

Insights and Commentary from Dentons

The combination of Dentons US and McKenna Long & Aldridge offers our clients access to 1,100 lawyers and professionals in 21 US locations. Clients inside the US benefit from unrivaled access to markets around the world, and international clients benefit from increased strength and reach across the US.

This document was authored by representatives of McKenna Long & Aldridge prior to our combination's launch and continues to be offered to provide our clients with the information they need to do business in an increasingly complex, interconnected and competitive marketplace.

U.S. Policy Direction for Renewable Energy and Offshore Oil Drilling in the Wake of the Deepwater Horizon Disaster

Contributed by: Geraldine Edens and Jon Sohn, McKenna, Long, & Aldridge LLP

The contrast between the risks of offshore oil drilling and significant offshore renewable energy opportunities in the United States is highlighted by the coincidental timing of the catastrophic BP Deepwater Horizon oil leak in the Gulf of Mexico and the announcement of the Department of Interior's (DOI) long-awaited approval of the Cape Wind 130-turbine project in Nantucket Sound. The two projects represent starkly different paths for sectors in U.S. energy policy: continued dependence on oil and other carbon-intensive fossil fuels or increased use of renewable energy sources to transition to a low carbon economy. While it is tempting to choose an "either/or" route for national energy policy, a closer analysis of the challenges for each sector is warranted. Proposed legislative and regulatory responses suggest a more incremental policy response in the short-term.

Benefits of Offshore Renewable Energy

According to the U.S. Department of Energy (DOE), there are an estimated 900,000 megawatts (MW) of untapped wind-based electricity along U.S. coasts and the Great Lakes, which is almost equal to the country's current total installed capacity. The Obama Administration seeks to build a "framework for offshore renewable energy development" that incorporates wind, wave, and ocean energy into the US offshore energy strategy.¹ To achieve this goal, offshore renewable energy will require a set of ambitious policy measures to build a significant

market share. Yet neither Congress nor the federal agencies appear to be moving swiftly to put these measures in place.

The drawn-out battle over the 420 MW offshore Cape Wind project took a step forward when DOI Secretary Ken Salazar announced federal approval of the project after nine years of extensive environmental, cultural, and socioeconomic reviews.² Commentators observe that the estimated cost of the Cape Wind project will ultimately pale in comparison to stopping the Gulf oil leak, finding new job opportunities for displaced coastal fisherman, and cleaning up devastated coastlines. In contrast, Cape Wind will reduce annual U.S. greenhouse gas emissions by approximately 734,000 tons - the equivalent of taking 175,000 cars off the road each year - create new jobs, and provide a sustainable source of energy.³ In addition, according to the Massachusetts Energy Facility Siting Board, Cape Wind will help stabilize and lower consumer electricity costs in the region.⁴ A recent report by Charles River Associates indicates that Cape Wind will reduce the wholesale price of power in New England by an annual average of \$185 million, resulting in an aggregate savings of \$4.6 billion over 25 years.⁵ The projected maximum electric output from the project would enable Massachusetts to meet a significant portion of its 15 percent by 2020 renewables target. Despite federal approval, lawsuits opposing the project are likely.⁶

© 2010 Bloomberg Finance L.P. All rights reserved. Originally published by Bloomberg Finance L.P. in the Vol. 3, No. 7 edition of the Bloomberg Law Reports—Sustainable Energy. Reprinted with permission. Bloomberg Law Reports[®] is a registered trademark and service mark of Bloomberg Finance L.P.

The discussions set forth in this report are for informational purposes only. They do not take into account the qualifications, exceptions and other considerations that may be relevant to particular situations. These discussions should not be construed as legal advice, which has to be addressed to particular facts and circumstances involved in any given situation. Any tax information contained in this report is not intended to be used, and cannot be used, for purposes of avoiding penalties imposed under the United States Internal Revenue Code. The opinions expressed are those of the author. Bloomberg Finance L.P. and its affiliated entities do not take responsibility for the content contained in this report and do not make any representation or warranty as to its completeness or accuracy.

