



ML Strategies Legislative Update

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Despite Democratic wins, Capitol Hill status quo remains

Expect legislative stalemate on energy and environmental issues but increased regulatory activity

Despite recent polls showing a close popular vote, President Obama won a decisive electoral vote victory, winning all of the battleground states. Election night also saw Senate Democrats increase their margin in the chamber as Democratic candidates defied expectations and eked out victories in largely Republican states like North Dakota, Montana, Indiana, and Missouri. Despite these gains for Democrats, Republicans maintained control of the House of Representatives, ensuring a divided Congress. Consequently, much of the partisan gridlock that has stalled legislation over the past year will continue. As the confetti from election night settles, the election does not present either party with a clear path to enacting its legislative agenda: indeed, the same players will be at the table as the Administration and Congress decide how to address a number of pressing fiscal and policy issues. The odds of substantive energy and environmental legislation in the next Congress is slim, but the Obama Administration—now freed from the restraints of re-election—is expected to utilize its executive powers and imprint its energy and environmental legacy through the regulatory process. Below is a more detailed look at the key energy and environmental issues to be addressed in the lame duck session of the 112th Congress and in the 113th Congress next year.

With election over, federal agencies expected to move forward with regulations

Federal agencies—chiefly the Environmental Protection Agency (EPA)—face a backlog of regulations that were put on hold in advance of the election. Just as the Administration has been slow-walking its regulatory agenda leading up to the election, we expect it will continue to do so post-election in an effort to not rock the boat too soon after the Election Day victory. For example, the Administration would be unlikely to quickly approve the Keystone XL pipeline (though an approval is expected), as that would offend environmentalists who rallied

to the President's re-election. Also, the Administration may hold back on some regulatory initiatives, as it still needs to compromise with Republicans on the fiscal cliff, and does not necessarily want to antagonize them in advance of those negotiations.

Environmental Protection Agency

EPA can be expected to advance several major and controversial regulations over the next year, some of which had stalled amid election year politics. Some of these pending regulations include the following:

- New source performance standards (NSPS) for greenhouse gas (GHG) emissions from new power plants.
- Mercury and air toxics standards for new power plants, which are currently being reconsidered (the agency is on track to issue the final rule by March 2013)
- A tougher national ambient air quality standard for ozone, a chief component of smog.
- Tightened standards for particulate matter. EPA signed a legal agreement with environmental groups in September to issue this standard by Dec. 14.
- A decision on whether or not to waive mandatory volumes of renewable fuel blended in the nation's fuel supply, as required by the renewable fuels standard. Governors of several livestock producing states have petitioned EPA for a waiver, citing the high price of corn.
- Standards for boilers, industrial incinerators, and cement makers (the rule has been pending at the Office of Budget and Management since May 17).
- Resolving how to address air pollution that crosses state lines. A federal court threw out CSAPR (the Cross-State Air Pollution Rule) earlier this year, but the agency has appealed the decision and is waiting to see whether the court will rehear the case. If it does not, the issue will be returned to the EPA, since CAIR (the Clean Air Interstate Rule of the Bush era) was left in place but has also been deemed inadequate by the courts.
- A report on the impact of hydraulic fracturing and drinking water (An initial progress report is expected by the end of 2012, and a final draft report is expected to be released for public comment and peer review in 2014). The report may provide impetus for those who want additional federal oversight.
- Regulation of coal ash under the Resource Conservation and Recovery Act. The rule is mired in litigation and EPA has received hundreds of thousands of comments, suggesting that a rule-making process would not be finished until at least 2014.
- Implementation of new Tier III gasoline standards, which will lower the sulfur content in fuel.
- Guidelines for third party verification of renewable identification numbers (RINs) under the renewable fuels standard (RFS2) are expected to be finalized early next year.

EPA will also press ahead with how to regulate carbon emissions from biomass. EPA's initial proposal recently faced criticism from the EPA's own Science Advisory Board, whose conclusions the biomass industry considers unwieldy and unworkable. Treatment of waste will be less controversial than that of round wood, but the EPA has not yet settled on an approach for either. Environmentalists seem to have steered EPA away from declaring all

biomass emissions to be carbon neutral, but it remains to be seen how EPA handles different feedstocks. EPA is also expected to study new pathways for advanced biofuels as part of the renewable fuels standard.

