Defending Liberty
Pursuing Justice

ABA Section of Environment, Energy and Resources

Energy Committees Newsletter

Vol. 7, No. 1 November 2009

EDITOR'S INTRODUCTION

David Montgomery Moore
Balch & Bingham
Atlanta, Georgia
dmoore@balch.com

Energy law has truly been most exciting and dynamic. The growing interest in public policy toward energy, its use, and production, has brought new focus and attention to our industry and created new solutions and new issues requiring the skills and experience of our Energy Committees members.

In this issue of the newsletter, Walter R. Hall II discusses significant decisions which affect electric energy restructuring, including FERC review of wholesale electric power contracts and several recent decisions regarding regulation of generation and transmission assets. Alexia B. Borden and Thomas G. DeLawrence explain recent federal energy policy initiatives and legislation that will shape future energy investment and development. Finally, Judy Gechman discusses the antitrust challenges facing the energy industry and identifies useful policies and procedures for energy companies to adopt in the face of such challenges.

APPELLATE REVIEW AND RESTRUCTURING OF THE ELECTRICITY MARKETS

Walter R. Hall II
Past Co-Chair, Restructuring of the Electric Industry Committee
WRHII@aol.com

2008-2009 has seen a continuation of significant Appellate Decisions affecting and to a degree altering the Federal Energy Regulatory Commission's (FERC or Commission) program for restructuring the electric industry and to achieve necessary expansions in electric infrastructure. Four decisions, which illustrate the standards applied by the appellate courts in their review of FERC's highly complex industry restructuring decisions are described below. These decisions clarify the application of the "Mobile-Sierra Doctrine" as applied to competitive, wholesale electric markets and also restrict FERC-asserted authority to authorize and site necessary new multi-state transmission lines.

In *Nevada Power Company, et al. v. Enron Power Marketing, Inc, et al.*, 103 F.E.R.C. ¶ 61,353, *reh'g*, 105 FERC ¶ 61,185 (2003), FERC adjudicated complaints filed by four distribution utilities alleging that rates for power received in three sets of long term wholesale power contracts (i.e., with terms of up to 8-10 years) negotiated during the California energy crisis were unjust and unreasonable, and which requested FERC-ordered modification of those contracts. Complainants alleged that dysfunctions in the

Energy Committees Newsletter
Vol. 7, No. 1, November 2009

This newsletter is a cooperative effort of the Carbon Trading and Energy Finance, Energy and Natural Resources Litigation, Energy and Natural Resources Market Regulation, Energy Infrastructure and Siting, Hydro Power, Oil and Gas, Petroleum Marketing, Restructuring of the Electric Industry, and Renewable and Distributed Energy Resources Committees. On behalf of these committees, David Montgomery Moore was editor of this issue.

In this issue:

Editor's Introduction
David Montgomery Moore 1

Appellate Review and Restructuring of the Energy Markets
Walter R. Hall II 1

Are There "ACES" in the Hole for the American Clean Energy and Security Act?
Alexia B. Borden and
Thomas G. DeLawrence 8

With Antitrust Amnesty, First Come Doesn't Serve but Prevention Beats the Cure
Judy Gechman 11

Copyright © 2009. American Bar Association. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the publisher. Send requests to Manager, Copyrights and Licensing, at the ABA, e-mail: copyright@abanet.org.

Any opinions expressed are those of the contributors and shall not be construed to represent the policies of the American Bar Association or the Section of Environment, Energy, and Resources.

2000–1 California spot markets (in which prices increased at times 150-fold over traditional levels and including market manipulation) caused rates established by forward contracts negotiated in the bilateral markets during this crisis period to exceed a just and reasonable level, and thus to be unlawful under the Federal Power Act (16 U.S.C. §824(c) to (e)). FERC ordered an evidentiary hearing before an administrative law judge (ALJ) to determine the "standard of review" to be applied in resolving these Complaints, and affirmed the ALJ's decision that the "public interest" standard of review of the Mobile-Sierra Doctrine (rather than the statutory just and reasonable standard of review) should apply. Despite issuance of a Staff Report concluding that the 2000–1 California electricity spot markets were seriously prejudiced by market manipulation and that California forward contract markets were also significantly affected, FERC denied Complainants requested contract modification relief after reviewing data respecting alternative contracting options and the magnitude of rate increase and other effects caused to each utility at the time the new contracts became effective, determining that relief was not required "in the public interest."

The Mobile-Sierra Doctrine derives its name from two cases decided on the same day in 1956 by the United States Supreme Court: *United Gas Pipe Line Co. v. Mobile Gas Services Corp.,* 350 U.S. 332, 344 (1956) and *Federal Power Commission v. Sierra Pacific Power Co.,* 350 U.S. 348, 355 (1956). In each case, a FERC-regulated wholesale utility sought to use the rate application provisions of the Natural Gas Act (15 U.S.C. § 717 *et. seq.*) (NGA) or Federal Power Act (16 U.S.C. § 791a *et. seq.*) (FPA) respectively to obtain higher rates for services it was then providing under long-term bilateral contracts negotiated with a major customer. The Supreme Court, in each case, reversed a FERC Order approving the new, higher rate as just and reasonable, concluding, as expressed in a later decision, that "[i]n wholesale markets, the party charging the rate and the party charged were often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a 'just and reasonable' rate as between the two of them." *Verizon Communications,*

