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Each bimonthly issue of the *Washington Energy Update* highlights useful energy regulatory tips and a wide range of issues impacting the energy markets.

If you have any questions or would like more information about anything appearing in this issue, please contact the editors or your White & Case relationship lawyer. Please let the editors know if you would like a particular topic covered in a future issue or have suggestions on how this newsletter can be improved.

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Energy Highlights

- On April 10, 2013, the President submitted his Fiscal Year 2014 Budget to Congress. The tax and spending blueprint would permanently extend the renewable electricity production tax credit (PTC) and make it refundable. In addition, the 1.5 cents (indexed annually for inflation) per kilowatt-hour production tax credit would be made available to solar electricity facilities. The refundable tax credit would be available for property on which construction begins after December 31, 2013. Unless extended by Congress, the PTC is set to expire at the end of 2013.
- On April 25, 2013, the Senate Finance Committee issued a tax reform options paper entitled "Infrastructure, Energy and Natural Resources." The paper lists prominent tax reform options suggested by witnesses testifying at hearings on tax reform to date, bipartisan commissions, tax policy experts and members of Congress. It also includes a number of potential goals for energy tax policy reform. The paper makes it clear that if a reformed tax code should include tax expenditures for energy and conservation, they should: "provide businesses with greater certainty; consolidate and simplify such tax expenditures; make such tax expenditures fairer and more efficient; encourage energy independence through a comprehensive approach; and carefully consider whether and how to address any positive or negative externalities." The text of the paper is posted at: www.finance.senate.gov.

DOE Begins to Authorize Pending LNG Export Applications—Cautiously

Jane Rueger

On May 17, 2013, after a nearly two-year hiatus, the Department of Energy, Office of Fossil Energy (DOE) issued its second-ever authorization to export domestically produced LNG to countries with which the United States does not have a free trade agreement (FTA). DOE granted the application of Freeport LNG Expansion, L.P. and FLNG Liquefaction, LLC (collectively, Freeport) for authorization to export up to 1.4 Bcf/day of LNG for a 20-year term. Project proponents hope that more authorizations will follow. However, the order signaled that DOE remains cautious in considering the collective impact of the authorizations it grants, and the fight over how much domestic LNG will ultimately be permitted to be exported to non-FTA countries is likely far from over.

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Section 3(a) of the Natural Gas Act (NGA) requires entities to obtain DOE authorization in order to export or import natural gas, including LNG, from/to the United States. While exports to countries with which the United States has an FTA are deemed in the public interest under Section 3(c) of the NGA, exports to non-FTA countries are granted unless DOE concludes that the proposed exportation is not in the public interest. With the shale boom and plunging domestic natural gas prices, interest in exporting LNG to gas-hungry parts of the world such as Japan has increased. There are currently about 20 applications to export LNG to non-FTA countries pending before DOE, and a recent Barclays report indicates that if all pending projects were actually built, the total capacity for LNG exports would be about 28.7 Bcf/day.

The gas industry's increased interest in exporting domestically produced LNG has been met with stiff resistance, not only from environmental groups concerned with the impact of global fossil fuel use but also from energy-intensive domestic industries, such as petrochemical manufacturing, that would prefer to prohibit the export of LNG in a bid to keep domestic gas prices near all-time lows. The issue has become politically charged as well, with high-ranking members of Congress on both sides of the aisle weighing in both in support of and opposition to LNG exports. After issuing its first authorization to export domestically produced LNG to non-FTA countries in 2011, DOE commissioned a study by NERA Economic Consulting to assess the potential macroeconomic impact of LNG exports. In December 2012, NERA completed its study, concluding that the United States would experience net economic benefits from increased LNG exports in all scenarios studied.

