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by Peter S. Glaser, Carroll W. McGuffey, III, & Hahnah Williams Gaines

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Likewise, we hope that members find the work in the pages to be well-crafted and informative. Articles are typically chosen by our Practice Group chairmen, but we strongly encourage members and general readers to send us their commentary and suggestions at info@fed-soc.org.

Sincerely,

Christian B. Corrigan

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Environmental Law & Property Rights

EPA's Section 111(d) Carbon Rule: What if States Just Said No?

*By Peter S. Glaser, Carroll W. McGuffey, III, & Hahnah Williams Gaines**

Note from the Editor:

This article is about whether sue and settle practices undermine congressional intent for cooperative federalism on environmental matters. As always, the Federalist Society takes no position on particular legal or public policy initiatives. Any expressions of opinion are those of the authors. The Federalist Society seeks to further discussion about sue and settle, federalism, and the Environmental Protection Agency. To this end, we offer links below to other perspectives on the issue, and we invite responses from our audience. To join this debate, please email us at info@fed-soc.org.

Related Links:

• Carbon Pollution Standards, Environmental Protection Agency: http://www2.epa.gov/carbon-pollution-standards/what-epa-doing

• Clean Air Act: SCCCL's 2011 Section 111 Project, Columbia Law School Sabin Center for Climate Change Law: http://web.law.columbia.edu/climate-change/clean-air-act

• Megan Ceronsky & Tomas Carbonell, *Section 111(d) of the Clean Air Act: The Legal Foundation for Strong, Flexible & Cost-Effective Carbon Pollution Standards for Existing Power Plants*, Environmental Defense Fund (Oct. 2013): http://blogs.edf.org/climate411/files/2013/10/Section-111d-of-the-Clean-Air-Act-The-Legal-Foundation-for-Strong-Flexible-Cost-Effective-Carbon-Pollution-Standards-for-Existing-Power-Plants-O.pdf

• Legal Memorandum for Proposed Carbon Pollution Emission Guidelines for Existing Electric Utility Generating Units, Environmental Protection Agency (June 2014): http://www2.epa.gov/sites/production/files/2014-06/documents/20140602-legal-memorandum.pdf

Introduction

"[W]here the Federal Government directs the States to regulate, it may be state officials who will bear the brunt of public disapproval, while the federal officials who devised the regulatory program may remain insulated from the electoral ramifications of their decision." These words, quoted with approval by Chief Justice Roberts in the Supreme Court's recent decision striking down the portions of the Affordable Care Act that attempted to coerce States to accept a significantly expanded Medicaid program,[1] apply with particular force to the latest proposal of the Environmental Protection Agency (EPA or Agency) to regulate greenhouse gases from the nation's coal-fired power plants.[2] In that proposal, promulgated under Section 111(d) of the Clean Air Act (CAA),[3] EPA seeks to compel States to become the enablers of the Administration's vision of what a "transformed"—and much more costly and unreliable—electric utility system should be. The question is, what if States refuse to go along? What if States refuse to give EPA the aggressive carbon-reduction plans the Agency is demanding?

Some States have good reason to resist. EPA's proposed regulations require States to submit plans establishing power-sector carbon dioxide performance standards. These standards must meet what EPA calls "goals" but which in reality are EPA-established State-by-State emissions caps. EPA developed these "goals" based on an aggressively unrealistic set of "building block" assumptions as to how each State should reengineer its electric grid to reduce the use of coal-fired electricity: (a) EPA assumed that coal plants can operate six percent more efficiently than they do now, when these plants already have every incentive to operate as efficiently as possible; (b) it assumed that every natural gas combined-cycle generator could operate 70 percent of the time, thereby reducing coal generation, even though only 10 percent of these generators operated at that level in 2012 when the country experienced historically low natural gas prices; (c) it assumed that every State should adopt aggressive renewable portfolio standards, even though only about half the States have those standards now and most of those that do have standards have less aggressive ones; and (d) it made truly heroic assumptions about future reductions in electric demand, including the assumption that electric demand in 2030 will be little higher than it is today,[4] and in fact will decline between 2020 and 2030,[5] even though the Census Bureau projects that the country will add more than two million people *per year* between now and then[6] and even though at some point the country should return to normal economic growth rates.

Given the stringency of EPA's goals, States would be required to adopt plans that are so onerous for coal generation that, according to the Agency's own projections, the amount of coal used for electric generation in this country would decline by almost 40 percent from 2009 levels.[7] As higher-cost electric resources replace coal, costs to utilities and their ratepayers would skyrocket. The well-respected economic consulting and analysis firm, NERA, concluded that the proposal is the most

* *Peter S. Glaser, Carroll W. McGuffey, III, & Hahnah Williams Gaines are attorneys with Troutman Sanders LLP.*

expensive environmental regulation ever imposed on the electric power sector, costing between $41 and $73 billion per year, with 14 states facing peak year electricity price increases that could exceed 20%.[8] Worse, regional grid reliability coordinators have already begun warning that the rule will cause portions of the grid to suffer "cascading outages" and "voltage collapse."[9] The North American Electric Reliability Corporation (NERC), the entity responsible for ensuring the reliability of the Nation's grid, recently produced an initial analysis that questioned the validity of the basic assumptions underlying the rule and raised a host of concerns as to how the rule could affect the grid.[10]

EPA's proposal is unprecedented in the 40-year history of the Section 111 performance-standards program, both in its severity and in its conceptual underpinnings. Before now, the agency has always formulated Section 111 standards based on what have come to be referred to as "inside-the-fence" measures—cost-effective actions that can be undertaken at the regulated facility itself, such as installing pollution controls.[11] When it comes to controlling carbon dioxide emission from coal generators, however, EPA obviously did not think that inside-the-fence measures would yield a sufficient level of emission reductions. EPA has conceded that the only feasible inside-the-fence measure for reducing coal-plant carbon dioxide emissions is improving the efficiency of the combustion process.[12] But even under EPA's highly aggressive assumptions as to the efficiency gains existing generators can hypothetically make, the result is only a six percent reduction in carbon dioxide emissions,[13] which is far short of the President's carbon goals.[14]

As a result, EPA has "creatively" reinterpreted its Section 111 authority for adopting performance standards and, for the first time, has proposed standards based on "outside-the-fence" actions. To do so, EPA has seized upon Section 111*(d)*, an obscure, seldom-used regulatory provision, to dictate a fundamental overhaul of the nation's electric system, a course that Congress rejected when it refused to adopt cap-and-trade legislation in the first two years of the current Administration when the Democrats had control of the House and a filibuster-proof majority in the Senate. Under EPA's Section 111(d) proposal, States are required to develop and implement plans to drastically increase the use of natural gas and renewable power, and to make sharp reductions in consumer use of electricity, in order to drive down the use of coal power to meet EPA's carbon-reduction goals.

EPA's proposal places many States in an extremely difficult, even untenable, position. EPA gives States only one year following final adoption of the rule to submit a plan that meets EPA's requirements.[15] This schedule may be administratively impossible for some States to meet given the monumental task of redesigning the State's electric system. Under other CAA programs, States typically are given up to three years to submit implementation plans to EPA,[16] and those plans are much less complex than the plan EPA demands here. Additionally, reengineering the State power grid is outside the authority and expertise of state environmental agencies. As to expertise, unlike any prior rule, this proposal will require the State environmental agencies to consult closely with numerous other state agencies and authorities that do have that expertise—at a minimum, the State public utilities commission and/or commerce commission, and the myriad of local electric authorities and boards responsible for municipal power and electric cooperatives. In addition to this cross-agency coordination, States must also coordinate with an unusually broad array of stakeholders, not only power industry and NGO representatives, but also manufacturers and other ratepayer and consumer advocate groups.

As to authority to act, the plan will almost certainly require additional state legislation. In many states, no single state agency has all of the authority that would be required to implement EPA's outside-the-fence measures. State legislation would be necessary to fill those authority gaps. The needed legislation is very unlikely to be adopted within a year (some legislatures meet only biannually), and some State legislatures may refuse to adopt the legislation at all. Although EPA's proposal gives States the option of taking two years to submit a plan under certain circumstances, States must still submit an "interim" plan within one year in which they make the critical decisions,[17] which some States may not be able to do. The proposal also allows a third year for plan submission, but only if the State opts into a regional plan[18] that will be very difficult to negotiate.

The State's task is made even more unpalatable by the prospect that the rule stands a high probability of ultimately being reversed in court, thus rendering worthless the extensive time, resources and political capital devoted to preparing the State's plan. The Supreme Court recently struck down EPA's greenhouse gas "Tailoring Rule" because "it would bring about an enormous and transformative expansion in EPA's regulatory authority without clear congressional authorization."[19] In the authors' opinion, the Court's ruling is a death knell for EPA's far more "enormous and transformative" Section 111(d) proposal. Indeed, EPA may not have authority to adopt *any* Section 111(d) regulations governing carbon dioxide emissions from the power sector, even much more modest inside-the-fence regulations.[20]

The challenge EPA's proposal poses to States is not just administrative, however; for many States, the rule will create real hardship for the States' citizens. EPA's proposal is built on a fault line, with California and northeastern and northwestern States, which do not use much coal, on one side, and most midwestern and southern States, which use much more coal, on the other. Coal-using States will be subjected to high compliance costs, which ultimately must be borne by the public in the form of significantly increased electric rates. For instance, the Midwest Independent System Operator (MISO), the grid operator for a region covering all or part of 15 States, preliminarily estimated that, just in MISO, the 20-year discounted compliance cost of the rule will be $55-$83 billion.[21] States will also be extremely concerned with the rule's impacts on the reliability of the power grid. Nick Akins, Chairman & CEO of American Electric Power, testified to Congress that last winter's cold weather required the company to operate 89 percent of the coal capacity that AEP will retire in 2015 due to EPA's Mercury and Air Toxics Standards rule.[22] Cheryl LaFleur, Chair of the Federal Energy Regulatory Commission (FERC) told a FERC conference that skyrocketing electricity and natural gas prices last winter

brought the electric grid "close to the edge" of breaking on several occasions.[23] And this was before EPA's Section 111(d) rules were even proposed, much less implemented. Examining the impact of the Section 111(d) rules in its 12-state region, the Southwest Power Pool concluded that the rules, as proposed, will result in violations of grid reliability standards leading to rolling blackouts and will leave the region far below needed reserve margins by 2020 and below the amount of power needed to meet load even without considering reserve margins by 2024.[24]

States, thus, may be taking a hard look at their options if EPA finalizes its Section 111(d) regulations anywhere near the lines proposed. Of course, many States will appeal the rule. But obtaining a judicial stay of the rule during the pendency of the litigation is always difficult, no matter how flawed the rule, and if no stay is obtained, it will likely take a year-and-a-half to two years for the appellate court to issue its decision, and additional time will be consumed if the case goes to the Supreme Court. In the meantime, States will be under a mandate to undertake enormously controversial and resource-draining administrative and likely legislative proceedings to prepare a hugely impactful plan that at least some States believe is antithetical to the interests of their citizens.

Thus, some States may be considering the consequences of either not submitting a plan at all or submitting a plan based on whatever traditional cost-effective, inside-the-fence measures may be available to reduce coal-plant carbon dioxide emissions, at least until a court determines that EPA's outside-the-fence approach is legally valid. They may wonder, if they take that course of action, what EPA's alternatives would be in response. The most obvious EPA option would be to impose a federal plan, an action EPA is expressly authorized to take under Section 111(d). But can EPA really impose a plan on States that contains outside-the-fence measures, such as ordering the State to adopt a renewable portfolio standard or placing a limit on the amount of electricity the State's citizens can consume? If EPA is unwilling or unable to impose outside-the-fence measures, would EPA just proceed against the State's coal generators, by limiting the amount of time these plants could operate so as to reduce their carbon dioxide emissions? Doing so risks leaving the State short of power. Would EPA want to be directly responsible if, as many States believe, the consequence could be power outages and significantly increased electric rates to consumers? And could EPA impose sanctions if a State fails to adopt a plan that EPA views as satisfactory?

These questions are explored below.

I. EPA Does Not Have Authority to Impose Sanctions

The notion that EPA could impose sanctions if States fail to submit the plan EPA demands can be dismissed quickly: EPA does not have that authority. EPA has not cited any such authority in its power-sector Section 111(d) rules, EPA's generic Section 111(d) rules do not provide for sanctions and provide only that EPA may impose a federal plan if a State fails to submit a "satisfactory" plan or no plan at all,[25] and Section 111(d) itself likewise authorizes only the single remedy of a federal plan.[26]

But what if EPA threatens to cut federal highway funds to the state or take administrative or judicial enforcement actions leading to penalties? While these sanctions are provided for under Section 179 (highway funding)[27] and 113 (administrative and judicial enforcement)[28] of the Act, neither authorizes sanctions for failure to comply with Section 111(d).

A. Section 179

Section 179 provides that EPA can cut off federal highway funding or increase the number of emissions offsets required for construction of new facilities in nonattainment areas under the National Ambient Air Quality Standards (NAAQS) program, if a State fails to comply with certain CAA obligations. But this provision plainly applies only to two types of State plans: (a) "any implementation plan or plan revision required under this part," meaning part D of Title I of the CAA, and (b) any such plan or plan revision "required in response to a finding of substantial inadequacy as described in section 7410(k)(5)."[29]

A State failure to submit a Section 111(d) plan (or failure to submit what EPA would view as a satisfactory plan) would not be a failure to submit a plan under part D of the CAA. Part D applies to NAAQS nonattainment State Implementation Plans (SIPs) submitted under Section 110 of the Act, not Section 111(d) performance-standards plans. As EPA states in its *Criteria for Exercising Discretionary Sanctions Under Title I of the Clean Air Act*, "section 179 provides for mandatory sanctions with respect to failures under part D…."[30] A Section 111(d) plan is obviously not a Section 110 nonattainment SIP.

Nor would a State's failure to submit a Section 111(d) plan (or failure to submit a "satisfactory" plan) be actionable under Section 7410(k)(5). A Section 7410(k)(5) inadequacy finding can be made only for inadequate SIPs under Section 110, not Section 111(d) plans. EPA has made clear that a Section 111(d) plan is not the same as a Section 110 SIP. Section 111(d) provides that EPA shall adopt regulations establishing a "procedure similar to" the Section 110 procedure for the submission of State plans. As EPA states, "[a]lthough there are similarities in the two programs,"[31] a "section 111(d) state plan is not a CAA section 110 state implementation plan (SIP)."[32] EPA also notes "the significant differences between CAA sections 110 and 111."[33]

In sum, EPA would have no basis to threaten a State's highway funding or to impose additional nonattainment area offset requirements if a State refused to submit a Section 111(d) plan or submitted one based only on cost-effective, "inside-the-fence" measures.

B. Section 113

EPA would also have no basis to impose sanctions under Section 113. Section 113(a)(3) provides that whenever "the Administrator finds that any person has violated, or is in violation of, any other requirement or prohibition of this subchapter … including, but not limited to, a requirement or prohibition of any rule," the Administrator can impose penalties, compel compliance, bring a civil action, or even request that the Attorney General commence a criminal action. Since the CAA defines any "person" to include a State, and since "this subchapter" includes Section 111(d), Section 113 might seem relevant in this context at a first glance.

Unquestionably, however, the Administrator could not

use Section 113 to take action against a State for failure to submit a satisfactory Section 111(d) plan. A long line of firm Supreme Court precedent, most recently the Court's decision in the Affordable Care Act case, confirms that the federal government can only seek to incent State participation in a federal regulatory scheme; it cannot compel compliance. "[T]he Constitution simply does not give Congress the authority to require the States to regulate," wrote Chief Justice Roberts in the Affordable Care Act case.[34] "That is true whether Congress directly commands a State to regulate or indirectly coerces a State to adopt a federal regulatory system as its own. Permitting the Federal Government to force the States to implement a federal program would threaten the political accountability key to our federal system."[35] This rationale has been used to reject the notion that States could be penalized under Section 113 for failing to regulate under the CAA.[36]

In short, EPA cannot invoke Section 113 to force States to comply or penalize a State's decision not to cooperate with EPA under Section 111(d).

II. EPA Authority to Impose Its Own Plan—A Credible Threat?

Although EPA lacks sanction authority, it definitely has authority under Section 111(d) to impose a federal plan if a State fails to submit a "satisfactory" plan (or does not submit one at all). But the Agency will face its own difficult challenges should it attempt to develop and implement federal Section 111(d) plans. In the first place, it is absolutely clear that EPA lacks authority under Section 111(d) to impose a federal plan containing outside-the-fence measures, such as ordering the State's natural gas generators to produce more electricity or the State's utilities to acquire more renewable or demand-side resources. Under Section 111(d), a performance standard is an "emission limitation;" it is not a standard for facilities to operate *more* which, in the case of natural gas generators, would have the effect of increasing those generators' emissions. Not even FERC or the Department of Energy, much less EPA, has authority to order electric generation facilities to operate more.[37] In addition, renewable sources of energy don't emit anything at all, and therefore cannot be regulated as a "stationary source" of emissions under the CAA. The notion that EPA could force increased natural gas and renewable energy generation is thus hollow.