Inc. v. FCC, 535 U.S. 467, 479 (2002). Thus, the Court held that a negotiated contract rate would, by virtue of its agreed character, be presumed as just and reasonable, and contract modification would not be ordered except "when necessary in the public interest." This, the Court held, would occur only if the negotiated rate interfered with the wholesale utility's ability to provide service or imposed an excessive cost burden on a contracting party or other customers. The Court further stated that this result "fully promote[s] the purpose of the Act[s] [which] by preserving the integrity of contracts . . . permits the stability of supply arrangements which all agree is essential" to the health of the industry involved. Over the years, a number of both Court and Commission decisions applied the Mobile-Sierra Doctrine to different factual situations (i.e., including challenges to both high and low rates), and defined further factors that could result in a "public interest" determination that contract modification was required, most particularly where the contract rate was found to impose an "excessive burden" on the public or one of the contracting parties. Also, that case law makes clear that, absent express language in a contract requiring application of the statutory just and reasonable review, review of a negotiated, contract rate is to occur under Mobile-Sierra's public interest terms. *See* Carmen L. Gentile, *The Mobile-Sierra Rule: Its Illustrious Past and Uncertain Future*, 21 ELJ 353, 386 (2000)(hereafter, Gentile), in which the Mobile-Sierra Doctrine is characterized as "akin to a dark and arcane science" whose principles are "simply stated" but "steeped in nuance" and "treacherously difficult to apply."

Applying Mobile-Sierra principles consistent with prior case law and those applied by FERC itself, the Ninth Circuit nonetheless reversed. *Public Utility District No. 1 of Snohomish County, Washington, et al. v. FERC,* 471 F.3d 1053 (9th Cir. 2006). First, the Court noted that the FPA, in Sections 205(c)-(d), "creates a role for privately negotiated wholesale power contracts," but such rates and terms are required to be just and reasonable. Next, the Court held that "in certain circumstances, a presumption applies that private parties to a wholesale electric power contract have negotiated 'a just and reasonable' contract over a designated period of time, lawful under the FPA throughout that period," which presumption may be overcome if "the contract adversely affects the public interest." *Id.* at 1057-61. The Court stated that "three prerequisites" are necessary to establish the "Mobile-Sierra presumption": (i) the contract must not by its terms preclude Mobile-Sierra review (as described above), (ii) the regulatory scheme in which the contracts are formed and implemented permits reasonable assurance that the rates thereby negotiated are just and reasonable, and (iii) that review must encompass all factors relevant to the contract's formation. *Id.* at 1061. The Court found that the latter two prerequisites were not satisfied. Although FERC has established standards and an extensive review process prior to granting market-based rate authority as well as various reporting requirements to collect information to permit it to monitor rates established under that authority (*see Market-Based Rates for Wholesale Sales of Electric Energy, Capacity and Ancillary Services by Public Utilities*, Order 697, 72 Fed. Reg. 39,904 (July 20, 2007) and related Orders), the Court concluded that these requirements were not sufficient to ensure that the contract established rates would be just and reasonable or that they would remain so or be modified as needed if market conditions changed after their implementation. The Court also specifically criticized FERC's failure to consider the 2003 Staff Report's conclusions respecting market manipulation in California spot markets and its significant effect upon the forward contract market at the time the contracts at issue were negotiated, facts which the Court interpreted as suggesting that the contract rates had not been just and reasonable when negotiated and first implemented. *Id.* at 1085-1087. Finally, the Court held that, independent of FERC's errors in deciding to apply the Mobile-Sierra public interest standard, it also misapplied the standard, treating the California contracts as "low-rate" contracts (as Mobile & Sierra were) rather than "high rate" contracts as the California contracts in fact were. In the former case, the Court noted, the "public interest" focus is on whether the contract rate is so low as to endanger the utility's ability to provide reliable service, whereas in the latter that focus must shift to whether the contract rates are "outside the 'zone of reasonableness'" required for just and reasonable rates, and thus are unlawful

overcharges to the public. *Id*. at 1087-89. *See also California Public Utilities Commission, et al. v. FERC,* 474 F.3d 587 (9th Cir. 2006) adjudicating a similar appeal from FERC denial of requested 2000-1 California contract modification for contracts negotiated by the state of California through the California Department of Water Resources.

In a 5–2 decision, in which two Justices recused themselves and a third joined only in the result (i.e., but not in the reasoning of the plurality opinion), the Supreme Court rejected the Ninth Circuit's reasoning but affirmed its judgment that FERC had erred in its application of Mobile-Sierra. *Morgan Stanley Capital Group, Inc. v. Public Utility District No. 1 of Snohomish County, Washington, et al.,* 128 S. Ct. 2733 (2008) (*Morgan Stanley*). The Court summarized application of the doctrine as follows: "Under the Mobile-Sierra doctrine, the Federal Energy Regulatory Commission . . . must presume that the rate, set out in a freely negotiated wholesale-energy contract meets the just and reasonable requirement imposed by law. The presumption may be overcome only if FERC concludes that the contract seriously harms the public interest." *Id*. at 2737. The Court further noted as to FERC's market-based tariff system under which wholesale competitive markets operate and the contract rates at issue were created: "Both the Ninth Circuit and the D.C. Circuit have generally approved FERC's scheme of market-based tariffs. We have not hitherto approved, and express no opinion today, on the lawfulness of the market-based-tariff system, which is not one of the issues before us." *Id*. at 2741-2.

