

TEXAS TRANSNATIONAL LAW QUARTERLY



**International
Law Section**

**THE
STATE
BAR
OF
TEXAS**

VOL. 22

JUNE 2009

NO. 3

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Submission of Articles

We welcome the submission of articles and recent developments for publication in the TTLQ. Authors may wish to check with the Editor about preemption of their topic. Articles should be approximately three to ten double-spaced pages inclusive of endnotes. Generally, citations should conform to the Bluebook form of citations. All articles should be submitted by email to Miranda-Lin.S.Bailey@exxonmobil.com.

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If you are aware of attorneys who are not members of the International Law Section of the State Bar of Texas or who may have failed to renew their membership, please give them the membership information that is included in the back of the TTLQ.

Online

Access this and past issues of the TTLQ at <http://www.ilstexas.org/ttlq.htm>.

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July 22, 2009

Dear Members of the International Law Section:

Welcome to this edition of the TTLQ and to the "New Year" for the International Law Section! As the new Chair of the Section, I would like to thank Joe Rudberg of Dallas for his service as Chair over the past year, to welcome Alex Cestero of Houston as our new Secretary-Treasurer and Miranda-Lin Bailey as our new TTLQ Editor-in-Chief, and to thank Betty Ungerman of Dallas for her willingness to serve as Vice Chair. Thank you also to the Council Members who have rotated off the Council and to our new Council Members for their willingness to serve. Welcome also to new members of the Section joining us for the first time, or rejoining us, this year.

We are planning a full year of activities, including some new ones. For example, the Section and several of our members expect to be involved in a new Task Force being established by the Texas Supreme Court to study certain issues associated with the practice of international law in our State. We also expect to welcome a delegation this coming Fall from the English Law Society and likely will host an event with them in Houston on November 3 that will provide an opportunity for our members and the delegation to network and discuss our similarities and differences. A major activity of this coming year, as it is each year, is planning for our 22nd Annual Institute. Please mark your calendars for March 3-5, 2010. While not yet completely firmed up, we do anticipate holding the 2010 Annual Institute in Houston on those dates.

Other activities include joining an incipient effort, initiated by the New York State Bar's International Law Section, to bring together for greater collaboration International Law Sections from across the country. Also, we look forward as a Section to greater involvement with the International Law Sections of various local Bar Associations around the State. Further, we are establishing committees to focus on membership, updating our website, reviewing our bylaws and other areas, in addition to continuing our strong focus on law student outreach and related presentations at law schools around the State. We will seek to provide more information to law students about the practice of international law, a particularly important issue in light of the current job markets for new law graduates. More details will follow on these and other matters.

All in all, we expect a busy year, and we welcome your ideas and involvement. Please feel free to reach out to any of the Officers or Council Members of the Section. I look forward to serving as your Chair for the coming year and thank you for that opportunity.

Very truly yours,

The Offshoring of Commercial Contract Management

By
John (“Johnny”) E. Miller

In my thirty-year contracts management career, I have seen a lot of changes and trends in the contract management field. But I can honestly say that some aspects of current commercial contract management offshoring activities may be the start of one of the biggest changes in the field of commercial contract management in recent memory.

Contract management involves working with an entity’s contracts to meet that entity’s business requirements while concurrently minimizing risks.¹ Effective contract management is a vital component of an entity’s overall risk management activities.

For the purposes of this article, offshoring is defined as the movement of a business process of an entity in one country to the same or another entity in a different country. In many cases, the business process is moved due to a lower cost of operations or the benefit of more efficient operations in the new location. Offshoring commercial contract management has both its advantages and its disadvantages.²

Ten Advantages of Offshoring

1. Using India as an example, high-quality, cost-efficient attorneys and other contracts professionals are readily available from the top schools in India (and at the top of their class as well) who have extensive training in U.S. contract matters to perform day-to-day commercial contract administration tasks at a substantial rate of cost savings. Further, the quality of the work is not sacrificed due to the substantial price differential. There are, of course, other countries now and in the future that can also do what India is doing regarding commercial contract management offshoring.

2. The offshore contract management resources can operate like an extension of the American entity’s contract or purchasing department.

3. Offshoring certain aspects of contract management frees up the entity’s U.S.-based

contract management or purchasing personnel to work on more complex strategic matters that can have a greater revenue impact, thus allowing the U.S.-based team to move up the value chain.

4. Properly selected offshore resources can provide the requisite data security and confidentiality.

5. The time differences between the United States and India allow the offshore resources to work while it is night time in the United States, thus improving deliverable response time. This creates a “follow-the-sun” capability for the U.S. entity to work on contract management activities on a non-stop 24/7 basis with their counterpart offshoring team.

6. Done properly, offshoring can produce improvements in service. These highly motivated offshore workforces are very capable. The benefits of learning to do the job better are obviously not limited to cost alone.

7. Offshoring functions to India can improve quality, since it allows an entity to spend substantially more time on a task due to lower labor costs, thus making the deliverables more robust and complete.

8. The U.S. team will have the ability to send overflow work to its offshore team in India.

9. The legal system in India is similar to that of the United States. This is an important feature in commercial contract management offshoring since it provides valuable initial training for offshore resources that is comparable to the U.S. legal environment.

10. It can potentially create a competitive advantage for the U.S. entity by enhancing productivity and innovation.

Ten Disadvantages of Offshoring

1. Offshoring carries with it the possibility of the loss of managerial control. This is because it is

more difficult to manage offshore service providers than to manage one's own employees in the United States.

2. There are often hidden costs involved in offshoring that are difficult to prepare for or calculate. These hidden costs include legal and administrative costs related to putting together an offshore agreement between the U.S. entity and the offshore entity, as well as the time spent to administer and coordinate the ongoing offshoring contract.

3. Offshoring can create a potential threat to security and confidentiality. The U.S. entity must be very careful not only in selecting an offshoring entity, but also in choosing which contract management business process activity it wants to offshore.

4. Offshoring could result in a possible loss of flexibility in rapidly reacting to changing business conditions.

5. Offshoring can potentially create export compliance problems.

6. Potential conflict of interest issues may arise, unless initial and ongoing due diligence is exercised.

7. Should something go wrong, it is a long distance between the U.S. entity and the offshored facility, which can lead to expensive, time-consuming trips to deal with matters personally.

8. Potential cultural issues in the offshore country can cause problems.

9. Political instability in the offshore country can sometimes be a problem.

10. Potential intellectual property risks can develop with the offshore entity.

Commercial Contract Management Offshoring Models

Captive Centers: Captive centers in India are formed by U.S. entities and their subsidiaries. A captive center is an entity's own internal captive center resource (or its subsidiary's captive center resource). This model is not likely to succeed unless it can grow to at least 100

professionals. Captive centers smaller than this are generally unable to provide good career paths to its professionals, who are likely to leave, especially because the job market in India is expected to remain hot for the next few years.³

Joint Ventures by U.S. Entities: As explained by the consulting firm Evalueserve, "Rather than opening their own captive centers, several U.S.-based entities have joint ventures with firms in India. However, since statistically most joint ventures fail – particularly in India – one needs to be cautious while pursuing this potential solution."⁴

Third-Party Offshore Vendors: Third-party offshore vendors provide offshore third-party contract management services to a U.S. entity. They generally work directly with the U.S. entity.

Third-Party Domestic Outsourcing Vendors with Offshore Resources: In this model, the third-party outsourcing provider is based in the United States and possesses offshore resources. It provides third-party contract management services to another U.S.-based entity by providing its offshore resources to the other U.S. entity.

