KING & SPALDING

Energy Newsletter

July 2014

TRANSACTIONAL

Russia

Russia's Second Renewable Energy Auction Gives Both Glimmer of Hope and Cause for Concern

Brandon Rice, Alex Blomfield, Alexandra Rotar

Moscow hopes to spur on the development of renewable energy projects through a renewable energy capacity auction framework. **More »**

Upstream Developments - Africa

Tanzania Publishes First Draft of a Long-Awaited Local Content Policy

Nina Howell

Tanzania's relatively rapid transition from an under-developed country to a potentially large LNG exporting nation has naturally brought with it a requirement to update and enhance existing legislation and regulations. We look at proposed provisions of a local content policy and consider industry's likely reaction. **More »**

DISPUTE RESOLUTION

Oil & Gas Litigation

New York's Highest Court Holds that Zoning Laws of New York Towns Banning Fracking Are Enforceable — A Brief Analysis of the Oral Arguments and the Court's Opinion

H. Victor Thomas

One lesson is clear: If a state wishes to avoid litigation as to whether municipalities are precluded from passing zoning laws that prohibit all drilling and fracking operations, it should enact a law that expressly states that zoning laws are superseded or preempted. **More »**

Environmental Litigation

U.S. Supreme Court Restricts EPA Regulation of Greenhouse Gas Emissions

Cynthia A.M. Stroman, Patricia T. Barmeyer, Les Oakes

Greenhouse gas emissions rules are allowable for sources otherwise subject to federal Clean Air Act permitting. **More »**

Oil & Gas Litigation

Nuisance Verdicts in the Barnett Shale: Two claims arising out of the same natural gas operations yield two very different verdicts

Elizabeth R. Taber, R. Bruce Hurley, Brannon C. Robertson

Within two months, two Forth Worth, Texas juries issued two distinct verdicts on largely the same facts. **More »**

Visit King & Spalding's Energy Blog at energylawexchange.com

Upcoming Events

September

Conference on Arbitration of Energy Disputes: New Challenges

- Keynote address by Doak Bishop along with panel appearances by K&S Lawyers

Sponsored by *King & Spalding* and *Voldgiftsinstituttet - The Danish Institute of Arbitration*

When: September 1-2, 2014
Where: Copenhagen, Denmark
Further Details Here

In The News

King & Spalding Advises Government of Greece On €700 Million Oil & Gas License Agreements »
More »

REGULATORY

International Trade

President Obama Signs Water Resources Reform & Development Act of 2014

J. Michael Taylor, Patrick J. Togni

President Obama recently signed into law the Water Resources Reform and Development Act of 2014 (WRRDA), which contains a provision requiring the use of American iron and steel in certain utility projects. **More »**

FERC

FERC Initiates Proceeding Regarding Price Formation In Organized Markets

Neil L. Levy, David G. Tewksbury, Stephanie S. Lim

FERC recently initiated a proceeding to evaluate issues regarding price formation in the organized electric energy and ancillary services markets operated by regional transmission organizations and independent system operators. **More »**

King & Spalding Earns 34 Practice Rankings and 125 Individual Rankings in Chambers USA 2014 Guide **More »**

D.C. Circuit Court Requires FERC To Consolidate its NEPA Review of Nominally Separate Interstate Gas Pipeline Projects [PDF] **More »**

Editorial Contacts

Charles J. (Tim) Engel III
+1 202 661 7800
tengel@kslaw.com
View Profile »

Jeffrey H. Perry
+1 202 626 5521
jperry@kslaw.com
View Profile »

About King & Spalding's Energy Practice

King & Spalding's energy practice has more than 255 lawyers in the U.S., Europe, the Middle East and Asia, giving King & Spalding one of the broadest and deepest benches of energy lawyers in the world. The firm is one of the most active law firms in the global energy industry advising and representing clients on a broad spectrum of transactions and disputes, and has received top rankings from *Chambers Global, Chambers USA, The Legal 500, The International Who's Who of Oil & Gas Lawyers, Euromoney's World's Leading Energy & Natural Resource Lawyers* and *The Best Lawyers in America.* For additional information, visit www.kslaw.com/practices/Energy.

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice. If you are not currently on our Energy Practice Group mailing list under your own name, and you would like to join to receive our monthly *Energy Newsletter* publication and to receive notices of future programs and occasional notices of legal developments in the industry, or wish to be taken off the distribution list for this Newsletter, you can make that request by submitting your contact information to Jeff Perry at jperry@kslaw.com.

