

Power

Washington Energy Update

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Each bimonthly issue of the *Washington Energy Update* highlights useful energy regulatory tips and a wide range of issues impacting the energy markets.

If you have any questions or would like more information about anything appearing in this issue, please contact the editors or your White & Case relationship lawyer. Please let the editors know if you would like a particular topic covered in a future issue or have suggestions on how this newsletter can be improved.

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Energy Highlights

- On June 22, 2012 FERC issued a NOPR proposing to approve NERC's modified definition of "bulk electric system" (BES). The modified definition would establish a bright-line test that would include all facilities operated at or above 100 kV in the BES, subject to certain exemptions and inclusions of specific categories of facilities. Comments are due September 4, 2012 in Docket Nos. RM12-6 and RM12-7. *Revisions to Electric Reliability Organization Definition of Bulk Electric System and Rules of Procedure*, 139 FERC ¶ 61,247 (2012).
- FERC approved a penalty of US\$19,500 against Southwestern Power Administration for violations of the NERC mandatory reliability standards. In so doing, FERC affirmed and explained its legal justification for imposing penalties for NERC violations against governmental agencies. *North American Electric Reliability Corporation*, 140 FERC ¶ 61,048 (2012).
- Effective August 27, 2012, FERC amended its regulations (18 CFR § 284.12) to incorporate by reference a new version of the North American Energy Standards Board (NAESB) business practice standards for natural gas pipelines. Among other things, Version 2.0 clarifies Gas/Electric Operational Communication Standards. *Standards for Business Practices of Interstate Natural Gas Pipelines*, 140 FERC ¶ 61,036 (2012).
- In July, FERC and the Bureau of Ocean Energy Management announced revised guidelines for marine hydrokinetic energy technology testing and commercial development activities on the Outer Continental Shelf. The revised guidelines are intended to clarify the regulatory process and promote a more efficient process for authorization of marine hydrokinetic research and testing. The revised guidelines are available [here](#).
- Fishermen's Energy announced on July 19 that it received the final regulatory approval necessary to begin construction of its offshore wind project near Atlantic City, New Jersey, from the US Army Corps of Engineers. Fishermen's Energy hopes that its Fishermen's Atlantic City Windfarm will be the first commercial offshore wind project built in North America, with an estimated online date in 2014.

FERC Proposes to Substantially Amend Its Transmission-Capacity Allocation Policies

Jane Rueger

FERC recently issued a proposed policy statement that, if adopted, would provide merchant transmission developers with increased flexibility to pursue bilateral negotiations with potential customers and make it substantially easier for such developers to obtain negotiated rate authority from FERC.¹ FERC also proposes to apply the new policy to non-incumbent, cost-based, participant-funded transmission developers, but not to incumbent transmission developers. Although FERC seeks to promote transmission development “while also...ensur[ing] transparency in the allocations of capacity...and, in turn, ...ensur[ing] that transmission service is provided at rates, terms and conditions that are just and reasonable and not unduly discriminatory;”² there are many crucial details that will have to be resolved either in a final policy statement or as FERC employs its new policy in specific cases in the future. Comments on the Proposed Policy Statement are due September 24, 2012.

Background

About three-and-a-half years ago, FERC revamped its approach to merchant transmission developers’ requests for negotiated rate authority in *Chinook*,³ winnowing its ten-factor test for granting negotiated rate authority down to four central “areas of concern”: (1) just and reasonable rates; (2) undue discrimination; (3) undue preference and affiliate concerns; and (4) regional reliability and operational efficiency. In analyzing opportunities for undue discrimination and undue preference, FERC relied heavily on open seasons held by the merchant transmission developer and FERC’s requirement that the results of open seasons be reported by compliance filing for comment.⁴ FERC further stated that affiliates should not be permitted to participate in open seasons absent a showing that the affiliate would not be afforded an undue preference.⁵ In addition, FERC announced its policy of permitting a merchant transmission developer to allocate some portion of its project’s capacity to an anchor customer via bilateral negotiations outside of its open season process.⁶

Since *Chinook*, FERC has addressed approximately ten merchant transmission developer applications for negotiated rate authority and has granted negotiated rate authority in all of those cases but one. In several cases, FERC permitted merchant transmission developers to allocate up to 75 percent of their project capacity to anchor customers where the developers argued that it was necessary to make the project financially viable. During this time, FERC also received—and rejected—its first proposal to develop a cost-based participant-funded transmission project from

a non-incumbent transmission developer that proposed to assign priority transmission rights to customers that funded the project.⁷ FERC held a technical conference in March 2011, followed by a workshop in February 2012, gaining further input on potential reforms of its capacity allocation policies.

Proposed Policy Statement

Describing its Proposed Policy Statement as a “roadmap” for entities to pursue projects that provide sufficient value to particular potential customers but are not selected in a regional planning process, FERC proposes to allow merchant and non-incumbent cost-based transmission developers to allocate up to 100 percent of their projects’ capacity to individual anchor customers through bilateral negotiations. Affiliates would also be able to serve as anchor customers for such projects, when capacity is allocated to them in a “transparent manner.”

In exchange for this greater flexibility, merchant and non-incumbent cost-based transmission developers would be required to engage in “open solicitations” in order to identify potential anchor customers and submit reports regarding the details of such open solicitations to FERC. The open solicitation would begin with a “broad notice issued in a manner that ensures that all potential and interested customers are informed of the proposed project.”⁸ The report would contain pertinent technical and contractual details regarding the project, including the criteria the developer intends to use to select customers with whom it will engage in bilateral negotiations. FERC proposes to require the developer to submit a report describing the outcome of its open solicitation after completion of the solicitation process and resulting negotiations.