As a result, EPA's federal-plan authority would be limited to inside-the-fence measures applied to coal plants. But given its aggressive carbon-reduction goals, EPA could not establish the traditional type of emission-rate limitations, based on cost-effective, inside-the-fence measures, that it has previously adopted under the New Source Performance Standards program, where facilities could operate as much as they wish so long as they meet the emission-rate standard. Instead, to impose its aggressive carbon goals through federal plans, the Agency would have to order a hard limit on a State's coal-plant operations, either through a limitation on the plants' annual carbon dioxide emissions or a limitation on their annual hours of operation (which are effectively the same thing). Since EPA could not order other generating facilities to operate more (or the State's electric consumers to consume less), EPA would leave it to the State to figure out how to replace the coal generation that EPA has prevented from operating.

Given the stakes involved, it is hard to imagine that EPA would want to take this action. States that do not submit the type of plan that EPA is demanding would be motivated by real fear that the plan EPA wants would create unacceptable consumer electric rate increases and jeopardize reliable operation of the grid. If EPA dismisses these concerns and simply mandates that the coal generators operate less, it takes the risk that other resources will be not be available in the time frame needed to maintain grid reliability. If it is wrong and blackouts or brownouts ensue, EPA would be the cause. The State would have done its best to resist this outcome—by advocating in comments and discussions with EPA and elsewhere that the agency should reformulate the rule, by challenging EPA's authority in court, and ultimately by refusing to be responsible for a plan that jeopardizes the State's electric system.

Oklahoma provides an illustrative example of the dilemma EPA would face. Coal and natural gas generation supply almost all of Oklahoma's electricity—45.5% of the State's generation is fueled with coal; 46.4% with natural gas.[38] Conventional hydro and other renewables supply the remaining amount.[39] In determining Oklahoma's carbon-intensity goal, EPA assumed that the State, by 2020, would replace roughly half its coal generation with natural gas generation.[40] If the State refused to submit the plan EPA wants, would the Agency really want to order Oklahoma's coal generators to halve their output, thus eliminating more than 20% of the State's total generation—in an environment where every other State from which Oklahoma could possibly purchase replacement electricity was also scrambling to cut coal generation and ramp up other generation to meet their own EPA-assigned goals?

Keep in mind that under EPA's proposed schedule, Oklahoma's plan would be due in June 2016, one year after the rule is finalized, and EPA's timetable for approving or disapproving the State plan would be June 2017.[41] EPA's proposed Section 111(d) rules do not state how long it would take EPA after it disapproved a State plan to impose a federal plan, but EPA over the years has been notoriously slow in acting on SIP submissions and formulating federal plans (even in the face of a statutory deadline). Assuming, in the best (and unlikely) case that EPA met its one-year deadline for disapproving Oklahoma's plan and simultaneously imposed a federal plan, the State would have little more than two-and-one-half years to find the substitute non-coal generation. Regardless of whether the agency does or does not have legal authority to order such reductions—and the State would surely argue that it does not—whether EPA would wish to take responsibility for the consequences of this type of action is another question altogether.

Oklahoma is not even the most extreme example. The "best" system that EPA has hypothesized for the States to meet their EPA-established goals would zero out coal generation in 12 States.[42] This would include Mississippi, where an electric utility currently has a $660 million scrubber project underway to meet other EPA regulations,[43] and Arizona, where several utilities have either recently undertaken or are in the process of undertaking pollution-control projects that cost in the hundreds of millions of dollars.[44] EPA's "best" system for meeting

its goal for Florida is to reduce coal generation by 90 percent.[45] Yet Florida utilities have recently invested almost $2 billion in pollution-control projects at those facilities.[46] Would EPA, whose regulations compelled these States' utilities to spend this money, now adopt a plan that would force these plants to close, simultaneously stranding these costs and jeopardizing grid reliability?

An additional consideration is the fact that the due date for EPA action on the State plan would be June 2017, meaning that the action would be due just six months into a new Administration, and EPA consideration of this action would take place during a Presidential election. Whether the outgoing Administration would wish to make anti-consumer EPA action a campaign issue, and whether a new Administration would wish to take on such a serious issue soon after taking office (or at all if a Republican President is elected), adds further complexity to the mix.

Certainly, EPA has imposed federal plans in the past. But EPA has never faced a situation where it will need to force a State to reengineer such an important sector of the State's economy with such potentially enormous consequences. The outcome of a State's refusal to comply cannot be predicted, but it would leave the State no worse off than if the State begrudgingly agreed to become EPA's partner in producing potentially disastrous consequences for the State. Moreover, the States challenge to EPA's disapproval of its State plan and implementation of a federal plan may well take place in a regional federal court of appeals rather than the D.C. Circuit.

III. Conclusion

The issue for States is how much they wish to collaborate in EPA's attempt to expand the CAA to make fundamental and irreversible changes to the power grid in a way that undoubtedly works for the Administration's political constituencies but will create severe harm in other areas of the country. In thoughtfully examining how to respond to EPA's demand that States lead from the front, while EPA leads from behind, States may conclude that challenging EPA to take public ownership of the consequences is preferable to acquiescence. Sometimes the best answer is to just say no.

Endnotes

1 Nat'l Fed'n of Indep. Bus. v. Sebelius, 132 S. Ct. 2566, 2602 (2012) (quoting New York v. United States, 505 U.S. 144, 168 (1992)).

2 Carbon Pollution Emission Guidelines for Existing Stationary Sources: Electric Utility Generating Units; Proposed Rule, 79 Fed. Reg. 34,830 (June 18, 2014).

3 42 U.S.C. § 7411.

4 See Data File: GHG Abatement Measures Scenarios 1 and 2 (3,773,750 GWh of consumption in 2014, rising to only 3,792,371 GWh in 2030).

5 EPA Clean Power Plan: Costs & Impacts on U.S. Energy Markets, Energy Ventures Analysis (Aug. 2014).

6 2012 National Population Projections, U.S. Census Bureau, http://www.census.gov/population/projections/data/national/2012/summarytables.html, Table 1, middle series projection.

7 EPA's Regulatory Impact Analysis for the Mercury and Air Toxics Standards rule reported power-sector coal use in 2009 as 942 million tons. Technical support information that the agency provided for its Clean Power Plan projects 576 million tons of power-sector coal use in 2030. *See* EPA spreadsheet G162, Data File, GHG Abatement Scenario 1.

8 Potential Energy Impacts of the EPA Proposed Clean Power Plan, NERA Economic Consulting (Oct. 2014).

9 Comment letter of Southwest Power Pool to EPA, October 9, 2014, p. 4.

10 Potential Reliability Impacts of EPA's Proposed Clean Power Plan, Initial Reliability Review, NERC (Nov. 2014), available at http://www.nerc.com/Pages/default.aspx.

11 Indeed, the statutory requirement for setting performance standards has usually been called "best demonstrated technology." *See, e.g.*, Julie R. Domike and Alec C. Zacaroli, The Clean Air Handbook, American Bar Association Section of Environment, Energy and Resources 2001, 328 (3d ed. 2011) .

12 *See* 79 Fed. Reg. at 34,836 (conceding that carbon capture and storage is not a feasible control technology for existing coal generators).

13 79 Fed. Reg. at 34,861.

14 *See* White House Release, President to Attend Copenhagen Climate Talks, (November 25, 2009) announcing goal of reducing greenhouse gas emissions by 17% below 2005 levels in 2020 and 83% by 2050.

15 79 Fed. Reg. at 34,915.

16 42 U.S.C. § 7410(a)(1).

17 79 Fed. Reg. at 34,915 & proposed § 60.5760(a).

18 79 Fed. Reg. at 34,915.

19 Utility Air Regulatory Group v. EPA, 134 S. Ct. 2427, 2444 (2014).

20 *See* In re Murray Energy Corp., No. 14-1112 (D.C. Cir.).

21 MISO, GHG Regulation Impact Analysis – Initial Study Results (September 17, 2014) (comparing the base-case with the more likely sub-regional (state-by-state) compliance case).

22 *Id.* at 2

23 Lynn Garner, *FERC Conference Highlights Problems of Using Natural Gas for Electric Generation* (BNA Apr. 1, 2014). *See also* Winter 2013-2014 Operations and Market Performance, FERC Docket No. AD 14-8-000 Technical Conference (April 1, 2014) (transcript at 6) available at http://www.ferc.gov/CalendarFiles/20140424112341-Transcript0401technical.pdf

24 "SPP'S Reliability Impact Assessment of the EPA's Proposed Clean Power Plan," attached to comment letter of Southwest Power Pool to EPA, October 9, 2014.

25 40 C.F.R. § 60.27.

26 42 U.S.C. § 7411(d)(2(A).

27 42 U.S.C. § 7509.

28 42 U.S.C. § 7413.

29 42 U.S.C. § 7509(a).

30 59 Fed. Reg. 1476, 1479-80 (January 11, 1994). *See also* EPA's Section 179 regulations, which "apply to any State in which an affected area is located and for which the Administrator has made one of the following findings with respect to any part D SIP or SIP revision required under the Act." 40 C.F.R. § 52.31(c). "Affected area" is defined as a nonattainment area. *Id.*, § 52.31(a)(3). It should be noted that Section 110(m), 42 U.S.C. § 110(m) provides that EPA may apply Section 179 sanctions "in relation to any plan," but only if EPA makes the findings required under Section 179(a)(1)-(4), which, as discussed, apply only to "any implementation plan or plan revision required under" part D.

31 79 Fed. Reg. at 34,909.

32 *Id.*

33 *Id.* at 34,834.

34 *Sebelius*,132 S. Ct. at 2602 (quoting *New York,* 505 U. S., at 178).

35 *Id. See also New York,* 505 U. S., at 175 (overturning a statute that sought to compel a State to enact certain waste regulations by requiring the State to take title of the waste if it did not).

36 Sierra Club v. Korleski, 681 F.3d 342, 351-52 (6th Cir. 2012) (Under *New York v. United States* and similar cases, Section 113 cannot be used to penalize a State for failing to regulate).

37 DOE has authority under the Federal Power Act, 16 U.S.C. § 824a(c), to order facilities to generate during an emergency, and of course a generation-owner, in joining an RTO or ISO, can accept tariff provisions under which it agrees to operate under certain conditions. But, of course, Section 111 of the CAA does not provide similar authority to EPA.

38 Institute for Energy Research, Oklahoma Energy Facts, www.instituteforenergyresearch.org/States (using EIA data).

39 *Id.*

40 *Id.* at column M.

41 79 Fed. Reg. at 34,951-52 & proposed §§ 60.5715, 60.5755.

42 Alaska, Arizona, California, Connecticut, Maine, Massachusetts, Mississippi, Nevada, New Hampshire, New Jersey, Oregon, and Washington, as shown on the EPA spreadsheet at http://www2.epa.gov/carbon-pollution-standards/clean-power-plan-proposed-rule-technical-documents-spreadsheets.

43 P*lant Daniel Scrubber Project More Than Halfway Complete, On Track for 2016 Completion*, GulfLive.com, Mar. 24, 2014, http://blog.gulflive.com/mississippi-press-news/2014/03/plant_daniel_scrubber_project.html (March 24, 2014, 5:38 PM).

44 Brief of Arizona Public Service Co. and Salt River Agricultural Improvement and Power District in *Arizona v. EPA*, No. 13-70355 et al. (Ninth Cir., August 19, 2013) at 5-6.

45 EPA spreadsheet at http://www2.epa.gov/carbon-pollution-standards/clean-power-plan-proposed-rule-technical-documents-spreadsheets.

46 *See* http://www.gulfpower.com/community/stewardship/air/plant-crist.cshtml., https://www.progress-energy.com/company/media-room/news-archive/press-release.page?title=Progress+Energy+Florida+completes+clean+air+project+at+Crystal+River+Energy+Complex+&pubdate=05-25-2010.

Federalism & Separation of Powers

Did Congress Really Give the Secretary of Homeland Security Unfettered Discretion Back in 1986 to Confer Legal Immigrant Status on Whomever He Wishes?

*By John C. Eastman**

Note from the Editor:

This article is about the executive action on immigration announced by President Obama on November 20, 2014. As always, the Federalist Society takes no position on particular legal or public policy initiatives. Any expressions of opinion are those of the author. The Federalist Society seeks to further discussion about immigration law, prosecutorial discretion, and the separation of powers. To this end, we offer links below to a variety of perspectives on the issue, and we invite responses from our audience. To join this debate, please email us at info@fed-soc.org.

Related Links:

- Ilya Somin, *Why Obama's Immigration Policy Is Constitutional*, Reason.com, Dec. 16, 2014: http://reason.com/archives/2014/12/16/why-obamas-immigration-policy-is-constit
- Eric Posner, *Obama's Immigration Plan Is Perfectly Constitutional*, Slate, Nov. 20, 2014: http://www.slate.com/articles/news_and_politics/jurisprudence/2014/11/obama_s_immigration_plan_the_constitution_allows_him_to_set_deportation.html
- Greg Sargent, *Gettiing Back to Basics in the Raging Debate over Deportations*, Wash. Post, Nov. 18, 2014: http://www.washingtonpost.com/blogs/plum-line/wp/2014/11/18/getting-back-to-basics-in-the-raging-debate-over-deportations/
- Erwin Chemerinsky & Sam Kleiner, *Obama Has the Law—and Reagan—on His Side on Immigration*, New Republic, Nov. 18, 2014: http://www.newrepublic.com/article/120328/obama-immigration-executive-action-why-it-will-be-legal
- Andrew C. McCarthy, *No, 'Prosecutorial Discretion' Does Not Justify Obama's Lawless Amnesty*, Nat'l Rev., Nov. 20, 2014: http://www.nationalreview.com/article/393094/no-prosecutorial-discretion-does-not-justify-obamas-lawless-amnesty-andrew-c-mccarthy
- John O. McGinnis, *The President's Disregard for Constitutive Norms*, Library of L. & Liberty, Nov. 25, 2014: http://www.libertylawsite.org/2014/11/25/the-presidents-disregard-for-constitutive-norms/
- Kate M. Manuel & Todd Garvey, *Prosecutorial Discretion in Immigration Enforcement: Legal Issues*, Congressional Research Service, Dec. 27, 2013: http://fas.org/sgp/crs/misc/R42924.pdf

There has been a lot of talk about prosecutorial discretion since November 20, 2014, when President Obama announced that he was unilaterally suspending deportation proceedings against millions of illegal immigrants. Despite the President's claim that his actions were simply "the kinds of actions taken by every single Republican president and every single Democratic President for the past half century," whether or not prosecutorial discretion can be stretched so far is actually an issue of first impression. But as serious as that issue is, it masks a much more fundamental constitutional question about executive power, for the President has not just declined to prosecute (or deport) those who have violated our nation's immigration laws. He has granted to millions of illegal immigrants a lawful status to remain in the United States as well, and with that the ability to obtain work authorization, driver's licenses, and countless other benefits that are specifically barred to illegal immigrants by U.S. law. In other words, he has taken it upon himself to drastically re-write our immigration policy, the terms of which, by constitutional design, are expressly to be set by the Congress.

One thing should be clear, though. What the President announced on November 20, 2014 is simply a difference in degree, not a difference in kind, of the unconstitutional action his administration took back in 2012 when it announced, via a memo, the Deferred Action for Childhood Arrivals (DACA) program. The purpose of this paper is to highlight just what the DACA program (and its November 20 expansion) did, the statutory and constitutional authority the President has claimed for the actions, and the serious constitutional problems with those claims.

First, the DACA program. On June 15, 2012, in a memorandum from then-Secretary of Homeland Security Janet Napolitano to the heads of the three immigration agencies (David V. Aguilar, Acting Commissioner, U.S. Customs and Border Protection (CBP); Alejandro Mayorkas, Director, U.S. Citizenship and Immigration Services (USCIS); and John Morton, Director, U.S. Immigration and Customs Enforcement

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(ICE)) (Attachment A), the Obama administration made several announcements, purportedly in the "exercise of prosecutorial discretion." The administration stated that it would not investigate or commence removal proceedings, would halt removal proceedings already under way, and would decline to deport those whose removal proceedings had already resulted in a final order of removal for a broad category of individuals who met certain criteria set out in the memorandum. Specifically, the following individuals would, categorically, receive what the Napolitano memo characterized as "deferred action": those who 1) came to the United States under the age of sixteen; 2) have continuously resided in the United States for at least five years preceding the date of the memorandum and are currently residing in the United States; 3) are currently in school, have graduated from high school, have obtained a general education development certificate, or are an honorably discharged veteran of the U.S. Coast Guard or Armed Forces; 4) have not been convicted of a felony offense, a significant misdemeanor offense, multiple misdemeanor offenses, or otherwise poses a threat to national security or public safety; and 5) are not above the age of thirty. Although the memo repeatedly asserts that these decisions are to be made "on a case by case basis," it is actually a directive to immigration officials to grant deferred action to anyone meeting the criteria. "With respect to individuals who meet the above criteria" and are not yet in removal proceedings, the memo orders that "ICE and CBP *should* immediately exercise their discretion, on an individual basis, in order to prevent low priority individuals from being placed into removal proceedings or removed from the United States." (emphasis added). And "[w]ith respect to individuals who are in removal proceedings but not yet subject to a final order of removal, and who meet the above criteria," "ICE *should* exercise prosecutorial discretion, on an individual basis, for individuals who meet the above criteria by deferring action for a period of two years, subject to renewal, in order to prevent low priority individuals from being removed from the United States." (emphasis added). USCIS and ICE are directed to "establish a clear and efficient process" for implementing the directive, and that process "shall also be available to individuals subject to a final order of removal regardless of their age."