With Republicans still in control of the House, Rep. Ed Whitfield is expected to keep pushing back against EPA regulations from his perch on the House Energy and Commerce Committee Energy and Power Subcommittee. Still, the divided Congress most likely means that Congressional opponents of EPA action will be unable to pass legislation restraining the agency's regulatory powers.

This intense Republican hostility to the EPA regulatory agenda would also make it difficult for President Obama to navigate the Senate confirmation process with new EPA Administrator. For that reason alone—leaving aside the fact that many Democrats think Administrator Jackson has done a solid job—the White House may encourage her to stay for a second term.

While many in industry fear an unshackled EPA, some environmentalists are weary that the President will compromise on his environmental agenda rather than push ahead with major climate or energy initiatives. They remember that the President's advisors delayed the ozone rule last year. Environmentalists fear that the Administration will approve the Keystone XL pipeline and are already planning new protests.

Department of Interior

The Bureau of Land Management plans to finalize before the end of 2012 a rule to regulate more closely hydraulic fracturing on public lands. A draft released earlier this year and strongly opposed by the oil and gas industry would require drillers to disclose the chemicals injected underground and impose stringent standards for well integrity and wastewater management. Had President Obama lost, the Administration probably would have been in more of a rush to finalize those standards before January. In addition, it is unclear whether Interior will levelize the royalty rates between offshore and onshore oil and gas production on federal lands; Secretary Salazar had previously stated that Interior might bring on shore royalty rates (12.5%) more in line with those off shore (18.75%).

At the same time, at the Bureau of Ocean Energy Management, Obama's win ensures that the agency will move forward with plans for opening the outer continental shelf for offshore wind. The agency is anticipating lease sales for the northeast early next year. While Interior finalized regulations for offshore renewable energy development in 2009, after they had languished for several years during the Bush Administration, Interior is facing its own criticism for not moving fast enough on implementing auction formats for competitive offshore wind leases. It is unclear whether Secretary Salazar, who has been a forceful advocate for renewable energy development on federal land, will leave the Department.

Department of Energy

Some Department of Energy funding announcements were delayed prior to the election. DOE also unsurprisingly refrained from any new loan guarantee announcements prior to the election. We expect funding awards for small modular reactors and for offshore wind

demonstration grants soon. The DOE also has about \$170 million to cover the credit subsidy for projects seeking 1703 loan guarantees. We expect that money to be distributed among 3-4 projects. The Department of Energy will also be releasing a report on the impacts of exporting natural gas. Incoming Senate Energy Committee Chairman Ron Wyden (D-OR) has said that until there is more macro-level study on the effect of exports, the government should not rush to implement policies promoting natural gas exports, as those exports might raise prices and harm domestic manufacturing.

In Congress, energy issues overshadowed by looming fiscal problems

As Congress returns next week for a lame-duck session of Congress, the issues it faces are daunting: looming expiration of tax cuts, the onset of sequestration, and a debt ceiling within reach—taken together, the so-called “fiscal cliff.” This is not to mention measures that typically would have been resolved by this point, such as the annual National Defense Authorization Act (NDAA), a new Farm Bill, and appropriations bills. Congress simply lacks the time to address all of the issues it faces. But even if Congress deals with only a few of the big issues, it could have a relatively productive session. If Romney had won the presidency or Congressional Republicans had picked up more seats, they presumably would have had less reason to compromise in a lame duck session, as they could wait for their new members to be seated next year.

But even with an Obama victory (and slightly more leverage for Democrats), the lame duck Congress most likely will not reach a “grand bargain” on the fiscal cliff, although there are several measures that could pass either as stand-alone bills or as part of a larger omnibus bill. Such measures include a Tax Extenders package, the annual National Defense Authorization Act (NDAA), the remaining six months of appropriations for FY13, a Cyber Security bill, the National Strategic and Critical Minerals Production Act, a modest energy efficiency package, the Law of the Sea Treaty, and Cybersecurity legislation. Further, we also expect to see an effort to provide disaster relief funding in the aftermath of Hurricane Sandy.