The Proposed Policy Statement, if adopted, represents at least a significant relaxation of FERC’s transmission capacity allocation policy. For the first time, FERC contemplates the allocation of 100 percent of a merchant or non-incumbent cost-based transmission project’s capacity to anchor customers based on bilateral negotiations instead of an open season. To the extent merchant and non-incumbent cost-based transmission developers comply with the open solicitation and reporting requirements, FERC proposes that they will be deemed to have satisfied FERC’s concerns regarding undue discrimination and undue preference, even where affiliates participate and are awarded capacity through bilateral negotiations. For merchant transmission developers, this would mean that two of the four criteria for negotiated rate authority are presumptively satisfied where the developer complies with the open solicitation and reporting requirements.⁹ While FERC previously relied to a substantial degree on open season reports to support a conclusion that no undue preference or undue discrimination would occur if a merchant transmission developer

was granted negotiated rate authority, the Proposed Policy Statement moves a step further by proposing an explicit presumption that a compliant open solicitation and report will satisfy those two prongs of FERC's analysis.

However, the Proposed Policy Statement raises numerous substantive questions that must be addressed either in a final policy statement or on a case-by-case basis as FERC employs its proposed new policies. How these questions are answered will determine the magnitude of FERC's policy change in this area. Fundamentally, the Proposed Policy Statement is unclear with regard to the ability of an interested party to protest the outcome of an open solicitation under Section 205 of the FPA. That is, will parties that believe an open solicitation was conducted unfairly be able to protest the results of the solicitation under Section 205 of the FPA, where the developer has the burden to prove that the solicitation was performed in a non-discriminatory and not unduly preferential way? Or, will their substantive complaints only be addressed pursuant to Section 206 of the FPA, under which the protesting party bears the burden of proving discrimination or undue preference? While FERC noted that requiring the report to be filed in the Section 205 docket in which a merchant transmission developer was granted negotiated rate authority "will allow interested entities to submit comments on the report, or otherwise protest *the contents or insufficiency of the report*,"¹⁰ it is not clear whether this means protesting parties will only be able to contest under Section 205 whether the report technically complies with the requirements for an open solicitation report in the Proposed Policy Statement, or whether they can also raise arguments regarding undue discrimination or undue preference that the merchant transmission developer would be obligated to refute in order to maintain negotiated rate authority. The Proposed Policy Statement adds uncertainty to this point where it states that "[i]f a party feels it was treated in an unduly discriminatory way, it may file a complaint under section 206 of the FPA..."¹¹ If FERC intends that the burden will be on protesting parties to prove undue discrimination or preference under Section 206 of the FPA as a result of an open solicitation, the Proposed Policy Statement represents a remarkable policy shift, essentially eliminating two prongs of the negotiated rate authority analysis.

The Proposed Policy Statement also leaves a number of other substantive questions open. For example, FERC noted that "[t]o the extent that a merchant transmission developer *substantially* complies with any such policies ultimately adopted by the Commission, the developer would be deemed to have satisfied the second (undue discrimination) and third (undue preference) factors of the four-factor analysis."¹² FERC did not attempt to explain what "substantial" compliance would entail, nor how far

from the stated open solicitation reporting requirements it would permit merchant (or non-incumbent cost-based) transmission developers to stray before losing the presumption. Similarly, FERC proposes to require merchant and non-incumbent cost-based transmission developers to update their public notices of a new proposed project "if there are any *material* changes to the nature of the project or the status of capacity allocation."¹³ The Proposed Policy Statement does not attempt to define what would constitute a "material" change, a term that can be interpreted in widely different ways.

The Proposed Policy Statement represents FERC's latest attempt to grapple with chronic underdevelopment of the transmission grid in the United States and to promote the ability of merchant and non-incumbent cost-based transmission developers to flexibly meet identified transmission needs. Whether the Proposed Policy Statement, if adopted, advances FERC's goal of encouraging competition and the growth of merchant generation in order to benefit ratepayers will depend on resolution of the questions left open by the Proposed Policy Statement and how FERC implements its policies going forward.

Energy Game-Changer: Electric Storage Systems

Donna M. Attanasio and Landis Wood

Storage has become a premier cleantech investment opportunity. Ernst & Young reported that energy storage totaled more than a third of the US\$1.1 billion US venture capital investment in cleantech for Q3 2011, which was the highest of any single sector that quarter.¹ In 2009, investment bank Piper Jaffray projected that the energy storage market would be at least US\$600 billion over the next 10 to 12 years.² In the US alone, the Department of Energy ("DOE") has projected that over the next 5 to 10 years, between 10 and 100 gigawatts of energy storage will need to be installed, creating a US\$35 billion industry.³ This article provides a brief overview of this fast-growing industry and describes recent developments in its regulatory treatment in the United States.

Why now?

The need for energy storage is not new. Electric power generation and consumption must be kept in balance in order to maintain a stable grid. This is typically done by varying generation levels to respond to changes in consumption (load), both to meet daily and seasonal variations in load levels and moment-to-moment fluctuations. Energy storage in the form of pumped hydro and hydro with pondage has a long history of use on the grid for such purposes.

But technologies for electric energy storage systems, such as battery technologies,⁴ flywheel technology, compressed air energy storage, electrochemical capacitors and superconducting magnetic energy storage,⁵ are becoming more efficient and more cost-effective, and a host of applications for these new technologies are being explored in the context of the needs of today's grid. These technologies have the capability to provide substantial value to the grid by helping to "move" energy from the period in which it is generated to the time it is needed: providing voltage and regulation service to help keep the grid stable and in balance; dampening load fluctuations; providing back-up power to end-users; and as operating reserves, to name only a few of the possible uses.⁶

These newer alternatives also increase the potential to use storage to defer new capital investments in generation, transmission and/or distribution by utilizing existing infrastructure more fully. For example, if generation can be transmitted during off-peak hours into a region that is transmission-constrained during peak periods and stored, transmission upgrades may be deferrable. Energy storage also has the versatility to be deployed at the distribution or even end-user level. End-user storage could include, for example, residential battery systems coupled with solar installations that are charged from the onsite resource for later use by the end-user or for sale to the grid during peak periods.⁷ As the Federal Energy Regulatory Commission ("FERC") has acknowledged, energy storage "can operate in ways that resemble production, transmission and/or distribution," in some cases, performing multiple functions simultaneously.⁸ With some projections of the capital expenditures necessary to upgrade the grid exceeding US\$100 billion through 2020,⁹ the potential for energy storage to offer cost-effective alternatives to traditional infrastructure investments is a strong driver fueling interest in the industry.

