Deep Water Royalty Relief Should be Extended

The recently expired program was a great success
The Deepwater Royalty Relief Act of 1995 was extremely successful in promoting exploration in water depths greater than 200 meters in the Gulf of Mexico. Annual deepwater oil production has increased from some 60,000 barrels per day to close to 450,000 barrels per day under the Act.

MMS is proposing sharp curtailments in that program
With the expiration of the Act in 2000, MMS has great latitude in deciding administratively what royalty relief, if any, to grant in future lease sales. Under this authority, MMS is proposing to sharply reduce the automatic suspension volumes at all depths, and to completely eliminate them in the 200 to 800 meter range. In lieu of automatic suspensions, MMS proposes to expand the scope of its discretionary relief program, allowing any marginal post-2000 lease to apply for discretionary royalty relief. It justifies this reduction in the program on several grounds, including: (a) that the installation of infrastructure already in place and learning from past development have so improved the economics of prospective projects that less relief is justified, and (b) that oil and gas prices are now far higher than they were in the past, and likely to remain so, further reducing the need for such relief.

The premises of these cutbacks are unfounded
Neither of these premises is justified. For example, movements into ultradeep waters will require new “pioneering” efforts, and new sources of development risk, from those faced in projects to date. There is no reason to presume these risks to be smaller than those faced to date. Furthermore, while it is true that the establishment of infrastructure at properties developed to date improves the economics of new leases in their vicinity, the adequacy of that existing infrastructure hinges largely on the size and distribution of the remaining undiscovered resource base, which is currently in the process of very significant reassessment by both industry and MMS itself. Finally, while it is true that current prices are at recent highs, it is only two years since they were at historic lows. Price volatility is the mark of this industry, and there is no basis for presuming that recent price increases are permanent. Moreover, there is no reason for government concern that high prices will generate a windfall to industry since both the previous and proposed programs provide price thresholds above which royalty suspension does not apply.

Any discretionary relief program will be heavily discounted
MMS offers an expanded discretionary relief program as a substitute for the automatic volumes which had been provided by the Act. While industry anticipates improvements in the administration of the current system, which has been so cumbersome as to produce only 7 applications and 4 approvals since 1995, until an acceptable track record is established, the promise of discretionary relief will tend to be heavily discounted by prospective bidders.

Cutbacks in royalty relief are poorly timed
Deepwater oil and gas are becoming an increasingly important share of our domestic energy prospects. An industry sponsored study by Advanced Resources International indicates that continuation of the system of royalty relief provided by the Act would stimulate development of an incremental one million barrels of oil equivalent per day of domestic oil and gas supply within the next decade. This new supply is desperately needed. It is a poor time to begin reducing the incentives to realization of that potential.
DOE Review of Agency Actions Affecting Energy

Statutory Language - Title I - General Provisions to Enhance Domestic Production

The Energy Policy and Conservation Act (42 U.S.C. 6201 et seq.) is amended as follows:

"All federal agencies shall include in any proposed major federal actions that could significantly affect energy supplies, distribution, or use, a statement on:

(i) the energy impact of the proposed action,
(ii) any adverse energy effects which cannot be avoided should the proposal be implemented, and
(iii) alternatives to the proposed action.

Prior to taking final action on any such major federal action, the agency shall consult with, and obtain the concurrence of, the Secretary of Energy. The Department of Energy is directed to establish an office within the Department to review agency actions for energy impacts, and make recommendations to the Secretary. The Secretary shall finalize all Department review decision within a reasonable time certain, but in no case more than 180 days."

Notes

1. The draft language is modeled on NEPA. But other models could be used; provisions contemplating consultation between lead agency and another agency appear in CZMA, CAA, etc. Depending on the sought after result, would an executive order be sufficient (e.g., old executive order on regulatory taking)?

2. One threshold question: What kinds of agency actions are covered? Under NEPA "major federal actions" embraces agency programmatic decisions (e.g., DOI 5-year OCS leasing program) as well as company specific decisions (e.g., leases, permits, etc.). Individual companies are likely to balk at another link in the decision making chain for their permit applications and the like, especially where they have market competitors. Industry more likely to embrace a process which creates a hurdle for agency policy initiatives that are not energy-related at their core (e.g., EPA environmental regulations affecting fuels, facility siting). Bottom line: any new legislation could define "major federal action" any way desired and need not adopt the NEPA definition as it has been construed so expansively by the courts.

3. Another threshold question: How much authority should DOE have? As drafted, the language above quietly requires DOE concurrence, in effect giving DOE veto power. A variation would be to create a presumption of concurrence, rebuttable only if the action-initiating agency provides compelling reasons for rejecting any DOE recommendations in whole or in part. Yet another, even milder, variation would require only that the lead agency consult with DOE without requiring, even presumptively, any DOE recommendations.

4. Another threshold question: How much detail should be prescribed in the DOE review process? For example, should the process include time limits (perhaps with a default)? Require for DOE recommendations, which if satisfied would earn concurrence? Outline a
process by which the lead agency deals with DOE recommendations? Provide for judicial review?
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The Strategic Petroleum Reserve (SPR) is the Nation's first line of defense against an
total disruption in petroleum supplies. It is an emergency supply of crude oil stored in huge
underground salt caverns along the coastline of the Gulf of Mexico.

