RSC
Republican Study Committee
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Legislative Bulletin……………………………….………January 18, 2007

Contents:

H.R. 6—CLEAN Energy Act

Summary of the Bills Under Consideration Today:

Total Number of New Government Programs: 1 new reserve fund

Total Cost of Discretionary Authorizations: $0

Effect on Revenue: $2.9 billion increase over five years; $7.7 billion increase over ten years

Total Change in Mandatory Spending: $2.6 billion decrease over five years; $6.3 billion decrease over ten years

Total New State & Local Government Mandates: 0

Total New Private Sector Mandates: 0

Number of *Bills* Without Committee Reports: 1

Number of *Reported* Bills that Don't Cite Specific Clauses of Constitutional Authority: 0

H.R. 6—CLEAN Energy Act (*Rahall, D-WV*)

Order of Business: The bill is scheduled to be considered on Thursday, January 18th, pursuant to H.Res. 66, a rule closing the bill to all amendments, waiving all points of order against the bill and its consideration—except the new earmarks and PAYGO rules enacted by the House for this Congress (see sections 404 and 405 of H.Res. 6), providing for three total hours of debate, and providing for one motion to recommit with or without instructions.

Summary: H.R. 6 would provide disincentives for the domestic production of oil and gas, capture additional royalties from some existing oil and gas leases, and steer additional federal dollars to alternative energy sources. Highlights of the bill are as follows:

Oil and Gas Domestic Disincentives

H.R. 6 would repeal various tax incentives for oil and gas production, and thus would **increase taxes** on oil and gas companies. One such tax increase would be the denial of a corporate tax deduction for income attributable to the production, refining, processing, transportation, and distribution of oil, natural gas, or any primary product thereof, beginning in 2008. (See the "Additional Background" section below for more details.) According to the Joint Committee on Taxation, this provision would amount to a **$7.6 billion tax increase** on oil and gas companies over ten years.

Another tax increase in the bill would be the extension, from five years to seven years, of the amortization of geological and geophysical expenditures for certain large oil companies for the purposes of calculating a tax deduction (and thereby making the resulting tax deduction smaller each year). Such expenditures are exploratory costs for gathering data (e.g. seismic surveys) on where resources are and how best to extract them. According to the Joint Committee on Taxation, this provision would amount to a **$104 million tax increase** on oil and gas companies over ten years.

H.R. 6 does NOT include provisions regarding a common accounting method in the oil and gas industry—the "last-in-first-out" (LIFO) method of accounting for inventory.

Payment of Oil and Gas Royalties

H.R. 6 would direct the Secretary of the Interior to agree to each "requested" renegotiation of current federal oil and gas leases in the Gulf of Mexico from 1998 and 1999 that did not include royalty price thresholds (because of an oversight by the Clinton Administration's Department of the Interior). These thresholds, had they been applied as in most other leases, would have required royalty payments to the Treasury when oil and gas prices rose above certain amounts ($28 per barrel of oil and $3.50 per million British thermal units of natural gas). The Government Accountability Office has estimated that the error has already resulted in $2 billion in lost royalty payments and could yield an additional $8 billion loss over the life of the leases.

If a lessee does not request to have its 1998 or 1999 lease renegotiated to include royalty price thresholds at or above the amounts above, it could opt to instead pay a fee of $9 per barrel of oil or $1.25 per million British thermal units (BTUs) of natural gas (in 2005 dollars), for producing leases when the price of oil exceeds $34.73 per oil or the price of natural gas exceeds $4.34 per million BTUs (effective on production beginning October 1, 2006). Non-producing leases would be subject to a $3.75-per-acre annual fee. (This provision is similar to Republican-sponsored language that was included in the House-passed OCS drilling bill last year, H.R. 4761, except the price thresholds were higher in the Republican language.)

Additionally, oil and gas companies would be prohibited from bidding on future oil and gas leases in the Gulf of Mexico unless they have either renegotiated their old leases to include royalty price thresholds or have paid all required fees described above.

CBO estimates that this section would yield **$6.3 billion in offsetting receipts** over ten years.

H.R. 6 would also repeal the following tax incentives provided in the 2005 Energy Policy Act (Public Law 109-58):

- royalty relief for natural gas production from deep wells in shallow Gulf of Mexico waters (section 344 of Public Law 109-58);
- royalty relief for deep water production in the Gulf of Mexico section 345 of Public Law 109-58);
- drilling permit fee waivers (section 365(i) of Public Law 109-58); and
- exploration incentives in Alaska's Naval Petroleum Reserve (section 347(k) and section 347(i) of Public Law 109-58).

