

Energy Litigation 2022 Outlook

February 2022

For clients and friends of the firm, the Baker Botts Energy Litigation team has identified key litigation issues and trends in the energy sector that you should know about. Please feel free to reach out to our team members if you have any questions about any of these issues and trends.

KEY ISSUE

CONTACT

1. **Energy Intersections.** As one of the leaders of our energy practices, I am focused on the growing opportunities involving intersections between traditionally separate energy sectors (power, oil and gas, renewables, services), and how those sectors can work together on new technologies and business opportunities that may provide the world with new energy and lower emissions. We need to lower or eliminate regulatory and legal barriers that inhibit new investments, and address new legal issues that arise. These developments are similar to the legal issues that we solved when I worked on power deregulation during the 2000s and on horizontal drilling in the 2010s. It is an exciting time to be an energy lawyer, and our cross-disciplined approach and expertise is in high demand.



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2. **Commingling and Allocation Disputes.** Oil and gas operators commonly combine production from two or more wells for treating and processing, which is both cost-effective and efficient. This may implicate state regulation, such as Texas’s Statewide Rules 26 and 27. It may also raise questions such as whether the allocation is done properly. We are continuing to see arguments concerning commingling and allocation, including defending attempts to invoke an argument that if commingling is done wrongfully, then the burden should shift to the operator to trace that royalty owner’s production or else be penalized.



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3. **Continued Fallout from Winter Storm Uri.** One year ago, in February 2021, Winter Storm Uri wreaked havoc on the Texas energy grid. The storm and the loss of power led to a wide variety of litigation involving every part of the energy industry, including power generators, transmission and distribution utilities, pipelines, and natural gas producers. There are a wide variety of personal injury cases, commercial litigation matters, and challenges to administrative actions taken by the PUCT and ERCOT during the emergency, including cases seeking to retroactively reprice the wholesale energy market for the period of the storm. Many of these cases may take years to resolve, and additional follow-on disputes may result in additional litigation.



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4. **CFTC Enforcement.** Compliance with the CFTC's new rules establishing federal position limits on key energy futures and options contracts begins in 2022. The CFTC enforcement division will begin to prioritize investigations into violations of these new rules in 2022, including investigations into energy market manipulation and related market misconduct such as spoofing.



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5. **What's Next on Climate in California and Trends in State and Local Gas Bans.** The California Air Resources Board (CARB) currently is in the statutorily mandated process of updating its state-wide plan for addressing greenhouse gas emissions—referred to as its "Scoping Plan." The Scoping Plan will identify numerous actions the state will take over the coming years, potentially including addressing the combustion of natural gas in existing buildings, phasing out the sale of liquid-fuel vehicles, and phasing out the production of petroleum in California. In addition, increasing pressure on the natural gas sector has been brought to bear through an evolving and multifaceted effort to eliminate natural gas use by homes and businesses. Whether its model building codes, state building codes, municipal ordinances, state legislation, indoor air quality standards, or allegations of greenwashing, the legal landscape is becoming increasingly difficult to navigate and risks harder to mitigate.

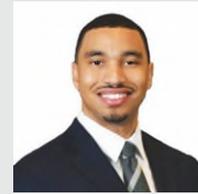


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6. **The Rise of EVs.** Electric Vehicle ("EV") adoption has accelerated in recent years due to technological, economic, and policy developments at the national, state, and local levels. By 2050, EVs could occupy as much as 76 percent of vehicle miles traveled. Further, increased electrification of the transportation sector spurred by EVs could contribute to a 60 percent increase in electricity demand by 2045. FERC is considering revisions to its rules to increase power supplies for vehicle electrification, including the possibility of allowing EV Fast Chargers to tap directly into the wholesale market. As the EV market expands and adoption increases, utility companies should expect significant changes in how customers use electricity and unprecedented strains on the electric grid. Utilities should also plan for constructing new or upgraded transmission lines to increase power supplies for vehicle electrification.