Decisions to withdraw crude oil from the SPR during an energy emergency are made by the
President. In the event of an energy emergency, SPR oil would be distributed by competitive
sale. Although used for emergency purposes only once to date (during Operation Desert Storm in
1991), the SPR's current size - nearly 565 million barrels - and the U.S. government's stated
policy to withdraw oil early in a potential supply emergency make the SPR a significant
deterrent to oil import cutoffs and a key tool of foreign policy.

Origins
The need for a national oil storage reserve has been recognized for at least five decades.
Secretary of the Interior Harold Ickes advocated the stockpiling of emergency crude oil in 1944.
President Truman's Minerals Policy Commission proposed a strategic oil supply in 1952.
President Eisenhower suggested an oil reserve after the 1956 Suez Crisis. The Cabinet Task
Force on Oil Import Control recommended a similar reserve in 1970. The 1973-74 oil embargo
underscored the need for a strategic oil reserve. The cutoff of oil flowing into the United States
from many Arab nations sent economic shockwaves throughout the Nation. In the aftermath of
the oil crises, the United States established the SPR. Congress passed the Energy Policy and
Conservation Act, 42 USC 6201 et seq. (EPCA), in 1975 to attempt to address numerous energy
security issues. EPCA contained a provision to create and fill a Strategic Petroleum Reserve
(SPR) "capable of reducing the impact of severe energy supply disruptions." Congress set a goal
to store a 90-day supply of crude oil (one billion barrels of crude oil in 1975).

President Ford signed EPCA on December 22, 1975. The Gulf of Mexico was a logical choice
for oil storage sites since more than 500 salt domes are concentrated along the coast, and it is the
location of many U.S. refineries and distribution points for tankers, barges and pipelines. In April
1977, the government acquired several existing salt caverns to serve as the first storage sites.
Construction began in June 1977, and the first oil was soon delivered to the SPR.

Current Status
Today, the SPR holds more than 565 million barrels of crude oil, the largest emergency oil
stockpile in the world. Together, the facilities and crude oil represent more than a $20 billion
national investment.
Fill was suspended in FY 1995 to devote budget resources to refurbishing the SPR equipment and extending the life of the complex through at least the first quarter of the next century. In 1999, fill was resumed in a joint initiative between the Departments of Energy and the Interior to supply royalty oil from Federal offshore tracts to the Strategic Petroleum Reserve.

Proposal

Presidents have made findings that increasing oil imports can threaten the Nation's national security. The history of the last 30 years demonstrates that energy price and supply volatility can result in significant, deleterious economic conditions.

Under the Outer Continental Shelf Lands Act and the Mineral Leasing Act, the Secretary of the Interior is authorized to take the federal government share of oil and gas production extracted from federal lands as a percentage share of the commodity produced. Further, those statutes permit the Interior Secretary to transfer the federal government's production share to the Secretary of Energy or Defense, as well as to other agencies.

In 1998, during a period of lethargic crude oil markets, the Secretaries of Energy and Interior entered into an agreement for the federal share of crude oil production to be deposited, directly or indirectly, into the Strategic Petroleum Reserve rather than being sold into the market, with the proceeds being deposited into the U.S. Treasury.

This program agreement successfully added to the volumes stored in the SPR. The program was suspended when the Secretary of Energy found that the federal share of oil production would be better utilized to be sold into domestic markets to augment supplies flowing to domestic refineries as world supplies tightened and upward price volatility pervaded energy markets.

Language

At the appropriate place insert the following:

The Secretary of the Interior shall enter into an agreement with the Secretary of Energy to transfer title to the federal share of crude oil production from federal lands for use at the discretion of the Secretary of Energy in filling the Strategic Petroleum Reserve during periods of crude oil market stability. The Secretary of Energy may also use the federal share of crude oil produced from federal lands for other disposal within the Federal Government, as he may determine, to carry out the energy policy of the United States.
Royalty in Value

Description: Under the terms of federal oil and gas lease agreements and current statutes, the federal government can take its royalty share of oil and gas production "in value" (money) or "in kind" (production). When royalty is taken in value, the point of valuation is the value at the well on the lease where the oil or gas was produced. On March 15, 2000, the MMS finalized new oil valuation regulations which became effective on September 1, 2000. The goals of the new rules as articulated by MMS were, certainly, simplicity and fairness. The final regulations were immediately challenged by the oil and gas industry in two cases filed in the D.C. District Court. Industry strongly opposes the new rules on a number of grounds, the most important being that they impose expanded obligations on oil and gas lessees which were not part of and are greater than their existing lease obligations with the government. Among other things, the new obligations impose valuation away from the lease, a "duty to market", increased costs of transportation, and contain affiliate resale valuation issues. In a recent D.C. District Court case, Judge Royce Lambeth rejected MMS' implied duty to market argument. In his opinion, Judge Lambeth stated, "as explained above, the court finds that an implied duty to market downstream is not consistent with the terms of the existing leases." This decision has been appealed by the MMS to the Federal Circuit. If the District Court rules similarly in the challenges to the oil valuation rules, the MMS would then potentially be required to re-write the rules to conform to Judge Lambeth's opinion. Further, the oil valuation rules are relevant to royalty taken in kind (RIK) as the benchmark for measuring the cost/benefit of RIK initiatives will be measured against royalty taken in value and thus, the bar for RIK will be raised by the new RIV regulations.