Offshoring Today

Some organizations require a large number of contracts and agreements to be drafted.

Several examples include incoming and outgoing non-disclosure agreements, products and services sales agreements, teaming agreements, subcontracts, software licensing agreements, software evaluation agreements, beta test agreements, software training agreements, software support and maintenance agreements, software services agreements, application service provider agreements, consulting agreements, technology licensing agreements, supplier agreements, service provider agreements, lease agreements, vendor agreements, original equipment manufacturer agreements, value-added reseller agreements, distributor agreements, statements of work, and service level agreements.

Since each agreement typically follows an entity's standard template, Indian contracts professionals can produce the initial drafts of

such agreements, which can then be reviewed and modified by their U.S. clients. As Evalueserve has noted in the context of legal process outsourcing, Indian contracts professionals can also be used for doing initial reviews of such documents, proofreading documents, “red-lining” documents, providing comments about the agreements, and ensuring these documents follow the guidelines provided by their U.S. clients.⁵

Other aspects of the commercial contract management business process are also being offshored, such as assisting with requests for information (RFI) and request for proposal (RFP) development, assisting with cost and price analysis, pricing assistance, preparing contract summaries to enhance contract awareness, preparing contract obligations roadmaps, assisting with contract modifications, reviewing subcontractor certificates of insurance, tracking deliverables, tracking contractual issues and risks, and other similar tasks.

The Future of Commercial Contract Management Offshoring

It can be expected that globalization of the commercial contract management business process will roll forward using the offshoring process. Given what is currently happening to the economy, entities will continue to be under increasing cost pressures, which will force them to look at more ways to reduce expenses. Therefore, entities will be looking at the offshoring of certain aspects of commercial contract management much more seriously.

Entities will continue to look for ways to take costs out wherever they can. As a result, offshoring will continue to move up the value chain to encompass more aspects of the commercial contract management business process. This process migration is inevitable. Further, the offshoring of certain aspects of the commercial contract management business process will continue to gain momentum at a much greater pace than most predict.

India’s domination of the commercial contract management offshoring sector will most likely continue due to such factors as:

- Labor arbitrage,
- English-speaking capabilities,
- Huge talent pool,

- Somewhat similar legal system to the United States,
- Local government backing,
- Use of cutting edge technologies,
- Improving telecom systems,
- Improving infrastructure, and
- Established management skills.

However, in time, other offshore entities in China, the Philippines, South Africa, Mauritius, Barbados, Romania, Eastern Europe, Malaysia, Morocco, and other countries will become worthy competitors trying to expand their “sweet spots” to reach certain aspects of commercial contract management offshoring.

The American comedian George Burns once said, “I look to the future because that’s where I’m going to spend the rest of my life.”⁶ Likewise, we need to look to the future by planning and preparing for the future impact of the offshoring of many aspects of the commercial contract management business process.

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¹ Sandra Levy, *Minimizing Risk Through Streamlined Contract Management Processes*, THE METROPOLITAN CORPORATE COUNSEL 28 (DEC. 2008).

² This article is not intended to be the definitive discussion on the offshoring of commercial contract management. However, it is designed to make you think a little bit about the offshoring of certain aspects of the commercial contract management business process. Obviously, although the primary focus of this article deals with commercial contract management, many aspects will also apply to government contract management as well.

³ Evalueserve, *Legal Process Outsourcing (LPO)—Hype vs. Reality* (undated), available at www.evalueserve.com/Media-And-Reports/HTML-Press-Releases/Recent/Legal_Process-Outsourcing-Hype_vs_Reality.aspx.

⁴ *Id.*

⁵ *Id.*

⁶ ThinkExist.Com, *Compilation of Quotations*, available at http://thinkexist.com/quotes/George_Burns.

International Commercial Arbitration and the Arbitration Fairness Acts of 2009

By
Ann Ryan Robertson

An anti-arbitration storm is brewing in the United States as a result of perceived injustices in arbitrations involving claims brought by individuals. Unfortunately, the arbitration bills that have recently been introduced in Congress to address these concerns may have unforeseen and, in some instances, far-reaching consequences. The proposed bills are not only poorly drafted, but also fail to appreciate the widespread acceptance of arbitration as a dispute resolution mechanism in commercial transactions and fail to acknowledge the important role of arbitration in international trade.

This article will examine the potential impact on international commercial arbitration of two of the pending bills: (1) the Arbitration Fairness Act of 2009, House Bill 1020 (the “House Bill”); and (2) the Arbitration Fairness Act of 2009, Senate Bill 931 (the “Senate Bill”).

The Tempest Forms

With the passage of the United States Federal Arbitration Act (the “FAA”) in 1925, Congress “declared a national policy favoring arbitration and withdrew the power of states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration.”¹ Since the FAA’s enactment, U.S. courts have repeatedly emphasized the importance of arbitration to the conduct of commercial transactions and upheld arbitration as an appropriate means of resolving a variety of disputes.

Embracing the courts’ acceptance of arbitration, U.S. businesses have widely incorporated arbitration clauses in their domestic contracts, perhaps most notably in the consumer and employment context.

Not surprisingly, international commercial arbitration remains companies’ preferred resolution mechanism for cross-border disputes because it offers many benefits, including the ability to avoid national courts, to select a mutually agreed upon forum, to select the decision makers, and to enforce arbitral awards around the world pursuant

to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (“New York Convention”).²

Over the past few years, however, consumer advocacy groups have mounted campaigns against the perceived injustices of arbitration in the consumer and employment arenas. Stories abound of consumers being required to arbitrate in distant locales under rules that favor business, of employees being required to agree to arbitration in order to obtain employment, and of the imposition of short contractual statutes of limitation as a means of foreclosing claims. The Arbitration Fairness Act of 2007 was introduced in response to this hue and cry, but ultimately died in committee.

A new wind now blows, as the Democrats control both the executive and legislative branches of government. This change in control, coupled with the deepening global economic crisis and the concomitant derogation of corporate America, portends the passage of an anti-arbitration bill in 2009.

On February 12, 2009, Representative Hank Johnson, Jr, a Democratic Congressman from Georgia, introduced the House Bill, which has the support of over sixty-four Representatives. Congressman Johnson described the House Bill as “not an anti-business bill, but a pro-consumer bill” designed to protect a citizen’s right to jury trial by prohibiting the use of mandatory arbitration clauses in employment and consumer contracts. In announcing the introduction of the bill, Representative Johnson specifically identified contracts involving wireless telephone services, credit cards, elder care facilities, and home buying as the types of contracts that typically include mandatory arbitration provisions.

Interest in the United States in reforming consumer and employment arbitration is high. Fair Arbitration Now, a coalition of consumer and other groups lobbying for passage of an anti-arbitration bill, organized and celebrated what they deemed “Arbitration Fairness Day” on April 29, 2009. Although it has since been criticized,³ a poll

conducted by Lake Research Partners was unveiled that day, showing:

- six in ten likely voters supported the Arbitration Fairness Act – including a majority of Democrats, Republicans and Independents;
- 59 percent of likely voters opposed the use of mandatory binding arbitration clauses in employment and consumer contracts;
- two-thirds of respondents could not remember ever reading about a forced arbitration provision buried in the fine print of employment terms or an agreement for goods and services; and
- more than 70 percent of the respondents believed they could take their employer or a corporation to court in the event of a dispute, unaware they could be subjected to mandatory binding arbitration.