The Plurality Opinion explained that FERC had indeed erred in its application of the public interest standard in that the determination of "excessive burden" to determine if the public interest standard permitting contract modification was satisfied, required analysis of the contracts effect throughout their term and not simply of the magnitude of price increase and other effects caused at the time of contract implementation. Thus, the Court held that, in determining if contract modification was required by Mobile-Sierra's public interest standard (i.e., if excessive burden was present), FERC needed to evaluate their burden "down the line" as measured by prices available after elimination of the dysfunctional market as well as during the early period of implementation. Second, the Court concluded that it was unable to determine from FERC's orders whether it had properly considered how FERC had ruled on Complainants' evidence that Sellers engaged in unlawful market manipulation with direct effect upon the contract. It noted that, if found to exist, such unlawful activity would eliminate the premise upon which application of the Mobile-Sierra Doctrine rests, i.e., that the contract rates are the product of fair, arms-length negotiations. *Id*. at 2749-51.

In the Plurality Decision, Justice Scalia also rejected much of the understanding of Mobile-Sierra upon which both FERC and the Ninth Circuit had reached their decisions. However, at the outset, the Court (as did the Ninth Circuit before it) emphasized that there exists but a single standard of lawfulness, the statutory "just and reasonable" standard, which governs the lawfulness of both tariff and contract rates and other terms. Mobile-Sierra's public interest standard is but a particular application of this statutorily prescribed standard, the Opinion explained, and not a separate and distinct standard as some earlier case law (and FERC in its decision) had indicated. *Id*. at 2745. The Court then rejects the need for advance prior review of a contract rate or term under the just and reasonable standard before Mobile-Sierra can apply (as arguably required by the Ninth Circuit), and further concludes that market turmoil or volatility at the time of contract formation is not by itself a reason to reject the Mobile-Sierra Doctrine's application. Holding such contracts to be unenforceable because their formation was surrounded by market turmoil, the Court concludes, would be counter-productive since it is precisely under such conditions that sophisticated market participants turn to longer-term contracts. *Id.* at 2746-47.

Rather, the Court states that "Sierra was grounded in the common sense notion that '[i]n wholesale markets, the party charging the rate and the party charged [are] often sophisticated businesses enjoying presumptively equal bargaining power, who could be expected to negotiate a "just and reasonable" rate as between the two of them.' [citation omitted] Therefore, only when the mutually agreed-upon contract rate seriously harms

the consuming public may the Commission declare it not to be just and reasonable." *Id*. at 2746. Thus, for the plurality in *Morgan Stanley*, Mobile-Sierra and its presumption of lawfulness apply simply from the fact of party agreement (i.e., a contract) establishing the contested rate or term, and not from any prior review or acceptance of it as just and reasonable by FERC. Interestingly, in concluding its explanation of why it rejects the Ninth Circuit's two Mobile-Sierra application prerequisites, the Plurality Opinion returns to its admonition that "we do not address the lawfulness of FERC's market-based rates scheme," noting that that scheme "assuredly has its critics," perhaps suggesting that it views the Ninth Circuit prerequisites as relevant to this latter question but not Mobile-Sierra.

Next the Plurality Opinion turns to interpreting what constitutes an "excessive burden" under Mobile-Sierra which would justify contract reformation, and rejects the Ninth Circuit's "zone of reasonableness" standard, concluding that it "fails to accord an adequate level of protection to contracts." Indeed, the Court notes that the Mobile-Sierra presumption would be of little value unless it protects agreed prices which are outside as well as within the just and reasonable "zone of reasonableness," as rates within the zone of reasonableness already pass muster as "just and reasonable." The Court further notes, rejecting a second Ninth Circuit position, that "[t]he standard for a buyer's challenge must be the same, generally speaking, as the standard for a seller's challenge," and thus rejects the Ninth Circuit and earlier case law dichotomy establishing a difference between "excessive burden" determinations in "high" and "low" rate cases. *Id*. at 2747-48. Nonetheless, in a footnote, the Plurality Opinion notes that the factors which are to be considered in evaluating "excessive burden" can be broad, and include "market manipulation by entities not parties to the challenged contract," but then notes that setting aside a contract rate requires a finding of "unequivocal public necessity" or "extraordinary circumstances." *Id*. at 2748. Indeed, several earlier cases and Commentators have described the "excessive burden" standard as "practically insurmountable" where no overriding public interest (i.e., such as industry restructuring) is at issue. *See* Gentile at 360 & 373.

The Dissent, authored by Justice Stevens, rejects the Plurality Opinion's agreement-based concept of Mobile-Sierra, asserting that it lacks support both in the statute and in prior Supreme Court case law. Rather, the Dissent reads *Sierra* to instruct that "the public interest is the touchstone for just and reasonable review of all rates, not just contract rates" and further concludes that "the Act makes unlawful all rates which are not just and reasonable, and does not say a little unlawfulness is permitted." Finally, the Dissent concludes that "Congress enacted the FPA precisely because it concluded that regulation was necessary to protect consumers from deficient markets. It follows, then, that 'the Commission lacks the authority to place exclusive reliance on market prices.'" *Id*. at 2751-59. The Dissent concludes that it too would vacate FERC's decision and would remand for a proper application of the statutory "just and renewable" standard to the contract rates, but without either the Plurality Opinion or Ninth Circuit's Mobile-Sierra reasoning each of which it views as improperly restricting and usurping FERC's FPA broad decisional role. *Id.* at 2759.

