Energy Efficiency and Conservation: New Legal Tools and Opportunities

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Energy efficiency and conservation measures are low-hanging fruit in the U.S. effort to reduce greenhouse gas emissions and wean ourselves from imported fossil energy. Some of this fruit is being picked through increasingly ambitious energy efficiency programs for motor vehicles, buildings, and appliances and equipment—the three dominant targets for federal energy efficiency programs for the last several decades. The U.S. Environmental Protection Agency and the U.S. Department of Transportation are working with the auto industry and other stakeholders to improve fuel efficiency and reduce greenhouse gas emissions from new light-duty motor vehicles—to 35.5 miles per gallon by 2016 and as high as 62 miles per gallon by 2025. Congress has encouraged states to improve energy efficiency in new residential and commercial buildings and provided funding for low-income weatherization assistance. Congress and the U.S. Department of Energy (DOE) have mandated efficiency standards for appliances and equipment, including refrigerators, electric lights, and industrial pumps.

In addition, many new and ambitious energy efficiency and conservation laws are being enacted at all levels of government—and with greater financial incentives than provided previously. These innovations are intended to overcome or minimize market barriers that discourage cost-saving investments, such as principal-agent problems, information and transaction costs, high internal discount rates, and up-front capital needs. Innovations such as public-private partnerships also require significant legal input and creativity for the client to reap the often remarkably large energy and cost savings.

These new financial and policy tools broaden the opportunities available to businesses, homeowners, and others to reduce their energy use and increase lawyers’ roles in assisting clients in using and combining these tools. In this rapidly changing legal landscape, lawyers have a more important role in facilitating energy efficiency investments than ever before.

The path to a sustainable, energy-efficient economy involves decoupling economic growth from energy consumption—reducing overall energy use even as the economy grows. Recent studies show that substantial energy-saving opportunities are available—opportunities that not only can save money but also increase both gross domestic product (GDP) and jobs. One study evaluated energy efficiency and conservation measures recommended in sixteen U.S. state climate change action plans. These measures, if implemented nationally, would yield in 2020 about 2.5 million net new jobs, a $159.6 billion expansion in GDP (in 2007 dollars), more than $5 billion in net direct economic savings at an average net savings of $1.57 per ton of greenhouse gas emissions avoided or removed. These measures could also, by 2020, reduce U.S. greenhouse gas emissions to 27 percent below 1990 levels. Thomas Peterson & Jeffrey Wennberg, Impacts of Comprehensive Climate and Energy Options on the U.S. Economy 6 (Johns Hopkins University 2010).

Similarly, McKinsey & Company found that the United States could reduce its energy consumption by 23 percent from projected 2020 levels through the use of hundreds of existing “net present value positive” energy efficiency measures. These measures could result in an “absolute decline” in U.S. energy consumption of 6.1 quadrillion end-use BTUs from 2008 levels by 2020. McKinsey & Company, Unlocking Energy Efficiency in the U.S. Economy iv (2009). Energy efficiency, the report concludes, “offers a vast, low-cost energy resource for the U.S. economy—but only if the nation can craft a comprehensive and innovative approach to unlock it.” Id. at iii. This article will review a range of financial legal mechanisms that could be a significant portion of such a “comprehensive and innovative approach.”

Developing Infrastructure to Upgrade Existing Buildings

There is no federal regulatory program requiring that existing residential and commercial buildings be renovated or upgraded for energy efficiency or requiring that states make this happen. While this is understandable, existing residential and commercial buildings are responsible for 38 percent of U.S. carbon dioxide emissions. DOE, 2009 Buildings Energy Data Book 2-24 & 3-18 (2009). Sixty percent of residences are not well insulated, and seventy percent of commercial buildings lack roof or wall insulation. Marilyn A. Brown et al., Towards a Climate-Friendly Built Environment 14 (2005). Energy efficiency retrofits in the nation’s 130 million homes could reduce home energy use by as much as 40 percent and energy bills by $21 billion annually. The lack of “straightforward and reliable information,” large upfront costs, and the lack of businesses and skilled workers to do retrofits have prevented the existence of a large-scale effective market. Middle Class Task Force & Council on Environmental Quality, Recovery Through Retrofit 1 (2009).
To overcome these barriers, DOE awarded $508 million under the American Recovery and Reinvestment Act of 2009 (ARRA), Pub. L. No. 111-5, to forty-one states, local governments, and other organizations for pilot programs to build energy efficiency building retrofit infrastructure. DOE plans to make the lessons learned from these programs available to other communities as part of its effort to scale up retrofits across the country (see BetterBuildings, www.eere.energy.gov/betterbuildings), thus helping to create a national infrastructure for retrofits that will present many legal issues (e.g., how to structure financing for retrofits, what kind of certifications should exist for energy auditors and installers, and how to handle property sales that occur before the retrofits are paid for).