By repeatedly using the phrase, "on a case by case basis," Secretary Napolitano seemed to recognize the existing norm that prosecutorial discretion cannot be exercised categorically without crossing the line into unconstitutional suspension of the law—without, that is, violating the President's constitutional obligation to "take care that the laws be faithfully executed." *See, e.g.*, *Heckler v. Chaney*, 470 U.S. 821, 832-33 n.4 (1985) (finding that judicial review of exercises of enforcement discretion could potentially be obtained in cases where an agency has adopted a general policy that is an "abdication of its statutory responsibilities"); *Kendall v. United States ex rel. Stokes*, 37 U.S. 524, 613 (1838) ("To contend that the obligation imposed on the President to see the laws faithfully executed, implies a power to forbid their execution, is a novel construction of the constitution, and entirely inadmissible"). Indeed, among the charges leveled against King George III in the Declaration of Independence was that he had suspended the laws and had declared himself "invested with power to legislate for us in all cases whatsoever." Moreover, the only federal court to have considered the issue in light of the DACA program held that the word "shall" in the relevant statutes mandated the initiation of removal for all unauthorized aliens, thus statutorily removing whatever prosecutorial discretion might otherwise exist. *Crane v. Napolitano*, 920 F. Supp. 2d 724, 740-41 (N.D. Tex. 2013);[1] 8 U.S.C. §1225(b)(2)(A) ("if the examining immigration officer determines that an alien seeking admission is not clearly and beyond a doubt entitled to be admitted, the alien shall be detained for a [removal] proceeding").

But even if that part of Napolitano's directive can properly be viewed as an exercise of prosecutorial discretion, Secretary Napolitano then went a significant step further. "For individuals who are granted deferred action by either ICE or USCIS," she ordered that "USCIS *shall* accept applications to determine whether these individuals qualify for work authorization during this period of deferred action." The memo does not describe how that determination should be made, but the notion that prosecutorial discretion can be used not just to decline to prosecute (or deport), but to confer a lawful status and work authorization as well, requires a distortion of the doctrine beyond recognition. The memo cites no legal authority whatsoever for this extraordinary claim.

Following the issuance of the Napolitano memo, legal experts and academics tried to find a hook for the President's asserted authority. Speculations centered on a particular federal regulation, 8 C.F.R. § 274a.12, which allows for work authorization for designated classes of aliens. Subsection (a)(10) of that regulation grants work authorization to "An alien granted withholding of deportation or removal for the period of time in that status . . ." and subsection (c)(14) allows for an application for work authorization by "An alien who has been granted deferred action, an act of administrative convenience to the government which gives some cases lower priority, if the alien establishes an economic necessity for employment." But as any first year law student knows, and as the regulation itself acknowledges, those provisions allowing for work authorization must be grounded in statutory authority, and none of the statutes cited in support of the regulation provide the necessary authority.

The regulation cites four statutory provisions: 8 U.S.C. §§ 1101, 1103, and 1324a, and 48 U.S.C. § 1806. We can safely dispense with the latter, as it deals exclusively with a transition immigration program for the Northern Mariana Islands. Section 1103 of Title 8 sets out the general authority of the Secretary of Homeland Security to administer and enforce the immigration laws; nothing in that provision gives the Secretary the discretion to ignore those laws.

Section 1101 is the "definition" section of immigration law, but through it, many of the authorizations for legal status are made by way of definitional exemptions from the general rule. The term "alien," for example, is defined in subsection (a)(3) as any person not a citizen or national of the United States. The term "immigrant" is, in turn, defined in subsection (a)(15) as every alien except an alien described in one of 22 separate statutory exemptions. This is where the "T" visa authority resides, so named because it is found in subsection (a)(15)(T). That provision very carefully delineates the authority to give a visa for lawful residence to victims of human trafficking

who are cooperating with law enforcement's investigation or prosecution of the trafficking crimes. Beyond these carefully delineated exceptions, there is no authority in this statute for the Attorney General, the Secretary of Homeland Security, the President, or any other executive official to grant authorization for legal status.

Section 1324a, which deals with employment of illegal immigrants, is the final authority cited in the regulation. Like Section 1101, it provides for certain authorizations by way of exemption from the general rule that employing an unauthorized alien is illegal. Section (a)(1) specifically makes it unlawful to hire "an unauthorized alien (as defined in subsection (h)(3) of this section)." Subsection (h)(3) in turn defines "unauthorized alien" as any alien who is not "lawfully admitted for permanent residence" (that would be all those carefully wrought exemptions in Section 1101(a)(15), such as the "T" visa) or an alien "authorized to be so employed by this chapter *or by the Attorney General*." (emphasis added). That last phrase, "or by the Attorney General" (and by extension the Secretary of Homeland Security, because of another statute transferring immigration duties from the Attorney General to the Secretary), is the only statutory hook anyone defending the President's actions in numerous debates I have had since the Napolitano memo was issued could point to. That is a pretty slim reed for all of the heavy lifting necessary to accept the President's assertion of complete discretion not only to decline to prosecute and/or deport illegal immigrants, but to grant them a lawful residence status and work authorization as well. Never mind that with such absolute discretion, none of the pages and pages of carefully circumscribed exemptions would be necessary. And never mind that the much more likely interpretation of that phrase is that it refers back to other specific exemptions in Section 1101 or Section 1324a that specify when the Attorney General might grant a visa for temporary lawful status, such as Section 1101(a)(15)(V), which allows the Attorney General to confer temporary lawful status on the close family members of lawful permanent residents who have petitioned the Attorney General for a non-immigrant visa while an application for an immigrant visa is pending. Here, then, is some text in the statute that, taken out of context and ignoring the elaborate web of requirements for eligibility for lawful status that had been carefully constructed by Congress over decades, purports to give the President, through the Attorney General, absolute discretion to ignore the lion's share of the nation's immigration laws.

And yet it is that slim reed, and that slim reed alone, which has now been confirmed as the only asserted source of authority. The same day the President announced his expansion of the DACA program to cover millions of additional illegal immigrants (November 20, 2014), the current Secretary of Homeland Security issued a memo of his own, stating: "Each person who applies for deferred action pursuant to the criteria above shall also be eligible to apply for work authorization for the period of deferred action, *pursuant to my authority to grant such authorization reflected in section 274A(h)(3) of the Immigration and Nationality Act*." (emphasis added) (Attachment B). As the U.S. Customs and Immigration Service explains on its website, "An individual who has received deferred action is authorized by DHS to be present in the United States, and is therefore considered by DHS to be lawfully present during the period of deferred action is in effect." That is why hundreds of thousands of DACA applicants were deemed to have "legal status," eligible to obtain work authorization and obtain driver's licenses (which were then used to open the door to a host of other benefits available only to citizens and those with lawful permanent residence). The new program will expand that number to millions, perhaps tens of millions. And it is a far cry from the exercise of prosecutorial discretion.

The section of the immigration law that includes the brief phrase on which this entire edifice has been erected was added in 1986 as part of the Immigration Reform and Control Act. The legislative record leading to the adoption of that monumental piece of legislation is extensive, but I have located no discussion whatsoever of the clause, much less anything supporting the claim that by including that clause Congress was conferring unfettered discretion on the Attorney General to issue lawful status and work authorization to anyone illegally present in the United States he chose, contrary to the finely wrought (and hotly contested) provisions providing for such lawful status only upon meeting very strict criteria.

Moreover, if the clause does provide the Attorney General (now Homeland Security Secretary) with such unfettered discretion, Congress has been wasting its time trying to put just such an authority into law. For more than a decade illegal immigration advocates have been pushing for Congress to enact the DREAM Act, the acronym for the Development, Relief, and Education for Alien Minors Act first introduced by Senators Dick Durbin and Orrin Hatch as Senate Bill 1291 back in 2001. The bill would give lawful permanent residence status and work authorization to anyone who arrived in this country illegally as a minor, had been in the country illegally for at least five years, was in school or had graduated from high school or served in the military, and was not yet 35 years old (although that age requirement could be waived). The bill or some version of it has been reintroduced in each Congress since, but has usually kicked up such a firestorm of opposition by those who view its principal provisions as an "amnesty" for illegal immigrants that even its high-level bipartisan support has proved insufficient to get the bill adopted.

But no matter. The President (or more accurately in this case, his Secretary of Homeland Security) in 2012 unilaterally gave effect to the DREAM Act as if it were law, and now has extended that "lawful" authorization to millions more. If the President already had the unilateral power to impose the DREAM Act and beyond, why all the angst in Congress for over a decade of trying to get the bill passed? Why did the President himself claim in 2011 that he had no such authority, when just a year later he claimed to have it?

This is not how our system of government is designed. Article I, Section 1 of the Constitution makes patently clear that "All legislative powers" granted to the federal government "shall be vested in" Congress, not the executive branch. And Article I, Section 8, Clause 4 makes clear that plenary power over naturalization is vested in Congress, not the President.

The Court has allowed Congress to delegate extensive regulatory authority to executive agencies, but requires that Congress provide an intelligible principle pursuant to which

the regulatory authority must be exercised. Although this important non-delegation principal has been weakened to near death by the courts over the last three-quarters of a century, the absolute and unfettered discretion that results from the President's interpretation of Section 1324a(h)(3) runs afoul of the non-delegation doctrine even in its moribund state. That cannot be the right answer under a Constitution devoted to the Rule of Law and not the raw exercise of power by men. The President's constitutional duty is to "take care that the laws be faithfully executed," not to rewrite them as he wishes, enforce them only when he wants, and otherwise render superfluous the great legislative body of the Congress, the immediate representatives of the ultimate sovereign authority in this country, "We the People."

President Obama was right about one thing when, in his November 20, 2014 speech, he stated: "Only Congress can do that." Indeed, there are few areas of constitutional authority that are more clearly vested in the Congress than determinations of immigration and naturalization policy. The Supreme Court has routinely described Congress's power in this area as "plenary," that is, an unqualified and absolute power. But the President went forward; contradicting even his own express statements over the past four years that he did not have the constitutional authority to do this.

Congress is not without constitutional checks on a president who exceeds his constitutional authority. It has the power to impeach a lawless President, for example—an important political check to constrain what is otherwise an awesomely powerful office. It also has the power of the purse, and it can use that power to prohibit the expenditure of funds for carrying out a president's dictate to extend work authorization to those not lawfully authorized to work.

Finally, there might well be viable litigation strategies. For example, lawfully authorized workers displaced by those to whom Obama has unlawfully extended work authorization have the kind of particularized injury that would give them legal standing to challenge the new policy. Workers compensation insurance carriers, too, might be able to challenge the policy, which forces them to extend coverage to those not legally able to work.

Endnotes

1 The Court subsequently ruled, however, that the claims in the case were within the exclusive jurisdiction of the Merit Systems Protection Board. *Crane*, No. 3:12-cv-03247-O, Order (N.D. Tex., July 31, 2013), available at http://www.crs.gov/analysis/legalsidebar/Documents/Crane_DenialofMotionfor-Reconsideration.pdf.

Financial Services & E-Commerce

Can the Dodd-Frank Act Be Reformed To Strengthen the Financial System and the Overall Economy? We Think So

By Wayne A. Abernathy & Alex J. Pollock***

Note from the Editor:

This article is about potential reforms to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The authors received extensive input from other members of the Federalist Society's Financial Services & E-Commerce Practice Group Executive Committee. Any expressions of opinion are those of the authors and/or the members of the executive committee who shared their ideas and recommendations. This is not an expression of the views of the Federalist Society, nor intended to influence the adoption of any particular legislation. Neither should it be considered an expression of the views of the firms or organizations with which the authors may be associated. The Federalist Society seeks to further discussion about the Dodd-Frank Act. To this end, we offer links below to other perspectives on the issue, and we invite responses from our audience. To join this debate, please email us at info@fed-soc.org.

Related Links:

• Center for American Progress, Dodd-Frank Financial Reform After 2 Years (July 2012): https://cdn.americanprogress.org/wp-content/uploads/issues/2012/07/pdf/dodd_frank.pdf

• Mike Konczal, *Ignore the Naysayers: Dodd-Frank Reforms Are Finally Paying Off*, The New Republic, Jul. 22, 2014: http://www.newrepublic.com/article/118814/dodd-frank-reforms-are-finally-paying

• Martin Neil Baily & Douglas J. Elliott, *Financial Reform Progress: Cause for Considerable Celebration and Some Concern*, Brookings Institution, Dec. 22, 2014: http://www.brookings.edu/research/opinions/2014/12/22-financial-reform-progress-celebration-concern-baily-elliott

• Hester Peirce & James Broughel, Dodd-Frank: What It Does and Why It's Flawed, Mercatus Center (2012): http://mercatus.org/publication/dodd-frank-what-it-does-and-why-its-flawed

I. Introduction & General Themes

A. Reform Amendments Already Approved by the House

During the 113th Congress, the House Financial Services Committee reported more than two dozen bills that amend provisions of the Dodd-Frank Act (DFA), in many cases with strong bipartisan majorities. Several of these have also been overwhelmingly passed by the House.

These bills address a variety of concerns that have been raised about DFA:

- Improving the operation of regulatory agencies created or impacted by Dodd-Frank. For example, one bill would subject the Bureau of Consumer Financial Protection (BCFP) to more accountability by replacing its sole director with a board and placing it under the regular Congressional authorization and appropriations processes. Another measure would require additional cost-benefit and economic impact analysis by the SEC of its regulations.

- Several bills would amend provisions regulating swaps or other derivatives.

- At least two would provide small business relief from DFA regulations or related securities laws.

These legislative proposals provide an excellent starting point for the 114th Congress to improve the supervision and regulation of the U.S. financial system.

B. Cost-Benefit Analysis Requirements for Rulemakings

For decades bi-partisan legislation and executive orders have required certain Federal financial regulators, including the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Office of the Comptroller of the Currency, to engage in cost-benefit analysis when preparing major and certain other rulemakings to ensure that rules are founded on facts and avoid imposing unnecessary burdens. However, these requirements are usually either ignored, do not apply to particular regulators (including the Federal Reserve), or are addressed in a cursory manner. Although the cost-benefit analyses of executive agencies have been subject to review by the Office of Management and Budget (OMB), the quality of that review has waxed and waned from administration to administration. With regard to *independent* agencies, there has been no administrative oversight of the quality of cost-benefit analyses. Rules that are not subjected to a good faith cost-benefit analysis not only fail to achieve their stated policy objectives, but they also hinder job creation and weaken the economy.

Financial regulators should be required to perform rigorous cost-benefit analysis as part of every rulemaking to get a

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full understanding of the potential impact of proposed rules, avoid flaws that could have been identified and addressed, and tailor rules to reduce regulatory burdens and more effectively achieve policy objectives. Additionally, financial regulators should be required to conduct further cost-benefit analysis at an appropriate time after rules have been implemented to determine the actual costs and burdens and make adjustments based on the new evidence.

C. Accountability for Financial Regulators' Activities in International Fora

Since Basel got into the business of developing global capital rules, U.S. regulators have gotten into the practice of taking financial regulatory issues to international bodies, working out "non-binding" global agreements, and then bringing them back to the U.S. to translate into very binding regulations. With the global imprimatur, U.S. regulators have been reluctant to deviate from the global deal in developing final rules. Key decisions are made away from the general view of the American public, embodying compromises to obtain global agreement, even when the compromises are out at odds with the realities of the U.S. markets and financial system.

U.S. regulators, before going abroad for negotiations on a regulatory project, should put the project out for advance public comment in the U.S. This can be done using the Advance Notice of Proposed Rulemaking (ANPR) procedures, inviting comment on the problem, its scope and consequences, and the possible avenues of resolution.

D. Extraterritoriality

U.S. financial regulators pursue some regulatory approaches not embraced internationally, and either to stimulate international cooperation or to ignore its absence the U.S. imposes final rules that follow U.S. firms, persons, or customers beyond U.S. shores. The result can place U.S. firms in a conflict of laws situation, drive foreign customers away from entanglements with U.S. firms or U.S. persons, and/or invite retaliation in kind by foreign regulators.

U.S. financial regulators need to refrain from extraterritorial application of their rules, seeking instead reciprocal or parallel arrangements with other governments wherever needed.

II. Specific Provisions

A. Reforming FSOC

DFA created a Financial Stability Oversight Council (FSOC), composed of the heads of the various financial regulators (and others), with powers that include designating individual financial institutions as systemically important (SIFIs) and then applying a heightened regulatory program as FSOC considers appropriate (administered by the Federal Reserve). Yet, the FSOC operates in an opaque fashion with closed hearings, little meaningful opportunity for public comment, and a lack of clear, objective standards for designating companies as systemic. By any measure, the FSOC's decision-making process violates the most basic notions of due process of law. Whether a company presents a systemic risk depends on whether the FSOC says it does, rather than whether a company satisfies transparent and specified metrics. The FSOC is a clear and far-reaching example of a transfer of important decision making authority from elected representatives to unelected officials of potentially a single political party (the current heads of the government agencies). In addition, the broad authority given to the FSOC raises questions about the institutional competence of the body to monitor systemic risk, since its member institutions failed to spot, and take action in response to, prior market bubbles and systemic risks such as government-sponsored enterprises involved in housing finance.