© 2014 King & Spalding

King & Spalding

Energy Newsletter

July 2014

TRANSACTIONAL

Russia

Russia's Second Renewable Energy Auction Gives Both Glimmer of Hope and Cause for Concern

Brandon Rice, Alex Blomfield, Alexandra Rotar

Having one of the richest conventional energy reserves in the world, Russia has traditionally downplayed the importance of renewable power generation. Therefore, it is not surprising that compared to other countries' policy targets around the globe, Russia's goal for electricity generation from renewable sources is starkly diminutive. In 2009 the government set its sights on achieving 4.5% of power generation from renewable sources by 2020,[1] but statements from officials over the past year indicate that, at most, Moscow is now only aiming for 2.5%. By comparison, fellow energy-rich Norway plans to boost wind power capacity alone by up to two gigawatts and Germany is aiming to produce 35% of its power from renewable sources by 2020. Even the European-laggard United Kingdom plans to hit the 15% mark by 2020. In this context, it is worth noting that Russia obtains a significant portion of its electricity from large-scale hydropower,[2] which Russian policy makers do not consider a renewable energy source for the purpose of calculating Russia's renewable energy targets.

Nevertheless Russia has introduced legislation supporting renewable power generation. In 2013 Russia introduced regulations allowing renewable generators to bid, through an auction process, for the opportunity to enter into long-term contracts for the sale and purchase of capacity.[3] The second such auction has just taken place and on 11 June 2014 Russia's Trading System Administrator announced its selection of companies to sign favorable capacity supply contracts on projects totaling 575 megawatts (MW) of installed capacity.[4] That, in theory, ought to give some hope that the country has finally got a workable incentive scheme in place. The first attempt to promote investment in renewables (based on a feed-in-tariff model)[5] never got off the ground, hounded by alleged legal and technical issues as well as concerns about the effect it would have on consumer prices. This time around, Moscow is looking to spur on the development of renewable energy projects through renewable energy capacity auctions.

In essence, capacity markets allow project developers and owners to trade the ability to generate power as a separate commodity to the power itself (the idea being that the committed capacity helps to 'keep the lights on' during times of peak demand and thereby mitigates 'security of supply' concerns that might otherwise hinder greater reliance on renewable energy). Supporters argue capacity auctions encourage investment in new generating capacity by providing a guaranteed financial return on investment and thereby enhancing projects' 'bankability'. Critics argue that capacity auctions incentivise inefficient investment because projects are developed primarily to cash-in on capacity payments and may not meaningfully generate power (albeit that developers naturally have an incentive to maximise investment return by doing both).

In Russia, capacity is traded on the basis of long-term capacity supply contracts concluded at competitive prices. The competitive auctions for renewable energy are slated to take place once a year and consist of two

stages. In the first stage, all projects that meet the basic requirements are selected to go on to the second stage. In the second stage, if the total capacity of all the proposed projects does not reach the maximum capacity on offer for that particular auction, then all projects get the go-ahead. If the total proposed capacity exceeds the set amount, then they are selected according to the lowest planned capital costs, until that set amount is reached. Planned capital expenditure is the only factor used in the selection of projects in the second round.

Those selected in the renewable energy capacity auction are awarded the right to sign capacity supply agreements guaranteeing a set monthly payment and promising a minimum return on investment.[6] To ensure profitability, capacity prices are determined by a multi-step process that takes into account the revenues required to recoup operating and capital costs, as well as the amount of electricity expected to be sold on the market. There are minimum electricity supply requirements that, if not met over each year of operation, trigger reductions in the capacity remuneration for generators in the following year. Generators need to deliver 14 percent of installed capacity for solar projects, 27 percent for wind projects and 38 percent for hydropower projects.

In order to make this new system work, the rules of the wholesale power market had to be amended to account for the intermittent nature of renewable energy sources. Thus, by way of Addendum 5, section 12(g) to Decree No. 449, renewable energy producers have been exempted from harsh penalties connected with failing to have the prescribed amount of capacity available when the grid system operator needs it. Instead, selected projects are required to interrupt or curtail their supply of power when demanded by the system operator. As an additional incentive, renewable energy generators can sign capacity supply agreements (and thus benefit from regulated prices) for 15 years, rather than the capacity supply agreements of ten years duration available to thermal power plants.

With 505 MW of capacity getting the go-ahead, solar projects account for the lion's share of the projects, totaling 575 MW, recently allocated the right to enter into capacity supply agreements. Of that, Solar Systems, a unit of China's Amur Sirius, came away as the biggest winner, with solar projects totaling 175 MW getting the nod. Not far behind was Avelar Solar Technology, with 155 MW worth of approved bids.

