

Summary of Key FERC-Related Provisions of the Energy Policy Act of 2005

On July 28, 2005, the House of Representatives approved the Energy Policy Act of 2005 ("Act") by a vote of 275 – 156. The following day, the Senate approved the Act by a vote of 74 – 26. All that remains for the \$12.3 billion dollar legislation to become law is the President's signature, which is expected to come sometime this week. The 1,724 page document addresses a wide variety of energy issues ranging from improvements to the energy infrastructure of the country to providing incentives for the use and development of alternate energy technologies. The Act also amends or repeals the Public Utility Holding Company Act ("PUHCA"), and gives the Federal Energy Regulatory Commission ("FERC" or "Commission") expanded power over utility mergers. The bill provides FERC with additional regulatory authority and responsibilities, while also significantly raising the amount of both civil and criminal penalties for companies that violate the Federal Power Act ("FPA") or Natural Gas Act ("NGA"). The following summary highlights key FERC-related provisions contained in the Act.¹

Natural Gas

Criminal Penalties

(Section 314)

- The Act amends the NGA and the Natural Gas Policy Act of 1978 ("NGPA") to include a drastic increase in the severity of the **criminal penalties** for directly violating, or causing to be violated, the provisions of the NGA or NGPA. The Act increases FERC's criminal penalty

authority from \$5,000 to **\$1,000,000**, with the possible maximum jail term increasing from 2 years to **5 years**.

- The Act also increases the penalty for willfully and knowingly violating a Commission rule, regulation or order issued under the NGA or NGPA from \$500 to **\$50,000** for each day of continued violation.

Civil Penalties

- The Act amends the NGA to grant FERC authority for the first time to assess civil penalties for violations of the NGA or any FERC action made under the authority of the NGA. This new authority allows FERC to impose civil penalties of not more than **\$1,000,000** for each day of continued violation.
- The Act also increases the civil penalty FERC may assess for violations of the NGPA, from \$5,000 to **\$1,000,000**.

Market Manipulation and Price Transparency

- The Act amends the NGA to explicitly prohibit the manipulation of the markets for the purchase or sale of natural gas and the transportation of natural gas regulated by FERC, by making it unlawful to employ any manipulative device (as those terms are used in Section 10(b) of the Securities Exchange Act of 1934) in contravention of FERC regulations. (Section 315).

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- FERC is also directed to prescribe rules that facilitate price transparency in the market for the sale and interstate transportation of natural gas. (Section 316).
 - The rules shall exempt from disclosure information that FERC determines would be harmful to the operation of an effective market or jeopardize system security. In devising these rules, FERC must seek to protect consumers from collusion and anticompetitive behaviors that may result from the untimely disclosure of information concerning specific transactions, and also shall rely on private publishers to the extent possible.
 - FERC cannot assess a penalty under this section for actions that occurred more than three years prior to the date of the receipt of a notice that a violation has occurred, absent a showing of fraud.
 - The Act also amends the NGA to grant FERC the authority to prohibit, temporarily or permanently, an individual who has violated the new market manipulation prohibitions (new section 4A of the NGA) from acting as an officer or director of a natural gas company or from engaging in the business of buying or selling natural gas or natural gas transmission services. (Section 318).
- This section restricts the Commission's review process, prior to January 1, 2015, by prohibiting the Commission from denying an application based on certain factors, thus making it easier for a company to install an LNG terminal solely for its own use. FERC cannot deny an application solely on the basis that the terminal will be used only by the applicant or an affiliate, or regulate the usage, rates, or terms of a contract regarding the use of the LNG terminal.
 - Section 3 of the NGA is amended to require the Commission to issue rules outlining a pre-filing process for LNG terminals. By these rules, an application for an LNG facility must comply with the pre-filing process required by the National Environmental Policy Act of 1969 (42 U.S.C. § 4321 et seq.). This process shall begin at least 6 months prior to filing for authorization to construct an LNG terminal.
 - The Commission shall consult with a state agency, designated by the Governor of the State in which the LNG terminal is proposed, on matters of State and local safety. State and local safety considerations include several enumerated factors, including the need to encourage remote siting of LNG facilities.
 - After this section has been enacted, the State may also furnish an advisory report on safety matters to the Commission (30 days prior to the application's filing). The Commission shall address the issues raised in this report prior to issuing an order authorizing the LNG project.
 - The State commission may also conduct safety inspections of the LNG facility once the terminal is operational.