The bill would also repeal the exploration incentive for planning areas off Alaska's shores (43 U.S.C. 1337(a)(3)(B)).

CBO estimates that these repeal provisions would yield **$210 million in offsetting receipts** over ten years.

Creation of a Renewable Energy and Conservation Reserve

H.R. 6 would provide that the additional revenue received in the U.S. Treasury because of the other provisions in this legislation would be held in a separate account known as the "Strategic Energy Efficiency and Renewables Reserve." This reserve fund would be used to offset the cost of any subsequent legislation accelerating the use of clean domestic renewable energy resources and alternative fuels, promoting the utilization of energy-efficient products and practices, promoting energy conservation, and increasing research, development, and deployment of clean renewable energy and efficiency technologies.

NOTE: the bill contains no enforcement mechanism for this reserve fund (i.e. no method to absolutely ensure that these funds will be spent on renewable fuels and not otherwise raided for other spending.).

The Budget Committee chairman would be directed to adjust the budget resolution to reflect any spending from the Reserve.

Additional Background:

Oil and Gas Domestic Disincentives

Current law (26 U.S.C. 199), passed as part of the "FSC-ETI" bill (Public Law 108-357), provides for a (phased-in 9%) corporate tax deduction for most domestic economic

manufacturing and production (except retail food sales and the transmission or distribution of electricity, natural gas, or potable water). This tax deduction was a replacement for the extraterritorial income ("ETI") exclusion deemed not to be compliant with requirements of the World Trade Organization. The underlying bill would add oil and gas production and distribution as an exception to this deduction so that they could not deduct such expenditures (and thus be subject to a substantial tax increase). This would amount to a multi-million-dollar tax increase on oil and gas companies that could yield higher energy prices for consumers.

Democrats have cited exorbitant oil-industry profits as the prime motivation behind this legislation. However, over the last five years, the oil and gas industry's earnings per dollar of sales have averaged 5.9 cents, compared to 5.2 cents average for all of American industry. (http://www.api.org/statistics/earnings/upload/oil-gas-earnings-vs-all%20industry.pdf)

Americans for Tax Reform has noted that, "Almost all large oil and gas companies are publicly-traded entities, whose shares are owned by millions of investors through their 401(k) plans, retirement plans and pension funds. Taxing away the earnings of those companies negatively impacts the ability of hard-working Americans to achieve a more financially secure future."

On January 16, 2007, the Wall Street Journal editorialized about H.R. 6 that "the biggest winner may be OPEC." On the same day, the New York Times editorialized in regard to the repeal of tax incentives in H.R. 6: "Fair enough, but that's not an energy policy."

Payment of Oil and Gas Royalties

Several oil companies, including BP, ConocoPhillips, and Shell, have already signed an agreement with the federal government to begin applying the royalty price thresholds to oil and gas drilled after October 1, 2006. [Other companies have not yet renegotiated.] However, with this legislation, the Democrats are trying to recapture the $2 billion in "unpaid royalties" to fund other initiatives. (On January 16, 2007, the Wall Street Journal noted that back in 1998, certain oil companies actually alerted the federal government to the absence of royalty price thresholds in their leases, but the Interior Department cleared them to go forward anyway.)

On May 18, 2006, the House voted 252-165 (http://clerk.house.gov/cgi-bin/vote.asp?year=2006&rollnumber=167) to prohibit funds from being used to issue any new leases that authorize production of oil or natural gas under the Outer Continental Shelf Lands Act to any lessee under an existing lease where such lease is not providing the "proper" royalties based upon market price.

Creation of a Renewable Energy and Conservation Reserve

According to the Department of Energy's Energy Information Administration (EIA), all renewable energy sources provide 3.1 % of our current energy supply. Wind power produces 0.1% of our energy, and solar provides less than 0.01% of our energy supply, while ethanol

provides 1.2% of our transportation fuel and hydrogen fuel cells are not currently in mass production.