The remaining 70 MW of capacity is split between wind and small-scale hydro power projects, and this is where the capacity auction scheme might be running into trouble. While 1.6 gigawatts of wind-generated capacity and 415 MW of hydropower were up for grabs, there were only one 51 MW wind project and three hydropower projects proposed. All four projects were selected, but their combined capacity totals only 3.5% of the capacity on offer. It's impossible to know exactly why wind and hydropower developers chose not to bid, but it's likely that onerous local content requirements are to blame for the depressed interest. To comply with regulations governing the incentive scheme, wind, solar and hydropower projects coming online in 2015 must be able to source 55, 50 and 20% of production equipment from Russian manufacturers, respectively. The following year, those figures jump to 65, 70 and 45%. There have been rumblings in the press that it may not be economically feasible to reach those targets, and in the case of wind projects, it may not be possible at all. Solar projects appear to have an easier time meeting the local content demands, one reason being that Rusnano (a giant state-controlled company that has invested billions of dollars to promote hi-tech development) has teamed up with billionaire Viktor Vekselberg's Renova Group to build a new solar panel production plant in Russia's Chuvash Republic.

Perhaps even more troubling for the future of the incentive scheme is the fact that the local content requirements likely run afoul of WTO requirements.[7] While that is likely not a concern for the individual bidders, it could ultimately pose a threat to the whole system. Given the government's desire to diversify and grow its economy, the local content demand was the authorities' way of getting something in return for subsidizing renewable energy development. Without that sweetener, the government may not be so keen to stomach the costs of the program.

One final wrinkle in Russia's alternative energy story concerns Crimea, the Black Sea peninsula recently annexed by Moscow. The small republic already has around 330 MW of solar and wind capacity in place, but operations have been halted in the aftermath of the controversial secession and annexation. While the peninsula was a part of Ukraine, solar producers received a special tariff of around 0.34 euro per kilowatt hour in 2013.

Russia's Ministry of Energy has estimated that it would cost around US $400 million per year to offer the same deal to Crimea's renewable energy producers. Doing so would also require further amendments to Russia's Federal Electricity Law. Despite such potential obstacles, investors are reportedly eyeing the region as one of the most favorable places to set up renewable energy projects.

Whether the new regulations will help Russia meet its modest renewable target remains to be seen. The regulatory framework in place appears to be working (at least for solar), but stringent local content requirements are likely pushing costs up and dampening investor interest. Then there's the further worry that those sourcing requirements are contrary to WTO laws.

---

[1] Decree No. 1715-r from 13 November 2009.
[2] Those with more than 25 MW of installed capacity.
[3] The rules for the scheme were laid out in Governmental Decree No. 449 from 28 May 2013.
[4] The first was conducted in September 2013.
[5] That aborted scheme was laid out in 2007 amendments to the Federal Electricity Law (No. FZ-35 from 26 March 2003).
[6] Addendum 2 to Decree No. 449 sets the return on investment at 14% for projects selected in 2013–2014 and 12% for those in 2015 and beyond. Return on investment for a given year is adjusted in line with changes in the average yield on long-term state bonds. (8.5% is used as the base rate for state bond yields.)
[7] *See*, *Dispute DS426 Canada –Measures Relating to the Feed-in Tariff Program, Decision of the Appellate Body of 6 May 2013.*

Alex Blomfield
London
+44 20 7551 2142
ablomfield@kslaw.com
View Profile »

Alexandra Rotar
Moscow
+7 495 228 8518
arotar@kslaw.com
View Profile »

Brandon Rice
Former Intern

KING & SPALDING

Energy Newsletter

July 2014

TRANSACTIONAL
Corporate / London

Tanzania Publishes First Draft of a Long-Awaited Local Content Policy

Nina Howell

In January we reported that Tanzania is in the process of developing new legislation and regulations for its emerging gas sector. In February this was followed by our report specifically on Tanzania's Natural Gas Policy (NGP) in which we noted how the NGP seeks to bring wide-ranging benefits to Tanzania across the entire value chain.

Tanzania's relatively rapid transition from an under-developed country to a potentially large LNG exporting nation has naturally brought with it a requirement to update and enhance existing legislation and regulations. Investors in Tanzania's gas sector have identified the lack of clear oil and gas policies as a substantial challenge, and the Government of Tanzania is now responding to that challenge. A key objective of the government in developing new laws and regulations is to increase local content to ensure that Tanzanian businesses and individuals participate strategically at every level across the natural gas value chain.

In April the Ministry of Energy and Minerals took a first step towards introducing a new policy on local content with the (belated) publication of a first draft of the "Local Content Policy of Tanzania for Oil and Gas Industry – 2014" (LCP). The LCP, once finalised, is to serve as a precursor to a Local Content Bill that will, in time, become local content legislation.

In this article we look at the key provisions of the draft LCP, and consider industry's initial reaction.

Local Content Objectives in the Natural Gas Policy

The first Natural Gas Policy (NCP), published by the government in October 2013, carried a clear message that "Natural gas resource found in Tanzania belongs to the people of the United Republic of Tanzania, and must be managed in a way that benefits the entire Tanzanian society."

