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Energy Cases To Watch In 2011

By **Derek Hawkins**

Law360, New York (January 1, 2011) -- Climate change will be at the forefront of litigation in 2011 as the U.S. Supreme Court gets ready to rule on whether states and citizens have standing to bring public nuisance lawsuits against large emitters of greenhouse gases. But utilities will also be looking to the courts for guidance on how to plan new energy infrastructure and tackle power reliability issues.

In addition to rulings on climate change and transmissions projects, attorneys will be keeping a sharp eye on developments in the area of natural gas drilling — a boon that has nonetheless given rise to legal disputes.

Energy companies will begin to feel the impact of 2010's sweeping financial reforms on the derivatives market, and new rulemaking may lead to new suits, attorneys said.

Here are some of the energy litigation that attorneys will be watching in 2011:

American Electric Power Co. Inc. et al. v. State of Connecticut et al.

The U.S. Supreme Court in its current term will rule on whether states and private parties can go to court seeking caps on carbon emissions from utilities, and whether courts can levy such caps outside policymaking procedures.

American Electric Power Co. Inc. and four other utility companies have asked the high court to reverse a decision by the U.S. Court of Appeals for the Second Circuit that classified climate change as a "public nuisance" actionable under common law.

Calling the case an "ordinary tort suit," the Second Circuit overturned a district court's ruling, agreeing with the plaintiffs — Connecticut, California, six other states, New York City and three organizations — that federal judges could, through decree alone, force utilities companies and facilities to cut back emissions.

Judges were not obligated to consider broader policy issues involved in emissions regulation because the suit only involved six coal-fired power plants, the appeals court ruled. The court also found that federal common law should steer its decision, and that the plaintiffs convincingly showed that American Electric and co-defendants had contributed to climate change.

American Electric went to the Supreme Court on Aug. 2, contending in its certiorari petition that a "nonstatutory, judicially created regime" for imposing emissions caps threatened the financial well-being and stability of "numerous sectors of the economy."

Such measures, the petitioners said, should be left in the hands of the U.S. Congress, the U.S. Environmental Protection Agency and state regulators. It could also open the floodgates to innumerable similar actions because "every entity and industry in the world" accounted for carbon emissions.

Foley & Lardner LLP's Tom Mullooly said the outcome of the case would determine whether common law could serve as another battle ground on which emissions opponents could pursue interests — a possibility that could create a flurry of new cases.

"Conceivably, you could have court orders where you have judges making decisions on what appropriate caps are, what emissions limits are," Mullooly said.

A ruling in Connecticut's favor could induce Congress to move more quickly on issues like cap and trade.

"If the court decides that could be appropriate for common law suits, it might put more pressure on Congress to take some kind of action and pre-empt the field," he said.

The Supreme Court granted American Electric's petition on Dec. 6.

American Electric is represented by Sidley Austin LLP.

The case is American Electric Power Co. Inc. et al. v. Connecticut et al., case number 10-174, in the U.S. Supreme Court.

New York Regional Interconnect Inc. v. Federal Energy Regulatory Commission

Several attorneys told Law360 they will be keeping an eye on a pair of cases before the U.S. Court of Appeals for the District of Columbia Circuit involving the manner in which independent energy authorities have handled orders from the Federal Energy Regulatory Commission.

The first is a suit brought by New York Regional Interconnect Inc., a private transmission company, challenging the New York transmission operator's interpretation of a series of FERC orders aimed at promoting energy transmission development.

The orders, which originated in the Energy Policy Act of 2005, were designed to provide incentive for new transmission projects by giving transmission owners, stakeholders and utilities an equal voice in the planning process, and by creating a new cost-allocation scheme to distribute project costs fairly among market participants.

In adopting the orders, New York Independent System Operator Inc., the nonprofit that manages the state's high-voltage transmission, created a two-pronged approach for evaluating proposed projects.

First, NYISO said it would conduct a cost-benefit analysis to determine if the savings created by the project would outweigh production costs within 10 years. It would then identify beneficiaries — chiefly major transmission-owning utilities like Consolidated Edison Inc. — and invite them to vote on whether the project should qualify for cost recovery.

The suit largely centers on the fact that NYISO set the bar for cost recovery at 80 percent approval from project beneficiaries — a figure that NYRI claimed was "tantamount to preventing construction by anyone" other than transmission-owning utilities.

NYRI protested the move before the FERC, arguing that the cost-benefit analysis was unreasonably narrow and that the rules discriminated against nonincumbent transmission developers.

When the case failed before the commission, NYRI took the matter to the D.C. Circuit on July 22.

Reiterating some of the same concerns, NYRI alleges that the voting provision is anti-competitive, effectively allowing transmission-owning utilities to veto any transmission project, even if the project is found to reduce energy congestion and lower energy delivery prices.

NYRI is seeking to eliminate the voting provision and compel the FERC to change the cost-benefit analysis to include more

criteria, among them a review of how a proposed project would affect energy prices.
“The question being raised is on how you price,” Regina Speed-Bost of Schiff Hardin LLP said. “There was a mandate that there’s need for additional transmission infrastructure, but ultimately it comes down to who pays for it.”

A lawyer for NYRI, Bill Booth of SNR Denton, said a positive ruling for the plaintiff could lead to cost-effective improvements in what he called New York’s languishing transmission system.

“If independent transmission companies are able to compete on a level playing field with incumbent utilities to invest in transmission and recover revenue requirements, you’ll see increased investment in New York transmission projects, and consumers will experience lower energy prices,” he said.

NYRI is represented by SNR Denton.