Since FERC began its most recent efforts to restructure the electric industry with the issuance of Order 888 in 1996, its many orders establishing market structures of the six RTO/ISOs, adjudicating disputes respecting their decisions and actions and establishing wholesale market processes for non-RTO/ISO regions of the country have resulted in more than fifty appellate decisions affirming and in some instances requiring modifications in FERC's program. In reviewing these FERC decisions, the Courts have applied the traditional appellate standards whereby FERC actions are to be affirmed unless found "arbitrary and capricious," i.e., FERC must "examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'" Findings of fact are to be affirmed "if supported by substantial evidence," and deference is to be provided in areas of technical expertise and balancing of competing policy interests whose decision is conferred upon FERC by the FPA. *See Maine Public Utilities Commission v. FERC*, 520 F.3d 464, 470-471 (D.C. Cir. 2008) (Maine PUC). For example, in 2008-9, challenges by State Regulators

and Attorney Generals (1) to FERC's approval of a new Forward Capacity Market for New England, and particularly its specified 2006 to 2010 transition payments prior to full auction market implementation, were rejected despite assertions that the record contained no specific generator cost data upon which the payments had been based, and (2) to the reasonableness of New England's prior "hybrid" market under which generators were permitted to demonstrate their need for cost-of-service recovery under Reliability-Must-Run Agreements or Peaking Unit Safe Harbor bidding procedures, or could choose to participate in the auction markets. This resulted, according to Complainants, in unjust and unreasonable rates due to the ability of generators to obtain either market-based rates or cost-of-service based rates, i.e., whichever would provide them with the highest compensation and thus pose the greatest rate burden on customers. *Id.*; *Blumenthal v. FERC*, 552 F.3rd 875 (D.C. Cir. 2009). In each case, the Court reviewed the evidentiary record and FERC's reasoning to assure that the necessary evidentiary and logical support was present, and then affirmed the FERC decision.

In *Maine PUC*, moreover, the D.C. Circuit addressed an additional Mobile-Sierra issue which, if its decision withstands requested Supreme Court review (*See NRG Power Marketing, LLC, et al. v. Maine Public Utilities Commission, et al.*, Writ of Certiorrari No. 08-674 (2009)), and if expanded in certain respects, may significantly limit the future reach of the Mobile-Sierra Doctrine. The case involved a partial settlement agreement approved by FERC which accepted and requested implementation of the New England Forward Capacity Market, but which eight parties (State Regulators, Consumer & Industrial Customer Advocates) refused to join. Nonetheless, the Agreement provided for application of Mobile-Sierra to all future challenges to market transition payments and final capacity auction prices whether brought by a settling or non-settling party, or by FERC. As in *Morgan Stanley*, the Court noted that Mobile-Sierra recognizes the "superior efficiency of private bargaining and its purpose is 'to subordinate the statutory filing mechanism to the broad and familiar dictates of contract law,'" noting that where a rate or term is adopted from a negotiated agreement of settlement "FERC applies a strong presumption that the settled rate is just and reasonable, and the Commission may only set aside the contract for the most compelling reasons." However, as Mobile-Sierra's application is predicated only upon "the existence of a voluntary contract between the parties" such as a settlement, and whereas the non-settling parties did not agree to that contract and moreover "vociferously objected" to it, "the Mobile-Sierra doctrine simply does not apply" and contract review as to these non-parties must be under the just and reasonable standard. *Maine Public Utilities Commission v. FERC*, 520 F.3d 464, 476-479 (D.C. Cir. 2008). While it involves significant differences of analysis, if this holding were to be subsequently applied to end-users or their representatives (i.e., State Regulators & Consumer Advocates), who similarly do not participate in negotiations or formally join as contracting parties in wholesale contracts, thereby permitting them to also challenge under the just and reasonable standard contract based rates and terms though negotiated and agreed to by wholesale market participants serving them in the retail market, much of the dispute with the doctrine's application would be overcome albeit at the significant cost of reducing its ability to enhance market stability. On April 27, 2009, the Supreme Court issued its Order granting the writ of certiorari, and oral argument has been scheduled for Nov. 3, 2009. *NRG Power Marketing, LLC, et al. v. Maine Public Utilities Commission, et al.*, 129 S. Ct. 2050, 173 L. Ed. 2d 1132 (2009). Petitioners argue in briefs filed in June and July that the D.C. Circuit decision conflicts with *Morgan Stanley*, eviscerates the Mobile-Sierra Doctrine and will destabilize energy markets by failing to provide proper effect to freely negotiated wholesale energy contracts.Clearly, and in light of the Plurality Opinion in *Morgan Stanley*, substantial further clarification is needed to permit a full understanding of how the doctrine will apply to competitive market determined prices.

An additional significant appellate decision issued in 2009 was *Piedmont Environmental Council, et al. v. FERC,* 2009 U.S. App. Lexis 2944 (4th Cir. 2009). In a Final Rule issued Dec. 1, 2006, FERC had determined that, under FPA § 216 added by the

Energy Policy Act of 2005, Congress had conferred upon it authority to authorize and site transmission plants despite State Regulator prior timely denial of an application for the same facility. *See Regulations for Filing Applications for Permits to site Interstate Electric Transmission Facilities*, 71 Fed. Reg. 69,440 (Dec. 1, 2006). As one of five circumstances in which FERC was authorized to exercise such authority, FPA Section 216(b)(1) provided the authority where "a state commission has withheld approval for more than one year after the filing of an application." In its Final Rule, FERC read this language to grant it authority where a State Commission in fact denied an application within the one year time frame, arguing that a denial also constituted a "withholding" of approval. In a 2–1 decision, the Court concluded that this interpretation of the statutory language was contrary to its plain meaning and moreover in conflict with the context of the statute in which Congress acted "in a measured way and conferred authority on FERC only when a state Commission is unable to act . . ., fails to act in a timely manner, or acts inappropriately by granting a permit with project-killing conditions." *Id.* at 9. The Court then adjudicated further challenges to the FERC Rule under the National Environmental Policy Act (42 U.S.C. § 4332, et. seq), concluding that issuance of the rule (which was procedural in character) was not a major Federal action requiring development of an environmental impact statement or assessment, but that FERC needed to consult with the Council of Environmental Quality before implementing the final rule. Congress, it should be noted, is presently considering major energy legislation which, in one provision, would explicitly grant FERC transmission authorization and siting authority either for transmission plant to be used in connection with renewable generation development or high voltage, trunk line projects of 345 kV or greater.