The following reforms would address some of these concerns:

- Congress should prohibit FSOC from making further designations of SIFIs until Congress has had the opportunity to review the authorities of FSOC and has, at a minimum, circumscribed its discretion and responsibilities in a manner that eliminates problems caused by its current broad authority and that is consistent with its institutional competence.

- Congress should designate government sponsored enterprises such as Fannie Mae and Freddie Mac as SIFIs, their systemic risks amply demonstrated in practice by the recent financial crisis.

- The FSOC should be reformed, at a minimum, to improve its transparency and establish specific metrics as to which activities would constitute systemic risks.

- The FSOC should have a clear process by which designated firms can take actions that would allow them to have their designations revoked.

- All private parties should have full, normal judicial recourse against the FSOC.

- The FSOC structure should be reformed to require that voting be conducted on an agency basis, rather than by the heads of an agency, to allow for the other Senate-confirmed principals of agencies to participate in the process.

- The Office of Financial Research (OFR) should either be repealed, with a requirement that financial regulators share data with the FSOC, or be removed from Treasury and placed in the Department of Commerce as a nonpartisan producer of information and analysis.

B. Artificial Asset Thresholds

Under the Dodd-Frank Act, all bank holding companies with assets of $50 billion or more are automatically subject to systemic risk regulation by the Federal Reserve, regardless of whether FSOC has identified any of these holding companies as being systemically significant. The Federal Reserve has exercised this authority by applying detailed, intrusive, and complex systemic risk regulation to all bank holding companies that satisfy the $50 billion threshold, regardless of the risks they present, even though the Dodd-Frank Act explicitly provides

that systemic risk regulation should be applied in a graduated fashion based on, among other factors, risk and accommodating different business models.

Congress should require the Federal Reserve to revise its systemic risk regulations to apply only where there are clear systemic risks and to focus such regulations on addressing these specific risks. This focus could help minimize systemic risk by signaling to the market which activities will face higher regulatory burdens, while also avoiding the imposition of unnecessary costs that are ultimately paid by bank customers and impact the economy generally by reducing the efficient allocation and management of capital.

C. Resolution Plans

DFA Section 165(d) requires certain financial institutions to submit to the FDIC and the Federal Reserve plans for the resolution of the institutions in case of failure. A fundamental problem is that the statute gives the FDIC and the Federal Reserve too much discretion to define the assumptions that companies are required to make in order for their resolution plans to avoid a determination that a company's plan is "not credible," a finding that can trigger a process of very intrusive regulatory mandates on healthy institutions, including potential reorganization, restructuring, and perhaps even divestitures. This discretion can result in assumptions that impose an immediate and substantial adverse impact on the U.S. economy, including on the supply and cost of money and credit, job creation, and economic output, in order to provide excessive protection against a remote event.

In order to restore balance and transparency to this process, Section 165(d) should be amended to:

- Require the FDIC and the Federal Reserve to make public, through a formal rulemaking, the assumptions that they would mandate that companies make under Section 165(d);

- Assign the Government Accountability Office (GAO) to conduct a study of the quantitative impact on the U.S. economy, including on the supply and cost of money and credit, job creation, and economic output of the United States, of any and all of these assumptions;

- Require the FDIC and the Federal Reserve to conduct a meaningful cost-benefit analysis of any assumptions required in resolution plans under Section 165(d) in order to avoid a "not credible" determination, subject to review by the OMB.

D. Stress Testing

The federal banking regulators primarily apply two stress test regimens, the Comprehensive Capital Analysis and Review (CCAR), and Dodd-Frank Act Stress Tests (DFAST). On the basis of the results of these stress tests, regulators impose a variety of conditions on banks, including limitations on dividends. While the stress-tests have many benefits, the process is too opaque and discretionary, which is inconsistent with the rule of law and good government, and is subject to the limitations of all modeling of future conditions (for example, none of the recent models included the impact of rapid decline in oil prices). In addition, CCAR and DFAST have become incredibly costly and time-consuming endeavors that interfere with the daily operations of institutions, making them less efficient and increasingly focused on satisfying regulatory requirements rather than on serving their customers.

In order to address these deficiencies, Title I should be amended to require the Federal Reserve to disclose to the public for comment the assumptions and parameters of the models it uses to conduct supervisory stress testing. It should also be amended to require regulators to conduct CCAR and DFAST in the least intrusive and least costly manner possible.

E. Orderly Liquidation Authority (Title II)

Title II of DFA creates an elaborate structure and set of rules for the orderly liquidation of failing financial institutions, where, it is assumed, normal bankruptcy procedures would be inadequate. A fundamental problem with the orderly liquidation authority in Title II is that it gives the FDIC too much discretion, which is inconsistent with the rule of law and undermines legal certainty and predictability, affecting the market treatment of healthy institutions. Some have criticized Title II as creating the market impression that investors in institutions (to which Title II would be applied) may receive financially better treatment than they might under bankruptcy procedures.

- New Chapter 14. To reduce the need for Title II, the Bankruptcy Code should be amended to facilitate a single-point-of-entry recapitalization strategy through a new Chapter 14.

- Duty to Maximize Value. To make Title II more consistent with the rule of law if invoked, Title II should be amended to impose a duty on the FDIC to maximize the value of a covered company for the benefit of the claimants in its receivership and eliminate the FDIC's discretion to discriminate among similarly situated creditors, unless and only if such differential treatment would maximize the value of the receivership for the benefit of all creditors (the bankruptcy standard for differential treatment).

- Regulators' Resolution Plans. Require the FDIC and the Federal Reserve to develop jointly a resolution plan under Title II for each company that is required to submit a resolution plan under Title I.

    - Require the FDIC and the Federal Reserve to announce publicly their preferred strategy for resolving each such company under Title II in sufficient detail to provide legal certainty and predictability to the public.

    - Impose a duty on the FDIC to use that preferred strategy to resolve the company if it is put into a Title II receivership, unless the FDIC, the Federal Reserve, and the Secretary of the Treasury jointly determine that the strategy would result in serious adverse effects on financial stability in the United States at the time of

the receivership.

- Remedy for Abuse of Discretion. To address the potential for abuse of discretion, provide after-the-fact judicial review of any exercise of discretion by the FDIC in carrying out its responsibilities under Title II with respect to any covered company.

F. Office of Minority and Women Inclusion (Waters Amendment)

DFA Section 342 requires financial agencies not only to evaluate their own "diversity" practices, but also to "assess" the "diversity policies and practices" of "entities regulated" by each financial agency. While it explicitly prohibits any new mandates or requirements on these entities, regulators have published elaborately detailed "guidance" on what they expect and will look for in their assessments. This kind of provision lays the groundwork for quotas and other restrictions, entirely unnecessary, since all of the "entities" covered are also subject to a variety of statutes prohibiting unlawful discrimination.

This provision should be deleted as superfluous at best and potentially leading to quotas and other intrusive and counterproductive government mandates.

G. Volcker Rule

DFA Section 619 prohibits federally insured banks from engaging in proprietary trading or investing in hedge funds (definitions and details left to five financial regulators to work out, individually or jointly). A fundamental problem with the Volcker Rule is that its principal definitions are vague, overbroad, and indeterminate, resulting in excessive legal uncertainty and unintended consequences. Another fundamental problem is that the statute's implementation, interpretation and enforcement are shared among five competing agencies, a bureaucratic structure that has proven to be unworkable.

The following amendments would address these flaws:

- Cost-Benefit Analysis. Impose a requirement on each agency to conduct a meaningful cost-benefit analysis of any proposed or final regulations implementing the Volcker Rule, subject to review by the OMB or an independent cost-benefit review agency.

- Single Agency. Simplify the administrative process by giving the power to implement, interpret, and enforce the statute to a single regulatory/executive agency.

- Exemptive Authority. Change the standard for the exercise of exemptive authority from the very restrictive standard of promoting and protecting the safety and soundness of banking entities and financial stability to the more traditional standard of "consistent with the purposes of the statute and the public interest."

- Proprietary Trading. Revise the definition of "proprietary trading" to mean the taking of short-term positions in financial instruments by individual traders or units for the specific purpose of making a profit for the banking entity's own account without any meaningful connection to client activity or hedging the banking entity's risk.

  - In particular, the concept of a "trading account" should be removed from the definition, because it has proven to be unworkable.

  - Add specific exemptions for the following activities:

    - asset-liability management;

    - trading in the sovereign debt of a country where a banking entity or its top-tier parent is organized or where a branch is located and licensed to do business, including debt of any multinational central bank (e.g., the European central bank) of which such country is a member;

    - trading in futures or other derivatives for U.S. government securities or permitted foreign sovereign debt.

  - Remove the backstop provisions, which are vague and unworkable.

- Hedge Funds and Private Equity Funds**.** The current rules and definitions have led to lawsuits, confusion, and repeated needs to address unintended consequences.

  - Limit the coverage of the terms "hedge funds" and "private equity funds," which should be clearly and specifically defined. Options include limiting the covered funds to collective investment vehicles engaged in proprietary trading or investing in portfolio companies that are not required to be registered under the Investment Company Act of 1940, rather than the current structure that relies upon any issuer that would be an investment company but for sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 or any similar company, which structure has proven to be overbroad and unworkable; or defining covered funds along the lines of the SEC's Form PF.

  - Revise the definition of "banking entity" as used in the Volcker Rule to apply to nothing more than insured depository institutions and broker dealers. Such a definition would, for example, exclude hedge funds, private equity funds, portfolio companies, registered investment companies, and foreign public funds, among other entities not intended to be treated as banking entities by the Volcker Rule.

  - Revise the definition of "covered transaction" to include the exemptions from that term contained in section 23A of the Federal Reserve Act and Regulation W.

  - Fix the conformance rules to be more practical, including by clarifying that any fund primarily

invested in non-publicly traded portfolio companies is an illiquid fund entitled to a full 5-year conformance period, without any further conditions to qualify.

H. Federalizing of Corporate Law

Several provisions in Dodd-Frank represent a significant expansion of Federal authority over areas of corporate governance traditionally subject to state law. This includes, among other provisions:

- A requirement for public companies to conduct "say-on-pay" votes on a regular basis;

- A requirement for the SEC to promulgate rules requiring clawbacks of executive compensation in the event of an accounting restatement, even in circumstances where the executive had no involvement in the matter leading to the restatement; and

- A grant of authority to the SEC to adopt so-called "proxy access" rules, in which certain shareholders would be entitled to include their nominees for director in the company's proxy materials.

In addition, Dodd-Frank mandates a number of corporate disclosure requirements intended to impact substantive behavior at companies, including, among other things, requirements for the SEC to adopt rules regarding conflict mineral disclosure and disclosure of pay ratios comparing CEO and median employee compensation.

Congress should eliminate Dodd-Frank mandated disclosure requirements not supported by empirical evidence and for which the costs of compliance vastly outweigh the benefits to shareholders—in other words, requirements that effectively hurt rather than help shareholders. This would include the conflict mineral and pay ratio disclosure requirements mentioned above. Congress should also review and revise DFA corporate governance provisions that interfere with the ability of boards of directors, under state law, to choose governance solutions. For example, this would include at a minimum (1) revising the clawback rules to provide more discretion to boards in deciding when to seek to clawback compensation from an executive that is not at fault and (2) eliminating the ability of the SEC to impose universal proxy access rules or any other similar governance reform not supported by empirical evidence or a proper cost-benefit analysis.

I. Consumer Bureau Reform

The Consumer Bureau (Bureau of Consumer Financial Protection) is arguably an even more flagrant violation of democratic checks and balances than is the FSOC. It is funded directly from the Federal Reserve (without any discretion by the Federal Reserve Board); is headed by a single Director, who has all authority for the Bureau and who can be removed from office only for cause; lacks any effective check to prevent its Director's actions from threatening the safety and soundness of banks; and receives proceeds from enforcement actions (to be placed in a fund for victims or, where these cannot be adequately identified, to be disbursed by the Bureau for financial education efforts). Given the Bureau's broad enforcement authority and concentration of power in the office of the Director, the structure of the Bureau violates the requirements of due process and basic notions of fairness by making the Director the prosecutor, judge, and jury in actions the Director brings against companies and individuals under the Bureau's jurisdiction, which may include firms or individuals that the Bureau in its own view determines to be engaged in consumer financial services.

The following amendments would help to address these problems:

- Convert the Bureau into an ordinary independent agency (for example along the lines of the FTC) with a bipartisan commission structure.

- The Bureau's automatic funding from the Federal Reserve—which is equivalent to funding from general revenues—should be revoked. The Bureau should be made subject to normal congressional authorization and appropriations processes, similar to the FTC.

- The Director of the Bureau should no longer be a member of the FSOC, since the Bureau has little to do with issues of national financial stability.

- The Bureau should be able to enforce no rules except those which have been duly adopted in accordance with the APA (no *ex post facto* enforcement).

- Any financial settlements/penalties from CFPB enforcement actions should be paid into the general Treasury.

- Require formal public rule-making to define the meaning and limits of the DFA-created "abusiveness" standard.

- Require formal public rule-making with respect to data-mining projects and efforts of the Bureau.

- Even if it remains part of the Federal Reserve, the Bureau's regulatory actions should be subject to OMB (OIRA) oversight and rigorous cost-benefit analysis standards.

J. HMDA Expansion

HMDA requires banks to gather and report data collected with regard to home mortgages and mortgage customers. The Dodd-Frank Act adds approximately 14 additional items of data to be collected and reported. In its draft regulations to implement the DFA changes, the Consumer Bureau has proposed to double the Dodd-Frank expanded number of HMDA data items to be collected. Collecting and submitting the data is not costless. Moreover, expanding the data points increases regulatory risk (either due to clerical error or regulatory disagreements about definitions, format, deadlines, and other pitfalls of regulatory risk), while also expanding the potential exposure to predatory class action lawsuits.

The Bureau should be prohibited from expanding the HMDA data collection beyond the items specified in the statute. In addition, statutorily mandated data on rates of loan approvals and disapprovals should be matched against the credit performance of borrowers grouped by the same categories. Unless such loan performance data are added to HMDA, there should be no other expansion of this burdensome and misleading reporting.

K. Special Interest Provisions (e.g. Conflict Minerals)

Several provisions were included in Dodd-Frank to address social foreign policy goals, such as conflict mineral disclosures and resource extraction payments, to be administered by the SEC. These provisions were never fully debated by Congress but were added during the conference committee, were not related to the financial crisis, fall outside of the skill set of the SEC, and cost the business community billions of dollars. Implementing rules have already either been thrown out or restricted in scope by the courts.

These provisions should be repealed, as the SEC's disclosure regime is designed to provide investors with the information they need to make investment decisions. That function should not be coopted to advance other policy goals, which would be more appropriately handled by the State Department.

Litigation

The BP Gulf Oil Spill Class Settlement: Redistributive "Justice"?

By John S. Baker, Jr.

Note from the Editor:

This article is about potential reforms to the Dodd-Frank Wall Street Reform and Consumer Protection Act. The authors received extensive input from other members of the Federalist Society's Financial Services & E-Commerce Practice Group Executive Committee. Any expressions of opinion are those of the authors and/or the members of the executive committee who shared their ideas and recommendations. This is not an expression of the views of the Federalist Society, nor intended to influence the adoption of any particular legislation. Neither should it be considered an expression of the views of the firms or organizations with which the authors may be associated. The Federalist Society seeks to further discussion about the Dodd-Frank Act. To this end, we offer links below to other perspectives on the issue, and we invite responses from our audience. To join this debate, please email us at info@fed-soc.org.

Related Links:

• The Truth About the BP Settlement, Herman Herman & Katz, LLC: http://hhklawfirm.com/bp-oil-spill/truth-bp-oil-spill-rig-explosion/

• Understanding the New BP Settlement, ClaimsComp, Inc. (2013): http://cdn2.hubspot.net/hub/218458/file-24566139-pdf/docs/e-book_bp_settlement_for_business_owners.pdf%3Ft%3D1363794569000

• *WSJ Opposes The Legal Settlement That Separates BP From Its Money*, Media Matters (Oct. 2014): http://mediamatters.org/mobile/blog/2014/10/28/wsj-opposes-the-legal-settlement-that-separates/201349

"Sympathy for the Devil" is the title of a recent op-ed in the *New York Times*.[1] Four years after the 2010 Deepwater Horizon oil spill, the author interviews BP's chief executive regarding the company's trials and tribulations in the massive federal court litigation in New Orleans. The article, generally favorable to BP, portrays the company as the victim of fraudulent claims paid out over objections it made in the federal courts. According to the article, BP has been forced to pay "hundreds . . . of bogus claims" for damages, like those to "[t]he wireless phone retailer who was awarded more than $135,000, even though its building had burned down before the spill [and an] attorney who was awarded more than $172,000, even though his license had been revoked in 2009." [2] As of this writing, BP is hoping that the Supreme Court will agree to accept its petition to review two decisions by the U.S. Fifth Circuit Court of Appeals.

