2007

SUPPLEMENT

to

ENERGY POLICY: THE REEL WORLD

Marla E. Mansfield

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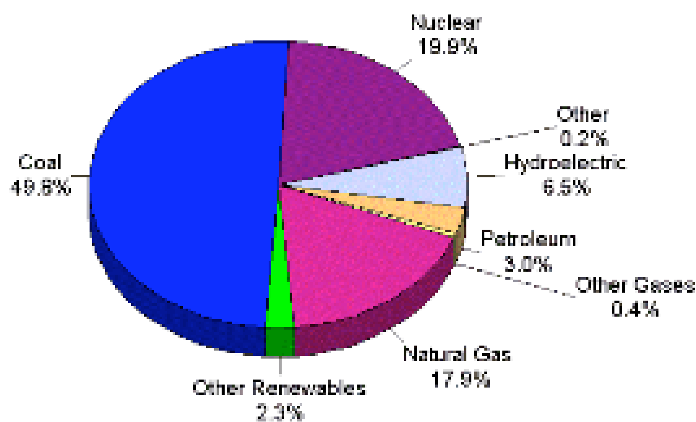
By 2005, consumption was up to 99.89 quads, broken up as follows:

Petroleum: 40.441 quads (28.87 quads imported; 10.84 from domestic production - 65% non-US production)
Natural gas: 22.64 quads
Coal: 22.83 quads
Hydro and other renewables: 6.16 quads
Nuclear power: 8.13 quads

The quads consumed in 2005 were distributed as follows:

Industrial: 31.98 quads
Transportation: 28.06 quads
Residential: 21.87 quads
Commercial: 17.97



A closer look at the 2005 usage reveals the following percentages of consumed energy: transportation -- 28%; residential and commercial buildings – 11.15%; and industrial – 21.05% Electricity generation consumed 39.91%. Increased reliance on electricity in the industrial and buildings sectors led to an almost doubling in the consumption of primary energy for electric generation in the period from 1975 to 2005 (from 20.3 quads to 39.84 quads). As for transportation, the sector as a whole accounted for 67.64% of the nation's petroleum use. The other important user of petroleum is industry, which uses 23.66% of the petroleum consumed in the United States. Additionally, about one-third of industry's consumption is for petrochemical feedstock, rather than energy.

In 2004, electricity was generated using the sources listed to the right. The graph is from http://www.eia.doe.gov/fuelelectric.html
The Energy Information Agency is a wealth of statistics and information on energy use. Some additional graphs and tables from 2005 are contained in the Appendix to this supplement. The website is http://www.eia.doe.gov/emeu/aer/overview.html

DELETE pages 14-15 and substitute:

D. A Glance at Policy Concerns

Many claim that the United States has no coherent energy policy and tends to react from crisis to crisis. It is true that the bulk of energy legislation is passed after supply disruptions, such as that of the Arab Oil Embargo of 1973 and 1974, and the doubling of oil prices in the wake of the Iranian revolution in 1979. Another round of energy legislation was passed in 1992, and it was not until the summer of 2005 that Congress passed another "comprehensive" energy bill. Nevertheless, several themes for the most prominent energy statutes are discernible.

Generally, the United States has been supportive of the traditional triumvirate of energy sources, namely, oil and gas, coal, and nuclear. Concern and promotion of alternative energy sources waxes and wanes with the price of oil. Prices in the summer of 2006 reach record absolute prices for a barrel of oil ($78), but the early 1980's had a higher relative cost for energy. Therefore, an interest in renewables and other alternative energy sources similar to the earlier decade can be expected.

Within this framework, three themes repeat and conflict in energy policy. The three goals - cheap and plentiful energy, environmental protection, and energy independence from foreign market pressures - can demand contradictory policies. For example, coal is plentiful in the United States so, to foster energy independence, its use should be encouraged. Coal combustion, however, has significant environmental consequences. One response to the dilemma would be to promote "clean coal" technology. Another would be to foster renewable fuels, such as ethanol, wind power, and solar energy. In another similar interchange, natural gas burns "cleaner" than coal or petroleum, but domestic production may have to be supplemented through "Liquid Natural Gas" (LNG), which would be imported.

Another debate in energy policy revolves on what mechanism to use to achieve these goals: regulation or market mechanisms. Traditional regulatory techniques include "command and control" rules on processes and price controls. Market-based interventions would create incentives to reach a goal and allow private responses to dictate the means. The United States has used a blend of both approaches, with the pendulum swinging back and forth between confidence in governmental expertise and private ingenuity.

Moreover, in addition to parochial concerns, the energy policy of the United States impacts upon world energy resources. In 1992, the United States accounted for approximately 25% of the world's energy usage. Its share of world energy usage has been decreasing, but not because energy usage has declined in the United States, but because it has increased elsewhere. According to the *International Energy Outlook 2006* of the Energy Information Administration, worldwide energy usage may increase 71% from 2003 to 2030. High demand in Asia and Central and South America will drive growth. Nations in these areas and elsewhere outside of the Organization for Economic Co-

operation and Development (non-OECD nations) will average a 3% per year increase per year in energy use. By contrast, energy use in the major industrial nations, or OECD nations, which include Japan and the U.S., should only increase by one-third as much as demand in the developing world. The expected energy demand is expected to reach 722 quadrillion BTU's by 2030. World electricity demand is predicted to more than double from 2003 to 2030. See, http://www.eia.doe.gov/oiaf/ieo/index.html

NOTE:

1. For additional reading, see The Energy Law Group, ENERGY LAW AND POLICY FOR THE 21ST CENTURY (Rocky Mountain Mineral Law Foundation 2000), especially Donald N. Zillman, *An Introduction to Energy*, in The Energy Law Group, ENERGY LAW AND POLICY FOR THE 21ST CENTURY (Rocky Mountain Mineral Law Foundation 2000) and Joseph P. Tomain, *Toward a Sustainable Energy-Environmental Policy*, in The Energy Law Group, ENERGY LAW AND POLICY FOR THE 21ST CENTURY (Rocky Mountain Mineral Law Foundation 2000).

DELETE pages 45-51 and substitute:

Three aspects of administrative law are discussed in the following Case, *Dominion Energy Brayton Point, LLC v. Johnson*. First, there is a permitting process, which is considered adjudication. The agency applies pre-existing standards to a particular set of facts. In this case, the permit is for a discharge of pollutants into water. The plaintiffs asserted that the agency must employ a "trial-type" hearing on the record for the adjudication. Second, the case discusses the fact that the agency employed rule-making to determine whether or not a hearing on the record was necessary for these types of adjudications. The agency rule-making interpreted the Clean Water Act as not requiring a hearing on the record. Third, the court considers how a court should review an agency interpretation of law. This portion of the case elucidates the so-called *Chevron* doctrine, from *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837 (1984). It also employs recent refinements to the relationship between court and agency competency to determine "what the law is." These last considerations are the central lesson of the case.

Jurisdictional requirements of the Clean Water Act, however, complicated the case. If a plaintiff is alleging that a regulation is invalid, the challenge must be made in the Circuit Court of Appeals within 120 days of the regulation's promulgation. 33 U.S.C. § 1369(b)(1)(E). However, a plaintiff may initiate a citizens' suit against the Environmental Protection Agency if the agency has failed to undertake a mandatory duty. The regulation involved in the case concluded that there was no mandatory duty to provide a hearing on the record. Therefore, the district court and thus the 1st Circuit had to examine the regulation to determine if it permissibly interpreted the law. If the regulation was a permissible interpretation of the law, the district court actually had no jurisdiction to consider the plaintiffs' case.

DOMINION ENERGY BRAYTON POINT, LLC v. JOHNSON,
In His Capacity as Administrator of the United States Environmental Protection Agency
443 F.3d 12 (1st Cir. 2006)

SELYA, Circuit Judge.

USGen New England, Inc., now Dominion Energy Brayton Point, LLC (Dominion), filed suit against the U.S. Environmental Protection Agency, its administrator, and its regional office (collectively, the EPA), alleging that the EPA failed to perform a non-discretionary duty when it refused to grant Dominion's request for a formal evidentiary hearing after issuing a proposed final National Pollution Discharge Elimination System (NPDES) permit. The district court dismissed the case for want of subject matter jurisdiction. On appeal, the central question presented concerns the effect of this court's decision in *Seacoast Anti-Pollution League v. Costle,* 572 F.2d 872 (1st Cir.1978), in light of the Supreme Court's subsequent decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.,* 467 U.S. 837 (1984). Concluding, as we do, that *Seacoast* does not control, we affirm the judgment below.

I. BACKGROUND

Dominion owns an electrical generating facility in Somerset, Massachusetts (the station). The station opened in the 1960s and, like most power plants of its era, utilizes an "open-cycle" cooling system. Specifically, the station withdraws water from the Lees and Taunton Rivers, circulates that water through the plant's generating equipment as a coolant, and then discharges the water (which, by then, has attained an elevated temperature) into Mount Hope Bay.

The withdrawals and discharges of water are regulated by the Clean Water Act (CWA), 33 U.S.C. §§ 1251-1387. For the last three decades, these actions have been authorized by a series of NPDES permits issued by the EPA pursuant to section 402(a) of the CWA. [Editor's Note: NPDES permits are needed to "discharge" a "pollutant" from a "point source." Heat can be a pollutant. *See*, Chapter 8 B, *infra*] The standards incorporated into those permits are determined under the thermal variance procedures laid out in section 316(a).

In 1998, the station applied for renewal of its NPDES permit and thermal variance authorization. The EPA issued a proposed final permit on October 6, 2003, in which it rejected the requested thermal variance. On November 4, Dominion sought review before the Environmental Appeals Board (the Board), ...and asked for an evidentiary hearing. The Board accepted the petition for review but declined to convene an evidentiary hearing.

On August 11, 2004, Dominion notified the EPA of its intent to file a citizen's suit under section 505(a)(2) of the CWA, 33 U.S.C. § 1365(a)(2), to compel the Board to hold an evidentiary hearing. Receiving no reply, Dominion proceeded to file its

complaint in the United States District Court for the District of Massachusetts. The EPA moved to dismiss.

The district court granted the motion on jurisdictional grounds. *See* Fed.R.Civ.P. 12(b)(1). In a bench decision, it concluded that it was without subject matter jurisdiction because the suit, though billed as a citizen's suit, constituted a direct challenge to the EPA's hearing rule and, thus, came within the exclusive jurisdiction of the circuit court under 33 U.S.C. § 1369(b)(1)(E). This timely appeal followed.

II. THE LEGAL LANDSCAPE

We set the stage for our substantive discussion by undertaking a brief review of the legal rules that frame the controversy at hand.

Before the EPA either issues an NPDES permit or authorizes a thermal variance, it must offer an "opportunity for public hearing." 33 U.S.C. §§ 1326(a), 1342(a). No definition of "public hearing" is contained within the four corners of the CWA.

The Administrative Procedure Act (APA) is also part of the relevant legal landscape. Most pertinent here are those sections that combine to describe the procedures for formal administrative adjudications. *See* 5 U.S.C. §§ 554, 556, 557. These procedures apply "in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing." *Id.* § 554(a). The APA does not directly address whether these procedures apply when a statute simply calls for an "opportunity for public hearing" without any specific indication that the hearing should be "on the record."

In *Seacoast,* this court interpreted "public hearing" (as used in sections 402(a) and 316(a) of the CWA) to mean "evidentiary hearing"--in other words, a hearing that comports with the APA's requirements for a formal adjudication. 572 F.2d at 878. Examining the legislative history of the APA, we adopted a presumption that "unless a statute otherwise specifies, an adjudicatory hearing subject to judicial review must be [an evidentiary hearing] on the record." *Id.* at 877. Applying that presumption to the CWA, we concluded that "the statute certainly does not indicate that the determination need *not* be on the record." *Id.* at 878 (emphasis in original).

So viewed, *Seacoast* established a rebuttable presumption that, in the context of an adjudication, an organic statute that calls for a "public hearing" should be read to require an evidentiary hearing in compliance with the formal adjudication provisions of the APA. Two other circuit courts reached the same conclusion, albeit through different reasoning. Acquiescing in this construction, the EPA promulgated regulations that memorialized the use of formal evidentiary hearings in the NPDES permit process. *See* NPDES; Revision of Regulations, 44 Fed.Reg. 32,854, 32,938 (June 7, 1979).

In 1984, a sea change occurred in administrative law and, specifically, in the interpretation of organic statutes such as the CWA. The Supreme Court held that "[w]hen

a court reviews an agency's construction of the statute which it administers," the reviewing court first must ask "whether Congress has directly spoken to the precise question at issue." *Chevron,* 467 U.S. at 842 If Congress's intent is clear, that intent governs--both the court and the agency must give it full effect. If, however, Congress has not directly addressed the question and the agency has stepped into the vacuum by promulgating an interpretive regulation, a reviewing court may "not simply impose its own construction on the statute," but, rather, ought to ask "whether the agency's answer is based on a permissible construction of the statute." *Id.* at 843.

This paradigm, sometimes called the *Chevron* two-step, increases the sphere of influence of agency action. If congressional intent is unclear and an agency's interpretation of a statute that it administers is reasonable, an inquiring court must defer to that interpretation. *See id.* at 843-44. That is so even if the agency's interpretation is not the one that the court considers to be the best available interpretation. *See id.* at 843.

Armed with the *Chevron* decision and a presidential directive to streamline regulatory programs, the EPA advanced a proposal to eliminate formal evidentiary hearings from the NPDES permitting process. *See* Amendments to Streamline the NPDES Program Regulations: Round Two, 61 Fed.Reg. 65,268, 65,276 (Dec. 11, 1996). In due course, the EPA adopted that proposal as a final rule. *See* Amendments to Streamline the NPDES Program Regulations: Round Two, 65 Fed.Reg. 30,886, 30,900 (May 15, 2000).

This revision depended heavily on a *Chevron* analysis. The agency began by "finding no evidence that Congress intended to require formal evidentiary hearings or that the text [of section 402(a)] precludes informal adjudication of permit review petitions." *Id.* at 30,896. Then, it weighed the risks and benefits of employing informal hearing procedures for NPDES permit review, "determining that these procedures would not violate the Due Process Clause." *Id.* Finally, it "concluded that informal hearing procedures satisfy the hearing requirement of section 402(a).

It was under this new regulatory scheme that the EPA considered Dominion's request to renew its NPDES permit and to authorize a thermal variance. Thus, it was under this scheme that the EPA denied Dominion's request for an evidentiary hearing.

III. ANALYSIS

The court of appeals reviews a dismissal for want of subject matter jurisdiction de novo. In doing so, the court accepts the well-pleaded factual allegations of the plaintiff's complaint and indulges all reasonable inferences in the plaintiff's favor. The appellate court is not wedded to the lower court's reasoning, but may affirm the order of dismissal on any ground fairly presented by the record.

Here, Dominion's claim on appeal rests on the premise that it has satisfied the jurisdictional requirements for a citizen's suit under section 505(a)(2) of the CWA. Subject to a notice requirement --suit may not be commenced "prior to sixty days after

the plaintiff has given notice of such [proposed] action," 33 U.S.C. § 1365(b)(2)--the statute invoked by Dominion grants federal district courts jurisdiction over any citizen's suit brought "against the Administrator [of the EPA] where there is alleged a failure of the Administrator to perform any act or duty under [the CWA] which is not discretionary," *id.* § 1365(a)(2). There is no question but that Dominion satisfied the applicable notice requirement. The crux of the case, therefore, is whether Dominion has pleaded the flouting of a non-discretionary duty.

One thing is crystal clear: on their face, the current EPA regulations do not establish a non-discretionary duty to provide the evidentiary hearing that Dominion seeks. Prior to the date of Dominion's request, the EPA vitiated the preexisting rule introducing evidentiary hearings into the NPDES permitting process. *See* 40 C.F.R. § 124.21(b) (explaining that the "EPA eliminated the previous requirement for NPDES permits to undergo an evidentiary hearing after permit issuance ... on June 14, 2000"). Dominion concedes this fact, but nonetheless relies on *Seacoast* as the source of a non-discretionary duty to convene an evidentiary hearing.

This reliance is misplaced. Even if *Seacoast* established a non-discretionary duty for section 505(a)(2) purposes when it was decided--a matter upon which we need not opine--Dominion's position ignores two important post-*Seacoast* changes in the legal landscape: the Supreme Court's decision in *Chevron* and the agency's subsequent promulgation of the current "no evidentiary hearing" rule.

We anticipated this situation in *Citizens Awareness Network, Inc. v. United States,* 391 F.3d 338 (1st Cir.2004), in which we noted that "while the type of hearing required by a statute turns on congressional intent, *Chevron* adds a new dimension, requiring that the agency's reasonable interpretation be accorded deference if there is any ambiguity as to that intent." *Id.* at 348 n. 4. We also recognized *Chevron's* possible ramifications for *Seacoast,* but did not have the occasion to confront the issue squarely. ... Now, with guidance from the Supreme Court's last term lighting our path, we address the matter and conclude that, as to the CWA's public hearing language, the *Chevron* doctrine trumps the potential application of stare decisis principles.

For present purposes, the critical precedent is *National Cable & Telecommunications Ass'n v. Brand X Internet Services,* --- U.S. ----, 125 S.Ct. 2688 (2005). There, the Court examined the relationship between the stare decisis effect of an appellate court's statutory interpretation and the *Chevron* deference due to an administrative agency's subsequent, but contrary, interpretation. Echoing *Chevron,* the Court reiterated that "[f]illing [statutory] gaps ... involves difficult policy choices that agencies are better equipped to make than courts." *Id.* at 2699. Then, concluding that *Chevron's* application should not turn on the order in which judicial and agency interpretations issue, the Justices held squarely that "[a] court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion." *Id.* at 2700. This approach "hold[s] judicial interpretations contained in precedents to the same demanding *Chevron*

... standard that applies if the court is reviewing the agency's construction on a blank slate." *Id.*

Brand X demands that we reexamine pre-*Chevron* precedents through a *Chevron* lens. The *Chevron* two-step applies. At the first step, a court "must look primarily to the plain meaning of the statute, drawing its essence from the particular statutory language at issue, as well as the language and design of the statute as a whole." *Strickland v. Comm'r, Me. Dep't of Human Servs.,* 48 F.3d 12, 16 (1st Cir.1995). At this step, the court may "examine the legislative history, albeit skeptically, in search of an unmistakable expression of congressional intent." *Id.* at 17. If the precedent at issue finds clarity at step one--that is, if the holding of the case rests on a perception of clear and unambiguous congressional intent--that precedent will govern. *See Brand X.* 125 S.Ct. at 2700. If, however, the precedent operates at *Chevron* step two--that is, if the case holds, in effect, that congressional intent is less than pellucid and proceeds to choose a "*best* reading" rather than "the *only permissible* reading," *id.* at 2701 (emphasis in original)--its stare decisis effect will, through *Chevron* deference, yield to a contrary but plausible agency interpretation, *see id.* at 2700.

Once this mode of analysis is understood and applied, Dominion's argument collapses. *Seacoast* simply does not hold that Congress clearly intended the term "public hearing" in sections 402(a) and 316(a) of the CWA to mean "evidentiary hearing." To the contrary, the *Seacoast* court based its interpretation of the CWA on a presumption derived from the legislative history of the APA--a presumption that would hold sway only in the absence of a showing of a contrary congressional intent. In other words, the court resorted to the presumption only because it could find no sign of a plainly discernible congressional intent. A statutory interpretation constructed on such a negative finding is antithetic to a conclusion that Congress's intent was clear and unambiguous.

The short of it is that the *Seacoast* court, faced with an opaque statute, settled upon what it sensibly thought was the best construction of the CWA's "public hearing" language. Such a holding is appropriate at step two of the *Chevron* pavane, not at step one. Consequently, under *Brand X, Seacoast* must yield to a reasonable agency interpretation of the CWA's "public hearing" requirement.

The only piece left to this puzzle is to confirm that the EPA's new regulations are, in fact, entitled to *Chevron* deference. This inquiry is a straightforward one. As our earlier discussion suggests (and as the *Seacoast* court correctly deduced), Congress has not spoken directly to the precise question at issue here. ... Accordingly, we must defer to the EPA's interpretation of the CWA as long as that interpretation is reasonable.

In this instance, the administrative interpretation took into account the relevant universe of factors. *See* 65 Fed.Reg. at 30,898-30,900 (considering "(1) [t]he private interests at stake, (2) the risk of erroneous decision-making, and (3) the nature of the government interest," and concluding that its new regulation was a reasonable interpretation of the CWA). ... The agency's conclusion that evidentiary hearings are

unnecessary and that Congress, in using the phrase "opportunity for public hearing," did not mean to mandate evidentiary hearings seems reasonable--and Dominion, to its credit, has conceded the point.

***

IV. CONCLUSION

We summarize succinctly. Although we in no way disparage the soundness of *Seacoast's* reasoning, the *Chevron* and *Brand X* opinions and the interposition of a new and reasonable agency interpretation of the disputed statutory language have changed the picture. Because we, like the *Seacoast* court, cannot discern a clear and unambiguous congressional intent behind the words "public hearing" in the CWA and because the EPA's interpretation of that term constitutes a reasonable construction of the statute, deference is due. It follows inexorably that no non-discretionary duty to grant Dominion an evidentiary hearing on its permit application exists. Consequently, the jurisdictional requirements of section 505(a)(2) have not been satisfied.

We need go no further For the reasons elucidated above, we conclude that the district court did not err in dismissing Dominion's action.
Affirmed.

DELETE N. 1, Page 51 and substitute:

NOTE:

Justice Scalia would extend *Chevron* deference to all "authoritative" agency determinations, in the sense that the relevant administrative decisionmaker concurred, whether or not the statutory interpretations were the subject of notice and comment rulemaking or formal adjudication. He, however, is now a minority of one. The remaining justices acknowledge two ways in which agency interpretations and judicial review relate to each other. First, the *Chevron* analysis applies to pronouncements that have "the authority of law, " such as formal adjudication and rulemaking. Therefore, such interpretations will be upheld if they are "reasonable" interpretations of an ambiguous statute. See, Christensen v. Harris County, 529 U.S. 576 (2000) and United States v. Mead Corporation 533 U.S. 218 (2001). These two cases posited that some agency interpretations, even of ambiguous statutes, were not due binding deference under *Chevron* when reasonable, but rather would command something referred to as "respect" in certain circumstances. The cases returned *Skidmore* deference to the judicial repertoire:

> We consider that the rulings, interpretations and opinions of the Administrator [of the Fair Labor Standards Act] under this Act, while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend on the thoroughness evident in its consideration, the validity of its reasoning, its

> consistency with earlier and later pronouncements, and all those factors which give the power to persuade, if lacking power to control

Skidmore v. Swift & Company, 323 U.S. 134, 140 (1944)

DELETE pages 58-62 and substitute:

NOTES:

1. Justice Holmes noted that not all diminutions of value would require compensation. His opinion expressly recognizes two situations in which government regulation could go very far: extinguishing a nuisance and creating an “average reciprocity of benefits” for citizens.

First, traditional nuisance law limits private property rights. No person may unreasonably use property to the detriment of neighbors This principle provides a perimeter for constitutional safeguards. A regulation forbidding a nuisance simply implements legislatively what a court could order by an equitable injunction. No compensation would therefore be due. In simple situations, the distinction between appropriating, such as obtaining sites for highways or post offices, and regulating activities that unreasonably impinge on neighboring land may give predictable and non-objectionable results. The line, however, between gaining a benefit for the public and ending detrimental activity may blur.

Second, no compensation may be needed when regulation increases values over-all. Land control can create value for the whole that would exceed the sum of individual parcel valuations that would result if each individual landowner would develop in any way desired. Validating these regulations echoes the rationale for enforcing equitable servitudes. This recognizes, as both Justices Holmes and Brandeis did, that there may, in civilized society, be a "reciprocity of advantage" in regulation. Whether the particular statute itself must encompass such reciprocity or whether it could be found in the wider realm of regulatory actions is debatable. In essence, if reciprocity exists, it provides compensation and therefore avoids violating the constitutional command.

2. Another distinction between requiring and not requiring compensation is the strength of the public purpose being forwarded. In the *Pennsylvania Coal* case, Justice Brandeis dissented vigorously. One striking difference between his opinion and that of the majority is in characterizing the problem the statute addressed. Holmes apparently viewed it as a dispute between the Mahon family and the coal company; Brandeis envisioned the city of Scranton sliding into a gaping hole. An example of an overriding social need negating compensation in *Miller v. Schoene*, 276 U.S. 272 (1928). Cedar trees harbored a pest deadly to neighboring apple orchards. The Court found the cedars could be destroyed without compensation : "it is obvious that there may be, and that here there is, a preponderant public concern in the preservation of the one interest over the other. *Id.*

at 279. Neither tree is noxious or detrimental to man *per se*; they are simply incompatible with each other. Faced with this dilemma, the legislature must choose:

> It would have been none the less a choice if, instead of enacting the present statute, the state, by doing nothing, had permitted serious injury to the apple orchards within its borders to go unchecked. When forced to such a choice the state does not exceed its constitutional powers by deciding upon the destruction of one class of property in order to save another which, in the judgment of the legislature, is of greater value to the public. It will not do to say that the case is merely one of a conflict of two private interests.... *Id.* at 279-80.

In the world of *Miller v. Schoene*, apples were crucial to the local economy. In some instances, therefore, universal declarations of value are possible.

3. In 1978, the Supreme Court decided that compensation was not needed when the New York City landmark protection laws rejected an attempt by the owners of Grand Central Terminal to build a large office building over the terminal. In this case, the Supreme Court adopted a test that more openly balanced several factors in the "too far" equation when income-producing property was at issue: 1) the character of the government action; 2) the economic impact of the regulation on the claimant; and 3) the interference, if any, with investment-backed expectations. *Penn Central Transportation Co. v. New York City*, 438 U.S. 104 (1978).

The *Penn Central* test is applied in a 1987 case. Coal companies challenged the Pennsylvania Subsidence Act, which requires that 50 percent of the coal beneath certain structures be kept in place to provide surface support. The complaint alleged, *inter alia*: 1) that Pennsylvania recognizes a separate "support estate" in addition to the surface and mineral estates in land; 2) that approximately 90% of the coal petitioners will mine was severed from surface estates between 1890 and 1920; 3) that petitioners typically acquired waivers of any damages claims that might result from coal removal; 5) that § 4, as implemented by the 50% rule, and § 6 violate the Fifth Amendment's Takings Clause; and 6) that § 6 violates Article I's Contracts Clause. The lawsuit gave the Supreme Court the opportunity to revisit *Pennsylvania Coal*. Carefully compare the *Keystone* case to *Pennsylvania Coal*.

DELETE pages 70-79 and INSERT:

In 2005, the Supreme Court rendered a decision about takings that was highly unusual in one respect: it was unanimous. Only Justice Kennedy wrote an additional concurrence, which is not included below.

LINGLE v. CHEVRON U.S.A. INC.
544 U.S. 528 (2005)

Justice O'CONNOR delivered the opinion of the Court.

On occasion, a would-be doctrinal rule or test finds its way into our case law through simple repetition of a phrase-however fortuitously coined. A quarter century ago, in Agins v. City of Tiburon, 447 U.S. 255 (1980), the Court declared that government regulation of private property "effects a taking if [such regulation] does not substantially advance legitimate state interests ...."*Id*., at 260 Through reiteration in a half dozen or so decisions since *Agins,* this language has been ensconced in our Fifth Amendment takings jurisprudence. See *Monterey v. Del Monte Dunes at Monterey, Ltd.,* 526 U.S. 687 (1999) (citing cases).

In the case before us, the lower courts applied *Agins'* "substantially advances" formula to strike down a Hawaii statute that limits the rent that oil companies may charge to dealers who lease service stations owned by the companies. The lower courts held that the rent cap effects an uncompensated taking of private property in violation of the Fifth and Fourteenth Amendments because it does not substantially advance Hawaii's asserted interest in controlling retail gasoline prices. This case requires us to decide whether the "substantially advances" formula announced in *Agins* is an appropriate test for determining whether a regulation effects a Fifth Amendment taking. We conclude that it is not.

I

The State of Hawaii, whose territory comprises an archipelago of 132 islands clustered in the midst of the Pacific Ocean, is located over 1,600 miles from the U.S. mainland and ranks among the least populous of the 50 States. Because of Hawaii's small size and geographic isolation, its wholesale market for oil products is highly concentrated. When this lawsuit began in 1997, only two refineries and six gasoline wholesalers were doing business in the State. As of that time, respondent Chevron U.S.A. Inc. was the largest refiner and marketer of gasoline in Hawaii: It controlled 60 percent of the market for gasoline produced or refined in-state and 30 percent of the wholesale market on the State's most populous island, Oahu.

Gasoline is sold at retail in Hawaii from about 300 different service stations. About half of these stations are leased from oil companies by independent lessee-dealers, another 75 or so are owned and operated by "open" dealers, and the remainder are owned and operated by the oil companies. Chevron sells most of its product through 64

independent lessee-dealer stations. In a typical lessee-dealer arrangement, Chevron buys or leases land from a third party, builds a service station, and then leases the station to a dealer on a turnkey basis. Chevron charges the lessee-dealer a monthly rent, defined as a percentage of the dealer's margin on retail sales of gasoline and other goods. In addition, Chevron requires the lessee-dealer to enter into a supply contract, under which the dealer agrees to purchase from Chevron whatever is necessary to satisfy demand at the station for Chevron's product. Chevron unilaterally sets the wholesale price of its product.

The Hawaii Legislature enacted Act 257 in June 1997, apparently in response to concerns about the effects of market concentration on retail gasoline prices. See 1997 Haw. Sess. Laws no. 257, § 1. The statute seeks to protect independent dealers by imposing certain restrictions on the ownership and leasing of service stations by oil companies. It prohibits oil companies from converting existing lessee-dealer stations to company-operated stations and from locating new company-operated stations in close proximity to existing dealer-operated stations. Haw.Rev.Stat. §§ 486H-10.4(a), (b) (1998 Cum.Supp.). More importantly for present purposes, Act 257 limits the amount of rent that an oil company may charge a lessee-dealer to 15 percent of the dealer's gross profits from gasoline sales plus 15 percent of gross sales of products other than gasoline.

Thirty days after Act 257's enactment, Chevron sued the Governor and Attorney General of Hawaii in their official capacities (collectively Hawaii) in the United States District Court for the District of Hawaii, raising several federal constitutional challenges to the statute. As pertinent here, Chevron claimed that the statute's rent cap provision, on its face, effected a taking of Chevron's property in violation of the Fifth and Fourteenth Amendments. ...

To facilitate resolution of the summary judgment motions, the parties jointly stipulated to certain relevant facts. They agreed that Act 257 reduces by about $207,000 per year the aggregate rent that Chevron would otherwise charge on 11 of its 64 lessee-dealer stations. On the other hand, the statute allows Chevron to collect more rent than it would otherwise charge at its remaining 53 lessee-dealer stations, such that Chevron could increase its overall rental income from all 64 stations by nearly $1.1 million per year. The parties further stipulated that, over the past 20 years, Chevron has not fully recovered the costs of maintaining lessee-dealer stations in any State through rent alone. Rather, the company recoups its expenses through a combination of rent and product sales. Finally, the joint stipulation states that Chevron has earned in the past, and anticipates that it will continue to earn under Act 257, a return on its investment in lessee-dealer stations in Hawaii that satisfies any constitutional standard.

[The District Court granted a summary judgement to Chevron. On appeal, the 9th Circuit found material questions of fact]

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On remand, the District Court entered judgment for Chevron after a 1-day bench trial in which Chevron and Hawaii called competing expert witnesses (both economists) to testify. Finding Chevron's expert witness to be “more persuasive” than the State's

expert, the District Court once again concluded that oil companies would raise wholesale gasoline prices to offset any rent reduction required by Act 257, and that the result would be an increase in retail gasoline prices. Even if the rent cap did reduce lessee-dealers' costs, the court found, they would not pass on any savings to consumers. The court went on to reiterate its determination that Act 257 would enable incumbent lessee-dealers to sell their leaseholds at a premium, such that incoming lessees would not obtain any of the benefits of the rent cap. And while it acknowledged that the rent cap could preclude oil companies from constructively evicting dealers through excessive rents, the court found no evidence that Chevron or any other oil company would attempt to charge such rents in the absence of the cap. Finally, the court concluded that Act 257 would in fact decrease the number of lessee-dealer stations because the rent cap would discourage oil companies from building such stations. Based on these findings, the District Court held that "Act 257 effect[ed] an unconstitutional regulatory taking given its failure to substantially advance any legitimate state interest."

The Ninth Circuit affirmed, holding that its decision in the prior appeal barred Hawaii from challenging the application of the "substantially advances" test to Chevron's takings claim or from arguing for a more deferential standard of review. The panel majority went on to reject Hawaii's challenge to the application of the standard to the facts of the case. Judge Fletcher dissented, renewing his contention that Act 257 should not be reviewed under the "substantially advances" standard. We granted certiorari, , and now reverse.

II

A

The Takings Clause of the Fifth Amendment, made applicable to the States through the Fourteenth, see *Chicago, B. & Q.R. Co. v. Chicago,* 166 U.S. 226 (1897), provides that private property shall not "be taken for public use, without just compensation." As its text makes plain, the Takings Clause "does not prohibit the taking of private property, but instead places a condition on the exercise of that power." *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles,* 482 U.S. 304, 314 (1987). In other words, it "is designed not to limit the governmental interference with property rights *per se,* but rather to secure *compensation* in the event of otherwise proper interference amounting to a taking." *Id.,* at 315, 107 S.Ct. 2378 (emphasis in original). While scholars have offered various justifications for this regime, we have emphasized its role in "bar[ring] Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." *Armstrong v. United States,* 364 U.S. 40, 49(1960).

The paradigmatic taking requiring just compensation is a direct government appropriation or physical invasion of private property. See, *e.g., United States v. Pewee Coal Co.,* 341 U.S. 114(1951) (Government's seizure and operation of a coal mine to prevent a national strike of coal miners effected a taking); *United States v. General Motors Corp.,* 323 U.S. 373 (1945) (Government's occupation of private warehouse effected a taking). Indeed, until the Court's watershed decision in *Pennsylvania Coal*

Co. v. Mahon, 260 U.S. 393 (1922), "it was generally thought that the Takings Clause reached *only* a 'direct appropriation' of property, or the functional equivalent of a 'practical ouster of [the owner's] possession.' " *Lucas v. South Carolina Coastal Council,* 505 U.S. 1003, 1014 (1992); see also *id.,* at 1028, n. 15 ("[E]arly constitutional theorists did not believe the Takings Clause embraced regulations of property at all").

Beginning with *Mahon,* however, the Court recognized that government regulation of private property may, in some instances, be so onerous that its effect is tantamount to a direct appropriation or ouster-and that such "regulatory takings" may be compensable under the Fifth Amendment. In Justice Holmes' storied but cryptic formulation, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." The rub, of course, has been-and remains-how to discern how far is "too far." In answering that question, we must remain cognizant that "government regulation-by definition-involves the adjustment of rights for the public good," *Andrus v. Allard,* 444 U.S. 51, 65 (1979), and that "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law," *Mahon, supra,* at 413.

Our precedents stake out two categories of regulatory action that generally will be deemed *per se* takings for Fifth Amendment purposes. First, where government requires an owner to suffer a permanent physical invasion of her property-however minor-it must provide just compensation. See *Loretto v. Teleprompter Manhattan CATV Corp.,* 458 U.S. 419 (1982) (state law requiring landlords to permit cable companies to install cable facilities in apartment buildings effected a taking). A second categorical rule applies to regulations that completely deprive an owner of "*all* economically beneficial us[e]" of her property. *Lucas,* 505 U.S., at 1019(emphasis in original). We held in *Lucas* that the government must pay just compensation for such "total regulatory takings," except to the extent that "background principles of nuisance and property law" independently restrict the owner's intended use of the property. *Id.,* at 1026-1032.

Outside these two relatively narrow categories (and the special context of land-use exactions ...), regulatory takings challenges are governed by the standards set forth in *Penn Central Transp. Co. v. New York City,* 438 U.S. 104 (1978). The Court in *Penn Central* acknowledged that it had hitherto been "unable to develop any 'set formula' " for evaluating regulatory takings claims, but identified "several factors that have particular significance." *Id.,* at 124. Primary among those factors are "[t]he economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations." *Ibid.* In addition, the "character of the governmental action"-for instance whether it amounts to a physical invasion or instead merely affects property interests through "some public program adjusting the benefits and burdens of economic life to promote the common good"-may be relevant in discerning whether a taking has occurred. *Ibid.* The *Penn Central* factors-though each has given rise to vexing subsidiary questions-have served as the principal guidelines for resolving regulatory takings claims that do not fall within the physical takings or *Lucas* rules.

Although our regulatory takings jurisprudence cannot be characterized as unified, these three inquiries (reflected in *Loretto, Lucas*, and *Penn Central*) share a common touchstone. Each aims to identify regulatory actions that are functionally equivalent to the classic taking in which government directly appropriates private property or ousts the owner from his domain. Accordingly, each of these tests focuses directly upon the severity of the burden that government imposes upon private property rights. The Court has held that physical takings require compensation because of the unique burden they impose: A permanent physical invasion, however minimal the economic cost it entails, eviscerates the owner's right to exclude others from entering and using her property-perhaps the most fundamental of all property interests. In the *Lucas* context, of course, the complete elimination of a property's value is the determinative factor. See *Lucas, supra,* at 1017 (positing that "total deprivation of beneficial use is, from the landowner's point of view, the equivalent of a physical appropriation"). And the *Penn Central* inquiry turns in large part, albeit not exclusively, upon the magnitude of a regulation's economic impact and the degree to which it interferes with legitimate property interests.

B

In *Agins v. City of Tiburon,* a case involving a facial takings challenge to certain municipal zoning ordinances, the Court declared that "[t]he application of a general zoning law to particular property effects a taking if the ordinance does not substantially advance legitimate state interests, see *Nectow v. Cambridge,* 277 U.S. 183, 188 (1928), or denies an owner economically viable use of his land, see *Penn Central Transp. Co. v. New York City,* 438 U.S. 104, 138, n. 36(1978)." 447 U.S., at 260. Because this statement is phrased in the disjunctive, *Agins'* "substantially advances" language has been read to announce a stand-alone regulatory takings test that is wholly independent of *Penn Central* or any other test. Indeed, the lower courts in this case struck down Hawaii's rent control statute as an "unconstitutional regulatory taking," 198 F.Supp.2d, at 1193, based solely upon a finding that it does not substantially advance the State's asserted interest in controlling retail gasoline prices. Although a number of our takings precedents have recited the "substantially advances" formula minted in *Agins,* this is our first opportunity to consider its validity as a freestanding takings test. We conclude that this formula prescribes an inquiry in the nature of a due process, not a takings, test, and that it has no proper place in our takings jurisprudence.

There is no question that the "substantially advances" formula was derived from due process, not takings, precedents. In support of this new language, *Agins* cited *Nectow v. Cambridge,* 277 U.S. 183, a 1928 case in which the plaintiff claimed that a city zoning ordinance "deprived him of his property without due process of law in contravention of the Fourteenth Amendment," *id.,* at 185,. *Agins* then went on to discuss *Village of Euclid v. Ambler Realty Co.,* 272 U.S. 365 (1926), a historic decision holding that a municipal zoning ordinance would survive a substantive due process challenge so long as it was not "clearly arbitrary and unreasonable, having no *substantial relation to the public health, safety, morals, or general welfare.*" *Id.,* at 395(emphasis added); see also Nectow, *supra*, at 188(quoting the same "substantial relation" language from *Euclid*).

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Although *Agins'* reliance on due process precedents is understandable, the language the Court selected was regrettably imprecise. The "substantially advances" formula suggests a means-ends test: It asks, in essence, whether a regulation of private property is *effective* in achieving some legitimate public purpose. An inquiry of this nature has some logic in the context of a due process challenge, for a regulation that fails to serve any legitimate governmental objective may be so arbitrary or irrational that it runs afoul of the Due Process Clause. See, *e.g., County of Sacramento v. Lewis,* 523 U.S. 833, 846 (1998) (stating that the Due Process Clause is intended, in part, to protect the individual against "the exercise of power without any reasonable justification in the service of a legitimate governmental objective"). But such a test is not a valid method of discerning whether private property has been "taken" for purposes of the Fifth Amendment.