Additional appellate decisions in 2008-9 include *City of Anaheim, California, et al. v. FERC,* 558 F.3d 521 (D.C. Cir. 2009) (reversing FERC Order of retroactive rate increase under FPA § 206(a) which permits only prospective relief); *Western Area Power Administration v. FERC*, 525 F.3d 40 (D.C. Cir. 2008) (affirming FERC approval of RTO administration fees and pass-through to end-users against Mobile-Sierra challenge that action constituted a modification of contracts since services were already provided under existing contracts by transmission providers with separate fees. Court agreed with FERC that RTO services were new and did not duplicate services); *American Forest and Paper Ass. V. FERC,* 550 F.3d 1179 (D.C. Cir. 2008) (affirming FERC interpretation of term "markets" in amendment to Public Utility Regulatory Policies Act as reasonable); *Consolidated Edison Co., et al. v. FERC*, 510 F.3d 333 (D.C. Cir. 2007) (affirming FERC remedial program for high rates in non-spinning reserve market of NYISO—implementation of price caps rather than invoking tariff emergency procedures and ordering refund—over customer challenge).

SECTION PUBLICATIONS AVAILABLE ONLINE!

Section members are able to view archived copies of the magazine *Natural Resources & Environment*, the newsletter *Trends,* and *The Year in Review* in .pdf format in the Section Members Only portion of the Section Web site at *www.abanet.org*.

As a Section member you have access to view these publications after logging onto the Web site with your ABA Member ID number and password.

ARE THERE "ACES" IN THE HOLE FOR THE AMERICAN CLEAN ENERGY AND SECURITY ACT?

Alexia B. Borden
Thomas G. DeLawrence
Balch and Bingham
Birmingham, Alabama
aborden@balch.com

By a narrow margin of 219-212, the House of Representative passed the American Clean Energy and Security Act (ACES) on June 26, 2009. H. Committee on Energy and Commerce, Summary of H.R. 2454, The American Clean Energy and Security Act (July 2009), *available at* http://energycommerce.house.gov/Press_111/20090724/hr2454_housesummary.pdf ACES was instituted "to create clean energy jobs, achieve energy independence, reduce global warming pollution and transition to a clean energy economy." It consists of five titles covering, respectively: clean energy, energy-efficient programs, global warming, the preservation of domestic industry and domestic and international adaptation to the bill, and agriculture and forest related offsets. Below is a summary of the major programs or initiatives included in ACES and a brief discussion of the U.S. Senate's version of the bill introduced on Sept. 30, 2009, by Sens. John Kerry and Barbara Boxer.

Scope of Coverage

Large stationary sources emitting more than 25,000 tons per year of greenhouse gases (GHGs), producers and importers of all petroleum fuels, and distributors of natural gas to residential and commercial users are among the numerous types of entities regulated under ACES. Carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride, and nitrogen trifluoride are the seven GHGs covered under ACES.

Cap and Trade of Emissions

ACES creates a "cap-and-trade" system that covers approximately 85 percent of the nation's GHG emissions. The bill requires covered entities to obtain "allowances" for their GHG emissions, with one allowance equaling one ton of GHG emitted. Covered entities must submit allowances in order to emit GHGs. The "cap" aspect of the system sets a maximum on the amount of GHGs an entity is allowed to emit in a calendar year. This maximum will become progressively lower over time and will reduce carbon emissions from 2005 levels by 17 percent in 2020 and 83 percent in 2050. The "trade" portion of the bill allows entities with a surplus of allowances to sell or trade them with entities expecting to exceed their allotted amount of allowances. Sources may also save an unlimited amount of unused allowances and apply them to future years, may preemptively borrow an unlimited number of allowances for the next year, and may pledge allowances for 2-5 years in the future to meet 15 percent of their compliance for the current year. The Environmental Protection Agency (EPA) estimates allowances will cost $13 per ton in 2015 and $27 per ton in 2030, and EPA will maintain a strategic reserve of 2.5 billion tons in case allowance prices are higher than expected over a 3-year period.

Covered entities are also allowed to offset their emissions under ACES by acquiring offset credits from uncapped sources, such as farmers, engaged in activities that reduce GHG emissions. Covered entities may acquire up to 2 billion tons of additional credits each year, with up to one billion coming from domestic sources and up to one billion coming from international sources. Credits, like allowances, can also be transferred among covered entities and provide what is considered a more cost-effective option for a covered entity to ensure its emissions are allowed.

The original drafters of ACES envisioned an auction system for the distribution of allowances. However, last minute changes to the bill mandate that 80 percent of available allowances be allocated to certain defined entities until 2025. Therefore, only 20 percent of allowances will be distributed through an auction system governed by EPA until 2025, although nearly 70 percent will be auctioned after 2031. Some of the revenue from auctioned credits is expected to be returned to consumers as rebates or tax credits. Additionally, ACES states that allowances should be

used to keep the cost of energy to consumers as low as possible. This cap-and-trade system parallels the regime established under the Kyoto Protocol of the United Nations Framework Convention on Climate Change (UNFCCC).