Status: The Senate and House held numerous hearings on MMS' proposed oil valuation rules last year and imposed a multi-year moratorium prior to the rules going final in March. The MMS is in the process of implementing the new rules and training internal personnel. As discussed above, the industry has challenged the rules in D.C. District Court.

Key Issues/Decisions: Should the MMS obtain a legal opinion from the new DOI Solicitor regarding valuation away from the lease and specifically on the duty to market issue? Should the Department engage in a review of transportation issues? Should the MMS have further policy discussions regarding decisions using an indexing methodology to approximate lease value and the issuance of valuation determinations? Should DOI revisit the issue of comparable sales and tendering?

Options:
- Obtain a legal opinion from the new DOI solicitor regarding the Department's position on the duty to market and the best methodologies to obtain value at the lease.
- After a review of Judge Lambeth's decision obtain a legal opinion from the new DOI solicitor regarding oil and gas transportation issues and consider whether to prosecute the appeal.
- Consider rewriting the gas transportation rules on appeal to the Federal Circuit and the oil valuation rules being challenged in light of the D.C. District Court decision.

Timing/Milestones: First 100 days.
Royalty in Kind

Description: Under the terms of federal oil and gas lease agreements and current statutes, the federal government can take its royalty share of oil and gas production “in value” (money) or “in kind” (production). In FY2000 federal royalties brought 5.2 billion dollars to the U.S. Treasury. Industry strongly supports the federal government taking its royalties in kind because of RIK’s certainty, simplicity, administrative costs savings, avoidance of disputes and costly litigation and potential for increased revenues to the U.S. Treasury. Enabling legislation to provide the federal government the authority and flexibility to fully implement RIK will increase the probability of success of RIK and result in the benefits to the public as noted.

Background: Some federal royalty has been taken in kind by the Secretary since the early 1920’s. The principal RIK program before 1996 was the Small Refiner RIK Oil Program. Since that time, the MMS has successfully managed RIK pilot programs for both oil and gas. Numerous hearings have been held in the House and Senate during the last four years on the benefits of RIK. The State of Texas testified before the House Resources Committee in 1997 that RIK was a successful solution to the problems associated with taking the State’s gas royalties in value. Alberta Canada also testified that RIK was a successful way to manage the Crown’s royalties. The state of Wyoming is building on its successful RIK pilot and is proactively expanding its RIK effort. The DOI has pursued RIK during the last six years and has initiated a number of significant Pilot programs to ascertain the feasibility of RIK. The agency states that it has achieved significant cost savings and revenue enhancement through its RIK Pilot programs.

Status: Currently, in addition to the Small Refiner RIK program, MMS has four, multi-year RIK programs in place- (1) a Wyoming oil RIK Pilot, (2) a State of Texas 8(g) gas RIK Pilot, (3) an OCS gas RIK Pilot, (4) and an OCS oil RIK Pilot. A full evaluation of the Wyoming pilot is expected soon. RIK oil has been used extensively to fill the Strategic Petroleum Reserve and in two pilot programs, RIK gas has been successfully used in federal facilities. Currently, MMS takes over 40% of federal royalty oil in kind, and over 15% of royalty gas in kind.

Discussion: Enabling legislation is required to provide the federal government the authority to fully implement RIK and to pay for RIK services such as transportation and processing? RIK should be considered part of a comprehensive national energy strategy and a permanent tool for the Minerals Management Service to use in fulfilling its mission.

Enabling legislation will allow the department to pay for costs associated with RIK such as transportation and processing, provide certainty to the lessee, the States and the federal government, provide for cooperation with the states, and avoid valuation problems that arise when royalty is taken in value.

Legislative action: Enact attached draft bill developed by Senate Energy Staff modifying the authorizing acts.
Transition Policy Issue Paper

Policy Considerations

Description: Since 1982, the Minerals Management Service of the Department of Interior has undergone numerous studies and initiatives on the agency's structure and organization. In 1992, the MMS instituted significant changes under the Vice-President's reinventing government initiatives. These initiatives have led to significant changes, including organizational restructuring currently under way as well as significant capital expenditures on information systems. Members of Congress in their oversight capacity, raised serious questions regarding the organizational restructuring initiatives contained in the FY 2001 budget. In particular, they questioned whether MMS had dedicated proper human resources to its team handling the government's RIK projects. Other initiatives to reinvent the department have fallen within the category of rewriting regulations into "plain English". Taken in total, the initiatives commenced in 1992 have and are effectuating significant changes within the Minerals Management Service of the Department of Interior.