Part of the current appeal of energy storage is its ability to complement renewable energy resources. Indeed, one of the most significant barriers to the exponential growth potential of renewable electric power is that intermittent or variable energy resources ("VER"), such as wind and solar, often have limited ability to respond to a grid operator's direction. For obvious reasons, they cannot generate in the absence of "fuel" in the form of wind or sun. Some grid-scale VER can follow a grid operator's direction to ramp down when load drops, but in some cases, for example, with small-scale rooftop solar, even that degree of flexibility is unavailable. As VER's share of the market increases, they may displace resources in the economic stack that can be more easily ramped up or down or that provide ancillary services, as well as energy, thus compounding their effect on the flexibility of grid operation and/or making grid operation more expensive, particularly in low-load hours.¹⁰ Further, peak generation periods for some VER do not coincide with peak periods of demand; for example, in California, wind blows most during the night and dies

down during the day. On top of that, the availability of wind and sunlight cannot be relied upon.¹¹ Contrast this with an energy grid's demand for constant and dependable power and the rift between renewables and stable grid operation becomes apparent.

But, energy storage can facilitate the integration of VER into the grid. According to Maurice Gunderson, senior partner at CMEA Capital, energy storage systems are a "game-changer in the alternative energy battle."¹² Energy storage can help by making the energy available later, when needed, and adding operational flexibility to the grid. For example, solar thermal generation plants with molten salt storage can continue to put power into the grid after sundown; and as described below, AES has installed battery storage in conjunction with several wind facilities which provides regulation service to the grid as well as smoothing the delivery of wind power into the system.

Recent Storage Projects

While energy storage systems are still expensive,¹³ projects are being installed around the world. As the California Public Utilities Commission ("CPUC") staff aptly points out, the absolute cost of energy storage is not as important as its cost-effectiveness, taking into account "the full range and types of costs and benefits" provided by storage.¹⁴

Countries around the world have promised to put billions of dollars to work in support of energy storage. For example, the DOE, through the American Recovery and Reinvestment Act ("ARRA"), has allocated US\$185 million to develop storage projects. The DOE's investment has supported US\$585 million in private investment. Recent grid-scale energy storage projects in the US supported by DOE grants include:

Primus Power

This is a California-based project involving the installation of a 25 MW/3 hr battery plant for the Modesto Irrigation District in California. The storage facility provides equivalent flow capacity to 50 MWs of natural gas engines. It is used to compensate for the variable nature of wind energy. The total cost of the facility was US\$73 million. The project received a US\$14 million grant from the DOE.

Xtreme Power/Duke Energy

Duke Energy received a US\$21 million grant from the DOE to help finance a 36 MW/15-min turnkey battery plant in No-Trees, TX. The storage facility provides ramp control and wind smoothing capabilities for a 153 MW wind farm.

PG&E

The DOE awarded PG&E a US\$25 million grant to aid in the financing of a 300 MW/10-hr CAES project in California. The project will be used for load leveling, as a reserve and for peak shifting. Total project cost is US\$356 million.

While a substantial amount of research and development of energy storage is ongoing, storage projects have left the drawing board and entered the market. In June 2011, FERC reported that the “first flywheel energy storage plant in Stephentown, New York is in full operation. The 20 MW facility is the world’s first grid-scale flywheel energy storage unit. It consists of 200 high-speed Beacon flywheels to provide fast-response frequency-regulation services to the New York electricity grid.”¹⁵ This project, which was also a recipient of a US\$43 million US loan guarantee, was initially owned by Beacon Power Corp. before it filed for bankruptcy in October 2011 and sold the project. The project was acquired by Stephentown Spindle, LLC.¹⁶

AES Energy Storage has placed several energy storage systems into operation. The AES ES Westover facility, a 20 MW advanced lithium-ion battery facility that uses bidirectional inverters and DC battery subsystems, provides frequency regulation to the New York Independent System Operator, Inc. (“NYISO”). The project was supported by a DOE loan guarantee of US\$17 million and entered service in phases beginning in 2010.¹⁷ AES Energy Storage’s Laurel Mountain project, a 32 MW battery system located in West Virginia at the site of a 125 MW wind farm, which began operating last year, plays a dual role. The wind facility generates energy. But, as explained by AES Energy Storage, “[t]he energy storage portion of the project provides frequency regulation in the PJM market while also being available to help manage the rapid rate of change of output that can occur with fluctuations in wind conditions.”¹⁸

The US is not the only show in town when it comes to energy storage. There are more than 150,000 MWs of installed energy storage capacity worldwide as of 2Q 2012.¹⁹ Asia accounts for the lion’s share, more than 60,000 MWs. In July 2012, Japan’s Ministry of Economy, Trade and Industry said that the storage market will grow to US\$250 billion by 2020 and that Japan will account for half of that market.²⁰ Noteworthy global energy storage projects include:

Güssing Renewable Energy GmbH – Austria Projects

US-based fuel cell manufacturer ClearEdge Power has contracted to provide Güssing with 50 MWs of fuel cell storage. The project will cost US\$500 million and be completed over the next eight years (8.5 MWs to be shipped in the next 36 months).

AES Gener/A123

Battery developer A123 recently completed installation of 20 MWs of lithium-ion battery storage to be used as a spinning reserve for AES Gener’s 500 MW Chilean power plant, Angamos. Previously, A123 installed a 12 MW spinning reserve storage system for AES Gener, the first such system installed in Chile.

China’s State Grid

BYD installed 36 MWh of battery storage to support 140 MWs of renewable power in China. The project may be the world’s largest battery storage system. The total project is worth more than US\$500 million and is supported by China’s “Golden Sun” program.