**Federal Tax Laws Supporting Renewable Energy and Energy Efficiency Projects**

Programs that provide funds to individuals or organizations for the purchase of “distributed” renewable energy property or energy efficiency property may qualify for a variety of federal or state tax incentives. Renewable energy projects are often combined with energy conservation and efficiency and can promote energy efficiency themselves. For instance, “distributed generation” reduces transmission losses when it is at or near where the energy is used. On-site production also can more readily be coupled with demand management to reduce peak load and the need for bringing additional fossil-fired power plants on-line to meet peak loads. Tax benefits, particularly for the renewable energy part of such projects, can take the form of federal production credits, federal investment tax credits, or grants in lieu of tax credits. These incentives are distinct from the direct subsidies or rebates for these efforts that are often provided by utilities, states, or local entities. In some cases, both energy efficiency and renewable energy projects may also qualify for tax-favored financing. Thus, some explanation of the financing tools for renewable energy is also needed.

**Business Tax Credits.** Businesses are entitled to an Investment Tax Credit (ITC), 26 U.S.C. § 48, equal to (1) 30 percent of the value of the capitalized basis costs to develop, design, build, and install solar electric, heating or cooling systems, fuel cells, small wind (100 kilowatts or less), or fiber optic solar lighting systems; or (2) 10 percent of the value of the capitalized basis costs for combined heat and power systems (often implemented as part of an energy savings program in commercial properties) and geothermal heat pumps (which may also be included in energy efficiency efforts), as well as geothermal electric systems and microturbines (stationary plant of less than 2 megawatts (MW) with an electricity-only efficiency of at least 26 percent). There is also a Production Tax Credit (PTC), 26 U.S.C. § 45, for electricity generated from utility-scale wind, geothermal, and closed-loop biomass systems, each of which qualifies for a tax credit equal to $0.022/kilowatt hour (kWh) (in 2010). A tax credit of $0.011/kWh is available for electricity generated from open loop biomass, small irrigation power, landfill gas, trash combustion, hydropower, and hydrokinetic energy. Due to recent changes to tax law under ARRA, taxpayers may generally elect to claim either the PTC or the ITC, 26 U.S.C. § 48(a)(5). The PTC and ITC are general business credits (benefits) inapplicable to individual taxpayers and nontaxable entities. As discussed below, there are separate individual tax credits for residential geothermal, solar, and energy efficiency investments, and the ARRA has also provided a grant program in lieu of tax benefits to increase the class of parties who can take advantage of these business tax credits.

**1603 Grant.** Arguably the most widely used energy incentive provided by ARRA was created by section 1603 and extended by the 2010 tax legislation. The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub.L. 111-312, 124 Stat. 3296, H.R. 4853, the “2010 Tax Extender Bill”). Section 1603 creates a grant in lieu of a tax credit to reimburse applicants for a portion (either 10 percent or 30 percent) of the cost of eligible property under the Code for nearly all technologies and project types that qualify under the PTC or ITC. Pub. L. No. 111-5, Dev. B, Title I, § 1603, Feb. 17, 2009; www.treas.gov/recovery/1603.shtml. Applicants must apply for this “1603 Grant” before October 1, 2012, and the energy property must be placed in service or the project must begin construction by December 31, 2011. The U.S. Treasury is committed to issuing funds within sixty days of the later of the submission of a complete application or the date the system is placed in service.