In stark contrast to the three regulatory takings tests discussed above, the "substantially advances" inquiry reveals nothing about the *magnitude or character of the burden* a particular regulation imposes upon private property rights. Nor does it provide any information about how any regulatory burden is *distributed* among property owners. In consequence, this test does not help to identify those regulations whose effects are functionally comparable to government appropriation or invasion of private property; it is tethered neither to the text of the Takings Clause nor to the basic justification for allowing regulatory actions to be challenged under the Clause.

Chevron appeals to the general principle that the Takings Clause is meant " 'to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.' " But that appeal is clearly misplaced, for the reasons just indicated. A test that tells us nothing about the actual burden imposed on property rights, or how that burden is allocated cannot tell us when justice might require that the burden be spread among taxpayers through the payment of compensation. The owner of a property subject to a regulation that *effectively* serves a legitimate state interest may be just as singled out and just as burdened as the owner of a property subject to an *ineffective* regulation. It would make little sense to say that the second owner has suffered a taking while the first has not. Likewise, an ineffective regulation may not significantly burden property rights at all, and it may distribute any burden broadly and evenly among property owners. The notion that such a regulation nevertheless "takes" private property for public use merely by virtue of its ineffectiveness or foolishness is untenable.

Instead of addressing a challenged regulation's effect on private property, the "substantially advances" inquiry probes the regulation's underlying validity. But such an inquiry is logically prior to and distinct from the question whether a regulation effects a taking, for the Takings Clause presupposes that the government has acted in pursuit of a valid public purpose. The Clause expressly requires compensation where government takes private property "*for public use.*" It does not bar government from interfering with property rights, but rather requires compensation "in the event of *otherwise proper*

interference amounting to a taking." *First English Evangelical Lutheran Church,* 482 U.S., at 315 (emphasis added). Conversely, if a government action is found to be impermissible-for instance because it fails to meet the "public use" requirement or is so arbitrary as to violate due process-that is the end of the inquiry. No amount of compensation can authorize such action.

Chevron's challenge to the Hawaii statute in this case illustrates the flaws in the "substantially advances" theory. To begin with, it is unclear how significantly Hawaii's rent cap actually burdens Chevron's property rights. The parties stipulated below that the cap would reduce Chevron's aggregate rental income on 11 of its 64 lessee-dealer stations by about $207,000 per year, but that Chevron nevertheless expects to receive a return on its investment in these stations that satisfies any constitutional standard. Moreover, Chevron asserted below, and the District Court found, that Chevron would recoup any reductions in its rental income by raising wholesale gasoline prices. In short, Chevron has not clearly argued-let alone established-that it has been singled out to bear any particularly severe regulatory burden. Rather, the gravamen of Chevron's claim is simply that Hawaii's rent cap will not actually serve the State's legitimate interest in protecting consumers against high gasoline prices. Whatever the merits of that claim, it does not sound under the Takings Clause. Chevron plainly does not seek compensation for a taking of its property for a legitimate public use, but rather an injunction against the enforcement of a regulation that it alleges to be fundamentally arbitrary and irrational.

Finally, the "substantially advances" formula is not only *doctrinally* untenable as a takings test-its application as such would also present serious practical difficulties. The *Agins* formula can be read to demand heightened means-ends review of virtually any regulation of private property. If so interpreted, it would require courts to scrutinize the efficacy of a vast array of state and federal regulations-a task for which courts are not well suited. Moreover, it would empower-and might often require-courts to substitute their predictive judgments for those of elected legislatures and expert agencies.

Although the instant case is only the tip of the proverbial iceberg, it foreshadows the hazards of placing courts in this role. To resolve Chevron's takings claim, the District Court was required to choose between the views of two opposing economists as to whether Hawaii's rent control statute would help to prevent concentration and supracompetitive prices in the State's retail gasoline market. Finding one expert to be "more persuasive" than the other, the court concluded that the Hawaii Legislature's chosen regulatory strategy would not actually achieve its objectives. Along the way, the court determined that the State was not entitled to enact a prophylactic rent cap without actual evidence that oil companies had charged, or would charge, excessive rents. Based on these findings, the District Court enjoined further enforcement of Act 257's rent cap provision against Chevron. We find the proceedings below remarkable, to say the least, given that we have long eschewed such heightened scrutiny when addressing substantive due process challenges to government regulation. The reasons for deference to legislative judgments about the need for, and likely effectiveness of, regulatory actions are by now well established, and we think they are no less applicable here.

For the foregoing reasons, we conclude that the "substantially advances" formula announced in *Agins* is not a valid method of identifying regulatory takings for which the Fifth Amendment requires just compensation. Since Chevron argued only a "substantially advances" theory in support of its takings claim, it was not entitled to summary judgment on that claim.

III

We emphasize that our holding today-that the "substantially advances" formula is not a valid takings test-does not require us to disturb any of our prior holdings. To be sure, we applied a "substantially advances" inquiry in *Agins* itself, see 447 U.S., at 261-262(finding that the challenged zoning ordinances "substantially advance[d] legitimate governmental goals"), and arguably also in *Keystone Bituminous Coal Assn. v. DeBenedictis,* 480 U.S. 470, 485-492 (1987) (quoting 'substantially advance[s]' " language and then finding that the challenged statute was intended to further a substantial public interest). But in no case have we found a compensable taking based on such an inquiry. Indeed, in most of the cases reciting the "substantially advances" formula, the Court has merely assumed its validity when referring to it in dicta.

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Twenty-five years ago, the Court posited that a regulation of private property "effects a taking if [it] does not substantially advance [a] legitimate state interes[t]." *Agins, supra,* at 260. The lower courts in this case took that statement to its logical conclusion, and in so doing, revealed its imprecision. Today we correct course. We hold that the "substantially advances" formula is not a valid takings test, and indeed conclude that it has no proper place in our takings jurisprudence. In so doing, we reaffirm that a plaintiff seeking to challenge a government regulation as an uncompensated taking of private property may proceed under one of the other theories discussed above-by alleging a "physical" taking, a *Lucas*-type "total regulatory taking," a *Penn Central* taking, or a land-use exaction violating the standards set forth in *Nollan* and *Dolan.* [Editor's Note: See note 9, after case, for an explication of the *Dolan* case]. ...

NOTES:

1. The Supreme Court continues to require the *Penn Central* balancing in most regulatory takings cases. It has found , however, that sometimes a regulation creates a "categorical taking" by either being 1) a physical appropriation, or 2) a "total regulatory taking." The last test was formalized in Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992). As part of the facts, Justice Scalia accepted the lower court's finding that South Carolina's ban on building on Mr. Lucas's lot rendered the lot "valueless." Because of dangers of erosion on the barrier island, no building was allowed seaward of a specified line. The Supreme Court, however, found a government could deny all value or

all economically viable use of land without compensating the private landowner, but only in limited circumstances. Sometimes such regulation could be justified:

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> Where the State seeks to sustain regulation that deprives land of all economically beneficial use, we think it may resist compensation only if the logically antecedent inquiry into the nature of the owner's estate shows that the proscribed use interests were not part of his title to begin with. This accords, we think, with our "takings" jurisprudence, which has traditionally been guided by the understandings of our citizens regarding the content of, and the State's power over, the "bundle of rights" that they acquire when they obtain title to property. It seems to us that the property owner necessarily expects the uses of his property to be restricted, from time to time, by various measures newly enacted by the State in legitimate exercise of its police powers; "[a]s long recognized, some values are enjoyed under an implied limitation and must yield to the police power."
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> Any limitation so severe [as to deprive the landowner of all economically viable use] cannot be newly legislated or decreed (without compensation), but must inhere in the title itself, in the restrictions that background principles of the State's law of property and nuisance already place upon land ownership. A law or decree with such an effect must, in other words, do no more than duplicate the result that could have been achieved in the courts --by adjacent landowners (or other uniquely affected persons) under the State's law of private nuisance, or by the State under its complementary power to abate nuisances that affect the public generally, or otherwise.
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> On this analysis, the owner of a lakebed, for example, would not be entitled to compensation when he is denied the requisite permit to engage in a landfilling operation that would have the effect of flooding others' land. Nor the corporate owner of a nuclear generating plant, when it is directed to remove all improvements from its land upon discovery that the plant sits astride an earthquake fault. Such regulatory action may well have the effect of eliminating the land's only economically productive use, but it does not proscribe a productive use that was previously permissible under relevant property and nuisance principles. The use of these properties for what are now expressly prohibited purposes was always unlawful, and (subject to other constitutional limitations) it was open to the State at any point to make the implication of those background principles of nuisance and property law explicit. In light of our traditional resort to "existing rules or understandings that stem from an independent source such as state law" to define the range of interests that qualify for protection as "property" under the Fifth (and Fourteenth) amendments, this recognition that the Takings Clause does not require compensation when an owner is barred from putting land to a use that is proscribed by those "existing rules or understandings" is surely unexceptional. When, however, a regulation that declares "off-limits" all economically productive or beneficial uses of land goes beyond what the relevant background principles would dictate, compensation must be paid to sustain it

If there is a "total taking." the second category would not create a compensable taking if the governmental regulation was simply abating a nuisance or otherwise enforcing a background principle of law. In other words, if the relevant state definition of property did not include the right to do what the government is now explicitly forbidding, there would be no taking requiring compensation..

2. The second category, the total taking, was phrased not only as restrictions that prohibit all economically viable *use*, but also as restrictions rendering property *valueless*, a difference in language that could have a difference in meaning. In *Tahoe-Sierra Preservation Council, Inc. v.. Tahoe Regional Planning Agency,* 122 S.Ct. 1465 (2002), the Court considered whether a moratorium on development during comprehensive land-use planning was a categorical or *per se* taking. The majority, in a Justice Stevens-authored opinion, found that the denial of all use for a limited period was not a *per se* or categorical taking; a court considering the issue would have to perform a *Penn Central* analysis. The majority emphasized that the regulation at issue in *Lucas* "effected a taking that 'was unconditional and permanent.'" All value of the fee interest was destroyed:

> The categorical rule that we applied in *Lucas* states that compensation is required when a regulation deprives an owner of "*all* economically beneficial uses" of his land. Under that rule, a statute that "wholly eliminated the value" of Lucas' fee simple title clearly qualified as a taking. But our holding was limited to "the extraordinary circumstance when *no* productive or economically beneficial use of land is permitted." The emphasis on the word "no" in the text of the opinion was, in effect, reiterated in a footnote explaining that the categorical rule would not apply if the diminution in value were 95% instead of 100%. Anything less than a "complete elimination of value," or a "total loss," the Court acknowledged, would require the kind of analysis applied in *Penn Central*.

In dissent, Chief Justice Rehnquist, Justice Scalia, and Justice Thomas argued that the important trigger was prohibition of *use*. Of course, Justice Stevens also did not find that all economic uses of the property were foreclosed; future use remained. This is the result of his refusal to "segment" the property owned on a temporal basis. See Note 5, *infra* and Marla E. Mansfield, *Tahoe-Sierra* Returns *Penn Central* to the Center Track, 38 Tulsa. L.Rev 263 (2002).

3. In *Lucas*, Justice Scalia discounted legislative pronouncements on the nature of the prohibited action and looked to pre-existing property laws. Justice Stevens, in his *Lucas* dissent, cautioned against this approach:

> Arresting the development of the common law is not only a departure from our prior decisions; it is also profoundly unwise. The human condition is one of constant learning and evolution--both moral and practical. Legislatures implement that new learning; in doing so they must often revise the definition of property and the rights of property owners. Thus, when the Nation came to understand that slavery was morally wrong and mandated the emancipation of all

> slaves, it, in effect, redefined "property." On a lesser scale, our ongoing self-education produces similar changes in the rights of property owners: New appreciation of the significance of endangered species, see, e.g., *Andrus v. Allard*, 444 U.S. 51 (1979); the importance of wetlands, see, e.g., 16 U.S.C. § 3801 et seq.; and the vulnerability of coastal lands, see, e.g., 16 U.S.C. § 1451 et seq., shapes our evolving understandings of property rights. Of course, some legislative redefinitions of property will effect a taking and must be compensated--but it certainly cannot be the case that every movement away from common law does so. There is no reason, and less sense, in such an absolute rule.

Justice Kennedy, in his concurrence, also believed that equating takings law with nuisance doctrine would improperly arrest the development of law. His view of the facts, however, differed.

4. If there is a "categorical rule" that total denial of a property's economic value or use is a taking unless the prohibited use is a "nuisance" or otherwise not part of the private property right, the problem is in defining the "property" impacted. Justice Stevens, dissenting in *Lucas* notes:

> ... [D]evelopers and investors may market specialized estates to take advantage of the Court's new rule. The smaller the estate, the more likely that a regulatory change will effect a total taking. .... In short, the categorical rule will likely have one of two effects: Either courts will alter the definition of the "denominator" in the takings "fraction," rendering the Court's categorical rule meaningless, or investors will manipulate the relevant property interests, giving the Court's rule sweeping effect.

Can you give examples of each technique? *Compare*, *Tabb Lakes, Inc. v. United States*, 10 F.3d 796, 802 (D.C. Cir. 1993), *with, Loveladies Harbor, Inc. v. United States*, 28 F.3d 1171 (Fed. Cir. 1994). *See also*, *Whitney Benefits, Inc. v. United States*, 926 F.2d 1169, 1172-73 (Fed. Cir.1991), cert. denied, 112 S.Ct. 406 (1991) and *Machinpongo Land & Coal Co., Inc. v. Commonwealth of Pennsylvania*, 719 A.2d 19 (Pa. 1998).

5. Determining the property impacted by the regulation, referred to as the denominator question, reflects the different positions of the dissent and majority in *Pennsylvania Coal v. Mahon* and again in *Keystone Bituminous Coal*. In essence, the question is whether to “segment” the property or consider it as a whole. In *Tahoe-Sierra Preservation Council, Inc. v.. Tahoe Regional Planning Agency,* 122 S.Ct. 1465 (2002), the Court reinforced the “property as a whole” methodology: “An interest in real property is defined by the metes and bounds that describe its geographic dimensions and the term of years that describes the temporal aspect of the owner's interest. Both dimensions must be considered if the interest is to be viewed in its entirety.” Therefore, a non-permanent ban on development would not totally destroy the value or ability to use a fee simple; when the moratorium ended, use could commence.

6. Recall that a "total taking" will not require compensation if the forbidden activity was not allowed under "background principles of law." In 2001, the court addressed whether or not the existence of a regulation at the time the individual claiming a taking acquired the land in and of itself made the regulation a "background principle of law." With various nuances and emphases, the court held that the pre-existence of the regulation alone did not preclude a categorical taking claim nor did it negate the possibility of a reasonable, investment-backed expectation that development could take place on the land. The latter inquiry is of import if the regulation did not rise to a total deprivation of use or value. Palazzolo v. Rhode Island, 121 S.Ct. 2448 (2001). For an extensive review of this case, see Marla E. Mansfield, *"By the Dawn's Early Light:" The Administrative State Still Stands After the 2000 Supreme Court Term (Commerce Clause, Delegation and Takings)*, 37 Tulsa L. Rev. 205, 271-301 (2001). The existence of the regulation, however, can be taken into account and color what expectations are reasonable, thereby negated a taking. Rith Energy, Inc. v. United States, 247 F.3d 1355 ("Rith I"“), *reh'g denied,* 270 F.3d 1347 (Fed.Cir.2001) (" *Rith II* "); and Appolo Fuels, Inc. v. U.S., 381 F. 3d 1338 (Fed. Cir. 2004). The latter cases deal with denials of mining under the Surface Mining Control and Reclamation Act of 1977.. The "highly regulated" nature of the coal mining industry tempered developmental expectations.

7. Two cases came to different views about whether regulation of extractive activities was a taking post-*Lucas*. The Michigan Court of Appeals has looked at the effect of oil and gas drilling prohibitions and found they could create a temporary taking of property. *Miller Brothers v. Dept. of Natural Resources*, 513 N.W.2d 217 (Mich. App. 1994). It held that the "nuisance exception" to a taking does not apply if the government is seeking to protect the surface, because the owner of the surface had a contractual duty to allow holders of mineral reservation to exercise their rights to extract oil and gas even if it caused some harm to the surface. In the coal mining arena, however, the Federal Circuit found no taking when the federal Office of Surface Mining issued a cessation order, finding subsidence put the public at risk of injury. *M & J Coal Co. v. United States*, 47 F.3d 1148 (Fed. Cir. 1995). The court held that despite a state mining permit, under federal law the OSM still had the right to issue federal cessation orders in cases of imminent danger to the public health and safety. M & J should have known at the time it acquired its rights that in would not be able to mine in a way that might endanger the public health and safety. Therefore, the "prescribed use interests were not part of [its] ... title to begin with."

8. For additional examples of prohibited actions not being a part of the underlying property right, other than the activity being a nuisance, *see*, U.S. v. 30.54 Acres of Land, 90 F.3d 790 (1996) (prohibition of using land for a coal tipping station, even if it destroys economic value, need not be compensated because navigational servitude allows government to regulate for navigation) and Kinross Copper Corp. v. State of Oregon, 981 P.2d 833 (Ore. App. 1999) (denial of a permit to discharge water from a mining operation is not a taking because mining claimant did not have a right to discharge waste into the waters of the state).

9. In *Lingle*, the Court distinguished its regulatory takings jurisprudence from the situation involving "exactions." An exaction is a dedication of land as a condition for granting development permission. One Supreme Court case asked whether a city could condition a building permit on the dedication of a portion of Dolan's property for flood control and traffic improvements. *Dolan v. Tigard*, 512 U.S. 374 (1994). In order to not violate the 5th Amendment prohibition of uncompensated takings, such a condition must serve a legitimate public purpose, and there must be a "nexus" between the condition imposed and the public purpose. In *Dolan*, retaining open areas in a floodplain was related to protection from flooding, and a bike path was related to alleviating traffic. However, there was one more inquiry: "whether the degree of exactions demanded by the city's permit conditions bear the required relationship to the projected impact of petitioner's proposed development." The Supreme Court required a "rough proportionality" to exist between the development's harm and the remedy. The majority found that forbidding pavement of the entire floodplain area was acceptable, but requiring public ownership of the open space through dedication of the area to a greenway was not necessary to prevent flooding. As for the bikeway dedication, "the city has not met its burden of demonstrating that the additional number of vehicle and bicycle trips generated by petitioner's development reasonably relate to the city's requirement for a dedication of the ... pathway easement."

10. Donald N. Zillman, *The Legal Framework*, in The Energy Law Group, ENERGY LAW AND POLICY FOR THE 21ST CENTURY, 3-40 to 3-49 (Rocky Mountain Mineral Law Foundation 2000).

INSERT at page 187:

NOTES:

2. The Supreme Court re-affirmed *Nantahala Pow*er *& Light Co. v. Thornburg*, 476 U.S. 953 (1986). It again held that allocations FERC makes in setting wholesale prices bind state utility commissions in setting retail rates. *Entergy Louisiana, Inc. v. Louisiana Public Service Comm.*, 539 U.S. 39 (2003).

3. Congress did not fully repeal PURPA in the 2005 Energy Policy Act. Instead it modified the purchase and sale requirements of utilities prospectively. The utility will not have a mandatory purchase requirement if FERC finds the qualified facility or qualified co-generator has access to a competitive wholesale market and transportation. Similarly, the utility will not be required to sell the qualified facility or co-generator electricity if FERC finds the co-generator or facility has access to a competitive retail market and transmission.16 USC § 824a-3(m). The utility, however, will have to provide interconnection service to all of its customers with on-site generation. 16 U.S.C. 2621(d)(15).

DELETE pages 220-232 and insert:

The leasing of oil and gas resources on the Outer Continental Shelf are governed by the Outer Continental Shelf Lands Act and its Amendments of 1978. 43 U.S.C. § 1331 *et seq.* The area involved may be 1,100,000,000 acres. The first OCS act, that of 1953, did not provide a comprehensive leasing mechanism. It was mostly concerned with jurisdictional issues. The 1978 amendments were an elaborate updating of the act, recognizing intervening economic and environmental concerns.

One predicate of the original 1953 act was President Truman's 1945 assertion of federal jurisdiction over the shelf. The Supreme Court concluded the entire Shelf, including coastal waters, was under federal control. *United States v. California*, 332 U.S. 19 (1947); *U.S. v. Louisiana*, 339 U.S. 699 (1950), *U.S. v. Texas*, 339 U.S. 707 (1950). Congress, however, in 1953 passed the Submerged Lands Act which "released and relinquished" to the coastal states the part of the Shelf that extended out from the mean high tide line for three miles or to their historic boundaries. The companion OCS Lands Act of 1953 affirmed President Truman's jurisdictional assertion. Federal jurisdiction extended outward, as later stated in the 1958 Geneva Convention on the Continental Shelf, to a depth of 200 meters "or beyond that limit to where the depth of the superjacent waters admits of the exploitation of the natural resources." The 1982 Law of the Sea Convention in Article 76(1) defines the current reach of a coastal state's jurisdiction on a continental shelf, namely on the seabed within 200 miles of a coast.[1]
The 1953 Outer Continental Shelf Act provided basic framework for mineral leasing. In time, this framework was deemed insufficient.

CALIFORNIA v. NORTON
150 F.Supp.2d 1046 (N D.Ca 2001)

WILKEN, District Judge.

The central dispute in this case is whether Defendant Mineral Management Service (MMS) must make, and provide to Plaintiff California Coastal Commission (CCC), a determination that the MMS's grant of suspensions of certain oil and gas leases on the Outer Continental Shelf (OCS) off the coast of California is consistent with the State of California Coastal Management Program (CCMP). The Court finds that the MMS must do so. ...

Plaintiffs State of California, the CCC, Gray Davis, Governor of California, and Bill Lockyer, Attorney General of California, move for summary judgment that MMS did not comply with the Coastal Zone Management Act (CZMA) when it granted the requests of

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1 21 I.L.M. 1245, 1285 (1982). By presidential proclamation, the U.S. has claimed a 200 mile exclusive economic zone in which the U.S. asserts exclusive natural resources jurisdiction. Presidential Proclamation No. 5030, March 10, 1983.

the lessees for suspension of the thirty-six leases at issue here without determining that the suspensions were consistent with the CCMP and providing the CCC the opportunity to review that determination.... Defendants Gale A. Norton, Secretary of the Interior, the Department of the Interior, the MMS, and the Regional Supervisor of MMS oppose this motion and cross-move for summary judgment that Defendants' grant of the suspensions of these leases complies with the CZMA.

BACKGROUND

I. Leases Governed By the Outer Continental Shelf Lands Act

Oil and gas leases on the Outer Continental Shelf (OCS) are governed by the Outer Continental Shelf Lands Act (OSCLA), 43 U.S.C. § 1331 *et seq.,* enacted in 1953. Pursuant to the OSCLA, the Department of the Interior may issue and administer leases for exploration for and production of oil and gas on the Outer Continental Shelf (OCS). These leases may have a primary term of five to ten years, and may continue after the primary term for as long as there is production of oil or gas in paying quantities, approved drilling or well reworking operations.

The OSCLA prescribes a four stage process for the development of oil and gas leases for exploration and production. The first stage is the development and publication of schedules of proposed sales of leases. *See* 43 U.S.C. § 1337; 30 C.F.R. part 256, subpart F (Lease Sales). The second stage is the sale of the leases. *See* 43 U.S.C. § 1337(a)(1); 30 C.F.R. part 256, subpart G (Issuance of Leases).

The third stage is the filing and review of the exploration plan (EP). *See* 43 U.S.C. § 1340; 30 C.F.R. § 250.203. At this stage, the lessee submits a proposed EP to the Regional Supervisor of the MMS for approval. The plan must include a description of the exploration activities, a description of the mobile drilling unit, a map of the proposed wells, and either a certificate of a consistency determination by the federal agency or a consistency certification by the State. *See* 43 U.S.C. § 1340(c); 30 C.F.R. § 250.203. The Regional Supervisor of the MMS must consult with the Governor of the affected State, or the Governor's designated representatives, and the Office of Ocean and Coastal Resource Management of the National Oceanic Atmospheric Administration before approving or disapproving the proposed EP.. After the EP has been approved by the Regional Supervisor, any revisions to it must be submitted to the Regional Supervisor for approval. If the Regional Supervisor determines that "a proposed revision could result in a significant change in the impacts previously identified and evaluated," 30 C.F.R. § 250.203(n)(2), the revisions are subject to the same approval process as the original EP.

Finally, the fourth stage is the filing and review of a development and production plan (DPP). *See* 43 U.S.C. § 1351; 5 C .F.R. § 250.204. The DPP must be submitted along with the lessee's certification that each activity is consistent with the State's coastal management program. *See* 43 U.S.C. § 1351(d); 30 C.F.R. § 250.204(b)(13). Development and production activities may be carried out only in accordance with the approved DPP. *See* 43 U.S.C. § 1351(b).

Pursuant to the OSCLA, 43 U.S.C. § 1334(a)(1), the MMS has the authority to grant suspensions of the primary term, or of an extended term, of the lease upon request of the lessee for reasons such as facilitating the development of the lease or making arrangements for transportation facilities. The MMS may also direct suspensions of the leases on its own initiative, for example, in the face of a threat of serious, irreparable, or immediate environmental harm. *See* 43 U.S.C. §§ 1337(b)(5); *see also* 30 C.F.R. §§ 250.168-180.

What is referred to as a suspension of the lease is actually a suspension of the running of the term of the lease, that is, in effect an extension of the lease.

II. The Leases At Issue

Between 1968 and 1984, the MMS, a division of the Department of the Interior, conducted four sales of oil and gas leases for the OCS off the coast of California, which resulted in forty leases being issued, each with a primary term of five years. Until October, 1992, the MMS, at the request of the lessees, had granted suspension of the leases, extending all of the primary terms of the leases. On October 15, 1992, MMS directed suspensions of the leases commencing on January 1, 1993. In May, 1999, when the directed suspensions were about to end, each of the lessees filed a request for a lease suspension. In May and June, 1999, a number of elected officials of the State of California wrote letters to the Department of the Interior opposing the lessees' pending requests for lease suspensions, and asking the MMS to postpone its decision on those requests until the CCC made a determination about its own authority, under the CZMA, to review the pending lease suspensions for consistency with the State's CCMP.

On June 25, 1999, independent of these letters from the State's elected officials, MMS directed additional suspensions of all forty of the leases until August 16, 1999, in order to have additional time to review the lessees' suspension proposals.

The CZMA, 16 U.S.C. § 1451 *et seq.,* had been enacted in 1972. In it, Congress declared a national policy which "has as its main purpose the encouragement and assistance of States in preparing and implementing management programs to preserve, protect, develop and whenever possible restore the resources of the coastal zone of the United States." S.Rep. No. 92-753 (1972), reprinted in 1972 U.S.C.C.A.N., 92nd Congress, Volume 3, at 4776. The CZMA encourages the States' development of coastal zone management programs and cooperation between the federal and State agencies engaged in programs affecting the coastal zone. *See Exxon Corporation v. Fischer,* 807 F.2d 842, 844 (9th Cir.1987) (explaining that the CZMA is "a mechanism for resolving conflicts between state coastal zone plans and federally approved activities"). The legislative history of the CZMA states, "There is no attempt to diminish state authority through federal preemption. The intent of this legislation is to enhance state authority by encouraging and assisting the states to assume planning and regulatory powers over their coastal zone." S.Rep. No. 92-753 (1972), reprinted in 1972 U.S.C.C.A.N., 92nd Congress, Volume 3, at 4776.

Since 1972, then, the CZMA has required that certain federal agency activities, and certain private activities done under the authority of a federal license or permit, that affect the coastal zone, be consistent with the State's coastal management program. *See* 16 U.S.C. § 1456(c). A federal agency carrying out an activity that affects the coastal zone must provide a consistency determination to the relevant State agency before final approval of the federal activity. *See* 16 U.S.C. § 1456(c)(1)(C). Any applicant for a required federal license or permit to conduct an activity, within or outside of the coastal zone, that affects any land or water use or natural resource of the coastal zone is required to furnish a certificate that its proposed activity is consistent with the State's coastal management program. *See* 16 U.S.C. § 1456(c)(3)(A). Title 15 C.F.R. part 930 *et seq.,* enacted pursuant to the CZMA, "describes the obligations of all agencies, individuals and other parties who are required to comply with the Federal consistency provisions of the Coastal Zone Management Act."

On July 27, 1999, the CCC advised the MMS that, pursuant to the CZMA, 16 U.S.C. § 1456(c)(3), it was asserting its authority to review the requests for suspension of the leases for consistency with the State's coastal management plan. The CCC set out a number of issues about which it was concerned, including the age of the leases, the poor quality of the oil, the proximity of the leases to marine sanctuaries, and changed environmental circumstances, such as the expansion of the territory of the threatened southern sea otter into the area. The CCC also advised the MMS that the lessees were to provide the State with a certification of consistency and the MMS could not approve the requested suspensions unless the State concurred with the consistency certification. The CCC indicated that, therefore, the MMS should hold the lessees' requested suspensions in abeyance.

On August 13, 1999, former Secretary of the Interior Bruce Babbitt, responding to the CCC, indicated that the lessees' suspension requests did not trigger California's consistency review authority because the requested suspensions did not have any effect on California's coastal zone.

On the same day, the MMS directed suspension of thirty-six of the forty leases for ninety days, in order to ensure that the lease development work complied with the CZMA.[2] On November 12, 1999, the MMS granted the lessees' requests for suspensions of the thirty-six leases at issue here, suspending the leases for nineteen to forty-five months. The MMS required that each lessee undertake certain "milestone" activities, including drilling a well, submitting a description of the proposed project, and submitting a revised EP or DPP, in order to continue the suspension.

DISCUSSION

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2 The MMS determined that the remaining four leases had expired and, therefore, did not qualify for further lease suspensions. The lessees of these four leases have administratively appealed the MMS's decision to deny their requests for suspension.

II. Coastal Zone Management Act

A. Federal Activity

As noted above, the CZMA requires federal agencies conducting activities that affect the coastal zone to determine that these activities are consistent with the State's coastal management program. Plaintiffs claim that the MMS's grant of a request to suspend an oil or gas lease is a "federal activity" which affects the coastal zone as defined by the CZMA and requires the MMS to give the State a consistency determination.

Between 1972 and 1984, it was not clear whether consistency review was required for the sale of leases on the OCS off the coast of California. In *Secretary of the Interior v. California,* 464 U.S. 312 (1984), the Supreme Court considered whether the sale of gas and oil leases for the OCS was a federal activity "directly affecting" the coastal zone, which would require a determination by the Secretary of the Interior that the lease sale was consistent with the State's coastal management plan. The Court concluded that Congress did not intend the CZMA to apply to activities on the OCS. The Court held that "the Secretary of the Interior's sale of outer continental shelf oil and gas leases is not an activity 'directly affecting' the coastal zone within the meaning of this statute." *Id.* at 315 The Court noted that a lease sale is one in a series of events that may culminate in activities which directly affect the coastal zone. .

The Court also found that CZMA § 1456(c)(1) referring to activities "conducted or supported by a federal agency" is not applicable to lease sales on the OCS. *Id.* at 330, The Court reasoned that the federal agency does not conduct or support the activities of drilling for oil or gas under the lease.

In 1990, Congress amended the CZMA to overrule *Secretary of the Interior. See* H.R.Rep. No. 101-964 reprinted at 1990 USCCAN 2374, 2675. Section 1456(c)(1)(A) was amended to delete the word "directly" modifying "affects," so that the statute now reads,
Each Federal agency activity within or outside the coastal zone that affects any land or water use or natural resources of the coastal zone shall be carried out in a manner which is consistent to the maximum extent practicable with the enforceable policies of approved State management programs. 16 U.S.C. § 1456(c)(1)(A). Furthermore, Congress indicated in the legislative history that "the term 'affects' is to be construed broadly, including direct effects which are caused by the activity and occur at the same time and place, and indirect effects which may be caused by the activity and are later in time or farther removed in distance but are still reasonably foreseeable." H.R.Rep. No. 101-964, 1990 USCCAN at 2675.

Congress also indicated in the legislative history that this amendment was intended "to make clear" that the sale of oil and gas leases is subject to the CZMA. *Id.* at 2676. By requiring the lease sale itself to be consistent with the State's coastal management program, Congress advanced the time for consistency review of a federal activity to an earlier stage than that of the development of the EP and the DPP. *See id.* The legislative

history states that the amendments should "leave no doubt that all federal agency activities and all federal permits are subject to the CZMA's consistency requirements." *Id.*

All of the parties agree that since the 1990 amendment of the CZMA, sales of leases for the exploration and development of oil or gas on the OCS are federal agency activities that require consistency determinations.

Plaintiffs argue that the MMS's grants of suspensions of the leases are likewise federal activities that affect the coastal zone, which requires the MMS to give the State a determination that these suspensions are consistent with the CCMP. Plaintiffs assert that, just as a sale of oil and gas leases on the OCS is reviewable as a federal activity affecting the coastal zone under the CZMA as amended, the grant of suspension of the leases, which substantially extends the primary term of the leases, is also reviewable as a federal activity affecting the coastal zone.

In further support of their argument, Plaintiffs point out that the grant of these suspensions requires certain activities, which are referred to as "milestones." These milestones include the spudding (drilling) of exploration and delineation wells which directly affect the coastal zone.

Defendants argue that the grant of a lease suspension is not a federal activity, as defined by the CZMA, and, therefore, the MMS is not required to give the State a consistency determination. Defendants also respond that the grant of the suspensions of the leases does not authorize any activity that could affect California's coastal zone and, therefore, the MMS is not required to determine that these suspensions are consistent with the State's coastal management program. Defendants assert that before any milestone, including the spudding of new wells, the construction of new offshore platforms and onshore facilities, oil transportation by tanker, and exploration, is authorized, each lessee must file a new or revised EP or DPP early in the lease suspension period. Pursuant to the CZMA, if a lessee files a new EP or DPP, those plans must be consistent with the CCMP. Further, Defendants state that if the lessee files a revised EP or DPP, the MMS will determine whether the revisions involve significant changes in environmental impacts from the impacts evaluated when the original EP or DPP was filed. If the MMS finds that the revisions do involve significant changes in environmental impacts, the revisions must be determined to be consistent with the CCMP before they can be approved. *See* 43 U.S.C. § 1340(e)(1); 30 C.F.R. § 250.203(n)(2). Therefore, Defendants argue that merely granting the suspensions does not authorize any activities or affect the coastal zone and thus that Plaintiffs' arguments are premature.

The Court finds that the MMS's grant of these suspensions is a federal activity, as defined by the CZMA in 16 U.S.C. § 1456(c)(1). Title 15 C.F.R. § 930.31, enacted pursuant to the CZMA, defines "federal activity" as "any functions performed by or on behalf of a Federal agency in the exercise of its statutory responsibilities." The MMS's grant of the suspensions is a federal activity which it carries out in the exercise of its statutory duties.

As noted above, Congress, in the 1990 amendments to the CZMA, advanced the time for review of oil and gas leases for consistency with a State's coastal management program to the time of the sale of the leases. These leases were not subject to consistency review when they were sold because that occurred prior to the clarifying amendments to the CZMA. These lease suspensions extend the primary term of the leases, which would have otherwise expired. At the time these suspensions were granted, the leases were fifteen to thirty years old, although they were entered into as five year leases. The suspensions allowed the leases to continue for lengthy additional terms, from one and half to four additional years. Because oil and gas leases must now be found to be consistent with the State's coastal management program at the time they are sold, the Court finds that the granting of these lengthy lease suspensions, long after the leases were sold and would otherwise have expired, must likewise be subject to a consistency determination as a federal activity affecting the coastal zone, as defined by the CZMA.

The Court's finding is bolstered by the fact that the lessees must engage in certain milestone activities, including the spudding of delineation and exploratory wells, in order to continue the suspensions. Thus, by approving the suspensions, the MMS requires the lessees to engage in activities that directly affect the coastal zone.

Defendants' claim that the future review of the EPs or DPPs that will be submitted for the milestone activities obviates the need to review the lease suspensions for consistency is not well taken. The CZMA, as amended, requires consistency review of leases when they are sold and requires review again later when the EPs and DPPs are submitted. *See* 16 U.S.C. §§ 1456(c)(1), (c)(3)(A) and (c)(3)(B). Thus, under the CZMA, as amended, the later review of the EPs or DPPs for consistency with the CCMP does not obviate the MMS's responsibility to provide the State with a consistency determination at the earlier stage when the lease is sold. Neither does it obviate the need for a consistency determination of the suspension of these leases, which were not reviewed for consistency with the CCMP at the time of their sale.

Furthermore, there is no assurance that if the lessees submit revised, rather than new, EPs and DPPs, those revised plans will be subject to consistency certification. The CZMA does not require all revisions to EPs or DPPs to be subject to consistency certification but rather allows the MMS to decide whether such revisions should be subject to a consistency certification

Therefore, because of Congress's intent to require a federal agency to give the State consistency determinations at the time of the sale of leases, which did not occur in this case, and because the MMS's grant of these suspensions requires activities that affect the coastal zone, the Court finds that the MMS must provide the State with a determination that the lease suspensions are consistent with the State's coastal management program, pursuant to CZMA § 1456(c)(1).

Defendants argue that even if granting lease suspensions is a federal activity as defined by the CZMA, 16 U.S.C. § 1456(c)(1), MMS has already complied by sending a *de facto*

negative determination in its August 13, 1993 letter to the CCC from former Secretary of Interior Babbitt.

Title 15 C.F.R. § 930.35(d) indicates that if a federal agency makes a "negative determination," it need not do a consistency determination or allow consistency review. In a "negative determination," the federal agency notifies the State agency that it has determined that the federal activity does not require consistency determination and briefly states the reasons for its conclusions. *See* 15 C.F.R. § 930.35(d).

The August 13, 1999 letter was not a negative determination as defined by 15 C.F.R. § 930.35(d). The letter did publish the MMS's findings that the granted lease suspensions "will not provide the lessees with any authority to conduct any activities that have the potential to affect the land or water use or natural resources of the State's coastal zone." *See* 5 AR 0865 (August 13, 1999 Letter). However, the letter indicates that the MMS directed suspensions of the leases in order to "maximize" the missions of the State and authorities to have

> a full opportunity to evaluate the appropriateness of developing the leases under the full panoply of Federal and State laws, including but not limited to the Coastal Zone Management Act, the Clean Water Act, the Clean Air Act, and the Commission's extensive regulations.

5 AR 864 (August 13, 1999 letter). Thus, the letter was merely notice to the State authorities that the MMS was gathering information about whether the passage of time and changed circumstances might require that the leases be evaluated under a number of statutes, including the CZMA.

B. Private Activities Requiring A Federal License or Permit

Notwithstanding whether the MMS's grant of the lease suspensions is a federal activity requiring consistency determination under 16 U .S.C. § 1456(c)(1), Plaintiffs argue that the grant of the lease suspensions is a federal license or permit for private activities that affect the coastal zone, as defined by § 1456(c)(3)(A), which require consistency certification. Because the Court has found that the MMS's grant of these suspensions is a federal activity covered by CZMA § 1456(c)(1), the Court will not address whether the MMS's grant of the lease suspensions is a federal license or permit for private activities that affect the coastal zone.

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CONCLUSION

Therefore, pursuant to the CZMA, the MMS must provide the State of California with a determination that its grant of the lease suspensions at issue here is consistent with California's coastal management program.

IT IS SO ORDERED.

NOTES & QUESTIONS:

1. The 9th Circuit affirmed the California v. Norton case, 311 F.3d 1162 (2002). The court provided the following background:

This case implicates California's ability to review and influence decisions of the federal government regarding oil drilling in federal waters off of California's coast. Our decision today necessarily involves a rather long and complex textual journey through an interwoven scheme of federal and State statutes and regulations. Before we embark, we briefly recollect the failures that these environmental protections are designed to prevent by providing for substantial State involvement in federal decisions concerning offshore oil drilling.