Renewable Energy

Starting in 2012, retail electric utility companies will be required to obtain at least 6 percent of their load with electricity generated from renewable sources, other qualifying energy sources, and electricity savings. This required percentage will gradually increase to a total of 20 percent in 2020. ACES states that at least 75 percent of the aforementioned gradually-increasing percentage should be derived from the use of renewable energy sources including wind, biomass, solar, geothermal, certain hydropower plants, marine and hydrokinetic energy, certain biogas and bio-fuels, landfill gas, wastewater treatment gas, coal mine methane, and certain waste-to-energy. The bill also creates a "federal renewable energy credit" system, with each energy credit representing one megawatt hour of electricity created by renewable sources. Retail electricity suppliers can sell, trade, or bank their credits for up to 3 years.

Investment in Clean Energy and Technology

ACES authorizes investment opportunities in clean energy technology and energy efficiency. EPA predicts ACES will invest $190 billion in these areas by 2025, including $90 billion in state programs that promote renewable energy and energy efficiency, $60 billion in carbon capture sequestration technologies, discussed below, and $20 billion in electric and advanced technology vehicles, among others. The bill establishes the Clean Energy Deployment Administration that will provide funding for private investments in clean energy that might otherwise struggle to acquire financing, including nuclear energy. It also establishes a $15 billion Clean Energy Manufacturing Revolving Loan Fund Program that will give money to states that will, in turn, provide loans to small manufacturers wanting to reduce GHG emissions at their facilities or establish new manufacturing facilities, or upgrade existing facilities, to produce clean energy technology products, energy efficient products, and component parts for those products.

One of the most interesting aspects of ACES is a provision essentially amounting to a tariff on imports from foreign countries who do not abide by carbon reduction strategies at least as strict as the United States. The provision enables the president to require U.S. importers of such goods to submit "international reserve allowances" before importing unless 85 percent of imported goods for a particular sector are from countries satisfying certain criteria. The provision was likely enacted to protect U.S. industries unable to produce goods at prices equal to foreign competitors who do not incur additional costs from compliance with carbon emission limits or climate change legislation. Nevertheless, many, including President Obama, consider these tariffs protectionist in nature.

ACES also includes building standards that require *new* buildings to reduce energy consumption by 50 percentby 2016. A funding source was also created to encourage older buildings to comply with the new provisions, providing owners or occupants up to 50 percent of the cost to retrofit the home or building. Lastly, ACES contains provisions that promote the development of "smart grid" technology, improved electrical transmission and use, and require FERC to reduce peak electric demand for electric utilities with loads in excess of 250 megawatts.

Carbon Capture Sequestration

ACES authorizes the EPA Director, through the Clean Air Act, to establish an incentive program for existing facilities using fossil fuels that also employ carbon capture and sequestration technology (CCS). Any coal plant permitted between 2009 and 2015 must implement CCS within 5 years after commencing operations or will lose its eligibility for federal financial assistance. All new coal plants constructed after 2020 must use CCS at the outset and all coal plants that have not used CCS must retrofit CCS by no later than 2025.

What's Going to Happen Next?

EPA predicts by 2025, as a direct result of ACES, 65 percent of new generation will be renewable and 92 percent will be low carbon. In addition, the Congressional Budget Office (CBO) estimates ACES will increase revenues by nearly $873 billion and spending by $864 billion between 2010–2019 and that the bill is expected to lower deficits by nearly $9 billion from 2010–2019. At the same time, however, the CBO estimates the bill will cost the average household $175 per year, while other estimates are much higher, including an $1,870 estimate by the Heritage Foundation. Therefore, great skepticism remains in certain sectors like the electric generating industry, one of the industries expected to be most affected by the legislation.

The U.S. Senate's version of the bill, entitled the "Clean Energy Jobs & American Power Act," was unveiled on Sept. 30, 2009. This version proposes a more aggressive reduction in GHG emissions—requiring a 20 percent reduction in GHG emissions by 2020 (compared to 2005 levels) and an 80 percent reduction by 2050—than the proposed cuts in ACES. The bill also reduces the amount of offset credits that may be imported from developing countries to 1.25 billion (ACES allowed up to 1.5 billion). The Senate's version includes a cap-and-trade system that is substantially similar to the one proposed in ACES and also increases financing for research, training, grant and safety programs in the nuclear sector. The bill must pass through six Senate committees before making it to the floor of the Senate. Not surprisingly, critics have quickly amassed a number of shortcomings in the bill, including concerns over the more than fifty blanks that still exist in the bill. Sen. Boxer is pushing to begin markup of the bill in October. However, most believe that climate change legislation will not make it to the Senate floor before 2010.

There is significant turmoil across party lines among the Senators associated with this bill. On Aug. 6, ten moderate Senate Democrats from states dependent on coal and manufacturing sent a letter to President Obama saying they would not support any climate change bill that did not protect American industries from competition from countries that did not impose similar restraints on climate-altering gases.

In order for the bill to pass the Senate, it will need sixty votes in its favor, which is looking to be an uphill battle based on the numerous competing interests at stake. In addition to the senators lobbying for certain provisions of the House bill to be changed in some shape or form, there are numerous special interests at work doing the same. For example, renewable energy companies may wish to raise the renewable use requirement higher, coal companies may seek greater access to allowances, natural gas and other fuel providers may seek greater incentives, financial markets may voice their concerns with the effect the legislation would have on energy derivatives and futures contracts, and other groups may express their dislike for the protectionist nature of tariffs imposed on imports from countries without similar environmental restrictions. *See generally*, Steven A. Mufson & David A. Fahrenthold, *For Senate, a Climate of Competing Interests,* The Wash. Post, Aug. 4, 2009. In fact, it has even been alleged that fake letters opposing climate change legislation have been sent to members of Congress by a coal-industry lobbying group.