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7. **Critical Infrastructure Cybersecurity.** Federal agencies, including the Cybersecurity and Infrastructure Security Agency (CISA), the National Security Agency (NSA), and the Federal Bureau of Investigations (FBI) have issued alerts warning against increased cyber threat actors, such as increased threat of Russian state-sponsored cyber-attacks targeting critical infrastructure, including energy, telecommunications, and government facilities. In fact, the latest large-scale cyber ransomware attack has targeted oil port terminal software in at least 17 ports in Western Europe, re-routing tankers and significantly disrupting supply chains. Cyberattacks like these are increasing in frequency and sophistication. Companies in all industries need to assess their security programs, incident response plans, and business continuity plans to be prepared.



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8. **Midstream Disputes in Era of Oil and Gas Consolidation.** As industry consolidation continues, midstream disputes will remain front-and-center. In addition to an uptick in force majeure and regulatory disputes caused by volatile weather events and pricing, successor entities will be evaluating dedication agreements and midstream agreements that they had no role in negotiating. As parties consider different ownership structures and strategies to monetize these assets, existing contracts will remain under scrutiny in 2022.



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9. **Sunset Review of the Texas Commission on Environmental Quality.** The primary environmental agency for the State of Texas is in undergoing Sunset Review. The Texas Commission on Environmental Quality (TCEQ) submitted its 600-page Self Evaluation Report last fall. Meanwhile, the Sunset Commission Staff are gathering information from the agency as well as seeking input from the public. The next major milestone will be publication of the Staff's Report in May 2022 which will include the Staff's first cut at recommendations—and likely address issues such as maximum statutory penalty and emissions events.



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10. **Disclosure Requirements and Regulations for ESG reporting.** As we head into a new era of energy transition, companies are increasingly focused on enhancing their environmental, social and governance (ESG) profile. To achieve this, energy companies are engaging in a wide variety of carbon emission reducing projects, partnerships, and other transactions. The possible development and rollout of new regulations addressing how those activities must be described and disclosed—particularly for publicly-traded firms—will be an important and interesting issue to watch in 2022.



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11. **Eminent Domain and Pipeline Construction.** The Texas Supreme Court recently granted the petition for review in No. 20-0567, *HSC Pipeline Partnership v. Hlavinka*. The case tees up two issues for the Court. First, the Court will examine whether eminent domain authority extends to a party constructing a pipeline to be used in transporting polymer grade propylene. In doing so, the Court will analyze its framework established in the *Texas Rice* line of cases as well as the Texas Natural Resources Code's grant of eminent domain authority to common carriers of "oil products." Second, the Court will consider whether a landowner, in testifying as to the value of a property interest subject to taking, may testify that the "highest and best usage" of the property is the sale of pipeline easements. The answers to these two questions will have important ramifications for landowners and pipeline companies alike.



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12. **Litigation Implications of the SEC's Climate Disclosure Requirements.** With the SEC's impending rules regarding climate disclosures to investors, there will certainly be an increased risk of government enforcement and investor litigation. What are the likely litigation implications of the new rules and what can companies do to address and mitigate those risks?



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- 13. FERC Regulations to Ease Energy Transition.** FERC will be looking at amending its regulations that are central to the ongoing energy transition, including: transmission planning, cost allocation, and generation interconnection reform on the power market side. On the natural gas side, FERC will continue to modify its process to review proposed infrastructure projects to better address ESG concerns.



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- 14. Managing Potential Civil and Criminal Enforcement in EPA RMP Inspections Following an Incident.** On January 5, 2022, the United States Environmental Protection Agency (EPA) issued its Draft Environmental Justice Action Plan (Draft EJ Action Plan), which identifies EJ measures that have been or will be implemented by EPA's Office of Land and Emergency Management (OLEM). The Draft EJ Action Plan aims to strengthen RMP prevention and emergency response requirements in overburdened communities (EJ Communities) to reduce the frequency and severity of accidental releases in EJ Communities where harms may be more impactful than in rural or less-populated areas. As a result, facilities subject to RMP regulations should anticipate greater scrutiny of their plans, especially where borderline EJ Communities may be impacted by a chemical release or incident. We are starting to see more EPA RMP inspections initiated following large-scale incidents. Therefore, Companies that experience an incident should expect an RMP inspection, potentially of the unit involved in the incident, and take steps to prepare.