One of the lead plaintiffs' lawyers thought that following the spill "BP did something remarkable [by] voluntarily . . . set[ting] up an administrative program …that aimed to fully compensate all the victims of the spill . . . [a]nd it backed all this up by setting aside $20 billion in a trust fund, with an open-ended commitment should that amount prove insufficient."[3]

Still, finding sympathy for BP in the general public will be difficult. Continuous coverage in 2010 of the Gulf oil spill gave people around the nation and the world a terribly negative view of BP.[4] The media reports caused great fear about the extent of the environmental damage, which at the time seemed potentially catastrophic for the Gulf. Businesses and employees located near the Gulf Coast faced uncertain economic fallout from the spill. Even if not directly affected, most of us living along the Gulf Coast knew people who suffered in one way or another from the spill.

As an opinion piece on *Forbes.com* observed, however, "it really doesn't matter" what the general public thinks about BP. "As long as BP sells oil in colossal quantities, it will continue to attract investment."[5] BP "remains an economic behemoth and a major player in a commodity the world hopelessly depends on."[6] Accordingly, four years after the spill, the Environmental Protection Agency has finally lifted its ban and allowed BP to bid for new leases in the Gulf of Mexico.[7]

So if BP neither needs nor receives much sympathy, how important is it that it is being defrauded of a few million dollars? A few million dollars seems like only a rounding error in terms of the many billions BP has already paid and will pay before all the spill-related matters are resolved. BP will survive and prosper, regardless of whether the Supreme Court reviews and reverses the decisions of the Fifth Circuit.

Of course, the scenarios of fraud cannot be measured against the defendant's size, total net worth, or prospects for profitability. The more important question is what the fraud will do to the federal courts. The unhappy answer to this question is found in the forceful dissenting opinion of Fifth Circuit Judge Edith Clement. She "indicts" a majority of her Fifth Circuit colleagues' refusal to review the fraud, saying that "Left intact, our holdings funnel BP's cash into the pockets of undeserving non-victims. These are certainly absurd results. And despite our colleagues' continued efforts to shift the blame for these absurdities to BP's lawyers, it remains the fact that *we are party to this fraud. . . .*"[8]

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Dr. Baker appreciates the research assistance provided by Joe Hart.

How is that possible? As part of the Settlement Agreement the parties negotiated an elaborately crafted, 17-page explanation of the proof required to support claims that economic damages suffered by potential plaintiffs were actually caused by the spill.[9] For many businesses in the areas most directly affected by the spill, the agreement provided a presumption of causation. In other words, businesses in the identified categories were not required to provide any evidence of causation. Thereafter, however, the court-appointed claims administrator issued an interpretation of the Settlement Agreement which BP said effectively eliminated causation. The district judge and a majority of the panel judges in the Fifth Circuit sided with the claims administrator. Thus, according to Judge Clement's dissent, the federal courts became a "party to this fraud"

> [b]y (1) adopting an unreasonable interpretation of the Settlement Agreement to remove any requirement of causation, and (2) certifying a class by ignoring the fact that although causation and traceability were initially written into the Settlement Agreement, the Claim Administrator's interpretation governing what would *actually happen* meant that Article III's requirements would be ignored in the class settlement's execution.[10]

I. BP: The Occasion For A Closer Look at Class Action Settlements

The strange developments in the BP Class Settlement offer an appropriate occasion to consider the fundamental constitutional question raised by the creation of class settlements—as a distinct form of class action. Such settlements presume that neither the plaintiffs' attorneys nor the defense attorneys have any intention of litigating. Objectors may well appeal a settlement. Having negotiated and agreed to the settlement, however, BP has taken a rare appeal.

As related below, BP bases its appeal on class action Rule 23 and Article III standing grounds stemming from the fraud alleged in the administration of the settlement. Regardless of any fraud, however, the constitutionality of the settlement class can be examined from a more generalized viewpoint of Rule 23 and Article III.

The fundamental Article III issue worthy of consideration is whether unconstitutionality is embedded in every settlement class action. Professor Martin Redish simply says "[t]he settlement class action, in short, is inherently unconstitutional."[11]

Redish's *Wholesale Justice* provides a thorough and discriminating treatment of the constitutional issues related to class actions.[12] He raises a number of constitutional issues regarding class actions, but he thinks most of them can be remedied.[13] It is the settlement class, however, that he contends is always necessarily unconstitutional. Why?

> Because by its nature it does not involve any live dispute between the parties that a federal court is being asked to resolve through litigation, and because from the outset of the proceeding the parties are in full accord as to how the claims should be disposed of, there is missing the adverseness between the parties that is a central element of Article III case-or-controversy requirement.[14]

BP argues that the claims administrator's inclusion in the class of claimants who have not sustained injuries caused by the spill violates Rule 23 and the standing requirements necessary to satisfy the "case or controversy" requirement of Article III. But what about the claimants in the settlement class whose injuries were caused by the spill—can even they satisfy Article III? The parties to litigation cannot create or consent to federal court jurisdiction.[15] Let's look at what happened when the parties attempted to do so in this litigation.

A. A Class that Settled, then Litigated

The first of three Fifth Circuit opinions describes the BP oil spill litigation as "one of the largest and most novel class actions in American history."[16] While no doubt exists about the unprecedented size and novelty of the BP litigation, it is misleading to label it a "class action." Actually, hundreds of cases, involving thousands of individual claimants, were filed in various federal courts and later consolidated in the Eastern District of Louisiana (New Orleans) by the Judicial Panel on Multidistrict Litigation, pursuant to 28 U.S.C. § 1407.[17]

During the centralized discovery phase of this multi-district litigation, the separate lawsuits continued. But along the way a court-appointed "Plaintiffs' Steering Committee" (PSC) was negotiating with BP. When a basic agreement was reached, plaintiff attorneys filed a class action. After only two days, the parties completed, signed, and filed in the court record the Settlement Agreement which had been reached prior to the filing.[18]

The Settlement class action[19] was designed to begin and end almost simultaneously. The new class action was filed on the assumption it would involve no litigation. Inverting normal processes, however, litigation between the parties commenced only after the settlement.[20] The litigation has been so convoluted that it is extremely difficult to summarize in an adequate, brief statement of the facts.[21]

The convoluted course of the appeals occurred because BP and objectors to the class settlement pursued different appeals. In panel decisions labeled *Deepwater Horizon I*,[22] and *Deepwater Horizon III*[23] BP twice appealed the interpretation of the Settlement Agreement, but not the Agreement itself. In *Deepwater Horizon II*[24] several objectors appealed certification of the settlement class itself. BP petitioned the Supreme Court on decisions in numbers II and III, even though it had not challenged the Agreement which was upheld in decision number II. After losing their appeal in the Fifth Circuit, the objectors apparently did not petition the Supreme Court on their case, number II. Instead, they filed as Respondents to the BP petition, but nevertheless urged the Court to grant review, without specifying whether they were referring only to decision number II.

In order to provide a readable and relatively concise

summary, the following statement includes lengthy quotes from a journalistic piece by self-described "class action geek," Alison Frankel, explaining much of the litigation.[25]

> Considering that BP's resolution of claims stemming from the Deepwater Horizon oil spill in 2010 is the biggest single-defendant private settlement in U.S. history, it's only fitting that the case has generated a spectacular – and procedurally peculiar – appellate record on the constitutionality of class actions. …
>
> The abbreviated appellate backstory dates back to December 2012, when U.S. District Judge Carl Barbier of New Orleans granted final approval to a class action settlement between BP and a steering committee of plaintiffs lawyers, negotiated over the course of more than a year. The settlement, which replaced a claims facility BP established right after the spill [administered by Ken Feinberg], was designed to compensate several different sorts of victims, from the shellfishing and tourism industries directly impacted by the spill to businesses whose losses were indirect fallout. As the settlement defined it, the class included everyone whose losses resulted from the Deepwater Horizon disaster.
>
> BP supported class certification and approval of the settlement. But the company developed qualms after Judge Barbier approved policy decisions by claims administrator Patrick Juneau that, in the company's view, enabled businesses unharmed by the oil spill to recover money from BP through creative accounting tactics. As business loss claims mushroomed, BP's lawyers from Kirkland & Ellis (which had negotiated the settlement) and Gibson, Dunn & Crutcher (which came in for the company after the deal was approved) appealed Barbier's order to the 5th Circuit. That appeal led to Judge Clement's opinion last October. Despite arguments by class counsel, represented on appeal by New York University law professor Samuel Issacharoff, that BP agreed to settlement terms that were open to the interpretation Barbier approved, Judges Clement and Leslie Southwick instructed Judge Barbier to reconsider his interpretation of deal terms. On her own, Clement went quite a bit further. If the BP settlement permitted claims by class members who had suffered no losses attributable to the oil spill, she said, then it was illegal. Uninjured plaintiffs don't have standing under Article III of the Constitution, Clement wrote, and judges can't create a cause of action that doesn't otherwise exist – even if the defendant wants to buy global peace through a settlement.
>
> Judge Southwick declined to join Clement's conclusions about constitutional standing, though he said it was logical, because he found it unnecessary. The third judge on the panel, Judge James Dennis, dissented vigorously, arguing that Clement's Article III analysis would erase the benefits of class action settlements by imposing expensive and unwieldy requirements at the class certification stage.
>
> While BP's appeal of Barbier's order was under way, class members who objected to the approval of the deal proceeded with a separate appeal at the 5th Circuit. In September, BP filed an extraordinary brief in that case. Even though the company had backed approval of the settlement at the trial court and had pledged to defend the agreement against objections, BP said that it was prepared to argue alongside objectors for decertification of the class unless Barbier's interpretation of the settlement agreement was reversed.
>
> BP maintained that position after the Clement panel's ruling in its appeal of Barbier's order. In fact, the company filed a supplemental brief citing Judge Clement's analysis to back its assertion that a class encompassing uninjured claimants does not pass constitutional muster.

This second appeal came before a panel consisting of two different judges, Judges Davis and Garza, along with Judge Dennis, the dissenting judge on the first panel. This decision, one of the two covered in the petition for certiorari, upheld the Certification of the Class Action which had been criticized on constitutional grounds in the earlier opinion by Judge Clement. As Ms. Frankel writes,

> [the] majority opinion writer Judge Davis was joined by Judge Dennis—yes, the same Judge Dennis who dissented from Clement's opinion in the other appeal – in upholding the settlement. Federal circuit courts, the majority wrote, have developed two different standards to guide trial judges in the evaluation of class action settlements that may sweep in uninjured claimants. The so-called Kohen test, followed by the 3rd,

7th and 9th Circuits, holds that settlement approval hinges on the constitutional standing only of named plaintiffs; as long as they have a viable federal-court claim, courts need not consider the standing of absent class members. The 2nd and 8th Circuits follow the Denney test, which requires that classes be defined to include only claimants with constitutional standing but does not insist that every absent class member submit evidence of personal standing. (Interestingly, according to the 5th Circuit, the 7th and 9th Circuits have used both the Kohen and Denney tests in reviewing class certification decisions.)

According to the 5th Circuit majority, Judge Barbier's approval of the BP settlement was justified under either test. Even BP has not challenged the standing of named plaintiffs in the case, which would satisfy the Kohen test. And the settlement agreement defined the class as those whose injuries were the result of the oil spill, which satisfies Denney. Judge Davis's opinion conceded that in the previous appeal, Judge Clement said the BP settlement would fail the Denney test if it permitted claims by uninjured plaintiffs. "In Judge Clement's view, if absent class members include persons who 'concede' that they have no 'causally related injury,' then a district court lacks jurisdiction to certify the class," the opinion said. But Clement misread Denney, according to Davis's opinion. By the agreement's definition, the BP settlement class includes people injured by the spill, he said. "Accordingly, using Judge Clement's formulation of the standard, the class in this case does not include any members who 'concede' that they lack any 'causally related injury,'" the majority wrote. "This ends the Article III inquiry under the Denney test, which does 'not require that each member of a class submit evidence of personal standing' so long as every class member contemplated by the class definition 'can allege standing.'"

BP's arguments that Barbier's post-approval interpretation of the deal rendered class certification unconstitutional were beside the point, according to the majority. The 5th Circuit's review, the opinion said, was based on the evidence before Judge Barbier in December 2012. If BP had wanted a deeper review of individual claims, according to the opinion, then it should not have settled through a class action. The company might have obtained rulings on the evidentiary standards for economic loss claims through summary judgment or at trial, the 5th Circuit majority said, but it's simply not part of the class certification inquiry to consider individualized claims.

Indeed, the majority said, BP knew (or should have known) that it was asking for something impossible. "In particular, BP's arguments fail to explain how this court or the district court should identify or even discern the existence of 'claimants that have suffered no cognizable injury' for purposes of the standing inquiry during class certification and settlement approval," the opinion said. "It would make no practical sense for a court to require evidence of a party's claims when the parties themselves seek settlement. . . . Logically, requiring absent class members to prove their claims prior to settlement . . . would eliminate class settlement because there would be no need to settle a claim that was already proven."

In dissent, Judge Emilio Garza followed Judge Clement on the issues of Article III standing and class certification. Meanwhile,

> . . . after Clement's panel ordered Judge Barbier to reconsider his interpretation of the settlement agreement, the trial judge basically stuck with his old holding on causation for business loss claimants (though he did modify his previous interpretation of accounting terms). BP raced back to Judge Clement's panel at the 5th Circuit to ask the appeals court to make permanent a temporary injunction against payments to uninjured claimants. The 5th Circuit ordered expedited briefing on BP's motion.

Ms. Frankel concluded, saying "this record is as interesting as it is weird."

But matters got more "weird" after Ms. Frankel's report. Following the expedited appeal, the original panel, for which Judge Clement wrote the lead opinion, refused BP's requested injunction and upheld the district court's interpretation of the Settlement Agreement. This time, Judge Southwick wrote the lead opinion, with Judge Dennis concurring in part and concurring in the judgment. Judge Clement, of course, dissented.

Judge Clement contended the issues presented to two different panels would have been better handled by the same panel.[26] Quite remarkably, the Fifth Circuit declined to sort out the three conflicting panel decisions.[27]

II. Article III: A Problem with Interpreting the

Settlement or with the Settlement Itself?

Given that BP agreed to the Settlement Class and that it relies on Judge Clement's opinions, it is understandable that it is not attacking the settlement itself. Nevertheless, the more fundamental issue is whether this and other settlement classes can satisfy Article III.

A. The Statements by the Parties as to the Question Presented

Tracking Judge Clement, BP presents the question to the Supreme Court in terms of a circuit split on Federal Rule 23 class actions and Article III standing of claimants who do not satisfy the causation requirement. The Respondent class, on the other hand, reframes the question as follows:

> May a party to a class action settlement who advocated settlement approval before the District Court, filed no notice of appeal, and appeared as an appellee urging affirmance, now seek to switch sides in order to overturn that same settlement through a petition for certiorari? [28]

The lawyers for the class hope to make the issue one of simple contract, but they cannot ignore the Rule 23 and Article III standing arguments. Of course, just as BP tracks Judge Clement and those who joined her,[29] the class tracks the position of the other judges on the claim about a circuit conflict on Rule 23 and Article III standing.[30]

For the moment, however, let's ignore that the Article III "case or controversy" issue is necessarily present throughout all phases of the litigation[31] and that courts have the duty to raise the subject-matter jurisdictional issues even if both sides fail to do so.[32]

If we do so, the first and the third of the arguments made by the class counsel might seem fairly reasonable. First, they argue that Supreme Court review of the constitutional issues would have had to have occurred after the ruling on the first appeal in which Judge Clement initially raised the constitutional issues, that those issues are not presented in either of the two cases in which BP is seeking review, and that BP is judicially estopped from switching sides on the settlement. Then, the third argument would follow and reduce the dispute to one which is "fundamentally a matter of contract interpretation between parties to a complicated settlement."[33]

The big problem with the "this is just a contract dispute" argument is that no contract would have been signed, but for the approval of the federal district court. In a law review article, one of the attorneys for the class, Professor Samuel Issacharoff, explains that the advantage of the BP and other settlement classes lies in the district court's approval, administration, and enforcement.[34] He rightly says that "[o]nly a court's imprimatur—and a deal that comports with the formalities and safeguards of the class action system—can bind absentees without their affirmative consent."[35]

B. Rule 23 and Article III

Rule 23, derived from the Supreme Court's authority under the Rules Enabling Act,[36] is not supposed to alter substantive rights.[37] As Professor Redish writes, however,

> Under the guise of procedure, class actions often effect dramatic alterations in the DNA of the underlying substantive law. The result – whether intended or not – is a form of confusion or even deception of the electorate, which is likely unaware that the essence of the governing substantive law has been altered because the alteration has occurred under the guise of procedural modification. Substantive law is altered, not through resort to traditionally recognized democratic procedures but rather by what is effectively a procedural shell game.[38]

Different views on the Fifth Circuit regarding whether Rule 23 has been satisfied in the BP case and whether a conflict exists with other circuits may well be rooted in unarticulated views about the malleability of the class action and the importance of protecting the substantive rights at stake. It is certainly possible that some judges, regardless of the circuit, are more inclined to shape class actions for the convenience of the courts, even while convincing themselves that such flexibility serves justice. But as Redish writes, "The class action collectivizes adjudication of those substantive rights, often revoking—either legally or practically—the individual right holder's ability to control the protection or vindication of his rights through resort to the legal process."[39]

Standing is one of the four components of Article III's "case or controversy" requirement.[40] The jurisprudence on the four components –standing, ripeness, mootness, and political question—enforce the adverseness between the parties required by Article III. The adverseness requirement can be met in a class action lawsuit; but in what is solely a class action settlement, adverseness is necessarily absent.