Regulation of Storage in the United States

Interest in investing in energy storage in the United States can be sustained only so long as such investments deliver a return, which requires consideration of the economic regulatory structure for storage. Our traditional regulatory structures are based on function, but the versatility of storage turns the paradigm on its head. Therefore, not surprisingly, the economic regulation of storage is still evolving. As noted in a staff report issued by the CPUC, “regulators do not yet know how [electric energy storage] costs and benefits should be allocated among the three main elements [i.e., generation, transmission and distribution] of the electric system.”²¹

FERC has looked at energy storage as both transmission and generation. In 2010, FERC issued a declaratory order at the request of Western Grid Development, LLC (“Western Grid”), finding its proposed energy storage device projects to be wholesale transmission facilities.²² Western Grid explained that the devices, sodium sulfur batteries, would function similarly to capacitor banks and operate at the direction of the California Independent System Operator Corporation (“CAISO”). Western Grid distinguished the facilities from generation because the units would absorb and discharge electric energy, not convert one form of energy into another. The facilities would be used to provide voltage support and help mitigate transmission overloads. It proposed to install its devices on the CAISO grid and collect a cost-of-service rate through the CAISO tariff, as do other owners of transmission operated by CAISO.

FERC found that Western Grid’s devices would be transmission facilities, if operated as proposed.²³ The finding was limited to the specific facts and circumstances presented and turned specifically on Western Grid’s proposal that it would purchase the energy needed to charge the facilities and receive a retail credit for discharge, but would not retain any differential, and would not arbitrage wholesale energy market prices.²⁴ Any revenue gained from charging and discharging energy would be credited back to customers. Over the objections of several intervenors, FERC also found that Western Grid would be entitled to receive certain rate incentives that are available pursuant to Section 219 of the Federal Power Act (“FPA”)²⁵ for transmission that benefits consumers by “ensur[ing] reliability and reduc[ing] the cost of delivered power by reducing congestion.”²⁶ In making this

somewhat controversial finding to treat the batteries as transmission, eligible to receive incentives, FERC recognized, “storage devices can resemble any of [generation, transmission or distribution] or even load.”²⁷

In contrast, in 2010, FERC found AES ES Westover, LLC to be an “exempt wholesale generator,” or “EWG,” which is, by definition, an entity engaged directly and exclusively in the generation and sale of electric energy. As noted above, AES ES Westover owns and operates a lithium-ion battery facility. However, unlike the Western Grid facility, AES ES Westover proposed to use the facility to sell ancillary services, specifically, Regulation and Frequency Response Service to the NYISO.²⁸ Accordingly, it sought and obtained market-based rate authority from FERC.²⁹ Subsequently, FERC also granted EWG status to the AES Laurel Mountain project, which would sell wind energy as well as regulation services from the combined wind farm/battery storage facility, also pursuant to market-based rate authority. Similarly, the owner of the flywheel storage system located in Stephentown, New York, is also an EWG that sells regulation service to NYISO pursuant to market-based rate authority.³⁰

Storage facilities capable of providing frequency regulation may benefit from FERC’s Order No. 755, which required regional transmission organizations and independent system operators under its jurisdiction to develop two-part rates for frequency regulation service; the specific rates payable would be determined by the market. Specifically, the Commission required (i) a capacity payment that includes the marginal unit’s opportunity costs, payable to all frequency regulation service providers that clear the market, and (ii) a payment for performance that would reward providers that more accurately follow the dispatch signal, upward or downward.³¹ While the benefits of Order No. 755 are not directed solely to energy storage providers, to the extent that storage providers are able to provide superior service, they will be entitled to payments that reflect their superior performance.

FERC has also turned its attention to treatment of energy storage resources within the Uniform System of Accounts. On June 22, 2012, FERC issued a notice of proposed rulemaking pursuant to which it proposes to create a new electric plant account within the production (i.e., generation) functional classification and to amend two existing electric plant accounts within the transmission and distribution functional classifications to record the installed cost of energy storage equipment owned by public utilities and licensees. Additional proposed changes address other accounting issues for energy storage facilities over the course of their life cycle including a methodology for accounting for “fuel” costs of charging or maintaining pressure as required by the resource. FERC proposes amendments to the annual reports, Form Nos. 1 and 1-F, that would require utilities with

energy storage operations to report detailed financial and operational information on energy storage assets and activities in new schedules for all functions.³² If implemented, the new reporting obligations will help increase our understanding of the costs and saturation of storage.

The CPUC has also turned its attention to energy storage. In a recent decision, it adopted a framework proposed by staff “that will allow us to analyze energy storage in a comprehensive manner and determine how this important resource can be integrated with our existing policies and properly valued.”³³

Conclusion

The technical capability, cost-effectiveness and regulatory environment for storage are all still evolving. But investors have already seen the potential, and the incremental growth of storage—proposed and operational—heralds a potentially bright future.

Getting Something for Nothing: FERC Office of Enforcement Alleges Market Manipulation in the ISO New England Demand Response Program

Jane Rueger

FERC recently issued four orders to show cause and notices of proposed penalties to three entities and an individual, each relating to alleged market manipulation in the ISO New England, Inc. (“ISO-NE”) market through its Day-Ahead Load Response Program (“DALRP”).¹ While all four orders relate to alleged manipulation of the DALRP, three of the four orders relate to the same alleged fact pattern and scheme. The proposed penalties range from US\$1.25 million up to US\$13.25 million, plus disgorgement of profits where applicable. The orders raise a host of considerations for any market participant with regard to the FERC Office of Enforcement’s (“OE”) evolving approach to investigating allegations of market manipulation, including liability where a market participant relies on expert advice in participating in FERC-jurisdictional markets. This article relies solely on facts and information provided in the OE reports attached to the show-cause orders, since the respondents have not yet submitted their answers to the show-cause orders.