**Energy Efficiency Commercial Building Deduction.** A commercial income tax deduction is available for new or renovated buildings when energy costs are reduced by at least 50 percent due to improvements in lighting systems, the building envelope, and heating, cooling, and water heating equipment, 26 U.S.C. § 179D. This deduction is unique in that it may be passed to a system “designer” designated by the owner of a publicly owned building, enabling public entities to partner with private taxpayer “designers” to lower the net costs of energy-efficient investments. To qualify, the completed project must meet ASHRAE 90.1-2001 standards and be in place before December 31, 2013. The project must be certified as meeting the 50 percent energy cost-savings goal, using approved computer modeling software.

**Accelerated Depreciation.** Under the Federal Modified Accelerated Cost-Recovery System (MACRS), businesses may recover investments in certain energy property through accelerated depreciation deductions, 26 U.S.C. § 168; IRS Publication 946. MACRS establishes “class lives” for various types of property, and a number of renewable energy and energy efficiency properties (systems) are classed as five-year properties. They include combined heat and power equipment, solar-electric and solar thermal property, wind property, geothermal property, fuel cells, and microturbines. Property that is leased to an ineligible entity, however, is subject to an alternative (longer) depreciation schedule. The 2010 tax legislation provided that most capital investment made in 2011 qualifies for 100 percent depreciation in 2011 and most capital investment made in 2012 qualifies for 50 percent bonus depreciation, with the rest spread out over the five-year MACRS period. See section 401 of the 2010 Tax Extender Bill.

**Residential Tax Benefits.** A number of federal tax benefits are available to individual taxpayers for installing energy efficiency and renewable energy equipment in their homes. Individual taxpayers purchasing or installing home envelope or home heating/cooling equipment may qualify for a tax credit equal to 30 percent of the cost of eligible equipment up to a $1,500 tax credit per home. Eligible home envelope technologies include insulation or sealing,
replacement windows, skylights or external doors, and qualifying window films or roofs. Eligible home heating and cooling investments include high-efficiency furnaces and boilers (annual fuel use efficiency ratings of 95 for gas and propane furnaces and 90 for gas, oil, or propane boilers); high-efficiency air conditioners and heat pumps (meeting the highest tier set by the Consortium for Energy Efficiency as of January 1, 2009); ground source or geothermal heat pumps; biomass stoves with a thermal efficiency of 75 percent or more that are used to heat a dwelling unit or water for use therein; high-efficiency fans for heating and cooling systems; and high-efficiency gas or propane water heaters.

Individual taxpayers may also qualify for onsite renewable energy tax credits for geothermal heat pumps, solar energy systems (either hot water or photovoltaic), and small wind systems (up to 100 kW nameplate capacity). The credit is equal to 30 percent, the cost (including both equipment and labor/installation) of systems placed in service before December 31, 2016. Manufacturers must provide a certification to the taxpayer that the equipment is eligible for the credit (see Residential Tax Benefits Manufacturers Certification: IRS Notice 2009-53).

Tax-exempt Bonds. Traditionally, state and local governments and certain other nonprofit organizations have had the ability to issue debt for capital expenditures in the form of bonds. Bonds are debt instruments issued by a state or local government or other eligible entity or instrumentality that is either sold in the public market (a Capital Market Transaction) or placed with investors by an investment banking firm or purchased directly by a bank (a Private Placement). Banks often also use the same credit analysis in determining whether to purchase a bond (a Private Placement) as they would use in making a private loan. The banks may also be subject to certain restrictions on the ability to hold tax-advantaged debt.

If the bonds are issued for a specified public purpose, the bond purchasers do not have to pay federal income tax on the interest income received from those bonds, as long as certain tax rules are met. Such bonds are referred to as tax-exempt bonds. Interest on the bond may also be exempt from state and local income taxes. As a result, tax-exempt bonds historically carry an interest rate that is lower than comparable taxable debt. Tax-exempt bonds could be used by a municipality to fund the capital expenditures for energy efficiency efforts on public buildings but could not be used to fund privately owned energy efficiency improvements on private residences or businesses.

Tax-exempt bonds may also be issued by Indian tribal governments, as authorized by the Indian Tribal Government Tax Status Act of 1982 (codified as amended at 26 U.S.C. § 7871), which provides that tribal governments are to be treated as states for certain purposes. To qualify as tax-exempt, bonds issued by a tribe must involve “the exercise of an essential governmental function.” 26 U.S.C. § 7871(b), (e). The essential governmental function has been problematic, and, in ARRA, Congress authorized a new temporary category of tax-exempt bonds, known as “Tribal Economic Development Bonds,” and directed the Secretary of the Treasury to conduct a study and report to Congress. Pub. L. No. 111-5, Div. B, Title I, § 1405. See also Department of the Treasury, Notice and Request for Comments, 75 Fed. Reg. 39,730 (July 12, 2010).