On Arbitration Fairness Day, Senator Russ Feingold, a Democratic Senator from Wisconsin, together with seven co-sponsors, introduced the Senate version of the Arbitration Fairness Act, stating:

Americans are sick and tired of a system that so strongly favors big corporations over consumers and in this case robs them of their constitutional right to their day in court. Americans are often given no choice but to give up their rights if they want to sign credit card agreements, cell phone contracts, job applications or other basic contracts. It's time for Congress to side with consumers and employees and end this practice of forced arbitration, which stacks the deck against the people Congress is supposed to represent.

Unfortunately, the House and Senate Bills, as drafted, potentially will have unintended negative effects on domestic and international commercial arbitrations.

The House Bill

The House Bill proposes to amend Chapter 1 of the FAA. The FAA currently does not distinguish between claims involving individuals and

business-to-business claims. It also does not distinguish between domestic arbitrations and international arbitrations sited in the United States. Any amendment to the FAA, therefore, has the potential to impact international commercial arbitration.

The Proposed Amendment to the FAA

The pertinent provisions, with the proposed changes to Chapter 1 of the FAA highlighted in italics, are:

Section 2. Validity and enforceability.

(a) A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such contract, transaction, or refusal, shall be valid, irrevocable and enforceable *to the same extent as contracts generally, except as otherwise provided in this title.*

(b) *No predispute arbitration agreement shall be valid or enforceable if it requires arbitration of—*

(1) an employment, consumer, or franchise dispute; or

(2) *a dispute arising under any statute intended to protect civil rights.*

(c) *An issue as to whether this chapter applies to an arbitration agreement shall be determined by Federal law. Except as otherwise provided in this chapter, the validity or enforceability of an agreement to arbitrate shall be determined by the court, rather than the arbitrator, irrespective of whether the party resisting arbitration challenges the arbitration agreement specifically or in conjunction with other terms of the contract containing such agreement.*

The House Bill is designed to take effect on the date of enactment and “shall apply with respect to any dispute or claim that arises on or after such

date.” Thus, it would declare invalid pre-dispute arbitration agreements entered into before the date of its enactment. As a consequence, the House Bill would potentially invalidate hundreds of thousands of commercial arbitration agreements, both domestic and international.

Simple Language with Almost Unlimited Reach

Although the House Bill’s wording is simplistic – “predispute arbitration agreement involving an employment, consumer, or franchise dispute or a dispute arising under any statute intended to protect civil rights” – the application of this wording is far reaching.

One analysis of the Arbitration Fairness Act of 2007, which included identical language, observed that the clause “could easily sweep in areas such as securities, antitrust, ERISA, certain bodies of Uniform Commercial Code law, bankruptcy law, certain bodies of admiralty and maritime law, governmental contracts, intellectual property and a host of others.”⁴

The simplicity of the language is problematic in other respects. By referring to “consumer dispute” without including a dollar carve-out provision to make large consumer transactions outside of the House Bill’s purview, neither the pre-dispute arbitration agreement involving the purchase of a television set nor the pre-dispute arbitration agreement involving the purchase of a personal plane would be valid.

The House Bill’s reference to an “employment dispute” has a similar failing. There are indeed instances when sophisticated parties with substantially equal bargaining power actively negotiate agreements containing arbitration clauses. The House Bill would declare these pre-dispute agreements invalid.

Likewise, the term “franchise dispute” is also flawed. The definition of “franchise” used in the House Bill follows the definition used by the Federal Trade Commission (the “FTC”), with certain differences. The FTC definition requires the payment of \$500 or more to the franchisor within six months after the franchisee business opens. Additionally, the FTC definition contains exceptions that exempt transactions between franchisors and sophisticated transferees. Unlike the FTC definition, the House Bill fails to specify a minimum fee that must be paid to qualify as a

franchise and does not provide for any exemptions.

Further compounding the problem is the fact that the House Bill expressly recognizes, without definition, that payment of an indirect franchise fee falls within the House Bill’s ambit. This results in uncertainty regarding whether a business relationship is actually a franchise relationship within the meaning of the House Bill.

Moreover, with the House Bill’s failing to differentiate between purely domestic franchises and multi-national franchises, U.S. franchisors would be placed in an untenable position. If the current draft of the House Bill becomes law, the United States multi-national franchisor will have two alternatives, neither of which is necessarily appealing: (1) choose a foreign law and venue to govern its arbitration agreement or (2) litigate disputes in local courts of varying quality and efficiency located across the globe.

The vagueness of the phrase “statute intended to protect civil rights” is equally troubling. Because the House Bill does not identify the “civil rights statutes,” the creative litigant, fettered only by the limits of his counsel’s imagination, could assert a “civil rights claim” and reap the perceived benefit of eliminating what would otherwise be an enforceable pre-dispute arbitration provision.

The Senate Bill

The Senate Bill attempts to address some of these concerns. Unlike the House Bill, which is an amendment to the FAA, the Senate Bill proposes to add a Chapter 4 to the FAA. A new Chapter 4 of the FAA would undoubtedly alleviate confusion and unnecessary litigation and would permit the development of a separate body of law regarding pre-dispute arbitration agreements in the consumer and employment arenas. Nevertheless, certain aspects on the proposed Chapter 4 are also unsettling.

The definition of “consumer dispute” is identical to the definition contained in the House Bill. The definition of “employment dispute” has been refined by specifically making reference to Section 3 of the Law Labor Standards Act of 1938. Nevertheless the Senate Bill suffers from the same definitional shortcomings as the House Bill.

Furthermore, to override the Supreme Court’s recent decision in *14 Penn Plaza LLC v. Pyett*,⁵

which upheld an arbitration clause in a collective bargaining agreement requiring union members to arbitrate discrimination claims, the Senate Bill specifically provides:

(2) COLLECTIVE BARGAINING AGREEMENTS – Nothing in this chapter shall apply to any arbitration provision in a contract between an employer and a labor organization or between labor organizations, except that no such arbitration provision shall have the effect of waiving the right of an employee to seek judicial enforcement of a right arising under a provision of the Constitution of the United States, a State constitution, or a Federal or State statute, or public policy arising therefrom.

The definition of “franchise dispute” in the Senate Bill has been refined to mean “a dispute between a franchisee with a principal place of business in the United States and a franchisor.” While the addition of this phrase does narrow the scope of the Senate Bill’s application, the refined definition still renders invalid a pre-dispute agreement to arbitrate between a United States franchisee and a foreign franchisor and would undoubtedly discourage foreign investment in the United States.

The Senate Bill also provides a detailed definition of “civil rights dispute,” obviously with an aim to curb possible creative legal thinking. Nevertheless, the Senate Bill would create an avenue for arbitration challenges by individuals based on claims arising under the constitutions of any of the fifty states.

Like the House Bill, the Senate Bill is effective on the date of enactment and “shall apply to any dispute or claims that arises after that date.” With a stroke of President Obama’s pen, untold pre-dispute arbitration agreements would become invalid.

Amendment to Chapters 2 and 3 of the FAA

In 1970 the United States acceded to the New York Convention, and Congress passed Chapter 2 of FAA in order to implement the convention.

In 1990 the United States implemented the Inter-American Convention on International Commercial

Arbitration (“Panama Convention”) by enacting Chapter 3 of the FAA. Chapter 1 of the FAA specifically states that it applies only to the extent it is not in conflict with Chapter 2 [the New York Convention] and Chapter 3 [the Panama Convention] of the FAA. This legislative scheme acknowledges the United States’ international obligations.