Status: Many initiatives are currently underway and others are planned for the immediate future. The MMS is currently undergoing organizational restructuring and is implementing a new financial system. Other training and personnel reorganization initiatives are underway as well. These changes can and do impact oil and gas lessees on the burdens they impose in a myriad of ways including revising electronic reporting requirements, estimating paperwork reduction, implementation of oil valuation rules, or revising existing lease forms. All told there is significant change ongoing.

Key Issues/Decisions: Are the organizational structure/reinventing government initiatives of MMS fully and cost-effectively meeting the goals of timely collection of revenues, simplicity and certainty for the federal government, the states, tribes and lessees? Has MMS allocated adequate resources for management of the RIK programs?

Options:
- No change. This would permit the time necessary to perform a thorough review of the fundamental changes that are occurring and are planned within the core revenue collection and disbursement functions and their impact on policies of the Minerals Management Service.

Timing/Milestones: The reinventing government/plain English initiatives impact the core of all MMS initiatives and therefore must be reviewed within the first 100 days of the new administration.
By the authority vested in me as President of the United States by the Constitution and the laws of the United States of America, in order to help the Federal Government coordinate a national effort to ensure reliable and affordable supplies of energy for all Americans, it is hereby ordered as follows:

Section 1. Policy. It is critical that the United States develop an energy policy that increases domestic production of energy in an environmentally responsible manner, and promotes development of new technologies that can conserve fossil fuels and reduce energy-related pollution. Furthermore, given the projected 25 percent increase in demand for motor vehicle fuels by 2020 in the United States, it is critical that the United States develop an energy policy that expedites the expansion of facilities critical to production, transportation, and manufacturing of oil, natural gas, and petroleum products.

It is imperative that agencies consider the energy implications of environmental and other regulatory actions to avoid unintended and inordinate complications in energy production and supply. The following principles should guide agency decisions that may affect energy matters:

(a) Energy is a central part of the global economy in which supply and demand are best satisfied through free markets and private sector initiatives. Government policies that minimize interference with a free-market system will contribute to fewer supply disruptions and, consequently, will help moderate price variability.

(b) U.S. national security and economic vitality are enhanced by diversifying energy sources and increasing domestic supplies.

(c) Government policies should create a predictable operating and investment environment for energy suppliers.

(d) Environmental concerns must be addressed but free-market-based incentives, rather than governmental command and control, provide the best foundation for cost-effective solutions.

(e) Technology can help increase supplies, lower costs and improve environmental performance and energy efficiency, merit both private initiative and government support.
Section 2. Consultation with Secretary of Energy Required. All federal agencies shall include in any regulatory action that could significantly and adversely affect energy supplies, distribution, or use, a detailed statement on (i) the energy impact of the proposed action, (ii) any adverse energy effects which cannot be avoided should the proposal be implemented, and (iii) alternatives to the proposed action. Prior to taking such regulatory action, the agency shall consult with, and obtain the concurrence of, the Secretary of Energy. The agencies' actions directed by this Executive Order shall be carried out to the extent permitted by law.

Section 3. Existing Regulations. To ensure that all existing rules, regulations, and agency policies are consistent with the President's priorities and the principles set forth in this Executive order, within applicable law, each agency shall within 90 days of the date of this Executive order, submit to the Director of the Office of Management and Budget a program under which the agency will periodically review its existing rules, regulations and policies to determine whether any such rules, regulations or policies could significantly and adversely affect energy supplies, distribution, or use and whether, after consultation with the Secretary of Energy, any such rule, regulation or policy should be modified or eliminated so as to make the agency's regulatory program in greater alignment with the President's priorities and the principles set forth in this Executive order. Any rules, regulations or policies selected for review shall be included in the agency's annual plan. The agency shall also identify any legislative mandates that require the agency to promulgate or continue to impose regulations that the agency believes are inconsistent with the policies set forth in this Executive order.

Sec. 4. Resolution of Conflicts. To the extent permitted by law, disagreements or conflicts between the Secretary of Energy and other agency heads that cannot be resolved by the Secretary of Energy and the other agency head shall be resolved by the President, or by the Vice President acting at the request of the President, with the Secretary of Energy and the other relevant agency head (and, as appropriate, other interested government officials). Vice Presidential and Presidential consideration of such disagreements may be initiated only by the Secretary of Energy, the head of the issuing agency, or by the head of an agency that has a significant interest in the regulatory action at issue. Such review will not be undertaken at the request of other persons, entities, or their agents.

Section 5. Definitions.

(a) "Agency," means any authority of the United States that is an "agency" under 44 U.S.C. 3502(1).

(b) "Regulation" or "rule" means an agency statement of general applicability and future effect, which the agency intends to have the force and effect of law, that is designed to implement, interpret, or prescribe law or policy or to describe the procedure or practice requirements of an agency.
(c) "Regulatory action" means any substantive action by an agency that promulgates or is expected to lead to the promulgation of a rule, regulation or policy, including, but not limited to, notices of inquiry, advance notices of proposed rulemaking, notices of proposed rulemaking, and guidance documents.