The NCP sets the scene for a new policy to be implemented to bring about (i) employment and training of Tanzanians; and (ii) investment to maximize the supply of Tanzanian goods and services. It recognizes that achieving the objective of maximizing local content requires the implementation of "sound policies, strategies, actions plans, continuous consultation amongst key stakeholders and strengthening capacity of various institutions such as Local Government Authorities (LGAs) and Community Based Organizations (CBOs) ." The NCP calls on international oil & gas companies (IOCs), in particular, to create opportunities for maximizing local content.

Key Provisions of the Draft Local Content Policy

In the draft LCP a "Local Business" is one that is incorporated in Tanzania and is wholly owned by Tanzanians or at least 51 percent of the shares are owned by Tanzanian nationals. An interest held by a Tanzanian entity can only be transferred to another Tanzanian entity. Ownership structures of businesses are to be carefully scrutinized to determine the authenticity of Tanzanian-owned shares, taking lessons from other countries that have faced the challenge of "shadow shareholders."

The draft LCP identifies five focus areas:

1. **Capacity building and technology transfer:** (i) IOCs and other players in the supply and value chain are encouraged and required to work with a Tanzanian partner; (ii) specific thresholds for local participation will be developed, with different thresholds for specific parts of the supply chain; (iii) strategies will be developed for fostering the transfer of technology and knowledge; (iv) operators are expected to prepare and implement plans for the transfer of technological know-how and skills; and (v) the government will set up a centre for Excellence for Oil & Gas to expedite skills and knowledge transfer.

2. **Participation of Tanzanians and Tanzanian owned entities:** (i) Operators are expected to prepare training programmes for all aspects of oil and gas industry activities and at all levels, to be revised annually; (ii) preference must be given to the employment of Tanzanians who have requisite qualifications, competence and experience; (iii) where a foreign national is being employed there must be a plan for a Tanzanian to succeed to that position; (iv) foreign experts will be subject to limited and non-renewable work permits; (v) the relevant Tanzanian authority will approve mandatory schemes for training Tanzanians; (vi) as far as practicable, goods and services produced by or provided in Tanzania by Tanzanian-owned businesses are to be used in preference to foreign goods and services provided in Tanzania by foreign businesses; (vii) Tanzanian-owned businesses shall receive a margin on price preference prescribed by future legislation; and (viii) where a foreign entity provides goods and services it shall operate from Tanzania and partner with a Tanzanian-owned and -registered company.

3. **Procurements and usage of locally produced goods and services:** The government will: (i) ensure there is a compulsory local content requirement in every invitation to bid for the provisions of goods and services; (ii) ensure that contractors and lead sub-contractors manage risks of local businesses to allow their participation; and (iii) ensure transparency, value for money and competitiveness in every procurement process undertaken by contractors and sub-contractors.

4. **Fabrication and manufacturing in-country: In order to increase and maximize manufacturing in Tanzania the government shall:** (i) ensure the availability of equity financing to local businesses engaged in fabrication and manufacturing; (ii) ensure that Tanzanians with required skills are available to participate in fabrication and manufacturing; (iii) encourage multinationals to bring their global oilfield services and equipment to Tanzania; and (iv) ensure the development of a consolidated domestic fabrication industry.

5. **Socio-economic responsibilities:** In order to promote equal opportunities, increase awareness of HIV and AIDS, ensure safe working conditions, and maximize benefits to local communities, the government will: (i) ensure that all projects in the oil and gas value chain, including training opportunities, are based on gender equality and equity; (ii) work with IOCs to facilitate the provision of preventive and curative education on HIV and AIDS and other infectious diseases to stakeholders in the oil and gas industry; (iii) ensure that operators in the oil and gas industry adhere to statutory and international best practices on environment management and protection; (iv) ensure that the industry establishes and adopts sound environmental management systems; (v) ensure that all investors and contractors are obliged to undertake locally prioritised community development programmes; and (vi) ensure that oil and gas companies submit credible Corporate Social Responsibilities action plans to an appropriate authority for approval.

Implementation

Implementing the local content requirements and objectives contained in the draft LCP will require the enactment of new legislation and the amendment of existing legislation. The government aims to enact at least three new pieces of legislation; (i) the Local Content Bill; (ii) a Natural Gas Bill; and (iii) a Natural Gas Revenue Management Bill. Amendments will be made to the relevant provisions of the Income Tax Act and the Energy & Water Utilities Regulatory Authority Act.

The draft LCP envisages a Petroleum Regulatory Authority and an independent National Local Content Committee. which will oversee the full implementation of the local content policy.