The Senate Bill proposes to amend Chapter 2 and Chapter 3 to provide that Chapters 2 and 3 apply “to the extent that this Chapter [2 or 3] is not in conflict with Chapter 4.” These provisions allow the courts to reject the applicability of Chapters 2 and 3 based solely on a conflict with Chapter 4.

The United States entered a reservation to the New York Convention, which provides that the United States will apply the Convention “to differences arising out of relationships . . . that are considered commercial under the national law.” Amendments to Chapter 2 and 3, therefore, are not necessary to protect the rights of consumers, employees and civil rights claimants, the stated objective of the anti-arbitration legislation.

Unfortunately, the proposed amendments to Chapters 2 and 3 would add an unnecessary layer of ambiguity to the analysis of whether a claim is commercial, would damage perception regarding the United States’ commitment to its international obligations, and would result in the enactment of a domestic law that would trump the United States’ treaty obligations.

Abrogation of Separability and Competence-Competence

The doctrine of separability is a basic tenet of arbitration, established over forty years ago by the U.S. Supreme Court in *Prima Paint v. Flood & Conklin*.⁶ The doctrine maintains that the agreement to arbitrate is separate or separable from the underlying contract containing the agreement. Accordingly, the invalidity of the underlying contract does not necessarily invalidate the agreement to arbitrate. As the agreement to arbitrate is effectively considered a separate agreement, it can be valid despite being contained in an invalid contract and importantly, the arbitrator retains jurisdiction to decide the validity of the underlying contract. Based on the doctrine of separability, if a party challenges the validity of the underlying contract, as opposed to the arbitration agreement itself, a court will refer the case to

arbitration.

The doctrine of competence-competence permits an arbitrator to rule on challenges to his own authority. Stated differently, competence-competence determines how authority to decide issues is allocated between the court and the arbitrator. Under established principles of competence-competence in U.S. jurisprudence, if the challenge is not based on an objection to the validity or scope of the agreement to arbitrate, the arbitrator proceeds first in resolving the parties' dispute.

Although the application of separability and competence-competence may vary among jurisdictions, it is universally accepted that an arbitrator may proceed with arbitration notwithstanding a jurisdictional challenge. In keeping with this universally accepted principle, while a party may ask a court to stay the arbitration under the FAA, absent a court order staying the arbitration, the arbitrator has the authority to proceed.

The House Bill would undermine these two principles. The House Bill places the sole authority to determine the validity of arbitration agreement with a court, "irrespective of whether the party resisting arbitration challenges the arbitration specifically or in conjunction with other terms of the contract containing the agreement with the courts." The end result is that an arbitrator would be required to stop a proceeding if a party alleged that a contract was invalid or unenforceable for any reason. Parties who had agreed to resolve their disputes outside of the court system would find themselves enmeshed in ancillary litigation with its attendant delays and costs. The autonomy of arbitration would be lost.

The Senate Bill contains a similar provision but limits the revocation of competence-competence and separability principles to the classes of disputes set forth in Chapter 4, as opposed to all arbitrations. However, because of the proposed amendments to Chapters 2 and 3 of the FAA, the Senate Bill's reach may extend further than intended, calling into question the applicability of competence-competence and separability principles in certain cross-border disputes.

United States Treaty Obligations

The goal of the New York Convention was not only to foster the recognition and enforcement of

commercial arbitration agreements in international contracts but also "to unify the standards by which agreements to arbitrate are observed and arbitral awards enforced in the signatory countries."⁷ The House and Senate Bills potentially place this goal at risk. For example, courts may deny enforcement of an arbitral award finding that the difference is not capable of settlement by arbitration under the law of that country" or against "public policy" under Article V §2 of the New York Convention. Courts might apply the new procedural rules on separability and competence to international awards under Section III of the Convention and refuse to enforce a foreign award. Although only possibilities, they nevertheless are valid concerns.

The Legal Community Responds

The problems with the House Bill, both in drafting and application, have not gone unnoticed and unaddressed by the international legal community, and the international legal community was in large part responsible for the improved but nevertheless imperfect Senate Bill.

In response to the House Bill, the Dispute Resolution Section of the New York State Bar Association prepared a position paper urging Congress to carefully review the arbitration bills introduced in Congress to ensure that they do not interfere with general commercial arbitration, particularly international arbitration "where arbitration is often the only practicable choice for dispute resolution."⁸

Among the suggestions proffered by the Dispute Resolution Section of the New York State Bar Association to meet the specific concerns of the legislature were "a new Chapter 4 of the FAA, an amendment to another relevant statute or [] a new and separate statute."⁹ The suggestion of a new Chapter 4 is contained in the Senate Bill.

The Council of the Section of Dispute Resolution of the American Bar Association, apparently in an attempt to compromise between "warring factions" within its ranks, recommended a pre-dispute opt-out provision in favor of the consumer, employee or civil rights claimant, as well as fairness protections in all arbitrations covered by the House Bill.¹⁰ As stated by the Chair of that section:

The Council's objective was to find a solution to some of the concerns raised in the AFA in a manner that preserved

voluntariness and fairness in arbitration, while maintaining an accessible and efficient forum for claimants.¹¹

Indeed, emotions regarding the need to reform consumer arbitration are running high. On May 5, 2009, for undisclosed reasons, but presumably in response to rancorous comments from its members, the Executive Committee of the Section of Dispute Resolution of the American Bar Association recommended to the Council of the Section of Dispute Resolution that it not go forward with its opt-out recommendation.

Actions Forward

The anti-arbitration storm will not abate anytime soon. While some progress has been made in narrowing the scope of the anti-arbitration legislation, the international business community must continue its efforts to educate the legislature regarding the unintended effects that may be visited on domestic and international commercial arbitrations by the enactment of an Arbitration Fairness Act. If the international community fails to educate the legislature regarding these unintended effects, “the central purpose of the FAA . . . to ensure that private agreements to arbitrate be enforced according to their terms”¹² may well be “gone with the wind.”

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fraud in the inducement of the contract generally); *R.M. Perez & Associates, Inc. v. Welch*, 960 F.2d 534, 539 (5th Cir.1992) (“If the fraud relates to the arbitration clause itself, the court should adjudicate the fraud claim. If it relates to the entire agreement, then the Federal Arbitration Act requires that the fraud claim be decided by an arbitrator.”).

⁷ *Scherk v. Alberto-Culver*, 417 U.S. 506, 520 (1974).

⁸ Christos Ravanides, *Arbitration Clauses in Public Company Charters: An Expansion of the Adr Elysian Fields or a Descent into Hades?* (undated), available at <http://www.nysba.org/Content/NavigationMenu58/DisputeResolutionReport/DrReport.doc>.

⁹ *Id.*

¹⁰ Memorandum from Lela P. Love, Chair, ABA Section of Dispute Resolution, to Members of the ABA Section of Dispute Resolution, *Re Update on Arbitration Fairness Act Issues* (May 5, 2009), available at <http://pubcit.typepad.com/files/drsectionstatement-1.pdf>.

¹¹ *Id.*

¹² *Mastriubiono v. Shearson Lehman Hutton*, 514 U.S. 42, 53-54 (1995).

¹ *Southland Corp. v. Keating*, 465 U.S. 1, 10 (1984).