Private Activity Bonds. Although tax-exempt bonds typically may not be issued for the benefit of private parties, there are limited exemptions to this rule. Exemptions include various “exempt facilities” that may be owned by private parties, including solid waste disposal and recycling facilities undertaking a public function, even if privately owned. Such bonds are referred to as private activity bonds (PABs). In addition to the traditional categories of PABs, additional types of bonds were created or expanded by ARRA, such as Recovery Zone Facility Bonds (which expired December 31, 2010) or Qualified Energy Conservation Bonds (which have a fixed allocation but no expiration date).

Taxable Bonds. The same entities that may issue tax-exempt bonds for capital expenditures for public purposes may also sometimes issue taxable debt for private purposes. For example, a municipality could issue bonds to provide funds that are lent to private individuals to fund energy efficiency improvements to private property. In such case, the bond purchaser would be subject to the payment of federal income tax on the interest income received from those bonds.

New Bonding Tools. ARRA provided for new and expanded public financing flexibility for energy efficiency and renewable energy generation projects. Although some provisions expired December 31, 2010, the chart below summarizes options available to municipalities and tribal governments wishing to fund integrated programs to promote energy efficiency and efficient use of alternative energy.

### New State Efficiency and Conservation Tools
States are increasingly active on energy efficiency—and they are doing so to create jobs and strengthen their economies. While California continues to lead, Alaska, Arizona, New Mexico, and Utah have all shown considerable improvement in recent years. State energy efficiency budgets doubled between 2007 and 2009. Maggie Molina et al., The 2010 State Energy Scorecard iii (American Council for an Energy-Efficient Economy (ACEEE) 2010). State and local governments and regulated utilities offer a variety of rebates, grants, loans, tax incentives, and other support for energy efficiency. U.S. Department of Energy, DSIRE™: Database of State Incentives

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**Bonding Tools Available for Financing Energy Projects**

<table>
<thead>
<tr>
<th>Type of Bond</th>
<th>Private Use Allowed?</th>
<th>Allocation Process</th>
<th>Expiration Date</th>
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<tbody>
<tr>
<td>Qualified Energy Conservation Bonds 26 U.S.C. § 54D</td>
<td>Yes, up to 30 percent of allocation. No limit for “Green Community Programs”</td>
<td>$3.2 billion allocated to population to states &amp; large localities (100,000+)</td>
<td>No Expiration Date</td>
</tr>
<tr>
<td>New Clean Renewable Energy Bonds 26 U.S.C. § 54C</td>
<td>No</td>
<td>$1.6 billion allocated to governmental bodies, municipal utilities, and co-op electric companies</td>
<td>Valid for three years after allocation received</td>
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for Renewables & Efficiency, Financial Incentives for Energy Efficiency, www.dsireusa.org/summarytables/finene.cfm. Other prominent tools employed by states include the following.


ACEEE estimated that enactment of federal legislation comparable to current laws in many states would “save American consumers and businesses almost $170 billion, create over 220,000 jobs,” and eliminate “the need to build 390 power plants.”

These standards’ energy and cost savings, if applied nationally, could be considerable. ACEEE estimated that enactment of comparable federal legislation would “save American consumers and businesses almost $170 billion, create over 220,000 jobs,” and eliminate “the need to build 390 power plants.” Such federal legislation would reduce projected 2020 U.S. greenhouse gas emissions by 4 percent. These impacts would be in addition to those achieved by existing state laws. Energy Efficiency Resource Standards: Hearing on S. 548 Before S. Comm. on Energy and Natural Resources, 111th Cong. (Apr. 22, 2009) (statement by Steven Nadel, Exec. Dir., ACEEE).

