

# Energy Committees Newsletter

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## **CONSTITUTIONAL BARRIERS CONFRONTING STATE RENEWABLE ENERGY PROGRAMS**

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In the absence of federal energy legislation promoting renewables beyond certain tax credits, various state programs become the foundation of U.S. renewable energy policy. The so-called “renewable resource portfolio standard” (RPS) is adopted in 22 of the states and the District of Columbia, and the renewable energy system benefit charge/trust fund (subsidy) is in place in 15 of the states and the District of Columbia, with additional states set to jump in (see Table 1. For more detailed treatment of this topic, see Steven Ferrey, *Sustainable Energy, Environmental Policy, and States’ Rights: Discerning the Energy Future through the Eye of the Dormant Commerce Clause*, 12 N.Y.U. ENVTL L.J. 507 (2005)).

The system benefits charge is a tax or surcharge mechanism for collecting funds from electric consumers, which then is recycled to support a range of activities. The money raised from the system benefits charge is used to “buy down” the cost of power produced from sustainable technologies, so that they can compete with more conventional electric technologies. However, there are serious Constitutional traps confronting some state initiatives.

The Supreme Court consistently strikes down as unconstitutional similar programs involving interstate goods taxed by states so as to provide local benefit or subsidy.

The more than a dozen states that have established renewable energy subsidy programs funded by system benefit charges should raise over this decade approximately \$3.4 billion. See, Mark Bolinger, et al., *States Emerge As Clean Energy Investors: A Review Of State Support For Renewable Energy*, ELECTRICITY J. 83 (Nov. 2001). Between 1998-2012, approximately \$3.5 billion will be collected by the original 14 states with renewable energy funds. See, Mark Bolinger, et al., *Clean Energy Funds: An Overview of State Support for Renewable Energy*, LBNL-47705, Apr. 2001, at vii (Those 14 states are California, Connecticut, Delaware, Illinois, Massachusetts, Montana, New Jersey, New Mexico, New York, Ohio, Oregon, Pennsylvania, Rhode Island and Wisconsin.). The rate of revenue raised ranges from \$0.07/mwh in Wisconsin up to almost \$0.6/mwh in Massachusetts. See, Bolinger, *States Emerge*, *supra* at 83. The subsidy level in California, Illinois, Pennsylvania and Rhode Island ranges from 0.59-1.954¢/kwh for wind and hydroelectric projects, and from 0.11-0.574¢/kwh for landfill gas projects. The funds are disbursed as either investments, grants, other subsidies, or research and development grants by the funding agency. Most only provide assistance to new projects, and not existing renewable projects. The diverse pattern of eligible “renewable” resources included under state definitions is set forth in Table 2.

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James E. Hickey, Jr. was editor of this  
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It is understandable that states seek to direct their renewable energy subsidies only to projects within their borders. While the New England states have carefully avoided geographic limitations in their program enactment language, Illinois, Nevada, New Jersey and Texas have not. In these states, geographic limitations to funding only in-state resources are embodied in the trust fund expenditures and/or the situs of renewable resources eligible for funding. Unfortunately, such limitations are vulnerable to legal challenge.

**State Renewable Energy Subsidy Schemes  
and the Commerce Clause**

Congress could federally preempt energy policy under its powers over interstate commerce, if it so chose, and often does so. While the Commerce Clause grants affirmative powers to Congress to regulate in a variety of areas, the so-called “dormant” Commerce Clause is interpreted as a limitation on the power of states to regulate to “unjustifiably . . . discriminate against or burden the interstate flow of articles of commerce.” *Oregon Waste Sys., Inc. v. Dep’t of Env. Protection*, 114 S. Ct., 1345, 1349 (1994); *accord., H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 534-38 (1949). Although states are permitted to promote in-state businesses, they are not permitted to protect those businesses from out-of-state competition. It is only natural, however, that when taxing retail customers on power purchased in the state, that state officials will want to expend the revenue raised on in-state renewable energy projects and programs. For discussion of whether sale of electricity is, and should be, treated as sale of a good or a service, *see*, S. FERREY, *THE NEW RULES: A GUIDE TO ELECTRIC MARKET REGULATION* 211-231 (Penwell Pub. 2000); S. Ferrey, *Inverting Choice of Law in the Wired Universe: Thermodynamics, Mass and Energy*, 45 WM. & MARY L. REV. 1839 (2004).

However, if local regulations discriminate facially or by intent against interstate commerce based on geographic location of that commerce, whether by regulation or taxation, courts still apply “strict scrutiny” to determine constitutionality and there is a high probability that the regulation will be invalidated. Where a regulation clearly on its face discriminates against interstate commerce, it is *per se* invalid unless the state justifies

its regulation in terms of a compelling local purpose and the unavailability of nondiscriminatory alternatives adequate to preserve such compelling local interests. *C & A Carbone v. Town of Clarkstown*, 511 U.S. 383, 402 (1994) (citing *Wyoming v. Oklahoma*, 502 U.S. 437, 454 (1992)); *Maine v. Taylor*, 477 U.S. 131, 138 (1986).