The alleged manipulation involved participation in the DALRP by the owners of two paper mills located in Maine. Both Lincoln Paper and Tissue, LLC (“Lincoln”) and Rumford Paper Company (“Rumford”) owned and operated behind-the-meter generation at their respective paper mills prior to participating in the DALRP. Each independently undertook baseline testing in July 2007 to

determine the quantity of energy each mill would have used absent participation in the DALRP. During the five days of baseline testing, each mill backed down its behind-the-meter generation by a certain amount during the testing hours, thereby reflecting a larger load in their baselines. Beginning in late July 2007 and continuing through early 2008, both Lincoln and Rumford submitted bids into the DALRP at the US\$50/MWh minimum set by the ISO-NE. Since the applicable ISO-NE market prices were higher than the DALRP minimum bid during this time, their bids were accepted, they were paid for providing demand response, and their baseline loads were never revised to reflect full use of their behind-the-meter generation. OE states that neither Lincoln nor Rumford actually had to reduce load or increase their behind-the-meter generation usage beyond normal operations prior to participation in the DALRP as a result of their DALRP bids. In this way, OE alleges that they were “compensated for doing nothing...”²

While *Lincoln* presents a stand-alone case, Rumford was advised by Competitive Energy Services, LLC (“CES”). CES is an independent consulting services company that was founded and owned by Richard Silkman, an economist and frequent expert energy industry witness. OE states that CES and Dr. Silkman approached Rumford about participating in the DALRP, developed the alleged “scheme” to increase Rumford’s baseline, and received compensation in the form of a percentage of all revenues related to Rumford’s participation in the DALRP. FERC issued show-cause orders to each of Rumford, CES and Dr. Silkman, individually related to the same alleged manipulative scheme.

These four show-cause orders raise issues that all market participants should be aware of with regard to OE’s overall approach to investigating alleged market manipulation:

A market participant does not get a “pass” for relying on expert advice.

OE did not let Rumford off the hook due to its reliance on its consultants, CES and Dr. Silkman, to devise the strategy employed. This may have been due in part to other evidence in the investigation; in *Rumford*, OE notes that some senior Rumford employees indicated in depositions that concerns they raised about the strategy were ignored. However, the underlying message to market participants is: You cannot outsource compliance.

OE will interpret the “in connection with” nexus to a jurisdictional transaction broadly to capture advisors and others who do not themselves participate in the market.

As it has in the past, FERC interprets its jurisdiction under the market manipulation provisions of the FPA broadly. OE asserts that CES’s and Dr. Silkman’s actions were “in connection with”

a FERC-jurisdictional transaction because they facilitated Rumford’s participation in the DALRP, provided misleading information to the ISO-NE and others, and profited from the strategy.³ Thus, even though neither CES nor Dr. Silkman participated themselves in the DALRP, and even though the actual market participant is separately charged with market manipulation, OE also seeks to penalize CES and Dr. Silkman for their part in the strategy. OE intends this as a warning that advisers and consultants must be aware of potential liability for market manipulation perpetrated by their clients where they provided substantial advice or could be viewed as having a “central role” in the alleged scheme.

Defenses may be summarily dismissed as “post hoc” rationalizations if unaccompanied by contemporaneously concurring evidence.

OE rejected the subjects’ defenses regarding the existence of a fraudulent scheme or intent, calling them “a succession of *post hoc* justifications.”⁴ While the show-cause orders suggest that some of the defenses offered may have been contradicted in some respects by contemporaneous evidence or by other defenses raised by the subjects, OE found that there was no contemporaneous evidence at all relating to the intent behind the establishment of the baseline, discounting the entities’ explanations in response to OE’s discovery requests.⁵ In light of OE’s position regarding the absence of contemporaneous documentation, market participants should evaluate the risks and benefits of documenting the purposes for and reasons behind their strategies for participating in a FERC-regulated market before engaging in those strategies.

Market failure is an uncertain defense to an allegation of market manipulation.

All four subjects argued that the ISO-NE rules for participation in the DALRP were unclear at the time Rumford and Lincoln performed their baseline tests and that the DALRP market rules did not prohibit the strategies they employed. In the absence of any guidance from ISO-NE regarding how a baseline load should be calculated, it was argued that the strategies should not be deemed fraudulent. OE rejected this argument, stating that “[w]hile ISO-NE’s tariff did not explicitly prohibit such actions, tariffs cannot explicitly prohibit all fraudulent actions that market participants may undertake. Indeed, § 1c of the Commission’s regulations exists to prohibit market participants from engaging in such fraud.”⁶ This outcome is markedly different from prior cases in which OE has found no market manipulation where no market rules were broken and the desire to maximize profits in response to signals created by market design was recognized as a legitimate business purpose.⁷ Of course, every case presents

unique facts, and OE seemed most troubled that Rumford and Lincoln did not merely profit from a price spread that existed in the market, but in essence created the profit opportunity by allegedly “artificially inflat[ing]”⁸ their baseline loads. Market participants should be particularly careful when considering a strategy that is susceptible to characterization as “compensation for nothing,”⁹ even if it is not prohibited by pertinent market rules.

Advisers and consultants holding themselves out as experts in the energy space should consider adopting compliance programs covering matters under FERC’s jurisdiction.

OE declined to give CES any credit for an effective compliance program, thus increasing the culpability score under the penalty guidelines in calculating the proposed civil penalty of US\$7.5 million. OE stated that “[e]ven smaller companies, like CES, should have basic policies in place to ensure that employees act in a manner consistent with the Commission’s regulatory requirements. This is particularly true in the case of CES, a company that holds itself out as an expert consultant on Commission markets and ISO-NE programs.”¹⁰ This finding is noteworthy given CES’s role as an adviser and consultant, rather than as a market participant itself. Advisers and consultants, particularly those who regularly provide expert advice regarding FERC-regulated activities, should review their compliance policies and ensure that they meet the standards for an effective compliance program set forth in the FERC Penalty Guidelines.

The FERC Commissioners are not all in agreement regarding calculations under the Penalty Guidelines.

