



# Z2 Frequently Asked Questions

## **An introduction to the background and issues regarding “Z2” and how Southwest Power Pool and certain SPP members are affected.**

SPP is working diligently to comply with a mandate by the Federal Energy Regulatory Commission (FERC) to resettle invoices for costs associated with certain transmission upgrades. The process has proven to be an extremely complicated task for SPP and members, but a solution is expected in the near future.

The dilemma has manifested in multiple stages over the last 15 years and is estimated to require resettlement of several hundred million dollars of electricity purchases. An intertwined technical, legal, financial, and engineering morass must be reconfigured in a fashion suitable for the courts while also being practical to administer. SPP is taking the endeavor seriously and with high priority. Multiple offices and dozens of staff throughout the organization are involved.

### *What is Z2?*

Z2 is an attachment to SPP’s tariff approved by FERC. It details a process to compensate utilities, generation owners and others in the SPP footprint for upgrading transmission capabilities on the grid. Such upgrades provide access to increased generation of electricity.

### *What problem was it meant to solve?*

In some cases, transmission customers benefit from transmission system upgrades funded by others. Attachment Z2 enabled those customers to make use of those grid enhancements while ensuring fair allocation of costs and benefits of the upgrades.

### *How does it work?*

Upgrade sponsors receive credits from SPP that would be funded by those entities that receive power that could not have been provided “but for” the upgrade. Credits for future power purchases were determined based on the subsequential incremental use of the upgrade by individual utilities.

### *What type of entity would pay under Z2?*

1) Generation interconnection customers; 2) utility customers that benefit from projects undertaken voluntarily by another utility; and 3) utilities that benefitted from power received from new transmission.

### *When did FERC approve Z2?*

FERC originally approved Z2 in 2008.

### ***What are the legal, engineering and other technical issues that delayed implementation and billing?***

Special software was needed to calculate the upgrade charges. Development proved to be complex. Variables included divvying power streams among multiple users; taking into account bi-directional flow of electricity; finalizing in what manner the credit would be paid; and determining different crediting methodologies for network integration and point-to-point transmission, among other things.

In 2013, further tariff changes to clarify the process were accepted by FERC. Multiple software vendors were used, following the termination of one vendor contract due to various issues. In 2016, a method for calculating upgrade charges was finalized.

### ***How did SPP seek and receive feedback?***

SPP created a stakeholder group (the Crediting Process Task Force) to offer input.

### ***For what period were refunds calculated?***

SPP calculated upgrade charges from 2008 to 2015. The users at this point had not been billed. The SPP tariff generally requires that bills be submitted no more than a year after the actual service is performed. Out of an abundance of caution, SPP requested a waiver for this one-year restriction from FERC. FERC approved the waiver, enabling SPP to back-bill transactions to 2008. Subsequently, billing commenced.

### ***What was the value of the revenue credits extended to the upgrade sponsors?***

\$147 million. These funds were paid to the upgrade sponsors/developers by the upgrade users through SPP.

### ***What was FERC's initial response to SPP's waiver request?***

FERC found the waiver requested by SPP met FERC's four-part test for approval for allowable billing beyond the one-year limit: 1) acting in good faith; 2) the waiver was of limited scope; 3) the waiver addressed a concrete problem; and 4) there would be no undesirable consequences.

### ***Why did SPP need a waiver?***

FERC understood the multitude of complications in developing a system to capture accurately the data necessary to determine Z2 credits. Without that data, it was impossible for SPP to accurately issue invoices related to Z2. Subsequently, FERC approved SPP's waiver request in 2016, enabling SPP to bill customers for the entire period 2008-2016, though FERC later reversed its waiver decision in 2019 following a decision by the DC Circuit Court of Appeals.

### ***Who issued that legal challenge?***

An SPP member utility asked the District of Columbia Court of Appeals to review the FERC waivers. That utility was one of several upgrade users that had benefitted from transmission upgrades by another member utility. Those upgrades were necessary to develop wind generation and connect it to the SPP grid for the use throughout the region by other utilities.