The Cape Wind approval has bolstered the offshore wind industry. In late May, General Electric Co. and Lake Erie Energy Development Corp. announced plans to build the first U.S. offshore, freshwater wind farm near Cleveland, Ohio. Lake Erie Energy Development Corp. (LEEDCo), a nonprofit economic development corporation, will review options for building the 20 MW project with a view to project completion by 2012. The longer-term goal is 1,000 MW of offshore wind by 2020 in the region.⁷ Other notable plans include the Delmarva and Bluewater projects in the Mid-Atlantic.⁸ Projects off the coasts of Rhode Island, Texas, and New York are also gaining momentum.⁹

Stop and Start Incentives, Investor Uncertainty

Despite the momentum, there are significant challenges for the renewable energy sector. In 2010, a number of prominent clean technology companies filed for bankruptcy. Two notable Chapter 11 proceedings were Hawkeye Renewables LLC, and Worthmore Renewable Solutions LLC.¹⁰ Analysts suggest that these bankruptcies were largely driven by the uncertain availability of federal tax credits and state renewable energy incentives. The production tax credit for wind energy, for example, provides a savings of 2.1 cents per kilowatt hour produced, but it is time limited and subject to congressional reauthorization.¹¹ The federal approach of short-term tax credit extensions makes longer-term investment strategies problematic. It also makes rational transmission planning difficult. At the state level, fiscal deficits and the threats of higher energy costs cause politicians and consumers to be cautious about renewable energy, which only serves to heighten investor anxiety.

The U.S. can bolster the renewables industry by providing long-term stability and funding. Mechanisms include establishing a price on carbon, setting national portfolio targets, enhancing production tax credits, providing loans and loan guarantees, facilitating power purchase agreements, and providing renewable energy credits. It remains to be seen if legislation Congress considers this session will assist the industry.

The recently-introduced American Power Act (APA),¹² sponsored by Senators John Kerry (D-MA) and Joseph Lieberman (I-CT), discusses the importance of renewable energy, but it does not provide specific support for the industry. Absent from the bill is any mention of a national renewable portfolio or electricity standard. There is speculation that the Senate will incorporate a 15 percent by 2020 renewable energy standard that is present in the American Clean Energy Leadership Act (ACELA),¹³ passed by the Senate Energy & Natural Resources Committee in July 2009. Alternatively, a "buffet" approach is the stated White House preference. The "buffet" refers to a process whereby Senate Majority Leader Harry Reid will cobble together a legislative package that has enough consensus to gain 60 votes in the Senate. Reid will pull these elements together from various proposals to form a new bill. The "buffet" could open the door for more aggressive renewable energy provisions. For example, Senators Olympia Snowe (R-ME) and Amy Klobuchar (D-MN) are advocating for a national renewable energy standard, requiring utilities to obtain 25 percent of their electricity from renewable sources by the year 2025 which is in S. 826,¹⁴ "The American Renewable Energy Act." However, the road to building the necessary levels of political support for any renewable targets and complimentary policies and measures in the Senate remains uncertain. Short-term tax credit extenders might be successful through bills such as the "American Jobs and Closing Tax Loopholes Act,"¹⁵ but this will not address the long-term stability that is needed for the industry.

Long Regulatory Timelines

As the Cape Wind project exemplifies, government approval processes for large-scale renewable projects require perseverance and patience. Offshore wind and other renewable asset classes face local opposition challenges and arduous regulatory processes that need to be streamlined for the U.S. to successfully transition to a low carbon economy. For example, the Cape Wind project, first proposed in 2001, has undergone nine years of studies, public hearings, reviews, lawsuits, voter referendums, political posturing, and

transfers of federal review and oversight authority that has involved a wide range of stakeholders and government agencies.¹⁶ At the federal level, the Army Corps of Engineers, the Environmental Protection Agency, the DOE, the U.S. Coast Guard, the DOI (the Minerals Management Service as well as the Fish & Wildlife Service), the Department of Commerce, and the Federal Aviation Administration have all been involved in the review and decision-making processes at some level.¹⁷ Unless a more certain and efficient process can emerge, the nine-year timeline of Cape Wind will likely be repeated, making large-scale renewable projects difficult to achieve.

