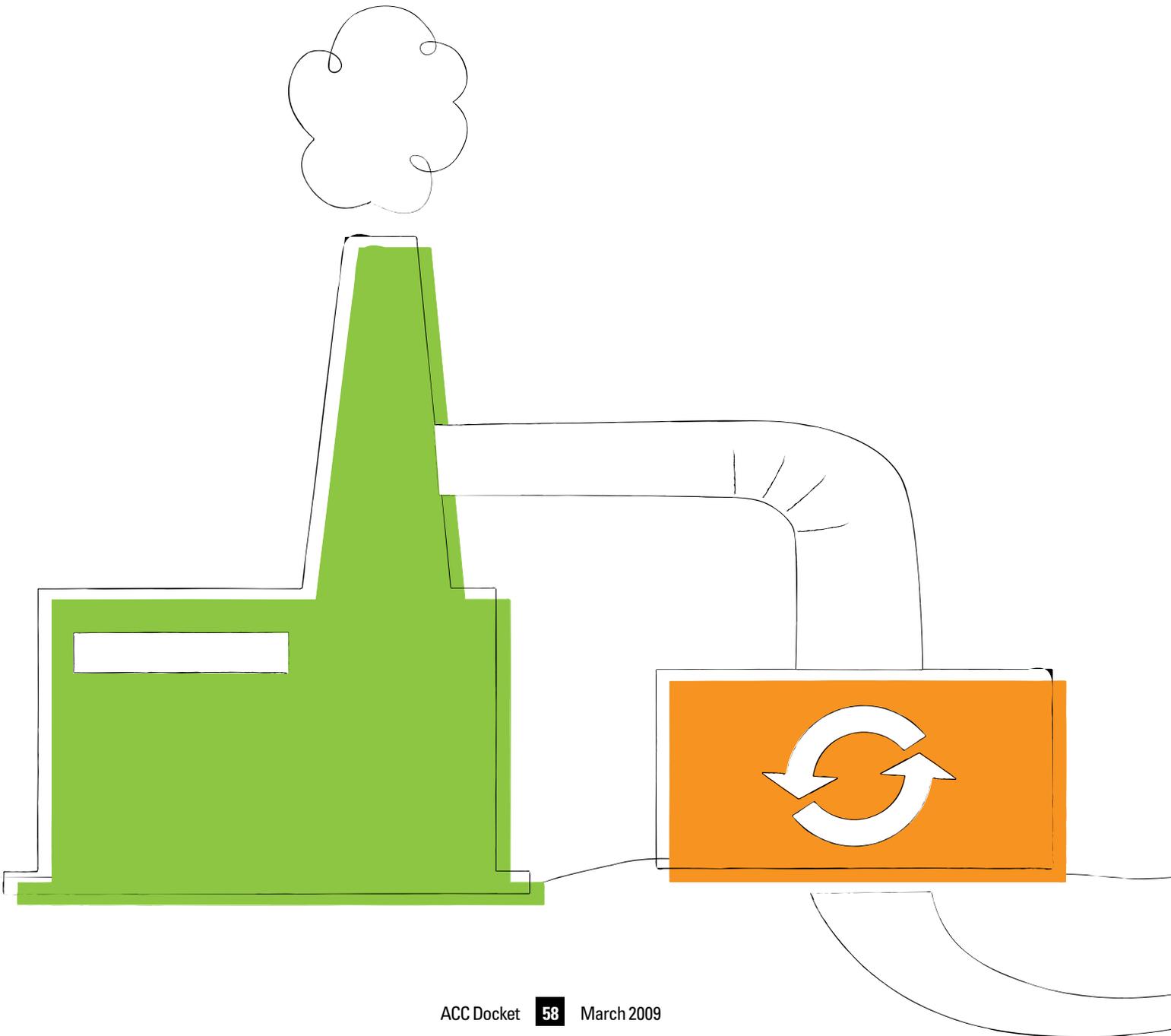


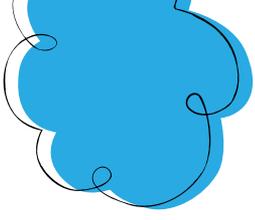
Does the New Federal

**WASTE ENERGY /**

**INDUSTRIAL EFFICIENCY**

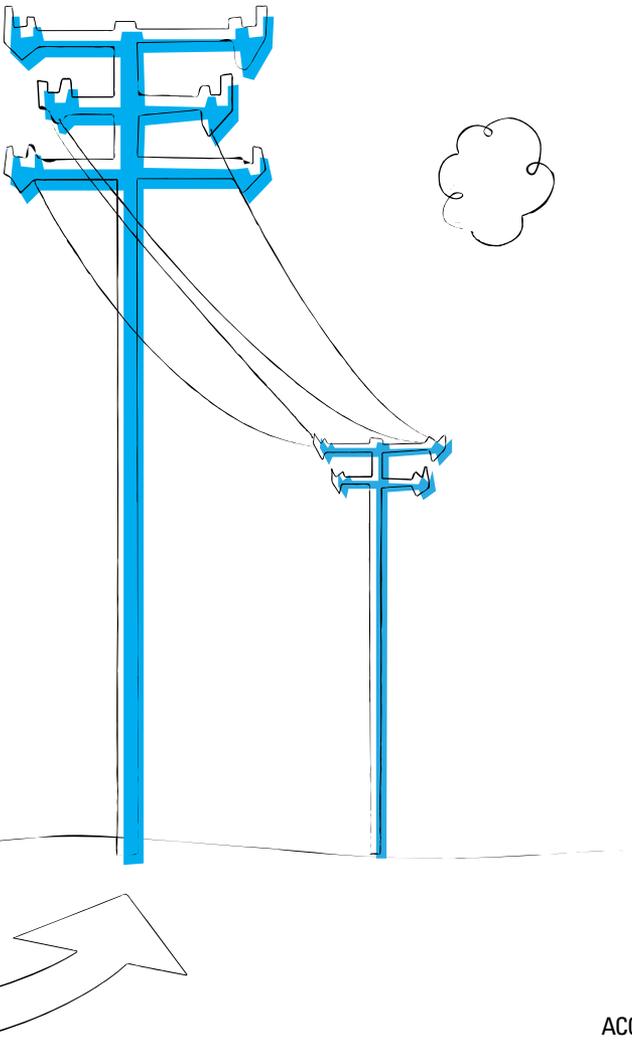
Make Sense for Your Company?





# PROGRAM

By Tracey B. Steiner  
&  
William D. DeGrandis



**W**ith rising costs and concerns about reducing both energy consumption and greenhouse gas emissions, Congress has again taken steps to promote cogeneration (“combined heat and power”), the capturing of the byproduct heat or “waste energy” generated by industrial or manufacturing processes that create electricity. Congress recently enacted the Energy Independence and Security Act of 2007 (EISA or the Act)<sup>1</sup>, which establishes various waste energy recovery programs that contain some important incentives to promote industrial energy efficiency. The Act authorizes grants for owners of qualifying projects that use industrial waste to produce useful thermal (heat) and electrical energy. It also makes available technical assistance and certain other incentives. In the light of the Act, consider: Do these new governmental energy programs make sense for your company? Do you have a corporate policy of enhancing the efficiency of its resources and reducing the impact of its operations on the environment? If the answer to either of these questions is “yes,” then your company should consider these new programs.

This article provides legal and practical information to help your company's management decide whether to devote resources to investigate this EISA program further. It also discusses financial and other incentives available under the Act's industrial waste energy programs and how to apply for them, highlighting certain legal/regulatory issues that your company will want to consider. Such implications include owning or operating power plants that qualify under this EISA program which may subject your company to regulation as a "public utility" at the state or federal level — or both — and as a "public utility holding company" at the federal level. As described further, your company can take practical steps to eliminate or significantly mitigate any such regulation, but failure to take precautionary measures could unnecessarily subject your organization to extensive regulatory requirements.