Professor Redish does not argue that actual class action *litigation* is necessarily unconstitutional. It is the settlement class, however, that he contends is always unconstitutional because it involves no litigation.

> A typical class action is legitimate because the interests of the plaintiffs and defendant are adverse. In that scenario, the monetary interests of class counsel, which are contingent on class recovery, are aligned with the absent class members' interest in maximum redress, incentivizing a presentation of the issues that benefits both equally. These incentives break down in the context of the non-adversarial settlement class. Because class counsel seeks the same outcome as the defendant, she has no reason to formulate her clients' arguments or destroy her opponent's case. Particularly, she lacks incentive to present to the court evidence that may shed unfavorable light upon the non-adversarial agreement, even though that evidence may reveal critical details about the effect of the settlement on

absent class members.[41]

C. The Individuals: "Skunks at the Tea Party"

Several parties objected to the settlement and appealed to the Fifth Circuit, where they lost in *Deepwater Horizon II*. Their simple, straightforward argument was that they were "inherently harmed by the inclusion of uninjured persons in the class" because the inclusion "'diminishes the relief for class members who are actually harmed.'"[42]

None of the major players in the litigation ever seemed to have questioned the constitutionality of a settlement class. Judge Barbier wrote that "Settlement classes are a typical feature of modern class litigation, and courts routinely certify them, under the guidance of *Amchem Products., Inc. v. Windsor*, to facilitate the voluntary resolution of legal disputes." [43] The experts tendered by both parties apparently indicated nothing to the contrary.[44]

As Professor Redish recognizes, in *Amchem* "the Court implicitly approved the concept of the settlement class as an alternative form of dispute resolution." [45] So, therefore, on what basis would practicing lawyers attack the constitutionality of settlement classes? Although *Amchem* "implicitly" approves settlement classes, it did so in dictum and it did not consider the constitutional issues.[46] Rather, "the Court reserved for a later date the question of whether the settlement class presents a justiciable case or controversy."[47]

How is it then that so many very bright lawyers and judges have failed to question the constitutionality of the settlement class? One answer may be that the constitutional point is so very simple that many sophisticated minds cannot see it. As Professor Redish writes,

> On the most basic analytical level, the unconstitutionality of the settlement class action should be obvious, purely as a matter of textual construction. There is simply no rational means of defining the terms "case" or "controversy" to include a proceeding in which, from the outset, nothing is disputed and the parties are in complete agreement. Moreover, from both historical and doctrinal perspectives, Supreme Court decisions could not be more certain that Article III is satisfied only when the parties are truly "adverse" to one another, which, at the time the relevant proceeding is undertaken, they are not in the case of the settlement class action.[48]

Another answer may be that both the plaintiffs and defendants like the settlement class. In reality, defense attorneys and corporations have many reasons to favor "aggregate settlements," as explained both by Professor Issacharoff [49] and Professor Redish.[50] Corporations may not be able to avoid defending a class action. But corporations are not legally required to enter into a separate settlement class. So when corporations and their attorneys enter such agreements, they believe on utilitarian grounds that that option, however expensive, is preferable to the alternatives. Precisely because the parties cannot always be relied upon to raise subject-matter jurisdiction, it is the duty of federal judges—no matter how much they prefer mass settlements solutions —to do so.

III. Collective and Redistributive Litigation Versus Litigation By and For the Individual

"The class action is 'an exception to the usual rule that litigation is conducted by and on behalf of the individual named parties only.'"[51] Through common-law reasoning, however, the exception often becomes the rule.[52] How might that be occurring?

> By collectivizing—often forcibly—the litigation process, the class action procedure threatens core notions of the process-based autonomy that is central to liberal democratic thought. The class action, then, gives rise to at least a prima facie tension between legally imposed collectivization and democratic meta decision making autonomy on the part of the individual.[53]

As evident from this quote, Professor Redish's consideration of class actions includes the perspective of political theory.[54] He has "described four normative models of political theory: liberalism, utilitarianism, democratic communitarianism, and civic republicanism."[55] His "thesis is that (1) the various normative approaches to the class action that have been advocated by prominent legal scholars are best understood largely as manifestations of one or another of these broader political theories, and (2) when viewed from this theoretical perspective, each should be found wanting because of its improper departure from the fundamental norms of liberal theory, which value the process–based autonomy of the individual."[56]

Professor Redish then "identif[ies] three class action models that illustrate the breadth and depth of legal scholarship on the normative rationale and proposed structure of the modern class action . . . [:] the "utilitarian justice" model, . . . the "communitarian process" model, . . . and the "public action" model."[57] Professor Issacharoff, Counsel of Record in the Supreme Court for the BP Settlement Class, is one of two prominent scholars who have developed the "communitarian process model."[58]

The communitarian process model "views a class as a stand-alone 'entity,' rather than an aggregation of separate individual claims."[59] Professor Redish finds that "[t]he constitutional implications of the entity perspective are both striking and troubling. Likening class actions to private voluntary associations permits . . . circumvent[ing]the due process inquiry, because [for] voluntary private organizations it is not the individual plaintiffs but rather the collectivity which seeks redress for the violation of its substantive rights."[60]

Using the settlement class is certainly an effective way of advancing the "entity theory" and what Redish labels "the communitarian justice model." Getting a settlement agreement with the defendant pretty well insulates such outcomes from

appellate judicial scrutiny, unless some objector raises the Article III issues.

In a law review article about the BP case, Professor Issacharoff noted that "the Supreme Court has made it more difficult to use class action to resolve large-scale disputes arising out of mass injuries."[61] That has produced "pressure to find alternative means of effectively resolving mass disputes at a wholesale level outside of the courtroom."[62] Accordingly, "[m]ass torts have shifted into MDLs, where parties must rely on non-class aggregate settlements in their quest for global resolution."[63] That has meant that "lawyers constructing these deals must use innovative and controversial contractual strategies to try to achieve full participation by claimants."[64]

The limits imposed on class actions by the Supreme Court are largely designed to ensure that Rule 23 does not contravene the Rules Enabling Act[65] or Article III. Accordingly, the creative use of MDLs to reach class settlements as advocated by Professor Issacharoff should be viewed as an unconstitutional "end-run" around Article III. Unless it is possible to avoid the standing and larger "case or controversy requirements" of Article III, the settlement class will not be available to produce the kind of redistributive "justice" sought by plaintiffs' lawyers in mass tort litigation and consented to by corporations and defense attorneys on utilitarian grounds.

IV. Conclusion

Prominent constitutional scholars who also litigate look for opportunities to bring the jurisprudence in line with what they think the law is or should be. Often, however, constitutional scholars are brought into a case only at the appellate level, which can limit their ability to shape the theory of the case. This case demonstrates the wisdom of the plaintiffs' lawyers representing the class who early on brought Professor Issacharoff into the litigation.[66] Professor Issacharoff has been able to shape the strategy and the settlement, as he has described in his law review article. He has not needed to lay out his entity theory in any of the appellate briefs.[67]

Defense attorneys might consider the importance of political and constitutional theory in any matter that might raise Article III issues. Very few litigators have time to read and reflect on the constitutional and political-theory foundations of what they do in practice. Moreover, class actions are so complicated that despite the countless articles on the subject not many academics have broadly considered the constitutional foundations.[68] For these reasons, the Vice President and Chief Counsel for AON, a leading insurance and reinsurance brokerage, has urged defense attorneys and in-house counsel to read and draw arguments from *Wholesale Justice*.[69]

The Supreme Court has avoided several opportunities during its last term to address issues raised in mass tort litigation.[70] Obviously, the plaintiffs' and BP's attorneys have opposing views on the importance of the Court reviewing their litigation. The constitutional problem posed by class settlements, however, transcends the narrow interests of both plaintiff and defense attorneys in the BP case. Whether in this case or in another one, the Court needs to consider class settlements in terms of separation of powers because maintaining the limits of Article III's "case or controversy" requirements is fundamental for protecting the individual liberties of all.[71] As Redish writes,

> by authorizing a federal court to redistribute resources as a means of enforcing legislative directives absent an adversary adjudication, the settlement class action effectively transforms the court into an administrative body, which is more appropriately located in the executive branch . . . [and] improperly transfers powers reserved to the executive branch to the federal judiciary, in clear contravention of separation-of-powers dictates.[72]

Endnotes

1 Joe Nocera, Op-Ed, *Sympathy for the Devil*, N.Y. Times, Aug. 2, 2014 at A17, *available at* http://www.nytimes.com/2014/08/02/opinion/joe-nocera-sympathy-for-the-devil.html?_r=0.

2 *Id.*

3 Samuel Issacharoff & D. Theodore Rave, *The BP Oil Spill Litigation and the Paradox of Public Litigation*, 74 La. L. Rev. 397 (2014). (footnotes omitted).

4 *Poll: BP Oil Spill Response Rated Worse than Katrina*, ABCNews.com, June 7, 2010, http://www.abcnews.go.com/PollingUnit/Media/poll-bp-spill-rated-worse-katrina-criminal-charges/story?id=10846473.

5 *See* Steve Olenski, *Nearly Four Years After Deepwater Horizon, Has BP's Brand Image Recovered?*, Forbes.com, Jan. 24, 2014, http://onforb.es/1eYhNNE.

6 *Id.* But, note that BP has been sued in American and British courts over the spill by investors. *See* Alison Frankel, *Institutional Investors Step off Sidelines to Sue BP for Fraud,* Reuters.com, April 21, 2014, http://blogs.reuters.com/alison-frankel/2014/04/21/institutional-investors-step-off-sidelines-to-sue-bp-for-fraud/; Terry Macalister, *BP faces Deepwater Horizon Lawsuit by Investors Including London Councils*, theguardian.com, (July 4, 2014, 5:46 PM), http:/www.theguardian.com/environment/2014/jul/04/bp-deepwater-horizon-class-action-texas.

7 Stanley Reed, *Ban Lifted, BP Bids $42 Million to Win Gulf Oil Leases in U.S. Auction*, N.Y. Times, Mar. 20, 2014, at B3, *available at* http://www.nytimes.com/2014/03/20/business/energy-environment/ban-lifted-bp-bids-42-million-to-win-gulf-oil-leases-in-us-auction.html.

8 In re Deepwater Horizon, 753 F.3d 516, 519-20 (5th Cir. 2014) *reh'g en banc denied*.

9 Amended Settlement Agreement at 201-17, In re: Oil Spill by the Oil Rig "Deepwater Horizon" in the Gulf of Mexico, on April 20, 2010, 910 F. Supp. 2d 891 (E.D. La. 2012) (No. 6430-2) *available at* http://www.deepwaterhorizoneconomicsettlement.com/docs/Amended_Settlement_Agreement_5.2.12_optimized.pdf#search (citing Exhibit 4B).

10 In re Deepwater Horizon, 753 F.3d at 519.

11 Martin H. Redish, Wholesale Justice: Constitutional Democracy and the Problem of the Class Action Lawsuit 178 (2009).

12 *See* Douglas Smith, *The Intersection of Constitutional Law and Civil Procedure: Review of* Wholesale Justice: Constitutional Democracy and the Problem of the Class Action Lawsuit, 104 Nw. U. L. Rev. 319 (2010), *available at* http://www.law.northwestern.edu/lawreview/colloquy/2010/9/ ("In *Wholesale Justice*, Professor Redish provides a thorough analysis of the constitutional implications of the class action mechanism. Unlike prior commentators and courts, which have focused mainly on limited constitutional issues arising in class action cases, Professor Redish's analysis sweeps more broadly. In the process, he brings to bear principles of constitutional law that have long lain dormant in the field of class action practice. His insights demonstrate that more than mere practical or policy concerns arise when class action procedures are used. Rather, they implicate—and often infringe—fundamental principles of constitutional law.").

13 *See* Redish, *supra* note 11, at 13-15.

14 *Id.* at 178.

15 Federal courts "have only the power that is authorized by Article III of the Constitution and the statutes enacted by Congress pursuant thereto. For that reason, every federal appellate court has a special obligation to 'satisfy itself not only of its own jurisdiction, but also that of the lower courts in a cause under review,' *even though both parties are prepared to concede it*." Bender v. Williamsport Area School District, 475 U.S. 534, 547 (1986)(citations omitted); Byrd v. Blue Ridge Rural Elec. Co-op., Inc., 356 U.S. 525, 537 (1958) ("The federal system is an independent system for administering justice to litigants who properly invoke its jurisdiction.").

16 In re Deepwater Horizon (*Deepwater Horizon I*), 732 F.3d 326, 345 (5th Cir. 2013).

17 In re: Oil Spill by the Oil Rig Deepwater Horizon in the Gulf of Mexico, on April 20, 2010, 910 F. Supp. 2d 891, 900 (E.D. La. 2012).

18 *Id.* at 902.

19 The settlement agreement provided for numerous types of claims, one of which was a claim for economic loss. The class definition limited eligibility for business economic loss claims to those claimants who conducted commercial activities in the Gulf Coast region between April 20, 2010, and April 16, 2012. Additionally, claimants must have experienced loss of income, earnings, or profits as a result of the spill. To demonstrate economic loss, claimants submitted documentation detailing the difference between their expected variable profit during a defined period of time prior to the spill and their actual variable profit during a defined period of time after the spill. If a claimant met all the other requirements of the class, he would be entitled to the difference between the variable profits in the two time periods. *See Deepwater I*, 732 F.3d at 330.

20 The current litigation over the class settlement resulted from two Policy Announcements issued by the Claims Administrator that interpreted the Settlement Agreement and were adopted by the district court. The first of these Policy Announcements concerned whether the variable profit used to determine a claimant's economic loss would be calculated using an accrual or a cash accounting method. In re Deepwater Horizon (*Deepwater II*), 739 F.3d 790, 797 (5th Circuit 2014). The second Policy Announcement interpreted the Settlement's "Causation Requirements for Economic Loss Claims" and declared that the Administrator would pay claims "without regard to whether such losses resulted or may have resulted from a cause other than the Deepwater Horizon oil spill" as long as the claimant met the established requisite economic loss using the method provided in the Settlement. *Deepwater I*, 732 F.3d at 331. While these issues are significantly intertwined, they were decided by two separate 5th Circuit panels in three separate appeals.

21 BP's "Statement of the Case" in its petition for certiorari contains twelve and one-half pages devoted to the facts and procedural history of the three appeals, only two of which are the subject of the petition for certiorari. Petition for Writ of Certiorari at 2-14, BP Exploration & Production Inc., v. Lake Eugenie Land & Development, Inc., (No. 14-123) 2014 WL 3834540. Likewise, the Response to the Petition also contains a fourteen and one-half page "Statement of the Case." Brief in Opposition to Petition for Writ of Certiorari at 5-17, BP Exploration & Production Inc., v. Lake Eugenie Land & Development, Inc., (No. 14-123) 2014 WL 5034632.

22 732 F.3d 326 (decided October 2, 2013).

23 In re Deepwater Horizon (*Deepwater Horizon III*), 744 F.3d 370 (5th Cir. 2014) (decided March 3, 2014).

24 739 F.3d 790 (decided January 10, 2013).

25 Alison Frankel, *With 5th Circuit Split on Class Constitutionality, What's Next for BP?*, Reuters.com (Jan. 14, 2014), http://blogs.reuters.com/alison-frankel/2014/01/14/with-5th-circuit-split-on-class-constitutionality-whats-next-for-bp/.

26 In re Deepwater Horizon, 753 F.3d 516, 521 (5th Cir. 2014) (Clement, J., dissenting) *reh'g en banc denied*; *Deepwater III*, 744 F.3d at 382 n.2 (Clement, J., dissenting).

27 753 F.3d at 516.

28 Brief in Opposition, *supra* note 20, at i.

29 The denial for a rehearing en banc was rejected with five judges voting for a rehearing (Judges Jolly, Jones, Clement, Owen, and Elrod) and eight judges voting against a rehearing (Chief Judge Stewart and Judges Davis, Dennis, Prado, Southwick, Haynes, Graves, and Higginson). 753 F.3d at 320. at 320 (majority opinion). While only Judges Jolly and Jones joined Judge Clement in dissenting from the denial, Judge Clement noted that Judge Garza would have also joined the dissent had he been able to vote as an active member of the en banc panel. *Id.* at 320-21 (Clement, J., dissenting).

30 Brief in Opposition, *supra* note 20, at 21-25.

31 Hollingsworth v. Perry, 133 S. Ct. 2652, 2661 (2013) ("Most standing cases consider whether a plaintiff has satisfied the requirement when filing suit, but Article III demands that an "actual controversy" persist through all stages of litigation."); Lujan v. Defenders of Wildlife, 504 U.S. 553, 561 (1992) ("Since [standing elements] are not mere pleading requirements but rather an indispensable part of the plaintiffs case, each element must be supported in the same way as any other matter on which the plaintiff bears the burden of proof, *i.e.,* with the manner and degree of evidence required at the successive stages of litigation.").