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- 15. Ownership of Produced Water in Texas.** Under current Texas law, where the surface estate is severed from the mineral estate the general rule is that the owner of the surface estate owns water that exists below the surface. However, the mineral estate owner (or lessee) also has the right under Texas law to use reasonable amounts of subsurface water for oil and gas operations on the lease. Disputes can arise, however, over the ownership of water when it is produced as part of oil and gas operations. Water is a scarce commodity and produced water can be valuable, leading to disputes over its character and nature, and who owns it or has the right to use (or reuse) it.



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- 16. Coal Combustion Residuals Enforcement and Regulation.** Coal-fired power plants manage coal combustion residuals (CCR, or coal ash) in landfills and surface impoundments. EPA released its first federal regulations addressing CCR in 2015, and has revised the regulations several times since with more rulemakings still pending. In addition to the prior and ongoing citizen suits brought related to the management of CCR, EPA is currently expanding its implementation and enforcement of the federal regulations. We are working with clients to develop short-term and long-term solutions that address these litigation and enforcement risks, ensure regulatory compliance, and align with business planning.



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- 17. Post-production Deductions in Calculating Royalties.** Courts in Texas and other jurisdictions continue to grapple with specific lease language in determining whether post-production costs are properly deducted from oil and gas royalties. Leases increasingly contain novel lease language such that a lessee's reliance on "at the well" language to provide for the deduction of post-production costs is only part of the analysis.



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- 18. Environmental Reviews & Energy Infrastructure.** The National Environmental Policy Act (NEPA) requires federal agencies to assess the environmental impacts of major federal actions. In 2021, the Council on Environmental Quality (CEQ) announced plans to roll-back many of the Trump-era NEPA reforms, including restoring action agency discretion to adopt procedures that are more stringent than CEQ's regulations and expanding consideration of various direct, indirect, and cumulative effects. NEPA rulemakings are expected to continue into 2022, with legal challenges likely ahead. Separately, the Corps of Engineers has temporarily suspended the issuance of various Section 404 nationwide permits (including NWP's for oil or natural gas pipeline activities, land-based renewable energy generation facilities, electric utility line and telecommunications activities, and utility line activities for water and other substances) pending review of the Section 401 certification rule. As these and other rulemakings continue into 2022, many observers note that the Biden Administration's ambitious clean energy goals largely hinge on the ability of the private sector to reliably and efficiently deploy new energy infrastructure, creating at least some incentive for federal agencies to try to find ways to improve environmental permitting and reviews.



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- 19. Fixed vs. Floating Royalties.** We are seeing renewed interest in royalty litigation over whether "double fractions" in a deed reserving or conveying an NPRI create a fixed or floating royalty interest. For example, does a deed reserving an NPRI stated as " $\frac{1}{4}$ of the $\frac{1}{8}$ royalty" reserve a fixed $\frac{1}{32}$ NPRI or a floating $\frac{1}{4}$ NPRI, calculated as $\frac{1}{4}$ of whatever royalty interest appears in existing or future leases? The question carries significant financial implications since the typical royalty in oil and gas leases has increased from $\frac{1}{8}$ in the 1930s to today's more generous $\frac{1}{5}$ or even $\frac{1}{4}$. There are two cases pending in the Texas Supreme Court that practitioners hope might resolve—or at least provide guidance on—the issue, but the Court has yet to accept review of either case. *See Thomson v. Hoffman*, No. 21-0711 (currently at the petition for review stage); *Van Dyke v. Navigator Grp.*, No. 21-0146 (currently at the briefs on the merits stage).



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- 20. White House Anti-Corruption Strategy.** The White House's December 2021 release of a detailed "Strategy on Countering Corruption" will result in a renewed government focus on the FCPA and other types of anti-corruption enforcement. While FCPA enforcement itself was relatively quiet the last several years, the DOJ and SEC also announced several enforcement-related policy changes during that time. Companies with international operations should consider their anti-bribery and corruption (ABC) and whistleblower policies in light of these changes and pay particular attention to third-party diligence.