## Background

Over the last 30 years, a number of industrial, manufacturing and other companies have owned and operated on-site electric generation facilities. In particular, paper companies actively pursued cogeneration projects because they could use both the heat and electricity produced by a generator for their operations. Mining companies built back-up generators for use in the event that the local utility's power was interrupted for any reason, and then used these back-up generators to meet their substantial electricity needs. Commercial real estate and industrial park developers also pursued on-site generation to enhance their properties, so that companies with energy-intensive operations had ready access to electricity at all times.

On July 31, 2007, US Representatives Rick Boucher (D-VA) and John D. Dingell (D-MI) presented H.R. 3236, "Energy Efficiency Improvement Act of 2007," which proposed an amendment to the Energy Conservation and Policy Act by introducing Part E — Industrial Energy Efficiency and three new sections regarding industrial waste energy. In short, the new sections provide for a survey of industrial waste energy and its potential use; incentives for the recovery and use of industrial waste energy (and the prevention of industrial waste); and the establishment of clean energy application centers to provide resources for the recovery of industrial waste. In December 2007, the House of Representatives added the provisions of H.R. 3236 to



TRACEY B. STEINER is a senior corporate counsel with the National Rural Electric Cooperative Association. Based in Arlington, NRECA represents the interests of its more than 900 member cooperatives who provide electric service to approximately 40 million consumers in 47 states. Her areas of focus include corporate governance, cooperative law and utility consumer issues. She can be contacted at [tracey.steiner@nreca.coop](mailto:tracey.steiner@nreca.coop).



WILLIAM D. DEGRANDIS is a partner in the Washington, DC office of Paul Hastings Janofsky & Walker. He has more than 25 years experience in the energy regulatory and transactions area and has represented clients before both state and federal regulatory commissions in power supply, transmission, merchant plant, merger, ratemaking, cogeneration, hydroelectric, utility holding company and related matters. He can be contacted at [billdegrandis@paulhastings.com](mailto:billdegrandis@paulhastings.com).

*The authors wish to thank Emily Abbott, attorney, and Karen Malan, senior paralegal, both of Paul Hastings Janofsky & Walker, for their assistance in preparing this article.*

H.R. 6, which would become the EISA. The EISA was approved by Congress and enacted on December 19, 2007, after being signed into law by President Bush.

The EISA program represents another legislative attempt to encourage industrials to generate their own electricity and promotes conservation by providing incentives for companies to use industrial waste for electricity production. In response to incentives established by the Public Utility Regulatory Policies Act of 1978 (PURPA), a number of industrials built cogeneration facilities that produced useful thermal energy and electricity. Under PURPA, excess electricity produced by a generator could be sold back to the local electric utility at an avoided cost of energy.

## Determining Eligible Projects

Your company will have an opportunity to comment on the types of projects that should be eligible for benefits under the EISA's "Recoverable Waste Energy Inventory Program." The Administrator of the Environmental Protection Agency (EPA), in cooperation with the Secretary of Energy and state energy administrators, will develop a waste energy inventory program. The EISA-mandated inventory program will establish an ongoing survey of all major industrial and large commercial combustion sources in the United States (as defined by the Administrator) and the sites where the sources are located. In addition, the survey will review the quantity and quality of waste energy produced at each source.

The Act required the EPA Administrator to publish a rule by September 15, 2008, establishing criteria for inclusion in the Registry of Recoverable Waste Energy Sources (Registry), but the rule has not been published as of this writing. Your company may wish to consider commenting on the proposed rule when it is published. Under the Act, the Administrator must include:

1. A requirement that the project must be economically feasible no later than five years after the date of first full project operation by virtue of offering a payback of invested costs (including incentives offered under the Act);
2. Standards to ensure the qualifying projects are not developed or used for the primary purpose of making sales of excess electric power under the regulatory provisions; and

3. Procedures for contesting the listing of any source or site on the registry by any state, utility or other interested person.<sup>2</sup>

Technical and financial support is available for waste energy projects that are included in the Registry. While not described in the Act, the Administrator's implementing rule will likely specify the type of technical support that is available. The Act authorizes partial funding of feasibility studies (up to one-half of project costs) to determine whether investment in recovery of waste energy, or combined heat and power, at a source would have a payback period of five years or less.