Liquefied Natural Gas ("LNG")

(Section 311)

- The Act amends the NGA by granting the Commission the exclusive authority to approve or deny applications for the siting, construction, expansion and operation of LNG terminals.

- An LNG terminal operator shall develop an emergency response plan in coordination with the United States Coast Guard and local agencies prior to final approval to begin construction.
- The Act also mandates that the Commission enter into a Memorandum of Understanding with the Secretary of Defense to coordinate the siting, construction, expansion or operation of an LNG facility that may affect an active military installation.

Natural Gas Storage

- The Act amends Section 4 of the NGA to allow the Commission to authorize a natural gas company to provide storage and storage-related services at market-based rates for new storage capacity related to a specific facility placed in service after the date of enactment. This shall be done even if the company fails to demonstrate that it lacks market power as long as FERC finds that the proposed rates are in the public interest, necessary to encourage construction of the storage capacity, and customers are protected. The Commission shall review these rates periodically to determine they remain just and reasonable and not unduly discriminatory. (Section 312).

Permit Process Coordination and Judicial Review of the Process (Section 313)

- The Commission shall act as the lead agency for the purposes of coordinating all Federal authorizations required to comply with the National Environmental Policy Act of 1969. The Commission shall have the authority to set the schedule for all Federal authorizations. FERC must also maintain a complete record of all

decisions made by Federal and State agencies regarding this process. This process pertains to the authorization of facilities under section 3 or section 7 of the NGA.

- The United States Court of Appeals for the circuit in which the facility is proposed to be located shall have original and exclusive jurisdiction over any civil suit for the review of the action of a Federal agency, or State agency acting pursuant to Federal law, concerning the permitting process for a facility subject to NGA section 3 or section 7 (including compliance with the Coastal Zone Management Act and other statutes).
- The United States Court of Appeals for the District of Columbia shall have original and exclusive jurisdiction over any civil action for the failure of any Federal or State agency to act in a timely manner in the permitting process required for a facility subject to NGA section 3 or section 7.

Electricity

Electric Reliability

- Amends Part II of the FPA by authorizing FERC to certify Electric Reliability Organizations ("EROs") to establish and enforce reliability standards for the bulk power system. (Section 1201). The Act does not, however, authorize FERC to require the enlargement of bulk-power system facilities or the construction of new transmission or generation capacity.
- In addition to outlining the requirements for an ERO prior to FERC certification, the bill also calls for FERC to issue a Final Rule implementing the requirements of this section within 180 days after it is enacted.

- FERC may grant an ERO the ability to devise reliability standards and enforce those standards once they have been approved by the Commission. Any penalty imposed by the ERO shall bear a reasonable relationship to the seriousness of the violation, and shall be subject to FERC review.
- The Act also provides for FERC to have the authority to form Regional Advisory Bodies to oversee the EROs and electric reliability generally upon petition by a two-thirds of the states within a region whose electric demand is at least 50% served from that region.

Transmission Infrastructure Modernization (Section 1221)

- The Act authorizes the establishment of National Interest Electric Transmission Corridors to alleviate congestion of transmission in the power grid. These corridors shall be reexamined every three years.
- Authorizes the Commission, under certain circumstances, to issue permits for the modification or construction of additional transmission facilities in the national interest in these corridors if the Commission deems state action to be insufficient or carried out inefficiently. Federal eminent domain authority is provided for any such facilities.

Transmission Operation Improvements (Sections 1231 – 1236)

- Open Access by Non-regulated Transmitting Utilities: the Act gives FERC authority to require an unregulated transmitting utility (as defined by FPA § 201 (f)) to provide transportation services at the same rate and under the same conditions that it uses when it deals with itself.

- Exemptions to this rule include if the facility produces less than 4,000,000 MWh of electricity per year, if the facility is not necessary for the operation of an interconnected transmission system, or if it meets other criteria determined to be in the public interest. These requirements do not apply to local distribution facilities.

Transmission Rate Reform

- The Act requires FERC, within one year of the bill's enactment, to establish incentive-based rate treatments for public utilities to promote reliability and reduce congestion. (Section 1241).
- The Act requires that the rules promulgated by FERC establishing these incentives shall promote capital investment in facilities for the transmission of electricity, attract new investment with an attractive return on equity, encourage improvement in transmission technology, and allow for the recovery of prudently incurred costs related to reliability and improved transmission infrastructure.