According to the Renewable Fuels Association, the U.S. uses 25% of the world's energy and produces 35% of the world's ethanol, which is second only to Brazil. After Brazil, the U.S. produces more than all other countries combined. The EIA predicts no significant usage of E85 (85% ethanol/15% gasoline) before the year 2020, and it predicts that E10 (10% ethanol/ 90% gasoline as used today) will supply just 3.5% of the nation's fuel by 2030. The EIA notes that ethanol yields about one-third less mileage than gasoline and cannot be transported in pipelines.

The EIA reports that hydrogen fuel requires large amounts of energy to produce, must be stored near absolute zero, and is highly explosive.

The EIA also reports that solar power requires tremendous amounts of space to produce (6,750 acres to produce the same amount of power that a conventional gas-fired 500 megawatt plant produces on 55 acres) and requires duplicate conventional capacity for when the sun is not shining. The EIA projects that solar will supply 0.6% of the country's total energy supply by the year 2030.

Wind power also has a space problem. Windmills require 29,250 acres to produce the same amount of power that a conventional gas-fired 500 megawatt plant produces on 55 acres and requires duplicate conventional capacity for when the wind isn't blowing. The EIA projects that wind will supply 0.5% of the country's total energy supply by the year 2030.

The EIA projects that all biomass will supply 0.6% of the country's total energy supply by the year 2030.

The EIA also notes that the generation of electricity is projected by year 2030 to come 61% from coal, 17% from natural gas, 16% from nuclear energy, 9% from renewables (same percentage as in 2005), and 2% from petroleum.

Source for much of the above: http://www.eia.doe.gov/oiaf/aeo/index.html. Additional information was provided by Winningreen, LLC.

Despite the uncertainties of renewable fuels, private investment in them has soared. On January 16, 2007, the Wall Street Journal noted that, "The research firm New Energy Finance has found that between 2004 and 2006 investment in alternative energy doubled to $63 billion. Venture capital funding of green-energy technologies has quadrupled since 1998."

Committee Action: On January 12, 2007, the legislation was referred to the following four committees: Natural Resources, Ways & Means, Rules, and Budget—none of which took subsequent public action.

Possible Conservative Concerns: There are many aspects of this legislation about which conservatives may be concerned:

- $7.7 billion in tax increases over ten years with no corresponding tax cut.
- $6.5 billion in fee (royalty) increases over ten years with no corresponding fee reductions.
- No provision to steer the increased revenues to deficit reduction.
- No real choice for oil and gas companies on their 1998/1999 leases—they either "choose" to renegotiate or they "choose" to pay a large fee. Otherwise, they cannot bid on future Gulf contracts— a financially unacceptable prospect for many oil and gas companies.
- Direct financial attacks solely on oil and gas companies, which provide the fuel and other products vital to our nation's economy, standard of living, and well-being.
- Disincentives for domestic energy production and investment, making foreign energy investment and reliance more attractive.
- No enforcement mechanism built into the renewable fuels reserve fund to ensure that it is not raided for other spending.

Administration Position: At press time, an Administration position was not available, though it will likely oppose the tax increases in the legislation.

Cost to Taxpayers: CBO estimates that the bill would decrease mandatory spending (via increases in offsetting receipts) by $705 million in FY2008, $2.62 billion over the FY2008-FY2012 period, and $6.31 billion over the FY2008-FY2017 period. CBO also estimates that the bill would increase revenues by $217 million in FY2008, $2.87 billion over the FY2008-FY2012 period, and $7.717 billion over the FY2008-FY2017 period.

Does the Bill Expand the Size and Scope of the Federal Government?: The bill would create one new reserve fund in the U.S. Treasury.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: Although the lease renegotiation provisions may not technically be private-sector mandates, they do force private companies into expensive choices: either renegotiate the 1998/1999 leases or pay a fee. If a company does neither, it could not bid on future Gulf of Mexico leases (a financially unacceptable prospect for oil and gas companies).

Does the Bill Comply with House Rules Regarding Earmarks?: Yes. An earmarks statement required under House Rules was filed in the Congressional Record last week. The bill contains no earmarks or limited tax/trade benefits.

Constitutional Authority: A committee report citing constitutional authority is unavailable.

Outside Organizations: **Americans for Tax Reform has announced that it will score a vote for this legislation as a vote to break its Taxpayer Protection Pledge.** Other groups opposing the legislation include the U.S. Chamber of Commerce, the American Petroleum Institute, the Domestic Petroleum Council, the Business Roundtable, and the National Association of Manufacturers.

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