Five miles off the shore of the small beach town of Summerland, California, at 10:45 a.m. on Tuesday, January 28, 1969, crews on Union Oil Company offshore Platform Alpha were pulling the drilling tube out of well A-21 in order to assess their progress. Mud began to ooze up from the depths through the well shaft, signaling that something had gone wrong below. Within minutes, tons of mud spewed out of the top of the well propelled by a blast of natural gas. Frantic platform workers quickly capped the well, but it was too late to stop the rushing rent of oil rising from 3,000 feet below the ocean floor. The unlined walls of the well shaft gave way and oil poured into the surrounding geological formation under the sea floor. As the pressure continued to build, the oil burst upward through the roof of the Venture Anticline, ripped five long gashes in the ocean floor, and rose 188 feet through the blue-green waters of the Santa Barbara channel. The flow continued at thousands of gallons per hour for more than a week, spreading a tar-black patch seaward over eight hundred square miles of ocean.

Then on the evening of Tuesday, February 4, the wind shifted and blew hard onshore, driving the oil into Santa Barbara harbor and fouling thirty miles of beaches up and down the coast. For weeks on end "[a] dense acrid stench clung to the shoreline as a force of 1000 men--many of them prisoners--pitchforked tons of straw onto the stained sand and murky tide to soak up the mess." *Great Oil Slick Cleanup--The 'Impossible' Task,* S.F. Chron., Feb. 10, 1969 at 2. The cleanup efforts proved largely ineffective against the mass of oil, and thousands of sea birds were killed along with seals and other marine mammals. By February 24, another well on Platform Alpha had blown out, and the oil-gushing fractures had spread over acres of ocean floor. County of Santa Barbara Planning and Development Energy Division,

The nation was confronted with an environmental disaster of unprecedented proportions that might have been avoided but for a failure of federal oversight. A federal regulator had approved Union Oil's request to waive safety requirements that called for well shafts to be lined with hardened casing to prevent just the type of accident that occurred. Secretary of the Interior Walter J. Hickel immediately accepted some measure of responsibility, and the White House Council on Environmental Quality later acknowledged that "[t]he federal government had largely ignored the need to protect commercial, recreational, aesthetic, and ecological values of the area."

In the aftermath of the spill, California Congressman John V. Tunney took to the well of the House to declare that "ill-planned offshore oil drilling" was a manifestation of "centuries of careless neglect of the environment [that] have brought mankind to a final crossroads," and that "the quality of our lives is eroded and our very existence threatened by our abuse of the natural world." 116 Cong. Rec. 498 (1970). President Richard Nixon personally viewed the damage and agreed that the Santa Barbara spill "frankly touched the conscience of the American people." *The Santa Barbara Oil Spill: A Retrospective* at 3.

B. Statutory Background

As President Nixon aptly observed, the Santa Barbara spill changed the nation's attitudes towards the environment. Some would trace the current framework of environmental protections in substantial measure directly to the Santa Barbara spill. *See, e.g.,* Miles Corwin, *The Oil Spill Heard 'Round The Country',* L.A. Times, Jan. 28, 1989. Of particular relevance here, the federal Coastal Zone Management Act and California's Coastal Act followed in the wake of the spill and both provided California substantial oversight authority for offshore oil drilling in federally controlled areas.

2. Prior to the passage of the "phased" leasing and development provisions of the 1978 Amendments, an OCS lease was interpreted to give the lessee the right to eventually develop the resources, albeit subject to continuing supervision by the Department of Interior for the protection of the environment. If the Department were to "suspend" drilling authorization necessary to the recovery of the mineral for an unreasonable time, however, it would be a "taking" of a property right, one which would require compensation. *Union Oil Company of California v. Morton*, 512 F.2d 743 (9th Cir. 1975). Similarly, the Mineral Leasing Act for onshore leases does not contain a statutory phasing. Therefore, unless the Department of Interior in the lease expressly retains the right to veto all proposed development, some oil and gas development must be allowed. *Sierra Club v. Peterson*, 717 F.2d 1409 (D.C.C.A. 1983); *Bass Enterprises Production Co. v. U.S.*, 45 Fed. Cl. 120 (1999) (denial of permits to drill a “temporary taking” of property requiring compensation equivalent to interest on profits company would have earned), on remand from 133 F.3d 893 (Fed.Cir. 1998) (denial of permits pending consideration of site as nuclear waste site not a permanent taking of property). See, Marla E. Mansfield, *Through the Forest of the Onshore Oil and Gas Leasing Controversy Toward a Paradigm of NEPA Compliance*, 24 LAND & WATER L.REV. 85 (1989).

3. Look carefully at the provisions of the OCLSA that allow the Department of Interior to veto proposed exploration after leasing:

(c) Plan approval; State concurrence; plan provisions

(1) Except as otherwise provided in this subchapter, prior to commencing exploration pursuant to any oil and gas lease issued or maintained under

> this subchapter, the holder thereof shall submit an exploration plan to the Secretary for approval. Such plan may apply to more than one lease held by a lessee in any one region of the outer Continental Shelf, or by a group of lessees acting under a unitization, pooling, or drilling agreement, and shall be approved by the Secretary if he finds that such plan is consistent with the provisions of this subchapter, regulations prescribed under this subchapter, including regulations prescribed by the Secretary pursuant to paragraph (8) of section 1334(a) of this title, and the provisions of such lease. The Secretary shall require such modifications of such plan as are necessary to achieve such consistency. The Secretary shall approve such plan, as submitted or modified, within thirty days of its submission, except that the Secretary shall disapprove such plan if he determines that (A) any proposed activity under such plan would result in any condition described in section 1334(a)(2)(A)(i) of this title, and (B) such proposed activity cannot be modified to avoid such condition. If the Secretary disapproves a plan under the preceding sentence, he may, subject to section 1334(a)(2)(B) of this title, cancel such lease and the lessee shall be entitled to compensation in accordance with the regulations prescribed under section 1334(a)(2)(C)(i) or (ii) of this title.43 U.S.C. § 1340(c)(1).

Section 1334(a)(2)(A)(I) of Title 43 provides:
(2) with respect to cancellation of any lease or permit--

> (A) that such cancellation may occur at any time, if the Secretary determines, after a hearing, that--
>
> > (i) continued activity pursuant to such lease or permit would probably cause serious harm or damage to life (including fish and other aquatic life), to property, to any mineral (in areas leased or not leased), to the national security or defense, or to the marine, coastal, or human environment;

See also 43 U.S.C. §1531(h)(1) (referring to disapproval of plans of development and production)

Is the government off scott-free if it denies all development? Is it able to say "no" for any reason or for no reason at all? Is the discretion to lease or not lease broader than the discretion to say no to a development plan. See, *Village of False Pass v. Clark*, 733 F.2d 605 (9th Cir. 1984) (J.Canby, concurring in part and dissenting in part).

4. Generally, Outer Continental Shelf Leases are subject to regulations issued under the Act. What if a subsequently passed *statute* required the Department of the Interior to put a moratorium on considering “plans of exploration” (POE’s) in order to study protection of the Outer Banks? Would the staged development scenario of the OCLSA allow for such a suspension of consideration? In *Conoco Inc. v. United States,* 35 Fed.Cl. 309 (1996), the Court of Claims ruled the prohibition of considering POE’s was a breach of

contract by the federal government. The lease assured that the Department of Interior would at least *consider* the POE's in good faith and would suspend the lease only upon one of the findings provided for in the OCLSA. The Federal Circuit Court of Appeals reversed this ruling on factual grounds: it found that what precluded plan approval was a finding by the governor of North Carolina that the development was not consistent with North Carolina's coastal zone protection plan. *Marathon Oil Co. v. U.S.*, 177 F.3d 1331(Fed. Cir. 1999).

In *Mobil Oil Exploration & Producing Southeast, Inc. v. United States*, 120 S.Ct 2423 (200), the Supreme Court reversed the Federal Circuit. Justice Breyer, writing for the Court, found the Department of Interior's failure to follow the procedures and standards referenced in the lease was a breach of the lease. Failing to approve the POE within thirty days was not a technical nor insubstantial breach, but was a repudiation of the lease, which allowed the lessees to seek restitution of their monies paid, regardless of proving specific damages. The sole dissenter, Justice Stevens, found that there was a breach of contract, but that damages for the delay would be a sufficient remedy because the lessees knew of North Carolina's objection to the project from the outset. The state's formal finding of inconsistency came only sixty days after the date that Interior should have granted its approval. The government continued to do environmental studies and the Department of Commerce considered the lessees' attempts to override the state's determination of inconsistency with the state's Coastal Zone Management Plan. Therefore, the government continued to perform under the leases and did not repudiate the leases. Why would stopping development on the ground that the development was inconsistent with North Carolina's Coastal Zone Management Plan not be a breach of contract?

5. Compare the authority the United States retains to regulate a leasehold with that which it maintains over a miner on an unpatented mining claim. *See*, *U.S. v. Friedland*, 152 F. Supp. 2d 1234 (D.C. Colo. 2001) (no liability for U.S. as "owner" under CERCLA).

6. In various forms through the years, Congress or the Executive branch has put much of the OCS off the east and west coasts off-limits to oil and gas leasing. The first Congressional moratorium was passed in an appropriations bill for the Department of Interior in 1982. The previous year, Secretary of Interior James Watt under President Ronald Reagan had proposed leasing almost one billion acres over a five-year period. The first moratorium merely forbade leasing off of certain California coasts. By 1989, the acreage Congress put "off limits" rose to more than 181 million acres, located not only off of California but also off New England and to the east of Florida. In 1990, President George Bush canceled lease sales off of California, Washington, Oregon Florida and in the Georges Bank area of the Atlantic Ocean. Additionally, he imposed a moratorium on leasing in those areas until 2002. In 1998, President Clinton similarly banned leasing off most of the U.S. coastline. Leasing remained an option in the central and western part of the Gulf of Mexico and off parts of Alaska. President George W. Bush also respected many of these areas as not subject to leasing. The American oil and gas industry, however, bemoaned the hamstringing of domestic production.

Rising oil and gas prices and revenue-sharing with states could modify the existing resistance towards leasing. The Energy Policy Act of 2005 takes a reserved step towards at least assessing leasing. For example, Section 357 requires an inventory of all laws and regulations at every governmental level that restrict development of identified offshore resources. Another section of the Act authorized $1 billion dollars to be paid to coastal states and subdivisions over a five-year period; this Section 354 earmarks the funding for planning and remedying impacts from OCS activities.

7. See generally, Marla E. Mansfield and James E. Hickey, Jr., *Oil*, in The Energy Law Group, ENERGY LAW AND POLICY FOR THE 21ST CENTURY, 7-21 to 7-24 (Rocky Mountain Mineral Law Foundation 2000).

D. State Regulation of Oil and Gas Production

As detailed in Chapter 4, states may regulate some natural gas providers that are utilities under regulated industry law. The states are also considered with oil and gas production. Regulation may be done to conserve the oil or gas resource itself or to protect other resources from the impacts of development. See Chapter 6, *infra*, for a discussion of state conservation laws. Environmental controls include well siting requirements and regulating the disposal of produced saltwater, drilling muds, and NORM ("naturally occurring radioactive material," which sometimes is associated with petroleum deposits). Many producing states have passed surface damage statutes to recompense surface owners for the diminution of value caused by drilling operations. Additionally, the Clean Air Act may reach emissions from some wellsites.

DELETE pages 287-298 and insert:

Because *Northwest Central* has brought us back to § 1(b) of the NGA, it is instructive to look at another exemption from federal jurisdiction, namely the exception of "gathering." Two questions arise. First, what is gathering? Offshore development has forced some reexamination of premises. Second, as you recall, prior to Order 636 and other efforts to achieve "unbundling," such as Order 436, interstate pipelines frequently charged one rate for total service: gas sales, transportation, storage, and gathering. In the post-636 world, interstate pipelines are seeking separate charges and some are selling their gathering lines to either a subsidiary or unrelated company. The new question is whether FERC may control these gathering facilities. In answering these questions, consider the following case.

In so doing, it is also instructive to look at two other sections of the NGA, namely §§ 4 & 5, which in relevant part read:

> All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate

> or charge that is not just and reasonable is declared to be unlawful. 15 U.S.C. § 717c(a); Section 4(a)
> Whenever the Commission, after a hearing ... shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission ... is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force and shall fix the same by order. 15 U.S.C. § 717d(a); Section 5(a)

Note that FERC must take cognizance of prices received by "natural gas companies" when they are "in connection" with jurisdictional sales or transmission.

WILLIAMS GAS PROCESSING - GULF COAST COMPANY, L.P. v. FERC
373 F.3d 1335 (2004)

I.

The Natural Gas Act (NGA), 15 U.S.C. §§ 717-717w, grants FERC jurisdiction over rates charged by any "natural-gas company for or in connection with the transportation or sale of natural gas." Id.§ 717c(a). A "natural-gas company," in turn, includes any firm "engaged in the transportation of natural gas in interstate commerce." Id. § 717a(6). The "gathering" of gas -- "generally defined as the process of taking natural gas from the wells and moving it to a collection point for further movement through a pipeline's principal transmission system," *Williams Gas Processing - Gulf Coast Co., L.P. v. FERC*, 331 F.3d 1011, 1013 (D.C.Cir.2003) (internal quotation marks omitted) -- is explicitly excluded, however, from FERC's jurisdiction. See 15 U.S.C. § 717(b) ("this chapter ... shall not apply to ... the production or gathering of natural gas"). Notwithstanding that jurisdictional limitation, FERC historically exercised jurisdiction over gathering services provided directly by interstate pipelines on the theory that such gathering services are provided "in connection with" the interstate transportation of gas. FERC, however, has never claimed jurisdiction over stand-alone gathering entities, i.e., gathering facilities that are neither owned by nor affiliated with a pipeline within FERC's jurisdiction.

In response to this regulatory environment, several jurisdictional pipelines that provided gathering services sought either to "spin off" their gathering facilities as unrelated corporations or to "spin down" the gathering operations to corporate affiliates by transferring ownership of the gathering facilities from the pipeline to a subsidiary. While a gathering service spun off from a jurisdictional pipeline into a separate corporation was clearly beyond FERC's NGA jurisdiction, the jurisdictional status of gatherers spun down from an interstate pipeline was less clear. FERC had claimed that it retained "in connection with" jurisdiction over the rates charged by spun-down gatherers. But FERC never found occasion to exercise its authority over such an entity. In fact, when the gathering affiliate in Northwest Pipeline challenged FERC's statutory authority for such

jurisdiction in the court of appeals, "[t]he Commission represented ... that its orders neither assert[ed] jurisdiction nor impl[ied] that it ha[d] jurisdiction over [the gathering affiliate] at the present time." *Williams Gas Processing Co. v. FERC*, 17 F.3d 1320, 1322 (10th Cir.1994). The Tenth Circuit therefore dismissed the petition for review for lack of a case or controversy.

The Commission sought to resolve the jurisdictional status of spun-down gathering entities in *Arkla Gathering Services Company*, 67 FERC ¶ 61,257, 1994 WL 237088 (1994). FERC there reviewed a jurisdictional pipeline's proposal to spin down its gathering facilities to an affiliate and various objections to that application. The Commission concluded that, as a general matter, it lacked jurisdiction over "companies that perform only a gathering function"; "whether they are independent or affiliated with an interstate pipeline," such gathering entities "are not natural gas companies" under the NGA. The Commission, though, found it hard to let go: FERC still maintained that it could, "in particular circumstances," reassert jurisdiction over a jurisdictional pipeline's gathering affiliate "where such action is necessary to accomplish the Commission's policies for the transportation of natural gas in interstate commerce." The Commission warned that "if an affiliated gatherer acts in concert with its pipeline affiliate ... and in a manner that frustrates the Commission's effective regulation of the interstate pipeline," the Commission would set aside "the separate corporate structures and treat the pipeline ... as it would if the gathering facilities were owned directly by an interstate pipeline." *Id*.

The Commission went on to explain, however, that only certain "types of affiliate abuses" -- those "arising specifically from the interrelationship between the pipeline and its affiliate" -- would "trigger the Commission's authority to disregard the corporate form" and permit it to assert jurisdiction over a spun-down gathering affiliate. *Id.* Such abuses included "the affiliate's giving preferences to market affiliate gas or tying gathering service to the pipeline's jurisdictional transmission service; the pipeline's giving transportation discounts only to those utilizing the affiliate's gathering service; and actions resulting in cross-subsidization between the affiliate's gathering rates and the pipeline's transmission rates." *Id.* While the Commission acknowledged that "an affiliate could undertake other types of anti-competitive activities," the Commission viewed its residual jurisdiction as reaching only scenarios "where the abuse is directly related to the affiliate's unique relationship with an interstate pipeline." *Id.* Only that brand of anti-competitive behavior breached "the arm's length relationship between the pipeline and an affiliated gathering company" and thereby authorized the Commission to treat a jurisdictional pipeline and its gathering affiliate "together as a single 'natural gas company' " subject to FERC jurisdiction. *Id*.

We affirmed FERC's approval of the spin-down of the Arkla gathering facilities. Specifically, we rejected the objections of various gas producers to the Commission's determination that it generally lacked NGA jurisdiction over gathering affiliates. We also approved -- "[a]s an abstract matter" -- the Commission's new policy concerning NGA gathering affiliates, stating "we have no reason to doubt the Commission's conclusion that a nonjurisdictional entity could act in a manner that would change its status by

enabling an affiliated interstate pipeline to manipulate access and costs of gathering." We explicitly acknowledged, however, that the question had not yet been squarely presented for resolution "because the Commission has yet to assert its jurisdiction over a gathering affiliate." That time has now come.

II.

Transcontinental Gas Pipe Line Corporation (Transco) is a FERC-regulated natural gas transportation company that operates approximately 10,500 miles of natural gas pipeline extending from the Gulf of Mexico to New York. In November 2000, Transco sought permission from FERC to spin down its gathering facilities in the Gulf of Mexico located offshore of North Padre Island, Texas to its gathering affiliate Williams Gas Processing - Gulf Coast Company, L.P. (WGP).[3] The North Padre Island (NPI) gathering facilities consist of two small offshore legs -- 3.83 miles of 10-inch pipeline and 18.79 miles of 20-inch pipeline -- both of which gather and move gas before converging offshore and connecting to Transco's separate 24-inch pipeline that provides IT-feeder service[4] to an onshore processing facility and eventually to Transco's main pipeline in Texas.

FERC approved the spin-down of the NPI gathering facilities to WGP over the objections of numerous producers and shippers, including Shell Offshore Inc., an intervenor in this proceeding. Moreover, as WGP engaged only in gathering and other nonjurisdictional activities, the Commission concluded that once ownership of the NPI facilities was transferred from Transco to WGP, those facilities would become exempt from FERC's NGA jurisdiction. ... Transco closed the spin-down of the NPI gathering facilities to WGP on December 1, 2001, and those facilities are now operated by Williams Field Services (WFS), a wholly-owned subsidiary of WGP.

Intervenor Shell Offshore Inc. (Shell) produced gas offshore of North Padre Island, Texas and delivered its gas into the NPI 20-inch gathering pipeline at an interconnection 3.08 miles from that pipe's interconnection to Transco's24- inch IT-feeder line. Prior to the spin-down of the NPI facilities, Transco charged Shell $0.08 per dekatherm to gather and transport Shell's gas 230 miles from Shell's NPI interconnection to Transco's main line. After the spin-down, WFS informed Shell that it intended to charge Shell $0.12 per dekatherm to gather and move Shell's gas just the 3.08 miles from Shell's NPI interconnection to Transco's 24-inch IT-feeder line. For its part, Transco proposed to maintain its transportation rate of $0.08 per dekatherm for the remaining 227 miles of IT-feeder service. Shell was thus being asked to pay $0.20 per dekatherm to move its gas to Transco's main line, whereas before the spin-down it had paid $0.08 per dekatherm for the same 230-mile haul.

Unable to reach an agreement with WFS on an appropriate gathering charge, on November 30, 2001, Shell filed a complaint with the Commission against Transco, WGP,

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[3] Both Transco and WGP are wholly owned by The Williams Companies, Inc., a publicly-traded corporation.

[4] This IT-feeder service is an interruptible gas transportation service that has higher priority than Transco's other interruptible service.

and WFS, and shortly thereafter shut in its gas. The complaint alleged that Transco and WFS were unlawfully leveraging their dominance in the North Padre Island gathering and transportation markets in an effort to force Shell to pay unjust and unreasonable gathering rates and to accept anticompetitive terms and conditions of gathering service, such as promising to dedicate its North Padre gas reserves to WFS gathering for the life of production. The complaint urged the Commission to find that Transco and WFS were acting in concert and in an anti-competitive manner that frustrated the Commission's ability to regulate Transco's jurisdictional pipeline, and further requested that FERC reassert jurisdiction over the NPI gathering facilities pursuant to its *Arkla Gathering* theory of residual jurisdiction.

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WFS attempted to reach a settlement with Shell, offering to provide gathering service for $0.08 per dekatherm. Shell countered with an offer of $0.019 per dekatherm, which WFS rejected. With the parties at loggerheads, the dispute was thrown to the Commission for resolution, [and the Commission sent the case for a hearing before an Administrative Law Judge.]

The hearing before the ALJ commenced in April 2002. ... [I]n June 2002 the ALJ ruled in Shell's favor, concluding that Transco and WFS "in fact have acted in concert in offering gathering services and have abused their monopoly market power in a manner that frustrates the Commission's effective regulation of Transco and the interstate transportation of natural gas from the North Padre Island (NPI) system." Consistent with the Commission's instructions, the ALJ left it for the Commission to decide whether or not to reassert NGA jurisdiction over the NPI gathering facilities.

The Commission affirmed the ALJ's factual findings, concluding that the ALJ's analysis was "generally well-reasoned and provide[d] a sound basis for reasserting NGA jurisdiction over the ... spundown NPI gathering facilities." The Commission applied the two-part test set forth in Arkla Gathering, though it did so in a manner that "diverge[d] slightly from the ALJ." As to the first part -- whether Transco and WFS had acted in concert -- the Commission adopted the ALJ's finding that they had. To address the second half of the test -- whether the concerted action frustrated the Commission's effective regulation of Transco -- the Commission first made a predicate finding: Because Transco's and WFS's actions were "conducted on a concerted basis, the actions of WFS can be attributed to Transco, and vice versa, as if the facilities were still part of the Transco system." The Commission therefore reframed the second question, asking "whether the rates and terms and conditions of service exacted directly by WFS, and indirectly by Transco, for the subject gathering services, are unjust and unreasonable or unduly discriminatory...." The answer was yes, and the Commission thus concluded that "[b]y demanding a monopolistically egregious rate in conjunction with anticompetitive terms and conditions of service, ... the single entity, Transco/WFS, frustrated the Commission's regulation over the rates and services provided on Transco." Based on these findings, the Commission reasserted NGA jurisdiction over the NPI gathering facilities and established $0.0169 per dekatherm as a just and reasonable unbundled gathering rate for Shell.

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WGP now seeks review in this court, raising substantially the same arguments as in its petition for rehearing before the Commission. We vacate the Commission's Order and Order on Rehearing and remand for further proceedings.

III.

We review orders of the Commission under the standards of the Administrative Procedure Act, upsetting agency action only when it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A). Under this standard, while we will defer to an agency's reasonable application of its own precedents, we will not countenance an agency's departure from its precedent without explanation. Under the NGA, the Commission's factual findings will be upheld so long as they are supported by substantial evidence. See 15 U.S.C. § 717r(b).

In this case, the Commission posited two statutory bases for reasserting jurisdiction over the NPI gathering facilities and setting a cost-based gathering rate -- the NGA and OCSLA. We address ...[only the NGA claim]..

A. NGA Jurisdiction

As discussed above, the NGA expressly disclaims jurisdiction over gas gathering. Where, however, the gathering entity is a corporate affiliate of a jurisdictional pipeline, the Commission, in its *Arkla Gathering* order, reserved the right to reassert jurisdiction over the gathering affiliate "in particular circumstances" pursuant to its "in connection with" jurisdiction under Sections 4 and 5 of the Act, id. §§ 717c, 717d. 67 FERC at 61,871. In fleshing out the "particular circumstances" that might give rise to a reclamation of jurisdiction, the *Arkla Gathering* decision established a two-part test: (1) concerted action between the jurisdictional pipeline and its gathering affiliate, (2) undertaken in a manner that frustrates the Commission's ability to regulate the jurisdictional pipeline.

But the *Arkla Gathering* decision did not end there. The Commission went on to elaborate that its ability to reassert jurisdiction was "limited to" abuses "directly related to the affiliate's unique relationship with an interstate pipeline," such as "tying gathering service to the pipeline's jurisdictional Transmission service" or "cross-subsidization between the affiliate's gathering rates and the pipeline's transmission rates." Id. Only those types of activities -- where the affiliate is leveraging its relationship with the pipeline to enhance its market power -- would "trigger the Commission's authority to disregard the corporate form" and treat the pipeline and its affiliate as a single entity.

The allegedly anti-competitive actions undertaken by WFS against Shell fall outside this category. Shell lays two main charges: that WFS (1) charged an exorbitant gathering rate; and (2) attached anti-competitive conditions to its gathering service, including that

Shell commit all its remaining reserves to be gathered by WFS. WFS could do these things for one reason only -- because it was a recently deregulated monopolist in the North Padre gathering market. The fact that WFS is an affiliate of Transco is utterly irrelevant to its ability to charge high rates, or to impose onerous conditions for gathering service. This irrelevance is demonstrated by the fact that WFS, as a deregulated monopolist, could have (and likely would have) undertaken the same course of conduct had Transco been owned by someone else entirely. The fact that WFS had an affiliate relationship with Transco neither enhanced nor detracted from its ability to charge high rates or impose onerous conditions.

In this respect, WFS's conduct is quite different from the tying or cross-subsidization examples in *Arkla Gathering*. A tying arrangement -- conditioning the sale of a good or service on the purchase of another different (or tied) good or service – creates a relationship between the tied products. If the tie is the result of the affiliation between two firms, with each firm producing one of the underlying goods, then it is that relationship that gives rise to the market-distorting competitive advantage of the tied product. So too in a cross-subsidization scenario. Cross subsidization occurs when a carrier attributes costs from its unregulated services to its regulated services, resulting in an inflated cost-based rate for the regulated service. Customers of the regulated monopoly thus bear part of the costs of -- i.e., they subsidize -- the unregulated service. The competitive advantage for the subsidized unregulated service depends on its relationship with the regulated service.

WFS, though -- unlike a participant in a tying or cross-subsidization scheme -- is able to engage in its allegedly anticompetitive conduct even in the absence of its affiliate relationship with Transco. Thus because WFS'sactions do not "aris[e] specifically from the interrelationship between [Transco] and [WFS]," they are not among the types of "affiliate abuses which would trigger the Commission's authority to disregard the corporate form" and to reassert jurisdiction. *Arkla Gathering Servs*., 67 FERC at 61,871.

Moreover, the Commission misapplied its two-part *Arkla Gathering* test. The point of the *Arkla Gathering* test is to identify the limited scenarios when the Commission "may look through, or disregard, the separate corporate structures and treat the pipeline and gatherer as a single entity." Id. Only when the Commission finds both concerted action between a jurisdictional pipeline and its gathering affiliate and that the concerted action frustrates the Commission's effective regulation of the pipeline, may it then pierce the corporate veil and treat the legally distinct entities as one.

Here, however, the Commission found the requisite frustration of regulation by piercing WFS's corporate veil one step earlier in the *Arkla Gathering* analysis. After finding concerted action between WFS and Transco, but before addressing the second part of the *Arkla Gathering* test, the Commission jumped to the conclusion, reasoning that "[b]ecause their actions have been found to have been conducted on a concerted basis, the actions of WFS can be attributed to Transco, and vice versa, as if the facilities were still part of the Transco system." Order, 100 FERC at 61,913. By conflating WFS and Transco into a single unit -- in FERC's words "the Transco/WFS monopoly," -- the

Commission could thus attribute the gatherer's alleged malfeasance to the pipeline, and apply the pipeline's regulatory requirements to the gatherer. This absolved the Commission of the burden of showing that the concerted action frustrated the Commission's ability to regulate the pipeline. If WFS is Transco, and Transco is subject to just and reasonable rate regulation, then WFS's (Transco's) price hikes frustrate FERC's ability to maintain just and reasonable rates on Transco (which includes WFS).

This line of reasoning founders as it adopts as its first premise (WFS is Transco) the *Arkla Gathering* test's ultimate conclusion -- that the corporate form may be set aside. This is a plainly unreasonable application of the Commission's *Arkla* decision. Therefore we must set aside the Commission's orders reasserting NGA jurisdiction over the NPI gathering facilities as arbitrary and capricious. Because our conclusion is based on deficiencies in the Commission's orders, we need not today confront WGP's broader statutory argument that NGA does not ever permit the Commission to assert jurisdiction over gas gatherers, including those affiliated with jurisdictional pipelines. We express no opinion on that question, leaving it for another day.

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NOTES

1. The primary function test to determine if an activity is gathering was articulated by the Commission in Farmland Industries, Inc., 23 F.E.R.C.¶ 61,063 at 61,143 (1983), and later modified in Amerada Hess Corp., 52 F.E.R.C. ¶ 61,268 at 61,987-88 (1990). It is sometimes referred to as the *Farmland* test. The court in *Conoco* explained:

> The primary function test is a set of factors that tend to indicate whether a facility is devoted to the collection of gas from wells-- gathering--or to the further ("downstream") long-distance movement of gas after it has been collected--interstate transportation. The test requires the Commission to "assess and weigh all of the specific facts and circumstances present in a given system." Several criteria are relevant, particularly the physical, geographical, and operational aspects of the facilities, but no factor is determinative, nor do all factors apply in every situation.
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> ***
>
> ... [T]he Commission here gave reasoned consideration to each of the pertinent factors of the primary function test, articulating conclusions based on factual findings. The Producers identify no critical evidence that would undermine the Commission's decision. In evaluating and balancing the several factors under the primary function test, the Commission brings to bear its considerable expertise about the natural gas industry. Consequently, in view of the substantial evidence to support the Commission's findings, there is no basis for the court to substitute its judgment for that of the Commission. *Conoco Inc. v. Federal Energy Regulatory Commission*, 90 F.3d 536 (D.C. Cir. 1996), *cert. denied* 519 U.S. 1142 (1997)

The six factors are: (1) the length and diameter of the relevant lines; (2) the extension of the facility beyond the central point in the field; (3) the lines' geographic configuration; (4) the location of compressors and processing plants; (5) the location of wells along all

or part of the facility; and (6) the operating pressure of the lines. The first five factors were relied on by the Commission in *Farmland* and the sixth factor was considered in *Amerada Hess*.

2. Because of the length and diameter of many offshore pipelines that are arguably gathering, there have been some controversies. See, *EP Operating Co. v. FERC*. 876 F.2d 46 (1989); *Exxon Mobil Gas Marketing v. FERC*, 297 F.3d 1071 (D.C. Cir. 2002) It should be noted that these considerations are to determine FERC jurisdiction under the NGA; FERC also has jurisdiction over OCS facilities under the OCSLA, but that authority may be limited to assuring that the facilities are operated as common carriers. Therefore, FERC prefers to rely on NGA authority, which, of course, includes the right to assure rates are "just and reasonable."

3. States may also attempt to regulate gathering. Oklahoma's statute allows a producer, purchaser, or gas transporter to file a complaint against a gatherer with the Corporation Commission. The Commission would then ascertain the reasonableness of the rates. At attempt to bolster this authority was vetoed by then Governor Keating during the summer of 1998, but later was passed.

INSERT at Page 298:

F. Jurisdiction over LNG (Liquified Natural Gas)

Natural gas has traditionally been transported by pipeline because of its gaseous state. Pipelines under long stretches of ocean are problematic at best, which therefore limited sources of natural gas. Liquified natural gas ("LNG"), however, can be transported by specialized tanker. Therefore, the LNG could be imported. The LNG is under high pressure. To make use of the LNG requires facilities to return it to the gaseous state. At this point, the former LNG is transported through the existing natural gas infrastructure. Siting of the onshore off-loading facilities has be controversial.

States, such as California in the case of a Long Beach facility, claimed that state public utility commissions should authorize construction, issuing the necessary certificates of necessity and convenience. The FERC argued the facilities were interstate in nature. Congress, in 2005, gave siting authority to FERC. It amended Section 1(b) of the NGA (15 U.S.C. 717 (b)) to expand FERC jurisdiction by inserting ‘‘and to the importation or exportation of natural gas in foreign commerce and to persons engaged in such importation or exportation,’’ after ‘‘such transportation or sale." The Energy Policy Act of 2005 defines steps for licensing LNG terminals. Other laws, however, still give state imput over siting. These laws include the Coastal Zone Management Act, the Clean Air Act, the Clean Water Act and the National Environmental Policy Act.

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2. Transmission Access: 1935 through Orders 888-2000

Otter Power allowed a court to order wheeling as an anti-trust remedy. The Court noted that this remedy would not interfere with the FERC's jurisdiction under the Federal Power Act. Under the initial Federal Power Act in 1935, the federal agency had only limited authority to require wheeling or to order interconnects. It could only do so if a state regulatory commission requested, or in time of war or other emergency. In 1978, PURPA gave FERC more authority to order wholesale wheeling on the application of a electric utility but imposed several limitations. The FERC order could not "unduly burden the wheeling entity" or "unreasonably impair service." Because the wheeling could not disturb existing competitive relationships or require the wheeler to transmit electricity that would replace sales of electricity pursuant to a contract or rate, the PURPA authority was not used to a large extent. The Energy Policy Act of 1992 changed this state of affairs in regard to transmission access. The Act gives FERC the power to order wholesale wheeling in individual settings when a third party requests. FERC may order electric utilities, qualifying facilities, and federal marketing agencies to wheel.[5] Before FERC will compel wheeling, however, several preconditions must be met.

The Supreme Court discusses not only the statutory history of open access, but FERC's administrative response. As with natural gas, FERC moved by rule to foster competitive markets.

NEW YORK v. FEDERAL ENERGY REGULATORY COMMISSION
535 U.S. 1 (2002).

STEVENS, J., delivered the opinion of the Court, Parts II and III of which were unanimous, and Parts I and IV of which were joined by REHNQUIST, C. J., and O'CONNOR, SOUTER, GINSBURG, and BREYER, JJ. THOMAS, J., filed an opinion concurring in part and dissenting in part, in which SCALIA and KENNEDY, JJ., joined, *post,* p. 1029.

Justice STEVENS delivered the opinion of the Court.

These cases raise two important questions concerning the jurisdiction of the Federal Energy Regulatory Commission (FERC or Commission) over the transmission of electricity. First, if a public utility "unbundles"--*i.e.,* separates--the cost of transmission from the cost of electrical energy when billing its retail customers, may FERC require the utility to transmit competitors' electricity over its lines on the same terms that the utility applies to its own energy transmissions? Second, must FERC impose that requirement on utilities that continue to offer only "bundled" retail sales?

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[5] §§ 211 and 212 of the Federal Power Act, as amended by the Energy Policy Act of 1992, codified at 16 U.S.C. § 824k

In Order No. 888, issued in 1996 with the stated purpose of "Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities," [6] FERC answered yes to the first question and no to the second. It based its answers on provisions of the Federal Power Act (FPA), as added by § 213, 49 Stat. 847, and as amended, 16 U.S.C. § 824 *et seq.,* enacted in 1935. Whether or not the 1935 Congress foresaw the dramatic changes in the power industry that have occurred in recent decades, we are persuaded, as was the Court of Appeals, that FERC properly construed its statutory authority.

In 1935, when the FPA became law, most electricity was sold by vertically integrated utilities that had constructed their own power plants, transmission lines, and local delivery systems. Although there were some interconnections among utilities, most operated as separate, local monopolies subject to state or local regulation. Their sales were "bundled," meaning that consumers paid a single charge that included both the cost of the electric energy and the cost of its delivery. Competition among utilities was not prevalent.

Prior to 1935, the States possessed broad authority to regulate public utilities, but this power was limited by our cases holding that the negative impact of the Commerce Clause prohibits state regulation that directly burdens interstate commerce. When confronted with an attempt by Rhode Island to regulate the rates charged by a Rhode Island plant selling electricity to a Massachusetts company, which resold the electricity to the city of Attleboro, Massachusetts, we invalidated the regulation because it imposed a "direct burden upon interstate commerce." *Public Util. Comm'n of R.I. v. Attleboro Steam & Elec. Co.,* 273 U.S. 83, 89 (1927). Creating what has become known as the "*Attleboro* gap," we held that this interstate transaction was not subject to regulation by either Rhode Island or Massachusetts, but only "by the exercise of the power vested in Congress." *Id.,* at 90.

When it enacted the FPA in 1935, Congress authorized federal regulation of electricity in areas beyond the reach of state power, such as the gap identified in *Attleboro,* but it also extended federal coverage to some areas that previously had been state regulated, see, *e.g., id.,* at 87-88 (explaining, prior to the FPA's enactment, that state regulations affecting interstate utility transactions were permissible if they did not directly burden interstate commerce). The FPA charged the Federal Power Commission (FPC), the predecessor of FERC, "to provide effective federal regulation of the expanding business of transmitting and selling electric power in interstate commerce." *Gulf States Util. Co.*

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6 FERC Stats. & Regs., Regs. Preambles, Jan. 1991-June 1996, ¶ 31,036, p. 31,632, 61 Fed.Reg. 21540 (1996). Order No. 888 also deals with the recovery of "stranded costs" by utilities, but this aspect of the order is not before us. [ED: "Stranded costs" represent facilities built and no longer required when a customer shifts servicer or when lower priced generation otherwise displaces the need for the facility. Facilities in the past had only been constructed after the relevant regulator granted a certificate of necessity and convenience. In principle, FERC believed these stranded costs should be recovered and detailed various scenarios.]

v. FPC, 411 U.S. 747, 758 (1973). Specifically, in § 201(b) of the FPA, Congress recognized the FPC's jurisdiction as including "the transmission of electric energy in interstate commerce" and "the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b). Furthermore, § 205 of the FPA prohibited, among other things, unreasonable rates and undue discrimination "with respect to any transmission or sale subject to the jurisdiction of the Commission," 16 U.S.C. §§ 824d(a)-(b), and § 206 gave the FPC the power to correct such unlawful practices, 16 U.S.C. § 824e(a).
Since 1935, and especially beginning in the 1970's and 1980's, the number of electricity suppliers has increased dramatically. Technological advances have made it possible to generate electricity efficiently in different ways and in smaller plants.[7] In addition, unlike the local power networks of the past, electricity is now delivered over three major networks, or "grids," in the continental United States. Two of these grids--the "Eastern Interconnect" and the "Western Interconnect"--are connected to each other. It is only in Hawaii and Alaska and on the "Texas Interconnect"--which covers most of that State--that electricity is distributed entirely within a single State. In the rest of the country, any electricity that enters the grid immediately becomes a part of a vast pool of energy that is constantly moving in interstate commerce. As a result, it is now possible for power companies to transmit electric energy over long distances at a low cost. As FERC has explained, "the nature and magnitude of coordination transactions" have enabled utilities to operate more efficiently by transferring substantial amounts of electricity not only from plant to plant in one area, but also from region to region, as market conditions fluctuate. Order No. 888, at 31,641.

Over the years, FERC has described the interconnected grids in a number of proceedings. For example, in 1967, the FPC considered whether Florida Power & Light Co. (FPL)--a utility attached to what was then the regional grid for the southeastern United States--transmitted energy in interstate commerce as a result of that attachment. The FPC concluded that FPL's transmissions were in interstate commerce: "[S]ince electric energy can be delivered virtually instantaneously when needed on a system at a speed of 186,000 miles per second, such energy can be and is transmitted to FPL when needed from out-of-state generators, and in turn can be and is transmitted from FPL to help meet out-of-state demands; ... there is a cause and effect relationship in electric energy occurring throughout every generator and point on the FPL, Corp, Georgia, and Southern systems which constitutes interstate transmission of electric energy by, to, and from FPL." *In re Florida Power & Light Co.,* 37 F.P.C. 544, 549 (1967). This Court found the FPC's findings sufficient to establish the FPC's jurisdiction. *Transmission Access Policy Study Group v. FERC,* 225 F.3d 667, 681 (C.A.D.C.2000) (case below), public utilities retain ownership of the transmission lines that must be used by their competitors to deliver electric energy to wholesale and retail customers. The utilities' control of transmission facilities gives them the power either to refuse to deliver energy produced

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7 In Order No. 888, FERC noted that the optimum size of electric generation plants has shifted from the larger, 500 megawatt plants (with 10-year lead time) of the past to the smaller, 50-to-150 megawatt plants (with 1-year lead time) of the present. These smaller plants can produce energy at a cost of 3-to-5 cents per kilowatt-hour, as opposed to the older plants' production cost of 4-to-15 cents per kilowatt-hour.

by competitors or to deliver competitors' power on terms and conditions less favorable than those they apply to their own transmissions. *E.g.,* Order No. 888, at 31,643-31,644.[8] Congress has addressed these evolving conditions in the electricity market on two primary occasions since 1935. First, Congress enacted the Public Utility Regulatory Policies Act of 1978 (PURPA), 16 U.S.C. § 2601 *et seq.,* to promote the development of new generating facilities and to conserve the use of fossil fuels. Because the traditional utilities controlled the transmission lines and were reluctant to purchase power from "nontraditional facilities," PURPA directed FERC to promulgate rules requiring utilities to purchase electricity from "qualifying cogeneration and small power production facilities." *FERC v. Mississippi,* 456 U.S. 742, 751 (1982).