By December 19, 2008, the Administrator was directed by the Act to establish the Registry of recoverable waste energy sources and sites that meet the statutory criteria. Thereafter, the Administrator is to update the Registry on a regular basis and make it available to the public on the EPA's website. According to EPA's Fall 2008 semiannual regulatory agenda (which just became available), EPA plans to release a notice of proposed rulemaking in January 2009.

Do not be surprised if you encounter some opposition when you seek to include your desired project in the Registry. In some cases, developing a new power plant may be controversial, especially on an industrial site where no power plants are presently located. Any state, an electric utility or other interested person may contest the listing of any source or site by submitting a petition to the Administrator. In addition, sites may be removed from the Registry. However, no project will be removed without the consent of the project's owners or operators, provided that they have submitted a petition for a public hearing (see below) and the petition has not been acted on or denied.

Project owners and operators will have the ability to "self-certify" their projects. Self-certifications will be subject to review by the EPA Administrator to prevent fraudulent listings.<sup>3</sup>

### Funding

The Act authorizes \$2 million in funding for fiscal years 2008 through 2012, and authorizes \$5 million in funding for state energy office functions in this area.<sup>4</sup> Congress will still have to appropriate these funds as part of its budget review process, and it is uncertain at this time whether the appropriated funds will be at the same level called for under the Act.

### Eligibility for Grants

The Secretary of Energy will establish a "Waste Energy Recovery Incentive Grant Program" that will provide incentive grants to:

1. Owners and operators of projects that successfully produce electricity or incremental useful thermal energy from waste energy;

2. Utilities purchasing and distributing the electricity; and
3. States that have achieved 80 percent or more of waste heat recovery opportunities.<sup>5</sup>

Who is eligible for these grants? Owners or operators of waste energy recovery projects, and in the case of excess power purchased or transmitted by an electric utility, the utility. Grants will only be made upon receipt of proof of waste energy recovery or excess electricity generation, or both, in a form prescribed by the Secretary of Energy.

### Incentives/Grants<sup>6</sup>

What types of grants are available? For waste energy recovery projects, if funding is appropriated, then grants will be made at the rate of \$10 per megawatt hour of documented electricity produced by the project from recoverable waste energy (or by prevention of waste energy in the case of a new facility) during the first three calendar years of production, beginning on or after December 19, 2007. If a project produces net excess power that is purchased or transmitted by an electric utility, 50 percent of the grant attributable to the net excess power will be paid to such electric utility.

Where the waste energy produced by a project is used for thermal energy, and for a purpose that differs from the one for which the project was principally designed, a project will be eligible for an additional \$10 for each 3,412,000 btus of the excess thermal energy used for such different purpose.

For states that have achieved 80 percent or more of waste heat recovery opportunities identified by the Secretary of Energy, the EPA Administrator will make a one-time grant of not more than \$1,000 per megawatt of waste heat capacity recovered (or thermal equivalent) to support state-level programs that identify and achieve additional energy efficiency.

The Secretary of Energy will establish rules and guidelines for grant eligibility. The Secretary is also required to publicize the grant program and award funds on an "impartial, objective and not unduly discriminatory basis" according to the merits of each project in recovering or preventing waste energy throughout the United States. No grants will be provided to any project that qualifies for specific tax incentives for combined heat and power or waste heat recovery.

To fund grants for eligible projects and utilities, the Act authorizes appropriations to the Secretary of Energy of \$100 million for fiscal year 2008 and \$200 million for each of fiscal years 2009 through 2012. The Secretary may obtain additional amounts for fiscal year 2008 and each subsequent fiscal year for administration of the grant program. To fund grants to the states, the Act authorizes appropriations of \$10 million for each of fiscal years 2008 through 2012. As noted above, these funds still have to be appropriated by Congress annually as part of its budget process.