**More Stringent Building Codes.** Since 1992, federal law has established something like minimal standards for energy efficiency in state and municipal building codes. 42 U.S.C. § 6833. (Tribal governments have not been included in this program. See Dean B. Suagee, Tribal Self-Determination in a Low-Carbon Economy, Nat. Res. & Envtl. 58 (Winter 2010).) Many states and localities have gone beyond the minimum standards and adopted building codes requiring higher efficiency ratings for insulation and windows and doors; standards for heating, ventilation, and air conditioning (HVAC) and appliances; and other measures to improve energy efficiency in new construction or new improvements. These can incorporate EPA ENERGY STAR or Leadership in Environmental and Energy Design (LEED) requirements. These requirements can overcome market barriers such as lack of consumer knowledge, the failure of mortgage or real estate markets to reflect energy operating costs, and the fact that responsibility for operating and capital costs are often divorced in commercial real estate markets. In addition, building and land use laws can prohibit restrictions on solar panels, outside clothes drying, and other similar measures that might otherwise be imposed by homeowner associations or local ordinances. One court, however, recently granted summary judgment invalidating the portions of the Albuquerque, New Mexico, green building ordinance prescribing energy efficiency standards for HVAC equipment more stringent than the federal minimum standards, holding that these portions were preempted by federal law. Air Conditioning, Heating and Refrigeration Institute v. City of Albuquerque, Civ. No. 08-633 MV/RLP, (D.N.MD Sept. 30, 2010); see also, 2008 U.S. Dist. LEXIS 106706 (D.N.M 2008).

**Public Funding or Benefit Programs for Efficiency.** Nineteen states implement public benefit funds for energy efficiency. DSIRE™: Rules, Regulations, & Policies for Energy Efficiency, www.dsireusa.org/summarytables/rppee.cfm. These are typically funded through a public benefit charge in the distribution service part of the electric bill ranging from 0.05 to 3 mills per kWh. The charge is collected and administered by different entities in different states—a state agency, an independent entity, or utilities—and the money is then spent on a variety of energy efficiency projects and activities. In the ten states participating in the Regional Greenhouse Gas Initiative (RGGI), the nation’s first cap-and-trade program for greenhouse gases, money from these programs also comes from the auction of carbon dioxide allowances. More than $750 million has been raised thus far from these auctions, and the RGGI states are investing more than half of that sum for energy efficiency. RGGI, RGGI Benefits and RGGI, Why Energy Efficiency? www.rggi.org/rggi_benefits.

**Required Disclosure of Energy Use in Sale of Property.** A small but growing number of state and local governments require disclosure of energy consumption in residential property sales or are considering proposals to do that. Andrea M. Guttridge, Redefining Residential Real Estate Disclosure: Why Energy Consumption Should be Disclosed Prior to the Sale of Residential Real Property, 37 Rutgers L. Rec. 164, 176–80 (2010).

**State Tax and Financing Tools.** Individual states have a broad range of additional incentives for energy efficiency and renewable energy projects. These include direct grants from governmental entities or utilities funded from general funds, tax incentives, carbon regulation regimes (such as RGGI), and other similar mechanisms. Determining the rules under which state and federal incentives interact can be complex but may result in substantially improved economics for the project.

**Sustainable Energy Utilities.** A Sustainable Energy Utility (SEU) is an entity created by a state or local government to provide funding and technical assistance for energy efficiency and conservation and distributed energy generation projects involving homes, businesses, nonprofit organizations, and municipalities. The first SEU, Efficiency Vermont, was established in 2000 pursuant to 30 V.S.A. § 209 (1999);
Efficiency Vermont, About Us, www.efficiencyvermont.org. See also CVR § 30-000-051 (2009). Delaware and the District of Columbia have also established SEUs. 29 Del. C. § 8059 (2008), D.C. Clean and Affordable Energy Act of 2008, D.C. Act 17-0497, respectively. Several other cities are in the process of developing SEUs.

An SEU serves a variety of functions that encourage implementation of energy efficiency and distributed alternative generation projects. An SEU can provide or assist financing. It can also exploit a variety of other funding sources, including tax exempt financing, stimulus grant and loan funds, utility efficiency funds, dedicated taxes, and funds from the sale of carbon or other pollution credits. It can facilitate public-private partnerships by taking advantage of tax credits and accelerated depreciation to develop these projects. It can also use financing and organizational techniques to aggregate smaller projects to achieve the scale necessary for development and financing. An SEU can also serve a center of expertise, providing technical assistance and identifying the contractors, partners, lenders, and investors who can assist in implementation.