Amendments to PURPA (Sections 1251-1254)

- The Act amends various sections of the Public Utility Regulatory Policies Act of 1978. The changes concern a variety of issues including an alternate method of metering electricity, the use of fossil fuels in generating electricity, and coordinating the response to extreme demand.

Repeal of Public Utility Holding Company Act of 1935 (PUHCA) (Sections 1261-1277)

- A portion of the energy bill which has significant implications for the gas and electric utility industry is the Public Utility Holding Company Act of 2005, which repeals the 1935 version of

PUHCA. (Section 1263) A thorough review of the repeal of PUHCA will be available in the form of a separate GT Alert.

Merger Review Reform

(Section 1289)

- While repealing PUHCA, the Act also expands FERC authority over utility mergers and acquisitions. Specifically, the Act amends section 203(a) of the FPA to grant FERC, in addition to its existing authority to review proposed mergers and acquisitions involving interstate public utility facilities currently within its jurisdiction, the authority to approve the merger or acquisition of existing electric generation facilities used for jurisdictional interstate wholesales of electricity.
- The Act also requires prior Commission approval of any merger or acquisition by an electric utility holding company with a transmitting utility, an electric utility, or another electric utility holding company, as defined in the Act.
- The Commission, within 6 months of the enactment of this Act, must adopt rules that allow for the review of such transactions in less than 180 days from the filing of an application unless good cause requires additional review time.

Market Transparency, Enforcement and

Consumer Protection

(Sections 1281 – 1290)

- The Act gives the Commission broad power to enact rules promoting transparency in the markets for the sale and transmission of electricity, while also considering the public interests of preserving the integrity of those markets and ensuring fair competition. These

provisions parallel similar amendments to the NGA discussed previously. In this regard, the Act:

- Amends the FPA to explicitly prohibit the reporting of false information relating to the price of electricity sold or the availability of transmission capacity. (Section 1282).
- Amends the FPA to explicitly prohibit the manipulation of the electric energy market by any entity, directly or indirectly. (Section 1283).
- The Act also significantly expands FERC's criminal and civil penalty authority, by increasing the criminal penalties for willful and knowing violations of the related sections of the FPA. The maximum fine increases from \$5,000 to **\$1,000,000** and the maximum jail sentence increases from 2 to **5 years**.
- The criminal penalty for violating a regulation, rule or order issued by FERC under the authority of the FPA also increases from \$500 to **\$25,000** for each day the violation continues.
- The scope of civil penalties is expanded to include all of part II of the FPA, not just enumerated sections. The penalty for a violation of this part increases from \$10,000 per day to **\$1,000,000** per day, for as long as the violation continues.
- Section 206 of the FPA is amended to expand the Commission's refund authority regarding short term (less than 31 days) sales of electricity, (Section 1286), and by permitting FERC to extend the refund effective date back to the date of the filing of any complaint.

- The Act amends section 314 of the FPA to allow for a court to prohibit an individual found to have violated the new anti-market manipulation provisions of the FPA from acting as an officer or director of an electric utility or engaging in the business of purchasing or selling electric energy or electric transmission services. (Section 1288).

Relief For Extraordinary Violations

(Section 1290)

- This section grants the Commission exclusive authority to determine whether to require “termination payments” for power not delivered under contracts entered into prior to June 20, 2001, by a seller of wholesale energy found by the Commission to have manipulated the electricity market.

Other Provisions of Interest

California Energy Crisis 2000-2001

(Section 1824)

- The Act mandates that FERC conclude its investigation of the unjust or unreasonable charges to California resulting from the “electricity crisis” of 2000-2001 as soon as possible. FERC must summarize the actions it has taken and anticipates taking in a report due to Congress by December 31, 2005. The Act explicitly reiterates FERC’s responsibility of ensuring that the refunds owed to California, resulting from the actions taken during the crisis, are paid to California.

Office of Indian Energy and Related Matters

(Sections 501 – 506)

- The Act provides for the establishment of an Office of Indian Energy Policy and Programs within the Department of Energy. The Director of the Office shall be appointed by the

Secretary of Energy. The Office shall promote the development of a more self-sufficient and efficient energy infrastructure on Indian lands. The office will also provide grants and loans to assist Indian tribes with the further development of energy resources found on tribal lands.

