

The Impact Of House Climate Legislation On FERC

By Catherine P. McCarthy and Brett A. Snyder, Dewey & LeBoeuf LLP

Law360, New York (July 17, 2009) — Now that the House has passed the American Clean Energy and Security Act of 2009 (ACES) and parallel legislation is making its way through the Senate process, it is appropriate to consider what roles the Federal Energy Regulatory Commission may assume if a climate change law is enacted.

ACES designates FERC as the regulator in charge of the primary market for “regulated allowances,” including allowances for carbon emissions. This would greatly expand FERC’s role as a federal regulator, significantly increasing the types of companies that FERC regulates.

ACES also gives FERC enhanced remedial powers in the form of new cease-and-desist authority and expanded transmission planning and siting responsibilities.

FERC Oversight of the Primary Carbon Emission Allowance Markets

Through an amendment to the Federal Power Act (FPA), ACES vests FERC with the authority to establish, operate and oversee the primary markets for regulated allowances. FERC is also given a broad mandate to police the regulated allowance markets, remedy market problems and discipline market participants. Within 18 months after the law is enacted, FERC is to promulgate regulations that:

- Provide for comprehensive market oversight;
- Prohibit fraud, market manipulation, excess speculation;
- Provide measures to limit “unreasonable fluctuations in the prices of regulated allowances;”
- Ensure market transparency and efficient price discovery;
- Establish position limitations and margin requirements for regulated allowances;
- Establish standards for qualification as, and operation of, “trading facilities” for regulated allowances and “clearing organizations” for such trading facilities;
- Limit or eliminate counterparty risks, market power concentration risks and other risks associated with trading regulated allowances outside of trading facilities; and
- Facilitate compliance with Title VII of the Clean Air Act.

Catherine McCarthy is a partner with Dewey & LeBoeuf in the firm’s Washington, DC, office and co-head of the firm’s Energy Regulatory Department. Brett Snyder is a partner with the firm in the Washington office.

The opinions expressed are those of the authors and do not necessarily reflect the views of Portfolio Media, publisher of Law360.

ACES also gives FERC significant enforcement power with respect to regulated allowance markets. This is consistent with enforcement power granted to FERC in the Energy Policy Act of 2005 (EPAct 2005) that FERC has exercised, in part, to incent utilities to step up their efforts to comply with FERC requirements.

Under ACES, if an entity violates a rule relating to the regulated allowance markets, FERC is permitted, after a hearing, to issue an order:

- Prohibiting the entity from trading on a trading facility for regulated allowances;
- Requiring trading facilities to refuse the entity all privileges for a specified period;
- Assessing the entity a civil penalty of up to \$1 million per day per violation; and
- Requiring disgorgement of unjust profits, restitution to entities harmed by the violation, or both.

Further, if FERC finds that a registered trading facility or clearing organization, or a director, officer, employee or agent of such an entity, has violated any FERC rule relating to regulated allowance markets, FERC can suspend or revoke the registration of a registered entity.

Regulating the primary market for regulated allowances may be a challenge for FERC. FERC does not currently oversee the exchange-type markets that ACES seems to contemplate, and in general FERC does not regulate such things as position limits and margin requirements.

Also, participants in the regulated allowances market will come from industries other than natural gas, electricity and oil, i.e., from industries unfamiliar with FERC and industries with which FERC will not be as familiar.

But FERC is well situated to meet the challenge. FERC's regulators have related experience in regulating centralized energy markets through its regulation of regional entities called Independent System Operators (ISOs) and Regional Transmission Organizations (RTOs).

Such entities provide centralized markets in which market participants can buy and sell defined energy products and ancillary services.

Also, FERC's oversight of the electric and gas markets and the regulated allowance markets will allow FERC to identify possible effects of one on the other, including manipulation of one through the other.

Importantly, FERC is not given the authority to regulate regulated allowance derivatives, such as futures, options and swaps. ACES identifies the Commodities Futures Trading Commission (CFTC) as the agency with authority to regulate the regulated allowance derivatives markets.

However, ACES also gives the president the authority to establish an interagency working group on carbon market oversight that will recommend to the president and Congress proposed regulations for the establishment, operation and oversight of markets for regulated allowance derivatives.

The working group is to be comprised of the head of the U.S. Environmental Protection Agency and “representatives of other relevant agencies.”

FERC and the CFTC have had jurisdictional turf wars in the recent past, and the split of jurisdiction set forth in the House Climate Bill may raise similar issues.

In *Amaranth Advisors LLC*, 120 FERC ¶ 61,085 (2007), FERC argued that, although it did not directly regulate the natural gas futures market, when manipulation of the futures market had an effect on the physical natural gas market, FERC had authority to remedy such activity.

In support, FERC observed that futures prices are often used to benchmark physical natural gas transactions. The CFTC, which has jurisdiction over the regulation of natural gas futures, has intervened in related court proceedings and objected to FERC’s assertion of jurisdiction.

This issue has yet to be resolved by the courts or Congress, and FERC and the CFTC could have different views on the scope of each agency’s jurisdiction over the regulated allowance and regulated allowance derivatives markets.

FERC Given Sweeping New Cease-and-Desist Authority

In addition to the provisions relating to carbon markets, ACES amends the Natural Gas Act (NGA), Natural Gas Policy Act of 1978 (NGPA) and the FPA to give FERC broad new cease-and-desist powers.

Under the amendment to the NGA, FERC may, after a hearing, issue an order requiring an entity to cease and desist from committing or causing any violation of the NGA or any of FERC’s rules and orders issued under the NGA.

The cease-and-desist order may also require an entity to comply with a rule or order or to provide an accounting or disgorgement. An order may also require future or ongoing compliance. FERC may dispense with a hearing if “notice and hearing prior to entry would be impracticable or contrary to the public interest.”