There seem to be four options for Congress to address the fiscal cliff: 1) Congress can **“do nothing”** on sequestration and the expiring tax cuts and simply leave this issue for the new 113th Congress next year, although this is really the worst case scenario and could cause deep pain to the economy; 2) A three or six month **“agreement to delay”** sequestration and extend tax cuts, although this does nothing to resolve the fiscal challenges and will only allow more time for the problems to grow (tax writing committee members also are horrified at the prospect of any extension of tax cuts less than a year); 3) a **“grand bargain”** along the line of Simpson-Bowles or the President’s \$4 trillion proposal (simply too heavy a lift and is unlikely to happen this year); and 4) an agreement for a one-year **“down payment”** that is achieved by agreeing on a patchwork of cuts, savings, and revenues that would allow Congress to regroup next year for a long-term plan or even a year-by-year solution. We think that the fourth option is the most likely.

Agricultural Policy

If Congress decides to move forward with a “down payment” approach, it will need to identify billions of dollars in savings. The Farm Bill passed by the Senate offers over \$20 billion in savings. Renewable energy advocates like the Senate version because it includes

mandatory funding for USDA energy title programs, even though the funding is a significant decrease from the 2008 Farm Bill's levels. While farm programs technically expired September 30, significant problems will kick in after Dec. 31, when dairy farmer market-assistance expires. To date, the House has lacked the votes to approve a bill. Democrats protest the \$16 billion in cuts to food stamps, but Tea Party caucus members believe not enough has been cut. While House Majority Leader Eric Cantor opposes the Farm Bill in principle, he recently signaled a willingness to bring up some sort of agriculture legislation before Congress adjourns. This continuing deadlock makes it unlikely to see a Farm Bill pass unless used for savings as part of a larger package.

Tax Policy

Another crucial issue for the energy sector is how Congress deals with expiring energy tax provisions. Senate Finance Committee members consider its summer markup of business tax extenders to be the opening salvo in negotiations with the House. However, Ways and Means Chairman Dave Camp (R-MI) declines to view the Senate proposal as anything but a not-paid-for Finance Committee package that has not been approved by the full Senate.

The wind tax credit has generated the most bipartisan support, but it also costs the most of the renewable credits (an estimated \$12 billion for this extension). Supporters of the wind credit are preparing rallies and speeches when Congress returns, but so are opponents of the credit. To date, opponents of the credit are not distinguishing between offshore and onshore wind. The Senate proposal extends the credit to those projects that commence construction before Dec. 31, 2013. While a one year extension, by changing the language from "placed in service" to "commence construction" the Senate gave renewable energy projects a more open ended date, as projects need not be finished by 2013 to obtain the credit. House Ways and Means Republicans are not pleased with this change and likely will try to gut that change. If Congress does agree to extend a broad package of tax credits, the wind credit is likely to be included in that deal. Other credits such as the cellulosic production tax credit may be able to hitch a ride.

Any extension of the tax credits will be driven by renewable energy champions in the Senate. Fortunately for the renewable energy industry, next year they will be able to count on new advocates including Senators-elect Baldwin (D-WI), Martin Heinrich (D-NM), Hirono (D-HI), and Warren (D-MA).

Both Senate Finance Chairman Baucus and House Ways and Means Chairman Camp want to address fundamental tax reform in the next Congress. But given the differences between the parties on what tax reform means (i.e., whether it includes tax increases), reaching a compromise will be a challenging proposition.

Energy and Environmental Policy

Two key committees for energy and environmental policy will see leadership changes in the next Congress. Incoming Senate Energy Committee Chairman Wyden (D-OR) is a thoughtful member with a history of bipartisanship. He is expected to focus on issues that can attract bipartisan support, even if they are narrow in scope. He is intent on fixing real problems and does not want to fight the same fights. Given his mindset, Wyden will not be championing

big ideas like a green bank, a clean energy standard, or a carbon tax. On the Senate Environment and Public Works Committee, Sen. Vitter (R-LA) will take over as ranking member from Sen. Inhofe (R-OK). Both represent major oil and gas producing states, and Vitter is expected to continue as a vocal advocate for the industry.

For renewable energy advocates, a mixed bag in state referenda

Two state level initiatives are worth noting. In Michigan, voters defeated a “25x’25” proposal, which would have required the state to obtain a quarter of its electricity from renewable energy sources by 2025. Michigan’s current law imposes a renewable energy portfolio standard of 10 percent by 2015. In California, voters narrowly passed a measure tweaking corporate taxes on out-of-state companies (basing taxes on California sales rather than California payroll). This would raise approximately \$1.1 billion more each year, and for the first five years, for the first five years, half of the new revenues would be dedicated to energy efficiency and clean energy projects in public buildings.

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