## Potential Additional Incentives<sup>7</sup>

For owners or operators of these projects, there are certain additional, optional incentives for recovery and use of industrial waste energy. These incentives become available only after the relevant state regulatory authority (typically the state public utility or public service commission) or nonregulated electric utility (i.e., one whose rates are not regulated by a state commission) conducts a public hearing regarding whether to adopt a standard that would make the incentives available. As discussed below, not only is it not certain that they will become available, but the incentives should be approached with caution.

Under the terms of the Act, project owners or operators may request that a state regulatory authority or nonregulated utility hold a public hearing to consider and determine whether it is appropriate to adopt a standard that would implement additional incentives for recovery and use of industrial waste energy. The relevant entity must begin conducting the hearing within 180 days of receipt of the hearing request. To be clear, the incentives discussed below are to be *considered* by a state regulatory authority or nonregulated electric utility. These entities are free to conclude that it is not appropriate to adopt the standard.

What are these optional incentives? There are three listed in the Act. The first provides for the sale of a project's net excess power to an electric utility. Excess power refers to any power from the project generation facility that the industrial does not need for its own use at the site. This provision provides a ready market for the sale of any such excess power. Sales made to an electric utility would be paid for on a per kilowatt hour equal to the full undiscounted retail rate paid to the utility for power purchased by the facility, minus per unit distribution costs, as applied to that type of purchasing utility. If the voltage of such net excess power must be converted to or from voltages exceeding 25 kilovolts, the purchase price will be further reduced by per unit transmission costs.

The second optional incentive would require an electric utility to transmit the net excess power on behalf of the project owner or operator to up to three separate locations on the system of the utility for direct sale to third parties at those locations. Such transmission of power would incur a transportation rate equal to the per unit distribution costs and margins that applies to that type of transporting utility. Such rates would be increased by per-unit transmission costs if the net excess power voltage that is available to be transported to third-party purchasers is transformed to voltages over 25 kilovolts. No utility would be required to purchase or transport net excess power that exceeds the available capacity of the wires, meter or other equipment of the electric utility serving the site, unless the owner or operator of the project agrees to pay for the necessary and reasonable upgrades to the equipment.

## New Investment Tax Credit

The Energy Improvement and Extension Act of 2008, signed into law on October 3, 2008, as part of the Emergency Economic Stabilization Act,<sup>8</sup> includes a 10 percent investment tax credit for the costs associated with the first 15 megawatts of a combined heat and power system property that is placed into service after the date of enactment. EPA's Combined Heat & Power Partnership has developed a fact sheet on these tax credit provisions, available at: [www.epa.gov/CHP/documents/chp\\_itc.pdf](http://www.epa.gov/CHP/documents/chp_itc.pdf).

The third optional incentive would permit the construction, ownership and operation of private electric wires by the project owner or operator to transport the power to up to three purchasers within a three-mile radius of the project. Such a private transmission line would be allowed to use or cross public rights-of-way without subjecting the project to regulation as a public utility. The new line would be treated for safety, zoning, land use and other legal privileges, the same as a utility company's electric transmission lines. However, this third option does not confer any grant of any power of eminent domain to take or cross private property for the new wires. In addition, the new wires should be physically segregated and not interconnected with any portion of the utility's system except on the customer side of the utility's revenue meter and in a manner that precludes any possible disruption or exportation of electricity onto the utility system.

Finally, the Act allows the utility and project owner or operator to reach agreement on alternative arrangements and rate payments that are mutually satisfactory and in accordance with state law.

Why should these additional options be considered with caution? Owners and operators of these projects will need to have a good working relationship with the local utility, especially if they desire to sell excess energy to the local utility or into the market. State regulatory authorities or nonregulated utilities would be required to hold a generic hearing to consider the incentives discussed above for these waste energy projects, and such a hearing will be open to all interested persons. Aside from your representatives, owners or operators of similar projects, ratepayers of the affected utilities and other interested parties might also desire to participate. Consequently, your company's and the affected utility's time and resources will be committed to a generic hearing to consider standards that neither the state regulatory authority nor the nonregulated utility will be required to adopt at the end of the day. In the mean-

time, valuable “one-on-one time” between your company’s representatives and the local utility may be pushed aside, as utilities allocate resources committed for these types of projects to these generic hearings.