32 United States v. Hays, 515 U.S. 737, 742 (1995) ("The question of standing is not subject to waiver, however: '[W]e are required to address the issue even if the courts below have not passed on it, and even if the parties fail to raise the issue before us. The federal courts are under an independent obligation to examine their own jurisdiction, and standing is perhaps the most important of the [jurisdictional] doctrines.'") (citations omitted).

33 Brief in Opposition, *supra* note 20, at 4.

34 *See* Samuel Issacharoff & D. Theodore Rave, *supra* note 3.

35 *Id.* at 426.

36 28 U.S.C.A. § 2072(a) (West 2014) ("The Supreme Court shall have the power to prescribe general rules of practice and procedure and rules for evidence for cases in the United States district courts (including proceedings before magistrate judges thereof) and courts of appeals.").

37 Shady Grove Orthopedic Associates, P.A., v. Allstate, Ins. Co., 559 U.S. 393, 406-07 (2010).

38 Redish, *supra* note 11, at 3 (footnote omitted).

39 *Id.*

40 Flast v. Cohen, 392 U.S. 83, 94-95 (1968) ("No justiciable controversy is presented when the parties seek adjudication of only a political question, when the parties are asking for an advisory opinion, when the question sought to be adjudicated has been mooted by subsequent developments, and when there is no standing to maintain the action.").

41 Redish, *supra* note 11, at 211.

42 Response for the Cobb Respondents on Petition for Writ of Certiorari at 2, BP Exploration & Production Inc., v. Lake Eugenie Land & Development, Inc., (No. 14-123) 2014 WL 5017955.

43 In re: Oil Spill by the Oil Rig Deepwater Horizon in the Gulf of Mexico, on April 20, 2010, 910 F. Supp. 2d 891, 913-14 (E.D. La. 2012) (internal citations omitted).

44 *See Id.*

45 Redish, *supra* note 11, at 185.

46 *Id.* and n. 48 ("*Amchem* , 521 U.S. at 612 (although noting that 'Rule 23's requirements must be interpreted in keeping with Article III's constraints.')"); *See also* Amchem Products, Inc. v. Windsor, 521 U.S. 591, 612 (1997) ("We agree that 'the class certification issues are dispositive,' because their resolution here is logically antecedent to the existence of any Article III issues, it is appropriate to reach them first.").

47 Redish, *supra* note 11, at 185.

48 *Id.* at 178 (footnotes omitted).

49 *See* Samuel Issacharoff & D. Theodore Rave, *supra* note 3, at 413-18.

50 Redish, *supra* note 11, 185-86.

51 Comcast Corp. v. Behrend, 133 S.Ct. 1426, 1432 (2013) (citing Califano v. Yamasaki, 442 U.S. 682, 700–01 (1979)).

52 Benjamin N. Cardozo, The Growth of the Law 38-40 (1924), *available at* Gale F3752241803.

53 Redish, *supra* note 11, at 4.

54 *See id.* at 93-106.

55 *Id.* at 106.

56 *Id.*

57 *See id.* at 106-25.

58 *Id.*

59 *Id.* at 115.

60 *Id.* at 150.

61 *See* Samuel Issacharoff & D. Theodore Rave, *supra* note 33, at 428 (citing Arthur R. Miller, *Simplified Pleading, Meaningful Days in Court, and Trials on the Merits: Reflections on the Deformation of Federal Procedure*, 88 N.Y.U. L. Rev. 286 (2013)).

62 *Id.*

63 *Id.* at 428-29.

64 *Id.* at 429.

65 Shady Grove Orthopedic Associates, P.A., v. Allstate, Ins. Co., 559 U.S. 393, 406-08 (2010).

66 Declaration of Samuel Issacharoff at 1, In re: Oil Spill by the Oil Rig Deepwater Horizon in the Gulf of Mexico, on April 20, 2010, 910 F. Supp. 2d 891 (E.D. La. 2012) (No. 7104-4).

67 The three appellate cases shared five overlapping appellate dockets [13-30095; 13-30329; 13-30315; 13-31220; 13-31316] and one district court docket [2:10-md-02179-CJB-SS]. Of the more than 30 briefs, motions, and responses filed by Professor Issacharoff that we were able to locate on the five separate appellate dockets, only one filing, the Plaintiffs-Appellees' Brief on the Merits, *Deepwater Horizon II*, 739 F.3d 790 (2013 WL 8902142), contained a citation to himself.

68 *See* Douglas Smith, *supra* note 12, at 319; *see also* Redish, *supra* note 11, at 20 ("I undertake an examination of the modern class action from an intellectual perspective that no other scholar has, to date, attempted.").

69 Mark Herrman, *Inside Straight: Torpedoing Class Actions*, AboveTheLaw.com (Jan. 12, 2012 at 10:12 AM), http://abovethelaw.com/2012/01/inside-straight-torpedoing-class-actions/.

70 See Heather A. Pigman, John M. Kalas, *High Court's Cert Denial Foments Greater Confusion Over Removal of Mass Actions Under Federal Law* (Washington Legal Foundation, October 23, 2014)

71 *See* The Federalist Nos. 47, 48 (James Madison).

72 Redish, *supra* note 11, at 182 (footnote omitted).

Telecommunications & Electronic Media

High Stakes: The FCC Gambles with America's Global Leadership

*By Kenneth T. Cuccinelli II**

Note from the Editor:

On February 4, 2015, Federal Communications Commission Chairman Tom Wheeler put forth a long-awaited net neutrality proposal. The net neutrality question has been discussed for more than a decade and attracted more than four million public comments. Chairman Wheeler's proposal to use the FCC's Title II authority to implement and enforce open internet protections has received strong support and criticism. The Federalist Society believes this is an extremely important issue and seeks to foster further discussion and debate. This article presents a criticism of the FCC's proposal. As an epilogue to the article, we have included Chairman Wheeler's full statement on the proposal. As always, The Federalist Society takes no position on particular legal or public policy initiatives. We also offer links below to various perspectives on both sides of the issue, including a prior Federalist Society publication on the topic, and we invite responses from our audience. To join the debate, please e-mail us at info@fed-soc.org.

Related Links:

- Harold Field, *Throwing Shade at Title II with Forbearance Fearmongering*, Public Knowledge, Oct. 2, 2014: https://www.publicknowledge.org/news-blog/blogs/throwing-shade-at-title-ii-with-forbearance-fearmongering
- Comments of Public Knowledge, Benton Foundation, Access Sonoma Broadband, GN Docket No. 14-28 (filed Jul. 15, 2014) : https://www.publicknowledge.org/assets/uploads/blog/Public_Knowledge_NN_NPRM_comments_2014_FINAL.pdf
- Katherine Ann Ruane, Congressional Research Service, Net Neutrality: The FCC's Authority to Regulate Broadband Internet Traffic Management (Mar. 2014): https://www.fas.org/sgp/crs/misc/R40234.pdf
- Marvin Ammori, *The Case for Net Neutrality*, Foreign Affairs, July/Aug. 2014: http://www.foreignaffairs.com/articles/141536/marvin-ammori/the-case-for-net-neutrality
- Leticia Miranda, *The FCC's Net Neutrality Proposal Explained*, The Nation, May. 21, 2014: http://www.thenation.com/article/179934/fccs-net-neutrality-proposal-explained#
- Robert M. McDowell, *The Turning Point for Internet Freedom*, Wall St. J., Jan. 19, 2015: http://www.wsj.com/articles/robert-m-mcdowell-the-turning-point-for-internet-freedom-1421712567
- Maureen K. Ohlhausen, *Net Neutrality vs. Net Reality: Why an Evidence-Based Approach to Enforcement, And Not More Regulation, Could Protect Innovation on the Web,* Engage: J. Fed. Soc'y Practice Groups, Feb. 2013: http://www.fed-soc.org/publications/detail/net-neutrality-vs-net-reality-why-an-evidence-based-approach-to-enforcement-and-not-more-regulation-could-protect-innovation-on-the-web
- Larry Downes, *Why Obama's Plan to Save The Internet Could Actually Ruin It*, Wash. Post, Nov. 11, 2014: http://www.washingtonpost.com/blogs/innovations/wp/2014/11/11/why-obamas-plan-to-save-the-internet-could-actually-ruin-it/

As early as the end of February, the Federal Communications Commission is poised to fundamentally unravel the light touch regulatory approach to Internet governance that has made America the world leader in broadband Internet access. The Commission is prepared to vote on an order that would apply 1930s monopoly-era telephone rules to the Internet, reversing over 15 years of successful bipartisan actions, in a decision that is unsupported by facts, law or common sense. Worse yet, the Commission has not identified a market failure or actual consumer harms to justify the decision. The result is a legally unstainable outcome that will create years of legal battles, ensuring a continued lack of certainty for consumers and businesses alike, and will undoubtedly chill investment in the most successful sector of our economy.

The FCC is exploring options for regulating broadband Internet access service in the wake of the U.S. Court of Appeals for the District of Columbia Circuit's decision in *Verizon v. FCC*.[1] As Attorney General of Virginia, I filed an *amicus* brief in the *Verizon* case in opposition to the FCC's position. The court found that Section 706 of the Telecommunications Act of 1996[2] gives the FCC authority to regulate broadband Internet service, but struck down the agency's "anti-blocking" and "anti-discrimination" rules as being outside the scope of that authority. The Court reasoned that these rules were the equivalent of common carrier obligations under Title II of the

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Communications Act of 1934, as amended (the "Act"). The Act subjects telecommunications carriers, but not information-service providers, to regulation under Title II, and the FCC has long classified broadband Internet access service as an "information service." Thus, the court concluded that the agency could not utilize its authority under Section 706 to impose Title II common carrier obligations on broadband Internet access service providers.

The FCC, led by Chairman Wheeler, subsequently issued a Notice of Proposed Rulemaking proposing, among other things, a new path toward promulgating Open Internet rules utilizing the agency's authority under Section 706.[3] The FCC proposed to permit broadband providers (e.g. Verizon, AT&T, and Comcast) to negotiate individualized, differentiated arrangements with similarly situated edge providers (e.g., Disney, Netflix, Google) subject to a separate commercial reasonableness rule or its equivalent. The FCC also proposed to modify and expand the existing transparency rules with separate disclosures to end users and edge providers. The FCC is considering expanding disclosures to end users and others beyond the scope of the existing rule, which covers broadband provider network practices, performance characteristics (e.g., effective download speeds, upload speeds, latency, and packet loss), and/or terms and conditions of service. Regarding disclosure to edge providers, the FCC sought comment on what additional disclosures would aid content, application, service, and device providers to develop, market, and maintain Internet offerings. The FCC also proposed to offer a new rationale for and reinstate the no-blocking rule struck down by the D.C. Circuit. Further, the FCC proposed a multi-faceted dispute resolution process and sought comment on the creation of an ombudsman to act as a watchdog to represent the interests of consumers, start-ups, and small businesses. In the FCC's view, these proposed rules would be permissible because they would permit individualized negotiations and thus are not Title II common carrier regulation. Nevertheless, the FCC emphasized that it will also "seriously" consider regulating broadband Internet access service as common carriage under Title II.

In the months following the NPRM's release, the FCC was swamped with several million comments. Unsurprisingly, the comments covered a broad spectrum of positions. Many commenters acknowledged the FCC's regulatory authority under Section 706 of the Act, but opposed additional regulation of broadband Internet access service. Other commenters supported the FCC's proposed use of its Section 706 authority to impose new regulations on broadband Internet access service.

Some commenters, however, were dissatisfied with the FCC's proposals, arguing that no exercise of authority under Section 706 would be sufficient to prevent broadband providers from charging some edge providers to deliver data to customers through Internet "fast lanes," while relegating other edge providers to the "slow lane." These "Net Neutrality" or "Open Internet" advocates argued that, to avoid this subversion of Internet "openness," the FCC must reclassify broadband Internet access service as a "telecommunications service" and regulate broadband providers as common carriers under Title II of the Act. In their view, only Title II would provide a legally sufficient basis for imposing the sweeping "anti-blocking" and "anti-discrimination" rules Open Internet advocates believe to be necessary. Unfortunately, the Title II supporters appear to be winning the day: In November, President Obama called for reclassification of broadband Internet access as a Title II telecommunications service, and FCC Chairman Tom Wheeler has announced his intent to accede to the President's wishes at the FCC's February 26th Open Meeting. In partial response, Senate and House Republican Commerce Committee leadership recently unveiled draft legislation to provide statutory authority to preserve the Open Internet, but would prevent the Commission from regulating the Internet under Title II or any other regulatory scheme.[4] There are serious legal and policy impediments to the FCC reclassifying broadband Internet service in this manner, however. Reclassification would require the FCC to reverse a more than 15-year-old bipartisan consensus that broadband Internet service should not be regulated as common carriage. As such, the agency bears a heavy burden of showing new, and undoubtedly creative, reasons to justify the new classification particularly because reclassification would necessarily rest "on factual findings that contradict those which underlay its prior policy."[5] And, such a change would not be limited exclusively to broadband network providers as some Open Internet advocates argue, but would open the door to sweeping new regulation over a broad range of market participants. Many have suggested that the FCC could reclassify broadband Internet access as a Title II service but exercise its discretion to only enforce a handful of the most important consumer oriented Title II obligations through a process known as "forbearance". While an option in theory, there is no agreement on which Title II requirements the Commission should forbear from and the path to this type of sweeping forbearance (dozens of statutory provisions and hundreds of rules would need to be forborn from) is far from proven. There will also be significant legal hurdles for the FCC to overcome by relying on a section of the Act to justify a significant regulatory change of course while simultaneously suggesting that the vast majority of Title II need not be applied.

I. Reclassification Would Change Radically the Regulatory Environment That Has Fostered the Extraordinary Growth of Broadband Internet

The Act establishes a strict regulatory demarcation between "information" and "telecommunications" services. A "telecommunications service" is "the offering of telecommunications for a fee directly to the public, regardless of the facilities used."[6] "[T]elecommunications," in turn, is "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[7] An "information service," on the other hand, is "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications . . . ."[8] Telecommunications services are subject to common carriage regulation under Title II of the Act; information services are not.[9]

For more than a decade, the FCC has classified broadband Internet access service as an information service and thus exempt from Title II regulation.[10] In a 1998 Report to Congress, the

FCC held that Internet Service Providers "conjoin the data transport with data processing, information provision, and other computer-mediated offerings, thereby creating an information service."[11] Since then, the FCC has repeatedly made this classification based on factual and legal grounds, all of which continue to militate in favor of continuing to classify broadband service as an information service. From a factual perspective, all broadband Internet access offerings, in 1998 and still today, involve both transmission and data processing components, but these components are so intertwined and integral to the overall service offering that they cannot be distinguished and separately classified on any principled basis.

Broadband Internet access service integrates the data processing and transmission components into a "single, integrated service that enables the subscriber to utilize Internet access service through [the] provider's facilities and to realize the benefits of a comprehensive service offering."[12] As such, the agency concluded that broadband Internet access service should be regulated as an integrated service and the Supreme Court agreed.[13] Thus, "when an entity offers transmission incorporating the 'capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information,' it does not offer telecommunications. Rather, it offers an 'information service' even though it uses telecommunications to do so."[14]

Broadband Internet service continues to be a unified service that integrates both information and telecommunications inputs. Transmission continues to be fundamentally intertwined with data functionalities such as Domain Name System ("DNS") and Dynamic Host Configuration Protocol ("DHCP") functionality, as well as integrated security, spam filtering, and distributed denial-of-service protections. Indeed, DNS and DHCP functionality is inextricably involved with nearly every broadband Internet access use. The fact that some customers may rely upon third-parties to provide some of these services and functions is not inconsistent with the conclusion that the overall broadband offering is an integrated service offering. As the FCC has acknowledged, these functionalities remain an integral part of the broadband Internet service offering "regardless of whether subscribers use all of the functions provided as part of the service . . . and regardless of whether every [broadband Internet access] service provider offers each function that could be included in the service."[15]

There are also compelling economic policy reasons that justify continuing to classify broadband Internet access service as an information service. Indeed, reclassifying broadband Internet as telecommunications so that the service can be regulated as common carriage under Title II simply makes no economic sense. Many of the FCC's Title II rules and regulations were designed more than 80 years ago for a communications service and market that was drastically different than the broadband Internet access market. Title II is intended to serve a market in which all communications are interconnected through the public switched telephone network ("PSTN") and customers are served by a single monopoly provider. The broadband Internet, by contrast, is a dynamic system of interconnected networks of servers, routers, links, and end-user devices that are owned and operated by consumers and by a multitude of competing service providers, offering different and competing services.

Amending the Act in 1996, Congress concluded that broadband services should exist in a minimal regulatory environment that promotes investment and limits unnecessary and unduly burdensome regulatory costs.[16] The FCC has followed suit, finding that classifying broadband Internet access service as an information service was warranted as a means for encouraging investment and innovation by insulating that service from the burdensome and outdated regulatory obligations associated with Title II of the Act.