Notably, subsidies, alone, are virtually *per se* constitutional unless the subsidy is partnered with a tax in such a manner that the scheme as a whole discriminates against interstate commerce. See, *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (1994) (A subsidy “ordinarily imposes no burden on interstate commerce, but merely assists local business.”); *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988) (“Direct subsidization of domestic industry does not ordinarily run afoul of [the Commerce Clause.”]; see also *Carbone, supra* (Town could subsidize a municipal landfill facility through general tax or bond financing.). The trust funds set up by several states as a means to subsidize or underwrite renewable energy projects, with a surcharge or tax on retail utility sales, are not an isolated subsidy. The renewable energy trust funds’ linkage to a rate surcharge on interstate power distribution and sale parallels a scheme found unconstitutional.

In *West Lynn Creamery, Inc. v. Healy*, the Supreme Court underscored that direct subsidization of in-state industry, when combined with a funding mechanism that is a tax or surcharge imposed on interstate commerce, including those out-of-state businesses not eligible for subsidy, creates a violation of the dormant Commerce Clause. In *West Lynn*, the Court conceded that either part of the program considered alone—the tax or the subsidy payments—would probably be constitutional. *West Lynn* at 199 (state argued unsuccessfully that each component of the program was valid, therefore the sum of the parts must also be valid). However, the Court assessed the “entire program,” unable to “divorce the premium payments from the use to which the payments [were] put.” *Id.* at 201.

In *West Lynn*, the Court faced a state regulatory action that, in total effect, subsidized and protected

Massachusetts’ in-state dairy industry from out-of-state competition. Each month proceeds from the fund, raised from taxing all (including interstate) wholesale transactions, were distributed to Massachusetts milk producers. Out-of-state milk dealers were ineligible to receive funds. This disbursement operated as a state subsidy of in-state dairy farmers, the initial link in the milk production process, by a tax imposed on all wholesalers nationwide participating in the state market, a subsequent link in the chain of commerce affecting this good.

In *West Lynn*, approximately one-third of the milk tax was imposed on milk produced in-state, and two-thirds imposed on interstate commerce on milk from out-of-state producers. *Id.* at 188 and 190 n.5. So, the two-thirds out-of-state subsidized the one-third of the producer’s located in-state. In some of the renewable trust funds, less than two-thirds of the taxed power may come from out-of-state, burdening fewer out-of-state producers. On average, about 50 percent of power ultimately sold proceeds through an interstate wholesale transaction prior to its retail sale, increasing from only about 8 percent as recently as 1984 and by the 1990s to 37 percent. See, S. FERREY, *LAW OF INDEPENDENT POWER*, Vol. I, at 8:3 through 8:4 and Table 8.5 (NY:West Publishers, 24th ed., 2006). But, whether the power taxed from out-of-state is one-third or two-thirds does not alter the basic legal distinction based on point of origin of the power: Though not all in-state generators benefit, all out-of-state generators are not included in the subsidy and thus are burdened as they must pay the tax. In *Bacchus Imports, Ltd. v. Dias*, 486 U.S. at 273, only a limited number of Hawaiian liquor producers were benefited by a tax credit. The fact that other Hawaiian liquor dealers would be bearing the same discriminatory burden as out-of-state competitors did not protect the tax credit from constitutional attack.

The *West Lynn* court held that “the imposition of a differential burden on any part of the stream of commerce from wholesaler to retailer to consumer is invalid, because a burden placed at any point will result in a disadvantage to the out-of-state producer.” *West Lynn* at 202 (citing *Brown v. Maryland*, 12 Wheat.

State	Renewable Energy Trust Fund	Portfolio Standards
Arizona		X
California	X	X
Colorado		X
Connecticut	X	X
Delaware	X	X
D.C.	X	X
Hawaii		X
Illinois	X	X
Iowa		X
Maine	X	X
Maryland		X
Massachusetts	X	X
Minnesota	X	X
Montana	X	X
Nevada		X
New Jersey	X	X
New Mexico		X
New York	X	X
Ohio	X	
Oregon	X	
Pennsylvania	X	X
Rhode Island	X	X
Texas		X
Vermont		X
Wisconsin	X	X

**Table 1. Portfolio Standards and Trust Funds in 20 First-Adopter States**

419, 444, 448). The state argued unsuccessfully that any incidental burden on interstate commerce resulting from the pricing order is outweighed by local benefits, including “protecting unique open space and related benefits.” *Id.* at 204 n.19. Similar environmental protection arguments can be made in support of renewable energy system benefit charges and subsidies. The Court stated that “even if environmental preservation were the central purpose of the pricing order that would not be sufficient to uphold a discriminatory regulation.” *Id.* at 204-205 (citing *City of Philadelphia v. New Jersey*, 437 U.S. 617, 626-627 (1978) (“Whatever New Jersey’s ultimate purpose, it may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently”)).