² Gerry Lagerberg & Loukas Mistelis, *International Arbitration: Corporate Attitudes and Practices 2008* 1 (PricewaterhouseCoopers 2008), available at www.pwc.com/arbitrationstudy.

³ See, e.g., Don Sniegowski, *Franchisee Urges Capitol Hill to Make Mandatory Arbitration Illegal*, BLUE MAU MAU (May 11, 2009), available at http://www.blumaumau.org/7282/franchisee_testifies_capitol_hill_make_mandatory_arbitration_illegal (citing Lisa A. Rickard, president of the U.S. Chamber Institute for Legal Reform, as having disavowed the accuracy of the poll).

⁴ Report of the Committee on the Federal Courts of the New York County Lawyers Association on the Arbitration Fairness Act of 2007, 249 F.R.D. 402 (Apr. 15, 2008).

⁵ ___ U.S. ___, 129 S. Ct. 1456 (2009).

⁶ 388 U.S. 395 (1967); see also, *Campaniello Imports, Ltd. v. Saporiti Italia S.p.A.*, 117 F.3d 655, 666 (2d Cir.1997) (while fraud in the inducement of making the agreement to arbitrate may be adjudicated by the court, the statutory language of the FAA does not permit a federal court to consider claims of

The Mexican National Infrastructure Program: Challenges Ahead

By
Alejandro Landa Thierry

As promised during his campaign, Felipe Calderon launched the National Infrastructure Program (*Programa Nacional de Infraestructura*) in July 2007. Nearly two years later, infrastructure projects in Mexico now face new challenges that will require cooperation among the public, private and social sectors. The purpose of this article is to provide a brief overview of the National Infrastructure Program for 2007 through 2012 (“NIP”) and the challenges associated with its implementation, as well as a general summary of the National Infrastructure Fund Trust (“FONADIN”).

National Infrastructure Program

The current Mexican administration has recognized that infrastructure is synonymous with economic, social and human development. Consequently, the implementation of a program for infrastructure construction has become one of the top priorities of the Mexican government.

Derived from the National Development Plan (*Plan Nacional de Desarrollo*), NIP was designed to increase trade and production, raise competitiveness of the economy, provide more families with basic services, favor market integration, encourage more balanced regional development, and create the jobs that Mexicans demand. In general terms, NIP states the objectives, strategies, goals and actions designed to increase the coverage, quality and competitiveness of Mexico’s infrastructure.

Divided in four sections, NIP addresses: (i) the current infrastructure situation in Mexico¹, (ii) the country’s long-term vision, (iii) a sectoral vision, and (iv) the investment requirements, in connection with the transportation, communications, water, and energy sectors. A list of more than 300 projects, along with other considerations regarding the sources of financing, sectoral and regional strategies and the prioritization of projects are also included.

Important multi-modal infrastructure projects, such as Colonet Port, are included as part of NIP’s agenda. The execution of such projects,

undoubtedly, will require great efforts and huge amounts of capital and experience.

Challenges Under NIP

With such an ambitious program come various challenges relating to structural issues, sector capacity, and financial hurdles.

On the structural sphere, common practice has identified that infrastructure projects have three main requirements (infrastructure projects pillars) for their success: (i) an executive project (*proyecto ejecutivo*), (ii) a right over the land where the project is being constructed or liberation of right of way (*liberación del derecho de vía*), and (iii) a stable legal framework. Due to the magnitude and quantity of projects to be addressed and the short time available to complete them, it has been quite difficult to satisfy such requirements for each project, consequently increasing the corresponding risks that the projects will be more expensive or less viable than their sponsors predicted.

Due to the financial crisis that Mexico experienced on 1994, Mexico’s construction sector suffered a recession, making it difficult for construction companies to grow. Accordingly, the country’s construction sector faces great obstacles to managing the magnitude and quantity of the infrastructure projects covered by NIP.

These shortfalls are compounded by the significant challenges in obtaining funding, given the current economic and financial climate. The projects envisioned under NIP require large amounts of capital and liquidity, which are hard to find in turbulent times.

FONADIN

As an effort to implement NIP successfully, the government created the National Infrastructure Fund Trust (*Fideicomiso Fondo Nacional de Infraestructura*) known as FONADIN, as

published on February 7, 2008, in the Official Gazette of the Federation (*Diario Oficial de la Federación*).

FONADIN concentrates the activities, assets and liabilities of the Trust for the Support of the Toll-Roads Rescue (*Fideicomiso de Apoyo para el Rescate de Autopistas Concesionadas*), know as FARAC, and the Investment Fund for Infrastructure (*Fondo de Inversion en Infraestructura*), known as FINFRA. The initial amount of FONADIN's funds was of approximately \$40,000 million pesos and it was estimated that in the following five years after its creation it would canalize about \$270,000 million pesos.

In general terms, the purposes of FONADIN are: (i) to promote the participation of the public, private and social sectors in the development of infrastructure and public services, (ii) to support the development of infrastructure public works in charge of the Federal Public Administration, (iii) to participate in the design, construction, financing, operation and transference of infrastructure and facilitate user access to it, (iv) to participate in the evaluation, structuring and execution of infrastructure projects, (v) to acquire, manage and assign rights and obligations set forth in concessions and permits, (vi) to dispose of the assets provided under FONADIN, and (vii) to execute, acquire and manage financial instruments associated with infrastructure projects.

FONADIN will play an important role in ensuring the viability of infrastructure projects in Mexico, as it will help promote innovative and creative funding schemes along with possible guaranty structures.

Conclusion

Due to the many challenges inherent in infrastructure projects in Mexico, the public, private and social sectors will play a fundamental role in the country's development. Coordination vehicles such as FONADIN represent a solid step in the government's commitment, but there will be many opportunities for those with creative legal and financial solutions to help resolve the related challenges.

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¹ According to the World Economic Forum in its 2006-2007 Report, in terms of the Infrastructure Competitiveness Index Mexico is ranked 64th out of 125 countries.

Abbreviated Guide to the American Clean Energy and Security Act of 2009

By
Christopher Carr, Larry Nettles, and Gregory Staple

Also known as H.R. 2454, the 1,427-page American Clean Energy and Security Act of 2009 (ACESA) was primarily authored by Congressmen Henry Waxman (D-CA) and Edward Markey (D-MA) and adopted by the U.S. House of Representatives on June 26, 2009. This abbreviated guide¹ provides an introduction to select sections of ACESA that have potentially international implications.

Overview of ACESA

This comprehensive energy and climate bill contains five titles.

Title I, which focuses on clean energy, establishes a new standard for combined energy efficiency and renewable electricity that requires major electric utilities to use an increasing amount of power from renewable sources beginning at 6 percent in 2012 and escalating to 20 percent in 2020. Up to one-quarter of this mandate can be met by energy efficiency or conservation measures, however, and states may also petition to have up to two-fifths of the mandate met by such activities.

Title I also creates the framework for a new ratepayer funded program to implement carbon capture and sequestration (CCS) technologies at fossil fuel power plants and industrial facilities; sets emission performance standards for new coal-fired power plants; authorizes new funding for the large scale introduction of electric and other advanced technology vehicles; promotes the deployment of smart electricity grids; and creates a new “Green Bank” known as the “Clean Energy Investment Fund” within the Department of Energy.