In addition, waste energy projects may be able to obtain the right to require a local utility to purchase their electric power or to transport the power to other locations under other existing laws and regulations. For example, a local utility can be compelled to acquire or transmit to other adjacent systems the excess electric energy of certain alternative energy projects, including waste energy projects, which are covered by PURPA. There is a federal/state legal and regulatory framework that has been established over 28 years of implementation of PURPA that is available for these purposes. Depending on the type and size of your waste energy project, your eligibility for PURPA benefits might obviate any perceived need to pursue the additional incentives provided under EISA.

### **Legal/Regulatory Considerations to Take Into Account**

There are a number of state and federal legal/regulatory requirements and conditions that may apply to owners or operators of projects that sell or transmit electric energy either at the retail or wholesale level. In many cases, waivers or exemptions may apply that will greatly reduce the risks of applicability of any such regulatory requirements. However, failure to structure these projects appropriately may lead to unnecessary and extensive regulatory requirements.

What are some of the basic conditions? Sellers of electric energy to retail customers could be considered public utilities under state law. States typically allow owners of electric projects to “self-supply” their own electric power requirements, and in some circumstances, states will allow interconnected affiliates of the project owner to use the project’s electric energy without triggering state utility regulation. Close review of state legal/regulatory requirements will be necessary to ensure that the project qualifies for any necessary exemptions or waivers. Failure to do so could lead to the owner, operator or both being subject to state utility commission transaction approval, filing, reporting and record-keeping requirements. While electric utilities operate in such an environment every day, companies that are not involved in electric power production have no such dealings with or regulation by state utility commissions.

At the federal level, selling excess energy at wholesale will subject the owner, and potentially the operator, to regulation as “public utilities” under the Federal Power Act (FPA). Extensive rate filing, reporting and record-keeping requirements would apply to fully regulated public utilities. However, these regulatory requirements can be greatly eliminated or mitigated if the owner applies and qualifies for certain exemptions and waivers that have been granted

to numerous nontraditional utilities that do not have market power or exclusive service territories.

Your company could also become a holding company under the Public Utility Holding Company Act of 2005 (PUHCA 2005) by reason of owning or controlling 10 percent or more of the outstanding voting securities of a public utility company. (A public utility company includes an entity that owns or operates electric generation, transmission or distribution facilities.) PUHCA 2005 is essentially a statute that deals with record-keeping and access to books and records. Such access relates to review of costs that are recovered through rates subject to either state commission (retail) or FERC (wholesale) rate jurisdiction. The regulatory reach of PUHCA 2005 is much less extensive than its predecessor, PUHCA 1935, which was a comprehensive statute requiring prior Securities and Exchange Commission approvals and considerable regulation of a wide variety of transactions engaged in by registered holding companies. While PUHCA 2005 entails much less of a regulatory burden, most non-utility companies still would rather not be subject to books and records requirements applicable to their parents and affiliates.

Nevertheless, exemptions are available for projects where the generation facility is used exclusively for a company’s self-use or if excess power is only sold at wholesale. Thus, developing an appropriate corporate structure to qualify for relevant exemptions and waivers of the state and federal regulatory requirements can ensure that any additional responsibilities are eliminated or greatly mitigated.

### **Other Practical Considerations**

It will take some time to undertake the technical, operational, financial, environmental and legal/regulatory

## **Learn More About Combined Heat and Power**

Environmental Protection Agency’s Combined Heat & Power Partnership [www.epa.gov/chp](http://www.epa.gov/chp).

Department of Energy’s Combined Heat & Power Technologies information pages [www.eere.energy.gov/de/chp/chp\\_technologies/](http://www.eere.energy.gov/de/chp/chp_technologies/).

Department of Energy’s Office of Distributed Energy Program [www.eere.energy.gov/de/](http://www.eere.energy.gov/de/).