Despite the fact that there is a legitimate local purpose for a renewable trust fund scheme, if the scheme discriminates geographically it can smack of traditional economic protectionism, and moreover, could be accomplished in a less burdensome non-geographically-based manner. Where a state directs that money raised from a tax on interstate commerce be used to support only renewable energy technologies sited in-state, as some states do *de facto* and others do *de jure*, it can constitute prohibited conduct. The only state programs documented in the existing literature to provide trust fund assistance to entities outside of the state to date are Massachusetts and Rhode Island (which provided a grant to a wind project in Massachusetts that was in danger of losing its construction permits). *See*, Mark Bolinger, et al., *Clean Energy Funds*, *supra*, at 19. It is reported that

State	Solar	Wind	Fuel Cell	Methane/Landfill	Biomass	Trash-to-Energy
California	x	x		x	x	x
Connecticut	x	x	x	x	x	x
Illinois	x	x			x	x
Maine	x	x	x		x	x
Massachusetts	x	x	x	x	x	x
Nevada	x	x	x			
New Jersey	x	x	x	x	x	x
New Mexico	x	x	x	x	x	x
New York	x	x				x
Oregon	x	x		x		x
Pennsylvania	x	x		x	x	x
Rhode Island	x	x		x	x	x
Texas	x	x		x	x	x
Wisconsin	x	x	x		x	x

  

State	Hydro	Tidal	Geothermal	Photovoltaic	Dedicated Crops
California	x		x	x	
Connecticut	x			x	
Illinois	x			x	x
Maine	x	x	x	x	
Massachusetts	x	x		x	x
Nevada			x	x	
New Jersey	x	x	x	x	
New Mexico	x	x	x	x	
New York	x	x	x	x	
Oregon	x	x	x	x	x
Pennsylvania	x		x	x	x
Rhode Island	x			x	
Texas	x	x	x	x	
Wisconsin	x	x	x		x

Note: “Photovoltaic” is included within “solar” in some states; “methane” and or “trash-to-energy” may be included within a broad definition of “biomass.”

**Table 2. “Renewable” Resources as Defined in State Statutes**

Connecticut and Pennsylvania also have expressed a willingness to fund out-of-state projects and the funding landscape changes some as programs develop. *Id.* at 43.

The key is that a renewable trust fund that facially or in application discriminates against interstate power, will be evaluated under the *Philadelphia v. New Jersey* strict scrutiny standard, and will likely be found *per se* unconstitutional. Where subsidies effectively are

denied *de facto* in application to out-of-state projects, even where there is no express “in-state” requirement, there could still be a violation in fact. However, it is possible that such situation might be reviewed by a court under the less severe *Pike* balancing test, *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), rather than the *Philadelphia* strict scrutiny test. This provides greater chance of judicial deference to the program. Therefore, how state renewable energy

legislation, regulation and policies are structured, makes a fundamental difference in the judicial standard applied to evaluate renewable program constitutionality. The choice and application of the judicial test typically is outcome-determinative.

Properly drafted, trust funds, which play a key role in state renewable energy policy, have a greater chance of constitutional survival. To continue progress on renewable energy deployment, and avoid uncertainty, state incentives must be structured to comply with constitutional requirements. While states can experiment, and indeed have taken the lead on renewable policy initiatives, the programs must be carefully sculpted within the legal parameters of the dormant Commerce Clause.

### **HYDRO POWER COMMITTEE**

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## **RGGI, FIRST U.S. MANDATORY CARBON CAP AND TRADE SYSTEM**

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*Any views expressed in this article by Joseph Siegel do not necessarily represent the views of the U.S. Environmental Protection Agency.*

*“Conversation about the weather is the last resort of the unimaginative.” Oscar Wilde*

If only those words were true today. The specter of climate change has made the subject of the weather and projections about the climate for the decades to come a subject of every day concern and discussion. The confluence of the solutions for climate change with the solutions for energy independence and energy security has fostered the launch in recent months of a host of initiatives around the country at the national, state and local level that would have the effect of reducing the growth of greenhouse gases. The biggest breakthrough is the recent landmark New England/Mid-Atlantic Regional Greenhouse Gas Initiative (RGGI) which creates the first mandatory greenhouse gas cap and trade program in the United States.

After more than two years of concentrated effort on developing the specifics of the RGGI design, an important threshold was achieved on Dec. 20, 2005, when a bi-partisan group of governors from seven states signed on to the RGGI Memorandum Of Understanding (the “MOU”) [www.rggi.org/agreement.htm](http://www.rggi.org/agreement.htm). The seven states currently committed to the RGGI regime are Connecticut, Delaware, Maine, New Hampshire, New Jersey, New York and Vermont (the “Signatory States”). Two states, Massachusetts and Rhode Island, which actively participated in the design of RGGI and negotiation of the MOU, have not yet agreed to implement the

program in their state. Pennsylvania, Maryland and the District of Columbia participated as observers. The program launch date is Jan. 1, 2009. It will reduce emissions of the principal greenhouse gas, carbon dioxide (CO<sub>2</sub>), in the region and provide a model for the country.