Title II concentrates on energy efficiency across multiple sectors of the economy by advancing new efficiency standards and programs for buildings, appliances, industrial facilities, and transportation vehicles. The title also creates various new federal grant programs to promote energy efficiency, including a new state block grant program and a state revolving loan fund to help manufacturers of clean energy and energy

efficient products. In addition, the bill directs the Department of Housing and Urban Development (HUD) to integrate energy efficiency standards into the agency’s public housing programs; Fannie Mae and Freddie Mac are also directed to foster second mortgages to finance energy efficiency improvements.

Title III, which focuses on global warming, would establish an economy-wide cap-and-trade program to reduce U.S. emissions of CO₂ and other greenhouse gases (GHGs) by 17 percent from 2005 levels by 2020, and just over 80 percent by 2050. Under this program, the Environmental Protection Agency (EPA) would issue a capped and steadily declining number of tradable emissions allowances to achieve these goals — hence the popular reference to “cap-and-trade.” Large GHG emitters, suppliers of petroleum-based fuels, and certain other parties would be required to have a sufficient number of allowances or GHG offset credits each year to cover their activities. Offsets are issued for activities that reduce or sequester GHGs (e.g., by trapping methane from landfills) by parties not covered by ACESA’s emissions cap.

To mitigate the cost of transitioning to a lower-carbon economy, ACESA would initially distribute free allowances to electric and gas utilities (for the benefit of rate payers), to energy intensive and trade-exposed industries, small refiners and state governments. Other allowances would be directed to fund a variety of GHG-reducing programs, such as energy efficiency, CCS, and renewable energy. Some allowances would also be auctioned to provide funds to reduce the impact of any energy price increases on low income tax payers. The new cap-and-trade program contemplated by Title III generally would preclude the EPA from regulating GHG emissions under existing provisions of the Clean Air Act (CAA) and would also impose a temporary moratorium on analogous state cap-and-trade programs.

Title IV of ACESA contains provisions to help energy intensive U.S. manufacturers address unfair competition from importers that are not

subject to similar GHG regulations. This title also contains provisions to promote green jobs; to increase the export of clean energy technologies; and to help communities and habitats adapt to the physical impacts of climate change. Climate change adaptation plans are also mandated for all federal agencies and a new foreign aid program is established to provide climate adaptation assistance to the most vulnerable developing countries.

Title V creates a new program within the Department of Agriculture for issuing offsets based on domestic agricultural and forestry practices (e.g., altered tillage practices; reforestation activities). This program is intended to complement the EPA's issuance of offsets related to other domestic activities as well as from non-U.S. offset projects.

This abbreviated guide focuses on Titles III and IV of ACESA, which may be of particular interest to the international lawyer.

Title III – Reducing Global Warming Pollution

This title would establish a new long term economy-wide program to reduce U.S. emissions of carbon dioxide and six other GHGs² by issuing a steadily declining number of tradable emissions allowances. The stated goal of ACESA is to reduce total GHG emissions by 17 percent from 2005 levels by 2020, and just over 80 percent by 2050.

The program would be implemented by adding two new titles (VII and VIII) to the CAA to be primarily administered by the EPA. Under these amendments, each year the owners of fossil fuel-fired electric power plants, major industrial emitters, natural gas utilities, producers and importers of petroleum-based fuels, and certain other parties are obliged to hold EPA-issued emissions allowances or equivalent carbon rights. The allowances (and/or offset credits) must be equal in amount to the metric tons of CO₂e that were either (a) emitted in the prior year or (b) would be released upon combustion of a covered fuel produced or imported in the prior year for sale or distribution in interstate commerce.

The new obligations would be phased in for different covered entities from 2012 to 2016.

Entities that emit less than 25,000 metric tons of CO₂e annually would not generally be required to hold GHG emissions allowances.

Based on the foregoing scheme, the point of regulation would vary by industry. Emissions from coal and natural gas would be regulated downstream at or near the point of combustion. Emissions from petroleum-based fuels and natural gas liquids (NGLs) would be regulated upstream where the product is first supplied to the market. Large stationary sources of GHG emissions that are subject to the permit requirements of the CAA (e.g., because they emit other regulated pollutants) would also be required to have a new or amended Title V air permit. The permit would incorporate the new GHG compliance mandates in the bill and would be predicated upon an advance compliance commitment by the sources' owner or operator.

To reduce the compliance costs for covered entities, the program would create a market for emissions allowances and offsets. Once issued, allowances and offsets generally could be freely traded, and the EPA would be required to register and track all transfers. Accordingly, entities with excess allowances would be able to sell them to entities whose annual emissions may exceed their own store of allowances. The total number of allowances generally would decrease by approximately 3 percent each year and the program contemplates that allowance prices would rise over time — thus incentivizing reduced emissions. From 2012 to 2020, allowance prices are expected to range between \$13 to \$26 per ton of CO₂.

Distribution of Free Allowances

To provide covered entities and consumers with a period to adjust to the compliance costs associated with the GHG caps adopted in Title III, the bill distributes free allowances for an initial period to electric and gas utilities, merchant coal generators, energy intensive industries, small refiners, state governments, and certain other parties. These free allowances are typically phased out after 2025. Some allowances are also set aside to support CCS and other clean energy technologies. Other allowances are to be auctioned to fund various U.S. and international climate adaptation programs.

The allocation to utilities is designed to cover approximately 90 percent of the emissions attributable to the fossil fuels they burn or distribute. However, the financial benefit of the allowances must be passed through to rate payers, and Sections 783 and 784 of the bill provide special protection for industrial rate payers, permitting a pro rata share of such benefits based on energy use. During this transition period, only approximately 15 percent of the annual pool of emissions allowances will be auctioned by the government for the direct benefit of energy consumers. Revenues from these auctions will be used to provide tax credits to low income consumers. After 2030, however, the great majority of emissions allowances are to be auctioned with the proceeds used to provide tax refunds on a per capita basis to all U.S. households.

Offset Credits

ACESA contains several other provisions that may substantially reduce the cost of emissions allowances for covered entities. Some of these provisions, however, may also dampen the incentive for covered entities to meet the nominal emissions reduction targets written into the bill from domestic activities.

Most importantly, for compliance purposes, a covered entity may substitute offset credits derived from reducing CO₂ emissions or sequestering CO₂ (or other GHGs) in sectors not directly subject to emissions caps (e.g., agricultural and forestry). Section 722(d)(1) of the bill authorizes up to two billion tons of CO₂e offset credits annually to meet the compliance requirements of covered entities. This provision inflates the nominal GHG emissions caps for covered entities by up to 30 percent in the early years (before 2020) and by an even larger proportion in later years (e.g., 36 percent in 2030). One half of the available offset tonnage may be satisfied by either domestically sourced offsets or international offsets. However, the EPA can increase the proportion of U.S. emissions that may be offset by international credits by 50 percent (up to 1,500 million tons) if enough low-priced domestic offsets are unavailable.³

Offset credits may be issued by both the EPA and the Department of Agriculture (DOA), with the DOA responsible for offsets sourced from domestic agricultural and forestry activities. See

Title V below. The EPA is charged with drawing up an initial list of appropriate domestic offsets and related validation procedures within one year and adopting final regulations for issuing offsets within two years. Among other rewards for early action, the EPA must also issue domestic offset credits to entities that reduce or sequester GHGs after 2009 under certain voluntary “early action” programs. Eligible projects can only generate early action credits for emissions reductions through the date that is three-years following the enactment of ACESA. These early offset credits also may be exchanged later for emissions allowances.