This light-handed regulatory approach has been an extraordinary success; network investment, innovation, and broadband availability are all flourishing.[17] "Whole new product markets have blossomed in recent years, and the market for applications has both diversified and exploded."[18] More than 99 percent of Americans now have access to either fixed or wireless broadband service[19] and consumers are benefitting from improvements in high-speed Internet offerings and will continue to do so.[20] 85% of US households have access to networks capable of delivering 100 Mbps[21] and the FCC's own data indicate that the average speed tier to which Americans subscribe increased 36% in 2013.[22] Access to broadband at these speeds did not happen by accident. According to recent analyses, U.S. broadband providers invested over $75 billion (or roughly $612 per household) in 2013 alone, up from $69 billion the prior year.[23] The US invests twice as much per household on broadband as the EU. Investment in telecommunications networks in the US per capita is $197, compared to only $129 across Europe and only $119 in the four largest EU countries (Germany, France, Italy, and the United Kingdom).[24] The United States is the world leader in broadband innovation and is at the epicenter of the global broadband economy.

Retreating from this position and classifying broadband Internet access service as a "telecommunications service" would upend this successful regulatory approach and potentially stymie the ongoing capital investment, technological innovation, and rapid deployment that have been the hallmarks of the broadband Internet market to date. For instance, lying at the heart of the Title II common carrier obligations are highly intrusive price and entry and exit regulations, and a duty of non-discrimination.[25] Price regulation essentially empowers the FCC – as opposed to the market – to determine the value of broadband and is precisely the kind of economic regulation that would stifle infrastructure investment. Entry and exit regulation would require the FCC to approve the addition or extension of new services or the discontinuance of old services, which the FCC is unlikely to accomplish at a pace that could even come close to matching the speed of innovation that has been the essential characteristic of the broadband Internet market to date. Further, the common carrier non-discrimination obligation may well call into question important interconnection arrangements such as those between Content Delivery Networks ("CDNs") (e.g., Akamai) and broadband Internet access providers.

Regulation as a common carrier would also include obligations to contribute to the Universal Service Fund, potentially creating a tax of ten percent or more on Internet access and im-

posing additional regulatory costs on the broadband system.[26] Common carriage regulation also carries with it highly restrictive limits on the use of call location information and could well disrupt the business models for highly popular location-based services such as Uber, Groupon, and Foursquare.[27]

In short, Title II regulation of broadband Internet access would chill investment and discourage innovation, impeding the fundamental public interest benefits enabled by the Internet. Reversing course in favor of Internet regulation would also threaten the United States' role as a global leader in the broadband economy. For instance, a drastic shift in policy here could drive capital to other countries. More significant, substantial new domestic regulation could embolden regimes that want to regulate content, thereby undermining the Internet as an engine for economic development and free speech. Reclassification would send the wrong signals across the globe.

II. Reclassification Would Reach Into Virtually Every Corner of the Broadband Internet System

The adverse effects of reclassification would be sweeping and would reach into virtually every corner of the broadband Internet system. As discussed, reclassification would require the FCC to identify a severable transmission component of broadband Internet access service that could be classified as a "telecommunications service." In "breaking down the distinction between information services and telecommunications services, so that some information services were classed as telecommunications services, it would be difficult [for the FCC] to devise a sustainable rationale under which all, or essentially all, information services did not fall into the telecommunications service category."[28] Indeed, it would be more than difficult; there is no rational basis for segregating the transmission and data processing components of broadband Internet access service.

Broadband was classified as an information service because it transmits data only in connection with further processing, and because that transmission is necessary to providing Internet access service.[29] Broadband services have become increasingly sophisticated and continue to integrate information services, including data storage or email services that involve storing or utilizing data; parental controls and other security functions that store security preferences, then filter data as it is retrieved or generated by the consumer; and services for personalizing home portal pages through generating or transforming information. Providers integrate into their broadband offerings ever-more advanced features and capabilities, such as cloud-based services for storing information, as well as for retrieving and acquiring information via software services; new spam filters and other reputation systems for processing potentially harmful data; and caching servers and CDNs that store media content to enable consumers to access that content at faster speeds. Today, broadband Internet services tightly integrate data transmission with data processing to the point that the two functions cannot realistically be separated at all.

The statutory definition of "telecommunications" itself underlines this conclusion. "[T]elecommunications" is "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[30] On the Internet, however, the information transmitted is changed in form routinely and often is accompanied by other information the user does not select, such as third-party advertisements. In other words, "telecommunications," as defined by the Act, simply does not exist separate and apart from data processing in the broadband Internet world. Thus, as the Supreme Court recognized, classifying as telecommunications carriers "all entities that use telecommunications inputs to provide information service" would *necessarily* subject "all information service providers that use telecommunications as an input to provide information service to the public" to common carrier regulation.[31]

Open Internet advocates reject this position, arguing that reclassification can be limited only to those providers that own last-mile transmission facilities. This position is wrong as a matter of law. The statutory definitions of "telecommunications service" and "information service" turn on the nature of the service offering and the functionalities provided to the customer and not on the facilities used to provide those functionalities or who owns those facilities.[32] As the Supreme Court acknowledged, "the relevant [statutory] definitions do not distinguish facilities-based and non-facilities-based carriers."[33] Reclassification would thus extend not only to network providers that own last-mile facilities, but also to providers that do not own last-mile facilities, including Internet Service Providers ("ISPs") such as Earthlink and AOL, CDNs such as Akamai, Internet backbone providers like Level 3, providers of broadband-enabled devices such as E-readers, Internet search engines and online advertising companies such as Google, online video services like Netflix, and cloud-computing services like Amazon.com's Elastic Compute Cloud.

All information services are by definition provided "via telecommunications,"[34] but if telecommunications is properly viewed as a distinct transmission component, then all of these entities, and many more, would be subject to classification as common carriers because they are providing "telecommunications service" – i.e., they are offering transmission functionality ("telecommunications") to the public for a fee.[35] For instance, even if they do not own last-mile transmission facilities, ISPs own other network facilities, including fiber-optic links that connect their local access equipment to cache servers and Internet backbone networks.[36] These companies also transport end users' data traffic throughout the Internet, even though they purchase transmission supplied by another provider's last-mile facilities. Likewise, online video and cloud-computing services interconnect directly with broadband Internet access service providers by means of their own facilities or leased transmission capacity, to enable the transmission of data to and from their own servers. Internet transport companies provide backbone Internet access and content-delivery services to thousands of large and small businesses and edge providers using facilities they either own or lease. CDNs use dedicated fiber-optic transmission capacity, perform packet-distribution functions similar to those of backbone networks, and use much the same equipment and architecture as backbone networks, transporting data around the globe, to and from cache servers located closer to their large and small business and edge provider customers.

E-readers enable Internet access through integrated wireless connectivity and web-browsing functionality. Internet search engines and online advertising companies provide for the transmission of search results and advertising messages to end users.

If the FCC accepts the notion that a transmission function is necessarily severable from information-processing functions for purposes of regulatory classification, there is no principled way to cabin the reach of Title II to just one segment of the Internet and not others. Thus, every entity that provides a transmission capability would potentially be regulated as a common carrier.

III. Conclusion

The calls for reclassification of broadband Internet access services give rise to a host of policy and legal problems and ultimately threaten the United States' position as the global leader in the broadband economy. Title II rules and regulations are designed for a market that no longer exists – a market in which all communications are interconnected with the PSTN and customers are served by a single monopoly provider. With no market failure or actual consumer harms identified, the rules can also be seen as a bureaucratic land grab to ensure the government has a central ongoing role in the Internet economy. The broadband Internet is a dynamic system of interconnected networks of servers, routers, links, and end-user devices that are owned and operated by consumers and by a multitude of competing service providers, offering a multitude of services. Subjecting this entire dynamic and innovative broadband marketplace to outdated Title II regulation would fundamentally undermine the extraordinary levels of investment and innovation in the market. Reclassification would affect virtually every entity providing broadband Internet services and would signal a retreat from a decade's-old bipartisan consensus that broadband Internet service should not be regulated as common carriage that would echo across the globe. Countries that are already over-regulating the broadband economy would be emboldened to continue down this dangerous path if the United States, a global leader, abandons its proven and successful innovation policy.

Endnotes

1 Verizon v. FCC, 740 F.3d 623 (D.C. Cir. 2014).

2 47 U.S.C. § 1302. Section 706 says that if the FCC finds "advanced services" (broadband) are not being deployed to all Americans in a timely manner, the Commission must take immediate action to remove barriers to such deployment. Thus according to the Court, if properly implemented, Open Internet rules could be justified using Section 706 authority on the theory that the promise of an Open Internet would remove barriers to investment and result in greater broadband deployment.

3 *See Protecting and Promoting the Open Internet*, 29 FCC Rcd 5561 (2014) ("*Notice*").

4 *Congressional Leaders Unveil Draft Legislation Ensuring Consumer Protections and Innovative Internet, available at* http://energycommerce.house.gov/press-release/congressional-leaders-unveil-draft-legislation-ensuring-consumer-protections-and.

5 FCC v. Fox Television Stations, 556 U.S. 502, 515 (2009).

6 47 U.S.C. § 153(53).

7 *Id.* § 153(51).

8 47 U.S.C. § 153(24).

9 *Verizon,* 740 F.3d at 655-58.

10 *See Inquiry Concerning High-Speed Access to the Internet Over Cable & Other Facilities; Internet Over Cable Declaratory Ruling; Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, 17 FCC Rcd 4798, 4824 ¶ 41 (2002) ("*Cable Modem Order*"), *aff'd sub nom.* Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967 (2005) (hereinafter *Brand X*); Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities et al., 20 FCC Rcd 14853, 14863-65 ¶¶ 14-17, 14909-12 ¶¶ 103-06 (2005); *Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks,* 22 FCC Rcd 5901, 5909-11 ¶¶ 19-26, 5912-14 ¶¶ 29-33 (2007); *United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service*, 21 FCC Rcd 13281 (2006).

11 Report to Congress, *Federal-State Joint Board on Universal Service*, 13 FCC Rcd 11501, 11540 ¶ 81 (1998) ("Report to Congress").

12 *Cable Modem Order*, 17 FCC Rcd at 4822-23 ¶ 38.

13 *Brand X*, 545 U.S. at 999-1000.

14 Report to Congress, 13 FCC Rcd at 11520 ¶ 39.

15 *Id.*

16 47 U.S.C. § 230(b)(2) ("It is the policy of the United States . . . to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation.").

17 *Notice*, 29 FCC Rcd 5571-72 ¶¶ 30-32.

18 *Id.* at 5571 ¶ 31.

19 National Broadband Map, *Broadband Statistics Report, Access to Broadband Technology by Speed*, at 3 (Feb. 2014), available at http://www.broadbandmap.gov/download/Technology%20by%20Speed.pdf.

20 Research by Cisco Systems, Inc. projects data speeds to nearly triple by 2018. Cisco Systems, Inc., "The Zettabyte Era: Trends and Analysis," at 2 (June 10, 2014), available at http://www.cisco.com/c/en/us/solutions/collateral/service-provider/visual-networking-index-vni/VNI_Hyperconnectivity_WP.pdf.

21 *See* https://www.ncta.com/industry-data.

22 *See Measuring Broadband America – 2014: A Report on Consumer Wireline Broadband Performance in the U.S.*, FCC Office of Engineering and Technology and Consumer and Governmental Affairs Bureau (Jun. 18, 2014), http://www.fcc.gov/reports/measuring-broadband-america-2014.

23 *See* Patrick Brogan, *Updated Capital Spending Data Show Rising Broadband Investment in Nation's Information Infrastructure*, USTelecom (Nov. 4, 2013), http://www.ustelecom.org/sites/default/files-/documents/103113-capex-research-brief-v2.pdf. *See also* National Cable & Telecommunications Association, Public Policy, *Setting the Record Straight on Broadband Investment*, May 13, 2014, https://www.ncta.com/platform/public-policy/setting-the-record-straight-on-broadband-investment/ (last visited July 11, 2014). *See also* CTIA, Annual Wireless Industry Survey, http://www.ctia.org/your-wireless-life/how-wireless-works/annual-wireless-industry-survey (last visited July 11, 2014).

24 Martin H. Thelle & Bruno Basalisco, *Copenhagen Economics, Europe Can Catch Up with the US: A Contrast of Two Contrary Broadband Models* (2013), Copenhagen Economics, *available at* http://www.copenhageneconomics.com/Website/News.aspx?PID=3058&M=NewsV2&Action= &NewsId=708.

25 *See* 47 U.S.C. §§ 201(b), 202, 203, and 214. Non-discrimination is related to end users and between and among carriers.

26 *Id.* § 254; *See* Robert Litan & Hal Singer, *Outdated Regulations Will Make Consumers Pay More for Broadband*, Progressive Policy Institute (Dec. 1, 2014), http://www.progressivepolicy.org/slider/outdated-regulations-will-make-consumers-pay-broadband.

27 *Id.* § 222.

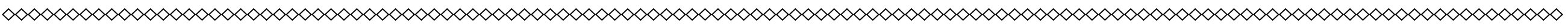
28 Report to Congress, 13 FCC Rcd at 11529 ¶ 57.

29 *Brand X*, 545 U.S. at 998.

30 47 U.S.C. § 153(51).

31 *Brand X*, 545 U.S. at 994.

32 *See, e.g.*, 47 U.S.C. § 153(53) (telecommunications service is "the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, *regardless of the facilities used*") (emphasis added).



33 *Brand X,* 545 U.S. at 997.

34 *See* 47 U.S.C. § 153(24) (defining "information service").

35 *Id.* § 153(53).

36 Report to Congress, 13 FCC Rcd at 11534, 11536 ¶¶ 69, 73, & n.138.

This Is How We Will Ensure Net Neutrality

Tom Wheeler, Chairman, Federal Communications Commission

Wired, Feb. 4, 2015: http://www.wired.com/2015/02/fcc-chairman-wheeler-net-neutrality/

After more than a decade of debate and a record-setting proceeding that attracted nearly 4 million public comments, the time to settle the Net Neutrality question has arrived. This week, I will circulate to the members of the Federal Communications Commission (FCC) proposed new rules to preserve the internet as an open platform for innovation and free expression. This proposal is rooted in long-standing regulatory principles, marketplace experience, and public input received over the last several months.

Broadband network operators have an understandable motivation to manage their network to maximize their business interests. But their actions may not always be optimal for network users. The Congress gave the FCC broad authority to update its rules to reflect changes in technology and marketplace behavior in a way that protects consumers. Over the years, the Commission has used this authority to the public's great benefit.

The internet wouldn't have emerged as it did, for instance, if the FCC hadn't mandated open access for network equipment in the late 1960s. Before then, AT&T prohibited anyone from attaching non-AT&T equipment to the network. The modems that enabled the internet were usable only because the FCC required the network to be open.

Companies such as AOL were able to grow in the early days of home computing because these modems gave them access to the open telephone network.

I personally learned the importance of open networks the hard way. In the mid-1980s I was president of a startup, NABU: The Home Computer Network. My company was using new technology to deliver high-speed data to home computers over cable television lines. Across town Steve Case was starting what became AOL. NABU was delivering service at the then-blazing speed of 1.5 megabits per second—hundreds of times faster than Case's company. "We used to worry about you a lot," Case told me years later.

But NABU went broke while AOL became very successful. Why that is highlights the fundamental problem with allowing networks to act as gatekeepers.

While delivering better service, NABU had to depend on cable television operators granting access to their systems. Steve Case was not only a brilliant entrepreneur, but he also had access to an unlimited number of customers nationwide who only had to attach a modem to their phone line to receive his service. The phone network was open whereas the cable networks were closed. End of story.

The phone network's openness did not happen by accident, but by FCC rule. How we precisely deliver that kind of openness for America's broadband networks has been the subject of a debate over the last several months.

Originally, I believed that the FCC could assure internet openness through a determination of "commercial reasonableness" under Section 706 of the Telecommunications Act of 1996. While a recent court decision seemed to draw a roadmap for using this approach, I became concerned that this relatively new concept might, down the road, be interpreted to mean what is reasonable for commercial interests, not consumers.

That is why I am proposing that the FCC use its Title II authority to implement and enforce open internet protections.

Using this authority, I am submitting to my colleagues the strongest open internet protections ever proposed by the FCC. These enforceable, bright-line rules will ban paid prioritization, and the blocking and throttling of lawful content and services. I propose to fully apply—for the first time ever—those bright-line rules to mobile broadband. My proposal assures the rights of internet users to go where they want, when they want, and the rights of innovators to introduce new products without asking anyone's permission.

All of this can be accomplished while encouraging investment in broadband networks. To preserve incentives for broadband operators to invest in their networks, my proposal will modernize Title II, tailoring it for the 21st century, in order to provide returns necessary to construct competitive networks. For example, there will be no rate regulation, no tariffs, no last-mile unbundling. Over the last 21 years, the wireless industry has invested almost $300 billion under similar rules, proving that modernized Title II regulation can encourage investment and competition.

Congress wisely gave the FCC the power to update its rules to keep pace with innovation. Under that authority my proposal includes a general conduct rule that can be used to stop new and novel threats to the internet. This means the action we take will be strong enough and flexible enough not only to deal with the realities of today, but also to establish ground rules for the as yet unimagined.

The internet must be fast, fair and open. That is the message I've heard from consumers and innovators across this nation. That is the principle that has enabled the internet to become an unprecedented platform for innovation and human expression. And that is the lesson I learned heading a tech startup at the dawn of the internet age. The proposal I present to the commission will ensure the internet remains open, now and in the future, for all Americans.