The two-year effort that led to the MOU focused on a great number of issues and involved extensive stakeholder participation. A myriad of policy issues were addressed and resolved in developing the final program design, including what sources should be governed by its provisions, what base line should be used and how much of a reduction should be required over what time frame, how the CO<sub>2</sub> allowances should be allocated among the states, how concerns about leakage should be addressed, whether and when offsets should be allowed, whether triggers should be established to give rise to offset rights and at what level price they should be set, what offsets should qualify, and how emissions, allowances and offsets should be tracked. Numerous studies were conducted to inform the decisions made on these issues and to analyze the costs and benefits of the program.

### **Who, What, When and How**

One of the decisions made to reduce the complexity of the program design, was limiting of the program's coverage to CO<sub>2</sub>, the most prevalent greenhouse gas representing 84 percent of total U.S. greenhouse gas emissions. Similarly, the program, as currently designed, will only regulate electricity generating units that have a rated capacity equal to or greater than 25 megawatts and burn more than 50 percent fossil fuel. Power plants account for approximately 40 percent of the CO<sub>2</sub> emissions in this country. Thus the program design accomplishes the dual goals of addressing major sources of CO<sub>2</sub> while at the same time starting out with a more limited program that is easier to administer. The MOU provides for multi-year compliance periods, initially a minimum of three years, to provide a mechanism for smoothing out weather related spikes in emissions by averaging them over a longer time. If the average regional spot price of CO<sub>2</sub> exceeds a certain dollar amount known as the safety valve trigger, the compliance period may be extended.

The regional base CO<sub>2</sub> emission budget was set at 121.3 million short tons, the approximate equivalent of the average emissions of the highest years between 2000 and 2004. Each state was given an allocation out of the regional cap based on 2000-2004 emissions, electricity consumption, population, potential emissions leakage and provision for new sources. The MOU contemplates keeping the states' base CO<sub>2</sub> emissions budget unchanged from 2009 through 2014. Commencing with 2015, each state's base annual emissions budget will decline by 2.5 percent a year so that by 2018 it will be 10 percent below the initial budget. The allocation of allowances to specific sources or into the open emissions market will be determined by each of the Signatory States as is "determined appropriate" by each, but all states will reserve 25 percent of their allowance allocation for consumer benefit or strategic energy purposes. Each power generator will be required to have enough allowances to cover its emissions at the end of each compliance period. If a source does not have enough allowances it can reduce its emissions, buy allowances or generate credits through offsets.

### **Market Mechanisms**

To reduce the possibility of increased electricity prices the RGGI design includes several market features that facilitate compliance at the lowest cost. Since greenhouse gases are a global problem that accumulate over time, geographic and temporal limits can be flexibly applied to some extent without jeopardizing the goals of the program. Thus, RGGI allows for early reduction credits for projects undertaken before 2009 that reduce emissions from power plants. Power plants can also bank surplus allowances, offsets and early reduction credits for use in subsequent compliance periods.

To provide additional flexibility, the RGGI program also provides for offset credits to sponsors of approved CO<sub>2</sub> emission offset projects. The offsets must be surplus, verifiable, real, permanent and enforceable. The MOU contemplates that over time additional offset categories will be added to the list but limited its recognition of offset credits to natural gas heating oil and propane energy efficiency, landfill gas

and combustion, methane capture from animal operations, forestation of non-forested lands, reduction in SF6 emissions from transmission and distribution equipment and reductions in fugitive emissions from natural gas transmission and distribution systems. If certain allowance price triggers are met, adjustments to the offset system are available to increase the ease of sponsoring offsets available for credit.

## **Leakage Concerns**

One of the principal concerns raised was the potential that the RGGI program may lead to “leakage” as power generators in neighboring states unrestricted by RGGI defeat RGGI’s purpose by providing electricity into RGGI states at a lower price thus “leaking” CO<sub>2</sub> emissions into the Signatory States. The MOU contemplates a study of the issue by an energy and environmental working group and monitoring to determine whether any leakage attributable to RGGI in fact occurs.

## **RGGI: Benefits, Costs and Impact on Growth**

Studies conducted for RGGI projected that the RGGI program would have minimal cost impacts with average retail price increases ranging from 0.3 percent to 0.6 percent or a range of \$3-16 per average household annually in 2015. An additional model was run utilizing a “high” gas price scenario which projected retail price impacts of 1.7 percent to 3.2 percent in 2015. However, it is anticipated and hoped that end-use energy efficiency due to RGGI and other policies will actually lead to savings in excess of any price impacts of the RGGI program. Studies of RGGI’s impact on the regional economy showed a negligible impact with a very small positive effect, in the range of 0.01 percent-0.02 percent due to the investment in new technologies.