Over a decade later, Congress enacted the Energy Policy Act of 1992 (EPAct). This law authorized FERC to order individual utilities to provide transmission services to unaffiliated wholesale generators (*i.e.,* to "wheel" power) on a case-by-case basis. See 16 U.S.C. §§ 824j-824k. Exercising its authority under the EPAct, FERC ordered a utility to "wheel" power for a complaining wholesale competitor 12 times, in 12 separate proceedings. FERC soon concluded, however, that these individual proceedings were too costly and time consuming to provide an adequate remedy for undue discrimination throughout the market.

Thus, in 1995, FERC initiated the rulemaking proceeding that led to the adoption of the order presently under review. FERC proposed a rule that would "require that public utilities owning and/or controlling facilities used for the transmission of electric energy in interstate commerce have on file tariffs providing for nondiscriminatory open-access transmission services." Notice of Proposed Rulemaking, FERC Stats. & Regs., Proposed Regs., 60 Fed.Reg. 17662 (hereinafter NPRM). The stated purpose of the proposed rule was "to encourage lower electricity rates by structuring an orderly transition to competitive bulk power markets." The NPRM stated:

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[8] In addition to policing utilities' anticompetitive behavior through the various statutory provisions that explicitly address the electric industry, discussed in more detail below, the Government has also used the antitrust laws to this end. For example, in *Otter Tail Power Co. v. United States,* 410 U.S. 366 (1973), the Court permitted the Government to seek antitrust remedies against a utility company which, among other things, refused to sell power at wholesale to some municipalities and refused to transfer competitors' power over its lines. The Court concluded that the FPA's existence did not preclude the applicability of the antitrust laws.

> "The key to competitive bulk power markets is opening up transmission services. Transmission is the vital link between sellers and buyers. To achieve the benefits of robust, competitive bulk power markets, all wholesale buyers and sellers must have equal access to the transmission grid. Otherwise, efficient trades cannot take place and ratepayers will bear unnecessary costs. Thus, market power through control of transmission is the single greatest impediment to competition. Unquestionably, this market power is still being used today, or can be used, discriminatorily to block competition." Id.

Rather than grounding its legal authority in Congress' more recent electricity legislation, FERC cited §§ 205-206 of the 1935 FPA--the provisions concerning FERC's power to remedy unduly discriminatory practices-- as providing the authority for its rulemaking. In 1996, after receiving comments on the NPRM, FERC issued Order No. 888. It found that electric utilities were discriminating in the "bulk power markets," in violation of § 205 of the FPA, by providing either inferior access to their transmission networks or no access at all to third-party wholesalers of power. Invoking its authority under § 206, it prescribed a remedy containing three parts that are presently relevant.

First, FERC ordered "functional unbundling" of wholesale generation and transmission services. FERC defined "functional unbundling" as requiring each utility to state separate rates for its wholesale generation, transmission, and ancillary services, and to take transmission of its own wholesale sales and purchases under a single general tariff applicable equally to itself and to others.

Second, FERC imposed a similar open access requirement on unbundled *retail* transmissions in interstate commerce. Although the NPRM had not envisioned applying the open access requirements to retail transmissions, but rather "would have limited eligibility to wholesale transmission customers," FERC ultimately concluded that it was "irrelevant to the Commission's jurisdiction whether the customer receiving the unbundled transmission service in interstate commerce is a wholesale or retail customer." *Id.,* at 31,689. Thus, "if a public utility voluntarily offers unbundled retail access," or if a State requires unbundled retail access, "the affected retail customer *must* obtain its unbundled transmission service under a non-discriminatory transmission tariff on file with the Commission." *Ibid.*[9]

Third, FERC rejected a proposal that the open access requirement should apply to "the transmission component of bundled retail sales." *Id.,* at 31,699. Although FERC noted that "the unbundling of retail transmission and generation ... would be helpful in achieving comparability," it concluded that such unbundling was not "necessary" and

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[9] While it concluded that "the rates, terms, and conditions of all unbundled transmission service" were subject to its jurisdiction, FERC stated that it would "give deference to state recommendations" regarding the regulation of retail transmissions "when state recommendations are consistent with our open access policies." Order No. 888, at 31,689.

would raise "difficult jurisdictional issues" that could be "more appropriately considered" in other proceedings. *Ibid.*

In its analysis of the jurisdictional issues, FERC distinguished between transmissions and sales. It explained:

> "[Our statutory jurisdiction] over sales of electric energy extends only to wholesale sales. However, when a retail transaction is broken into two products that are sold separately (perhaps by two different suppliers: an electric energy supplier and a transmission supplier), we believe the jurisdictional lines change. In this situation, the state clearly retains jurisdiction over the sale of power. However, the unbundled transmission service involves *only* the provision of 'transmission in interstate commerce' which, under the FPA, is exclusively within the jurisdiction of the Commission. Therefore, when a bundled retail sale is unbundled and becomes separate transmission and power sales transactions, the resulting transmission transaction falls within the Federal sphere of regulation." *Id.,* at 31,781[10]

In 1997, in response to numerous petitions for rehearing and clarification, FERC issued Order No. 888-A, FERC Stats. & Regs., Regs. Preambles, July 1996-Dec.2001, ¶ 31,048, p. 30,172, 62 Fed.Reg. 12274. With respect to various challenges to its jurisdiction, FERC acknowledged that it did not have the "authority to order, *sua sponte,* open-access transmission services by public utilities," but explained that § 206 of the FPA explicitly required it to remedy the undue discrimination that it had found. Order No. 888-A, at 30,202; see 16 U.S.C. § 824e(a). FERC also rejected the argument that its failure to assert jurisdiction over bundled retail transmissions was inconsistent with its assertion of jurisdiction over unbundled retail transmissions. FERC repeated its explanation that it did not believe that regulation of bundled retail transmissions (*i.e.,* the "functional unbundling" of retail transmissions) "was necessary," and

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[10] FERC also explained that it did not assert "jurisdiction to order retail transmission directly to an ultimate consumer," *id.,* at 31,781, and that States had "authority over the *service* of delivering electric energy to end users .... State regulation of most power production and virtually all distribution and consumption of electric energy is clearly distinguishable from this Commission's responsibility to ensure open and non-discriminatory interstate transmission service. Nothing adopted by the Commission today, including its interpretation of its authority over retail transmission or how the separate distribution and transmission functions and assets are discerned when retail service is unbundled, is inconsistent with traditional state regulatory authority in this area." *Id.,* at 31,782-31,783.
With respect to distinguishing "Commission-jurisdictional facilities used for transmission in interstate commerce" from "state-jurisdictional local distribution facilities," *id.,* at 31,783, FERC identified seven relevant factors, *id.,* at 31,771, 31,783-31,784. Recognizing the state interest in maintaining control of local distribution facilities, FERC further explained that, "in instances of unbundled retail wheeling that occurs as a result of a state retail access program, we will defer to recommendations by state regulatory authorities concerning where to draw the jurisdictional line under the Commission's technical test for local distribution facilities ...." *Id.,* at 31,783-31,785.

again stated that such unbundling would raise serious jurisdictional questions. FERC did not, however, state that it had no power to regulate the transmission component of bundled retail sales. Rather, FERC reiterated that States have jurisdiction over the retail *sale* of power, and stated that, as a result, "[o]ur assertion of jurisdiction ... arises only if the [unbundled] retail transmission in interstate commerce by a public utility occurs voluntarily or as a result of a state retail program." *Id.,* at 30,226.

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Because of the importance of the proceeding, we granted both the petition of the State of New York et al. (collectively New York) questioning FERC's assertion of jurisdiction over unbundled retail transmissions and the petition of Enron Power Marketing, Inc. (Enron), questioning FERC's refusal to assert jurisdiction over bundled retail transmissions. We address these two questions separately. At the outset, however, we note that no petitioner questions the validity of the order insofar as it applies to wholesale transactions: The parties dispute only the proper scope of FERC's jurisdiction over *retail* transmissions. Furthermore, we are not confronted with any factual issues. Finally, we agree with FERC that transmissions on the interconnected national grids constitute transmissions in interstate commerce. See, *e.g., FPC v. Florida Power & Light Co.,* 404 U.S. 453, 466-467(1972).

III

The first question is whether FERC exceeded its jurisdiction by including unbundled retail transmissions within the scope of its open access requirements in Order No. 888. New York argues that FERC overstepped in this regard, and that such transmissions--because they are part of retail transactions--are properly the subject of state regulation. New York insists that the jurisdictional line between the States and FERC falls between the wholesale and retail markets.

As the Court of Appeals explained, however, the landscape of the electric industry has changed since the enactment of the FPA, when the electricity universe was "neatly divided into spheres of retail versus wholesale sales." 225 F.3d, at 691. As the Court of Appeals also explained, the plain language of the FPA readily supports FERC's claim of jurisdiction. Section 201(b) of the FPA states that FERC's jurisdiction includes "the transmission of electric energy in interstate commerce" and "the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b). The unbundled retail transmissions targeted by FERC are indeed transmissions of "electric energy in interstate commerce," because of the nature of the national grid. There is no language in the statute limiting FERC's *transmission* jurisdiction to the wholesale market, although the statute does limit FERC's *sale* jurisdiction to that at wholesale. ...

In the face of this clear statutory language, New York advances three arguments in support of its submission that the statute draws a bright jurisdictional line between wholesale transactions and retail transactions. First, New York contends that the Court of Appeals applied an erroneous standard of review because it ignored the presumption against federal pre-emption of state

law; second, New York claims that other statutory language and legislative history shows a congressional intent to safeguard pre-existing state regulation of the delivery of electricity to retail customers; and third, New York argues that FERC jurisdiction over retail transmissions would impede sound energy policy. These arguments are unpersuasive.

The Presumption against Pre-emption

Pre-emption of state law by federal law can raise two quite different legal questions. The Court has most often stated a "presumption against pre-emption" when a controversy concerned not the scope of the Federal Government's authority to displace state action, but rather whether a given state authority conflicts with, and thus has been displaced by, the existence of Federal Government authority. In such a situation, the Court " 'start[s] with the assumption that the historic police powers of the States were not to be superseded ... unless that was the clear and manifest purpose of Congress.' " *Hillsborough County v. Automated Medical Laboratories, Inc.,* 471 U.S. 707, 715 (1985) These are not such cases, however, because the question presented does not concern the validity of a conflicting state law or regulation.

The other context in which "pre-emption" arises concerns the rule "that a federal agency may pre-empt state law only when and if it is acting within the scope of its congressionally delegated authority[,] ... [for] an agency literally has no power to act, let alone pre-empt the validly enacted legislation of a sovereign State, unless and until Congress confers power upon it." *Louisiana Pub. Serv. Comm'n v. FCC,* 476 U.S. 355, 374 (1986). This is the sort of case we confront here--defining the proper scope of the federal power. Such a case does not involve a "presumption against pre-emption," as New York argues, but rather requires us to be certain that Congress has conferred authority on the agency. As we have explained, the best way to answer such a question--*i.e.,* whether federal power may be exercised in an area of pre-existing state regulation--"is to examine the nature and scope of the authority granted by Congress to the agency." *Ibid.* In other words, we must interpret the statute to determine whether Congress has given FERC the power to act as it has, and we do so without any presumption one way or the other.

As noted above, the text of the FPA gives FERC jurisdiction over the "transmission of electric energy in interstate commerce and ... the sale of electric energy at wholesale in interstate commerce." 16 U.S.C. § 824(b). The references to "transmission" in commerce and "sale" at wholesale were made part of § 201 of the statute when it was enacted in 1935. Subsections (c) and (d) of § 201 explain, respectively, the meaning of the terms "transmission" and "sale of electric energy at wholesale."   This statutory text thus unambiguously authorizes FERC to assert jurisdiction over two separate activities --transmitting and selling. It is true that FERC's jurisdiction over the *sale* of power has been specifically confined to the wholesale market. However, FERC's jurisdiction

over electricity *transmissions* contains no such limitation. Because the FPA authorizes FERC's jurisdiction over interstate transmissions, without regard to whether the transmissions are sold to a reseller or directly to a consumer, FERC's exercise of this power is valid.

Legislative History

Attempting to discredit this straightforward analysis of the statutory language, New York calls our attention to numerous statements in the legislative history indicating that the 1935 Congress intended to do no more than close the "*Attleboro* gap," by providing for federal regulation of wholesale, interstate electricity transactions that the Court had held to be beyond the reach of state authority in *Attleboro,* 273 U.S., at 89. To support this argument, and to demonstrate that the 1935 Congress did not intend to supplant any traditionally state-held jurisdiction, New York points to language added to the FPA in the course of the legislative process that evidences a clear intent to preserve state jurisdiction over local facilities. For example, § 201(a) provides that federal regulation is "to extend only to those matters which are not subject to regulation by the States." 16 U.S.C. § 824(a). And § 201(b) states that FERC has no jurisdiction "over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter." 16 U.S.C. § 824(b).

It is clear that the enactment of the FPA in 1935 closed the "*Attleboro* gap" by authorizing federal regulation of interstate, wholesale sales of electricity--the precise subject matter beyond the jurisdiction of the States in *Attleboro.* And it is true that the above-quoted language from § 201(a) concerning the States' reserved powers is consistent with the view that the FPA was no more than a gap-closing statute. It is, however, perfectly clear that the original FPA did a good deal more than close the gap in state power identified in *Attleboro.* The FPA authorized federal regulation not only of wholesale sales that had been beyond the reach of state power, but also the regulation of wholesale sales that had been *previously subject* to state regulation. See, *e.g., Attleboro,* 273 U.S., at 85-86 (noting, prior to the enactment of the FPA, that States could regulate aspects of interstate wholesale sales, as long as such regulation did not directly burden interstate commerce). More importantly, as discussed above, the FPA authorized federal regulation of interstate *transmissions* as well as of interstate wholesale sales, and such transmissions were not of concern in *Attleboro.* Thus, even if *Attleboro* catalyzed the enactment of the FPA, *Attleboro* does not define the outer limits of the statute's coverage.

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Our evaluation of the extensive legislative history reviewed in New York's brief is affected by the importance of the changes in the electricity industry that have occurred since the FPA was enacted in 1935. No party to

these cases has presented evidence that Congress foresaw the industry's transition from one of local, self-sufficient monopolies to one of nationwide competition and electricity transmission. Nor is there evidence that the 1935 Congress foresaw the possibility of unbundling electricity transmissions from sales. More importantly, there is no evidence that if Congress had foreseen the developments to which FERC has responded, Congress would have objected to FERC's interpretation of the FPA. Whatever persuasive effect legislative history may have in other contexts, here it is not particularly helpful because of the interim developments in the electric industry. Thus, we are left with the statutory text as the clearest guidance. That text unquestionably supports FERC's jurisdiction to order unbundling of wholesale transactions (which none of the parties before us questions), as well as to regulate the unbundled transmissions of electricity retailers.

Sound Energy Policy

New York argues that FERC jurisdiction over unbundled retail transmission will impede sound energy policy. Specifically, New York cites the States' interest in overseeing the maintenance of transmission lines and the siting of new lines. It is difficult for us to evaluate the force of these arguments because New York has not separately analyzed the impact of the loss of control over unbundled retail transmissions, as opposed to the loss of control over retail transmissions generally, and FERC has only regulated unbundled transactions. Moreover, FERC has recognized that the States retain significant control over local matters even when retail transmissions are unbundled.... We do note that the Edison Electric Institute, which is a party to these cases, and which represents that its members own approximately 70% of the transmission facilities in the country, does not endorse New York's objections to Order No. 888. And, regardless of their persuasiveness, the sort of policy arguments forwarded by New York are properly addressed to the Commission or to the Congress, not to this Court.

IV

Objecting to FERC's order from the opposite direction, Enron argues that the FPA gives FERC the power to apply its open access remedy to *bundled* retail transmissions of electricity, and, given FERC's findings of undue discrimination, that FERC had a duty to do so. In making this argument, Enron persistently claims that FERC held that it had no jurisdiction to grant the relief that Enron seeks. That assumption is incorrect: FERC chose not to assert such jurisdiction, but it did not hold itself powerless to claim jurisdiction. Indeed, FERC explicitly reserved decision on the jurisdictional issue that Enron claims FERC decided. ... Absent Enron's flawed assumption, FERC's ruling is clearly acceptable.

As noted above, in both Order No. 888 and rehearing Order No. 888-A, FERC gave two reasons for refusing to extend its open access remedy to bundled retail transmissions. First, FERC explained that such relief was not "necessary."

Order No. 888, at 31,699; see also Order No. 888-A, at 30,225. Second, FERC noted that the regulation of bundled retail transmissions "raises numerous difficult jurisdictional issues" that did not need to be resolved in the present context. Both of these reasons provide valid support for FERC's decision not to regulate bundled retail transmissions.

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To remedy the wholesale discrimination it found, FERC chose to regulate all wholesale transmissions. It also regulated unbundled retail transmissions, as was within its power to do. See Part III, *supra.* However, merely because FERC believed that those steps were appropriate to remedy discrimination in the wholesale electricity market does not, as Enron alleges, lead to the conclusion that the regulation of *bundled* retail transmissions was "necessary" as well. Because FERC determined that the remedy it ordered constituted a sufficient response to the problems FERC had identified in the wholesale market, FERC had no § 206 obligation to regulate bundled retail transmissions or to order universal unbundling.

Of course, it may be true that FERC's findings concerning discrimination in the wholesale electricity market suggest that such discrimination exists in the retail electricity market as well, as Enron alleges. Were FERC to investigate this alleged discrimination and make findings concerning undue discrimination in the retail electricity market, § 206 of the FPA would require FERC to provide a remedy for that discrimination. See 16 U.S.C. § 824e(a) (upon a finding of undue discrimination, "the Commission shall determine the just and reasonable ... regulation, practice, or contract ... and shall fix the same by order"). And such a remedy could very well involve FERC's decision to regulate bundled retail transmissions--Enron's desired outcome. However, because the scope of the order presently under review did not concern discrimination in the retail market, Enron is wrong to argue that § 206 requires FERC to provide a full array of retail-market remedies.

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Accordingly, the judgment of the Court of Appeals is affirmed.
It is so ordered.

NOTES:

1. Rule 888 also added principles for ISOs - Independent System Operators - which would co-ordinate transmission and be responsible for grid reliability. These entities must been governed in a non-discriminatory manner, have no financial interest in the performance of any market participant, and would need strict conflict-of-interest controls. The rule did not require use of ISOs. The rule also provided that, despite the *Mobile-Sierra* line of cases, parties to contracts would be able to unilaterally propose contract changes; these would, of course, be subject to FERC review.

2. After three years of operation under Orders 888 and 889, the FERC noticed many changes in the electric industry. For one, utilities had divested themselves of generating facilities. Independent power producers and marketers were placing new and more requirements on the nation's transmission system, a situation that would only increase as more states restructured their retail electric markets. The number of participants could negatively impact on the reliability of the system and the ability to transmit electricity where it was desired. Therefore, FERC promulgated Order 2000. This Order urged utilities to join "Regional Transmission Organizations." These "RTOs" would coordinate electric transmission on a regional basis. Utilities were to file with FERC how they were to achieve these goals, but FERC did not mandate the type of organization that would suffice. Utilities could create a not- for-profit Independent Systems Operator ("ISO"), a for-profit transportation company ("Transco"), or a hybrid entity to provided the necessary service.

MAINE PUBLIC UTILITIES COMMISSION v. FERC
454 F.3d 278 (D.C.Cir. 2006)

In these consolidated cases, owners of electric transmission facilities and several state public utility commissions petition for review of orders of the Federal Energy Regulatory Commission conditionally approving a proposal to form a regional transmission organization in New England ("RTO-NE"). The transmission owner members ("TOs") challenge FERC's authority to reject the provision of their Transmission Operating Agreement providing that FERC review withdrawals from the RTO under *Mobile-Sierra* 's public interest standard.[11] The TOs also contend that FERC's rejection of this provision, and its rejection of an incentive adjustment to the TOs' return on equity ("ROE") for local transmission service, were arbitrary and capricious. The State Commissions maintain that FERC's approval of a 50 basis point incentive adjustment to the TOs' ROE for regional transmission was arbitrary and capricious.

RTOs are a creation of FERC's, and FERC has broad authority over the decision to approve a RTO. A proposal to establish a RTO is essentially a proposal to change the rates on file; as such, FERC had authority under Section 205 of the Federal Power Act ("FPA"), 16 U.S.C. § 824d (2000), to modify the operating agreement as a condition of approving the RTO. Further, in light of concerns about the effects on market participants and the electricity market, FERC was not arbitrary and capricious in requiring the "just and reasonable" standard of review for withdrawals from the RTO. Finally, consistent with the court's deferential review under § 205 of the FPA of FERC's determinations regarding rate design, FERC's ROE incentive adjustments were not arbitrary and capricious. Accordingly, we deny the petitions for review.

[11] The "*Mobile-Sierra* doctrine" is derived from the Supreme Court's companion cases, *United Gas Pipe Line Co. v. Mobile Gas Service Corp.,* 350 U.S. 332(1956), and *Federal Power Commission v. Sierra Pacific Power Co.,* 350 U.S. 348 (1956).

I.

In Order 2000, FERC required all public utilities that own, operate, or control interstate transmission facilities either to file a proposal to participate in a RTO or to describe their efforts toward joining one. *See Regional Transmission Organizations,...* ("Order 2000"), ("Order 2000-A") (codified at 18 C.F.R. § 35.34 (2006)). FERC conceived of the RTOs as mechanisms for providing large and stable transmission systems that would reduce regional pricing disparities and create an efficient market for new power generators. By combining various utilities' segmented transmission facilities into a regional transmission grid under the control of one independent entity, FERC anticipated that RTOs would eliminate certain transmission inefficiencies and opportunities for discrimination that hindered the formation of competitive wholesale electric energy markets and that these new structures would therefore result in significant benefits to the public.

By 2003, however, FERC had fully approved only two RTOs. To encourage timely formation of RTOs, FERC proposed a 50 basis point incentive adjustment ("adder") to the ROEs for TOs participating in a FERC-approved RTO, and established the deadline of December 31, 2004 for qualifying for the proposed incentives.

On October 31, 2003, an independent system operator ("ISO"), ISO-New England, and a group of TOs submitted for FERC approval, under Section 205 of the FPA, a proposal to establish RTO-NE. Under the TOs' Transmission Operating Agreement ("TOA"), the TOs would transfer operational authority over their transmission facilities to the RTO, subject to certain reserved rights. Section 10.01 of the TOA set the terms and conditions for members' withdrawal from RTO participation and termination of the RTO, providing in subpart (f) that withdrawal "shall be effective unless the FERC finds that such ... withdrawal is contrary to the public interest under the public interest standard of review as set forth" in the *Mobile-Sierra* doctrine. In a related filing, on November 4, 2003, the TOs requested approval of a ROE recoverable under the regional and local transmission rates charged by RTO-NE. The ROE would consist of a base ROE of 12.8 percent, an additional 50 basis points for participation in the RTO (and an additional 100 basis points to reward future expansion by the New England TOs, which is not at issue). The TOs sought the 50 basis point adder "to reward their willingness to transfer operational control authority over their transmission facilities to RTO-NE," and noted that FERC's proposed *Pricing Policy* stated: any entity that transfers operational control of transmission facilities to a [FERC]-approved RTO would qualify for an incentive adder of 50 basis points on its ROE for all such facilities transferred.

FERC conditionally approved the RTO-NE by Order of March 24, 2004. *See* ("*Approval Order*"). The petitioners challenge three determinations FERC made in the *Approval Order:* First, FERC rejected the TOs' proposal that the *Mobile-Sierra* "public interest"

standard govern FERC review of termination and withdrawal from RTO-NE and ordered that the TOA be modified to set the "just and reasonable" standard for such review in accordance with Section 205 of the FPA and FERC's published guidance. ("*Guidance* "). FERC explained that the "public interest" standard "would prohibit any meaningful review ... under Section 205 ... even in those instances where revisions to RTO-NE's operating agreements may be necessary or appropriate as a result." Second, FERC summarily approved, without suspension or hearing, the 50 basis point ROE adder for regional transmission service, agreeing with the TOs that their voluntary entry into RTO-NE and their commitment to transfer day-to-day operational control to the RTO warranted the ROE adder. FERC explained that the adder was consistent with its rulings in other cases and appropriate here "because of the region-wide benefits that w[ould] be set in place ...." Third, FERC rejected the TOs' proposed 50 basis point adder for local network service transmission not controlled by the RTO on the ground that it was beyond the scope of the incentive. The TOs were directed to make a compliance filing within 90 days. Upon various intervenors' requests for rehearing or clarification of the *Approval Order,* FERC reaffirmed its determinations by Order of November 3, 2004. ("*Rehearing Order* "). These petitions for review followed.

II.

The TOs challenge FERC's modification of the termination provision of the TOA on the ground that FERC violated the *Mobile-Sierra* doctrine by rejecting the "public interest" standard agreed to by the parties and ordering that termination and withdrawals be subject to the "just and reasonable" standard, which would grant FERC more searching review. The TOs maintain that just as they have the statutory right under Section 205 of the FPA to set rates and the right to enter into RTO contracts waiving some of those rights, they also have the right to set rate-related terms, including the length of their service agreements.

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Under Section 201(b) of the FPA, Congress has vested FERC with jurisdiction over "all rates, terms, and conditions of electric transmission service provided by public utilities in interstate commerce, as well as over the sale of electric energy at wholesale." *Atlantic City Elec. Co. v. FERC,* 295 F.3d 1, 4 (D.C.Cir.2002); 16 U.S.C. § 824(b). Section 205, in turn, provides that the rates, terms, and conditions of electrical transmission service subject to FERC jurisdiction "shall be just and reasonable, and any such rate or charge that is not just and reasonable is ... unlawful" and bars utilities from exercising "undue preference" or "undue prejudice" in the rates charged. 16 U.S.C. § 824d(a) & (b). A public utility may file changes to rates, charges, classification, or service at any time after providing 60 days' public notice. *Id.* § 824d(d). These changes go into effect immediately. FERC, however, can conduct a hearing under Section 205 to review any rate changes and suspend them for a period of five months, but it may reject them only upon finding that the proposed rate changes fail to meet the standards of Section 205, with the utility bearing the burden of demonstrating that the proposed changes are "just and reasonable," 16 U.S.C. § 824d(a), and non-preferential, *id.* at 824d(b) In addition, under Section 206, FERC "itself may initiate rate changes ... but only upon finding that

the existing rates are unjust, unreasonable, unduly discriminatory or preferential." 16 U.S.C. § 824e(a)

Under the *Mobile-Sierra* doctrine, however, "utilities may choose to voluntarily give up, by contract, some of their rate-filing freedom under section 205." *Atlantic City,* 295 F.3d at 10-11. Thus, a utility may negotiate a transmission contract with a provision relinquishing its right to file for a unilateral change in rates. Similarly, "by broad waiver, the parties [to a jurisdictional contract] may eliminate ... [FERC]'s power to impose changes under § 206, except the indefeasible right of [FERC] under § 206 to replace rates that are contrary to the public interest." *Papago Tribal Util.,* 723 F.2d at 953. Such fixed-rate contracts are not subject to unilateral amendment by a party to the contract, and once accepted for filing, FERC may subsequently order modification only upon finding that the modification is required by the "public interest," and upon a showing that the changes are just, reasonable, and nondiscriminatory, The "public interest" standard was described in *Federal Power Commission v. Sierra Pacific Power Co.* as requiring modification of previously approved contracts in instances "where [the existing rate structure] might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." *Sierra,* 350 U.S. at 355.

As a threshold matter, and contrary to the TOs' position, it is not clear that *Mobile-Sierra* has any relevance to FERC's initial review of a contract to establish a RTO. As FERC points out, this court has only had occasion to apply the *Mobile-Sierra* public interest standard to FERC-approved contracts rather than those submitted to FERC for initial approval. This interpretation is consistent with *Mobile-Sierra* 's recognized purpose of ensuring contract stability by "subordinat[ing] the statutory filing mechanism to the broad and familiar dictates of contract law." *Borough of Lansdale v. FPC,* 494 F.2d 1104, 1113 (D.C.Cir.1974). Indeed, the TOs recognize that the TOA effects changes in existing transmission service contracts and is thus subject to FERC approval under Section 205. Thus, given that RTOs are FERC's creation, FERC has substantial leeway in deciding the conditions under which it will approve a proposal to establish a RTO. This circumstance--in which a proposal for an RTO has not yet received initial approval--is distinguishable from other situations in which parties have entered into a fixed-rate contract and FERC "must summarily reject rate filings inconsistent with the outstanding fixed rate contract whether or not the contracts have been filed with the [FERC]." *Borough of Lansdale,* 494 F.2d at 1114.

Again, "the purpose of the *Mobile-Sierra* doctrine is to preserve the benefits of the parties' bargain as reflected in the contract, assuming that there was no reason to question what transpired at the contact formation stage." *Atlantic City,* 295 F.3d at 14. FERC points out that there is no expectation of contract stability when a contract is submitted to FERC for the first time, has yet to be approved by FERC, and has not yet gone into effect-- particularly when that contract is a complex agreement establishing a new regional structure impacting all market participants. This hardly seems the situation *Mobile-Sierra* was designed to guard against, viz., where one party to a rate contract on file with FERC attempts to effect a unilateral rate change by asking FERC to relieve its

obligations under a contract whose terms are no longer favorable to that party. Absent a pre-existing FERC-approved RTO operating agreement, the TOs fail to explain why FERC would be obligated, under either the FPA or the Administrative Procedure Act, 5 U.S.C. § 706(2)(A) (2000), to approve all of the terms of the TOA, which is submitted as part of the RTO-NE proposal.

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In essence, the TOs contend that they have a right to contract for *Mobile-Sierra* protections with respect to a future unilateral decision to change an existing transmission service agreement--i.e., the decision to withdraw from RTO-NE--and that FERC may not abrogate this right by requiring, in its initial review of the contract under Section 205, that a provision be struck that purportedly protects the withdrawal decision from FERC review under the standards in Sections 205 and 206. Although the court acknowledged in *Atlantic City* that the right to set rates in the first instance is a statutory right of utilities, 295 F.3d at 10, and that Section 205 does not authorize FERC to require a utility to cede the right to initially set such rates, there is no indication in the statute or in *Atlantic City* that Sections 202(a) [12] or 205 must be interpreted to grant utilities the unilateral right in proposing a RTO to avoid the levels of review provided by the statute and the terms of FERC's published Guidance. To the extent that the FPA does not expressly address this question, FERC's interpretation of its authority under Section 205 is permissible and therefore entitled to deference by the court under step two of the *Chevron* analysis. *See Chevron,* 467 U.S. at 843. After all, the "right" provided by Subsection 10.01(f) of the TOA--that unilateral withdrawal shall be "effective unless the FERC finds that such ... withdrawal is contrary to the public interest"--is not a right one signatory has against another; it is not, as TOs suggest, a mere "term" of the transmission agreement in the sense of the length of time that the agreement will be in effect. Instead, it is an attempt to limit the statutory authority of FERC, a non-signatory to the agreement, which FERC has not yet approved and accepted for filing. Absent FERC's approval of RTO-NE and the terms of the TOA, this provision cannot alter the statutory status quo ante.

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The TOs' next challenge to FERC's modification of the TOA's withdrawal provision as arbitrary and capricious--on the ground that the modification is inconsistent with the voluntary nature of RTO participation recognized in Order 2000--fares no better....

On rehearing, FERC made clear that the TOs' ability to withdraw from the RTO without Section 205 "just and reasonable" review could "have a substantial [deleterious] impact on other market participants and the markets themselves." *Rehearing Order,*(para.41). Intervenors argued before the agency that by giving the TOs a unilateral right of

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[12]Section 202(a) provides, in relevant part, that:

For the purpose of assuring an abundant supply of electric energy throughout the United States ... [FERC] is empowered and directed to divide the country into regional districts for the voluntary interconnection and coordination of facilities for the generation, transmission, and sale of electric energy, and it may at any time thereafter, upon its own motion or upon application, make such modifications thereof as in its judgment will promote the public interest. 16 U.S.C. § 824a(a).

withdrawal, the TOA gave the TOs too much leverage over day-to-day operations. FERC had initially explained that the proposed withdrawal arrangement could subvert the independence of the RTO, contrary to the principles for RTOs set forth in Order 2000. On rehearing, FERC further explained "full, meaningful review ... would not be possible ... governed by a standard of review," such as the "public interest" standard, which "limits the application of the just and reasonable standard." *Rehearing Order,*(para.40). FERC foresaw that a TO's withdrawal from an RTO "can have a substantial impact on other market participants and the markets themselves." *Id.* (paras.40-41). Given that FERC anticipates that RTOs will encourage entry into the market, and that entrants have and will rely upon a transmission grid controlled by an independent entity, ensuring meaningful FERC review of changes regarding control of the grid is a reasonable accommodation between FERC's responsibility to protect the public and the utilities' contractual rights to arrange their affairs.

The TOs offer no persuasive response to either of FERC's concerns about market impact. Although they emphasize that, under Order 2000, RTO formation was to be voluntary, there is nothing inconsistent with the TOs' voluntary decision to organize themselves into RTO-NE, and FERC's insistence on compliance with its announced RTO terms and conditions. *See Approval Order,*(para.59). As intervenors observe, the TOs were not required to proceed with RTO-NE if they found the termination condition unacceptable. Moreover, having received the benefits of RTO status, including the 50 basis point adder to ROE, the TOs can hardly demonstrate that it is reasonable to permit withdrawals without FERC's first considering the impact on the criteria in Order 2000....

III.

FERC's determinations on the ROE adders involve matters of rate design, which are technical and involve policy judgments at the core of FERC's regulatory responsibilities. Hence, the court's review of whether a particular rate design is just and reasonable is highly deferential.

The State Commissions challenge FERC's approval of the 50 basis point incentive adder for regional service, which FERC determined to be "just and reasonable." The State Commissions contend that: (1) the adder pretends to offer incentives for transmission restructuring that has already occurred; (2) FERC failed to calibrate its use of non-cost-based rate elements to ensure that the resulting increases in rates would be no more than is necessary to create such purported incentive for RTO formation; (3) FERC's determination is inconsistent with its conclusion, in a factually-similar case involving a restructured power pool, that such an adder would not motivate RTO formation; and (4) FERC's three rationalizations for the adder fail because they are inaccurate, conclusory, and ignore the need to avoid creating windfalls for public utilities.

FERC's findings refute the State Commission's first objection. FERC found that ISO-NE's full independence was "limited by its contractual arrangement with NEPOOL," whereby "market participants, not ISO-NE, have the primary authority to establish and revise rates, terms, and conditions governing the operation of the New England wholesale

electricity market." [*Approval Order,*(para.52)] FERC had previously found that this governance model could not meet FERC's independence requirement under Order 2000 unless the market participant committees within NEPOOL were advisory. By contrast, FERC found that the RTO-NE proposal meets the independence requirements by calling for a governance structure designating authority over the operation of New England markets "squarely in the hands of a financially disinterested entity rather than with market participants." *Approval Order,* (para.53). In addition, the five-year term with automatic renewal of the TOA would contribute to greater institutional stability and independence than ISO-NE's day-to-day operations under interim contracts. Moreover, FERC points out, because "the adder rewards the [TOs] for their future participation, as well as for their initial surrender of control over their facilities," Respondent's Br. at 35, FERC reasonably concluded the adder does not only reward past action....

Second, FERC did the necessary calibration, determining the 50 basis point adder to be within the zone of reasonableness. ... Here, FERC was applying policy considerations to choose from among several "cost-recovering rate[s]." *FPC v. Conway Corp.,* 426 U.S. 271 (1976). Because a ROE is "not susceptible to a precise calculation," *Rehearing Order,* (para.207), and "is based, rather, on a range of reasonable returns, which take into account a number of factors that may be both cost-related and policy-related, including business risk factors," *id.,* courts have recognized that there is a zone of reasonable ROEs and have held FERC to an end-result test. FERC points out that there is not a sufficiently long track record with which to measure the full value of the benefits of RTOs on market performance. In FERC's words on rehearing: in the RTO context, "it is appropriate ... to adjust the allowed return for [TOs] that undertake commitments designed to enhance the overall competitiveness and efficiency of the wholesale markets, so long as the resulting rate of return is within the range of reasonable returns." *Rehearing Order,* (para.207). Given the expertise implicated in FERC's determination, and the measures it took to explain and cabin the adder, the court can conclude that the determination meets this minimum standard for reasonableness.

Third, approval of the 50 point adder is consistent with FERC precedent, and FERC's *Pricing Policy....*

In light of FERC's findings, which are supported by substantial evidence, *see* 16 U.S.C. § 8251(b), FERC reasonably could conclude, as it did, that the transformation from an ISO to a RTO would impose significant obligations on member TOs. For the first time, an independent entity would control the open access transmission tariff and other terms governing the market with resulting significant benefit to the public.

The State Commissions' other challenges are unpersuasive. The objection that generic policies do not justify imposing the adder because generalized policy statements (let alone proposed policy) cannot justify agency action, misses the mark. In *Public Service Commission of Kentucky*, the court did not indicate that allowing adders to a ROE was outside of the ambit of FERC's ratemaking authority under Section 205; rather, the court held that notice to interested parties that adders were being considered was required prior to FERC's acceptance of them, *see* 397 F.3d at 1012. Congress has since enacted the

Energy Policy Act of 2005, albeit after FERC issued the orders challenged here, which authorizes FERC to "provide for incentives to each transmitting utility or electric utility that joins a Transmission Organization." Pub.L. No. 109-58, § 1241(c) (codified at 16 U.S.C.A. § 824s(c) (West Supp.2006)). The objection that, even if the adder power now falls within FERC's authority, this does not relieve FERC's obligation to determine if a non-cost based component was reasonable, overlooks FERC's explanations in the *Rehearing Order* that a ROE is not susceptible to a precise calculation The objection also overlooks FERC's explanations in the *Approval Order* that the 50 point basis adder falls within a zone of reasonableness, (para.246) and that pre-existing regional arrangements by ROE filers failed to meet the independence requirements of Order 2000.

Finally, contrary to the TOs' contention, FERC's rejection of the adder for local rates was not arbitrary. Aware of the long-standing practice in New England of distinguishing between facilities providing regional services from those providing local services, see *Approval Order,* 106 F.E.R.C. at 62,022 n.11, FERC explained that the purpose of the 50 basis point adder was to encourage utilities to cede control of regional facilities to an independent entity responsible for providing regional transmission service under the terms and conditions of a regional tariff, *see Rehearing Order,* 109 F.E.R.C. at 61,599 (para.201). By contrast, the TOs retained significant control of local service, which operated under individual tariffs. Hence, FERC reasonably concluded that there was nothing to reward.

Accordingly, we deny the petitions for review.

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3. Re-Examining Regulatory Boundaries: Of Energy Crises and Beyond

In the new regulatory climate, FERC had to consider whether or not entities other than the traditional sellers of interstate electricity or transmission services had to be regulated. States also grappled with the question of whether or not to restructure the retail end of the equation. Both state and federal changes are revealed in the following case.