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21. EPA Authority to Control Power Plant Emissions. The U.S. Supreme Court is set to determine the scope of EPA's authority to limit greenhouse gas (GHG) emissions from existing fossil fuel-fired power plants under Section 111(d) of the Clean Air Act (CAA). EPA has tried twice already to regulate GHG emissions from the power plant sector. The first rule, the expansive 2015 Clean Power Plan (CPP), was challenged and stayed by the Court before it went into effect and was later repealed when EPA issued a narrower replacement in 2019, the Affordable Clean Energy (ACE) rule, which was overturned in January 2021 by the D.C. Circuit. EPA's efforts to craft a third rule might be constrained by the Supreme Court, however, which will hear oral argument on February 28, 2022, regarding whether EPA's authority under the CAA to set GHG emissions standards is limited to measures that will reduce GHG emissions at the source itself or whether EPA has broader authority to set emission standards at fossil fuel-fired power plants that take into account greater use of renewables or demand side management and emissions trading. The Court's forthcoming ruling will shape EPA's next attempt to regulate GHG emissions from power plants under Section 111(d).



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22. Disputes Arising Out of Changes in Government Policies in the Energy Sector.

We are observing an accelerating legislative trend led by governments in several jurisdictions having enacted new policies in the energy sector. New policies have had (or are likely to have) a dramatic impact on energy companies and their assets. For example, several European States have recently announced new legislation aimed at accelerating the phase-out of coal and/or altering renewable energy subsidy regimes. In some cases, by enacting such legislative changes, States risk breaching investors' legitimate expectations and may thereby fall foul of their obligations under international investment treaties. For example, the Kingdom of the Netherlands is facing international claims from investors over its 2019 Climate Act which introduced a phased ban of the use of coal to generate electricity. Some States have recognized investors' entitlement to compensation for the financial impact of the overhauled energy policies (e.g., Germany in the Vattenfall case arising out of Germany's nuclear phase-out). We foresee intensified litigation activity involving energy companies seeking redress for losses caused by changes in energy legislation.



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23. State Tax Energy Infrastructure Litigation. Taxing agencies across multiple states are taking increasingly aggressive positions on sales and use tax issues, forcing taxpayers to dispute and litigate the taxability of transactions that have not previously been treated as taxable. On a separate front, opponents of new energy infrastructure projects continue to assail the validity of tax incentive agreements between local governments and developers as a putative basis for stopping the development of those projects. Those attacks compound the difficulty for major energy infrastructure developers who also face challenges from state legislatures and agencies skeptical of broad application of tax-inventive programs. We do not see any of these trends slowing in the foreseeable future and are actively involved in litigation on each front.



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24. **Environmental Justice Focus.** Environmental agencies are increasingly focused on justice issues in their decisions on permits, rulemaking and enforcement. Our energy clients are expanding their awareness and active engagement of community issues in all of their environmental programs.



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25. **Tensions Between Oil and Gas Activities and New Renewables Development.** With continued emphasis on renewable energy development, disputes can arise between efforts to foster that development and ongoing oil and gas activities. The El Paso Court of Appeals recently recognized this tension, noting that while “Texas produces the nation’s largest share of oil and gas,” “its public policy favors adding renewable energy sources into the State’s energy portfolio.” *Lyle v. Midway Solar, LLC*, 618 S.W.3d 857, 862 (Tex. App.—El Paso 2020, pet. denied). The *Lyle* court went on to address the potential application of the accommodation doctrine—a traditional oil and gas concept—in a dispute between mineral estate owners and a solar energy company that had entered into a surface lease to construct a solar energy facility on a portion of the property. As renewable energy projects expand throughout the State, we expect to see similar disputes arise and will be keeping a keen eye on how courts balance the potentially competing interests at play in these scenarios.



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26. **Redesign of the Texas Power Market.** In February 2021, Winter Storm Uri left many Texans without power for days and took a toll in terms of both lives and dollars. In the wake of the storm, the Texas Legislature passed a number of statutes calling for changes to the Texas power market, especially the Electric Reliability Council of Texas (ERCOT) market. The Public Utility Commission of Texas (PUCT), ERCOT, and a broad array of stakeholders began last year to grapple with how best to design and implement changes to meet the legislative mandates. Already the PUCT has dramatically lowered the price cap for wholesale power in ERCOT and directed ERCOT to begin a number of design changes, with more to come. ERCOT will be challenged to meet the aggressive timetable set for these market changes with its current financial and human resources. As these changes move to the stage of actually drafting new market rules, we expect lively and important debates among stakeholders regarding the details that have yet to be worked out on issues as varied as demand response programs, new ancillary services, on-site or emergency fuel requirements, weatherization, and credit requirements for market participants.