- The Act, pursuant to the establishment of the Office of Indian Energy Policy and Programs, establishes that an Indian tribe may grant a right-of-way over tribal land for a pipeline or electric transmission line, without approval of the Secretary of Energy if certain conditions are met. These conditions are: 1) that the right-of-way is executed under a resource agreement approved by the Secretary; 2) that the term of the agreement does not exceed 30 years; 3) that the pipeline or transmission line serves a facility located on tribal land; 4) and that the tribe has entered into an energy resource agreement with the Secretary. If these conditions are not met, the Secretary of Energy would have the ability to review and grant approval to a proposed right-of-way agreement.
- Provides for the submission of tribal energy resource agreements, to be approved by the Secretary of Energy, the terms of which address a variety of issues concerning business agreements, leases and right-of-way agreements. Some of the issues addressed in the resources agreement would be the term of agreements such as those concerning leases and right-of-way, renewal of those agreements and the economic return due the Indian tribe under those agreements.
- In addition, Section 1813 of the Act requires the Secretaries of Energy and Interior to conduct a joint study of issues regarding energy rights-of-way on Indian land within one year, in consultation

with Indian tribes, the energy industry, appropriate governmental entities (presumably including FERC), and affected businesses and consumers. The study must include:

- An analysis of historic rates of compensation paid for energy rights-of-way on tribal land;
- Recommendations for how to determine fair compensation to Indian tribes for energy rights-of-way;
- An assessment of tribal interests implicated by energy rights-of-way on tribal land; and
- An analysis of relevant national energy transportation policies relating to energy rights-of-way on tribal land.

Hydroelectric Power

(Sections 241 -246)

- Provides for the resolution of any disputed issues of material fact by trial-type hearing, of no more than 90 days, for issues relating to the issuance of licenses for construction of structures used in the production of hydroelectric power on land reserved by the Federal Government. The procedures for this trial-type hearing must be determined within 90 days of the enactment of legislation jointly by the Secretaries of Agriculture, Interior and Commerce in consultation with FERC.
- Provides for more input by the applicant in the application process concerning federally reserved lands. The applicant may propose alternative conditions to a license once a condition has been deemed necessary by the Secretary under whose supervision the reserved land falls.

- Provides for an production-based incentive payment to non-Federally owned hydroelectric facilities that meet certain qualifications, for a period of 10 years. The amount of the incentive will be based on the number of kilowatt hours generated during the incentive period, capped at \$750,000 per calendar year. This incentive plan will only be available for 20 years after the enactment of the legislation.
- Authorizes a similar incentive payment plan to benefit owners and operators of hydroelectric facilities at existing dams for improvements in efficiency (by at least 3%) at these plants. These incentive payments are limited to 10% of the cost of the capital improvements that directly result in the increased efficiency and are limited to one payment per facility not to exceed \$750,000.

Fossil Energy

(Sections 961 – 968)

- The Act authorizes the Secretary of Energy to, among other things, conduct a “program of research, development, demonstration and commercial application of oil and gas” concerning exploration, transportation and distribution infrastructure, and environmental research. (Section 965). These studies will be performed with the goal of improving the “efficiency, effectiveness and environmental performance” of fossil energy production, with an eye toward managing the decline in the domestic supply of oil and gas resources.

Studies

(Sections 1801-1840)

- The Act commissions a variety of studies to examine various energy issues. The areas of study include, among others:
 - An inventory of natural gas and oil storage,
 - Low volume natural gas reservoirs,
 - The progress of Alaska natural gas pipeline,
 - Hydroelectric generation, and
 - Distributed generation.
- Section 1815 establishes an interagency task force to study and analyze competition in the wholesale and retail electricity markets. The task force shall submit its findings within one year.
- Section 1818 requires the Secretary of Energy to submit a report on natural gas supplies and demand, with the purpose of “achieving a balance” between the supply and demand for natural gas.

- Section 1831 authorizes the Secretary of Energy to review the policies and programs enacted by the Energy Policy Act of 1992, as they related to the development of alternate fueled vehicle technology.

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Footnotes

¹ Citations to specific sections of the Act are indicated in parentheses.

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