Section 6. Judicial Review. This order does not create any right or benefit, substantive or procedural, enforceable at law or equity by a party against the United States, its agencies or instrumentalities, its officers or employees, or any other person.
The National Energy Security Act of 2001

The National Energy Security Act of 2001, sponsored by Sens. Frank Murkowski (R-AK), John Breaux (D-LA) and Trent Lott (R-MS), provides a variety of incentives to increase domestic energy production, including programs to get more electricity out of the 103 U.S. nuclear plants. The legislation also lays the groundwork for construction of advanced nuclear plants.

The bill's nuclear-related provisions are part of a comprehensive, balanced legislative response to growing U.S. energy concerns. Among other things, the bill (S. 388) would:

- Offer incentives to increase the supply of virtually all domestic energy resources.
- Fund research and development of advanced nuclear, coal, natural gas and energy-efficiency technologies.
- Provide incentives to encourage the purchase of energy-efficient homes, cars and appliances.
- Provide incentives to encourage the use of renewable energy.
- Mandate a reduction in energy use at federal facilities of 30 percent by 2005, and 50 percent by 2020; and mandate an increase in the fuel economy of federal car and light-truck fleets.
- Expand federal programs to mitigate the impact of higher energy prices on low-income households, including weatherization assistance and increased funding for the Low-Income Home Energy Assistance Program (LIHEAP).

Background

Murkowski introduced the legislation on February 26—at a time when Federal Reserve Chairman Alan Greenspan pointed to the role of rising energy prices in the slowing U.S. economy. The bill addresses both short- and long-term U.S. energy problems, which include:

- Shortages of electric generation and transmission capacity, which have become a critical concern in several regions of the United States. In California, shortages of electric generating capacity have contributed to skyrocketing electricity rates, the near-bankruptcy of two major electric companies, and blackouts affecting millions of people and thousands of businesses—all at a cost of billions of dollars. Meanwhile, electricity use nationwide is projected to increase 30 percent to 35 percent by 2010.

- Growing U.S. dependence on imported oil, which accounted for 55 percent of U.S. consumption in 2000. The U.S. Department of Energy (DOE) estimates 65 percent of oil supply will be imported by 2020 unless current policies are changed. The bill seeks to reduce U.S. dependence on imported oil to 50 percent by 2011.

- Rising crude oil and natural gas prices, which have contributed to sharp increases in the cost of gasoline, home heating and electricity in some regions of the nation.
The National Energy Security Act of 2001
March 6, 2001
Page 2 of 3

The National Energy Security Act of 2001 recognizes that nuclear energy, which supplies 20 percent of U.S. electricity and two-thirds of all the country's emission-free electricity, must be expanded to assure adequate generating capacity. Toward that goal, the bill includes nuclear-related provisions in several areas:

Studies
- Requires the Nuclear Regulatory Commission (NRC) to report within six months on the state of the nuclear industry, the potential for increased electricity generation at nuclear power plants and any improvements in process for extending the operating licenses of today's plants or licensing new nuclear plants.
- Requires DOE to report annually on the regional availability and capacity of domestic energy sources to maintain the electric grid. The report must recommend options for increasing the use of non-emitting sources, such as nuclear energy.
- Requires DOE to conduct an independent study of innovative financing techniques that would facilitate construction of new electricity supply technologies with higher initial capital costs, including advanced design nuclear plants. Financing techniques may include federal loan guarantees, federal price guarantees, special tax considerations and direct federal investment.

Office of Spent Fuel Research
- Establishes a DOE Office of Spent Nuclear Fuel Research to investigate innovative technologies for treatment, recycling and disposal of used nuclear fuel and high-level radioactive waste. Annual reports to Congress are required.

Price-Anderson Act Extension
- Extends the Price-Anderson no-fault insurance law, which incurs no cost to the federal government or taxpayers, for an additional 10 years. The bill adopts the recommendations of the NRC and DOE for ensuring that immediate and substantial compensation is available to the public in the event of an incident at a commercial nuclear power plant or DOE facility.

Nuclear Production Incentives
- Authorizes the Secretary of Energy to make incentive payments to increase emission-free electricity production at nuclear power plants. The bill authorizes payment of one-tenth of a cent for each kilowatt-hour produced in excess of the previous calendar year, with payments capped at $2 million per plant, per year, for up to 15 years. The bill authorizes $50 million annually through 2015.
- Authorizes DOE to pay owners of nuclear plants up to 10 percent of the cost of capital improvements directly related to increasing electrical output by at least 1 percent. No single facility could receive more than $1 million, or more than a single payment. The bill authorizes $20 million annually for the program.
The National Energy Security Act of 2001
March 6, 2001
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The National Energy Security Act of 2001
March 6, 2001
Page 3 of 3

DOE Research & Development

- Authorizes $60 million annually for DOE's Nuclear Energy Research Initiative (NERI), allowing new R&D projects to be launched and existing projects to be continued. The NERI program is a mid- to long-term R&D effort that addresses potential barriers to expanded use of nuclear energy, whether it is economics, proliferation, or used fuel management.

- Authorizes $10 million for DOE's Nuclear Energy Plant Optimization (NEPO) program. DOE and private industry share the cost of R&D aimed at increasing production at nuclear power plants without compromising safety. NEPO research programs focus on boosting the reliability and productivity of nuclear plants and support efforts to achieve license renewals through management of the long-term effects of plant aging.