## *What led FERC to change its stance?*

In a [separate case](#) unconnected to SPP, the DC Court of Appeals issued a decision involving a Virginia utility and PJM, which is a regional transmission organization that serves mid-Atlantic states. The utility ran up \$15 million in natural gas purchases requested by PJM to meet the energy needs of a “polar vortex” in 2014. PJM agreed with the utility that compensation was due. However, FERC and the Court of Appeals ruled that doing so would violate the “filed rate doctrine” barring retroactive charges that aren’t allowed by the terms of a tariff.

## *How did the PJM case affect Z2 for SPP?*

Given the precedent of the PJM case, the [court found](#) that FERC had no authority to waive or change a rate in a tariff, even if that waiver was for good cause. Subsequently, FERC in 2019 reversed the Z2 waiver it had granted SPP three years earlier. FERC found that the Z2 credits going back to 2008 would amount to unlawful retroactive ratemaking, such as in the PJM case.

## *What else did FERC order?*

SPP was required to refund upgrades users that paid to compensate upgrade sponsor utilities for developing new transmission.

## *What points did SPP make in response?*

SPP maintained that it had provided upgrades users adequate notice of coming charges through the stakeholder process which regularly communicated updates on Z2. Furthermore, SPP noted that FERC had granted waivers previously.

## *What did the Court of Appeals say?*

Attachment Z2 of the tariff contains no language that allows waivers to the billing requirements elsewhere in the tariff. Also, the references to Z2 pending charges through the stakeholder process wasn’t specific enough. The court did note the question of “equities of this situation” but emphasized that FERC had “no authority” to allow billing for services that occurred more than a year in the past.

## *Where does that leave SPP and its members?*

SPP must refund certain utilities, through credits, for their Z2 payments that compensated other utilities and transmission sponsors for their work. To accomplish this, SPP will withhold funds from transmission sponsors.

## *What happens next?*

SPP has calculated that individual refunds total \$147 million (plus \$33.4 million in interest). Refunds will go to transmission service customers during 2008 to 2015. SPP is awaiting an order from FERC to begin distribution.

To calculate and distribute resettlements on activity from September 2015 until the production system can be utilized, an interim software solution is being developed.

Settlements performed by SPP will follow a dual track of (1) Z2 credit resettlements for services begun in 2015 and (2) routine production monthly settlements for current day activity.

By 2029, Z2 settlements are expected to be in sync with routine monthly settlements. It will require unwinding \$20+ billion in previous Schedule 7,8,9,11 settlements to resettle Z2 activity. Only 1-2% of everything resettled will be related to Z2.

### ***How will SPP keep members informed?***

SPP will continue to keep members apprised of the situation through user forums and other groups allowing feedback. SPP continues to actively focus on Z2 with the best possible outcome for our members in mind. Resources from the following areas of SPP are involved: engineering, finance, information/technology, legal, project management, regulatory, settlements and communications.

### ***What are the pending legal issues?***

On September 16, the Eighth Circuit Court of Appeals in St. Louis issued a [ruling](#) that brings the years of Z2 litigation close to an end. In this case, multiple transmission sponsors/developers had filed complaints with FERC seeking to be compensated for facilities they funded and for allowing access to other entities to use these facilities' capacity that resulted (since FERC had switched course on previously allowing SPP to invoice retroactively beyond one year). On appeal, the court agreed with FERC that the one-year billing limit also applied in this instance which prohibited the compensation requested by the complainants. Requests for a rehearing may be sought by the appealing parties as a matter of course. SPP expects that upon final appeals court action and remand to FERC, the Commission will direct SPP to issue invoices to reimburse the transmission users, which had previously been billed pursuant to Attachment Z2.

### ***What is the status of Z2?***

SPP requested an elimination of Z2 in 2020, given the various issues that resulted. This followed a recommendation from the Holistic Integrated Tariff Team (HITT) which sought to mitigate risk. FERC granted.