## **Next Steps**

A draft model rule, designed to implement the MOU, was issued by the signatory states on March 23, 2006. [www.rggi.org/modelrule.htm](http://www.rggi.org/modelrule.htm). The draft provides details on applicability, source compliance requirements, allowance allocations, penalties and

offset standards, among other things. Participating states are expected to adopt the model rule provisions in order to ensure reciprocity between the states in the region-wide trading program. However, certain provisions are left to each state’s discretion. For example, states are free to develop their own allocation provisions provided at least 25 percent of the allocations go to a consumer benefit or strategic energy purposes account. A 60-day comment period on the draft model rule ends on May 22, 2006. Thereafter, the RGGI states anticipate a 45-day period to revise the draft so that the model rule can be released in July 2006.

The Signatory States have committed to establish RGGI under state law by Dec. 31, 2008. Some states will require legislative action while others will be able to commence implementation through regulation. A regional organization will be created in New York City to provide a forum for deliberative action by the signatory states, track emissions and allowances, work on development of additional offset standards and offer technical assistance on offset projects. This organization will not have any regulatory or enforcement authority.

The MOU specifically provides that non-Signatory States may become Signatory States and that the Signatory States will work together to encourage additional states to join. The MOU also provides that any Signatory State can withdraw from the MOU upon 30 days written notice.

A comprehensive review of the program and its implementation is scheduled for 2012. As it is contemplated and hoped that RGGI will provide a model and inspire a mandatory national CO<sub>2</sub> cap regime, the MOU proposes that the Signatory States will advocate for a federal program that rewards first movers and provides for transitioning into the federal program if it is comparable.

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## THE END OF REGULATION UNDER THE PUBLIC UTILITY HOLDING COMPANY ACT OF 1935 AND WHAT IT MEANS

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*The author wishes to express his appreciation to his colleagues, Monica W. Sargent and Michael R. Ray for their assistance in the preparation of this article.*

Since 1935, registered holding companies and their subsidiaries have been subject to pervasive regulation under the Public Utility Holding Company Act of 1935 (PUHCA 1935). On Feb. 8, 2006, PUHCA 1935 was repealed in accordance with the Energy Policy Act of 2005 (EPAc 2005). In addition to the repeal of PUHCA 1935, EPAc 2005 enacted the Public Utility Holding Company Act of 2005 (PUHCA 2005) and expanded the Federal Energy Regulatory Commission's (FERC's) merger authority under Section 203 of the Federal Power Act (FPA).

As directed by EPAc 2005, on Dec. 8, 2005 the FERC issued its final rules implementing the repeal of PUHCA 1935 and the enactment of PUHCA 2005 (the "Final Rules"). Order No. 667, FERC Docket RM05-32-000, Dec. 8, 2005. Additionally, on Dec. 23, 2005, the FERC adopted its rules implementing its expanded authority under Section 203 of the FPA. Order No. 669, FERC Docket RM05-34-000, Dec. 23, 2005.

### **PUHCA 1935 vs. FPA**

With the repeal of PUHCA 1935, public utility subsidiaries of formerly "registered holding companies" became subject to the provisions of the FPA from which they were previously exempt (Section 318 of the FPA was repealed by EPAc 2005, provided that, where a conflict of jurisdiction existed between the FPA and PUHCA 1935, PUHCA 1935 applied to the exclusion of the FPA). Such entities are permitted to continue to engage in activities authorized by the Securities and Exchange Commission (SEC) under

PUHCA 1935 until the *later* of the date such authorization expires or Dec. 31, 2007. If relying on PUHCA 1935 authorization, such entity must continue to comply with the terms of such authorization and make all required filings under the authorization with the FERC. Additionally, any PUHCA 1935 financing authorizations must have been filed with the FERC as of March 10, 2006.

There were a number of activities that were either prohibited or severely limited by PUHCA 1935. For example, registered holding companies and their subsidiaries were restricted from the acquisition of other utilities that could not be integrated into a single integrated public utility system, and from making any contribution to a political candidate or in support of any political party or engaging in any other non-utility business activities. Such restrictions are removed as a result of the repeal of PUHCA 1935.

Reports by holding companies under Section 14 of PUHCA 1935 have been eliminated. However, unless otherwise exempted or granted a waiver by the FERC, each service company in a holding company system must file with the FERC by May 1, 2006, and by May 1 each year thereafter, an annual report on FERC Form No. 60. FERC Form No. 60 is a streamlined version of SEC Form U-13-60, the form of annual report under PUHCA 1935. Service companies in formerly exempt holding company systems are not required to file a FERC Form No. 60 until May 1, 2008.

