

## Energy Industry Updates for August 2010

### Wind Projects Caught in Fangs of Indiana Bats

With the ever-increasing number of wind turbines being constructed, various government and private organizations are pursuing research into the impact of wind turbines on birds and bats with particular focus on endangered species. Earlier this year, the U.S. Fish and Wildlife Service (FWS) and Fowler Ridge I Wind Farm in Benton County, Indiana announced a plan to research ways to reduce the impact of wind generation on bats after finding a dead endangered Indiana bat near a wind turbine. Fowler Ridge I, like all projects, had conducted due diligence wildlife surveys and consulted with state and federal wildlife agencies prior to construction and operation. The project was found to represent a very low risk for bats in general and the endangered Indiana bat in particular, but the finding of the dead bat led to further scrutiny by the FWS.

The Indiana bat has been listed on the endangered species list since 1967. It is found over most of the Eastern half of the United States. Almost half of all Indiana bats hibernate in caves in Southern Indiana. Indiana bats are small, weighing only one-quarter of an ounce, and have a wingspan of nine to 11 inches.

While several wind farms, including Fowler Ridge, have recently requested incidental take permits from the FWS, others have been sent notices of intent to sue under the Endangered Species Act for failing to obtain incidental take permits. An incidental take permit is required when a non-federal action may result in a "take" of an endangered or threatened species. In June 2010, a coalition of environmental organizations and individuals filed a notice of violation against a Constellation Energy, Inc. project proposed for Garrett County, Maryland. The notice alleges that the project will result in an unpermitted taking of Indiana bats and another protected bat species. While construction on the project is proceeding, the legal wrangling is far from over. Constellation has stated they expect to request an incidental take permit for the protected bat species in the project area. Another nearby wind project also received a notice of violation from the same coalition.

In another case, the Beech Ridge wind project in Greenbrier County, West Virginia agreed this summer to request an incidental take permit to settle a lawsuit and also agreed to limit operation of turbines to times of the day when bats are not normally flying. Turbine operations are also prohibited between April 1 and November 15 while the permitting process is underway. An injunction had been issued in the case late last year.

Developers of wind projects must increasingly evaluate whether to seek an incidental take permit even where environmental and biological studies might not indicate that threatened or endangered species, like the Indiana bat, live or breed in the project area. Proactively seeking an incidental take permit may protect projects from lawsuits under the Endangered Species Act and head off challenges for project opponents.

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### California Legislature Passes Energy Storage Bill

A bill that mandates utility-scale energy storage has passed the California Legislature and, at press time, is awaiting Governor Arnold Schwarzenegger's signature.

The Senate analysis of the bill, AB 2514, clarifies that the legislative intent was to increase the amount of energy storage located within the California grid to (i) encourage load peak leveling, (ii) assist with the "smooth and dispatchable" operation of intermittent renewable generators, and (iii) provide better frequency regulation.

AB 2514 defines an "energy storage system" as "commercially available technology that is capable of absorbing energy, storing it for a period of time, and thereafter dispatching the energy."

AB 2514 requires load-serving entities, including electrical corporations, community-choice aggregators, electric-service providers, and local publicly owned electric utilities to include energy storage systems in their distribution networks. The bill requires the California Public

Utilities Commission (CPUC) to implement annual procurement targets for these entities. The CPUC will establish performance benchmarks for the acquisition of “viable and cost-effective energy storage systems” that load-serving entities must meet by 2015 and 2020 and that local publicly owned electric utilities must meet by 2016 and 2021.

Earlier drafts of the legislation mandated civil penalties for failure to meet the benchmarks, though AB 2514 as passed did not include these penalties.

CPUC proceedings to set the initial performance benchmarks must be initiated by March 1, 2012.

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## CPUC Proposes Feed-In Tariff Pilot Program

On Tuesday, August 24, 2010, the CPUC issued a proposed decision to launch a new renewable incentive program designed to drive development of mid-sized renewable energy systems — those ranging in size from one MW to 20 MW.

The CPUC proposal establishes a one GW pilot program for power from eligible mid-sized renewable energy systems. The program requires California’s three largest investor-owned utilities — Pacific Gas & Electric, Southern California Edison, and San Diego Gas & Electric — to hold biannual competitive auctions into which renewable developers can bid, known as the Renewable Auction Mechanism. Utilities must award contracts starting with the lowest-cost viable project and moving up in price until the MW requirement is reached for that round. The program will use standard terms and conditions to lower transactional costs and provide the contractual transparency needed for effective financing. Development security and relatively short project development timelines ensure project viability.

The CPUC proposal has several advantages, which include the following:

- While transmission is the most significant barrier to development of large-scale renewable projects, the proposed program establishes a market for smaller renewable projects that can be incorporated into existing utility distribution infrastructure.
- Smaller projects likely will be easier to finance than large-scale ones.
- The proposed program will use competition to establish a price that is both sufficient for project development and protective of ratepayers. This mitigates the difficulty in implementing fixed-price feed-in tariffs, whereby if the fixed price is set too low, then incentives to develop renewable projects are decreased, and if the fixed price is set too high, then ratepayers pay unnecessary costs.