In consultation with the State Department, the EPA would also issue U.S. offset credits derived from projects in developing countries. Credits may be issued in exchange for pre-existing foreign credits granted pursuant to the Clean Development Mechanism (CDM) or a successor treaty established by the 1992 UN Framework Convention on Climate Change (UNFCCC). The integrity of CDM offsets must be assured by safeguards that are at least as strict as those in the bill, and all offsets generally must be verified by accredited third parties.

In addition to using domestic and international offset credits, a covered party may also satisfy its compliance obligation by using time-limited or “term offset credits” for projects that sequester CO₂ or reduce GHG emissions. However, entities using term offset credits are required to post financial security equal to the cost of obtaining permanent credits or allowances to replace the expired term offsets. The issuance of term offset credits is discussed further under Title V.⁴

Other Cost Containment Measures

ACESA also directs the EPA to create a “strategic” reserve of allowances equal to approximately 2.5 billion tons of CO₂e. This amount is roughly 2 percent of the total allowance pool from 2012-2050. A portion of this reserve is to be auctioned quarterly, beginning in March 2012, at a minimum auction price of \$28 (in 2009 dollars); the price is subject to a 5 percent annual escalator in 2013 and 2014. Thereafter, prices are set at

60 percent above the rolling three-year average of allowance prices reported by registered carbon trading facilities. Only covered entities

are eligible to bid in these auctions and eligible bidders may not buy allowances equal to more than 20 percent of their most recent annual compliance obligations. The EPA is also given authority to outsource strategic reserve auctions to third parties.

In addition, ACESA permits unlimited banking of allowances for use in future compliance years. Allowances with a future “vintage” may also be “borrowed” without interest to satisfy an obligation for the immediately preceding year, thereby creating a rolling two year compliance period. A covered entity also may meet up to 15 percent of its annual obligation by holding allowances with vintages up to five years later than the compliance year, subject to an 8 percent annual in-kind interest payment.

Finally, ACESA permits a covered entity to hold an unlimited number of qualified international emissions allowances for compliance purposes. The use of foreign allowances is to be authorized by the EPA, in consultation with the Secretary of State, if the allowances are issued under a GHG control program that imposes an absolute tonnage limit and is at least as strict as ACESA. This provision, along with the role accorded international offset credits, would make the U.S. an integral part of the global market for carbon rights.

This market developed after the 1997 Kyoto Protocol was adopted and is likely to be expanded by any follow-on treaty to curb GHG emissions worldwide that emerges from the upcoming December 2009 meeting of the UNFCCC’s signatories in Copenhagen.

Supplemental Emissions Reductions

ACESA sets aside a special tranche of allowances for curbing global deforestation.

Deforestation and other land use changes are responsible for an estimated 20 percent of annual global GHG emissions, and the sponsors of the bill believe that mitigation of these trends outside the United States may be more cost effective ton-for-ton than many U.S. GHG reduction measures. The set-aside is equal to 5 percent of the total U.S. allowance pool from 2012-2025 and 2-to-3 percent of the pool thereafter. These allowances may be distributed by the EPA as funding in-kind to eligible developing countries, international organiza-

tions, and private or public groups to stem deforestation. The goal is to achieve cumulative supplemental GHG reductions of 720 million tons of CO₂e by 2020 and six billion tons by 2025.

The bill also grants the EPA broad authority under the CAA for drawing up emissions standards for uncapped stationary sources of GHG that exceed 10,000 tons of CO₂e annually (e.g., are below the proposed 25,000 tons/year threshold) and, in the aggregate, are responsible for at least 20 percent of the uncapped GHG emissions. Under new Section 811 of the CAA, the EPA would be required to bring these uncapped sources under the agency’s new standards over a 10-year period. Compliance costs under a new standard are not to exceed the costs that would be incurred if a regulated entity had to obtain emissions allowances.

Greenhouse Gas Reporting

To evaluate the program’s effectiveness and to provide a factual basis for auditing compliance, Part B of Title VII establishes a new federal GHG registry. It is to be based on new quarterly GHG emissions reports from all covered entities beginning in March 2011.

The EPA is also directed to obtain quarterly reports from other entities that would be covered by ACESA had they met the annual 25,000 metric tons of CO₂e threshold, so long as they emit at least 10,000 metric tons of CO₂e in any year. Emissions data is to be self-certified and filed electronically. The EPA must publish all GHG emissions data on the internet subject to the protection of certain confidential business information.

The GHG registry provisions in the bill are similar but not identical to the EPA’s proposed GHG registry rules released for public comment in March 2009. Thus, if the EPA’s GHG reporting rules are adopted prior to the passage of ACESA, it is possible that the Congress will defer to the agency’s rules and delete any GHG registry provisions from the cap-and trade provisions. On the other hand, to the extent that any new law would cover a broader range of parties than the agency’s reporting rules now contemplate (e.g., because uncapped sources emitting more than 10,000 tons of CO₂e annually may be subject to future emissions

standards), then the current GHG registry rules may remain.

State Pre-emption

The new cap-and-trade program mandated by ACESA would not completely pre-empt state GHG regulations. Instead, new Title VIII, Part F to the CAA would place a six-year moratorium (2012-2017) on the implementation or enforcement of analogous GHG emission caps. The moratorium only applies to state GHG controls that are based on an absolute tonnage limit and preserves the right of the states to maintain alternative GHG control measures (e.g., emission performance standards) or to adopt programs addressing entities that are not capped at the federal level. There is also no attempt to pre-empt state GHG reporting rules.

To assist entities facing significant compliance costs under three existing state GHG caps — the Regional Greenhouse Gas Initiative (RGGI), the Western Climate Initiative, and

California Assembly Bill 32 — Part H of Title III (at Section 790) directs the EPA to adopt allowance exchange rules. Under the rules, state GHG allowances issued prior to January 1, 2012, when the federal program generally becomes effective, can be exchanged for federal emissions allowances in an amount sufficient to compensate a party for the cost of obtaining and holding the state allowances. Federal allowances so exchanged are to be subtracted from the allowance pool that would otherwise be auctioned.

Oversight of Carbon Markets

The cap-and-trade scheme established by ACESA would be likely to create a market for U.S. emissions allowances and offset credits totaling over \$50 billion a year in 2012. Accordingly, ACESA provides for oversight of the market for carbon rights and derivative instruments by the FERC and the Commodities Future Exchange Commission (CFTC). The FERC is given jurisdiction over trading in government-issued allowances and offsets.⁵ The CFTC would regulate derivatives, (futures contracts, swaps) unless an interagency working group to be convened by the President recommends otherwise; in that event additional legislation might be required.

Regulators must adopt strict measures to prohibit fraud, market manipulation, and excess speculation. Rules to foster market transparency and to limit or eliminate counterparty risk, market power concentration risks, and other risks associated with over-the-counter trading are also mandated.

The FERC and any other federal agency with jurisdiction over the trading of any regulated emissions right or contract is granted the same enforcement powers as the CFTC. Market manipulation, fraud, and false or misleading statements regarding a regulated instrument is a felony punishable by up to 20 years in prison and a fine of up to \$25 million.

Pending the adoption of comprehensive legislation to reform the regulation of derivatives, ACESA also expands the power of the CFTC to regulate derivative transactions related to energy commodities, including coal, crude oil, gasoline, diesel and jet fuel, propane, electricity and natural gas. The CFTC is granted authority to set position limits regarding such contracts, to require detailed reporting of market data and to mandate clearance of contracts through registered derivatives clearing organizations. Exemptions may be granted for bona fide hedging operations.