Initial Reactions to the Draft LCP

The Ministry of Energy and Minerals asked for interested parties (IOCs and nationals of Tanzania) to provide comments on the draft LCP by 20 May. Initial feedback on the draft LCP appears to indicate that oil and gas companies consider the local content requirements to be too stringent, and that waivers will be required (or at least the requirements will need to be diluted). It has also been noted that the draft LCP gives absolute priority to "Tanzanian citizens." Currently the East African Community (EAC) members of Burundi, Kenya, Rwanda, Tanzania, and Uganda are advancing towards free movement of goods, services and labour, and it is quite likely that the other EAC members may object to the priority given to "Tanzanian citizens." The industry's reaction to the draft LCP may not be fully known until the next draft of the LCP is published, although there is expected to be further dialogue between the government and interested parties in the meantime.

Nina Howell
London
+44 20 7551 7543
nhowell@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

King & Spalding

Energy Newsletter

July 2014

DISPUTE RESOLUTION
Oil & Gas Litigation

New York's Highest Court Holds that Zoning Laws of New York Towns Banning Fracking Are Enforceable — A Brief Analysis of the Oral Arguments and the Court's Opinion

H. Victor Thomas

A non-profit, Food & Water Watch, reports that 421 measures against fracking have been passed by state and local governments and that communities across the nation are lobbying their local and state elected officials because they believe fracking poses an unacceptable risk to their drinking water. Energy companies, however, maintain that the process is safe when done properly, brings economic development to communities, and is necessary to achieve national energy independence.

A key battleground for this controversy is the region overlying the Marcellus Shale, a rock formation rich with natural gas that extends from Ohio and West Virginia into Pennsylvania and New York. Seventy New York municipalities have zoning laws that prohibit oil and gas drilling operations, including fracking, and more than a hundred have enacted moratoriums on drilling activities.

New York's highest court agreed to hear appeals from an energy company and a gas lessee challenging two lower court decisions that upheld zoning laws that ban drilling and fracking in the towns of Middlefield and Dryden. *Norse Energy Corp. USA, v. Town of Dryden*. Numerous amicus briefs were filed, including a brief by the American Petroleum Institute.

The appeal was decided on June 30, 2014. The webcast and transcript of the oral arguments, which may be found on the New York Court of Appeals' website, contain many questions and comments by the justices that may provide insight into the issues that concern them.

Appellants' principal argument was that all zoning ordinances banning fracking or drilling activities are preempted by, and are unenforceable under, a 1981 amendment to a New York statute that was enacted long before fracking became controversial. The statute, ECL §23-0303(2), states:

> The provisions of this article [of the Oil, Gas and Solution Mining Law ("OGSML")] shall supersede all local laws or ordinances relating to the regulation of the oil, gas and solution mining industries; but shall not supersede local government jurisdiction over local roads or the rights of local governments under the real property tax law.

Appellants argued that the plain language of this provision: (1) vests exclusive control over oil and gas activities in the state, including the responsibility for proper well spacing and location; and (2) supersedes all municipal zoning laws prohibiting drilling or fracking operations because such laws constitute a regulation of the oil and gas mining industries. Appellants further argued that the fact that the statute provides for only two

exceptions (local roads and real property tax) evidences a legislative intent that zoning ordinances are superseded along with all other regulations not stated in the two express exceptions.

One of the courts below, however, interpreted the statute differently, stating: "The zoning ordinance at issue, however, does not seek to regulate the details or procedure of the oil, gas and solution mining industries. Rather, it simply establishes permissible and prohibited uses of land within the town for the purpose of regulating land generally." The towns also argue that the OGSML preemption provision is indistinguishable from a preemption provision contained in another New York statute that has been interpreted by the New York courts to *not* preempt zoning laws. The towns further argue that: (1) the right of towns to regulate and zone land use is an important fundamental right; (2) that statutes that have been found to preempt or limit this right expressly reference zoning and land use laws; and (3) therefore, because the OGSML does not expressly reference zoning laws, it does not preempt them.

Both sides argued that important public policy interests were at stake and that the statute should be interpreted to support the policy interest favored by that side. For example, Appellants' brief asked: "What prudent operator would ever invest in oil and gas development in New York if, after the fact, municipalities could, based upon a 3-2 majority vote, enact broad based drilling bans that obliterate the operator's entire property interest?" The towns replied that this was a false concern because several other oil and gas producing states permit localities to prohibit drilling within their borders, including California, Illinois, and Texas, and oil and gas investment is flourishing in these states.

Another policy argument that drew interest from the justices was that to properly develop the state's energy resources, the state needs to be able to decide where drilling may take place and that doing so effectively would become unworkable if 932 towns in the state are allowed to override the state's drilling decisions.

The Court held that New York's current statutes fail to provide a "clear expression" of intent to preempt the municipal ordinances:

> These appeals are not about whether hydrofracking is beneficial or detrimental to the economy, environment or energy needs of New York, and we pass no judgment on its merits. These are major policy questions for the coordinate branches of government to resolve. The discrete issue before us, and the only one we resolve today, is whether the State Legislature eliminated the home rule capacity of municipalities to pass zoning laws that exclude oil, gas and hydrofracking activities in order to preserve the existing character of their communities. There is no dispute that the State Legislature has this right if it chooses to exercise it. But in light of ECL 23-0303 (2)'s plain language, its place within the OGSML's framework and the legislative background, we cannot say that the supersession clause—added long before the current debate over high-volume hydrofracking and horizontal drilling ignited—evinces a clear expression of preemptive intent.