On June 11, 2010, Secretary Salazar and the governors of 10 East Coast states signed a Memorandum of Understanding establishing an Atlantic Offshore Wind Energy Consortium to promote the efficient development of wind resources on the Outer Continental Shelf, as well as a new regional renewable energy office to coordinate and expedite these projects.¹⁸ This effort holds some promise for advancing offshore wind energy, but the details remain to be seen.

Congressional Legislation and Offshore Oil

The regulatory road ahead for the U.S. offshore oil and gas industry is less black and white than it may seem. While there are calls to scale-down the industry in the wake of the Deepwater Horizon spill, there is questionable political appetite in Congress for such an approach.

The APA, for example, illustrates the political dynamics that are in play. The APA includes offshore oil provisions that promise to be controversial, but are a key component to reach the necessary 60 votes to pass the bill. The bill seeks to enhance offshore drilling and return 37 percent of the revenues to the states. An additional 12.5 percent of the revenues will go to state and federal land and water conservation fund programs.¹⁹ The APA allows states to prohibit oil and gas leasing within 75 miles of the coastline of a state. In addition, if a required assessment of proposed offshore drilling activities indicates that an oil spill

would significantly impact a state, that state may enact a law prohibiting oil and gas leasing in the area proposed for drilling. Thus, for example, if an oil spill from proposed drilling activities offshore of South Carolina would impact Florida, Florida could veto the federal lease. The political ramifications of the Deepwater Horizon oil leak will largely influence the debate over this legislation.

Federal Response to the Deepwater Horizon Leak

President Obama ordered the DOI to complete within 30 days an initial report on the cause of the explosion and subsequent spill.²⁰ The Administration has also announced that no new offshore drilling leases will be issued until it is determined whether additional safeguards are needed. The Senate Democratic Caucus is calling for BP to establish a \$20 billion fund²¹ to pay for cleanup costs and to compensate individuals and businesses affected by the oil leak.

On May 19, 2010, DOI Secretary Ken Salazar signed a Secretarial Order that divides the Minerals Management Service into three functions.²² The Bureau of Safety and Environmental Enforcement will inspect oil rigs and enforce safety regulations. The Bureau of Ocean Energy Management will oversee leasing and development. The Office of Natural Resources Revenue will collect royalties. The Order has been favorably received.

The Oil Pollution Act (OPA)²³ was enacted in 1990 after the Exxon-Valdez oil spill to prevent and to respond to oil spills. Under the OPA:

- Companies are liable for the entire cost of cleaning up the spill;
- Oil spill liability is capped at \$75 million for claims from individuals, companies and governments; and
- An Oil Spill Liability Trust Fund can cover claims exceeding the liability cap.

Under the tax code, the Trust Fund is funded by an eight cents-per-barrel tax on oil. Trust Fund payments are limited to \$1 billion dollars per oil spill incident (*i.e.* the Gulf Spill — where damages

are projected to surpass \$14 billion).²⁴ Natural resource damage claims paid from the Trust Fund are limited to \$500 million per incident.²⁵

The Administration released a list of policy principles²⁶ for a legislative response to the oil spill. They include raising the statutory expenditure limit for the Oil Spill Liability Trust Fund from \$1 billion to \$1.5 billion and the cap on natural resources damage assessments and claims from \$500 million to \$750 million. To fund the increase, the Administration would raise the tax oil companies pay to fund the Oil Spill Liability Trust Fund from eight cents per barrel to nine cents per barrel beginning in 2010. Additionally, the Administration wants to work with Congress "to develop levels for the various caps that provide for substantial, and proportional, increases." The Administration did not propose raising the economic damages cap above \$75 million.

Congressional Response

House and Senate committees continue to hold hearings with officials from BP, Transocean, Halliburton, and the Obama Administration. More hearings are expected in the coming weeks. In early June, Senate Majority Leader Reid sent a letter to Chairmen Max Baucus, Jeff Bingaman, Barbara Boxer, Chris Dodd, Patrick Leahy, Joe Lieberman, Blanche Lincoln and Jay Rockefeller requesting legislation to ensure that BP and other oil companies are accountable for the cost of their "negligence," and "to address both the existing situation and to reduce the risks of such a catastrophe happening again."²⁷ Senator Reid requested that recommendations be submitted before the Fourth of July.