Commissioner LaFleur submitted a concurring opinion in Rumford, Lincoln and CES, stating that she agreed with the direction to show cause but disagreed with the proposed civil penalties in each case. Noting that in these cases the cumulative value of monetary loss to the market was directly related to the duration of the alleged violations (i.e., the entities earned more from the alleged scheme each day that their bids were accepted in the DALRP), Commissioner LaFleur objected to applying an adder to the base penalty for both monetary loss and the duration of the violations.¹¹ As a consequence, she would have proposed a civil penalty less than half of that proposed in each show-cause order. It will be worth noting whether and how any forthcoming orders adopting a civil penalty in these cases address these concerns.

In sum, these four show-cause orders reflect OE’s evolving and increasingly aggressive approach to investigating allegations of market manipulation.

China Initiates AD, CVD Investigations Into Solar-Grade Polysilicon Imports From the United States

Scott Lincicome and Justin Miller

On July 20, 2012, the Chinese Ministry of Commerce (MOFCOM) published official notices announcing the initiation of anti-dumping (AD) and countervailing duty (CVD) investigations of solar-grade polysilicon imports from the United States. The notices also announced the initiation of an AD investigation of the same merchandise imported from Korea. Solar-grade polysilicon, which is classified under tariff code 28046190 of the Import and Export Tariff Code of China, is a primary input for the production of solar panels.

Four Chinese companies, namely Jiangsu Zhongneng Polysilicon Technology Development Co., Ltd. (a subsidiary company of GCL-Poly Energy Holdings Limited), LDK Solar Co. Ltd., China Silicon Corporation Ltd. and Daqo New Energy Co., Ltd., filed the petition on July 2, 2012. The petition cites several US companies as possible targeted exporters for the AD investigation, including AE Polysilicon Corporation, Hemlock Semiconductor Group, Hoku Corporation, MEMC Electronic Materials, Inc., and REC Silicon Inc. The petition also cites several US federal and state-level subsidy programs to be investigated within the CVD investigation. These programs are listed in the table below.

US Subsidy Programs to Be Investigated Under Solar-Grade Polysilicon CVD Investigation

Level at Which Subsidy is Distributed	Subsidy Name or Description
Federal	Advanced Energy Manufacturing Tax Credit
State (Michigan)	Refundable Photovoltaic Manufacturing Tax Credit
State (Michigan)	Michigan Economic Growth Authority (MEGA) High-Tech Tax Credit
State (Michigan)	Personal Property Tax Exemption in Distressed Communities
State (Michigan)	Industrial Facilities Exemption
State (Michigan)	High-Tech Anchor Company
State (Michigan)	(Subsidy name not provided)
State (Michigan)	Renewable Energy Renaissance Zones—Michigan Renaissance Zone Act
State (Michigan)	Alternative Energy Personal Property Tax Exemption

State (Michigan)	MEGA Standard Job Creation Tax Credits
State (Michigan)	Michigan Department of Transportation (MDOT)—Transportation Economic Development Fund—Category A Grant
State (Michigan)	Economic Development Job Training
State (Tennessee)	“Bill No. 3” and “No. 5,” which were issued in 2009 to provide financial support to Hemlock’s infrastructure
State (Tennessee)	Grants for training Hemlock Semiconductor Group’s employees
State (Tennessee)	Subsidy to Hemlock Semiconductor Group for low-price acquisition of land
State (Washington)	Preferential tax rate for polysilicon producers pursuant to the State Law Section 82.04.294
State (Washington)	Research and development expenses deducted pursuant to the State Law Section 82.04.4452
State (Pennsylvania)	Machinery and Equipment Loan Fund
State (Idaho)	Workforce Development Training Fund
State (Idaho)	Free land use rights provided to Hoku Corporation in 2007

The AD and CVD investigations will examine imports during the 12-month period July 1, 2011 through June 30, 2012. MOFCOM’s separate material injury analysis will examine the condition of the Chinese domestic industry during the period January 1, 2008 through June 30, 2012.

MOFCOM will issue a definitive determination prior to July 20, 2013, but could also extend the deadline for issuing the final determination until no later than January 20, 2014.

China’s initiation of these AD and CVD investigations is the latest in a series of green energy-related trade disputes between the United States and China. In December 2010, the United States requested World Trade Organization (WTO) consultations with China regarding subsidies provided to Chinese wind power equipment manufacturers. Also in December 2010, China initiated an AD investigation, which has since been terminated, into US imports of distiller’s dried grains, a byproduct of ethanol. In November 2011, the Department of Commerce (DOC) initiated AD and CVD investigations into Chinese imports of solar cells. Also in November 2011, MOFCOM initiated a trade barrier investigation into certain US subsidy policies applied on its clean energy industry. Most recently, in January 2012, DOC initiated AD and CVD investigations into imported wind towers from China.

International Energy Regulators Discuss Challenges and Solutions in Energy Policy: Report on the 2012 Asia-Pacific Energy Regulatory Forum

Caileen Gamache

On August 1 – 2, 2012, energy regulators from around the globe convened at FERC’s headquarters in Washington, DC to share industry experiences and collaborate on policy strategies at the 2012 Asia-Pacific Energy Regulatory (“APER”) Forum.

The APER Forum was established in 2011 at the recommendation of the Asia-Pacific Partnership on Clean Development and Climate in order to facilitate an international exchange of information on regulatory policy and practice, thereby promoting the development of best practices in gas and electricity matters. Delegates from Australia, Canada, China, the Czech Republic, Ghana, India, New Zealand, Pakistan, Singapore, Thailand and the United States participated in the Forum, along with several other attendees nationally and internationally active in the industry. The focus of the 2012 APER Forum was on matters related to transitioning to a low-carbon economy, energy infrastructure and market regulation, and competition reform. FERC Commissioners Moeller and Norris and former FERC Chairman Kelliher delivered opening remarks, which were followed by formal presentations on national strategy, innovation and issues by delegates from Australia, China, Canada, India, New Zealand, Thailand and the United States. Following the formal presentations, panels assembled to discuss the following topics: Carbon Trading and Policies for Low-Carbon Consumption, Smart Grid Technologies That Enhance Efficiency, Grid Reliability, Renewables in New Markets, Market Regulation, Oil and Gas Development and the Impact of Competition on Reliability of Supply. The panels were composed of delegates and other relevant energy industry participants, and panelists led lively exchanges about national policies, innovations, and obstacles among the delegates and audience.