Justice Pigott issued a dissenting opinion that disagrees with the majority's interpretation of the supersession clause.

One lesson from the case is clear. If a state wishes to avoid litigation as to whether municipalities are precluded from passing zoning laws that prohibit all drilling and fracking operations, it should enact a law that expressly states that zoning laws are superseded or preempted.

The litigation and legislative battles over fracking continue to rage with both sides scoring wins. Although New York courts have upheld zoning laws prohibiting fracking, on June 4, 2014, North Carolina's governor signed a law that lifts a 2012 moratorium and that clears the way for permits to be issued for gas drilling by fracking by next spring.

H. Victor Thomas

Houston
+1 713 276 7363
vthomas@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

KING & SPALDING

Energy Newsletter

July 2014

DISPUTE RESOLUTION
Environmental Litigation
U.S. Supreme Court Restricts EPA Regulation of Greenhouse Gas Emissions
Cynthia A.M. Stroman, Patricia T. Barmeyer, Les Oakes

On June 23, 2014, the U.S. Supreme Court issued its widely anticipated decision in *Utility Air Regulatory Group v. EPA* concerning the U.S. Environmental Protection Agency's regulation of greenhouse gas emissions (GHGs) from stationary sources. In a divided decision with a majority opinion written by Justice Antonin Scalia, the Court ruled that EPA may require stationary sources to control GHGs *if* those sources would be required to obtain PSD or Title V permits for conventional pollutants. However, the Court rejected EPA's rewriting of the Clean Air Act 100- or 250-ton permitting thresholds to expand its regulatory net to capture sources that would become newly subject to PSD or Title V permitting based only on their potential to emit GHGs in amounts less than 100,000 tons per year.

Background

In the Court's landmark 2007 decision in *Massachusetts v. EPA*—widely known as the "single largest expansion in the scope of the Clean Air Act in its history"—the Court held that Title II of the Act authorized EPA to regulate GHGs from new motor vehicles if the Agency formed a "judgment" that those emissions contributed to climate change. EPA leveraged this opportunity and interpreted the Act and its rules to mean that once GHGs were regulated under any part of the Clean Air Act, Title V and PSD permitting requirements would automatically apply to any stationary source with the potential to emit GHGs in excess of the respective 100- or 250-ton statutory air pollutant thresholds. Recognizing the regulatory burden this interpretation would impose on smaller sources never before subject to PSD or Title V requirements—such as malls, apartments buildings, and schools—EPA attempted to "tailor" its program for those "new" sources by redefining the statutory threshold for GHGs to 100,000 tons per year, as opposed to the statutorily-required 100 or 250 tons.

The Decision

In yesterday's decision, the Court saw EPA's attempt to "tailor" a clear 100- or 250-ton statutory threshold to 100,000 tons as an overstep in the Agency's authority and an impermissible attempt to "tailor legislation to bureaucratic policy goals by rewriting unambiguous statutory terms." EPA had argued that the Act required it to interpret the phrase "air pollutant" broadly in the PSD and Title V provisions to include greenhouse gases, ignoring the fact that the Agency routinely used a much more "narrow, context-appropriate" definition of air pollutant when applying the concept to specific operative portions of the Act. Justice Scalia quoted an amicus brief from administrative law professors in the Court's majority opinion, agreeing that "while *Massachusetts v. EPA* 'rejected EPA's categorical contention that greenhouse gases *could not* be 'air pollutants' for purposes of the Act,' it did not 'embrace EPA's current, equally categorical position that greenhouse gases *must* be air pollutants for all purposes,' regardless of statutory context." For the PSD permitting trigger, the Court further

pointed out that EPA's own regulations historically interpreted "air pollutant" as limited to *regulated* air pollutants, and that the Agency also informally took the same position with regard to Title V.

For those stationary sources already subject to PSD and Title V for other pollutants (the so-called "anyway" sources, such as power plants, refineries and heavy manufacturing facilities), the Court supported EPA's interpretation that those sources, because of their conventional pollutant emissions, may also be required to limit emissions by employing BACT for GHGs. This determination has wide-reaching implications given that these "anyway" sources account for roughly 83% of U.S. stationary-source greenhouse gas emissions. While the Court did not agree with petitioners' argument that BACT is "fundamentally unsuited to greenhouse-gas regulation" because it shifts emissions controls from "end-of-stack" to a focus on energy efficiency, it did caution EPA that its decision should not be taken as a "free rein for any future regulatory application of BACT in this distinct context."