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27. **Anti-Dilution Provisions in Oil and Gas Leases.** Oil and gas leases may place restrictions on the lessee’s pooling authority to protect the interests of the lessor. One such restriction is an anti-dilution provision, which stipulates that a specified amount or percentage of lease lands must be included when pooling the lease into a unit. Failure to comply with anti-dilution provisions can lead to disputes over the validity of the pooling and the royalties owed. Lessees who want to pool lands from multiple leases should be wary of conflicting anti-dilution provisions and determine how to handle them in advance of pooling.



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- 28. FTC and State AG Cybersecurity Enforcement.** Federal regulators and state attorneys general will likely step up enforcement efforts against companies that fail to maintain reasonable security. In 2022, the FTC is widely expected to promulgate data security rules that would impose steep civil penalties on companies that fail to comply, and state AGs will continue to bring individual and multistate actions involving data breaches and security issues.



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- 29. Contractual Disputes Arising Out of Major Weather Events.** Last year brought severe weather events— such as Winter Storm Uri and wildfires across the western United States—that affected deliveries of oil and gas product and threw a wrench in the “normal course of business” for many actors in the energy sector. Accordingly, there has been a large uptick in contractual disputes and force majeure-related litigation. As these events seem to become a more “regular” part of our lives with each passing year, businesses should be prepared to respond to these types of suits and proactively guard their companies against liability and loss that may result from such emergencies.



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- 30. How the Supreme Court’s Administrative-Law Revolution Affects the Energy Industry.** The Supreme Court has recently expounded upon the so-called “major questions” doctrine, which holds that Congress must speak clearly if it wishes to delegate regulatory authority to an administrative agency over questions of “vast economic and political significance.” In cases involving OSHA’s vaccine mandate and the CDC’s eviction moratorium, the Court invalidated sweeping agency action after finding that the relevant statutory language was too ambiguous to authorize unilateral agency action on these major questions of American life. What does the rise of the major questions doctrine mean for the energy industry? May EPA use ambiguous and seemingly narrow statutory power to impose emissions controls to force power plants to switch from coal to clean energy? May EPA use its authority to impose emissions limits on automobiles to force manufacturers to shift their fleets from combustion engines to zero-emissions vehicles? These and other issues will be addressed in the coming years, as the Court grows increasingly aggressive in enforcing limits on administrative power.



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- 31. EPA Methane Rules.** In November 2021, EPA published proposed New Source Performance Standards (NSPS) designed to reduce methane emissions from the oil and natural gas sector. The proposal would expand NSPS requirements for sources that are new, modified, or reconstructed after November 15, 2021, and includes standards for sources not previously regulated. EPA is also proposing the first nationwide emission guidelines for states to limit oil and gas methane emissions. Finally, the proposal would reaffirm the Agency’s pre-2020 interpretation of Clean Air Act Section 111(b)(1), whereby EPA does not need to make a pollutant-specific contribution finding in order to promulgate an emission standard for a pollutant emitted by a source category. EPA is accepting public comments until January 31, 2022 and intends to issue a supplemental proposal that will include regulatory language. EPA expects to issue a final rule in October 2022.



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- 32. Hydrogen Disputes.** Hydrogen is expected to be key in efforts to reach net zero emissions. Given that hydrogen involves establishing an entirely new value chain and is not just another addition to the renewable energy economy, we expect disputes to arise at various junctures. It is not yet clear, for example, how governments will verify and issue certification of hydrogen as green. There is uncertainty involving the downstream and offtake elements of the value chain, as more than 80% of investments in hydrogen have focused on upstream processes. The development of an interconnected transportation network for hydrogen will require extensive repurposing and retrofitting of existing gas pipelines and infrastructure. Because hydrogen production is dominated by multi-party joint ventures, disputes will arise from these contractual arrangements. We can, in addition, expect to see disputes over carbon taxes on hydrogen imports, and investment disputes arising from changes to a legal and regulatory framework.