**PACE Financing Programs.** In a Property Assessed Clean Energy (PACE) program, a municipality provides loans for solar energy, energy efficiency, and other clean energy improvements to homeowners and businesses within its jurisdiction. The borrower agrees to an individual tax or other assessment on its real property sufficient to repay the loan plus interest over the term of the loan. At least twenty-three states and the District of Columbia have legislation specifically authorizing PACE programs. DOE, Database of State Incentives for Renewables & Efficiency, www.dsireusa.org/summarymaps/index.cfm?ee=1&RE=1. PACE programs may be established under existing authority in other states. For example, in Pennsylvania a municipality authority can establish a PACE program and recover assessments under the state’s Municipality Authorities Act—the same authority that water and sewer authorities use to recover charges.

Although ARRA programs encouraged the development of PACE programs, the Federal Housing Finance Authority has announced that the establishment of a PACE assessment will disqualify a home for receiving a Fannie Mae or Freddie Mac mortgage. Federal Housing Finance Authority, FHFA Statement on Certain Energy Retrofit Loan Programs (July 6, 2010), www.fhfa.gov/webfiles/15884/PACESTMT7610.pdf. This announcement will deter many homeowners from taking advantage of a PACE program and has deterred the passage of new authorizing legislation in other states.

**Creative Use of These Tools in Philadelphia**

A public-private partnership for a Philadelphia sewage gas cogeneration facility demonstrates how some of the tools described here can be creatively combined to benefit clients and reduce energy consumption. Philadelphia had developed a design for a ½ MW cogeneration facility to recover methane gas from its wastewater treatment process, generate electricity in a turbine, and utilize as much of the waste heat as possible from the wastewater treatment process. The city could not justify use of its general obligation bonding authority for the project so issued an RFP for a public-private partnership. In the proposed structure, a private party would enter into a lease or a power purchase agreement and take advantage of the investment tax credit or section 1603 grant in lieu of a tax credit, thus reducing the capital cost by the amount of the tax credit. The private party would be entitled to the value of renewable energy credits that would be generated by the project and any greenhouse gas emissions reduction credits generated. The RFP makes tax-exempt bond financing available to the private bidders. The city would realize reduced electricity prices while producing electricity without fossil fuel resources.

**Ten Ways Lawyers Can Contribute to Energy Efficiency and Conservation**

Lawyers have many opportunities to do well by doing good and assist their clients in reducing energy use. Lawyers can:

1. Advise clients on the regulatory and financial advantages of implementing energy efficiency projects, including advice on tax advantages, greenhouse gas credits and opportunities to generate credits, and co-benefits in pollution reduction (e.g. offsets, achieving compliance through pollution reduction).
2. Assist clients to incorporate green building concepts into development and construction as well as architect/engineer, lease, and financing agreements.
3. Renegotiate building leases between landlord and tenant to incorporate and allocate benefits of energy efficiency and conservation measures.
4. Assist municipalities, tribal governments, and nonprofit organizations in using financial tools and tax incentives to implement energy efficiency projects.
5. Provide legal assistance in complying with energy efficiency and alternative energy requirements.
6. Assist municipalities, states, tribal governments, or nonprofits in establishing SEUs and developing model documentation and summaries of incentives available for alternative energy and energy efficiency projects.
7. Assist in development and permitting of energy efficiency and alternative energy projects.
8. Assist in the development of PACE programs or similar public-private financing programs.
9. Assist clients in developing new finance products, such as pooled energy efficiency home loan products.
10. Make energy efficiency improvements in their office and receive public recognition through the ABA-EPAL Office Climate Challenge or adopt an office sustainability policy based on the ABA SEER Model Law Firm Sustainability Policy Project. www.americanbar.org/groups/environment_energy_resources/projects_awards.html. This participation can provide valuable practical experience, add credibility with clients, and improve the bottom line.

These tools and opportunities—and many more—enable both lawyers and their clients to save money through reduced energy use and, thus, reduce greenhouse gases and other air pollution at the same time. Lawyers who begin to gain knowledge and experience now will be more attractive to prospective clients than those who wait.