Stationary sources that are not already subject to PSD or Title V, such as large offices, residential buildings, and hotels, may not be out of the woods yet, though. In a footnote in the majority opinion, the Court suggested that EPA might have an opportunity to bring its interpretation of the PSD trigger in line with its longstanding interpretation of the permitting requirements for areas where NAAQS were not attained ("nonattainment" areas) if it were to limit the definition of "air pollutants" to those with localized effects on air quality, or just those for which the area in question is designated "attainment" or "unclassifiable." Using this reasoning, the Agency could issue revised rules concerning stationary sources not otherwise subject to PSD. Given that such rules would not significantly raise the level of regulated emissions above the 83% already encompassed by "anyway" sources, the question is whether and when EPA will consider it worth the effort.

Cynthia AM Stroman
Washington, D.C.
+1 202 626 2381
cstroman@kslaw.com
View Profile »

Patricia T. Barmeyer
Atlanta
+1 404 572 3563
pbarmeyer@kslaw.com
View Profile »

Les Oakes
Atlanta
+1 404 572 3314
loakes@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

DISPUTE RESOLUTION
Oil & Gas Litigation

Nuisance Verdicts in the Barnett Shale: Two claims arising out of the same natural gas operations yield two very different verdicts

Elizabeth R. Taber, R. Bruce Hurley, Brannon C. Robertson

On April 10, 2014, a Fort Worth jury rejected a landowner's nuisance claim against a well operator in *Teri Anglim v. Chesapeake Operating Inc.*, 2011-008256-1. Plaintiff Teri Anglim claimed that Chesapeake's operations at two wells—the Wedgewood 1H and the Valkyrie 1H—located approximately 595 feet from her home in the Barnett Shale released offensive substances that contaminated the air around her home, constituting a private nuisance.

Anglim further alleged that the "scope of operations at the Chesapeake drill site is extensive," that "large vehicles are constantly arriving and departing the facility," that loud and constant noises originated at the site, and that the site's mere presence was a nuisance. The jury rejected these arguments, unanimously finding that Chesapeake's conduct was not abnormal and out of place in its surroundings.

But just one month later, on May 23, 2014, another jury in Fort Worth awarded a couple $20,000 for their private nuisance claim against Chesapeake related to the same wells. Samuel and Jane Crowder, represented by the same lawyer as Ms. Anglim, claimed that Chesapeake's operations at the Wedgewood and Valkyrie wells, which were located approximately 329 feet from their home in the Barnett Shale, constituted a nuisance. The jury refused to find a permanent nuisance, but found that Chesapeake's past activities constituted a temporary nuisance.

Notably, in between these two Chesapeake verdicts, on April 24, 2014, a Dallas, Texas jury awarded a Texas family nearly $3 million for a nuisance claim involving property damage and personal injuries arising out of natural gas activities in *Lisa Parr v. Aruba Petroleum*. The $2,925,000 *Parr* verdict against Aruba Petroleum included $275,000 for loss of market value on the Parrs' home. This case did not involve the Wedgewood or Valkyrie wells, but wells located in a different field.

Two more cases where landowners have asserted nuisance claims against Chesapeake for its operations at the Wedgewood and Valkyrie wells are currently pending in Tarrant County, Texas. Both were filed by the same attorney for Ms. Anglim and the Crowders. In one, *Diana Mann v. Chesapeake Operating, Inc.*, 2011-008232-3, the landowner lives 420 feet from the wells. In the other, *Maurillo and Ceclia Gutierrez v. Chesapeake Operating, Inc.*, 2011-008274-3, the landowners live 330 feet from the wells. These cases are both set for trial on August 25, 2014.

It is unlikely that the amount of the Crowder's verdict will greatly incentivize plaintiffs to pursue claims (unlike the result in the *Parr* case), but it does demonstrate the viability of nuisance claims arising out of natural gas operations in residential areas. Comparing *Anglim*, *Crowder*, and *Parr* also demonstrates how

differently juries interpret nuisance cases. The two pending nuisance cases against Chesapeake may be instructive in assessing potential trends for nuisance claims based on natural gas operations, including whether the distance to the well site seems to influence juries and whether juries will continue to reject the idea of a permanent nuisance.

Elizabeth R. Taber
Houston
+1 713 276 7304
etaber@kslaw.com
View Profile »

R. Bruce Hurley
Houston
+1 713 276 7383
bhurley@kslaw.com
View Profile »

Brannon C. Robertson
Houston
+1 713 751 3248
brobertson@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

KING & SPALDING

Energy Newsletter

July 2014

REGULATORY
International Trade
President Obama Signs Water Resources Reform & Development Act of 2014
J. Michael Taylor, Patrick J. Togni

President Obama recently signed into law the Water Resources Reform and Development Act of 2014 ("WRRDA"). The President's action follows Congressional approval of the Conference Agreement reached in May by House and Senate negotiators that resolved the differences between each chamber's version of the water resources reauthorization legislation.