The broad and unprecedented sweep of these new CFTC market oversight provisions are of widespread concern in the energy industry. Among other things, this concern led to a last minute amendment that provides for the repeal of the CFTC's expanded authority over energy derivatives upon adoption of general "legislation that includes derivative regulatory reform."⁶

Regulatory Enforcement

ACESA includes various provisions to ensure that covered entities meet their annual compliance obligations. If a covered entity fails to hold the required number of emissions allowances, it shall be liable to a penalty equal to twice the fair market value of the missing allowances. The violator also must make up the deficit in the next year or such longer period as the EPA may provide.

Violation of the new CAA titles added by ACESA, or the EPA rules adopted thereunder, may subject a covered entity to civil and administrative penalties under the CAA.

Criminal penalties may also be sought by the EPA for knowing violations of the CAA or the EPA's rules. Significantly, however, the bill passed by the House drops provisions in earlier versions that created liberal standing provisions for citizens to bring suit to enforce ACESA.

Title IV – Transitioning to a Clean Energy Economy

Preserving Domestic Competitiveness

Subtitle A begins by establishing an annual rebate program for certain industrial sectors based around the concept of “carbon leakage.” This term is defined as any substantial increase in GHG by manufacturing entities located in countries without commensurate GHG regulations that is “caused by an incremental cost of production increase in the United States” due to U.S. GHG regulations.

Certain energy-intensive, greenhouse-gas-intensive, and trade-intensive sectors and subsectors (defined through the six-digit classification in the North American Industrial Classification System (NAICS)) will be presumptively eligible for the rebate program. In addition, any person may petition the EPA to designate a sector as rebate-eligible. The amount of rebate available is calculated by an entity according to a defined formula taking into account the entity's cost of compliance with GHG regulations, manufacturing output, GHG emissions-intensity, and electricity efficiency. Eligible industrial sectors would be determined no later than June 30, 2011, along with the initial value of rebates per unit of production for each sector.

By February 1, 2013, the EPA must publish the first updated list of eligible sectors and rebate values, with future updates required every four years. Rebates in the form of emission allowances will be distributed for each vintage year no later than October 31 of the preceding calendar year. Beginning in 2026, the rebate amount is to be reduced by 10 percent annually until the rebate program is phased out. Additionally, the rebates applicable to a particular sector may be subject to an accelerated ten year phase out period based on a Presidential determination that more than 85 percent of the global output from a sector is

manufactured in countries that are parties to an international climate change agreement, or otherwise have a GHG intensity comparatively less than that of the comparable U.S. sector.

International Reserve Allowances

Subtitle A also states that, absent U.S. participation in a multilateral climate change agreement meeting certain specified objectives by January 1, 2018, or a finding that an international reserve allowance program would not be in the national economic interest as to a particular sector, the President shall establish an international reserve allowance program for each eligible industrial sector. Should the President make such a finding that an international reserve allowance program is unnecessary as to a particular sector for the reasons set forth above, a joint resolution of Congress is necessary to approve such a determination to avoid imposing the program.

If an international reserve allowance program is established, the EPA, in conjunction with U.S. Customs and Border Protection, must adopt rules requiring U.S. importers in identified sectors to purchase international reserve allowances. The program could take effect as early as January 1, 2020. The EPA would also set the price of the allowances equal to the auction clearing price established at the most recent emission allowance auction, and set forth a methodology for determining the quantity of international reserve allowances to be tendered in conjunction with the importation of a covered good. However, covered goods produced in either “foreign countries that the United Nations has identified as among the least developed of developing countries” or foreign countries responsible for less than 0.5 percent of the total global GHG emissions would be exempt from the program.

Exporting Clean Technology

Under Subtitle D, the President is to establish an “interagency group” which will determine the eligibility of developing countries to receive assistance to encourage widespread deployment of technologies that reduce GHG emissions and to encourage the adoption of policies that substantially reduce emissions of GHGs. In addition, the assistance will encourage compliance with existing international

property rights. Only developing countries that have ratified an international treaty, have put in force national policies, and have undertaken “nationally appropriate” GHG mitigation activities that will achieve substantial GHG reductions are eligible for funding. The Secretary of State, in consultation with the interagency group, is authorized to select eligible projects to receive funding.

Assistance will be allowances allocated for clean technology activities in the form of bilateral assistance to multilateral funds or institutions. Such activities include those that achieve substantial reductions in GHG emissions and/or achieve capacity building. Sample projects include: CCS; renewable electricity generation; projects that increase the efficiency of electricity consumption, distribution, or transmission; and projects that reduce transportation sector emissions through increased efficiency or use of fuels that have lifecycle emissions that are substantially lower than those attributable to fossil fuel-based alternatives.

Adapting to Climate Change

Subtitle E establishes an interagency committee consisting of representatives from various federal agencies conducting global change research to ensure an integrated federal response to the impacts of climate change. The interagency committee is directed to undertake vulnerability assessments, coordinate federal and international activities with global change research activities, and serve as the forum for the development of the “National Global Change Research and Assessment Plan.” The President will develop the Plan, which will contain global change research and assessment. The President will also establish an interagency United States Global Change Research Program, lead by the Office of Science and Technology Policy.

The Under Secretary of Commerce for Oceans and Atmosphere, building upon the resources of the National Weather Service and the weather and climate programs of the National Oceanic and Atmospheric Administration (NOAA), is directed to establish a National Climate Service (NCS). The NCS will coordinate NOAA programs and serve as a clearinghouse to provide federal, state, local, and tribal government decision-makers with access to information relating to the impacts of climate

change and adaptation to such impacts. Each federal agency⁷ is directed to review climate impacts on matters within its jurisdiction and develop plans for addressing those impacts.

The bill also establishes a climate change adaptation fund to provide federal support for state, local, and tribal projects to reduce vulnerability to climate change impacts. In addition, the bill requires the Secretary of Health and Human Services to promulgate a national strategy for mitigating the impacts of climate change on public health. The bill further establishes an interagency Natural Resources Climate Change Adaptation Panel to address the impacts of climate change on natural resources. A special fund will be created to carry out adaptation activities related to natural resources.

Finally, to address international adaptation issues, the bill creates an International Climate Change Adaptation Program within USAID to provide U.S. assistance to help the most vulnerable developing countries adapt to climate change.

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¹ This article contains excerpts from Vinson & Elkins LLP’s larger publication on the topic, which is available through the authors or by contacting Wayne Harris, at wharris@velaw.com.

² The other GHGs are methane (CH₄), nitrous oxide (NO_x), sulfur hexafluoride (SF₆), and hydrofluorocarbon, a perfluorocarbon and nitrogen trifluoride. The EPA is also given discretion to bring other anthropogenic gases under the new program.

³ After 2017, however, a covered entity must hold 1.25 international offsets in lieu of every one emission allowance.

⁴ Significantly, however, if an entity substitutes a regular domestic offset credit for a term offset credit, the use of that domestic credit is not subject to the 50 percent limit on use of such credits. See Section 722(d)(2)(D).

⁵ Under Title I, FERC also will police the market for the new federal renewable energy certificates (RECs) issued by the agency.

⁶ See Part IV, Subtitle E of Title III at Section 358.

⁷ Including NOAA, EPA, the Departments of Agriculture, Commerce, Defense, Energy, Health and Human Services, Homeland Security, Housing and Urban Development, Interior, and Transportation, as well as the Army Corps of Engineers, the Centers for Disease Control, FEMA, NASA, and the United States Geological Survey.

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