Meanwhile, the House and Senate tax committees introduced legislation that would extend numerous individual tax breaks that expired at the end of 2009.²⁸ With regard to the oil and gas industry, the legislation would amend the tax code to treat "carried interest income" as ordinary income, subject to a maximum tax rate of 35 percent. Carried interest income is now taxed at the capital gains tax rate of 15 percent. The oil and gas industry

opposes this measure because smaller companies use carried interest income as a method for raising funds to develop new resource areas. The legislation would also increase the liability cap in the Oil Spill Liability Trust Fund from \$1 billion to \$5 billion. To pay for this increase, the legislation raises the 8-cent-per-barrel tax that oil companies pay into the fund to 32-cents-per-barrel.

Other legislative proposals include:

- **H.R. 5267**,²⁹ introduced by Rep. Anh Cao (R-LA.), would amend the Gulf of Mexico Energy Security Act of 2006 to accelerate the increase in the amount of Gulf of Mexico oil and gas lease revenues that is shared with states. The bill was sent to the House Natural Resources Committee.
- **S. 3343**,³⁰ introduced by Sen. Frank Lautenberg (D-NJ), would direct DOI to establish an annual fee on federal offshore lease areas for oil and gas production and to use the fees collected to reduce US dependence on oil. The bill has been sent to the Energy and Natural Resources Committee.
- **S. 3344**,³¹ introduced by Sen. Sheldon Whitehouse (D-RI), would establish an independent, nonpartisan commission to investigate the causes and impact of, and evaluate and improve the response to, the April 20 explosion, fire and loss of life on the Deepwater Horizon. The bill is before the Senate Energy and Natural Resources Committee.
- **S. 3345**,³² introduced by Sen. Whitehouse (D-RI), would remove the cap on punitive damages established by the Supreme Court in *Exxon Shipping Co. v. Baker*. The bill is before the Senate Commerce Committee.

Conclusion

The two historic events in US energy history, one promising and one catastrophic, demonstrate the policy challenges that lie ahead in achieving energy

security and mitigating climate change. It easy to get caught up in the rhetoric comparing the two events and it is understandable that many analyses focus on choosing one path or the other. Despite the Cape Wind success and the BP oil disaster, it remains a steep political challenge to move beyond the incremental approach for scaling-up clean energy while strengthening the regulatory and liability rules for the oil industry. It is quite possible that both issues will be woven into the same legislative bill in the coming weeks if the White House "buffet" approach gains traction. One thing is certain: the rhetoric of comparing and contrasting these two projects and sectors will increase in Congress.

Geraldine (Geri) E. Edens is a partner in the Environment, Energy & Product Regulation practice at MLA where she handles cases involving environmental litigation, regulatory matters and issues regarding law and science. Ms. Edens represents Cape Wind Associates.

Jon D. Sohn is Counsel in the Environment, Energy & Product Regulation practice at MLA. He is an experienced climate change and clean energy public policy leader who has prepared domestic and international environmental policy and regulations.

¹ Walt Musial, *Offshore Wind Energy Potential for the United States*, Department of Energy Presentation (2005), available at http://www.windpoweringamerica.gov/pdfs/workshops/2005_summit/musial.pdf.

² U.S. Department of Interior, Press Release, *Secretary Salazar Announces Approval of Cape Wind Energy Project on Outer Continental Shelf off Massachusetts* (Apr. 28, 2010), available at <http://www.doi.gov/news/doinews/Secretary-Salazar-Announces-Approval-of-Cape-Wind-Energy-Project-on-Outer-Continental-Shelf-off-Massachusetts.cfm>.

³ *Id.*

⁴ Massachusetts Energy Facility Siting Board, Press Release, *Siting Board Grants State, Local Permits to Cape Wind* (Mar. 28, 2009) (on file with authors).

⁵ Charles River Associates, *Analysis of the Impact of Cape Wind on New England Energy Prices* (2008), available at

<http://crai.com/uploadedFiles/Publications/analysis-of-the-impact-of-cape-wind-on-new-england-energy-prices.pdf>.

⁶ Jay Lindsay, *Cape Wind Project Challenges: Lawsuits and Financing*, Huffington Post, Apr. 29, 2010, available at http://www.huffingtonpost.com/2010/04/29/cape-wind-project-challen_n_556797.html.