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- 33. FERC Continues Push for Enhanced Grid Security.** FERC continues to prioritize efforts to enhance the cyber security of the Bulk Electric System (BES). For example, FERC proposed in a January 20, 2022 notice of proposed rulemaking to direct the North American Electric Reliability Corporation (NERC) to develop new or modified Critical Infrastructure Protection (CIP) Reliability Standards incorporating an Internal Network Security Monitoring requirement. This proposal is intended to further mitigate inadvertent cyber security risks to the BES that can be presented by trusted actors. Implementation of any such CIP revisions would necessarily present novel regulatory risks for market participants and require those market participants to modify existing compliance policies and procedures.



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- 34. Energy Sector Use of Securitization.** In the energy sector, "securitization" refers to the issuance of bonds to finance extraordinary costs which are then collected over time, usually through charges on customer bills. Because they are statutorily authorized and backed by statutory guarantees of repayment, they provide a lower cost financing tool than traditional forms of utility cost recovery. Originally employed in the energy sector to allow utilities to recover their "stranded costs" following deregulation, securitizations have more recently been used to recover large costs associated with storm restoration and coal plant retirements. Following the February 2021 winter storm that affected much of the country, a number of states (Texas, Oklahoma, Kansas, and Arkansas) passed new securitization legislation to address the enormous costs—system restoration, high natural gas spot market prices, high prices for wholesale electricity and ancillary services—resulting from the storm. Other states are considering similar securitization statutes. Many of those securitizations will take place during 2022 and will generate new charges on customer bills for the next 5, 10, 15, or 20 years, or perhaps even longer.



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35. New Criteria for Transmission Lines in Texas. Because most of the power grid in Texas is a purely intrastate system, free from interstate squabbles and subject to more limited federal oversight, Texas has been successful in building significant new electric transmission infrastructure while other areas of the country have struggled to do so. In 2021, the Texas Legislature made two changes to increase the consideration given to reliability issues by the Public Utility Commission of Texas (PUCT) when reviewing proposed transmission projects. First, the new law requires that when an application for a new transmission project is being justified on reliability grounds, the PUC must consider historical load, forecasted load growth, and additional load seeking interconnection. Second, the new law requires that when an application for a new transmission project is being justified on economic grounds, the costs and benefits to be considered are the costs and benefits to consumers (not to the utility or to generators) and that the cost-benefit analysis consider current and future expected congestion levels and the ability of the proposed project to reduce such congestion. The final changes to existing rules to implement the new statutes is likely to affect the relative ease or difficulty of obtaining approval for new transmission projects in Texas.

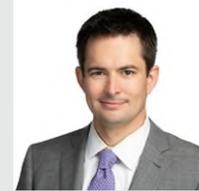


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36. Behind the Meter Power Arrangements. There has been a dramatic increase in interest among those who produce electric power (generation) and those who use it ("load") in co-locating power generation facilities and power consuming facilities. In many instances, parties wish to add new generation "behind the meter" at an existing load site (a solar facility next to a manufacturing facility, e.g.) or to add new load at an existing generation site (a bit coin mining facility next to a gas-fired power plant, e.g.). Placing the new facility "behind the meter," so it sits on the other side of the existing facility from, and is not connected to, the existing power grid can offer various operational, engineering, and cost advantages. However, as these arrangements have grown in popularity, grid operators, regulators, and utilities have also paid increasing attention to implications for grid reliability and transmission system cost allocation. In many areas of the country, regulations have not fully caught up to the increased interest. The coming year is likely to see rapid and perhaps contentious developments in the rules and regulations applicable to behind the meter projects.



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37. Return to Work. Energy companies will continue to grapple with the effects of the pandemic and we expect the coming year will bring new challenges as the "at home" workforce continues to return to a much different office than they left in 2020. This could have any number of ripple effects from increases in FMLA claims as employees are working increasingly set office hours, to challenges with what client entertainment will be allowed, to how to decide which employees will work remotely on a permanent basis.



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