As of the date of repeal, public utilities that were previously required to obtain SEC approval under Sections 6 and 7 of PUHCA 1935 to issue securities become subject to Section 204 of the FPA. Registered holding companies and all of their subsidiaries were required to obtain SEC approval for security issuances but Section 204 approval is only required for public utilities. Like Section 6 of PUHCA 1935, Section 204 of the FPA exempts the issuance or renewal of, or assumption of liability on, short-term debt that aggregates less than 5 percent of the value of the other securities of the public utility then outstanding. Section 204 of the FPA also includes an exemption similar to Rule 52 under PUHCA 1935 that exempts

from such requirements a public utility that is organized and operating in a state under the laws of which its security issues are regulated by a state commission.

Under PUHCA 1935, the SEC had to approve the acquisition of a public utility company or the acquisition by a registered holding company or any subsidiary thereof of any securities or utility assets or any other interest in any business. To address a perceived gap left by the repeal of PUHCA 1935, EAct 2005 expanded the FERC's jurisdiction over mergers and acquisition. Pursuant to Section 203 of FPA, as amended by EAct 2005, the FERC's approval is required for the acquisition by a public utility of (1) facilities subject to the jurisdiction of the FERC in excess of \$10,000,000, (2) securities of a public utility in excess of \$10,000,000 and (3) a generation facility in excess of \$10,000,000. Approval of the FERC will also be required under Section 203 of the FPA for a holding company to (a) acquire any security in excess of \$10,000,000 of a transmitting utility, an electric utility or another holding company in a holding company system that includes a transmitting or electric utility and (b) merge or consolidate with a transmitting utility, electric utility or a holding company system that includes a transmitting or electric utility with a value in excess of \$10,000,000. However, under the FERC's rules implementing its expanded authority over utility mergers, a holding company has blanket authorization to acquire any security of any subsidiary in its holding company system, with certain limited exceptions.

## **PUCHA 2005**

### ***FERC Access to Books and Records, Accounting and Records-Retention Requirements***

PUHCA 2005 primarily grants to the FERC and state public service commissions access to the books and records of holding companies and other companies in the holding company systems. PUHCA 2005 requires that each holding company and each associate company shall be required to maintain and make available to the FERC, such books and records as the FERC determines are relevant to costs incurred by a public utility or natural gas company that is an associate

company of such holding company and necessary or appropriate for the protection of utility customers with respect to jurisdictional rates. Each affiliate of a holding company or of any subsidiary company of a holding company shall be required to maintain and make available to the FERC such books and other records with respect to any transaction with another affiliate as the FERC determines are relevant to costs incurred by a public utility or natural gas company that is an associate company of such holding company and necessary or appropriate for the protection of utility customers with respect to jurisdictional rates. The FERC is also given the authority to examine the books and records of any company in a holding company system, or any affiliate thereof, as the FERC determines are relevant to costs incurred by a public utility or natural gas company within such holding company system and necessary or appropriate for the protection of utility customers with respect to jurisdictional rates.

The FERC did not provide specific guidance detailing the relevant books and records that must be maintained and made available to the FERC under EAct 2005. The FERC does intend to provide further guidance at a technical conference to be convened within one year of the effective date of PUHCA 2005.

In addition to the access to books and records, all holding companies and all service companies must comply with the FERC's record retention requirements and each service company that is not a special-purpose company must maintain and make available books and records in accordance with the FERC's Uniform System of Accounts. The FERC has provided transition periods to meet these requirements.

### ***Applicability of FERC Access to Books and Records, Accounting and Record-Retention Requirements***

There is no distinction between formerly "registered holding companies" and formerly "exempt holding companies" under PUHCA 2005. PUHCA 2005 and the implementing rules apply to all holding companies. A "holding company" under PUHCA 2005 is defined

as a company that directly or indirectly owns, controls or holds, with power to vote, 10 percent or more of the outstanding voting securities of a public-utility company or a holding company of any public-utility company and any person, determined by the FERC, to have a controlling influence over the management or policies of any public-utility company. Excluded from the definition of a holding company are (1) banks, savings associations or trust companies, or their operating subsidiaries that own, control or hold, with the power to vote, public utility or public utility holding company securities so long as the securities are held under certain conditions and (2) brokers or dealers that own, control, or hold with the power to vote, public utility or public utility holding company securities so long as the securities are held under certain conditions. Section 1262.

PUHCA 2005 and the implementing rules do provide certain exemptions from the requirements of PUHCA 2005. Any person that is a holding company, solely with respect to one or more (1) qualifying facilities under the Public Utility Regulatory Policies Act of 1978 (QF); (2) exempt wholesale generators (EWG); or (3) foreign utility companies (FUCO) is exempt from the new FERC access to books and records requirements and any accounting, record-retention or reporting requirements contained in Subchapter U of the FERC's Regulations.

Several other classes of entities and transactions also may file to obtain an exemption from the requirements of PUHCA 2005. 18 C.F.R. 366.3.