An impending deadline looming over all of the climate change discussion is the United Nations Climate Change Conference scheduled for December 2009 in Copenhagen, Denmark. Known as "COP 15," the conference will consist of members of the UNFCCC that seek international solutions to climate change and GHG emissions. One of the goals of the conference is to develop a climate change treaty to replace the Kyoto Protocol. The Kyoto Protocol, which is set to expire in 2012, establishes binding targets for the reduction of GHG emissions and was signed and ratified by 184 parties of the United Nations Climate Convention. One notable exception to the Kyoto Protocol was the United States, but according to President Obama the United States will be involved going forward. Because this conference may develop a new international climate change treaty, this conference will possibly impact Congress' approach to the climate change bill, and may encourage negotiation among the senators so that the United States will have a climate change plan before committing to an international agreement.

WITH ANTITRUST AMNESTY, FIRST COME DOESN'T SERVE BUT PREVENTION BEATS THE CURE

Judy Gechman
Baker & Hostetler LLP
Houston, Texas
jgechman@bakerlaw.com

Introduction

As recent events illustrate, antitrust issues affect the energy industry. With that thought in mind, this article will provide a primer regarding antitrust enforcement and policies which may assist companies in preventing, or at least mitigating, some of the antitrust risks.

Antitrust Enforcement

A single member of a price fixing cartel can bring that cartel down if the member approaches the Department of Justice's Antitrust Division (the "DOJ") to report its involvement. An informant's motivation is simple. The first cartel participant to come forward can qualify for full amnesty under the DOJ's leniency program, avoiding prison and criminal fines. There have even been instances in which, DOJ, the agency responsible for criminal enforcement of federal antitrust laws in the United States, had the cooperating executive of the reporting company wear a wire to cartel meetings and filmed cartel meetings with hidden cameras.

International cooperation among competition authorities in various countries has been increasing. Along with this has come an increase in coordinated multijurisdictional "dawn raids." These are unannounced raids, often conducted at dawn to take advantage of the element of surprise so as to prevent suspected participants from eluding arrest and destroying evidence.

The energy industry is not immune from the risk of cartels and antitrust enforcement, especially in the oilfield equipment and tool manufacturing and the oilfield services sectors. DOJ often discovers cartels through its leniency program. Below is a general description of how the program works and suggested best practices for companies to consider to minimize the risk of becoming caught up in cartels.

Full Amnesty: Who Gets it and How it Works

One of the most salient features of the DOJ's leniency program is that complete amnesty is automatic if there is no pre-existing investigation and the conditions described below are met, known as "Part A Leniency." Only the first one to report can qualify for full amnesty. The second one in may get some degree of leniency, depending on circumstances, but there is much less certainty for the second one.

The leniency program is very effective, because it is very risky for a company, once it discovers that it is involved in a conspiracy, to wait to step forward. The first one to report gets a "marker" to hold its place as first reporting participant while the company conducts an internal investigation to ascertain whether it was involved and the extent of its involvement, creating a race to the enforcement authorities.

DOJ divides leniency requirements into several categories. The criteria for qualifying for the most basic and desirable of these, Part A Leniency, are:

- a company reports illegal activity before an investigation has begun;
- at the time of the report, DOJ had not received information from any other source;
- the company took prompt and effective action to stop its illegal activity;
- the company cooperates fully, both initially and throughout the investigation;
- where possible, the company makes restitution; and
- the company did not coerce another party to participate and was not the leader in, or originator of, the illegal activity.

If a company is granted Part A Leniency, its officers, directors, and employees who cooperate also receive complete amnesty from criminal prosecution. The identities of the applicants to the leniency program are kept confidential unless they waive confidentiality or a

court authorizes disclosure of their identities. Depending on a number of factors, the second one to report may get some degree of leniency. But the second to report does not get complete amnesty.

Criminal Penalties

In 2005, the Antitrust Criminal Penalty Enhancement and Reform Act of 2004 (2004 Act) was implemented. The 2004 Act increased penalties: the maximum statutory criminal fine for companies rose from $10 million to $100 million and for individuals from $350,000 to $1,000,000 and the 2004 Act increased the maximum prison term from 3 years to 10 years.

Dealing with the Risk of Private Lawsuits

A company that is found to have violated the criminal antitrust laws has to worry about private follow-on civil suits, a disincentive to self-reporting. Under antitrust law, antitrust defendants who lose to private plaintiffs in a civil suit are required to pay treble damages. To create incentives for self-reporting, in addition to increasing the criminal penalties described above, the 2004 Act provides for de-trebling of damages in private actions and removes the possibility of joint and several liability with the other members of the cartel, serving as major enhancements to the leniency program. To take advantage of these provisions, the applicant and its executives are required to provide full cooperation to the private plaintiffs in their lawsuit against the other conspirators.

An Ounce of Prevention is Worth a Pound of Cure—Best Practices

Communication with competitors is sometimes necessary and can be legal if done for legitimate business reasons that do not violate the antitrust laws. A good business practice, like having ethics and insider trading policies, for companies to employ is to establish a compliance program. With an effective compliance program, communication with competitors about such topics as product safety, standard setting, and mergers can be monitored and the settings in which such communications may take place can be prescribed to prevent straying, even inadvertently, into conduct that violates the antitrust laws.