- Authorizes $25 million for a new Nuclear Energy Technology Development (NETD) program for a roadmap to design and develop a new nuclear power plant in the United States.

Tax Code Changes

- Permits amounts paid for temporary storage of used nuclear fuel to be treated as a deductible operating expense, rather than as a capitalized cost.

- Permits non-utility owners of nuclear plants to deduct amounts paid into a nuclear plant decommissioning fund. Specifically, the bill allows deductions whether the decommissioning fund recovers costs through traditional cost-of-service rates, market-based rates, or in transition charges during the changeover to a competitive electric marketplace. Tax-free transfer of decommissioning funds from regulated utility companies to new owners is also permitted.

- Allows rapid, seven-year depreciation of new power plants, including nuclear plants, to foster investment in new electric power supply.

Clarification of State Clean Air Programs

- Clarifies that State Implementation Plans (SIP) under the Clean Air Act should recognize the increased use of emission-free sources of electricity generation as qualified air pollution control measures. This would make activities to increase the use of emission-free sources, including expanding production at nuclear plants or building new ones, eligible for CAA economic incentive programs. Currently, such incentives are available only to activities that prevent and control air emissions.

Outlook

Murkowski has set a goal of achieving Senate passage of the NES Act of 2001 by this summer. The bill's balanced approach to increased electricity production from all energy sources, the electricity crisis in California, rising prices for oil and natural gas nationwide and the realization of the impact of high energy prices on the U.S. economy have enhanced the bill's prospects.
Date: Monday, April 02, 2001

To: U.S. Department of Energy
   Joe Kelliher
   Phone: 202-586-1060
   Fax: 202-586-7210

From: The Duberstein Group, Inc.
      Henry Gandy
      Phone: 202-728-1100
      Fax: 202-728-1123

Pages: ___3____

Subject: Joe: From GM – please take a look and give me your thoughts. I have been speaking with Andrew about this and have shared it with him. Trying to provide constructive suggestions on CAFE, including a discussion on alternatives.
Energy policy works best when it relies on market forces. In contrast, Corporate Average Fuel Economy (CAFE) regulations have put domestic auto manufacturers at odds with their customers, working against the market and creating serious competitive effects without reducing fuel consumption.

CAFE is a Flawed Policy
CAFE has been ineffective at achieving its original goal of reducing imported oil, and would be ineffective at reducing greenhouse gas emissions. Vehicle fuel economy has doubled since the early 1970s, but petroleum use is higher due to increased travel. The fuel economy increase during the 1970s and early 1980s was driven by high fuel prices, not CAFE. When gasoline prices declined in the early 1980s, customers stopped emphasizing fuel economy in their purchase decisions, and the standards began putting domestic manufacturers at odds with their consumers. CAFE penalizes full-line manufacturers, which must meet the same standard as firms specializing in smaller vehicles. Domestic automakers were forced to: offer expensive technology that consumers were unwilling to pay for, deny consumers the types of vehicles they sought, or degrade other vehicle attributes. Higher prices and compromised vehicles reduce sales and harm suppliers, dealers, jobs, and the economy. In addition, studies indicate CAFE reduces occupant safety if manufacturers are forced to make vehicles lighter.

Solutions that Work Through the Market
Open markets should be relied on as the best means for efficient use of resources by industry and consumers. Government policy should focus on: 1) removing obstacles to the efficient functioning of markets, 2) providing support for basic research that would not be supported by normal market forces, and 3) addressing through broad-based market mechanisms, set at appropriate levels, externalities that cannot be adequately addressed by technology development or market efficiency improvements (e.g., environmental).

Explicit consideration should be given to setting goals and priorities, as well as identifying trade-offs. U.S. energy goals can be grouped into the following areas:

- Adequate and reliable energy supplies,
- Affordable energy prices,
- Energy efficiency,
- Environmental protection,
- Energy security, and
- Advanced technology development for future improvements.

Supply
Fossil fuels will be the dominant energy source for many years. Development of alternatives and installation of new infrastructure would take decades. If dramatic reductions in fossil fuel use ultimately prove necessary, we may need to move to hydrogen. This transition would likely begin with gasoline-powered fuel cells and, as fuel cells improve, move to hydrogen from sources such as renewables or nuclear.
Energy Prices
Substantial benefits for national competitiveness and our standard of living flow from low cost energy. Affordable and reliable energy is vital to our business. Energy is most efficiently distributed, and shortages are avoided, if free market pricing mechanisms are allowed to work. If conservation is needed beyond the capacity of available technology, broad-based pricing mechanisms are the most efficient means for additional conservation.

Energy Efficiency
Market forces are sufficient to ensure rational consumer behavior in purchasing major energy consuming products. Manufacturers rationally respond to this customer need by offering those designs and technologies which best meet consumer demand for a range of attributes, including energy efficiency. Regulation has been counterproductive.

Energy Security
Energy independence is not an achievable goal in a global economy. Security can best be enhanced through developing numerous, diverse energy supplies, especially domestic ones, and maintaining emergency stockpiles such as the Strategic Petroleum Reserve.