Under the NGA amendments, FERC may also issue a “temporary order” to protect the dissipation or conversion of assets prior to completion of the hearing for a cease-and-desist order.

With a temporary order, FERC can also require an entity, in light of actual or threatened violations of the NGA, to take action to prevent significant harm to energy consumers, substantial harm to the public interest, or frustration of FERC’s ability to conduct the proceedings and redress violations.

The cease-and-desist authority under the amendments to the NGPA is virtually identical to that under the NGA.

Under a somewhat different structure in the amendment to the EPA, FERC may, after a hearing, issue a “temporary order” requiring an entity: (1) to cease and desist from committing or causing any violation of the EPA or any of FERC’s rules and orders issued under the FPA; (2) to take such action as necessary to prevent a violation; and (3) to prevent significant harm to covered entities under the Clean Air Act, market participants, or the public interest and frustration of FERC’s ability to redress the violation.

FERC may also dispense with a hearing if “notice and hearing prior to entry would be impracticable or contrary to the public interest.”

Under the ACES amendments to the EPA, FERC may also, after a hearing, issue a “temporary order” forbidding the significant dissipation or conversion of assets.

Again, FERC may also dispense with a hearing if “notice and hearing prior to entry would be impracticable or contrary to the public interest.”

This is a sweeping new authority that allows FERC to enjoin “any entity” from violations of the EPA, the NGA and the NGPA. From past experience, FERC is likely to take an expansive view of its new authority.

In the context of market manipulation provisions of the Energy Policy Act of 2005, FERC asserted that it had “broad jurisdiction over the entities that engage in certain conduct affecting our subject matter jurisdiction” and that the term “any entity” allowed it to reach entities not otherwise directly regulated by FERC.

FERC will likely seek to exercise its cease-and-desist powers not only against entities that it directly regulates in the natural gas, electricity and now additional companies engaged in regulated allowance markets, but also all entities whose activities could be seen as manipulating or negatively affecting those markets.

FERC Granted Additional Transmission Planning and Siting Authority

ACES also gives FERC enhanced electric transmission planning and siting authority. It establishes the following two broad policy objectives as the foundation for implementation of this new authority:

Regional electric grid planning should facilitate the deployment of renewable and other zero-carbon and low-carbon energy sources for generating electricity to reduce greenhouse gas emissions while ensuring reliability, reducing congestion, ensuring cyber-security, minimizing environmental harm and providing for cost-effective electricity services throughout the United States; and regional electric grid planning to meet these objectives should result from an open, inclusive and transparent process, taking into account all significant demand-side and supply-side options, including energy efficiency, distributed generation, renewable energy and zero-carbon electricity generation technologies, smart-grid technologies and practices, demand response, electricity storage, voltage regulation technologies, high-capacity conductors with at least 25 percent greater efficiency than traditional ACSR (aluminum stranded conductors steel reinforced) conductors, superconductor technologies, underground transmission technologies, and new conventional electric transmission capacity and corridors.

Not later than one year after enactment, FERC must adopt “national electric grid planning principles” derived from these policy objectives to be applied to ongoing and future interstate electric transmission planning.

Regional planning entities are to submit initial regional electric grid plans to FERC not later than 18 months after FERC promulgates the national electric grid planning principles for FERC review of consistency of the plan with those principles.

Regional plans may then be combined into larger regional plans, up to interconnection-wide and national plans, as determined by FERC.

FERC is to provide a report to Congress within three years of enactment containing the results of the planning process, including summaries of the “adopted regional plans.”

FERC’s ability to “force” resolution of conflict among planning entities during the planning process is not entirely clear.

Under ACES, FERC is given authority to “encourage” regional transmission planning entities to “cooperate and coordinate” across regions and to “harmonize” regional electric grid planning with planning in adjacent or overlapping jurisdictions “to the maximum extent feasible.”

FERC is also to work with stakeholders “to resolve any conflict or competition among proposed planning entities in order to build consensus” and promote the policy objectives. In the event regional plans conflict, FERC shall “assist” the regional planning entities in resolving such conflicts.

In addition to planning, FERC has been given new siting authority in the Western Interconnection. ACES would remove the Western Interconnection from the permit process related to national electric corridors under section 216 of FPA, which is headed by the Secretary of Energy, and would instead grant a new authority to FERC to issue a certificate of public convenience and necessity in the West.

ACES would give relevant Western Interconnection States the first opportunity to review and approve the siting of a facility, but would allow FERC to step in if necessary.

This article is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

No part of this publication may be reproduced, in whole or in part, in any form, without our prior written consent.

© 2009 Dewey & LeBoeuf LLP
All rights reserved.

For further information on Dewey & LeBoeuf, please visit www.dl.com

7987 REV01 07-27-2009

Specifically, FERC could issue the certificate for the construction or modification of a transmission facility if FERC found that, among other considerations:

- The facility was identified in one or more final regional or interconnection-wide electric grid plans submitted as discussed above;
- Any conflict among regional electric grid plans concerning the need for the facility was resolved;
- The facility was identified as needed in significant measure to meet demand for renewable energy in such plans;
- The facility is a multi-state facility; and
- An application for the project had previously been filed with a state agency with jurisdiction and that state agency did not issue a decision within one year, denied the application or authorized the siting of the facility subject to conditions that unreasonably interfere with the project's development.

ACES provides for close coordination among FERC, which would be the lead agency in a certificate proceeding, and other agencies that would issue a federal authorization in relation to the project, and it also requires all permit decisions and related environmental reviews (such environmental impact statements) to be completed within one year, unless another federal law conflicts with that timeline, in which case they are to be completed "as soon thereafter as is practicable." A certificate would carry eminent domain authority under section 216(e) of the FPA.