PUBLIC UTILITY DISTRICT NO. 1 OF SNOHOMISH COUNTY
v. DYNEGY POWER MARKETING, INC.
384 F.3d 756 (9th Cir. 2004), cert. denied, 125 S.Ct. 2957 (2005)

SCHROEDER, Chief Judge:
This litigation arises out of the California Energy Crisis of 2000-01, when shortages of power and high electricity prices caused blackouts and general turmoil in the electricity markets of the west coast. In this case, Public Utility District No. 1 of Snohomish County, Washington ("Snohomish"), a utility providing electricity to consumers in Washington state, has sued various generators and traders of wholesale electricity for violations of California state antitrust and consumer protection laws. Snohomish charges that the defendants manipulated the market and restricted electricity supplies in order to cause artificially high prices in the market from which Snohomish purchased power. Snohomish seeks treble damages and injunctive relief.

The district court held that the claims were preempted by federal law, which authorizes the Federal Energy Regulatory Commission ("FERC") to set wholesale electricity rates. Snohomish appeals, contending that FERC's policy of setting rates in accordance with market forces amounts to an abdication of rate making. Because FERC has exclusive jurisdiction over interstate sales of wholesale electricity, and continues to engage in regulatory activity, we affirm. *See California v. Dynegy, Inc.,* 375 F.3d 831, 850-853 (9th Cir.2004); *Pub. Utility Dist. No. 1 of Grays Harbor County Washington v. Idacorp, Inc.,* 379 F.3d 641, 2004 WL 1774769 (9th Cir. Aug. 10, 2004).

BACKGROUND

Before 1996, FERC reviewed electricity rates that were cost-based. The primary factor in setting the rate was the cost of producing and transmitting the electricity. Power suppliers proposed rates by adding up their costs and accounting for an expected rate of return. FERC reviewed and approved tariffs that contained detailed breakdowns of costs and specified rates of return. *See* 18 C.F.R. § 35.1(a) (requiring utilities to file "rate schedules"); 18 C.F.R. § 35.2(b) (defining what information must be included in a "rate schedule"); 18 C.F.R. § 35.13(h)(22) (requiring utilities to state their expected rate of return). Utilities were also required to give a thorough explanation of "how the proposed rate or charge was derived." 18 C.F.R. § 35.12(b)(2)(i). These rate schedules had to be filed at least 60 days before the utility could charge the requested rate, and the rate could be implemented only after FERC approved it. *See* 18 C.F.R. §§ 35.2(e), 35.3(a). After a rate was approved, a utility could charge only the filed rate until a request to change the rate was submitted and approved by FERC. 16 U.S.C. § 824d(d); 18 C.F.R. § 35.13.

In 1996, California changed this cost-based system of setting wholesale electricity rates to a market-based system, where the rate was determined in a structured market. The California legislature passed Assembly Bill 1890, Cal. Pub. Util.Code § 330 *et seq.,* in an effort to reduce the price of electricity by replacing cost-based rate regulation with rates that were determined by competitive forces. The legislation created two non-governmental entities to operate markets and otherwise manage the sale of electricity: the California Power Exchange ("PX") and the California Independent System Operator ("ISO"). These entities were subject to FERC's regulation.

The PX operated a market for the purchase and sale of electricity in the "day-ahead" and "day-of" markets. The price in these markets was set by evaluating bids submitted by market participants. A seller could submit a series of bids that consisted of price-quantity pairs representing offers to sell (e.g. 5 units at $50 each, but 10 units if the price is $100 each). Similarly, a buyer could submit a series of bids that consisted of price-quantity pairs representing offers to buy. The PX would then establish aggregate supply and demand curves and set the "market clearing price" at the intersection of the two curves. Then every exchange would take place at the market clearing price, even though some buyers had been willing to pay more and some sellers had been willing to sell for less.

The ISO managed the transmission network, managing imbalances between supply and demand and maintaining the reliability of the transmission grid. As part of these responsibilities, it operated a "real-time" or "spot" market used to balance supply and demand at precise points in time. For example, if customer demand for a particular hour was not met, then the ISO was required to procure power on the spot market to maintain the stability of the grid. In the markets the PX and ISO managed, rates for wholesale electricity rose dramatically during 2000 and 2001. This caused consumer utilities to pay record high prices to traders and generators.

FACTUAL AND PROCEDURAL HISTORY

In this suit, Snohomish alleges that the defendants violated the Cartwright Act, Cal. Bus. & Prof.Code § 16720 *et seq.* (California's antitrust law), and California's Unfair Competition Law, Cal. Bus. & Prof.Code § 17200 *et seq.* The defendants are all generators and traders who sold electricity in the California wholesale market. (The proceedings against one defendant, PG & E Energy Trading Holding Corp., is under a bankruptcy court stay.) Snohomish alleges that the defendants withheld supply, waited until emergency conditions were declared and prices rose, and then offered their supply at the higher prices. Snohomish also alleges that the defendants engaged in a variety of sham transactions in order to manipulate and inflate prices. These transactions had colorful names like "Death Star" and "Get Shorty."

The consumer utilities that were the buyers in the California wholesale markets have instituted proceedings before FERC on these matters. FERC has investigated the defendants' practices, and issued an order that describes the market manipulation techniques Snohomish alleges, analyzes whether these practices violate any of the tariffs filed with FERC, and outlines appropriate remedies. *See Am. Elec. Power Serv. Corp. et al.,* 103 FERC ¶ 61,345, 2003 WL 21480252, at *9 (Jun. 25, 2003). The order provides a detailed discussion of the practices challenged here.

Snohomish's complaint alleged these practices caused Snohomish "to pay prices for electricity in excess of rates that would have been achieved in a competitive market." Snohomish asked the district court to enjoin the defendants from engaging in unlawful and unfair business acts, order the defendants to disgorge all monies wrongfully obtained, order the defendants to pay restitution, award compensatory and treble damages, and award costs, interest, and attorney's fees.

The district court granted the defendants' motion to dismiss, ruling under three alternative but related theories that it did not have jurisdiction to resolve the issues raised in Snohomish's complaint. The district court ruled that Snohomish's claims were barred by both the filed rate doctrine and by principles of field and conflict preemption. The district court held that granting the relief Snohomish requested would interfere with FERC's exclusive jurisdiction over the regulation of interstate wholesale energy rates because Snohomish sought damages stemming from the difference between the rates the

defendants charged and hypothetical rates that, according to the complaint, would have "been achieved in a competitive market." Snohomish appealed.

DISCUSSION

Snohomish argues that the preemption doctrines, upon which the district court relied, should not apply when market-based rates are involved because the market, and not FERC, is determining the rates. The fundamental question in this case is whether, under the market-based system of setting wholesale electricity rates, FERC is doing enough regulation to justify federal preemption of state laws. The answer to this question is controlled by two recent decisions of this court: *Dynegy,* 375 F.3d 831, and *Grays Harbor,* 379 F.3d 641. Under the system at issue here, FERC has waived many of the requirements that applied under the cost-based system. For example, the actual prices are no longer filed with FERC 60 days before they can be charged and the utilities do not provide FERC with detailed schedules of their costs. Instead, the price of wholesale electricity is determined in the markets operated by the PX and the ISO.

FERC continued to oversee wholesale electricity rates, however, by reviewing and approving a variety of documents filed by the defendants, the PX, and the ISO. First, each seller was to file a market-based umbrella tariff, which "preauthorizes the seller to engage in market-based sales and puts the public on notice that the seller may do so." *California v. British Columbia Power Exchange Corp.* ("*BC Power Exchange I* "), 99 FERC ¶ 61,247, 2002 WL 32035504, at *13 (May 31, 2002). FERC approved these market-based tariffs only upon a showing that the seller lacked or had mitigated its market power. The theory is that a seller cannot raise its price above the competitive level without losing substantial business to rival sellers unless the seller has market power, and therefore that FERC's determination that a seller lacks market power provides a "strong reason to believe" that sellers will be able to charge only just and reasonable rates. *See Elizabethtown Gas Co. v. FERC,* 10 F.3d 866, 871 (D.C.Cir.1993) (discussing the Natural Gas Act).

Second, FERC required each seller to file quarterly reports, which contained certain required information including the minimum and maximum rate charged and the total amount of power delivered during the quarter. FERC has found this requirement necessary to ensure that rates will be on file as required by FPA § 205(c), to allow FERC to evaluate the reasonableness of the charges as required by FPA § 205(a), and to allow FERC to continually monitor the seller's ability to exercise market power.

Third, FERC reviewed and approved detailed tariffs filed by the PX and the ISO, which described in detail how the markets operated by each entity would function. Many of the rules governing market operations were originally submitted by the PX and the ISO for information purposes only, but FERC required that these protocols be filed with and approved by the Commission as part of the PX and ISO tariffs. Each participant in the PX and the ISO markets was required to sign an agreement acknowledging that the tariff filed by either the PX or the ISO would govern all transactions in that market.

After the energy crisis unfolded, FERC ordered wholesalers to disgorge profits that resulted from the kinds of practices Snohomish has alleged here. FERC found that many of these practices were prohibited by the protocols that were filed as part of the PX and ISO tariffs. *See generally Am. Elec. Power Serv. Corp. et al.,* 103 FERC ¶ 61,345, 2003 WL 21480252.

This court has rejected Snohomish's argument that the preemption-related doctrines at issue do not apply when market-based rates are involved. *Grays Harbor,* 379 F.3d 641. In *Grays Harbor,* we were confronted with issues that are nearly identical to those involved here. *Id.* at 646 n. 3. The plaintiff in that case brought state-law contract claims against a company that sold wholesale electricity seeking rescission and reformation of a contract that was entered into at the height of the energy crisis when wholesale electricity prices were near their peak. The plaintiff alleged that the high prices were the result of market manipulation and asked the court to afford relief after determining "a price that reflects a fair price absent dysfunction, manipulation and the intentional withholding of electric power...." *Id.* at 645. Our court concluded that the same three preemption-related doctrines that the district court relied on here required the dismissal of the claims in *Grays Harbor.* We concluded that the district court was precluded from giving the plaintiff the relief it sought because, to award that relief, the district court would have had to determine a "fair price." *Id.* at 648. We held that this would interfere with FERC's exclusive jurisdiction to set wholesale rates and was therefore barred by field preemption, conflict preemption, and the filed rate doctrine.

Snohomish's claims in this case allege violations of state antitrust and unfair competition law rather than the state contract law claims involved in *Grays Harbor,* but Snohomish's claims also ask the district court to determine the rates that "would have been achieved in a competitive market." This is the same determination as the "fair price" determination that we held was barred by preemption principles in *Grays Harbor.* We therefore hold that Snohomish's claims are barred by the filed rate doctrine, by field preemption, and by conflict preemption.

Snohomish also requests injunctive relief, but our court has also held that this relief is barred by the filed rate doctrine and preemption principles. In *Dynegy,* we held that the State of California's claims for violations of California's unfair competition law,, which included a claim for injunctive relief, were barred. We said: "remedies for breach and non-performance of FERC-approved operating agreements in the interstate wholesale electricity market fall within the exclusive domain of FERC." *Dynergy,* at 375 F.3d at 836. Here, FERC approved tariffs that included the market protocols that governed sales in the PX and ISO markets. FERC has found that most, if not all, of the practices alleged in Snohomish's complaint violated these protocols. Snohomish's claim for injunctive relief is therefore preempted. It "encroach[es] upon the substantive provisions of the tariff, an area reserved exclusively to FERC, both to enforce and to seek remedy." See *Id.*.

FERC approved tariffs that governed the California wholesale electricity markets. Therefore, if the prices in those markets were not just and reasonable or if the defendants sold electricity in violation of the filed tariffs, Snohomish's only option is to seek a remedy before FERC. We therefore affirm the district court's order dismissing Snohomish's claims for lack of jurisdiction.

AFFIRMED.

NOTES:

1. The case noted that the two non-governmental entities created by California legislation, namely the California Power Exchange (“PX”) and the California Independent System Operator (“ISO”), were subject to FERC's regulation. At this point, it is instructive to look again at 16 U.S.C. § 824 (§201 of the FPA). Section (b) contains the three-fold grant of jurisdiction to FERC:

> (b) The provisions of this subchapter shall apply [1] to the transmission of electric energy in interstate commerce and [2] to the sale of electric energy at wholesale in interstate commerce .... [3] *The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy*, but shall not have jurisdiction, except as specifically provided in this subchapter and subchapter III of this chapter, over facilities used for the generation of electric energy or over facilities used in local distribution or only for the transmission of electric energy in intrastate commerce, or over facilities for the transmission of electric energy consumed wholly by the transmitter. (numerals and emphasis added)

The PX and ISO were regulated under the third category: as “facilities” for interstate wholesale sales or transmission. The FERC does not limit its jurisdiction to physical assets nor to those who take title to electricity. If a party can have material influence over the price of electricity, then the party can be regulated; “the power to set price ... [indicates] exercising control over wholesale sales of Electricity” *Automated Power Exchange, Inc. v. FERC,* 204 F.3d 1144 (D.C.Cir. 2000).

2. The Federal Power Act, of course, governs FERC’s jurisdiction over electricity and the National Gas Act deals with natural gas regulation. The two are distinct statutes, but have some conceptual parallels. FERC’s jurisdiction under the FPA over “all facilities for such transmission or sale of electric energy” is similar to its jurisdiction under the NGA of activities “natural gas companies” pursue “in connection with” jurisdictional sales or transmission. *See*, *Williams Gas Processing - Gulf Coast Company, L.p. v. FERC ,* *supra*, this supplement.

The following case details more about the California experiment in restructuring. In both the preceding case and *Lockyer*, the wholesale buyers, and thus retail sellers, were the ones driven to bankruptcy. In it restructuring, California had put ceilings on retail prices, so the costs to the utility/ retail sellers could not be totally passed through to the ultimate

consumer. Nevertheless, in the summer of 2000, consumer prices did skyrocket. For example, in San Diego energy rates in July increased from 6¢/KWh to 20¢KWh. Average bills increased from $50 to $120.

CALIFORNIA *ex rel.*. LOCKYER v. F.E.R.C.
383 F.3d 1006 (9th Cir. 2004)

THOMAS, Circuit Judge:

This case presents the question, *inter alia,* of whether the Federal Energy Regulatory Commission ("FERC") properly authorized and administered market-based energy tariffs. The State of California ("California"), through its Attorney General, claims that it did not, and that California energy consumers are entitled to as much as $2.8 billion in refunds. We conclude that FERC's authorization of market-based tariffs in this case complied with the Federal Power Act, but that FERC abused its administrative discretion by declining to order refunds for violations of its reporting requirements. We therefore grant California's petition in part and remand this case to FERC for refund proceedings.

I

California's energy crisis in 1995 prompted the California Public Utilities Commission and the California legislature to restructure the electric energy industry. The resulting legislation, Assembly Bill 1890 ("AB 1890"), was designed to dismantle the investor-owned, government-regulated utility model and create a deregulated market in which price would be established by competition. Act of September 23, 1996, *codified in* Cal. Pub. Util.Code §§ 330-398.5. Under AB 1890, the major investor-owned, vertically-integrated utilities were required to divest a substantial portion of their power generation plants, to sell the output of their remaining generation capacity to a newly created wholesale clearinghouse known as the California Power Exchange Corporation ("CalPX"). CalPX, which was created by AB 1890, was to provide a centralized auction market for the trading of electricity. It was thus deemed a public utility pursuant to the Federal Power Act, *see* 16 U.S.C. § 824(e), and thus subject to regulation by FERC, *see* 16 U.S.C. § 824(b), (d).[13] AB 1890 created another non-profit entity, the Independent System Operator ("ISO"), also subject to FERC jurisdiction, which was to be responsible for managing California's electricity transmission grid and balancing electrical supply and demand. Its operations were to be governed by a tariff and protocols filed with FERC. Under AB 1890, purchases and sales of wholesale power by investor-owned utilities were now subject to FERC jurisdiction. *So. Cal. Edison,* 307 F.3d at 801.

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[13] This is not our first foray into the thicket of California's attempt to deregulate the power industry. Thus, an exhaustive rendition of the factual background is not required. Further general details are provided in some of our previous decisions. *See, e.g., State of California ex rel. Lockyer v. Dynegy,* 375 F.3d 831, 2004 WL 1488195 (9th Cir. July 6, 2004); *Southern California Edison Co. v. Lynch,* 307 F.3d 794, 801 (9th Cir.2002); *In re California Power Exchange Corporation,* 245 F.3d 1110, 1114-19; Duke Energy Trading and Marketing, L.L.C. v. Davis, 267 F.3d 1042, 1045-46 (2001).

Thereafter, three major investor-owned utilities filed applications with FERC seeking approval of the establishment of CalPX and the ISO, authority to convey operational control of the transmission facilities to the ISO, and authority to sell electrical energy at market based rates. *See Pacific Gas and Electric Co.,* 77 FERC ¶ 61,265 (1996); *Pacific Gas and Electric Co.,* 77 FERC ¶ 61,204 (1996); *Pacific Gas and Electric Co.,* 77 FERC ¶ 61,077 (1996).

A condition of FERC's approval of an entity's market-based rate authority was a FERC determination that the entity lacked, or had adequately mitigated market power in the California markets. FERC conducted these inquiries as a means of carrying out its statutory mandate under the Federal Power Act to ensure "just and reasonable" wholesale rates for electricity. 16 U.S.C. § 824d(a). FERC approved the utilities' requests, and granted permission for the utilities to sell electricity at market-based rates in California. FERC also approved the establishment of the ISO and CalPX, which then commenced operations in late March 1998.

In June 2000, wholesale electricity prices increased dramatically. In August, San Diego Gas & Electric Company filed a complaint under § 206 of the Federal Power Act ("FPA") against all sellers of energy and ancillary services into the CalPX and ISO markets. In response, FERC instituted hearing procedures under FPA § 206 to investigate the justness and reasonableness of the rates of sellers that were subject to FERC jurisdiction into the ISO and CalPX markets.

Electricity prices remained at high levels in the winter of 2001, and California's largest utility, Pacific Gas and Electric Company, filed a voluntary petition in bankruptcy under Chapter 11 of the United States Bankruptcy Code. In January of 2001, the Governor of the State of California declared a state of emergency. Pursuant to that order, and in light of rolling blackouts, the Governor directed the State Department of Water Resources ("DWR") to purchase wholesale power on the spot market. By October of 2001, California Energy Resources Scheduler ("CERS"), a division of DWR, had spent approximately $10 billion buying energy on the spot market.

In November of 2000, having reviewed San Diego Gas & Electric's complaint, FERC adopted several reform measures. FERC found that the "California market structure provide[d] the opportunity for sellers to exercise market power" in times of tight supply and that such market power could result in "unjust and unreasonable rates." *San Diego Gas & Electric Co. v. Sellers of Energy and Ancillary Services into Markets Operated by the California Independent System Operator and the California Power Exchange,* 93 FERC ¶ 61,121 (2000). In addition to ordering structural and rule changes, FERC ordered an evidentiary hearing to determine the appropriate refund. However, FERC limited the refund to ISO and CalPX spot market transactions during the period from October 2, 2000 through June 20, 2001.

A year later, the State of California filed the instant complaint against all sellers of power and ancillary services subject to FERC jurisdiction in markets operated by the ISO and

CalPX and sellers of power to CERS (collectively, "California Wholesalers"), alleging that FERC's market-based rate filing requirements violated the FPA and that, even if valid, the reports filed by electricity sellers did not contain the transaction-specific information the FPA requires. California claimed that FERC's improper decision to limit the refund period reduced the refunds owed to California purchasers by as much as $2.8 billion.

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The California Wholesalers contended, and FERC ultimately concluded, that California's complaint amounted to an impermissible collateral attack on prior Commission orders pertaining to FERC's market-based rate authority and procedures, on prior FERC determinations regarding refund liability, and as to FERC's decisions to grant the various defendants their respective market-based rate authority. FERC granted the complaint in part, holding that where the California Wholesalers had reported aggregated rather than transaction-specific data, the reports failed to comply with FPA § 205(c). Rather than ordering refunds for the reporting violations, however, FERC held that "the failure to report transactions in the format required by FERC for quarterly reports is essentially a compliance issue" for which "re-filing of quarterly reports to include transaction-specific data is an appropriate and sufficient remedy." 99 FERC ¶ 61,247 at 62,068 (2002).

California timely filed a petition for review of FERC's decision and properly invokes our jurisdiction to review final orders of FERC pursuant to 16 U.S.C. § 8251(b).

II

The Federal Power Act governs the transmission and wholesale sales of electrical energy in interstate commerce. 16 U.S.C. § 824(b). Pursuant to its authority under the FPA, FERC has exclusive jurisdiction over interstate wholesale power rates. *Id.; Nantahala Power and Light Co. v. Thornburg,* 476 U.S. 953, 956 (1986). The FPA requires that all rates for the transmission and sale of wholesale electricity be filed with FERC and published for public review.. FERC is obligated to ensure that wholesale power rates are "just and reasonable," and applied in a non-discriminatory manner. Indeed, FERC's authority to determine whether wholesale rates are "just and reasonable" is exclusive. *Mississippi Power & Light Co. v. Mississippi,* 487 U.S. 354, 371 (1988).

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The Supreme Court first articulated the filed rate doctrine as applied to the power industry in 1951 in *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.,* 341 U.S. 246, 251-52 (1951). The Court held that rates established in power sales contracts filed with and accepted by FERC's predecessor, the Federal Power Commission, were not only binding on the parties, but on the federal courts. *Id.* In short, under the filed rate doctrine, once rates have been accepted for filing under FPA § 205, utilities must adhere to those rates absent a waiver. *Arkansas Louisiana Gas Co. v. Hall,* 453 U.S. 571, 577, (1981). The rate filed by the wholesale seller of electricity or fixed by FERC is the only lawful charge and "[d]eviation from it is not permitted upon any pretext." *AT & T v. Central Office Telephone, Inc.,* 524 U.S. 214, 222(1998). Unless the filed rates are challenged administratively, the filed rates become the legal rates. If the rates are challenged, then FERC decides whether the rates are "just and reasonable" and not "unduly

discriminatory." Parties may challenge FERC's resolution of these issues in a petition for review before the appropriate United States Court of Appeals. 16 U.S.C. § 8251(b). However, appellate review is deferential.

With a fixed rate tariff, the review process is relatively straightforward. A wholesaler would file a rate, which would become the legal rate unless challenged. If FERC determined that the rate was not "just and reasonable" after a challenge, then it would order refunds.

However, approximately a decade ago, companies began to file market-based tariffs that did not specify the precise rate to be charged. As a result, FERC then departed from its historical policy of basing rates upon the cost of providing service plus a fair return on invested capital, and began approving market-based tariffs.

California contends that the market-based tariff system approved by FERC in this case violates the FPA because it relies on unfiled, privately negotiated rates to satisfy statutory rate filing requirements, and that this cannot be sustained even when the agency has made a prior determination that market forces will drive rights into a zone of reasonableness.

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The use of market-based tariffs was first approved in the natural gas context,, then as to wholesale sellers of electricity, *see Louisiana Energy and Power Authority v. FERC,* 141 F.3d 364, 365 (D.C.Cir.1998). However, approval of such tariffs was conditioned on the existence of a competitive market. Thus, market-based applications were approved only if FERC made a finding that "the seller and its affiliates [did] not have, or adequately [had] mitigated, market power." *Id.*[14] The principle justifying this approach as "just and reasonable" was that "[i]n a competitive market, where neither buyer nor seller has significant market power, it is rational to assume that the terms of their voluntary exchange are reasonable, and specifically to infer that the price is close to marginal cost, such that the seller makes only a normal return on its investment." *Tejas Power Corp. v. FERC,* 908 F.2d 998, 1004 (D.C.Cir.1990).

In support of its contention that market-based tariffs are impermissible under the FPA, California relies on *MCI Telecommunications Corp. v. AT & T,* 512 U.S. 218(1994) and *Maislin Indus. US v. Primary Steel Inc.,* 497 U.S. 116, 132 (1990). ...

However, the regulatory scheme before us is different from those under consideration in *MCI* and *Maislin.* The agencies in *MCI* and *Maislin* relied on market forces alone in approving market-based tariffs. In contrast, FERC's system consists of a finding that the applicant lacks market power (or has taken sufficient steps to mitigate market power), coupled with strict reporting requirements to ensure that the rate is "just and reasonable" and that markets are not subject to manipulation. Here, FERC required the wholesale seller to file a market analysis every four months, and quarterly reports summarizing its

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14 FERC defines market power as a seller's ability to "significantly influence price in the market by withholding service and excluding competitors for a significant period of time." *Citizens Power & Light Corp.,* 48 FERC ¶ 61,210 at 61,777 (1989).

transactions during the preceding three months. These transaction summaries include both long and short-term contracts, purportedly with reports of some sales for intervals as small as ten minutes. FERC has affirmed in its presentation before us that it is not contending that approval of a market-based tariff based on market forces alone would comply with the FPA or the filed rate doctrine. Rather, the crucial difference between *MCI/ Maislin* and the present circumstances is the dual requirement of an ex ante finding of the absence of market power *and* sufficient post-approval reporting requirements. Given this, FERC argues that its market-based tariff does not run afoul of *MCI* or *Maislin,* and we agree.

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For all of these reasons, California's facial challenge to market-based tariffs fails.

III

Our determination that market-based tariffs do not, *per se,* violate the FPA does not end our inquiry. California also argues that, even if market-based tariffs are lawful in concept, FERC failed to administer the tariffs in accordance with their terms and abused its discretion in limiting available remedies for regulatory violations. On these issues, we agree with California.

As we have discussed, there is nothing inherent in the general concept of a market-based tariff that violates the FPA; however, as *MCI* and *Maislin* affirm, a market-based tariff cannot be structured so as to virtually deregulate an industry and remove it from statutorily required oversight. The structure of the tariff complied with the FPA, so long as it was coupled with enforceable post-approval reporting that would enable FERC to determine whether the rates were "just and reasonable" and whether market forces were truly determining the price.

For example, in *Enron Power Marketing, Inc.,* 65 FERC ¶ 61,305, FERC emphasized that transaction-specific reporting "is necessary so that the marketer's rates will be on file as required by section 205(c) of the FPA, to evaluate the reasonableness of the charges, and to provide for ongoing monitoring of the marketer's ability to exercise market power." Similarly, FERC has stated that transaction-specific data is the "minimum needed for market monitoring purposes." *Revised Public Utility Filing Requirements,* 99 FERC ¶ 61,107 (2002).

Despite the crucial nature of the transactional reporting, as FERC admits, the reporting requirements were not followed in the period at issue. Indeed, non-compliance with FERC's reporting requirements was rampant throughout California's energy crisis. FERC itself has acknowledged that during the height of the energy crisis the quarterly reports of several major wholesalers failed to include the transaction-specific data through which the agency at least theoretically could have monitored the California energy market:

> The quarterly reports submitted ... by a number of the respondents do not comply with [the] requirements. For example, Williams Energy Marketing and Trading Company, Dynegy Power Marketing, Inc., Mirant Americas Energy Marketing, LP

> and Reliant Energy Services, Inc. filed aggregated data in their transaction reports for the fourth quarter 2000 and all four quarters of 2001.... Similarly, any other filings that report aggregate data did not comply with the reporting requirements.

State of California ex rel. Bill Lockyer, Attorney General of the State of California v. British Columbia Power Exchange Corp. et al., 99 FERC ¶ 61,247 at 62,066 (2002).

Thus, the very mechanism that distinguished FERC's tariff from those prohibited by the Supreme Court in *MCI* and *Maislin* was, for all practical purposes, non-existent while energy prices skyrocketed and rolling brown-outs threatened California's businesses and citizens.

Despite the promise of truly competitive market-based rates, the California energy market was subjected to artificial manipulation on a massive scale. With FERC abdicating its regulatory responsibility, California consumers were subjected to a variety of market machinations, such as "round trip trades"[15] and "hockey-stick bidding,"[16] coupled with manipulative corporate strategies, such as those nicknamed "FatBoy," "Get Shorty," and "Death Star."[17]

However, despite the integral nature of the reporting requirements to an effective market-based tariff, and despite the patent failure of many of the affected companies to

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15 Round-trip trades are a mechanism for market manipulation through which an entity attempts to inflate transaction volume through the continuous and frequent sale of a particular commodity. The trades create the appearance of increased revenue and demand, but in actuality produce no net income.

16 Hockey-stick bidding is a fraudulent practice whereby an extremely high price is demanded for a small portion of a product in light of known inelastic demand (as was the case for energy in California during the energy crisis).

17 These monikers are strategies referred to in now notorious internal memos at the Enron Corporation that were released to the public by FERC. "FatBoy" refers to a strategy through which the Houston-based energy company allegedly withheld previously agreed-to deliveries of power so it could sell the energy at a higher price on the spot market. To execute this, the company would over-schedule its load; supply only enough power to cover the inflated schedule; and thus leave extra supply in the market, for which the ISO would pay the company. Via the "Get Shorty" strategy, traders were able to fabricate and sell emergency back-up power (known as ancillary services) to the ISO, receive payment, then cancel the schedules and cover their commitments by purchasing through a cheaper market closer to the time of delivery. Under the "Death Star" strategy, Enron allegedly sought to be paid "for moving energy to relieve congestion without actually moving any energy or relieving any congestion." *See 'FatBoy,' 'Get Shorty,' and 'Inc-Ing': A Look at Enron Trading Practices,* May 13, 2002, Electric Utility Week 7, 2002 WL 10510230; *see also Enron Memos Put FERC in the Hot Seat; All Western Sellers Will be Grilled,* May 13, 2002, Electric Utility Week 1, 2002 WL 10510221 (noting, *inter alia,* that while Enron's monikers may have been unique, its practices in the California energy market were not).

provide even minimal reporting, FERC's position here is that violation of tariff reporting requirements is merely a technical “compliance issue,” and it is therefore without authority to order refunds retroactively based on reporting failures.

FERC misapprehends its legal authority in this context. In fact, FERC possesses broad remedial authority to address anti-competitive behavior. Indeed, in the past, FERC has ordered refunds in instances where utilities violated FPA § 205, either by violating the terms of an accepted rate, or by charging rates without first seeking approval under FPA § 205. In *The Washington Water Power Co.,* 83 FERC ¶ 61,282 (1998), FERC ordered profits disgorged because a regulated utility had violated posting requirements and conferred undue preferences on its marketing affiliate. To do otherwise would allow companies to flout our regulations, and overcharge consumers with impunity.” 24 FERC ¶ 61,199 at 61,461, *reh'g order,* 24 FERC ¶ 61,380, *reh'g denied,* 25 FERC ¶ 61,308 (1983).

Here, because the reporting requirements were an integral part of a market-based tariff that could pass legal muster, FERC cannot dismiss the requirements as mere punctilio. If the ability to monitor the market, or gauge the “just and reasonable” nature of the rates is eliminated, then effective federal regulation is removed altogether. Without the required filings, neither FERC nor any affected party may challenge the rate. Pragmatically, under such circumstances, there is no filed tariff in place at all. The power to order retroactive refunds when a company's non-compliance has been so egregious that it eviscerates the tariff is inherent in FERC's authority to approve a market-based tariff in the first instance. FERC may elect not to exercise its remedial discretion by requiring refunds, but it unquestionably has the power to do so. In fact, if no retroactive refunds were legally available, then the refund mechanism under a market-based tariff would be illusory. Parties aggrieved by the illegal rate would have no FERC remedy, and the filed rate doctrine would preclude a direct action against the offending seller. That result does not comport with the underlying theory or the regulatory structure established by the FPA.

One of the animating ideas behind the FPA and the filed rate doctrine was, as we have discussed, the prevention of price discrimination and the imposition of unjust and unreasonable rates by requiring that all customers receive the same published rate. As the Supreme Court noted in *Maislin,* the purpose of the filed rate doctrine is undermined when it is impossible to review the reasonableness of privately negotiated, unfiled rates. 497 U.S. at 132. If the tariff is interpreted as FERC urges here, then the tariff runs afoul of *Maislin,* the filed rate doctrine, and the FPA. If, on the other hand, we view the reporting requirements as integral to the tariff, with implied enforcement mechanisms sufficient to provide substitute remedies for the obtaining of refunds for the imposition of unjust, unreasonable and discriminatory rates, then a market-based tariff is permitted. FERC cannot have it both ways. The FPA does not permit it.

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In this instance, our statutory construction of FERC's authority is dictated by the plain language and words of the Federal Power Act, and by a common sense application of the principles underlying the FPA. To cabin FERC's section 205 refund authority under the

circumstances of this case would be manifestly contrary to the fundamental purpose and structure of the FPA, and cannot be sustained under *Maislin* and *MCI.*

FERC's construed limitations on its own authority are not supported by a careful examination of the FPA. Either the quarterly report requirement is an integral part of the authorizations under § 205, in which case violations of the requirement cannot be dismissed as mere “compliance issue[s],” or the reporting requirement is a mere compliance issue, in which case, where FERC neglects to require the filing of the reports, and thus does not engage in an active ongoing review, the only arguably serious regulatory screening that exists is FERC's initial determination with respect to a seller's market power-a determination that may bear little or no relation to the realities of subsequent circumstances.

It is true that pending a § 205 investigation, FERC may suspend a rate for a period of up to five months, at which point the proposed rate becomes effective subject to a refund if FERC ultimately determines the initially-suspended rate to be unreasonable. However, when the § 205 determination consists of a blanket approval of market-based rates determined solely (at least at the outset) on a lack of market power, the purgatorial period contemplated by the statute does not exist. Either FERC determines an entity has market power and thus is unauthorized to sell at market-based rates, or FERC determines an entity lacks market power and is thus authorized to sell at market-based rates. In the case of the former, there is no market-based rate authority whatsoever subject to the remedies in § 205. In the case of the latter, because the “rates” are already “approved,” the only remedies are prospective, and, for that matter, unavailable for a period of 60 days pursuant to § 206(b). In other words, the § 205(e) refund remedy is, practically speaking, eliminated under the scheme as FERC would have us interpret it. Such an interpretation comports neither with the statutory text nor with the Act's “primary purpose” of protecting consumers. So while we agree with FERC that market-based tariffs are not *per se* invalid under the FPA, it is clearly incorrect to conclude that the reporting requirements are anything less than essential to a valid administration of the market-based system at issue in this case.

As we have noted, FERC itself has recognized that it possesses the authority to impose retroactive refunds for § 205 violations in *Washington Water Power* and *Delmarva Power.* Here, the reporting requirements were an integral part of a market-based tariff that could pass legal muster. The FPA cannot be construed to immunize those who overcharge and manipulate markets in violation of the FPA. In short, the governing statute can be easily construed in accordance with the principles articulated by the Supreme Court in *Brown & Williamson.* Therefore, FERC's *Chevron* argument necessarily fails.

For these reasons, we agree with California that FERC improperly concluded that retroactive refunds were not legally available. Although California urges us to order refunds, we decline to do so. It is more appropriate for FERC to reconsider its remedial options in the first instance. We therefore grant the petition and remand to FERC for further proceedings consistent with this opinion.

NOTES:

1. California's restructuring scheme had some aspects that distinguished it from other state attempts to offer retail choice. California required utilities to purchase much wholesale electricity in lieu of self-generation, but discouraged forward purchasing contracts. Additionally, there had been no new siting for generating or transmission facilities in recent years so that utilities in California had to import much electricity.

2. The 9th Circuit continued to examine FERC's oversight of contracts entered into during the energy crisis in California. In reviewing the longer-term contracts executed during the high spot market price period, FERC refused to modify them retroactively. FERC employed the *Sierra-Mobile* doctrine, which it claimed would enable it to change the contract only if the "public interest" required such change. Because the FERC found no excessive burden on rate-payers, it refused to modify the contracts. The 9th Circuit remanded the case. First, it found the relevant review standard to be whether the prices were "just and reasonable." The predicate to using the *Sierra-Mobile* doctrine was not present; the court would only use *Sierra-Mobile* if the original contract was freely negotiated between two sophisticated parties and thus deserved a presumption of reasonableness. With market-based rates, there was no initial review of the prices after the contract was executed and filed with FERC.. The particular contract was not subject to FERC oversight. FERC's simple finding that the wholesale seller did not have market power at one point does not insulate its contracts from review. Because of the disruption of the spot market by manipulation, the contracts were not entitled to a reasonableness presumption. FERC must examine the circumstances at contract formation. Second, even if the demands of "public interest" were the standard, FERC inaccurately assessed the public interest by focusing on factors needed to allow a seller to unilaterally raise rates. The case involved a buyer seeking to lower prices. *PUD No. 1 of Snohomish County Washington v. FERC*,– F.3d –, 2006 WL 3717533 (9th Cir. 2006); *PUC of California v. FERC*, – F.3d –, 2006 WL 3717673 (9th Cir. 2006).

3. To enable a state to offer retail competition to its consumers, it must re-think the "regulatory contract" that existed in the past between the regulated Local Distribution Company and the regulatory commission. Traditionally, the LDC received an exclusive franchise to deliver electricity in a given area. In other words, the LDC was a regulated monopoly. In some states, existing statutes were construed as giving the regulatory commission discretion to change exclusivity administratively. For example, New Hampshire statutes set out the standard its PUC would employ in granting or withholding permission to enter the electric distribution business:

> Permission. The commission shall grant such permission whenever it shall, after due hearing, find that such engaging in business, construction or exercise of right, privilege or franchise would be for the public good, and not otherwise; and may prescribe such terms and conditions for the exercise of the privilege granted under such permission as it shall consider for the public interest... RSA 374:26

The New Hampshire Supreme Court held that this statute did not, as a matter of law, require exclusive franchises:

> We do not believe that this discussion of electric and gas utilities as monopolies of practical necessity in 1930 was intended to bind future generations to a policy based on the perceived technological and economic limitations of that day. Rather, we described the monopoly status of these utilities as derived from "sound economic reasons," a justification of policy and not of law. What was sound regulatory policy in 1930 may be anachronistic today. In recognizing "the theoretical right to obtain a competing grant," this court made clear the commission's authority to grant a competing franchise should the public good so require. *Appeal of Public Service Company of New Hampshire*, 141 N.H. 13, 676 A.2d 101 (1996)

The New Hampshire statutory grant to its PUC is similar in wording to the statutes of at least 40 other states. Therefore, the case could have wide-spread value as precedent.

4. By contrast, the Michigan Supreme Court ruled that its Public Service Commission had no jurisdiction under Michigan statutes to order retail wheeling, which would infringe on the management prerogatives of the local distribution company. It emphasized that an agency is a creature of statute, with no common law powers. *Consumers Power Co. v. Michigan Public Service Co.*, 596 N.W.2d 126 (Mich. 1999). In Michigan, therefore, retail restructuring would have to be by statute. Other jurisdictions have also either required or desired to make such changes by statute.
5. See generally, Suedeen G. Kelly, *Electricity*, in The Energy Law Group, ENERGY LAW AND POLICY FOR THE 21ST CENTURY, 12-25 to 12-30 and 12-32 to 12-36 (Rocky Mountain Mineral Law Foundation 2000).
6. For a thoughtful essay on the impacts of electric restructuring, see Suedeen G. Kelly, "The New Electric Powerhouses: Will They Transform Your Life?" 29 ENVTL. L. 285 (1999). Professor Kelly notes three issues that require individualized and creative solutions: stranded costs, utility mergers, and cost-shifting from industrial users to residential users.