For a summary of the highlights from the Forum, please click [here](#) to review our full report.

Endnotes

FERC Proposes to Substantially Amend Its Transmission-Capacity Allocation Policies

1. *Allocation of Capacity on New Merchant Transmission Projects and New Cost-Based, Participant-Funded Transmission Projects*, 140 FERC ¶ 61,061 (2012) (“Proposed Policy Statement”).
2. *Id.* at P 10.
3. *Chinook Power Transmission, LLC*, 126 FERC ¶ 61,134 (2009) (“Chinook”).
4. *Id.* at P 41 (“This open season reporting requirement and the process by which parties are afforded an opportunity to file complaints will continue to be the primary tools by which the Commission ensures that merchant transmission developers do not unduly discriminate.”).
5. *Id.* at P 50.
6. *Id.* at P 42.
7. *Grasslands Renewable Energy LLC*, 133 FERC ¶ 61,225 (2010).
8. Proposed Policy Statement at P 15.
9. FERC did state in a footnote that it “will continue to require merchant and other transmission developers either to file an OATT or to turn over control to an RTO or ISO.” *Id.* at P 4 n.7.
10. *Id.* at P 22 (emphasis added).
11. *Id.* at P 20 (emphasis added).
12. *Id.* at P 12 n.29 (emphasis added).
13. *Id.* at P 17 (emphasis added).

Energy Game-Changer: Electric Storage Systems

1. Ernst & Young, *Large Energy Storage deals push US VC investment in cleantech to \$1.1 billion in Q3 2011*, (Nov. 2, 2011), available at <http://www.ey.com/US/en/Newsroom/News-releases/Large-Energy-Storage-deals-push-US-VC-investment-in-cleantech>. Energy storage was the third largest sector in cleantech for 2011, representing US\$932.6 million of the US\$4.9 billion invested in cleantech in 2011. Ernst & Young, *2011 U.S. Venture Capital Investment in Cleantech Steady at US\$4.9 Billion Despite Tough Economy*, (Feb. 1, 2012), available at <http://www.ey.com/US/en/Newsroom/News-releases/2011-US-venture-capital-investment-in-cleantech>.
2. Elaine S. Kwei, Preetesh U. Munshi & Jesse Pichel, *Energy Storage: Game-Changing Component of the Future Grid*, at 4-5 (Feb. 2009), available at <http://www.eosenergystorage.com/articles/PiperJaffrayEnergyStor2009-02.pdf>.
3. U.S. Dep’t of Energy, Office of Electricity Delivery & Energy Reliability, *Energy Storage Program Planning Document*, 5-6 (February 2011), available at http://energy.gov/sites/prod/files/oeprod/DocumentsandMedia/OE_Energy_Storage_Program_Plan_Feburary_2011v3.pdf. The Office of Electricity Delivery & Energy Reliability has enacted the Energy Storage Systems Program, with the goal of advancing storage technology and deployment and reducing the cost of energy storage by 30% over the next three years with the help of a US\$200 million funding level.
4. Including: sodium sulfur, flow batteries, lead acid, advanced lead carbon and lithium-ion.
5. Cal. Pub. Utils. Comm’n, Policy & Planning Div., Staff White Paper, *Electric Energy Storage: An Assessment of Potential Barriers and Opportunities*, at 4 (July 9, 2010) (“CPUC White Paper”) (identifying superconducting magnetic energy storage as being capable of storing energy “indefinitely with low loss” and “discharg[ing] almost instantaneously with high power output for a brief period of time with less loss of power than for other technologies”), available at <http://www.cpuc.ca.gov/NR/rdonlyres/71859AF5-2D26-4262-BF52-62DE85C0E942/0/CPUCStorageWhitePaper7910.pdf>.