The final version of WRRDA signed by President Obama adopts the same American iron and steel ("AIS") requirement that was included in the Consolidated Appropriations Act of 2014, and which requires the use of specific AIS products in (1) all treatment works projects funded by a Clean Water State Revolving Fund assistance agreement and (2) all public water system projects funded by a Drinking Water State Revolving Fund assistance agreement in Fiscal Year 2014. The U.S. Environmental Protection Agency (EPA) administers that AIS requirement and has already issued interpretive guidance and waivers to permit the use of non-domestic iron and steel products in specific projects. *See* water.epa.gov/grants_funding/aisrequirement.cfm.

As a result of WRRDA's enactment, the AIS requirement also will apply to a new funding program known as the Water Infrastructure Finance and Innovation Act ("WIFIA") and to funds made available from a state water pollution control revolving fund under Title VI of the Federal Water Pollution Control Act (33 U.S.C. § 1381 *et seq*.). WRRDA authorizes $175 million in WIFIA funding during fiscal years 2015-2019 (which is a reduction from $250 million in funding contained in the Senate version of the bill).

Like the Consolidated Appropriations Act of 2014 before it, WRRDA mandates that no funding from either of the above sources may be used for "a project for the construction, alteration, maintenance, or repair of a public water system or treatment works unless all of the iron and steel products used in the project are produced in the United States."

"Iron and steel products" are defined by WRRDA to include the following types of "products made primarily of iron and steel":

- lined or unlined pipes or fittings,
- manhole covers,
- municipal castings,
- hydrants,
- tanks,
- flanges,

- pipe clamps and restraints,
- valves,
- structural steel,
- reinforced precast concrete, and
- construction materials.

As explained above, the EPA provided additional interpretive guidance regarding the AIS provisions of the Consolidated Appropriations Act. Thus, the EPA may allow for use of the same guidance in connection with WIFIA and State water pollution control revolving funding authorized by WRRDA.

In sum, WRRDA expands the reach of the AIS requirement to WIFIA and to state water pollution control revolving funds. The final version of WRRDA adopted the AIS language contained in the Consolidated Appropriations Act of 2014. Thus, the interpretive guidance already issued by the EPA should also be instructive, at least informally, for the programs covered by WRRDA's AIS requirement.

J. Michael Taylor
Washington, D.C.
+1 202 626 2385
jmtaylor@kslaw.com
View Profile »

Patrick J. Togni
Washington, D.C.
+1 202 626 2958
Charlotte
+1 704 503 2600
ptogni@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.

July 2014

REGULATORY
FERC

FERC Initiates Proceeding Regarding Price Formation In Organized Markets

Neil L. Levy, David G. Tewksbury, Stephanie S. Lim

On June 19, 2014, the Federal Energy Regulatory Commission ("FERC") initiated a proceeding to evaluate issues regarding price formation in the organized electric energy and ancillary services markets operated by regional transmission organizations ("RTOs") and independent system operators ("ISOs"). FERC did so in response to concerns raised in other proceedings about whether the energy and ancillary services are producing accurate price signals.

FERC stated, "Ideally, the locational energy market prices in the energy and ancillary services markets would reflect the true marginal cost of production, taking into account all physical system constraints, and these prices would fully compensate all resources for the variable cost of providing service." In such an ideal scenario, the RTOs/ISOs would not need to commit resources beyond those whose offers cleared the market, and customers would adjust consumption in response to price without the need for administrative curtailment. FERC recognized, however, that technical and operational limitations may preclude achieving this ideal "for the foreseeable future." For example, until market software can model all of the electric transmission system's constraints, RTOs/ISOs will continue to be required to manually dispatch resources to resolve some constraints, and to make uplift payments to cover the shortfall between a resource's offer and the market clearing price. Nevertheless, FERC suggested that "there may be opportunities for RTOs/ISOs to improve the energy and ancillary service price formation process."

Accordingly, FERC directed its Staff to convene a series of workshops and technical conferences to explore improvements to the RTO/ISO market designs and operational practices relating to the following topics: the use of uplift payments; offer price mitigation and offer price caps; scarcity and shortage pricing; and operator actions that affect prices. The first workshop is anticipated to take place in September 2014, and is expected to address the issue of uplift.

Neil L. Levy
Washington, D.C.
+1 202 626 5452
nlevy@kslaw.com
View Profile »

David G. Tewksbury
Washington, D.C.
+1 202 626 5454
dtewksbury@kslaw.com
View Profile »

Stephanie S. Lim
Washington, D.C.
+1 202 626 8991
slim@kslaw.com
View Profile »

The content of this publication and any attachments are not intended to be and should not be relied upon as legal advice.