The case is New York Regional Interconnect Inc. v. Federal Energy Regulatory Commission, case number 09-1309, in the U.S. Court of Appeals for the District of Columbia Circuit.

North American Electric Reliability Corp. v. Federal Energy Regulatory Commission

A second case involving the FERC will also find a place on attorneys’ short lists for its potential to affect the agency’s jurisdiction over how regional entities implement federal energy policies.

In the next year, the D.C. Circuit is expected to rule on whether North American Electric Reliability Corp., a nonprofit appointed by the U.S. government to ensure the adequacy of the continent’s power system, can modify or override a directive from the FERC.

In particular, North American Electric Reliability is fighting an order by the commission instructing it to change its procedures for developing reliability standards that govern the bulk electric system in the U.S.

The order, handed down March 18, said NERC’s current procedures contained defects that allowed members of its balloting body to “effectively veto” commission directives by refusing to pass reliability standards.

In the order, FERC also took issue with the fact that the NERC teams that draft reliability standards were composed of industry volunteers “that may or may not agree with the commission’s directive.”

Maintaining that the Federal Powers Act entitled it to propose rule changes, the commission gave NERC 90 days to revise its standards development process to rein in the drafting teams and comply with FERC directives.

NERC balked at the order, winning an additional 90-day extension and petitioning the commission to reconsider the order. The corporation argued that the proposed revisions would allow FERC to dictate the “specific content” of a reliability standard, run afoul of the Federal Powers Act and severely handicap its main functions.

On Sept. 16, the commission denied NERC’s request for a rehearing, reconsideration and stay of the order, and on Nov. 10, NERC asked the D.C. Circuit to review the matter.

Attorneys characterized the case as a jurisdictional battle stemming from provisions in the Energy Policy Act, which expanded the federal government’s authority to oversee the reliability of the bulk electric system.

“At issue in this case is, how much authority does the FERC have to direct development of the law itself?” Susan Court, a Hogan Lovells attorney, told Law360. “FERC said it has the authority to give direction to NERC and the stakeholders. NERC and the industry people came back and said, ‘No, your authority is limited to approving or remanding, not giving direction.’”

Court, who served as the FERC’s director of enforcement from 2005 to 2009, said the case could have far-reaching effects for investor-owned electric utilities, as well as co-ops and municipal utilities, which would lose voice in the standard

development process if the commission prevailed.
“It’s all about controlling their own fate,” Court said. “This will be a seminal case in the body of FERC law.”

NERC is represented by Schiff Hardin LLP.

The case is North American Electric Reliability Corp. v. Federal Energy Regulatory Commission, case number 10-1383, in the U.S. Court of Appeals for the District of Columbia Circuit.

Penneco Oil Co. Inc. v. County of Fayette

The recent boom in natural gas drilling in the Marcellus Shale — the sedimentary rock formation that spans eight U.S. states on the east coast — has given rise to a host of new, contentious cases as energy companies converge on the region.

Suits involving royalties, lease disputes and environmental concerns have cropped up as shale states slowly develop the statutory framework to govern drilling in the region.

Attorneys will be watching Penneco Oil Co. Inc.’s appeal to the Pennsylvania Supreme Court in a suit claiming the zoning board in Fayette County, Pa., improperly restricted oil and gas drilling in some areas of the county.

Penneco argued that the zoning board’s ordinance was pre-empted by state law and unfairly burdened operators. The Commonwealth Court of Pennsylvania sided with the county on June 21, ruling that the zoning board was entitled to regulate certain aspects of drilling. Penneco appealed on Oct. 14.

The lower court’s finding that the zoning board hadn’t created a “comprehensive regulatory scheme” could inspire other municipalities to do the same, potentially hampering energy companies, said Nicole Bagnell of Reed Smith LLP.

“It’s important because it deals with whether a local government can regulate through zoning oil and gas operations,” she said. “In this case, the local municipality was regulating the exact same things the state regulators did.”

In a related issue, some attorneys said they expected to see legal challenges to the Pittsburgh city council’s November decision to ban gas drilling in its city limits.

The council unanimously approved the measure on Nov. 16, becoming the first city in the state to enact such an ordinance.

“This was a dramatic step for the council to have taken,” K&L Gates LLP's David Fine said. “The city will have a significant task in trying to justify the wholesale exclusion.”

Bagnell went further, saying the ban wouldn’t last.

“It won’t survive legal challenges,” she said. “It’s not constitutional to take away people's property rights.”

Penneco is represented by Eckert Seamans Cherin & Mellott LLC.

Fayette is represented by Meyer Darragh Buckler Bebenek & Eck PLLC and the county solicitor.

The case is Penneco Oil Co. Inc. et al. v. County of Fayette et al., case number 556 WAL 2010, in the Pennsylvania Supreme Court.

Energy Derivatives Litigation

The sweeping financial reform legislation Congress passed in the summer of 2010 will touch the energy industry in 2011, provoking review petitions and appeals that could brew into full-blown suits, attorneys said.

The Dodd-Frank Wall Street Reform and Consumer Protection Act tasked the U.S. Securities and Exchange Commission, the U.S. Commodity Futures Trading Commission and other federal agencies with implementing dozens of new rules, many of which must be drafted and public by mid-July.

New regulations on the $600 trillion derivatives market — chiefly new rules for swap transactions — will likely hit energy companies hardest, Court said.

“Natural gas companies, oil companies, fuel companies, etc. — they engage in swap transactions to hedge commercial risk. Some even hold themselves out as swap dealers,” Court said. “They’re directly affected. The main question is, will they fall under certain exemptions?”