4. Electricity and the Energy Policy Act of 2005

The Energy Policy act of 2005 bolstered FERC authority in regard to electricity in several areas. First, it increased FERC's ability to investigate and punish market manipulation. Second, it repealed the Public Utility Holding Company Act and transferred the public interest review functions of that act to FERC. Third, the Act gave FERC back-up authority to authorize transmission facilities when state processes become stymied. Fourth, it enabled FERC in limited situations to order open access on facilities that were not subject to FERC jurisdiction. The Act also required FERC to investigate ways to stimulate investment in electric infrastructure. One final aspect of note is the Act mandated creation of a reliability program to assure the reliability of electric supply in the competitive era. FERC maintains a website to track its compliance with its duties: http://www.ferc.gov/legal/maj-ord-reg/fed-sta/ene-pol-act.asp

INSERT AT PAGE 345:

NOTE 1 (a):

1. (a). In December of 2005, the Taum Sauk dam collapsed. One billion gallons of water were released into a Missouri state park. The waters swept away the park superintendent's house. Prior to the collapse, FERC had said the dam was safe. See, http://www.ferc.gov/industries/hydropower/safety/projects/taum-sauk.asp

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NOTE 5(a):

5a. The Court of Appeals for the District of Columbia considered several relicensing issues in *City of Tacoma v. FERC*, 460 F.3d 53 (D.C.Cir. 2006). The city of Tacoma instituted the project in 1924 under a license from the Federal Power Commission that only considered the portion of the project on federal lands. By 1964, the law had been interpreted to require consideration of the entire project. Therefore, when the original license expired in 1974, the city applied for a "major project" license. FERC considered the proceeding to be a relicensing, and finally completed proceeding in 1998 . An Indian tribe urged that the baseline for impact on its reservation's fishing resource should be the pre-project, pre-1924 river. This claim was rejected; the proceeding was a relicensing. However, the tribe and the Department of Interior won on other issues related to § 4(e) conditions . See, addition to Note 1, original text page 357, which is *infra*.
The city, however, lost one of its major arguments. It argued that FERC could not issue a license on terms that made the license economically unviable. The court concurred with FERC that renewal was not required:

> In some cases, a change in congressional priorities might cast doubt on a once viable project and lead to closure of the project when its license expires, either because FERC denies a new license outright or because FERC issues a new license that the licensee finds too costly or burdensome. In FERC's decommissioning policy statement, FERC argues persuasively that it cannot guarantee license renewal when Congress has greatly altered the regulatory landscape during the course of the prior license term. Moreover, the very fact that a license may not exceed fifty years, indicates Congress's intent that projects be reevaluated from time to time in light of changing circumstances and national priorities, and this reevaluation necessarily implies that in some cases new licenses will not be issued.
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> In light of these sweeping changes in FERC's statutory mandate, FERC not only has the authority but also the obligation to evaluate existing projects completely anew upon expiration of their license terms. If Congress's enactments are to have any meaning at all, then Congress must have envisioned major changes at some if not all of these existing projects. In cases where these changes render the project impractical, then closure becomes a possibility. As FERC put the point: "[T]he Commission does not read the [Federal Power] Act as requiring it to issue a license." 60 Fed.Reg. at 342. Nothing in the FPA suggests that Congress intended

> to "grandfather" existing projects so they could continue to operate indefinitely despite changes in national priorities.
>
> Tacoma relies heavily on the provision of the FPA requiring FERC to grant new licenses "upon reasonable terms," 16 U.S.C. § 808(a)(1), but we cannot accept the implication that "reasonable terms" means the same terms that were imposed eighty years ago, or that "reasonable terms" means terms that ignore the present-day statutory mandate. In fact, section 15 of the Act states the opposite: "[T]he commission is authorized [upon expiration of a license] to issue a new license to the existing licensee upon such terms and conditions as may be authorized or required *under the then existing laws and regulations.*" *Id.* (emphasis added).
>
> Therefore, the question we must decide is whether "reasonable terms" can, in some cases, be terms that may have the effect of shutting a project down or occasioning a change of ownership. We think the answer is yes, especially here where, according to FERC's factual finding, Tacoma has recouped its initial investment plus a significant annual return on that investment. The obligation to give "equal consideration" to wildlife protection and the environment, *id.* § 797(e), implies that, at least in some cases, these environmental concerns will prevail. At the very least, the Act is ambiguous, and FERC's interpretation of its statutory authority is reasonable and entitled to deference under *Chevron,* 467 U.S. at 842-43.

The court did not decide whether FERC could impose decommissioning costs on the licensee.

INSERT AT PAGE 357:

ADDITION TO NOTE 1

FERC had passed regulations requiring that the Departments having jurisdiction over land within the license area provide the § 4(e) conditions to FERC within 60 days. FERC refused to include conditions that were "untimely." This was found to be an inappropriate unilateral restriction on the duties and rights of the appropriate agency. *City of Tacoma v. FERC*, --- F.3d ----, 2006 WL 2411362 (D.C.Cir. 2006). Additionally, the court found that the conditions could relate to impacts on the entire reservation, not merely on the part of the reservation on which the project directly intrudes.

DELETE pages 359-368 and INSERT:

Two distinct sections of the Clean Water Act are discussed in the following case. The Supreme Court in *Warren* is primarily concerned with the CWA requirement that a federal licensee receive a certification from the relevant state if the licensed activity involves a "discharge." The state must certify that the license will comply with all of the state's laws. This requirement is § 401 of the CWA It applies not only to the hydroelectric licenses FERC issues, but to all federal licenses. If a state develops conditions to make the license comply with state law, these conditions must be inserted in

the federal license. The *Warren* case distinguishes the § 401 certification process from § 402 of the CWA, which requires a party to have a permit before discharging a pollutant into the waters of the United States from a point source. This section involves the so-called NPDES permit. Under the cooperative federalism model, states with approved programs can issue these permits. The CWA makes it illegal for a point source to discharge a pollutant into waters of the United States without such a permit.

WARREN CO. v. MAINE BOARD OF ENVIRONMENTAL PROTECTION
126 S.Ct. 1843 (2006)

SOUTER, J., delivered the opinion of the Court, in which ROBERTS, C. J., and STEVENS, KENNEDY, THOMAS, GINSBURG, BREYER, and ALITO, JJ., joined, and in which SCALIA, J., joined as to all but Part III-C.

Justice SOUTER delivered the opinion of the Court.

The issue in this case is whether operating a dam to produce hydroelectricity "may result in any discharge into the navigable waters" of the United States. If so, a federal license under § 401 of the Clean Water Act requires state certification that water protection laws will not be violated. We hold that a dam does raise a potential for a discharge, and state approval is needed.

I

The Presumpscot River runs through southern Maine from Sebago Lake to Casco Bay, and in the course of its 25 miles petitioner, S.D. Warren Company, operates several hydropower dams to generate electricity for its paper mill. Each dam creates a pond, from which water funnels into a "power canal," through turbines, and back to the riverbed, passing around a section of the river just below the impoundment.

It is undisputed that since 1935, Warren has needed a license to operate the dams, currently within the authority of the Federal Energy Regulatory Commission (FERC) under the Federal Power Act. FERC grants these licenses for periods up to 50 years, after a review that looks to environmental issues as well as the rising demand for power.

Over 30 years ago, Congress enacted a specific provision for licensing an activity that could cause a "discharge" into navigable waters; a license is conditioned on a certification from the State in which the discharge may originate that it will not violate certain water quality standards, including those set by the State's own laws. Today, this requirement can be found in § 401 of the Clean Water Act, codified at 33 U.S.C. § 1341:

> "Any applicant for a Federal license or permit to conduct any activity ... which may result in any discharge into the navigable water[s] shall provide the licensing or permitting agency a certification from the State in which the discharge originates ... ." § 1341(a)(1).

> "Any certification provided under this section shall set forth any effluent limitations and other limitations, and monitoring requirements necessary to assure that any applicant for a Federal license or permit will comply with [§§ 1311, 1312, 1316, and 1317] and with any other appropriate requirement of State law set forth in such certification, and shall become a condition on any Federal license or permit subject to the provisions of this section."[18] § 1341(d)

In 1999, Warren sought to renew federal licenses for five of its hydroelectric dams. It applied for water quality certifications from the Maine Department of Environmental Protection (the state agency responsible for what have come to be known as "401 state certifications"), but it filed its application under protest, claiming that its dams do not result in any "discharge into" the river triggering application of § 401.

The Maine agency issued certifications that required Warren to maintain a minimum stream flow in the bypassed portions of the river and to allow passage for various migratory fish and eels. When FERC eventually licensed the five dams, it did so subject to the Maine conditions, and Warren continued to deny any need of § 401 state certification. After appealing unsuccessfully to Maine's administrative appeals tribunal, the Board of Environmental Protection, Warren filed this suit in the State's Cumberland County Superior Court. That court rejected Warren's argument that its dams do not result in discharges, and the Supreme Judicial Court of Maine affirmed. We granted certiorari, and now affirm as well.

II

The dispute turns on the meaning of the word "discharge," the key to the state certification requirement under § 401.[19] The Act has no definition of the term, but provides that "[t]he term 'discharge' when used without qualification includes a discharge of a pollutant, and a discharge of pollutants."[20] 33 U.S.C. § 1362(16). It does define "discharge of a pollutant" and "discharge of pollutants," as meaning "any addition of any pollutant to navigable waters from any point source." § 1362(12). But "discharge" presumably is broader, else superfluous, and since it is neither defined in the

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[18] The statutes cross-referenced go to effluent limitations and other limitations, 33 U.S.C. §§ 1311, 1312, standards of performance, § 1316, and toxic effluent standards, § 1317. As we have explained before, "state water quality standards adopted pursuant to § 303 [of the Clean Water Act, 33 U.S.C. § 1313,] are among the 'other limitations' with which a State may ensure compliance through the § 401 certification process." *PUD No. 1 of Jefferson Cty. v. Washington Dept. of Ecology,* 511 U.S. 700, 713 (1994).

[19] No one disputes that the Presumpscot River is a navigable water of the United States.

[20] The term "pollutant" is defined in the Act to mean "dredged spoil, solid waste, incinerator residue, sewage, garbage, sewage sludge, munitions, chemical wastes, biological materials, radioactive materials, heat, wrecked or discarded equipment, rock, sand, cellar dirt and industrial, municipal, and agricultural waste discharged into water." 33 U.S.C. § 1362(6).

statute nor a term of art, we are left to construe it "in accordance with its ordinary or natural meaning." *FDIC v. Meyer,* 510 U.S. 471, 476 (1994).

When it applies to water, "discharge" commonly means a "flowing or issuing out," Webster's New International Dictionary 742 (2d ed.1949); see also *ibid.* ("[t]o emit; to give outlet to; to pour forth; as, the Hudson *discharges* its waters into the bay"), and this ordinary sense has consistently been the meaning intended when this Court has used the term in prior water cases. See, *e.g., Marsh v. Oregon Natural Resources Council,* 490 U.S. 360, 364 (1989) (describing a dam's " 'multiport' structure, which will permit discharge of water from any of five levels"); *Arizona v. California,* 373 U.S. 546, 619, n. 25(1963) (Harlan, J., dissenting in part) (quoting congressional testimony regarding those who " 'take ... water out of the stream which has been discharged from the reservoir' "); *United States v. Arizona,* 295 U.S. 174, 181 (1935) ("Parker Dam will intercept waters discharged at Boulder Dam").

In fact, this understanding of the word "discharge" was accepted by all Members of the Court sitting in our only other case focused on § 401 of the Clean Water Act, *PUD No. 1 of Jefferson Cty. v. Washington Dept. of Ecology,* 511 U.S. 700 (1994). At issue in *PUD No. 1* was the State of Washington's authority to impose minimum stream flow rates on a hydroelectric dam, and in posing the question presented, the Court said this:

> "There is no dispute that petitioners were required to obtain a certification from the State pursuant to § 401. Petitioners concede that, at a minimum, the project will result in two possible discharges-the release of dredged and fill material during the construction of the project, and the discharge of water at the end of the tailrace after the water has been used to generate electricity." *Id.,* at 711.

The *PUD No. 1* petitioners claimed that a state condition imposing a stream flow requirement on discharges of water from a dam exceeded the State's § 401 authority to prevent degradation of water quality, but neither the parties nor the Court questioned that the "discharge of water" from the dam was a discharge within the ambit of § 401. And although the Court's opinion made no mention of the dam as adding anything to the water, the majority's use of the phrase "discharge of water" drew no criticism from the dissent, which specifically noted that "[t]he term 'discharge' is not defined in the [Clean Water Act] but its plain and ordinary meaning suggests 'a flowing or issuing out,' or 'something that is emitted.' " *Id.,* at 725 (opinion of THOMAS, J.) (quoting Webster's Ninth New Collegiate Dictionary 360 (1991)).

In resort to common usage under § 401, this Court has not been alone, for the Environmental Protection Agency (EPA) and FERC have each regularly read "discharge" as having its plain meaning and thus covering releases from hydroelectric dams.[21]

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[21] Warren relies on a document from the EPA as a counterexample of the EPA's position in this regard. ... The memorandum does not help Warren, however; it interprets § 402 of the Clean Water Act, not § 401, and construes the statutory phrase "discharge of a pollutant," which, as explained below, implies a meaning different under the statute

Warren is, of course, entirely correct in cautioning us that because neither the EPA nor FERC has formally settled the definition, or even set out agency reasoning, these expressions of agency understanding do not command deference from this Court. See *Gonzales v. Oregon,* 546 U.S. ----, ----, 126 S.Ct. 904, 908, 163 L.Ed.2d 748 (2006) ("*Chevron* deference... is not accorded merely because the statute is ambiguous and an administrative official is involved"); *Skidmore v. Swift & Co.,* 323 U.S. 134, 140, 65 S.Ct. 161, 89 L.Ed. 124 (1944). But even so, the administrative usage of "discharge" in this way confirms our understanding of the everyday sense of the term.

III

Warren makes three principal arguments for reading the term "discharge" differently from the ordinary way. We find none availing.

A

The first involves an interpretive canon we think is out of place here. The canon, *noscitur a sociis,* reminds us that "a word is known by the company it keeps," *Gustafson v. Alloyd Co.,* 513 U.S. 561, 575, and is invoked when a string of statutory terms raises the implication that the "words grouped in a list should be given related meaning," *Dole v. Steelworkers,* 494 U.S. 26, 36 (internal quotation marks omitted); see also *Beecham v. United States,* 511 U.S. 368, 371(1994) ("That several items in a list share an attribute counsels in favor of interpreting the other items as possessing that attribute as well").

Warren claims that the canon applies to § 502(16) of the Clean Water Act, which provides that "[t]he term 'discharge' when used without qualification includes a discharge of a pollutant, and a discharge of pollutants." 33 U.S.C. § 1362(16). Warren emphasizes that the "include[d]" terms, pollutant discharges, are themselves defined to require an "addition" of pollutants to water. § 1362(12). Since "discharge" pure and simple is keeping company with "discharge" defined as adding one or more pollutants, Warren says "discharge" standing alone must require the addition of something foreign to the water into which the discharge flows. And because the release of water from the dams adds nothing to the river that was not there above the dams, Warren concludes that water flowing out of the turbines cannot be a discharge into the river.

The problem with Warren's argument is that it purports to extrapolate a common feature from what amounts to a single item (discharge of a pollutant plus the plural variant involving more than one pollutant). The argument seems to assume that pairing a broad statutory term with a narrow one shrinks the broad one, but there is no such general usage; giving one example does not convert express inclusion into restrictive equation, and *noscitur a sociis* is no help absent some sort of gathering with a common feature to extrapolate. It should also go without saying that uncritical use of interpretive rules is especially risky in making sense of a complicated statute like the Clean Water Act, where technical definitions are worked out with great effort in the legislative process. ...

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from the word "discharge" used alone. The memorandum, in fact, declares that "[i]t does not address any ... terms under the statute other than 'addition.' " *Id*., at 18.

B

Regardless, Warren says the statute should, and even must, be read its way, on the authority of *South Fla. Water Management Dist. v. Miccosukee Tribe,* 541 U.S. 95(2004). But that case is not on point. *Miccosukee* addressed § 402 of the Clean Water Act, not § 401, and the two sections are not interchangeable, as they serve different purposes and use different language to reach them. Section 401 recast pre-existing law and was meant to "continu[e] the authority of the State ... to act to deny a permit and thereby prevent a Federal license or permit from issuing to a discharge source within such State." S.Rep. No. 92-414, p. 69 (1971). Its terms have a broad reach, requiring state approval any time a federally licensed activity "may" result in a discharge ("discharge" of course being without any qualifiers here), 33 U.S.C. § 1341(a)(1), and its object comprehends maintaining state water quality standards, see n. 1, *supra*.

Section 402 has a historical parallel with § 401, for the legislative record suggests that it, too, was enacted to consolidate and ease the administration of some predecessor regulatory schemes.... But it contrasts with § 401 in its more specific focus. It establishes what Congress called the National Pollutant Discharge Elimination System, requiring a permit for the "discharge of any pollutant" into the navigable waters of the United States, 33 U.S.C. § 1342(a). The triggering statutory term here is not the word "discharge" alone, but "discharge of a pollutant," a phrase made narrower by its specific definition requiring an "addition" of a pollutant to the water. § 1362(12).

The question in *Miccosukee* was whether a pump between a canal and an impoundment produced a "discharge of a pollutant" within the meaning of § 402, and the Court accepted the shared view of the parties that if two identified volumes of water are "simply two parts of the same water body, pumping water from one into the other cannot constitute an 'addition' of pollutants." *Miccosukee* was thus concerned only with whether an "addition" had been made (phosphorous being the substance in issue) as required by the definition of the phrase "discharge of a pollutant"; it did not matter under § 402 whether pumping the water produced a discharge without any addition. In sum, the understanding that something must be added in order to implicate § 402 does not explain what suffices for a discharge under § 401.

C

Warren's third argument for avoiding the common meaning of "discharge" relies on the Act's legislative history, but we think that if the history means anything it actually goes against Warren's position. Warren suggests that the word "includes" in the definition of "discharge" should not be read with any spacious connotation, because the word was simply left on the books inadvertently after a failed attempt to deal specifically with "thermal discharges." As Warren describes it, several Members of Congress recognized that "heat is not as harmful as what most of us view as 'pollutants,' because it dissipates quickly in most bodies of receiving waters," 1 Legislative History of the Water Pollution Control Act Amendments of 1972 (Committee Print compiled for the Senate Committee

on Public Works by the Library of Congress), Ser. No. 93-1, p. 273 (1973) (remarks of Cong. Clark), and they proposed to regulate thermal discharges less stringently than others. They offered an amendment to exclude thermal discharges from the requirements under § 402, but they also wanted to ensure that thermal discharges remained within the scope of § 401 and so sought to include them expressly in the general provision covering "discharge." See *id.,* at 1069-1070, 1071. The proposed definition read, "[t]he term 'discharge' when used without qualification includes a discharge of a pollutant, a discharge of pollutants, and a thermal discharge." *Id.,* at 1071.

Of course, Congress omitted the reference to "thermal discharge," and settled on the definition we have today. Warren reasons that once Congress abandoned the special treatment for thermal pollutants, it merely struck the words "thermal discharge" from 33 U.S.C. § 1362(16) and carelessly left in the word "includes." Thus, Warren argues, there is no reason to assume that describing "discharge" as including certain acts was meant to extend the reach of § 401 beyond acts of the kind specifically mentioned; the terminology of § 401 simply reflects a failed effort to narrow the scope of § 402.

This is what might be called a lawyer's argument. We will assume that Warren is entirely correct about the impetus behind the failed attempt to rework the scope of pollutant discharge under § 402. It is simply speculation, though, to say that the word "includes" was left in the description of a "discharge" by mere inattention, and for reasons given in Part IV of this opinion it is implausible speculation at that. But if we confine our view for a moment strictly to the drafting history, the one thing clear is that if Congress had left "thermal discharge" as an included subclass of a "discharge" under § 502(16), Warren would have a stronger *noscitur a sociis* argument. For a thermal discharge adds something, the pollutant heat... Had the list of examples of discharge been lengthened to include thermal discharges, there would have been at least a short series with the common feature of addition. As it stands, however, the only thing the legislative history cited by Warren demonstrates is the congressional rejection of language that would have created a short series of terms with a common implication of an addition.

Warren's theory, moreover, has the unintended consequence of underscoring that Congress probably distinguished the terms "discharge" and "discharge of pollutants" deliberately, in order to use them in separate places and to separate ends. Warren hypothesizes that Congress attempted to tinker with the definition of "discharge" because it wanted to subject thermal discharges to the requirements of § 401, but not § 402. But this assumption about Congress's motives only confirms the point that when Congress fine-tunes its statutory definitions, it tends to do so with a purpose in mind. See *Bates v. United States,* 522 U.S. 23, 29-30 (1997) (if "Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion" (internal quotation marks omitted)).

IV

Warren's arguments against reading the word "discharge" in its common sense fail on their own terms. They also miss the forest for the trees.

Congress passed the Clean Water Act to "restore and maintain the chemical, physical, and biological integrity of the Nation's waters," 33 U.S.C. § 1251(a); ... the "national goal" being to achieve "water quality which provides for the protection and propagation of fish, shellfish, and wildlife and provides for recreation in and on the water." 33 U.S.C. § 1251(a)(2). To do this, the Act does not stop at controlling the "addition of pollutants," but deals with "pollution" generally, see § 1251(b), which Congress defined to mean "the man-made or man-induced alteration of the chemical, physical, biological, and radiological integrity of water." § 1362(19).

The alteration of water quality as thus defined is a risk inherent in limiting river flow and releasing water through turbines. Warren itself admits that its dams "can cause changes in the movement, flow, and circulation of a river ... caus[ing] a river to absorb less oxygen and to be less passable by boaters and fish." Brief for Petitioner 23. And several *amici* alert us to the chemical modification caused by the dams, with "immediate impact on aquatic organisms, which of course rely on dissolved oxygen in water to breathe." Brief for Trout Unlimited et al. as *Amici Curiae* 13; see also, *e.g.,* Brief for National Wildlife Federation et al. as *Amici Curiae* 6 (explaining that when air and water mix in a turbine, nitrogen dissolves in the water and can be potentially lethal to fish). Then there are the findings of the Maine Department of Environmental Protection that led to this appeal:

> "The record in this case demonstrates that Warren's dams have caused long stretches of the natural river bed to be essentially dry and thus unavailable as habitat for indigenous populations of fish and other aquatic organisms; that the dams have blocked the passage of eels and sea-run fish to their natural spawning and nursery waters; that the dams have eliminated the opportunity for fishing in long stretches of river, and that the dams have prevented recreational access to and use of the river." *In re S.D. Warren Co.,* Maine Board of Environmental Protection (2003), in App. to Pet. for Cert. A-49.

Changes in the river like these fall within a State's legitimate legislative business, and the Clean Water Act provides for a system that respects the States' concerns. See 33 U.S.C. § 1251(b) ("It is the policy of the Congress to recognize, preserve, and protect the primary responsibilities and rights of States to prevent, reduce, and eliminate pollution"); § 1256(a) (federal funds for state efforts to prevent pollution); see also § 1370 (States may impose standards on the discharge of pollutants that are stricter than federal ones).

State certifications under § 401 are essential in the scheme to preserve state authority to address the broad range of pollution, as Senator Muskie explained on the floor when what is now § 401 was first proposed:

> “No polluter will be able to hide behind a Federal license or permit as an excuse for a violation of water quality standard[s]. No polluter will be able to make major investments in facilities under a Federal license or permit without providing assurance that the facility will comply with water quality standards. No State water pollution control agency will be confronted with a fait accompli by an industry that has built a plant without consideration of water quality requirements.” 116 Cong. Rec. 8984 (1970).

These are the very reasons that Congress provided the States with power to enforce “any other appropriate requirement of State law,” 33 U.S.C. § 1341(d), by imposing conditions on federal licenses for activities that may result in a discharge, *ibid.*

Reading § 401 to give “discharge” its common and ordinary meaning preserves the state authority apparently intended. The judgment of the Supreme Judicial Court of Maine is therefore affirmed.

It is so ordered.

NOTES:

1. In 1982, the D.C. Circuit Court of Appeals found that changes in water quality brought about by dam operations were not "discharges of pollutants," and therefore did not need a National Pollution Discharge Elimination System (NPDES) Permit under § 402. *National Wildlife Federation v. Gorsuch*, 693 F.2d 156 (D.C.Cir.1982). The Seventh Circuit made a contrary ruling, *Greenfield Mills, Inc. v. Macklin*, 361 F.3d 934 (7th Cir. 2004). See Chapter VIII, Section C, *infra*.

2. In *PUD No. 1 of Jefferson Cty. v. Washington Dept. of Ecology,* 511 U.S. 700 (1994), the Supreme Court upheld the State of Washington's authority to impose minimum stream flow rates on a hydroelectric dam. Justice Thomas dissented, noting the tension between the duty to include conditions states impose under § 401 certification, and the primacy the Federal Power Act gives to FERC:

> Although the Court notes in passing that "[t]he limitations included in the certification become a condition on any Federal license," it does not acknowledge or discuss the shift of power from FERC to the States that is accomplished by its decision. Indeed, the Court merely notes that "any conflict with FERC's authority under the FPA" in this case is "hypothetical" at this stage, because "FERC has not yet acted on petitioners' license application." We are assured that "it is quite possible ... that any FERC license would contain the same conditions as the State § 401 certification."
>
> The Court's observations simply miss the point. Even if FERC might have no objection to the stream flow condition established by respondents in this case, such a happy coincidence will likely prove to be the exception, rather than the rule. In issuing licenses, FERC must balance the Nation's power needs together with the

need for energy conservation, irrigation, flood control, fish and wildlife protection, and recreation. 16 U.S.C. § 797(e). State environmental agencies, by contrast, need only consider parochial environmental interests. *Cf., e.g.*, Wash.Rev.Code § 90.54.010(2) (1992) (goal of State's water policy is to "insure that waters of the state are protected and fully utilized for the greatest benefit to the people of the state of Washington"). As a result, it is likely that conflicts will arise between a FERC- established stream flow level and a state-imposed level.

Moreover, the Court ignores the fact that its decision nullifies the congressionally mandated process for resolving such state-federal disputes when they develop. Section 10(j)(1) of the FPA, 16 U.S.C. § 803(j)(1), which was added as part of the Electric Consumers Protection Act of 1986 (ECPA), provides that every FERC license must include conditions to "protect, mitigate damag[e] to, and enhance" fish and wildlife, including "related spawning grounds and habitat," and that such conditions "shall be based on recommendations" received from various agencies, including state fish and wildlife agencies. If FERC believes that a recommendation from a state agency is inconsistent with the FPA--that is, inconsistent with what FERC views as the proper balance between the Nation's power needs and environmental concerns--it must "attempt to resolve any such inconsistency, giving due weight to the recommendations, expertise, and statutory responsibilities" of the state agency. § 803(j)(2). If, after such an attempt, FERC "does not adopt in whole or in part a recommendation of any [state] agency," it must publish its reasons for rejecting that recommendation. *Ibid.* After today's decision, these procedures are a dead letter with regard to stream flow levels, because a State's "recommendation" concerning stream flow "shall" be included in the license when it is imposed as a condition under § 401(d).

More fundamentally, the 1986 amendments to the FPA simply make no sense in the stream flow context if, in fact, the States already possessed the authority to establish minimum stream flow levels under § 401(d) of the CWA, which was enacted years before those amendments. Through the ECPA, Congress strengthened the role of the States in establishing FERC conditions, but it did not make that authority paramount. Indeed, although Congress could have vested in the States the final authority to set stream flow conditions, it instead left that authority with FERC. See *California v. FERC*, 495 U.S., at 499. As the Ninth Circuit observed in the course of rejecting California's effort to give *California v. FERC* a narrow reading, "[t]here would be no point in Congress requiring [FERC] to consider the state agency recommendations on environmental matters and make its own decisions about which to accept, if the state agencies had the power to impose the requirements themselves." *Sayles Hydro Associates v. Maughan*, 985 F.2d 451, 456 (1993).

3. For some additional commentary, see George William Sherk, *Approaching A Gordian Knot: The Ongoing State/Federal Conflict Over Hydropower*, 31 LAND & WATER L. REV. 349 (1996).

4. A third section of the Clean Water Act not discussed in these cases but of some notoriety is the § 404 process, which requires a permit to place “dredge and fill” in the “waters of the United States.” The Corps of Engineers of the U.S. Army generally issues these permits. The extent of the Corps’s jurisdiction, including over wetlands, has generated many disputes. The Supreme Court has not clarified the matter. Its last decision had no majority opinion. In a 4-1-4 decision, Justice Kennedy entered a concurrence to remand the decision, but his rationale differed greatly from the other four justices who would not have upheld the lower court’s disposition. The four dissenters would have ratified the Corps’s jurisdictional regulations. Rapanos v. U.S, 126 S.Ct. 2208 (2006).

INSERT at page 448:

NOTE 1 (a):

The deed construed in *Buchanan* conveyed the minerals including the following:

> ... property, rights and privileges, in, of, to, on, under, concerning and appurtenant. ... All the coal, minerals and mineral products, ... such of the standing timber as may be, or by the Grantee, his heirs or representatives, its successors, or assigns, be deemed necessary for mining purposes, ... use and operate the same and surface thereof, ... in any and every manner that may be deemed necessary or convenient for mining, and therefrom removing, ... and in the use of said land and surface thereof by the Grantee, his heirs or representatives, successors and assigns, shall be free from, and is, and are, hereby released from liability or claim of damage to the said Grantor, their representatives, heirs and assigns, ... there is reserved to the Grantor all the timber upon the said land, except that necessary for mining, and the purposes hereinbefore mentioned, and the free use of land for agricultural purposes, so far as such use is consistent with the property, rights and privileges hereby bargained, sold, granted or conveyed, and the right to mine and use coal for Grantor's own personal household and domestic purposes. *Buchanan v. Watson*, 290 S.W.2d 40, 41 (Ky. 1956)

The deed contained in *Croley* reserved the minerals and provided the following:

> Reserving all coal, oil, gas, stone, water and any other minerals in, on or under the land, together with the right of ingress and egress to take, enter, mine, cut and remove any and all minerals in, on or under the land. In the event any of the operation in the reservation aforesaid injures or damages any growing crop on the surface, then the person so damaging the growing crop shall pay for the damage done. Second party [the grantee] is given the right to mine for his own use only in his dwelling only coal from the premises, provided his action in so doing does not interfere in any operation of the first party under the reservation, or anyone under it. *Croley v. Round Mountain Coal Co.*, 374 S.W.2d 852, 853 (Ky. 1964)

INSERT at page 457:

CLEAN AIR MARKETS GROUP v. PATAKI
338 F.3d 82 (2nd Cir. 2003)

JOSÉ A. CABRANES, Circuit Judge.

Defendants appeal from an April 9, 2002 judgment of the United States District Court for the Northern District of New York (David N. Hurd, *Judge*) granting summary judgment to plaintiff-appellee Clean Air Markets Group ("CAMG"). The District Court held that New York's Air Pollution Mitigation Law, N.Y. Pub. Serv. L. § 66-k ("section 66-k"), is preempted by Title IV of the Clean Air Act Amendments of 1990 ("Title IV"), 42 U.S.C. §§ 7651-7651o, and therefore violates the Supremacy Clause of the United States Constitution, U.S. Const. art. VI, cl. 2....

For the following reasons, we agree with the District Court that section 66-k is preempted by the Clean Air Act...

Background

We assume familiarity with the relevant facts, which have been set forth in detail by the District Court. *See Clean Air Markets Group v. Pataki,* ("*CAMG* "), 194 F.Supp.2d 147, 151-54 (N.D. N.Y. 2002). Accordingly, for purposes of this appeal we restate only the facts necessary to our disposition, viewing them in the light most favorable to the defendants.

In 1990, Congress amended the Clean Air Act of 1970, 42 U.S.C. §§ 7401 *et seq.* Title IV of the Clean Air Act Amendments of 1990 has the express purpose of "reduc[ing] the adverse effects of acid deposition through reductions in annual emissions of sulfur dioxide." 42 U.S.C. § 7651(b). According to Title IV's statement of purpose, "it is the intent of [Title IV] to effectuate such reductions ... through ... an emission allocation and transfer system." *Id.* In other words, the purpose of Title IV is to implement a "cap-and-trade" system in order to reduce sulfur dioxide ("SO_2") emission, which is a leading cause of "acid rain" and other forms of "acid deposition" that are harmful to the environment. Under the cap-and-trade system created by Title IV, electricity-generating utilities ("utilities") are each allocated a certain number of emission allowances per year, and each allowance authorizes the utility to emit one ton of SO_2. Every successive year, the total cap on allowable SO_2 emissions is reduced, and fewer allowances are allocated. Pursuant to the system created by Title IV, SO_2 allowances "may be transferred ... [to] *any other person* who holds such allowances." 42 U.S.C. § 7651b(b) (emphasis added). By permitting the sale of unneeded allowances, the cap-and-trade system creates a financial incentive for utilities to reduce their SO_2 emissions.
Title IV's cap-and-trade system seeks to minimize acid deposition, the most common form of which is acid rain. Acid deposition has been a particular problem in the Adirondack region of New York State. The thin, calcium-poor soils and igneous rocks in

this area make it highly susceptible to acidification. Acid deposition in this region has caused substantial harm to aquatic life and other natural resources.

Because SO 2 emissions can travel hundreds of miles in the wind, much of the acid deposition in the Adirondacks results not from SO 2 emissions in New York, but, rather, from SO 2 emissions in fourteen "upwind" states. These states include New Jersey, Pennsylvania, Maryland, Delaware, Virginia, North Carolina, Tennessee, West Virginia, Ohio, Michigan, Illinois, Kentucky, Indiana, and Wisconsin.

In 2000, the New York legislature sought to address this problem by passing the Air Pollution Mitigation Law, N.Y. Pub. Serv. L. § 66-k ("section 66-k"). Pursuant to this statute, the New York State Public Service Commission ("PSC") is required to assess "an air pollution mitigation offset" upon any New York utility whose SO 2 allowances are sold or traded to one of the fourteen upwind states. The amount assessed is equal to the amount of money received by the New York utility in exchange for the allowances. Moreover, the assessment is made regardless of whether the allowances are sold directly to a utility in an upwind state or are subsequently transferred there. Accordingly, in order to avoid the assessment, New York utilities must attach a restrictive covenant to any allowances they sell that prohibits their subsequent transfer to any of the fourteen upwind states.

Plaintiff-Appellant CAMG is an association of electricity generation companies, SO 2 emissions allowance brokers, mining companies, and trade associations. On November 15, 2000, CAMG filed the instant action against Governor Pataki and the Commissioners of the New York Public Service Commission. The complaint sought to enjoin the enforcement of section 66-k on the grounds that it (1) is preempted by Title IV of the Clean Air Act Amendments of 1990 and (2) violates the Commerce Clause of the United States Constitution. On January 24, 2001, the defendants each moved for summary judgment. CAMG filed a cross-motion for summary judgment on March 26, 2001.

In an opinion and order filed on April 9, 2002, the District Court granted CAMG's motion for summary judgment, denied the defendants' summary judgment motions, and permanently enjoined the defendants from enforcing section 66-k. ... This timely appeal followed.

Discussion

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On appeal, defendants first argue that the District Court erred in holding that section 66-k violates the Supremacy Clause of the Constitution The Supreme Court has instructed that the Supremacy Clause "invalidates state laws that 'interfere with, or are contrary to,' federal law." *Hillsborough County*, 471 U.S. at 712(quoting *Gibbons v. Ogden,* 9 Wheat. 1, 211, 6 L.Ed. 23 (1824)). Federal law may supersede state laws under the Supremacy Clause in three ways. First, "Congress is empowered to pre-empt state law by so stating in express terms." *Id.* at 713,. Second, preemption of all state law in a particular field "may be inferred where the scheme of federal regulation is sufficiently comprehensive to

make reasonable the inference that Congress left no room for supplementary state regulation." *Id.*. Finally, "[e]ven where Congress has not completely displaced state regulation in a specific area, state law is nullified to the extent that it *actually conflicts* with federal law." *Id.* (emphasis added). Such a conflict necessarily arises where " 'compliance with both federal and state regulations is a physical impossibility.' " *Id.* Moreover, an actual conflict exists when a state law " 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,' " in enacting federal legislation. *Id.*

The District Court held that section 66-k is preempted by Title IV because section 66-k "'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of [Title IV].' " *CAMG*, 194 F.Supp.2d at 158 (quoting *Hillsborough County,* 471 U.S. at 713). Defendants disagree, arguing that section 66-k supports the ultimate purpose of Title IV by helping to protect natural resources.

The Supreme Court has held, however, that "[i]n determining whether [a state law] stands as an obstacle to the full implementation of [a federal statute], it is not enough to say that the ultimate goal of both federal and state law is [the same]." *International Paper Co. v. Ouellette,* 479 U.S. 481, 494 (1987). Even where federal and state statutes have a common goal, a state law will be preempted "if it interferes with the *methods* by which the federal statute was designed to reach this goal." *Id.* (emphasis added).

There can be no doubt that section 66-k interferes with the method selected by Congress for regulating SO2 emissions. Title IV expressly states that "it is the intent of [Title IV] to effectuate [SO2 emission] reductions ... *through ... an emission allocation and transfer system.*" 42 U.S.C. § 7651(b) (emphasis added). In creating this system, Congress sought to grant utilities "the opportunity to reallocate among themselves their total emissions reduction obligations *in the most efficient and cost-effective way possible.*" S. Rep. 101-228, at 303 (1989), *reprinted in* 1990 U.S.C.C.A.N. 3385, 3686 (emphasis added). In the words of the District of Columbia Circuit: "The basic idea of [Title IV's allowance trading system] is that if polluters for which cutbacks are relatively costly can buy pollution entitlements from ones for which cutbacks are relatively cheap, *the nation* can achieve a much greater overall cutback for a given expenditure of resources (or achieve a given cutback for a lower expenditure)." *Texas Mun. Power Agency v. EPA,* 89 F.3d 858, 861 (D.C.Cir.1996) (emphasis added). In order to implement this scheme on a national scale, Title IV permits allowances to "be transferred ... [to] *any other person* who holds such allowances." 42 U.S.C. § 7651b(b) (emphasis added).

The legislative history of Title IV provides further support for the fact that Congress intended the allowance transfer system to be nationwide. In implementing Title IV, the House of Representatives initially passed a bill that would have divided the nation into two geographic regions and would have required the transferring utility and the receiving utility to have been located in the same region. *See* H. Rep. No. 101-490, at 372 (1989). This geographic restriction also appeared in the bill passed by the Senate Committee on Environmental and Public Works. S. 1630, 101st Cong. § 403(b) (1989). However, the bill passed by the Senate contained no geographic restrictions, instead providing for a

national allowance trading system, S. Rep. 101-228, at 303 (1989), *reprinted in* 1990 U.S.C.C.A.N. 3385, 3686, and the bill that ultimately emerged from the House-Senate Conference, and that was signed by the President, also included no geographic restrictions on the allowance trading system, Pub.L. No. 101-549, 104 Stat. 2399, 2590-91 (codified at 42 U.S.C. § 7651b(b)). Instead, the enacted bill clearly states that allowances "may be transferred ... [to] *any other person* who holds such allowances," *id.,* anywhere in the United States.

The regulations adopted by the Environmental Protection Agency ("EPA") in order to implement Title IV further support the conclusion that the nationwide allowance trading system is an essential element of Title IV. *See Hillsborough County,* 471 U.S. at 713, 105 S.Ct. 2371 ("[S]tate laws can be preempted by federal regulations as well as by federal statutes."); *Freeman v. Burlington Broadcasters, Inc.,* 204 F.3d 311, 321-22 (2d Cir.2000) ("Federal regulations have the same preemptive force as federal statutes."). In particular, the EPA regulations expressly mandate that state programs for granting "acid rain permits" pursuant to Title V of the Clean Air Act Amendments "shall not restrict or interfere with allowance trading." 40 C.F.R. § 72.72(a). These regulations were adopted over the objection of New York State, which argued vigorously in favor of a scheme that permitted allowance trading to be geographically restricted. In rejecting New York's arguments, the EPA explained that "[t]he national transfer of allowances was clearly contemplated by the drafters of the act." Acid Rain Program: General Provisions and Permits, Allowance System, Continuous Emissions Monitoring, Excess Emissions and Administrative Appeals, 58 Fed.Reg. 3590, 3614-15 (Jan. 11, 1993). Accordingly, the EPA structured the regulations implementing Title IV to "create ... a national system of tradable pollution permits." *Madison Gas & Elec. Co. v. EPA,* 4 F.3d 529, 530 (7th Cir.1993).

Although section 66-k does not technically limit the authority of New York utilities to transfer their allowances, it clearly interferes with their ability to effectuate such transfers. First, by requiring utilities to forfeit one hundred percent of their proceeds from any allowance sale to a utility in an upwind state, section 66-k effectively bans such sales. Moreover, the only way for New York utilities to ensure that they will not be assessed pursuant to section 66-k is to attach to every allowance they sell a restrictive covenant that prohibits the subsequent transfer of the allowance to an upwind state. Because such a restrictive covenant indisputably decreases the value of the allowances, section 66-k clearly "restrict[s] or interfere[s] with allowance trading," 40 C.F.R. § 72.72(a). In sum, section 66-k impermissibly "interferes with the *methods* by which [Title IV] was designed to reach [the] goal" of decreasing SO2 emissions, and therefore it "stands as an obstacle" to the execution of Title IV's objectives. *International Paper,* 479 U.S. at 494 (emphasis added).