US Clean Heat & Power Association (links to regional initiatives, Department of Energy national laboratories working on CHP technologies, and other resources) [www.uschpa.org](http://www.uschpa.org).

review associated with the projects. You will want to allow adequate lead time and have a realistic timeline for consideration of the relevant issues and completion of the project, if it proceeds. If your company has no experience with self-generation or on-site electric generation joint ventures, you may want to consult with project developers who have significant experience in the area. They have the background and resources to help your project proceed more smoothly and will have materials and form agreements available for your consideration, so that you will not have to “re-invent the wheel” with regard to document preparation.

If having adequate capital is a concern, there are lenders and investors, including private equity funds, who may be willing to invest in waste energy projects. They typically provide funding through a project finance model, where they create a special purpose subsidiary that holds the project assets and is the borrower under the loan agreement. Revenue flow from the project would pay for financing and related costs and thus may pose less of a financial burden on your own company.

### A Review Worth In-house Counsel's Time

The programs created by EISA may be worth your company's review, especially if your company has corpo-

rate goals for increasing resource efficiency and reducing impacts of operations on the environment. The financial incentives under EISA must be funded by Congress, and if they are, this may help spur your company to consider and perhaps pursue such projects.

While your company may be concerned initially about new regulatory requirements to which it may be subject based on its ownership or operation of such waste energy projects, many of the more burdensome requirements can be avoided through an appropriate project structure that qualifies for existing waivers or exemptions from federal and state legal/regulatory requirements. 

Have a comment on this article? Email [editorinchief@acc.com](mailto:editorinchief@acc.com).

### NOTES

- 1 Pub. Law No. 110-140 (2007).
- 2 Sec. 372(b) (note that all subsequent section references are to the Energy Conservation and Policy Act, 42 U.S.C. § 6291 et seq. which is amended by the provisions of the EISA).
- 3 Sec. 372(e) (42 U.S.C. § 6342).
- 4 Sec. 372(i).
- 5 Sec. 373(a) (42 U.S.C. § 6343).
- 6 Sec. 373 (42 U.S.C. § 6343).
- 7 Sec. 374 (42 U.S.C. § 6344).
- 8 110 P.L. 343 (2008). See Section 103(c) for the investment tax credit specific to combined heat and power system property.

## ACC Extras on...Energy and the Environment

### ACC Docket Articles

- *A Field Guide to Corporate Social Responsibility for In-house Counsel* (2008). Chances are that your company gives (or has given) a charitable donation, and as the in-house attorney you may not even raise an eyebrow. However, what responsibilities do businesses have to the communities in which they do business? [www.acc.com/docket](http://www.acc.com/docket)
- *Is Green the New Black?* (2007). Corporate social responsibility has become more than an afterthought, with companies everywhere going green. But is it just in style to be eco-friendly? This article explores how important protecting the environment has become in the corporate world, and details how companies like yours are doing their part. [www.acc.com/docket](http://www.acc.com/docket)

### Program Material

- *Reporting Environmental Releases Violations — When Time is of the Essence* (2006). Are you versed in the requirements surrounding mandatory versus voluntary reporting of environmental releases and violations? It's likely your company

is relying on you to provide legal guidance on this issue and you need to be prepared to answer the questions if/when they come up. This program material can help. [www.acc.com/legalresources/resource.cfm?show=20080](http://www.acc.com/legalresources/resource.cfm?show=20080)

### InfoPAK<sup>SM</sup>

- *Energy Handbook* (2006). The Energy Policy Act of 2005 is a landmark statute, affecting virtually everyone in the US energy industry. This InfoPAK is intended to help you quickly find and understand provisions that affect you, and is arranged by industry sector. [www.acc.com/infopaks](http://www.acc.com/infopaks)

### Green House Counsel

- Sponsored by Holland + Knight, this weekly web feature delivers resources, tips and facts to help your company adopt policies that are environmentally friendly — and often cost-effective, too. [www.acc.com/gogreen](http://www.acc.com/gogreen)

ACC has more material on this subject on our website. Visit [www.acc.com](http://www.acc.com) where you can browse our resources by practice area or use our search to find documents by keyword.