Environmental Protection
Vehicle tailpipe emissions of regulated gases such as CO, NOx and VOCs are controlled by standards set in grams per mile. Perversely, CAFE standards, which increase travel by reducing the variable cost per mile driven, contribute to higher levels of these regulated pollutants. Encouragement of longer retention of older vehicles through CAFE also leads to higher levels of regulated pollutants. With respect to the global climate issue, which is very long term in nature, the emphasis at this time should be on expanding our understanding of climate science and accelerating technology development to be prepared to respond dramatically as necessary. Given the major reductions that could be necessary in atmospheric CO2 levels, minor fuel economy improvements driven by CAFE would only divert resources from the more important task of developing long term technologies such as fuel cells, carbon sequestration, and decarbonization of fuels.

Advancing Technology Development
Rather than focusing on the failed policies of the past, a better approach takes a longer-term vision of moving to a hydrogen economy with fuel cells. Fuel cells offer potential for both mobile and stationary power, helping to relieve strains on the electricity grid. Fuel cells also have minimal emissions of regulated pollutants and could become important for national competitiveness. The best opportunity for higher nearer term efficiency that maintains choice for family-sized transportation is seen in Europe, where diesels offer up to a 30% fuel economy improvement. That technology could provide similar benefits to the U.S. given appropriate tailpipe emissions regulation. Public policies can support this by:
- Expanding public-private research partnerships (e.g., advanced diesel research),
- Providing customer incentives for moving advanced technologies into the market,
- Utilizing government purchasing power to accelerate the commercialization of advanced technologies (e.g., hybrid transit buses),
- Accelerating technology transfer from the National Labs to the private sector,
- Assessing the infrastructure needed for advanced technologies, especially hydrogen.
We do have more. I'll get back to you with supplementary material as soon as possible. Curious as to whether any of the other suggestions we've made - particularly the short-term administrative measures recommended in the first e-mail I sent you - have any traction. By the way, I heard some word yesterday that the NEP development group may have produced a draft. Can you shed any light on that?

-----Original Message-----
From: Kelliher, Joseph [mailto:Joseph.Kelliher@hq.doe.gov]
Sent: Wednesday, March 21, 2001 4:38 PM
To: 'Jim Ford'
Subject: RE: Recommendations on National Energy Policy
Importance: High

Do you have more detail on the CZMA issue? Your description suggests that legislation is not needed, and that changing the regulations would suffice. Is that true? Also, please explain in more detail how the current regulations relating to consistency impede offshore development, it is not clear what the problem is. Thanks.

-----Original Message-----
From: Jim Ford [mailto:Fordj@api.org]
Sent: Tuesday, March 20, 2001 2:51 PM
To: Kelliher, Joseph
Subject: Recommendations on National Energy Policy
Importance: High

Hi, Joe. As we discussed, attached are a set of papers on national energy policy recommendations. Much of it is designed to be self-explanatory. The last document is a suggested executive order to ensure that energy implications are considered and acted on in rulemakings and other executive actions. This draft has DOE as the coordinator. Probably also need to make energy a major portfolio item for a senior White House aide.

Let me know if you have questions or additional info needs. Thanks.

Jim Ford
682-8210
fordj@api.org <mailto:fordj@api.org>
Good morning.

This is the document I told you was in "the works" on NSR in relation to the national energy strategy. As promised, it is attached.

I hope this is helpful. After talking with you yesterday, the last thing you need is another issue to deal with. Thanks for your consideration.

Again, I look forward to lunch on Tuesday.

Best regards,

Mike

<<A National Energy Strategy Should Include Reform of EPA.doc>>
A National Energy Strategy Should Include Reform of EPA's New Source Review Program

The Federal Clean Air Act established a "New Source Review" permitting program for industrial facilities that undergo "modifications" as defined in the Act and by the EPA could trigger a process called "New Source Review". This permitting process requires a detailed review by the EPA of modifications as well as possible retrofitting of additional pollution control equipment on the facility. In 1980, EPA adopted rules to implement the NSR program and these rules were amended in 1992 for facilities in the electric utility industry.

**EPA's historical interpretation allowed plants to be maintained and repaired.**

These rules and EPA's historical interpretation have generally been consistent with the intent of the statute, only focusing on changes or modifications that increased a facility's maximum achievable emission rate and not merely on more hours of operation. The rules also excluded from scrutiny routine repair and replacement of equipment and efficiency improvements at facilities from the definition of what constitutes modification. In a proposed, but never finalized, 1996 rule and in recent legal actions EPA has re-interpreted these regulations in extreme ways that not only places in legal jeopardy past work conducted at facilities but also threatens the safe, reliable and efficient operation of energy production facilities across the country.

**EPA's new interpretation makes maintenance and repair subject to NSR.**

EPA's re-interpretation of the NSR rules discourages any repair or replacement project that might make an electric utility generating unit more available to operate — projects that improve the safety, efficiency or reliability of the unit. These are the types of projects that are necessary for utilities to operate their units in a manner consistent with their duty to provide a reliable supply of electricity to their customers and to assure safe operations for their employees. Projects, like these, that only allow units to operate more hours have never been considered projects that trigger NSR modification requirements unless they also increase the design capacity of the unit to emit pollutants (i.e., increase the maximum achievable emission rate). EPA's new interpretation brings into question any project that could enable a unit to operate more hours in the future than it had in the past.