Defendants argue that, even if section 66-k “stands as an obstacle” to the execution of Title IV's objectives, *see Hillsborough County,* 471 U.S. at 713, it does not “actually conflict” with federal law because it is expressly permitted by two other statutory provisions of the Clean Air Act. First, defendants draw our attention to 42 U.S.C. § 7416, a savings clause that preserves state authority “to adopt or enforce (1) any standard or limitation respecting emissions of air pollutants or (2) any requirement respecting control or abatement of air pollution.” Defendants argue that section 66-k is a “requirement respecting control or abatement of air pollution,” *id.,* that is not preempted because it “simply goes further than the relevant federal law,” Pataki Br. at 26. But, as properly noted by the District Court, section 66-k does not set requirements for air pollution control or abatement within New York, but, rather, attempts to “control emissions in another state.” *CAMG,* 194 F.Supp.2d at 159. Nothing in the language of 42 U.S.C. § 7416 permits such legislation.

Defendants also maintain that section 66-k is authorized by 42 U.S.C. § 7651b(f), which provides in relevant part that the allowance trading system “shall [not] be construed as requiring a change of any kind in any State law regulating electric utility rates and charges or affecting any State law regarding such State regulation or as limiting State regulation ... under such a State law.” But section 66-k does not regulate “utility rates and charges” and it does not “affect[ ] any State law regarding” the regulation of “utility rates and charges.” Accordingly, 42 U.S.C. § 7651b(f) does not save section 66-k from preemption.

In sum, section 66-k is preempted by Title IV of the Clean Air Act Amendments of 1990 because it impedes the execution of “the full purposes and objectives” of Title IV, *see Hillsborough County,* 471 U.S. at 713, and because it is not otherwise authorized by federal law. Accordingly, section 66-k violates the Supremacy Clause of the United States Constitution.

In light of this holding, we need not review the District Court's conclusion that section 66-k also violates the Commerce Clause of the Constitution, and we express no view on the propriety of its Commerce Clause analysis.

Conclusion

For the reasons stated above, the judgment of the District Court is affirmed..

NOTES:

1. Mercury is also a pollutant emitted primarily by coal-burning electric generating plants. President Bush proposed a “cap and trade” program for mercury. Environmentalists and others objected to the plan because it would not address “hot spots.” In other words, plants could comply with the law without eliminating emissions, but through trading for emission permits. Therefore, mercury could continue to be deposited in certain locales.

2. New York and other northeastern states had been concerned about being downwind of Midwestern generating plants at numerous times. For example, in 1995 a controversy arose about whether proposed Order 888 would impact on the environment. The FERC in a draft document required by an environmental planning statute (the Draft Environmental Impact Statement required by the National Environmental Policy Act) claimed that deregulation of wholesale generation sales and the open access afforded would have no significant impact on the environment. However, competition from the Midwest and Southeast disturbed northeastern utilities. Northeastern states and others claimed that states downwind from the Midwest would receive greater NO (nitrogen oxide) loads because of the tendency to use old coal fired plants in the Midwest that are not as burdened with NOx restrictions. NOx emissions are precursors of ozone smog in urban areas. They contribute significantly to the severity of violations of EPA ambient ozone standards. Prevailing winds move the pollutants into the populated Northeast from areas to the west and south. A group from Harvard, the Harvard Electric Policy Group, argued that the government should push for early retirement of older coal-generating utility plants as mitigation for pollution that electric restructuring will cause. A 3% increase in coal-plant use would translate to 500,000 more tons of NOx, which erodes the Clean Air Act Amendment (CAAA) target by 24.6%. Also, unregulated CO2 greenhouse gases could increase by 43 million tons. If all utilities and generators compete, there will be an incentive to use old plants. Conversely, there will be an incentive to retire nuclear plants early rather than make expensive repairs (those costing over $100 million) if the utility cannot put the repairs in its rate base. Decreasing nuclear output by 6000 MW would translate to an increase of NOx equal to 5% of the CAAA targets and 14-28 million tons of CO2.[22]

The FERC, in its final Environmental Impact Statement and in its final rule-making, asserted that the rule will have no great environmental impact and, in fact, would alleviate NOx by 2005; emissions would be lowered by 2% if competitive conditions in the electric industry favored the use of natural gas. FERC continued to argue that it lacks the ability to order mitigation. EPA objected to the FERC's analysis and submitted the question to the Council for Environmental Quality (CEQ). The CEQ resolves inter-agency disputes on environmental matters. FERC commissioners complained that referral was inappropriate because FERC is an independent agency and therefore not subject to the political refereeing of the administration's CEQ. In a letter to both agencies, CEQ found the matter resolved when FERC agreed to re-look at mitigation under the Federal Power Act if the programs of EPA are unsuccessful in protecting against emission increases. No such re-examination took place.

INSERT at page 505:

ADDITIONS to NOTES:

Add to end of note 3: The *Rith* case was upheld on appeal, but with slightly different reasoning. *Rith Energy, Inc. v. U.S.*, 247 F.3d 1355, (Fed.Cir. 2001).

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[22] See, ENERGY REPORT, February 12, 1996, pages 105-107 - quoting Henry Lee and Negeen Darani, "Electricity Restructuring and the Environment," Center for Science and International Affairs at the Kennedy School of Government, Harvard.

Add to end of note 7. The *Bragg* case was overturned on appeal because the court found that the 11th Amendment of the United States Constitution precluded the suit against the state. *Bragg v. West Virginia Coal Ass'n,* 248 F.3d 275 (4th Cir.2001).

DELETE page 511-526 and insert the following notes and two cases:

Nuclear energy first contributed twenty percent of the electricity generated nationally in 1992. This feat occurred after nuclear electrical generating units peaked at 112 in 1990, and despite the fact that the last order for a nuclear generating unit was placed in 1978. Since 1998, the number of operating nuclear generating units in the United States has declined to103 units. But despite a heavy increase in electrical generation overall, and a reduction in the number of units, nuclear power's share of the electricity generating market has consistently hovered around twenty-percent since first reaching this percentage in 1992. Various charts created by the Energy Information Administration ("EIA") provide the raw data for the analysis of Nuclear's contribution to the overall energy picture, and these are available for review on EIA's website, http://www.eia.doe.gov. The specific percentages for each year are as follows: 1993 - 19.6%; 1994- 19.7%; 1995 - 20.1%; 1996- 19.6%; 1997 - 18.09%; 1998 - 18.7%; 1999- 19.6%; 2000 - 19.84%; 2001 - 20.7%; 2002- 20.4%; 2003 - 20%; 2004 -20.2%; and 2005 - 19.5% . Through May of 2006, nuclear provided 20.3% of the electricity produced this year. Electric Power Monthly, August 2006 Edition, available at http://www.eia.doe.gov/cneaf/electricity/epm/epm_sum.html.

Nuclear generation in the past retained its market share despite the lack of additional capacity through the increased operating efficiency of the existing units. Load factors have increased dramatically and the operating costs are at approximately 1.8 cents per kilowatt hour. Some of this improvement resulted from technological advances, but some of the higher efficiency might be traced to entrepreneurial changes. Independent power producers began to operate nuclear generating units in 1999. By 2004, independent power producers were responsible for 39.6% of electricity generated by nuclear power. Electric utilities generated the remaining 60.4% of the electricity. New plants, however, were not coming on line. Now, for the first time since 1978, there is activity towards creating new nuclear generating capacity, but if electricity consumption continues its growth pattern, nuclear may no longer continue to have a twenty percent share of the market.

The Future of Nuclear

The renaissance in the nuclear industry is clear throughout the energy cycle.. Uranium mines are opening or re-opening along the Utah-Colorado border and other locales in the west, including Texas, as the price for yellowcake uranium ore has increased from $7 a pound in 2000 to more than $50 per pound. Further down the fuel cycle, the first new nuclear facility in thirty years began construction in New Mexico. The Nuclear

Regulatory Commission licensed the facility to Louisiana Energy Services on June 23, 2006. *See* Greenwire (August 31, 2006), available at http://www.eenews.net/Greenwire/2006/08/31/archive/12. It is a $1.5 billion nuclear enrichment plant, designed to enrich uranium for nuclear fuel. Additionally, increases in electric generating capacity for existing facilities are being planned. First to re-operate will be the Browns Ferry 1 unit. After spending $1.8 billion since 1992, the Tennessee Valley Authority ("TVA") plans to reopen the Browns Ferry 1 unit in the summer of 2007. Although fully licensed, the unit was shut down in 1995. This will add 1280 megawatts to TVA's grid. Greenwire (August 24, 2006), at http://www.eenews.net/Greenwire/2006/08/24/archive/6

Various legal and policy objectives have converged to stimulate the nuclear industry. In favor of this development, nuclear generation does not contribute to air pollution problems such as global warming. Additionally, the fuel cycle does not rely on imported material. Nevertheless, the cost per kilowatt of construction is estimated at approximately $1500, which could be double that of building a new coal-fired generating plant. In the recent past, the Nuclear Regulatory Commission ("NRC"), as well as Congress in the last two major energy policy bills, addressed regulatory concerns, which impact on the costs of construction.

B. The Licensing Decision

The federal government initially controlled all nuclear activities under the 1946 version of the Atomic Energy Act, 60 Stat. 755. In amendments to the Act in 1954, Congress decided to allow private development of nuclear power, with federal regulatory oversight. Initially, the Atomic Energy Commission had two functions: it was to promote the peaceful use of nuclear energy and to regulate industry. Many saw this as a potential conflict. This dual role ended in 1974. The AEC was abolished, and the research and promotional duties assigned to the Energy Research and Development Administration, and the regulatory function to the Nuclear Regulatory Commission.

Both Congress and the NRC have streamlined the licensing process for a nuclear reactor in the past two decades. Prior to 1992, every nuclear facility had to undergo two licensing procedures: one for construction and one before operation. In the Energy Policy Act of 1992, Congress simplified the procedure with a combined license. The Atomic Energy Act of 1954, as amended, 42 U.S.C. 2235. This license would be issued before construction, and there would only be a subsequent hearing at the operating stage if the criteria in the combined license were alleged to have not been met. The Atomic Energy Act of 1954, as amended 42 U.S.C. 2239(a)(1). Moreover, in the past, the design of each generating unit was approved within each individual licensing decision. In 1987, the NRC by regulation allowed design approval of a reactor separate from an individual licensing procedure. Rules and Regulations of the Department of Energy, Nuclear Power Plant Standardization, 10 C.F.R. Pt. 50. When the design is approved, it will not later have to re-examined when selected for a generating plant, thus lessening the overall costs of licensing and construction through standardization. Additionally, NRC has procedures to grant preliminary site approval, again before an individual plant is proposed.10 C.F.R.

Pt. 52. The NRC granted two design approvals in 1997 (which will be valid for fifteen years) and considered a preliminary site permit. See generally, Neal H. Lewis, Interpreting the Oracle: Licensing Modifications, Economics, Safety, Politics, and the Future of Nuclear Power in the United States, 16 Albany L. J. Of Science & Tech 27 (2006).

The following case looks at some licensing issues.

SAN LUIS OBISPO MOTHERS FOR PEACE v. NUCLEAR REGULATORY COMMISSION
449 F.3d 1016 (9th Cir. 2006)

THOMAS, Circuit Judge.

This case presents the question, *inter alia,* as to whether the likely environmental consequences of a potential terrorist attack on a nuclear facility must be considered in an environmental review required under the National Environmental Policy Act. The United States Nuclear Regulatory Commission ("NRC") contends that the possibility of a terrorist attack on a nuclear facility is so remote and speculative that the potential consequences of such an attack need not be considered at all in such a review. The San Luis Obispo Mothers for Peace and other groups disagree and petition for review of the NRC's approval of a proposed Interim Spent Fuel Storage Installation. We grant the petition in part and deny it in part.

I

The NRC is an independent federal agency established by the Energy Reorganization Act of 1974 to regulate the civilian use of nuclear materials. Intervenor Pacific Gas and Electric Company ("PG & E") filed an application with the NRC under 10 C.F.R. Part 72 for a license to construct and operate an Interim Spent Fuel Storage Installation ("Storage Installation" or "ISFSI") at PG & E's Diablo Canyon Power Plant ("Diablo Canyon") in San Luis Obispo, California. The NRC granted the license. The question presented by this petition for review is whether, in doing so, the NRC complied with federal statutes including the National Environmental Policy Act of 1969 ("NEPA"), 42 U.S.C. §§ 4321-4437, the Atomic Energy Act of 1954 ("AEA"), 42 U.S.C. §§ 2011-2297g, and the Administrative Procedure Act ("APA"), 5 U.S.C. §§ 551-706. [The court found AEA and the APA were not violated.]

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Rather than mandating particular results, NEPA imposes on federal agencies procedural requirements that force consideration of the environmental consequences of agency actions. At NEPA's core is the requirement that federal agencies prepare an environmental impact statement ("EIS") ...[for] .. " every recommendation or report on proposals for legislation and other major Federal actions significantly affecting the quality of the human environment...."

As an alternative to the EIS, an agency may prepare a more limited environmental assessment ("EA") concluding in a "Finding of No Significant Impact" ("FONSI"),

briefly presenting the reasons why the action will not have a significant impact on the human environment. If, however, the EA does not lead to the conclusion that a FONSI is warranted, the agency remains obligated to prepare an EIS. While NEPA requires the NRC to consider environmental effects of its decisions, the AEA is primarily concerned with setting minimum safety standards for the licensing and operation of nuclear facilities. The NRC does not contest that the two statutes impose independent obligations, so that compliance with the AEA does not excuse the agency from its NEPA obligations. The AEA lays out the process for consideration of the public health and safety aspects of nuclear power plant licensing, and requires the NRC to determine whether the licensing and operation of a proposed facility is "in accord with the common defense and security and will provide adequate protection to the health and safety of the public." 42 U.S.C. § 2232(a).

The NRC is not, however, required to make this determination without assistance; federal law provides a framework for hearings on material issues that interested persons raise by specific and timely petition. 42 U.S.C. § 2239(a); 10 C.F.R. §§ 2.308-.348; 5 U.S.C. §§ 551-706. The initial hearing is held before a three-person Atomic Safety and Licensing Board ("Licensing Board"). The Licensing Board's findings and decision constitute the agency's initial determination, although a party may file a petition for review with the Commission within 15 days of the Licensing Board's decision. If the petition is granted, the Commission specifies the issues to be reviewed and the parties to the review proceedings, and renders a final decision. A party may then petition this court for review of the Commission's final decision.

II

With this general statutory background, we turn to the facts underlying the petition for review. On December 21, 2001, PG & E applied to the NRC pursuant to 10 C.F.R. Part 72 for a license to construct and operate a Storage Installation at Diablo Canyon. The Storage Installation would permit the necessary and on-site storage of spent fuel, the byproduct of the two nuclear reactors at that site. PG & E expects to fill its existing spent fuel storage capacity at Diablo Canyon sometime this year. Therefore, unless additional spent fuel storage capacity is created, the Diablo Canyon reactors cannot continue to function beyond 2006.

PG & E proposes to build a dry cask storage facility. The basic unit of the storage system is the Multi-Purpose Canister ("Canister"), a stainless steel cylinder that is filled with radioactive waste materials and welded shut. The Canisters are loaded into concrete storage overpacks that are designed to permit passive cooling via the circulation of air. The storage casks, or the filled Canisters loaded into overpacks, are then placed on one of seven concrete pads. The Storage Installation would house a total of 140 storage casks, 2 more than the 138 projected to be required for storage of spent fuel generated at Diablo Canyon through 2025.

> [The NRC issue an Environmental Assessment that mentioned terrorism, but did not believe that the NRC had to extensively consider the environmental impacts of

> a terrorist attacked, as alleged by the San Luis Obispo Mothers for Peace and Sierra Club.]

The NRC has also initiated several actions to further ensure the safety of spent fuel in storage. Additional security measures have been put in place at nuclear facilities, including ISFSIs currently storing spent fuel. These measures include increased security patrols, augmented security forces and weapons, additional security posts, heightened coordination with law enforcement and military authorities, and additional limitations on vehicular access. Also, as part of its comprehensive review of its security program, the NRC is conducting several technical studies to assess potential vulnerabilities of spent fuel storage facilities to a spectrum of terrorist acts. The results of these studies will be used to determine if revisions to the current NRC security requirements are warranted.

*** [The court rejected the petitioners's claims under the AEA and APA.]

... [W]e come to a different conclusion as to that determination's compliance with NEPA. Because the issue whether NEPA requires consideration of the environmental impacts of a terrorist attack is primarily a legal one, we review the NRC's determination that it does not for reasonableness....

Here, the NRC decided categorically that NEPA does not require consideration of the environmental effects of potential terrorist attacks. In making this determination, the NRC relied on *PFS,* where it "consider[ed] in some detail the legal question whether NEPA requires an inquiry into the threat of terrorism at nuclear facilities."*[Private Fuel Storage],*56 NRC 340, 343 (2002). In that case, intervenor State of Utah filed a contention claiming that the September 11 terrorist attacks "had materially changed the circumstances under which the Board had rejected previously proffered terrorism contentions by showing that a terrorist attack is both more likely and potentially more dangerous than previously thought." *Id.* at 345. The NRC concluded that even following the September 11th attacks, NEPA did not impose such a requirement, reasoning:

> In our view, an EIS is not an appropriate format to address the challenges of terrorism. The purpose of an EIS is to inform the decisionmaking authority and the public of a broad range of environmental impacts that will result, with a fair degree of likelihood, from a proposed project, rather than to speculate about 'worst-case' scenarios and how to prevent them.

Id. at 347.

The NRC determined that four grounds "cut[ ] against using the NEPA framework" to consider the environmental effects of a terrorist attack: (1) the possibility of a terrorist attack is far too removed from the natural or expected consequences of agency action; (2) because the risk of a terrorist attack cannot be determined, the analysis is likely to be meaningless; (3) NEPA does not require a "worst-case" analysis; and (4) NEPA's public process is not an appropriate forum for sensitive security issues. *Id.* at 348. We review each of these four grounds for reasonableness, and conclude that these grounds, either individually or collectively, do not support the NRC's categorical refusal to consider the environmental effects of a terrorist attack.

A

The Commission relied first on finding that the possibility of a terrorist attack is too far removed from the natural or expected consequences of agency action. *Id.* at 347. Section 102 of NEPA requires federal agencies to prepare "a detailed statement ... on the environmental impact" of any proposed major federal action "significantly affecting the quality of the human environment." 42 U.S.C. § 4332(1)(C)(i). The question thus becomes whether a given action "significantly affects" the environment.

The NRC claims that the appropriate analysis of Section 102 is that employed by the Supreme Court in *Metropolitan Edison Co. v. People Against Nuclear Energy,* 460 U.S. 766, 773 (1983). In *Metropolitan Edison,* the Court noted that "[t]o determine whether Section 102 requires consideration of a particular effect, we must look to the relationship between that effect and the change in the physical environment caused by the major federal action at issue," looking for "a reasonably close causal relationship ... like the familiar doctrine of proximate cause from tort law." 460 U.S. at 774. The Commission claims that its conclusion that the environmental impacts of a possible terrorist attack on an NRC-licensed facility is beyond a "reasonably close causal relationship" was a reasonable application of this "proximate cause" analogy.

The problem with the agency's argument, however, is that *Metropolitan Edison* and its proximate cause analogy are inapplicable here. In *Metropolitan Edison,* the petitioners argued that NEPA required the NRC to consider the potential risk of psychological damage upon reopening the Three Mile Island nuclear facilities to those in the vicinity. Noting that NEPA is an environmental statute, the Supreme Court held that the essential analysis must focus on the "closeness of the relationship between the change in the environment and the 'effect' at issue." 460 U.S. at 772.

The appropriate analysis is instead that developed by this court in *No GWEN Alliance v. Aldridge,* 855 F.2d 1380 (9th Cir.1988). In *No GWEN,* the plaintiffs argued that NEPA required the Air Force to consider the threat of nuclear war in the implementation of the Ground Wave Emergency Network ("GWEN"). We held "that the nexus between construction of GWEN and nuclear war is too attenuated to require discussion of the environmental impacts of nuclear war in an[EA] or [EIS]." 855 F.2d at 1386.

The events at issue here, as well as in *Metropolitan Edison* and *No GWEN,* form a chain of three events: (1) a major federal action; (2) a change in the physical environment; and (3) an effect. *Metropolitan Edison* was concerned with the relationship between events 2 and 3 (the change in the physical environment, or increased risk of accident resulting from the renewed operation of a nuclear reactor, and the effect, or the decline in the psychological health of the human population). The Court in *Metropolitan Edison* explicitly distinguished the case where the disputed relationship is between events 1 and 2: "we emphasize that in this case we are considering effects caused by the risk of accident. The situation where an agency is asked to consider effects that will occur if a risk is realized, for example, if an accident occurs ... is an entirely different case." *Id.* at 775 n. 9. In *No GWEN,* we followed the Court's admonition and, in addressing the

relationship between events 1 and 2, we held that the *Metropolitan Edison* analysis did not apply "because it discusse[d] a different type of causation than that at issue in this case ... [which] require[d] us to examine the relationship between the agency action and a potential impact on the environment." *Id.* at 1386. *No GWEN* relied on our decision in *Warm Springs Dam Task Force v. Gribble,* 621 F.2d 1017, 1026 (9th Cir.1980), which held that "an impact statement need not discuss remote and highly speculative consequences." Applying that standard to the plaintiffs' claims that the military GWEN system's installation would "increase the probability of nuclear war," and "that GWEN would be a primary target in a nuclear war," we held both propositions to be "remote and highly speculative," and, therefore, NEPA did not require their consideration.

In the present case, as in *No GWEN,* the disputed relationship is between events 1 and 2 (the federal act, or the licensing of the Storage Installation, and the change in the physical environment, or the terrorist attack). The appropriate inquiry is therefore whether such attacks are so "remote and highly speculative" that NEPA's mandate does not include consideration of their potential environmental effects.

The NRC responds by simply declaring without support that, as a matter of law, "the possibility of a terrorist attack ... is speculative and simply too far removed from the natural or expected consequences of agency action to require a study under NEPA." 56 NRC at 349. In doing so, the NRC failed to address Petitioners' factual contentions that licensing the Storage Installation would lead to or increase the risk of a terrorist attack because (1) the presence of the Storage Installation would increase the probability of a terrorist attack on the Diablo Canyon nuclear facility, and (2) the Storage Installation itself would be a primary target for a terrorist attack. We conclude that it was unreasonable for the NRC to categorically dismiss the possibility of terrorist attack on the Storage Installation and on the entire Diablo Canyon facility as too "remote and highly speculative" to warrant consideration under NEPA.

In so concluding, we also recognize that the NRC's position that terrorist attacks are "remote and highly speculative," as a matter of law, is inconsistent with the government's efforts and expenditures to combat this type of terrorist attack against nuclear facilities. In the PFS opinion, the NRC emphasized the agency's own post-September 11th efforts against the threat of terrorism:

> At the outset, however, we stress our determination, in the wake of the horrific September 11th terrorist attacks, to strengthen security at facilities we regulate. We currently are engaged in a comprehensive review of our security regulations and programs, acting under our AEA-rooted duty to protect "public health and safety" and the "common defense and security." We are reexamining, and in may cases have already improved, security and safeguards matters such as guard force size, physical security exercises, clearance requirements and background investigations for key employees, and fitness-for-duty requirements. More broadly, we are rethinking the NRC's threat assessment framework and design basis threat. We also are reviewing our own infrastructure, resources, and communications.

> Our comprehensive review may also yield permanent rule or policy changes that will apply to the proposed PFS facility and to other NRC-related facilities. The review process is ongoing and cumulative. It has already resulted in a number of security-related actions to address terrorism threats at both active and defunct nuclear facilities.

56 NRC at 343.

Among these actions is the establishment of an Office of Nuclear Security and Incident Response, "responsible for immediate operational security and safeguards issues as well as for long-term policy development [,] work[ing] closely with law enforcement agencies and the Office of Homeland Security[,] ... coordinat[ing] the NRC's ongoing comprehensive security review." *Id.* at 344-45.

We find it difficult to reconcile the Commission's conclusion that, as a matter of law, the possibility of a terrorist attack on a nuclear facility is "remote and speculative," with its stated efforts to undertake a "top to bottom" security review against this same threat. Under the NRC's own formulation of the rule of reasonableness, it is required to make determinations that are consistent with its policy statements and procedures. Here, it appears as though the NRC is attempting, as a matter of policy, to insist on its preparedness and the seriousness with which it is responding to the post-September 11th terrorist threat, while concluding, as a matter of law, that all terrorist threats are "remote and highly speculative" for NEPA purposes.[23]

B

The NRC's reliance upon the second *PFS* factor, that the Risk of a Terrorist Attack Cannot be Adequately Determined, 56 NRC at 350, is also not reasonable. First, the NRC's dismissal of the risk of terrorist attacks as "unquantifiable" misses the point. The numeric probability of a specific attack is not required in order to assess likely modes of attack, weapons, and vulnerabilities of a facility, and the possible impact of each of these on the physical environment, including the assessment of various release scenarios. Indeed, this is precisely what the NRC already analyzes in different contexts. It is therefore possible to conduct a low probability-high consequence analysis without quantifying the precise probability of risk. The NRC itself has recognized that

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[23] The view that a terrorist attack is too speculative to be a required part of NEPA review would seem to be inconsistent with the NRC's pre-9/11 security procedures. Since 1977, the NRC has required licensed plants to have a security plan that is designed to protect against a "design basis threat" for radiological sabotage. *See* General Accounting Office, *Nuclear Regulatory Commission: Oversight of Security at Commercial Nuclear Power Plants Needs to be Strengthened,* GAO-030752 (2003) at 6. "The design basis threat characterizes the elements of a postulated attack, including the number of attackers, their training, and the weapons and tactics they are capable of using." *Id.* Thus, the NRC-even before the terrorist attacks of 9/11-did not consider such attacks too "remote and speculative" to be considered in agency planning. To the contrary, the agency has long required analysis of means and methods of hypothetical attacks against specific facilities, with the goal of establishing effective counter-measures.

consideration of uncertain risks may take a form other than quantitative "probabilistic" assessment. In its "Proposed Policy Statement on Severe Accidents and Related Views on Nuclear Reactor Regulation," 48 Fed.Reg. 16,014 (1983), the Commission stated that:

> In addressing potential accident initiators (including earthquakes, sabotage, and multiple human errors) where empirical data are limited and *residual uncertainty is large,* the use of conceptual modeling and scenario assumptions in Safety Analysis Reports will be helpful. They should be based on *the best qualified judgments of experts,* either in the form of subjective numerical probability estimates *or qualitative assessments of initiating events and casual [sic] linkages in accident sequences.*

48 Fed.Reg. at 16,020 (emphasis added).

No provision of NEPA, or any other authority cited by the Commission, allows the NRC to eliminate a possible environmental consequence from analysis by labeling the risk as "unquantifiable." ...If the risk of a terrorist attack is not insignificant, then NEPA obligates the NRC to take a "hard look" at the environmental consequences of that risk. The NRC's actions in other contexts reveal that the agency does not view the risk of terrorist attacks to be insignificant. Precise quantification is therefore beside the point.

Even if we accept the agency's argument, the agency fails to adequately show that the risk of a terrorist act is unquantifiable. The agency merely offers the following analysis as to the quantifiability of a potential terrorist attack:

> The horrors of September 11 notwithstanding, it remains true that the likelihood of a terrorist attack being directed at a particular nuclear facility is not quantifiable. Any attempt at quantification or even qualitative assessment would be highly speculative. In fact, the likelihood of attack cannot be ascertained with confidence by any state-of-the-art methodology. That being the case, we have no means to assess, usefully, the risks of terrorism at the PFS facility.

56 NRC at 350. The agency nonetheless has simultaneously shown the ability to conduct a "top to bottom" terrorism review. This leaves the Commission in the tenuous position of insisting on the impossibility of a meaningful, i.e. quantifiable, assessment of terrorist attacks, while claiming to have undertaken precisely such an assessment in other contexts. Further, as we have noted, the NRC has required site-specific analysis of such threats, involving numerous recognized scenarios.[24]

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[24] The NRC's assertion that a risk of terrorism cannot be quantified is also belied by the very existence of the Department of Homeland Security Advisory System, which provides a general assessment of the risk of terrorist attacks. *See, e.g.,* World Market Research Centre, Global Terrorism Index 2003/4 (offering a probabilistic risk assessment of terrorist activities over a 12-month period).

Thus, we conclude that precise quantification of a risk is not necessary to trigger NEPA's requirements, and even if it were, the NRC has not established that the risk of a terrorist attack is unquantifiable.

C

The NRC's third ground, that it is not required to conduct a "worst-case" analysis, is a non sequitur. Although it is a true statement of the law, the agency errs in equating an assessment of the environmental impact of terrorist attack with a demand for a worst-case analysis.

The Council on Environmental Quality ("CEQ") regulations, 40 C.F.R. §§ 1500.1-1518.4, promulgated with the "purpose [of] tell[ing] federal agencies what they must do to comply with [NEPA] procedures and achieve the goals of [NEPA]," have been interpreted by the Supreme Court as "entitled to substantial deference." *Robertson v. Methow Valley Citizens Council,* 490 U.S. 332, 355 (1979)). These regulations mandated worst-case analyses until 1986, when CEQ replaced the former 40 C.F.R. § 1502.22, requiring an agency, when relevant information was either unavailable or too costly to obtain, to include in the EIS a "worst-case analysis and an indication of the probability or improbability of its occurrence," with the new and current version of the regulation, which requires an agency to instead deal with uncertainties by including within the EIS "a summary of existing credible scientific evidence which is relevant to evaluating the reasonable foreseeable significant adverse impacts on the human environment, and ... the agency's evaluation of such impacts based upon theoretical approaches or research methods generally accepted in the scientific community." 40 C.F.R. §§ 1502.22(b)(3), (4). The current requirement applies to those events with potentially catastrophic consequences "even if their probability of occurrence is low, provided that the analysis of impacts is supported by credible scientific evidence, is not based on pure conjecture, and is within the rule of reason." 40 C.F.R. § 1502.22(b)(4). The Supreme Court held in *Robertson* that the amendment of the regulations had nullified the worst-case analysis requirement.

The Commission is therefore correct when it argues that NEPA does not require a worst-case analysis. It is mistaken, however, when it claims that "Petitioners' request for an analysis of [the environmental effects of] a successful terrorist attack at the Diablo Canyon ISFSI approximates a request for a 'worst-case' analysis that has long since been discarded by the CEQ regulations ... and discredited by the Federal courts." According to the NRC, "[m]aking the various assumptions required by [P]etitioners' scenario requires the NRC to venture into the realm of 'pure conjecture.' " We disagree.

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... Petitioners do not seek to require the NRC to analyze the most extreme (i.e., the "worst") possible environmental impacts of a terrorist attack. Instead, they seek an analysis of the range of environmental impacts likely to result in the event of a terrorist attack on the Storage Installation. We reject the Commission's characterization of this request as a demand for a worst-case analysis.

D

The NRC's reliance on the fourth *PFS* factor, that it cannot comply with its NEPA mandate because of security risks, is also unreasonable. There is no support for the use of security concerns as an excuse from NEPA's requirements. While it is true, as the agency claims, that NEPA's requirements are not absolute, and are to be implemented consistent with other programs and requirements, this has never been interpreted by the Supreme Court as excusing NEPA's application to a particularly sensitive issue. See *Weinberger v. Catholic Action of Hawaii*, 454 U.S. 139 (1981) (holding that the Navy was required to perform a NEPA review and to factor its results into decisionmaking even where the sensitivity of the information involved meant that the NEPA results could not be publicized or adjudicated). *Weinberger* can support only the proposition that security considerations may permit or require modification of some of the NEPA procedures, not the Commission's argument that sensitive security issues result in some kind of NEPA waiver.

The application of NEPA's requirements, under the rule of reason relied on by the NRC, is to be considered in light of the two purposes of the statute: first, ensuring that the agency will have and will consider detailed information concerning significant environmental impacts; and, second, ensuring that the public can both contribute to that body of information, and can access the information that is made public. To the extent that, as the NRC argues, certain information cannot be publicized, as in *Weinberger,* other statutory purposes continue to mandate NEPA's application. For example, that the public cannot access the resulting information does not explain the NRC's determination to prevent the public from *contributing* information to the decisionmaking process. The NRC simply does not explain its unwillingness to hear and consider the information that Petitioners seek to contribute to the process, which would fulfill both the information-gathering and the public participation functions of NEPA. These arguments explain why a *Weinberger*-style limited proceeding might be appropriate, but cannot support the NRC's conclusion that NEPA does not apply. As we stated in *No GWEN*: "There is no 'national defense' exception to NEPA ... 'The Navy, just like any federal agency, must carry out its NEPA mandate to the fullest extent possible and this mandate includes weighing the environmental costs of the [project] even though the project has serious security implications.' " 855 F.2d at 1384

E

In sum, none of the four factors upon which the NRC relies to eschew consideration of the environmental effects of a terrorist attack satisfies the standard of reasonableness. We must therefore grant the petition in part and remand for the agency to fulfill its responsibilities under NEPA.

Our identification of the inadequacies in the agency's NEPA analysis should not be construed as constraining the NRC's consideration of the merits on remand, or circumscribing the procedures that the NRC must employ in conducting its analysis. There remain open to the agency a wide variety of actions it may take on remand,

consistent with its statutory and regulatory requirements. We do not prejudge those alternatives. Nor do we prejudge the merits of the inquiry. We hold only that the NRC's stated reasons for categorically refusing to consider the possibility of terrorist attacks cannot withstand appellate review based on the record before us.

We are also mindful that the issues raised by the petition may involve questions of national security, requiring sensitive treatment on remand. However, the NRC has dealt with our nation's most sensitive nuclear secrets for many decades, and is well-suited to analyze the questions raised by the petition in an appropriate manner consistent with national security.

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NOTES:

1. The NRC recognized that it had to consider the "back end" of the nuclear process in addressing the cost and benefits of a licensing decision. Spent fuel impacts would be "adverse environmental effects which cannot be avoided should the proposal be implemented" and should be considered before making "irreversible and irretrievable commitments of resources" as NEPA requires. *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council*, 435 U.S. 519 (1978). The effects, however, were found to be "relatively insignificant" in the 1970's and would not have changed a decision to license plants.

2. The *Vermont Yankee* decision is also cited for two other administrative law propositions. First, even though an individual license is an adjudicatory process, an agency can use rule-making to determine facts that would be identical and applicable to all licensing decisions. Second, the Administrative Procedure Act constitutes the procedures agencies must follow in rule-making and judges cannot impose additional procedural requirements. The Atomic Energy Act of 1954 (42 U.S.C. 2239(a)(1)

3. The Energy Policy Act of 2005 ("EPAct") provides additional incentives for nuclear generation. Public Law 109-58, §§ 601-610 (August 8, 2005). First, EPAct re-authorized the Price-Anderson Act for twenty years. This Act is extensively considered in the "Reaction to Accidents" section of this Chapter.

The EPAct, however, did not simply continue past support for the industry. Other direct incentives are included. For example, it provides for loan guarantees for new reactors. Public Law 109-58, §§ 1701-1704 (August 8, 2005)., 42 U.S.C. §§ 16511-16514. To be eligible, the technology must be "advanced nuclear energy technologies." *Id.* at 16513 (b)(4). Additionally, the federal government will offer "risk insurance" to the first two reactors for up to $500 million and offer it to the next four reactors for up to $200 million. Public Law 109-58, §§ 638-639 (August 8, 2005), 42 U.S.C. § 16014. The risks insured against include delays in permitting or regulatory approval. *See* 10 CFR Part 950 Standby Support for Certain Nuclear Plant Delays, Friday, August 11, 2006 71 FR 46306-01. As a further incentive, the EPAct includes a production tax credit for eight years of 1.8 cents per kilowatthour for up to 6 gigawatts of capacity built before 2021. If

the capacity limit is met before 2021, the credit ends. Public Law 109-58, § 1306 (August 8, 2005), 26 U.S.C. § 45J The EPAct also provides research and development funding for prototype plants. Public Law 109-58, §§ 641-645 (August 8, 2005), 42 U.S.C. §§ 16021-16025. This endeavor is referred to as the ""Next Generation Nuclear Plant Project." On September 28, 2006, DOE announced awards of about $8 million dollars under the program to three companies.

4. Although there is some disagreement about whether these incentives will be sufficient to spur all the generation sought, additional activity is evident. An NRC report listed 19 letters of intent for site-specific combined license applications on hand at the end of June, 2006. These cover 27 generating units. Moreover, the EIA predicts that nuclear generation will increase from 99.6 gigawatts in 2004 to 108.8 gigawatts in 2030. Annual Energy Outlook 2006 with Projections to 2030, Report #:DOE/EIA-0383(2006), http://www.eia.doe.gov/oiaf/aeo/electricity.htm. It attributes six of these gigawatts of expansion to new operating units spurred by the tax credits, with 3.2 gigabytes of expansion at existing units. Moreover, the EIA predicts that existing generating units will continue to operate and be re-licensed when their existing licenses expire. Nevertheless, because of the increased demand for electricity, nuclear energy will not likely maintain its 20% share of the electric market. The EIA forecasts that by 2030, its share will decrease to 15%.

What is the proper role of the state in the process of determining whether a nuclear facility should be built? Local zoning and other general land-use laws are not necessarily overruled. What other authority do states have to influence whether a nuclear plant will or will not be built within their borders? The following case does not involve a regulated utility building a nuclear generating plant. Would such a situation differ from that involved in *Skull Valley*? Consider *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission,* 461 U.S. 190, 203 (1983), which is discussed in the main case.

SKULL VALLEY BAND OF GOSHUTE INDIANS v. NIELSON
376 F.3d 1223 (10th Cir. 2004)
cert denied sub nom Nielson v. Private Fuel Storage L.L. C., 126 S.Ct.. 790 (2005

HENRY, Circuit Judge.

The Governor and Attorney General of Utah, along with Utah environmental and transportation officials, appeal the district court's ruling that the state's statutes regulating the storage and transportation of spent nuclear fuel are preempted by federal law. The Utah officials argue that the district court should not have reached the merits of this dispute because (1) the plaintiffs who challenge the statutes-a consortium of utility companies (Private Fuel Storage, Inc.) and an Indian tribe (the Skull Valley Band of Goshute Indians)-lack standing to bring this lawsuit and (2) the case is not ripe for

review. Alternatively, the Utah officials argue that the majority of the challenged statutes are not preempted.

We agree with the district court's resolution of the standing question. Private Fuel Storage (PFS) and the Skull Valley Band have properly asserted that their legally protected interests have been injured by the challenged statutes and that these injuries are likely to be redressed by a favorable decision. Moreover, in light of the D.C. Circuit's recent resolution of the Utah officials' challenge to federal statutes and regulations concerning spent nuclear fuel, we further conclude that the case is now ripe for review.

On the merits, we agree with the district court's ruling that the Utah statutes are preempted by federal law. We therefore affirm the district court's decision.

I. BACKGROUND

This case is one of many arising out the vexing problem of transporting and storing the spent nuclear fuel (SNF) that is generated by nuclear power plants. Because SNF remains radioactive for thousands of years, long-term storage strategies are essential. However, the search for the safest solution has been long and difficult.

In 1982, Congress passed the Nuclear Waste Policy Act (NWPA), 42 U.S.C. §§ 10101-10270. The NWPA requires the United States Department of Energy to construct a permanent storage facility for the disposal of SNF. The NWPA also establishes a federally monitored temporary storage program in the event that a permanent facility is not available by the deadline.

Under NWPA, the United States Department of Energy and various utility companies controlling nuclear reactors entered into agreements to accept SNF no later than January 31, 1998. However, the Department of Energy has estimated that, at the earliest, it will not have a permanent repository to receive SNF until 2010 Unless Congress, the Department of Energy, and the Nuclear Regulatory Commission (NRC) take heroic steps, even this date is optimistic.