⁷ General Electric, Press Release, *GE and Lake Erie Energy Development Corporation Announce Great Lakes Offshore Wind Partnership at AWEA* (May 24, 2010) (on file with authors).

⁸ David Ehrlich, *Delmarva and Bluewater in Offshore Wind Farm Contract*, Cleantech Group Update (Jun. 24, 2008), available at <https://cleantech.com/news/3021/bluewater-wind-to-build-delaware-offshore-wind-farm>.

⁹ *Rhode Island governor to sign bill speeding wind farm regulation*, Associated Press, Jun. 14, 2010, available at <http://www.wind-watch.org/news/2010/06/14/rhode-island-governor-to-sign-bill-speeding-wind-farm-regulation/>.

¹⁰ Steven Church, *Hawkeye Renewables May Attempt March Bankruptcy Exit*, Bloomberg News, Dec. 22, 2009.

¹¹ American Wind Energy Association, *What is the Current Status of the Production Tax Credit?* (2010), available at <http://awea.org/policy/ptc.html>.

¹² American Power Act Discussion Draft, 111th Cong. (2010).

¹³ S. 1462, 111th Cong (2009).

¹⁴ S. 826, 111th Cong (2009).

¹⁵ H.R. 4213, 111th Cong (2010).

¹⁶ James Quilter, *Timeline- The Nine-Year Saga of Cape Wind*, Wind Power Monthly, Apr. 29, 2010, available at <http://www.windpowermonthly.com/news/EmailThisArticle/1000169/Timeline---nine-year-saga-Cape-Wind>.

¹⁷ *Id.*

¹⁸ U.S. Department of the Interior, Press Release, *Salazar Signs Agreement with 10 East Coast Governors to Establish Atlantic Offshore Wind Energy Consortium* (June 8, 2010), available at <http://www.doi.gov/news/pressreleases/Salazar-Signs-Agreement-with-10-East-Coast-Governors-to-Establish-Atlantic-Offshore-Wind-Energy-Consortium.cfm>.

¹⁹ American Power Act Discussion Draft, 111th Cong. Sections 1201-1205 (2010).

²⁰ Department of Interior, *Increased Safety Measures for Energy Development On the Outer Continental Shelf* (May 27, 2010), available at <http://www.doi.gov/deepwaterhorizon/loader.cfm?csModule=security/getfile&PageID=33598>.

²¹ Steven Tetrault, *Reid suggests BP pay \$20 Billion for Compensation Fund*, Las Vegas Review-Journal, Jun. 15, 2010 at A1.

²² U.S. Department of Interior, Press Release, *Salazar Divides MMS's Three Conflicting Missions* (May 19, 2010), available at <http://www.doi.gov/news/pressreleases/Salazar-Divides-MMSs-Three-Conflicting-Missions.cfm>.

²³ 33 U.S.C. § 2701–2761 *et seq.*

²⁴ U.S. Department of Homeland Security, *OSLTF Funding For Oilspills* (Jan. 2006), available at http://www.uscg.mil/npfc/docs/PDFs/OSLTF_Funding_for_Oil_Spills.pdf.

²⁵ *Id.*

²⁶ The White House, Press Release, *Fact Sheet: Deepwater Horizon Oil Spill Legislative Package* (May 12, 2010), available at <http://www.whitehouse.gov/the-press-office/fact-sheet-deepwater-horizon-oil-spill-legislative-package>.

²⁷ Office of Senator Harry Reid, Press Release *Reid, In Letter, Urges Swift Action On Oil Spill Accountability And Clean Energy Legislation From Committee Chairmen* (Jun. 3, 2010), available at <http://democrats.senate.gov/newsroom/record.cfm?id=325442&>.

²⁸ Andrew Taylor, *Democrats Propose Further Tax Hike on Offshore Oil*, Houston Chron., Jun. 8, 2010, at A1.

²⁹ H.R. 5267, 111th Cong. (2010).

³⁰ S. 3343, 111th Cong. (2010).

³¹ S. 3344, 111th Cong. (2010).

³² S. 3345, 111th Cong. (2010).