In general, there is a clear gap in the development of mid-sized renewable energy projects in California; the state has robust policies for developing utility-scale projects and for putting smaller systems on homes and businesses, but mid-sized projects have been underdeveloped. The CPUC can act to finalize and adopt the proposed program in as soon as 30 days. If adopted, this program will present significant opportunities for further development of renewable energy systems and will bring new sources of clean energy to California.

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## FERC Rejects Wind Balancing Service Proposal

This month, FERC rejected a proposal by Puget Sound Energy, Inc. requiring all wind generation resources within Puget’s balancing area to purchase Wind Following Service from Puget or otherwise procure such service. According to Puget, this service was designed to allow Puget to recover capacity costs associated with following and balancing intra-hour variations in output from wind generation. Puget argued that the service was necessary to meet reliability standards that require continuously balancing generation and load and maintaining sufficient reserves to keep the Puget system balanced. Puget stated that it currently has sufficient stored hydroelectric capacity to balance the variability of wind generation, but that it expects a capacity shortfall in the future.

The rate for the Wind Following Service would be calculated by multiplying the percentage of wind generator’s installed capacity that must be backed up by the incremental monthly cost of reserving one kilowatt of quick-responding natural gas generation. Puget’s proposed initial rate was \$2.70 per kilowatt-month and would be recalculated annually.

FERC rejected Puget’s proposal stating that Puget failed to show that its rate calculation would not result in an over-recovery of its costs. Puget also had not adequately demonstrated that its rate calculation was a reasonably accurate representation of the opportunity costs Puget incurs to provide a following service for wind generators. Finally, Puget also had not explained how self-scheduling for the service would work, such as the types and locations of resources that may be used.

FERC’s rejection was without prejudice to Puget filing a revised proposal that addresses FERC’s concerns. While it is unclear whether Puget will file a revised proposal, it is likely that many utilities are considering similar proposals in an attempt to allocate costs associated

with the integration of renewable energy resources.

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## D.C. Circuit Upholds FERC Decision to Maintain Price Caps on Natural Gas Pipeline Capacity Sales

The United States Court of Appeals for the District of Columbia Circuit recently upheld two FERC orders that permanently lift cost-based price ceilings on natural gas shippers' releases of unused firm pipeline transportation capacity into the short-term market (one year or less), while retaining price ceilings on sales by natural gas pipelines.

In Orders No. 712 and No 712-A, issued in 2008, FERC determined that, unlike shippers releasing capacity, pipelines could potentially exercise market power and might have an incentive to hamper construction of new transportation capacity if allowed to charge market-based rates for short-term sales. To alleviate this concern while lifting the price ceilings for capacity sales by shippers, FERC retained the ceilings for capacity sales by pipelines. The Interstate Natural Gas Association of America (INGAA) petitioned for review of these orders, claiming that pipelines' construction decisions were not influenced by prices in the short-term market. They also argued that Orders No. 712 and 712-A provide shippers with an unfair competitive advantage over pipelines by creating a bifurcated gas transportation market in which the capped pipeline prices will artificially inflate prices in the uncapped market.

The D.C. Circuit rejected the INGAA's arguments. The court found that INGAA did not adduce evidence contradicting FERC's concerns, supported by economic theory, that if pipelines find that maintaining scarce pipeline capacity increases their profits, they may be inclined to withhold construction of long-term capacity, since such capacity could result in reduced profitability. With respect to the question of artificially inflated prices in the uncapped market, the D.C. Circuit found that, in balancing the risks of market distortions against the possibility of market power wielded by the pipelines in the short-term market, FERC made a reasonable determination that protecting against undue market power is a priority. Finally, the D.C. Circuit found FERC's decision to be consistent with the Natural Gas Act's fundamental policy of protecting natural gas customers from the monopoly powers of pipelines.

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## Rhode Island Attorney General Files Suit to Reverse Approval of Deepwater Wind Power Purchase Agreement

Rhode Island Attorney General Patrick Lynch has filed suit against his own state's Public Utilities Commission (PUC) seeking to overturn the PUC's approval of a power purchase agreement (PPA) between offshore-wind developer Deepwater Wind and utility company National Grid. The project and the PPA have generated controversy from the start. Earlier this year, the PUC rejected a PPA for the same offshore-wind project.

That initial rejection led the Rhode Island General Assembly to pass a law in June 2010 amending the process for approval of PPAs and forcing the PUC to reconsider the Deepwater Wind agreement. Mr. Lynch contends that, because it is aimed at reversing a particular decision of the PUC and benefits a single developer, the new law is unconstitutional. He is asking the state Supreme Court to overturn the law and reverse the PUC's approval. Mr. Lynch's suit is the third seeking to prevent the agreement from taking effect. The Conservation Law Foundation and a pair of local plastics manufacturers also have asked the state Supreme Court to intervene.

If implemented, the PPA would allow Deepwater Wind to begin construction of a 20-megawatt, eight-turbine demonstration project off of Block Island in Rhode Island. Deepwater Wind hopes to complete the project before the end of 2012.

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