PFS is a consortium of utility companies, which formed in order to seek temporary storage options for the SNF storage problem. In May 1997, PFS entered into a lease of Skull Valley Band tribal land located fifty miles from Salt Lake City. PFS sought to build an SNF storage facility there. The Bureau of Indian Affairs of the United States Department of Interior has conditionally approved the lease,[25] and PFS has submitted an

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25 As we have noted in another case involving the lease between PFS and the Skull Valley Band, "[t]he Superintendent [of the BIA] conditioned his approval of the lease (1) upon the successful completion of an environmental impact statement (EIS) evaluating the environmental impacts of the lease in accordance with the National Environmental Policy Act (NEPA), and (2) upon the issuance of a license by the Nuclear Regulatory Commission." *Utah v. United States Dep't of the Interior,* 210 F.3d 1193, 1195 (10th Cir.2000).

application for licensure of the facility with the NRC, which remains pending. Under the federal regulations, the proposed facility is characterized as an "independent spent fuel storage installation," *see* 10 C.F.R. § 72.3, and must satisfy detailed requirements before it may be constructed. *See* 10 C.F.R. § 72.1 (noting that "the regulations in this part establish requirements, procedures, and criteria for the issuance of licenses to receive, transfer, and possess" SNF).

The Utah officials intervened in the NRC proceedings, arguing that the NRC lacked the authority to license the proposed facility. The NRC rejected that argument, concluding that "Congress, in enacting the Atomic Energy Act, gave the NRC authority to license privately owned, away-from-reactor facilities and did not repeal that authority when it later enacted the Nuclear Waste Policy Act of 1982." *In re Private Fuel Storage, L.L.C.* 56 N.R.C. 390, 392 (2002). The Utah officials appealed that ruling, and the D.C. Circuit has recently affirmed the NRC's decision.

In addition to contesting the licensing proceedings before the NRC, the state of Utah passed a series of statutes between 1998 and 2001 that regulate the storage and transportation of SNF. As the district court explained, the statutes are comprised of four general categories: (1) amendments to Utah's Radiation Control Act, which establish state licensing requirements for the storage of SNF, and which revoke statutory and common law grants of limited liability to stockholders in companies engaged in storing SNF; (2) "the County Planning Provisions" which require county governments to impose regulations and restrictions on SNF storage; (3) "the Road Provisions,", which vest the Governor and the state legislature with authority to regulate road construction surrounding the proposed SNF storage site on the Skull Valley reservation; and (4) "the Miscellaneous Provisions,", which require drug and alcohol testing of employees of companies engaged in SNF storage and which authorize litigation to determine water rights in areas under consideration for SNF storage. As the district court held that "the Miscellaneous Provisions" did not violate the Commerce Clause, and PFS and the Skull Valley Band do not challenge that ruling on appeal, only the first three categories are at issue here.

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III. Supremacy Clause Claim

We now proceed to the merits of this dispute. The Utah officials argue that the district court erred in concluding that federal law preempts the challenged statutes. According to the Utah officials, the following statutory provisions are not preempted: (1) the sections of the County Planning Provisions that prohibit counties from offering certain services to SNF storage facilities; (2) the Unfunded Potential Liability Provisions, which require those seeking to create an SNF storage site to "pay to [the state Department of Environmental Quality] not less than 75% of the unfunded potential liability" arising out of the operation of the facility, Utah Code Ann. § 19-3-319(3); (3) the provisions rescinding limited liability for officers and equity interest owners of companies operating SNF storage facilities; (4) the Road Provisions, which vest the governor and the state

legislature with control over the area surrounding the proposed SNF site; and (5) specific provisions of the state licensing scheme set forth in Part 3 of Utah's Radiation Control Act.

We begin by examining general principles of federal preemption. Then we turn to the Utah officials' specific challenges to the district court's ruling.

A. Federal Preemption

The district court's ruling is grounded in the Supremacy Clause of the United States Constitution, which states that "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof ... shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. The Supremacy Clause "embodies the fundamental principle that in certain areas the United States must act as a single nation, led by the federal government, rather than as a loose confederation of independent sovereign states." *Abraham v. Hodges,* 255 F.Supp.2d 539, 549 (D.S.C.2002). In light of the Supremacy Clause, Congress may, within the limits set forth elsewhere in the Constitution, enact legislation that preempts state law.

The preemptive effect of federal law may be apparent from the text of the statute. *See Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Commission,* 461 U.S. 190, 203 (1983) ("It is well-established that within Constitutional limits Congress may preempt state authority by so stating in express terms."). Federal preemption may also be implicit:

> Congress' intent to supercede state law altogether may be found from a scheme of federal regulation so pervasive as to make reasonable the inference that Congress left no room to supplement it because the Act of Congress may touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject, or because the object sought to be obtained by the federal law and character of obligations imposed by it may reveal the same purpose.

Id. at 203-04, 103 S.Ct. 1713 (internal quotation marks omitted).

Even absent such "field preemption," however, federal law may still preempt state law to the extent that state law actually conflicts with federal law. Such conflicts occur when "compliance with both federal and state regulations is a physical impossibility,"*Pacific Gas,* 461 U.S. at 204 (internal quotation marks omitted), or when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Id.* (internal quotation marks omitted).

In each instance, the question of preemption is one of determining Congressional intent. Therefore, in order to determine whether the Utah statutes at issue are preempted, we must examine the federal statutes regulating nuclear power.

B. Federal Regulation of Nuclear Power

Federal regulation of privately-owned nuclear power facilities began with the Atomic Energy Act of 1954. Until that time, the ownership of nuclear technology remained a federal monopoly. The 1954 Act "stemmed from Congress' belief that the national interest would be served if the Government encouraged the private sector to develop atomic energy for peaceful purposes under a program of federal regulation and licensing." *English v. Gen. Elec. Co.* 496 U.S. 72, 79 (1990). "The Act implemented this policy decision by opening the door to private construction, ownership, and operation of commercial nuclear-power reactors under the strict supervision of the Atomic Energy Commission." *Id.* Congress thus allowed the licensing of private construction, ownership, and operation of commercial nuclear power reactors. However, the 1954 Act gave the Atomic Energy Commission "exclusive jurisdiction to license the transfer, delivery, receipt, acquisition, possession, and use of nuclear materials." *Pacific Gas,* 461 U.S. at 207,....

In 1957, Congress amended the Atomic Energy Act through the Price-Anderson Act, 42 U.S.C. § 2210. The Price-Anderson Act creates specific protections from tort liability for the operators of nuclear facilities: "(1) an aggregate ceiling on the liability for nuclear tort claims; (2) a channeling of liability provision to protect private entities from liability for their indirect participation in atomic development; and (3) an indemnification program," under which the federal government requires nuclear facilities to obtain private insurance coverage up to a certain level and indemnifies the facilities above that amount, up to a specified liability ceiling. *Kerr-McGee Corp. v. Farley,* 115 F.3d 1498, 1503 (10th Cir.1997).[26]

Two years later, Congress again amended the Atomic Energy Act. The purpose of the 1959 amendments was to " 'clarify the respective responsibilities ... of the States and the [Federal Government] with respect to the regulation of byproduct, source, and special nuclear materials, and generally to increase the States' role' " by authorizing the Atomic Energy Commission to enter into agreements with state governors authorizing " 'coordinated and compatible' " state regulation of certain nuclear materials. *English,* 496

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[26] Congress substantially amended the Price-Anderson Act in 1966 and 1988. The 1966 amendments "[1] require participants in the nuclear industry to waive certain key defenses to liability that might otherwise be permissible under applicable State or Federal law[;] ... [2] apply [ ] the ... defense waiver provision only to public liability actions arising from an extraordinary nuclear occurrence, [and] ... [3] confer [ ] upon the United States district court in the district in which an extraordinary nuclear occurrence takes place original jurisdiction with respect to any public liability action arising out of such an [occurrence]." *Cook v. Rockwell Int'l Corp.,* 273 F.Supp.2d 1175, 1184-85 (D.Colo.2003) (internal quotation marks and citations omitted). "The focus of the 1988 Price-Anderson Amendments Act was on extending and increasing the pool of funds available to compensate victims of a nuclear incident and on extending, clarifying, and in some cases expanding the reach of various aspects of the Price-Anderson system." *Id.* at 1187.

U.S. at 81, (quoting 42 U.S.C. § 2021(a)(1) and (g)) (alternations in original). However, the 1959 amendments limited the scope of these federal-state agreements.

> Congress specifically directed the Atomic Energy Commission to retain authority and responsibility with respect to regulation of ... the construction and operation of any production or utilization facility ... and ... the disposal of such ... byproduct, source or special nuclear material as the Commission determines ... should, because of the hazards or potential hazards thereof, not be so disposed of without a license from the Commission.

Pacific Gas, 461 U.S. at 209 (quoting 42 U.S.C. § 2021(c)); *see also Silkwood v. Kerr-McGee Corp.,* 464 U.S. 238, 250 (1984) (explaining that "Congress' decision to prohibit the states from regulating the safety aspects of nuclear development was premised on its belief that the Commission was more qualified to determine what type of safety standards should be enacted in this complex area. As Congress was informed by the AEC, the 1959 legislation provided for continued federal control over the more hazardous materials because 'the technical safety considerations are of such complexity that it is not likely that any State would be prepared to deal with them during the foreseeable future.' ") (quoting H.R.Rep. No. 1125, 86th Cong., 1st Sess. 3 (1959), U.S.Code Cong. & Admin.News 2872, 2874).

In 1974, Congress passed the Energy Reorganization Act, 42 U.S.C. §§ 5801 et seq., which abolished the Atomic Energy Commission and transferred its licensing and regulatory functions to the NRC. The 1974 Act also "expanded the number and range of safety responsibilities under the NRC's charge." *English,* 496 U.S. at 81.
In 1982, Congress enacted the Nuclear Waste Policy Act, 42 U.S.C. §§ 10101-10270. That act was passed "in response to 'a national problem' created by the accumulation of spent nuclear fuel from private nuclear generators, as well as radioactive waste from reprocessing such fuel, activities related to medical research, diagnosis, and treatment, and other sources." *Bullcreek,* 359 F.3d at 538 (quoting 42 U.S.C. § 10131(a)(2)). Noting that previous efforts of the federal government to find a permanent solution to the problem of storing SNF have been inadequate, the NWPA establishes a schedule for developing a permanent federal repository. As an alternative to a permanent facility, the statute also establishes a federally-monitored temporary storage program. Congress also found that those who generate SNF have " 'the primary responsibility to provide for, and ... to pay the costs of, the interim storage of such ... spent fuel,' " and it thus "limited the federal government's obligation to assist private nuclear generators with interim storage." *Id.* (quoting 42 U.S.C. § 10131(a)(5) and discussing § 10151(a)(1)). Accordingly, the NWPA requires private operators of nuclear facilities to exhaust onsite options for storage.

Pursuant to these statutes, the Atomic Energy Commission and the NRC have promulgated detailed regulations regarding the operation of nuclear facilities, including the storage of SNF. *See* 10 C.F.R. Part 72; *Bullcreek,* 359 F.3d at 538 (stating that the 1954 Act "authorized the NRC to regulate the possession, use, and transfer of the constituent materials of spent nuclear fuel, including special nuclear material, source material, and byproduct material" and that "[w]hile the [Atomic Energy Act] does not specifically refer to the storage or disposal of spent nuclear fuel, it has long been

recognized that the [Atomic Energy Act] confers on the NRC authority to license and regulate the storage and disposal of such fuel"). These regulations establish requirements for the licensing of spent nuclear fuel storage facilities both at and away from the reactor site. The regulations also establish recordkeeping and inspection requirements, site evaluation criteria, design requirements, quality assurance, and training and certification of personnel.

C. Supreme Court Decisions

Three Supreme Court decisions have addressed the preemptive effect of this extensive federal regulatory scheme in considerable detail: *Pacific Gas,* 461 U.S. at 203-23; *Silkwood,* 464 U.S. at 248-57; and *English,* 496 U.S. at 80-90. Interestingly, in all three cases, the Court concluded that the state laws at issue were *not* preempted. Obviously, the parties disagree as to how these decisions should be applied to the Utah statutes.

In *Pacific Gas,* a utility company sought an injunction barring the enforcement of a state statute imposing a moratorium on the construction of new nuclear power plants in California pending development of a plan for disposal of nuclear waste. Examining the text of the Atomic Energy Act, the Court identified "a field in which the federal interest is ... dominant"-"the radiological safety aspects involved in the construction and operation of a nuclear plant." 461 U.S. at 204-05 (internal quotation marks omitted).

Accordingly state laws within "the entire field of nuclear safety concerns" are preempted, even if they do not directly conflict with federal law. *Id.* at 212. Thus, "[a] state moratorium grounded in safety concerns falls squarely within the prohibited field," as would "a state judgment that nuclear power is not safe enough to be further developed." *Id.* at 213. However, if state regulation is grounded in "a non-safety rationale," it may fall outside the preempted field. *Id.*

The Court concluded that a non-safety rationale supported California's moratorium: the economic costs of allowing construction of additional nuclear power plants before adequate SNF storage facilities could be developed. *Id.* at 216 (accepting the state's "avowed economic purpose" in enacting the statutory moratorium). Thus, the statute lay outside the preempted field.

The Court also concluded that the moratorium did not conflict with the objectives of federal law. Although the primary purpose of the Atomic Energy Act is the promotion of nuclear power, that power is not to be developed "at all costs." *Id.* at 222 Congress had left to the states to determine whether, as a matter of economics, a nuclear power plant should be constructed.

In *Silkwood,* 464 U.S. at 248-57, the Court applied these preemption principles to a state law punitive damages award arising out of exposure to radioactive materials at a nuclear power plant. Focusing on the legislative history of the Price-Anderson Act and the amendments to it, the Court held that the punitive damages award was not preempted and found "ample evidence" that Congress did not intend to bar such a remedy. *Id.* at 251.

The Court acknowledged a tension between the federal government's exclusive power to regulate "the radiological safety aspects involved in the construction and operation of a nuclear plant," *Pacific Gas,* 461 U.S. at 205 and "the conclusion that a state may nevertheless award damages based upon its own law of liability." *Silkwood,* 464 U.S. at 256. Nevertheless, Congress intended to stand by both concepts. *See id.* ("It may be that the award of damages based on the state law of negligence or strict liability is regulatory in the sense that a nuclear plant will be threatened with damages liability if it does not conform to state standards, but that regulatory consequence was something that Congress was quite willing to accept.").

The Court added that in certain instances, the recovery of damages for radiation injuries might still be preempted. However:

> insofar as damages for radiation injuries are concerned, preemption should not be judged on the basis that the federal government has so completely occupied the field of safety that state remedies are foreclosed but on whether there is an irreconcilable conflict between the federal and state standards or whether the imposition of a state standard in a damages action would frustrate the objectives of the federal law. *Id.*

In *English,* 496 U.S. at 90, the Supreme Court considered another state law cause of action, concluding that, like the state law in *Silkwood,* it too was not preempted. An employee of nuclear fuel production facility had filed a claim for intentional infliction of emotional distress arising out of her employer's allegedly retaliating against her for having reported suspected violations of nuclear safety violations to the NRC. The Court held that the state law claim "d[id] not fall within the pre-empted field of nuclear safety," *id.,* and did not conflict with a provision of the 1978 amendments to the Atomic Energy Act that encourages employees to report safety violations and establishes a procedure to protect them from any resulting retaliation. *Id.* at 82 (discussing 42 U.S.C. § 5851).

The Court rejected the broad reading of *Pacific Gas* offered by the defendant employer, which suggested that the federal statute protecting nuclear industry employees from retaliation preempted all state tort laws that traditionally have been available to employees alleging outrageous conduct by their employers. Under the preemption inquiry established by *Pacific Gas,* the Court reasoned, "part of the pre-empted field is defined by reference to the purpose of the state law in question," and "another part of the field is defined by the state law's actual effect on nuclear safety." *Id.* at 84.

The Court then noted that the state tort law at issue was not motivated by safety concerns. Thus, the preemption inquiry should focus upon the effect of the state law, asking whether the law had "some direct and substantial effect on the decisions made by those who build or operate nuclear facilities concerning radiological safety levels." *Id.* at 85. Because such a direct and substantial effect was lacking, the Court concluded that the state law claim did not fall within the preempted field of nuclear safety.

Nevertheless, the *English* court did acknowledge that a state law claim for intentional infliction of emotional distress might have some effect on radiological safety decisions:

> We recognize that the claim for intentional infliction of emotional distress at issue here may have some effect on these decisions, because liability for claims like petitioner's will attach additional consequences to retaliatory conduct by employers. As employers find retaliation more costly, they will be forced to deal with complaints by whistle-blowers by other means, including altering radiological safety policies. Nevertheless, we believe that this effect is neither direct nor substantial enough to place petitioner's claim in the pre-empted field.

English, 496 U.S. at 85.

Several other courts have applied the preemption analysis set forth in *Pacific Gas, Silkwood,* and *English* to state laws barring the transportation and storage of SNF. Some of these decisions have concluded that the challenged laws are within the preempted field of nuclear safety. Other decisions have concluded that the challenged state laws conflicted with the objectives of federal law and were thus preempted on that ground.

D. Application of Supreme Court Decisions to the Utah Statutes

In defending the challenged statutes, the Utah officials rely primarily on two parts of the preemption analysis set forth in *Pacific Gas, Silkwood,* and *English.* First, they contend that PFS and the Skull Valley Band have failed to offer sufficient evidence that the statutes have "some direct and substantial effect" on decisions made by those who would operate the SNF storage facility. *English,* 496 U.S. at 85. Second, the Utah officials contend that the challenged statutes are analogous to the state laws upheld in *Silkwood* and *English.* We consider these arguments in relation to the specific statutes that the Utah officials seek to defend in this appeal.

1. The County Planning Provisions

The Utah officials challenge the district court's merits ruling regarding the County Planning Provisions. As we have noted, those provisions allow a county to either (a) adopt an ordinance barring the transportation and storage of SNF, or (b) allow such transportation and storage, but only if the county adopts a comprehensive land use plan containing detailed information regarding the effects of any proposed SNF site upon the health and general welfare of citizens of the State. Counties are indemnified if they choose the former option. The County Planning Provisions also prohibit counties from providing "municipal-type services," including fire protection, garbage disposal, water, electricity, and law enforcement, to SNF transportation and storage facilities within the county. According to the Utah officials, the district court erred in holding that these provisions are preempted by federal law.

First, the officials question the district court's ruling that these provisions would dramatically increase the costs of operating a SNF storage facility by requiring the operator to provide its own "municipal-type services." They note that the record

contains no evidence of such increased costs. *See* Aplts' Br. at 85-86 (arguing that "Utah, as the nonmoving party in the summary judgment context, is entitled to the inference that the cost to PFS of contracting for local law enforcement services is equal to or more than the cost to PFS of providing the allowed alternative, a private security force"). Second, the Utah officials contrast the costs to PFS of providing such services to the $10 million punitive damages award in *Silkwood.* If such an award did not have a direct and substantial effect on those making radiological decisions, the defendant officials contend, then neither would the challenged restrictions on county services. Third, the Utah officials maintain that the County Planning Provisions are analogous to state laws upheld by other courts. Fourth, the officials characterize the County Planning Provisions as concerning "areas that characteristically have been governed by the States." Aplts' Br. at 88 (quoting *Pacific Gas,* 461 U.S. at 205-06).

We agree with the district court that the County Planning Provisions are preempted. In requiring county land use plans to "address the effects of the proposed [SNF storage] site upon the health and general welfare of the citizens of the state," including "specific measures to mitigate the effects of high-level nuclear waste ... [to] guarantee the health and safety of citizens of the state," Utah Code Ann. § 17-27-301(3)(a), these provisions address matters of radiological safety that are addressed by federal law and that are the exclusive province of the federal government. *See Pacific Gas,* 461 U.S. at 205 ; *see also Kentucky,* 252 F.3d at 820-21; (holding that conditions regarding the disposal of radioactive waste imposed by a state agency in a landfill permit were preempted by federal law).

Although the provision requiring a county to address radiological safety issues in its land use plan may not apply if a county adopts an ordinance banning the storage of high level nuclear waste within its borders, *see* Utah Code Ann. § 17-27-301(3)(b), that alternative provision is itself grounded in safety concerns. *See Pacific Gas,* 461 U.S. at 213 (holding that "[a] state moratorium [on nuclear power plant construction that was] grounded in safety concerns falls squarely within the prohibited field"); *Jersey Cent. Power & Light,* 772 F.2d at 1110-12 (holding that a township ordinance prohibiting importation of SNF or other radioactive wastes for the purpose of storage was preempted by federal law). That conclusion follows from the text of the County Planning Provisions, which refers to the effects of nuclear waste on the health and welfare of Utah citizens. Moreover, unlike the state officials in *Pacific Gas,* the Utah officials here have failed to offer evidence that the provision allowing a county to ban SNF transportation and storage is supported by a non-safety rationale.

The arguments advanced by the Utah officials here do not undermine our conclusion. We do agree with the defendants that the record does not allow a comparison between the costs that would be incurred by PFS if the county provided municipal services to the storage facility and the costs that would be incurred by the use of private contractors to provide those services. However, we do not agree that the burden that the defendant officials seek to impose upon PFS and the Skull Valley Band is appropriate. *Pacific Gas, Silkwood,* and *English* do not turn the preemption inquiry upon a precise determination of costs imposed upon the operators of nuclear facilities by the application

of state law. Although there may be some costs imposed by a statutory scheme that are so minimal that they could not have a "direct and substantial effect" on decisions made by those who operating SNF facilities, *see English,* 496 U.S. at, that argument cannot save the pervasive ban on providing municipal services here at issue. That ban targets only those engaged in SNF transportation and storage and does so for safety reasons. Those factors are sufficient to render a precise determination of the relative costs unnecessary.

Silkwood and *English* do not save the County Planning Provisions. In holding in *Silkwood* that a $10 million award of punitive damages on a state law claim was not preempted, the Court relied upon "ample evidence that Congress had no intention of forbidding the states from providing" "state-law remedies [to] those suffering injuries from radiation in a nuclear plant." *Silkwood,* 464 U.S. at 251. *English* relies on the same evidence. The Utah officials identify no analogous evidence that Congress intended to allow detailed regulation of nuclear facilities by county governments, and we have found none.

Moreover, *Silkwood* and *English,* both involve generally applicable state tort law that existed before Congress began to regulate nuclear power. *See Buckman Co. v. Plaintiffs' Legal Comm.,* 531 U.S. 341, 352 (2001) (observing that "[Ms.] Silkwood's claim was ... based ... on traditional state tort law principles of the duty of care owed by the producer of plutonium fuel pins to an employee working in its plant"). Neither case concerns state laws that target the nuclear industry, as the Utah provisions do here.

The two other cases on which the Utah officials rely are also distinguishable. In *In re Long Island Lighting Co. (Shoreham Nuclear Power Station, Unit I),* LPB-55-12, 21 N.R.C. 644 (1985), the NRC's Licensing Board concluded that a New York statute and a county ordinance prohibiting the use of private parties to perform law enforcement functions at nuclear facilities was not preempted by federal law concerning nuclear safety. As a result, the Board allowed the state and local governments to bar the use of private parties in an emergency response plan. However, the Licensing Board based that conclusion upon considerable evidence that Congress "deliberately decided not to invade State authority [regarding emergency response plans] or to force States to take specific planning action." *Id.* at 907. Moreover, "the statutes at issue were passed long before [the operator of the nuclear facility] began emergency planning ... and for purposes totally unrelated to nuclear power or emergency planning." *Id.* at 904.

Similarly, in *Citizens for an Orderly Energy Policy v. County of Suffolk,* 604 F.Supp. 1084 (E.D.N.Y.1985), the court held that a county legislature's resolution stating that it would refuse to cooperate in radiological emergency response planning was not preempted by federal law. However, that holding too was based upon the legislative history indicating that "Congress considered the possibility that a state or local government or both would fail to participate in emergency planning." *Id.* at 1096. Rather than requiring such participation by unwilling local governments, the court noted, Congress provided that utilities could present their own emergency response plans to the NRC. *Id.*

There is no analogous legislative history supporting the County Planning Provisions here. Rather than allowing state and local governments to ban SNF transportation and storage or to impose their own licensing requirements, Congress has reserved such regulation to the federal government. Thus, the decisions invoked by the Utah officials do not support their argument.

Finally, we disagree with the Utah officials that the County Planning Provisions are not preempted because they concern “areas that characteristically have been governed by the States.” Aplts' Br. at 88 (quoting *Pacific Gas,* 461 U.S. at 205-06). Although it is true that the County Planning Provisions address law enforcement, fire protection, waste and garbage collection and other similar matters that have been traditionally regulated by local governments, that fact does not trump the preemption analysis that the controlling Supreme Court decisions require us to undertake. Under that analysis, we consider the purpose and effect of the state law at issue, and, as a result, a state cannot use its authority to regulate law enforcement and other similar matters as a means of regulating radiological hazards. That is what the County Planning Provisions attempt to do, and they are thus preempted by federal law.

2. The Unfunded Potential Liability Provisions

Next, the Utah officials argue that the Unfunded Potential Liability Provisions are not preempted. At issue here are the sections of the Utah licensing scheme that require the operator of a SNF storage facility to pay to the state of Utah an amount equal to at least 75% of the “unfunded potential liability” of the project. Utah Code Ann. § 19-3-319(3). That amount is determined by the Department of Environmental Quality, based upon “the health and economic costs expected to result from a reasonably foreseeable accidental release [of SNF].” *Id.* § 19-3-301(5).

According to the Utah officials, these unfunded liability provisions are designed to “fill in the gaps” in the liability coverage established by the Price-Anderson Act, 42 U.S.C. § 2010. ...As a result, they argue, these provisions are analogous to the state laws upheld by the Supreme Court in *Silkwood* and *English.* Moreover, the officials maintain that there is no evidence in the record either that these provisions will have a direct and substantial effect upon decisions regarding radiological safety levels or that the provisions conflict with the objectives of federal law. *See* Aplts' Br. at 94 (arguing that the unfunded liability provisions “operate only in an area that Congress has left outside the scope of its regulatory scheme ([the Price-Anderson Act])”).

In support of their “gap-filling” argument, the Utah officials point to “hot debate and considerable uncertainty,” regarding “just which entities and what kinds of nuclear events the [Price-Anderson] Act covers.” Aplts' Br. at 91. They characterize the unfunded liability provisions as a legitimate response to this uncertainty.

***

In considering this argument, we first note that there is some uncertainty as to the proper preemption analysis. In *Silkwood,* the Supreme Court stated that “insofar as damages for

radiation injuries are concerned," 464 U.S. at 256,the appropriate inquiry is whether a conflict exists between federal and state law rather than whether Congress has preempted the entire field. The law at issue there was an award of punitive damages arising out of a state tort claim. In contrast, the state laws at issue here do not involve a claim for damages asserted by a party exposed to radiation. Instead, the statutes concern fees imposed by the state to ensure payment to injured parties if such exposure occurs.

In these circumstances, the parties disagree as to how to read *Silkwood's* limitation upon the preemption inquiry. PFS and the Skull Valley Band argue that field preemption is applicable, while the Utah officials contend that the court should consider only whether a conflict exits between the state's unfunded liability provisions and federal law or whether, under *English,* those provisions will have a direct and substantial effect upon decisions regarding radiological safety levels.

In the absence of controlling Supreme Court precedent, we will afford the Utah officials the benefit of the doubt, assuming without deciding, that Utah's unfunded liability provisions concern "damages for radiation injuries," *see Silkwood,* 464 U.S. at 256, in that they seek to ensure that there are adequate resources to allow injured parties to recover for those injuries. Nevertheless, even under the more limited preemption inquiry set forth in *Silkwood,* we conclude that the unfunded liability provisions are preempted. In our view, the fact that there may be gaps in the Price-Anderson Act's indemnification and insurance scheme does not establish that states are free to fill those gaps, as Utah has done here.

That conclusion follows from the response of the NRC's Atomic Safety and Licensing Board to the potential gaps in the Price-Anderson scheme. In reviewing PFS's license application, the Licensing Board has recognized that the Price-Anderson Act may not apply to certain aspects of the proposed storage facility. *See In re Private Fuel Storage. L.L.C.,* 51 N.R.C. 101, 132 (2000) (concluding that "it is apparent that in all material respects, transportation-related incidents will be covered under the provisions of the Price-Anderson Act ... and regulatory implementing provisions" but that the NRC "at this juncture ... has decided *not* to invoke its discretionary authority" to apply the Price-Anderson Act to SNF storage facilities) (emphasis added). Nevertheless, the Licensing Board proceeded to determine whether PFS had obtained liability insurance "sufficient to cover cost recovery for any foreseeable accident at the PFS facility." *Id.* at 130. As to offsite liability, the Board found sufficient PFS's $200 million nuclear energy liability policy, the largest one currently available. As to onsite liability, the Board concluded that further inquiry was necessary before it could properly determine whether PFS had sufficient insurance.

Thus, in requiring PFS to demonstrate the sufficiency of its insurance coverage regarding operations not necessarily covered by the Price-Anderson Act, the Licensing Board has itself filled some of the gaps in that regulatory scheme. Those gap-filling measures are authorized by the Atomic Energy Act and accompanying regulations. *See* 42 U.S.C. §§ 2073, 2092, 2093, 2111, and 2201(b) (granting the NRC regulatory jurisdiction over the constituent materials of spent nuclear fuel); 10 C.F.R. § 72.40(a)(6) (providing, inter

alia, that an applicant for a license to store SNF must be "financially qualified" to engage in the proposed activity); *id.* § 72.44 (providing that the NRC may impose conditions on a license)...

In light of the "gap-filling" undertaken by the NRC and its Licensing Board, Utah's unfunded liability provisions conflict with the objectives of federal law. Those statutes allow the state of Utah to make an independent determination of "the dollar amount of the health and economic costs expected to result from a reasonably foreseeable accidental release of waste involving a transfer or storage facility, or during transportation of waste, within the exterior boundaries of the state" and subject the operator of an SNF storage facility to the loss of its license unless it pays 75% of that amount to the DEQ. Utah Code Ann. § 19-3-301-(5)(a), 19-3-319(3)(a). Under the federal licensing scheme however, it is not the states but rather the NRC that is vested with the authority to decide under what conditions to license an SNF storage facility. The Utah statutes are thus preempted by federal law....

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3. Abolition of Limited Liability

Next, the Utah officials argue that the district court erred in holding that federal law preempts the state statute abolishing limited liability for stockholders in companies operating SNF storage facilities, Utah Code Ann. § 19-3-316. The officials focus on the district court's conclusion that the abolition of limited liability would impose additional costs upon PFS. *See Skull Valley,* 215 F.Supp.2d at 1247 (stating that "[a]t the least, there would be an additional, substantial cost of insurance to officers, directors, and PFS, and a corresponding effect on the safety measures employed by the facility"). According to the Utah officials, there is no evidence in the record that such costs would be incurred. Additionally, the Utah officials contend that "PFS never demonstrated and the district court never determined what, if any, of PFS's proposed activities will fall outside the [Price-Anderson Act's] scope." Aplts' Br. at 97. Thus, they reason, it remains possible that PFS's shareholders would face no liability for a radiological accident involving the proposed storage facility.

Because Utah's abolition of limited liability "frustrate[s] the objectives of federal law," *Silkwood,* 464 U.S. at 256, we agree with the district court that the challenged statute is preempted. Under Utah law, stockholders are generally not personally liable for the debts of a corporation. ... The Supreme Court has noted that "[l]imited liability [of stockholders] is the rule not the exception; and on that assumption large undertakings are rested, vast enterprises are launched, and huge sums of capital attracted." *Anderson v. Abbott,* 321 U.S. 349, 362 (1944). Section 19-3-316 removes this well-established protection, and does so for reasons that the Utah officials concede are related to radiological safety concerns. ...

In contrast, in enacting the Atomic Energy Act and subsequent amendments, "Congress' purpose was to remove the economic impediments in order to stimulate the private development of electric energy by nuclear power while simultaneously providing the

public compensation in the event of a catastrophic nuclear incident." *Duke Power Co. v. Carolina Envtl. Study Group, Inc.,* 438 U.S. 59, 83, (1978). By upending a fundamental principle of corporate law as applied to SNF storage facilities, § 19-3-316 disrupts the balance that Congress sought to achieve. In light of the conflict between the state statute and federal objectives, we agree with the district court that it is unnecessary to consider evidence of the specific costs imposed upon PFS by the elimination of limited liability.

Moreover, we again reject the Utah officials' contention that the state laws that survived preemption in *Silkwood* and *English* are analogous to the Utah statute. Here, the abolition of limited liability attempts a sea change in the law of corporations and is targeted at the nuclear industry only. The statutes do not involve a state tort remedy that existed prior to the enactment of federal legislation regarding nuclear power and that Congress intended to preserve.

ADD to NOTES on 526-27:

NOTE:
1(a) In *Pacific Gas*, California passed a statute that forbade approval of a nuclear plant until the NRC approved a permanent waste disposal technology; until such time, no one could apprise the accurate cost of a nuclear electric generating plant. What is the traditional state sphere over electric utilities? Why might a client have to deal with both the federal and state licensing authorities?

6. One of the most important limitations on enthusiasm for nuclear energy is that the manner of permanent fuel rod disposal has not yet been resolved. Congress selected Yucca Mountain as a permanent depository, but the target date for its opening has come and past. The Department of Energy has been forced to pay utilities significant amounts per year for the delay in accepting spent fuel for disposal. Current Department of Energy estimates have Yucca Mountain opening in 2017.

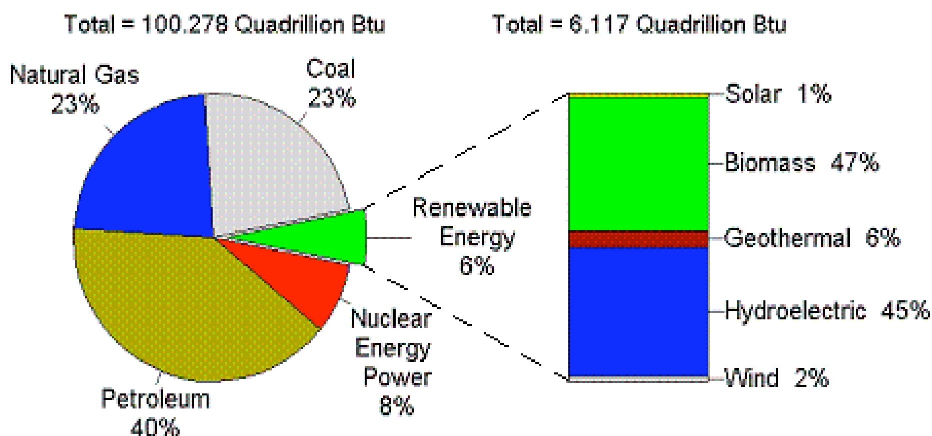
In the meantime, there is disarray in how best to address the problem. The Bush Administration champions a Global Nuclear Energy Partnership program for international cooperation in reprocessing spent fuel. See, http://www.gnep.energy.gov. On the other hand, the Senate proposed 37 interim waste storage sites in the fiscal 2007 energy appropriations bill, an effort that would create additional stress for the NRC. To meet this workload, the NRC has added 200 employees for fiscal year 2006 and anticipates adding another 200 employees in 2007, but these employees are needed just to handle reactor applications. Greenwire (August 30, 2006) at http://www.eenews.net/Greenwire/2006/08/30/archive/11

INSERT at 569:

UPDATE ON ALTERNATIVE RESOURCES

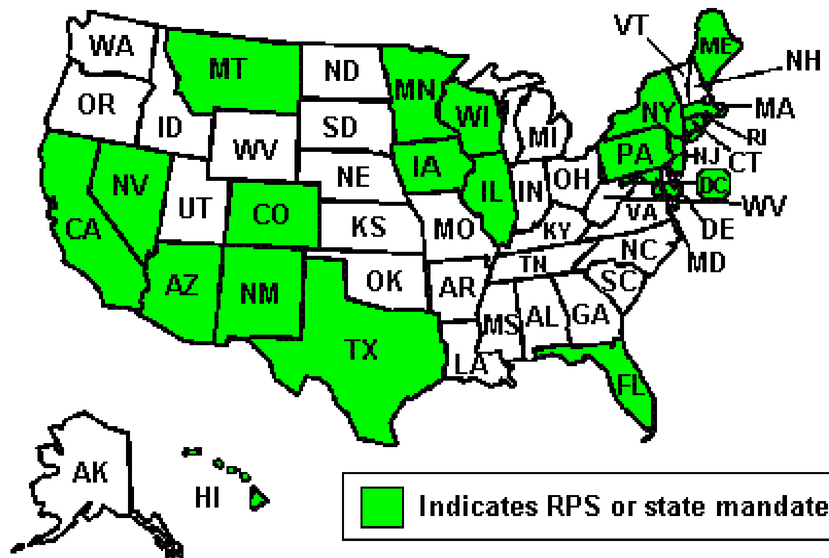
Renewable energy continued to be of interest. Two types of energy use are the main thrust of innovation: electric generation and transportation. For electricity, wind generation had the fasted growth. For transportation, ethanol production and the increased availability of hybrid vehicles spurred savings in petroleum usage. Ethanol is produced from vegetative sources (corn, switchgrass) and may be blended with gasoline. When the percentage of ethanol is relatively low, no modification of vehicles is needed. However, for an 85% ethanol blend, different cars require different technology. Hybrid cars generally use petroleum to create electric power while driving, greatly increasing the mileage per gallon of gasoline.

The Energy Information Service analyzed the role of renewables as part of the total energy of total energy usage. Its report released in June of 2006 employed 2004 date. What renewables provided are represented by this chart:



Energy Information Agency, Renewable Energy Annual, 2004 Edition, available at http://www.eia.doe.gov/cneaf/solar.renewables/page/rea_data/rea_sum.html

Some of the push for renewables has been driven by the states, which have enacted "Renewable Portfolio Standards," which require utilities to provide certain percentages of electricity generated by renewable means. The Energy Information Agency summarized the status of such requirements as of 2005:



Energy Information Agency, Renewable Energy Annual, 2004 Edition, available at http://www.eia.doe.gov/cneaf/solar.renewables/page/rea_data/rea_sum.html
The Energy Policy Act of 2005 ("EPAct) has other provisions to foster renewable use, but its final enactment did not contain a federal RPS. Such a provision, requiring a goal of 10 percent of electricity being so-generated by 2020, was contained in the Senate bill but stricken in committee. However, the final act did include a goal that the federal government obtain certain percentages of its electric use from renewable resources if economically and technically feasible. The EPAct, moreover, did extend the Production Tax Credit, which was first enacted as part of the Energy Policy Act of 1992. This provides tax advantages to generators of electricity from certain resources, including wind, solar, and biomass. The EPAct also provided incentives to non-taxpaying entities, such as municipalities, to also employ such technology. Additionally, consumers are given incentives to install renewable energy systems in residences and small businesses. Many incentives and grants were included for research.

The EPAct also clarified jurisdiction over some renewable projects. The Department of Interior was given authority over leasing offshore lands for use in producing, transmitting, or transporting of energy from sources other than oil and gas. Most noteworthy, this would include wind power from turbines located offshore. More generally, the Act encourages more renewable energy production from federal lands.

INSERT at 592:

ADD TO NOTE 1

Congress did not fully repeal PURPA in the 2005 Energy Policy Act. Instead it modified the purchase and sale requirements of utilities prospectively. The utility will not have a mandatory purchase requirement if FERC finds the qualified facility or qualified co-generator has access to a competitive wholesale market and transportation. Similarly, the utility will not be required to sell the qualified facility or co-generator electricity if FERC finds the co-generator or facility has access to a competitive retail market and transmission.16 USC § 824a-3(m). The utility, however, will have to provide interconnection service to all of its customers with on-site generation. 16 U.S.C. 2621(d)(15).

INSERT at 612:

ADD TO NOTE 1

The Court of Appeals for the 2nd Circuit found a flow control statute did not violate the dormant Commerce Clause when the local government owned the transfer facility. The Supreme Court considered the case in the 2006-2007 Supreme Court term. United Haulers Ass'n, Inc. v. Oneida-Herkimer Solid Waste Management, 438 F.3d 150 (2nd Cir. 2006), *cert. granted*, 127 S. Ct. 35 (2006).