**EPA's new interpretation defines "routine" very narrowly.**

EPA's modification requirements also do not apply to repair or replacement activities that are "routine" in the utility industry. In the final days of the Clinton Administration, EPA published in the Federal Register a notice announcing a Region V NSR applicability determination, affirmed by Administrator Browner, involving a turbine repair project at Detroit Edison's Monroe Power plant. In that determination, EPA established a 24 factor test that could render virtually any
project that improved efficiency or reliability at an existing electric utility boiler "non routine" and therefore potentially subject to NSR permitting requirements. This determination creates a serious regulatory impediment to utilities undertaking the type of projects that provide the only short-term hope of expanding existing generating capacity (i.e., efficiency improvements) and of maintaining the availability of existing generation (i.e., reliability improvement projects). The Utility Air Regulatory Group (UARG) has filed a "protective" petition to review that decision in the D.C. Circuit.

**EPA's new interpretation threatens electricity reliability and efficiency.**
EPA's current interpretation of the NSR rules are counter to the need for the important safe, reliable and efficient operation of electric utility generating units across the nation. Especially in the energy short western U.S., the ability to maintain and operate generation could be compromised by EPA's current position. Put succinctly, the routine maintenance and repair of electric utility plants such as has been performed in the industry over the last seventy-five years is not lawful under EPA's current interpretation.

**A National Energy Strategy should reaffirm EPA's historical interpretations.**
A National Energy Strategy that is focused on increasing supply should find ways to resolve the inconsistency between the Strategy's goals and EPA's current NSR interpretation. This could be accomplished by EPA's confirmation of the historical approach to the NSR modification requirements which would exclude from NSR review projects that are routine repair and replacement and allow utilities and other industries to move forward with needed projects so long as the projects do not increase the maximum achievable emission rate of a unit. This reaffirmation of historical interpretations would insure the reliable supply of electric energy and would not negatively impact air quality.
I will follow up with a short statement on above tomorrow. Call me with questions.
Political
The threshold question is whether a multipollutant strategy would
detract or
enhance a National Energy strategy. I will not go into the downsides,
but
they revolve around attention that any pollutant plan would garner and
take
away from core energy issues. But let me give you at least some reasons
to
include such language.

As you know, there will be a lot of talk about how increasing generation
will result in increased emissions. If some action is not taken on
controlling emissions that will become a negative, at least to some.
Secondly, if Bush is serious about pushing a utility emissions plan, it
will
have a whole lot greater chance to pass as part of the Energy bill as
opposed to being a stand-alone bill.

Depending on how the pollutant plan is written, it will gain support
from
some in industry if it provides regulatory certainty. In addition, if
NSR
is reformed/eliminated for new and old generators, we believe it would
actually spur new generation, by removing economic incentives that
courage
capital to remain in very old coal generation.

Discussion
Remember that the purpose of most pollutant plans is to reduce emissions
from so-called grandfathered plants. That is the multi-pollutant (NSR
reform-emissions reductions etc) only applies to these old plants. To
understand why, you need a refresher course on how the Clean Air Act
treats
old and new sources. Recognizing that it was economically impossible to
treat old and new sources the same, the CAA set up a two-tiered system.
Old
sources would have to install the Best Achievable Control Technology
(BACT);
new sources a much more stringent Lowest Achievable Emissions Rate
(LAER).
The caveat was if old sources made major modifications to their
facilities,
they too would fall under NSR and LAER. The thought was that in the
near
future major modifications would be made and all these old facilities
would
soon be cleaned up.

But that didn't happen. Facilities had economic incentive not to make
major
modifications, and did just enough maintenance to keep these plants open
but
not enough to trigger NSR. They thought. Last year, EPA started taking
many of these utilities to court saying that the changes they made were
in fact major modifications and that they should have to retrofit with LAER technology.

So the system is totally screwed. Old facilities are not cleaning up, so EPA is going after them through the courts on a case-by-case basis, which is very inefficient. Meanwhile, LAER is so restrictive that there may never be a new coal powered plant built in our lifetime, and it's difficult (although it is happening) even to get gas-fired generators permitted.

Our idea was, we would start to clean up old plants, and loosen somewhat LAER standards on new plants. This will make it easier for all new generation, coal and gas to come on board. Because enviro's wouldn't like the fact that "command and control" NSR is gone, we will trade it off with a declining emissions cap. And so that old generation will not have to immediately adopt expensive new technology we will set up a trading program with circuit breakers to make sure it doesn't get to expensive. This would give them the option to decide when to stop buying credits and put on new pollution control technology and provide some encouragement for capital to migrate to new generation.

Finally, we wanted to reward efficiency, so allocations would be made year-to-year based on output.

Obviously, this is a dream list. Not all will be done. But perhaps some of these ideas could be floated and adopted. This is my work, and may not cover other questions you have so feel free to shoot away.