6. The California Public Utilities Commission staff has identified 20 potential applications for the California market. *Order Instituting Rulemaking Pursuant to Assembly Bill 2514 to Consider the Adoption of Procurement Targets for Viable and Cost-Effective Energy Storage Systems*, C.P.U.C. D.12-08-016, Decision Adopting Proposed Framework for Analyzing Energy Storage Needs, at 23 (issued Aug. 6, 2012) (“CPUC Energy Storage Decision”).
7. Other end-user technologies that have been in existence for decades could be more widely used if proper economic incentives are provided. For example, large office conference centers and office buildings can be (or have been) equipped with thermal storage devices that chill or freeze fluid during off-peak hours so that it can be used to cool the building during peak hours.
8. *Third-Party Provision of Ancillary Services; Accounting and Financial Reporting for New Electric Storage Technologies*, 139 FERC ¶ 61,245 at P 67, FERC Stats. & Regs. ¶ 32,690 at P 67 (2012); *id.* at P 55.
9. Ashley Halsey III, *Aging power grid on overload as U.S. demands more electricity*, Wash. Post, Aug. 1, 2012, A1.
10. See Cal. Indep. Sys. Operator, Corp., *Integration of Renewable Resources, Operational Requirements and Generation Fleet Capability at 20% RPS*, at 92-93 (Aug. 31, 2010), available at <http://www.caiso.com/Documents/Integration-RenewableResources-OperationalRequirementsandGenerationFleetCapabilityAt20PercRPS.pdf> (identifying grid issues and recommending, among other things, use of tools that would provide greater operational flexibility).
11. On June 22, 2012, FERC issued Order No. 764, requiring VER to provide meteorological and forced outage data to their interconnected transmission provider in order to improve forecasting of VER generation. *Integration of Variable Energy Resources*, Order No. 764, 139 FERC ¶ 61,246, FERC Stats. & Regs. ¶ 31,331 (2012). In the same order, FERC directed transmission providers to offer intra-hour scheduling, with the intent that more granular scheduling will provide greater accuracy as VER adjust their operations throughout the day in response to prevailing conditions. Such measures improve the ability of the grid operator to predict and react to changes in VER output. But notwithstanding such improvements in predicting and managing the variability, the output remains subject to the forces of nature.
12. Eric Wesoff, *Update: California Energy Storage Bill AB 2514 Signed Into Law by Governor* (Sept. 29, 2010) (quoting Gunderson), available at <http://www.greentechmedia.com/articles/read/vc-meas-gunderson-on-utility-scale-storage/>.
13. See Electricity Storage Association, http://www.electricitystorage.org/images/uploads/static_content/technology/technology_resources/capital-cost_large.gif (viewed Aug. 6, 2012).
14. CPUC White Paper at 5.
15. Fed. Energy Regulatory Comm’n, Office of Energy Projects, Energy Infrastructure Update for June 2011 at 3, available at <http://www.ferc.gov/legal/staff-reports/06-11-energy-infrastructure.pdf>.
16. *Stephentown Regulation Servs. LLC*, 138 FERC ¶ 62,193 (2012) (“Stephentown”); Notice of Consummation, Docket No. EC12-68-000 (filed March 8, 2012).
17. *AES ES Westover, LLC*, 131 FERC ¶ 61,008 (2010) (“Westover EWG order”); Notice of Change In Status in Ownership or Control of Generation and Transmission Facilities, Docket Nos. ER10-3142-003, *et al.*, Appendix B at 1 (filed Dec. 23, 2011); *AEE2, L.L.C.*, 134 FERC ¶ 61,096 at P 4 (2011).
18. *AES Energy Storage Projects*, Laurel Mountain, available at <http://www.aesenergystorage.com/projects.html> (viewed Aug. 3, 2012). See also AES Laurel Mountain, LLC, Docket No. EG11-10-000, Notice of Self-Certification as an Exempt Wholesale Generator (filed Nov. 9, 2010).
19. Pike Research, *Energy Storage Tracker 2Q12 Global Energy Storage Projects by World Region, Market Segment, Technology, and Application* (published 2Q 2012).
20. CleanBiz Asia, *Japan to follow clean energy push with advances in storage* (quoting the Ministry of Economy, Trade and Industry) (July 11, 2012), available at <http://www.cleanbiz.asia/story/japan-follow-clean-energy-push-advances-storage>.
21. CPUC White Paper at 2.

22. *Western Grid Dev., LLC*, 130 FERC ¶ 61,056 at P 2 (2010) (“*Western Grid*”).
23. *Id.* at P 43.
24. *Id.* at PP 19, 45-46.
25. *Western Grid* at P 16.
26. 16 U.S.C. § 824s. Significantly, however, FERC’s grant of the incentives was contingent on Western Grid’s project being approved by CAISO in its transmission planning process. In 2011, FERC denied Western Grid’s complaint against CAISO for failing to include the projects in the CAISO’s 2009-2010 transmission planning process. *Transmission Tech. Solutions, LLC & Western Grid Dev., LLC v. Cal. Indep. Sys. Operator Corp.*, 135 FERC ¶ 61,077 (2011).
27. *Western Grid* at P 44.
28. *AES ES Westover, LLC*, Docket ER10-712-000, Application for Acceptance of Market-Based Rate Tariff and Granting of Waivers and Blanket Authorization, at 3 (filed Feb. 5, 2010).
29. *AES ES Westover, LLC*, Docket Nos. ER10-712-000, *et al.* (unpublished delegated letter order issued Apr. 23, 2010).
30. *Stephentown*, 138 FERC ¶ 62,193; *Stephentown Spindle, LLC*, Docket No. ER12-1260-000, Letter Order (issued Apr. 16, 2012) (accepting market-based rate tariff name change to Stephentown Spindle).
31. *Frequency Regulation Compensation in the Organized Wholesale Power Markets*, Order No. 755, 137 FERC ¶ 61,064, FERC Stats. & Regs. ¶ 31,324 (2011).
32. *Third-Party Provision of Ancillary Services; Accounting and Financial Reporting for New Electric Storage Technologies*, 139 FERC ¶ 61,245, FERC Stats & Regs. ¶ 32,690 (2012).
33. CPUC Energy Storage Decision at 26.

Getting Something for Nothing: FERC Office of Enforcement Alleges Market Manipulation in the ISO New England Demand Response Program

1. *Lincoln Paper & Tissue, LLC*, 140 FERC ¶ 61,031 (2012) (“*Lincoln*”); *Rumford Paper Co.*, 140 FERC ¶ 61,030 (2012) (“*Rumford*”); *Competitive Energy Servs., LLC*, 140 FERC ¶ 61,032 (2012) (“*CES*”); *Richard Silkman*, 140 FERC ¶ 61,033 (2012) (“*Silkman*”).
2. *Rumford*, OE Report at 16; *Lincoln*, OE Report at 12.
3. *Silkman*, OE Report at 18; *CES*, OE Report at 17.
4. *Rumford*, OE Report at 18.
5. *See, e.g., Lincoln*, OE Report at 16.
6. *Id.* at 22 (footnote omitted); *Rumford*, OE Report at 26-27 (footnote omitted).
7. *See, e.g., Blumenthal v. ISO New England, Inc.*, 135 FERC ¶ 61,117 (2011); *N.Y. Indep. Sys. Operator, Inc.*, 128 FERC ¶ 61,049 (2009); *Findings of a Non-Public Investigation of Potential Market Manipulation by Suppliers in the New York City Capacity Market*, Docket Nos. IN08-2-000 and EL07-39-000, Enforcement Staff Report (Feb. 28, 2008).
8. *Rumford*, OE Report at 1; *Lincoln*, OE Report at 1.
9. *Rumford*, OE Report at 16; *Lincoln*, OE Report at 12.
10. *CES*, OE Report at 28.
11. *See, e.g., Rumford*, Concurring Opinion at 2-3.