Companies that meet the definition of holding company are required to notify the FERC of their status by filing FERC Form-65. New holding companies must notify the FERC of their status no later than 30 days after their formation. Form FERC-65 is an informal filing and will not be noticed in the Federal Register, but will be available on the FERC's Web site.

Persons seeking to claim an exemption from PUHCA 2005 or waiver of the FERC's regulations under PUHCA 2005 may file form FERC-65A (Exemption Notification) or form FERC-65B (Waiver Notification). Such persons shall be deemed to have a

temporary exemption upon a good faith filing. Notices of all such notifications of exemption or waiver will be published in the Federal Register. If the FERC has taken no action within 60 days after the date of the filing, the exemption or waiver shall be deemed granted. Persons may also seek an individual exemption or waiver other than those specifically identified in the rule by filing a petition for declaratory order. Such petition will be noticed in the Federal Register and no temporary waiver or exemption will attach.

### ***The FERC's Review of Costs for Non-power Goods and Services***

PUHCA 2005 grants to the FERC the authority to review and authorize the allocation of the costs for non-power goods or administrative or management services provided by an associate company organized specifically for the purpose of providing such goods or services to any public utility in the same holding company system. The FERC only gains such authority at the *election* of the system (the public utility holding company, together with its subsidiary companies) or a state commission having jurisdiction over the public utility. There is no provision relating to the removal of such authority after the election is made. Thus, it appears that the FERC will continue to review and authorize the allocation of such costs until the FERC orders otherwise.

The FERC has determined that traditional service companies that employ an "at cost" standard for pricing may continue to do so; provided, however, that transactions for non-power goods and services by non-traditional service companies (*i.e.*, non-regulated service companies or special purpose affiliates, such as fuel supply or construction companies) must employ the existing FERC "market" standard for pricing. 18 C.F.R. 366.5.

Any holding company system whose public utility operations are confined substantially to a single state is exempt from such review. Upon petition for declaratory order or upon its own motion, the FERC may exclude from the scope of its review and authorization any class of transactions that the FERC

finds is not relevant to the jurisdictional rates of a public utility.

The new regulatory regime for holding companies and public utilities has undergone an extreme transformation over the past several months and this is not the end of the process. The FERC has announced that it will initiate future rulemaking proceedings, as well as convene a technical conference, to address additional actions to be taken as well as to address other transitional issues. As new rules and additional interpretive guidance are released, the extent of the FERC's jurisdiction over the activities of holding companies and subsidiaries within holding company systems will continue to evolve.

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Oct. 4-8, 2006  
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**25th Annual Water Law Conference**

Feb. 22-23, 2007  
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Dramatic increases in oil and gas prices and production mean an opportunity for states with severance tax statutes to secure their energy independence and court one of the fastest-growing industries in the country—all without raising taxes and reducing other appropriations.

Severance taxes are typically levied on the extraction of non-renewable minerals and fossil fuels. Thirty states have some form of severance tax, which are usually based on the level of production (typically of oil and gas) and on the price of the extracted product.

For some states, current and expected extraordinary worldwide demand for energy means severance tax collections of never-before realized amounts. For example, Colorado's 2003 severance tax collections totaled over \$30,000,000, while its 2004 severance tax collections totaled over \$115,000,000. This is a one-year increase of more 300 percent.

Colorado and other states with greatly increased severance tax collections should consider appropriating a portion of these collections to support their energy independence, to develop industry that will survive "peak oil" and provide replacement forms of tax revenue when the oil and gas are gone, or too expensive to extract. All of this can be done by investing in renewable energy projects and related technologies.

Historically, renewable energy was perceived at best as "interesting." More often, though, renewable energy was regarded as a pipe dream. Either way, renewable energy did not make economic sense. But, oh, how things have changed.

Improved renewable energy technologies and increased fossil fuel costs are making renewable energy more and more cost effective. As a result, the renewable energy industry is one of the fastest growing industries in the United States:

- Installed wind-energy capacity in the United States increased by almost 35 percent from 2004 to 2005, with almost 2500 megawatts of new wind power installed.
- According to the National Biodiesel Board, U.S. biodiesel production increased 300 percent (from 25 million to 75 million gallons) from 2004 to 2005. The U.S. Department of Energy further estimates that U.S. biodiesel production could reach 1.2 billion gallons within the decade.
- Solar energy demand is growing at about 20 to 25 percent per year.
- (And all of this goes without mentioning the enormous potential of hydrogen and fuel cells.)

This industry growth is why in 2005 investment giant Goldman Sachs bought the former family-run wind developer Zilkha Renewable Energy for (reportedly) \$450 million.