A best practice toward prevention is for a company to determine where there is potential for high risk conduct by employees by conducting an antitrust audit during which counsel talks to officers, marketing and purchasing employees, and others, as relevant for the type of business being audited. Typically, as part of the audit, the documentation being used for various aspects of the business is reviewed. If employees are engaging in high-risk conduct, and assuming that no illegal activity is taking place, the company may develop alternatives that accomplish, from a business standpoint, the objectives currently being accomplished in a high-risk manner.

For example, in 2006, in conducting an internal audit, a manufacturing company that sells both direct and to distributors, discovered the potential for a problem where employees involved in pricing products to distributors were also responsible for pricing products sold directly by the company. While there was no indication that any improper conversations had occurred, the company decided, as part of its compliance program, to separate the functions of the employees. Other typical findings include wording in standard documentation that may imply improper practices even when there are none as well as the lack of an e-mail policy or a sufficiently clear e-mail policy.

The Federal Sentencing Guidelines (Guidelines), which are followed by most courts, provide that a compliance program should contain certain elements. According to the Guidelines, an effective program needs to include the exercise of due diligence to prevent and detect criminal conduct. An antitrust audit, as described above, is one approach that provides a systematic way of preventing and detecting criminal conduct.

The Guidelines describe the kind of corporate culture that a company should have to ensure effective compliance and ethical behavior.

Under the Guidelines, due diligence and promotion of the proper organizational culture require, at a minimum:

1. Written standards of conduct, policies, and procedures that promote a company's compliance commitment;

2. Designation of a chief compliance officer with specific responsibility for managing the compliance program;
3. Regular, effective training programs for all affected employees;
4. Procedures to receive complaints while protecting the anonymity of complainants;
5. A system to respond to allegations of improper/illegal activities and the use of appropriate disciplinary measures;
6. Incentives to promote compliance; and
7. Use of audits and/or other evaluation techniques to monitor compliance and reduce identified problem areas.

An antitrust audit is an important tool for developing a tailored compliance policy and program. A compliance program can be helpful if it is actually used by management to make and keep employees aware of the antitrust prohibitions and to heighten awareness of the risks and costs of being sued. The expense of implementing these prevention measures is extremely modest, particularly in comparison with the cost, both financially and to reputation, of dealing with an antitrust violation.

Amnesty and Compliance: Lessons Learned

An internal audit is a powerful tool for making sure that if there is an antitrust problem, the company discovers it and turns itself in to DOJ before being turned in by someone else. Regardless of what an audit uncovers, companies should carefully design and implement compliance programs to prevent putting themselves in high risk situations.

Judy Gechman *is a counsel in the Houston office of Baker & Hostetler LLP. Her practice involves corporate governance, securities, mergers and acquisitions and antitrust matters.*

AMERICAN BAR ASSOCIATION
SECTION OF ENVIRONMENT, ENERGY, AND RESOURCES

Calendar of Section Events

ABA Midyear Meeting
Feb. 3–9, 2010
Orlando

28th Annual Water Law Conference
Feb. 17–19, 2010
San Diego

39th Annual Conference on Environmental Law
March 18–21, 2010
Salt Lake City

Eastern Water Resources Conference
May 20– 21, 2010
Orlando

ABA Annual Meeting
Aug. 5–10, 2010
San Francisco

18th Section Fall Meeting
Sept. 29–Oct. 2, 2010
New Orleans

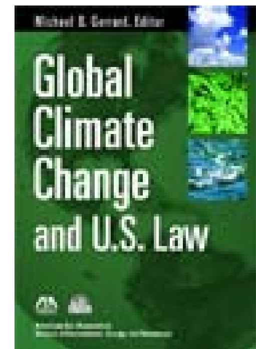
For *more information, see the Section Web site at www.abanet.org/environ/.*

Course materials from many prior Section programs are available through the ABA Web Store as well as audio files from select Section CLE programs and teleconferences. Details can be found at www.abanet.org/environ/ programs/pastcle.html.

FROM ABA PUBLISHING AND THE SECTION OF ENVIRONMENT, ENERGY, AND RESOURCES

Global Climate Change and U.S. Law

Michael B. Gerrard, Editor



Because global climate change presents extraordinary challenges to the environment and the economy of United States as well as those of other nations, the debate about how to effectively implement more climate-friendly policies is sure to continue and amplify. The scientific case for strong action is becoming more compelling every month, and opinion polls show that the American public increasingly agrees. The law will play an important part in developing mechanisms to protect the climate, such as conserving energy, using renewable sources of energy, and implementing emission caps and trading programs.

Global Climate Change and U.S. Law provides comprehensive coverage of the country's law as it relates to global climate change. After a summary of the factual and scientific background, Part I outlines the international and national legal framework of climate change regulation and associated litigation. Part II describes emerging regional, state and local actions, and includes a 50-state survey. Part III covers issues of concern to corporations, including disclosure, fiduciary duties, insurance, and subsidies. Part IV examines the legal aspects of efforts to reduce greenhouse gases, such as voluntary efforts, emissions trading, and carbon sequestration. *Global Climate Change and U.S. Law* includes key resource aids, including a glossary of climate related terms; a list of acronyms; extensive endnotes; and a comprehensive index.

2007 784 pages 7x10 paperback
Product Code: 5350156
Regular Price: $59.95
Section of Environment, Energy, and Resources Member Price: $49.95

TO ORDER ABA BOOKS, CALL 1-800-285-2221 OR VISIT THE ABA WEB STORE AT WWW.ABABOOKS.ORG
QUESTIONS? E-MAIL: SERVICE@ABANET.ORG