive covenants compared to construction loan facilities.

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