The U.S. renewable energy industry is now a multi-billion dollar per year industry, and it's growing. This growth is reason enough for every state and community (regardless of their fossil fuel and severance tax position) to court renewable energy businesses and projects. Iowa and Cambria County, Pennsylvania, saw this in 2005, with each locating a wind turbine manufacturer within its borders—Clipper Wind (a new company) in Cedar Rapids, Iowa, and Gamesa Corp. (a Spanish company) in Cambria County, Pennsylvania. For Iowa and Cambria County this means 141 jobs and 236 jobs, respectively. The companies that provide renewable energy and the companies that support them like Clipper and Gamesa (and also renewable energy projects) produce direct jobs, income taxes, property taxes, sales taxes, energy independence and, quite simply, energy for hospitals, schools, infrastructure, development, office buildings, shopping malls and for our economies.

The sheer potential of the industry should be reason enough for every state to follow what Iowa and Cambria County and others have done. But, the states that should be most interested in attracting renewable energy projects and companies are those that now depend on fossil fuel development as part of their tax base. The revenue they derive from this energy production will dry up when the oil and gas are no longer there to produce or when it is simply too expensive to extract.

The states that address their future energy needs now will be best poised to preserve their tax base and deliver the energy that is absolutely essential to their economies. Tapping a portion of current severance tax collections is a painless way to do this. But, it must be done now. When the costs of fossil fuel production are prohibitive, severance taxes will be gone, and this investment opportunity will be gone, as well.

The growth and the new economic potential of the renewable energy industry should be a wake-up call. This growth is happening (in large part) because fossil fuel demand is increasing and supplies are limited.

U.S. energy consumption is enormous, amounting to 99.7 quadrillion Btu in 2004, and consumption is growing. U.S. consumption is expected to increase at a rate of 1.1 percent per year until 2025. Moreover, there is increased competition worldwide for the sources of this energy. For instance, new Asian economies (*e.g.*, China and India) are growing rapidly, and so is their energy consumption. Consumption in these regions is expected to grow at a rate of 3.2 percent per year until 2025. At the same time, fossil fuel resources are declining.

Some government projections estimate that based on 2003 consumption figures, we have only 45 years of oil and 66 years of natural gas left. Regardless of whether we accept this or any other view of the global fossil fuel situation (*e.g.*, that we're beyond peak oil) there is no denying that our energy costs are increasing and that they will continue to increase.

We need new energy sources. The solution does not rest with fossil fuels. What we use (and have used)

cannot be replenished. And world demand means we cannot for long depend on what is left. And the solution does not rest solely with conservation. Conserve as much as we want for as long as we can, and we still have not generated energy or found a single energy source.

Sound like a recipe for disaster? Possibly, if ignored. But it's also an amazing opportunity. For many states (Colorado included) this situation presents a one-time opportunity to reap the financial benefits of being an oil and gas producer, to invest that money in its replacement industry, and to build the projects that will provide the replacement power. This does not have to be a "Chicken Little" situation. For forwarding-thinking states this is possibly the best chance to invest what is essentially free money into this new energy industry.

Application of severance tax revenues to renewable energy projects and businesses is not an elixir. But it is a timely and easy option. Energy states can invest their severance tax collections in an array of programs—funding grants, tax credits (*e.g.*, Minnesota's production tax credit), energy trusts (*e.g.*, Massachusetts) or even investment funds (*e.g.*, New Mexico). Wisely invested in the right commercial venture, the payoff can be enormous. (Think about the return for Iowa and Cambria County.) And, if state programs can be coupled with smart city and local government programs (*e.g.*, property and sales tax abatements and other incentives), an even greater return is possible, not to mention the benefit of identifying and securing new energy sources.

## LAW FIRMS CAN CONTRIBUTE TO "RENEWABLE LITERACY" WORLD-WIDE— ACT LOCALLY AND ACT GLOBALLY

Professor Steve Ferrey, who authored one of this month's articles, is involved in establishing a special project in which section members and their firms could be involved to directly and measurably impact renewable energy and education in a global context. He and others have established a new charitable 501(c)(3) foundation called "Computers Across Borders" to accept still working used laptop computers from law firms when they are replaced or their leases expire, and then recycling these laptops to underserved schools and teachers in both the United States and in developing countries where renewable energy is the primary power source. Since laptops have very low power consumption and are easily transported, they are ideally suited for educational use in those parts of developing nations dependent on off-grid renewable power. Steve has worked in developing nations implementing renewable energy reforms for World Bank and U.N. projects for more than a decade, and the foundation will work with multilateral aid organizations to target candidate countries, villages and schools, with an initial overseas project identified in Senegal where there is a model village renewable energy demonstration up and running.

Computers Across Borders is now putting together an advisory board and proceeding to commence active programs. Interested attorneys can participate by working with their firms to donate used laptops at the end of their service lives (or provide the contact information of the I.T. rep from whom computers are leased; leased computers typically also are donated at the end of their lease term by the lessor), or helping with other efforts to target worthy recipients, including helping to navigate the export laws for such used equipment. You can contact Steve at [sferrey@suffolk.edu](mailto:sferrey@suffolk.edu) or at (617)573-8103.

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