In approving Freeport's application, DOE concluded that permit opponents failed to demonstrate that authorization would be inconsistent with the public interest. The order found that "exports proposed in this application are likely to yield net economic benefits to the United States." The order concluded that the NERA study and its conclusions are "fundamentally sound" and provided "substantial additional support" for Freeport's application. DOE stated that it expects more gas to be produced if LNG exports are authorized than if they are prohibited, finding that "granting the requested authorization is unlikely to adversely affect the availability of natural gas supplies to domestic consumers or result in natural gas price increases or increased price volatility such as would negate the net economic benefits to the United States." EIA currently projects record production rates of 69.3 Bcf/day in 2013 and 70.1 Bcf/day in 2014.

Nevertheless, DOE sounded a note of caution, "hasten[ing] to add that DOE will take a measured approach" in reviewing other pending applications to export domestically produced LNG to non-FTA countries. The order asserts that DOE views "most seriously" the economic impacts of higher natural gas prices and possible increases in gas price volatility that may occur with increasing LNG exports. Recognizing the need to "monitor market developments closely as the impact of successive authorizations of LNG exports unfolds," DOE stated that it will "assess the cumulative impacts of each succeeding request for export authorization in the public interest with due regard to the effect on domestic natural gas supply and demand fundamentals." DOE has indicated that it plans to address the backlog of pending export applications starting with (1) pending applications where the applicant received approval on or before December 5, 2012 from FERC to use the FERC pre-filing process, in the order that DOE applications were received; (2) pending applications where the applicant did not receive approval to use the FERC pre-filing process, in the order that DOE applications were received; and (3) future applications to DOE, in the order received. Queue position will therefore be extremely important as DOE begins to address its current backlog. It remains to be seen how much domestically produced LNG DOE will allow to be exported in aggregate, and the fight over whether each additional permit is in the public interest will likely continue for some time.

Senators Want to Extend Master Limited Partnerships to Renewables

Patrick Holten

Under current law, a business entity with publicly traded interests may be taxed as a partnership if 90 percent or more of its income is derived from qualified sources (Internal Revenue Code section 7704). Qualifying income sources include income and gains derived from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting gas and oil) and real estate operations. Such entities are commonly referred to as master limited partnerships ("MLPs") or publicly traded partnerships ("PTPs").

According to the National Association of Publicly Traded Partnerships, there are more than 100 MLPs currently being traded on major exchanges. So-called "midstream" oil and gas companies, those focused on gathering, processing, pipelines, and distribution, account for the majority of current MLPs. The total market capital of MLPs is approximately US$445 billion, with the natural resource sector accounting for US$400 billion of that total.

Senators Chris Coons (D-DE), Jerry Moran (R-KS), Debbie Stabenow (D-MI) and Lisa Murkowski (R-AK) recently reintroduced legislation (S. 795) that would extend the MLP ownership structure to include renewable energy power generation projects and renewable transportation fuel projects. The "Master Limited Partnerships Parity Act" would amend the Internal Revenue Code to allow income from wind, biomass, geothermal, solar, municipal waste, hydropower and other renewable projects to be considered as qualifying income for MLPs.

A companion bill was also introduced in the House by Rep. Ted Poe (R-TX). The Administration praised expanding section 7704 to include renewable projects late last year when then-Energy Secretary Steven Chu said the bill would "have a profound effect on capital private investment."

Recently, the bill caught the attention of Senate taxwriters in their quest to rewrite the tax code. The Senate Finance Committee included the proposed legislation in an options paper for reforming tax policies affecting energy and infrastructure. By including Senator Coons's bill, the Finance Committee at least recognizes that expanding MLPs to include renewables belongs in the universe of ideas for improving the current tax code.

The Chairmen of the Senate Finance Committee and House Ways and Means Committee are committed to pursuing comprehensive tax reform with the goal of advancing a bill later this year. Many are still skeptical that they can overcome the myriad political and policy pitfalls inherent in rewriting the tax code. However, when the committees do start the process of actually considering legislation, expanding MLPs to include renewable projects will be a part of that debate.

FERC Takes on Formula Rate Protocols

Jane Rueger

In May 2012, FERC instituted an investigation and paper hearing into whether the formula rate protocols under the Midcontinent Independent System Operator, Inc.'s (MISO) Open Access Transmission, Energy, and Operating Reserve Markets Tariff (OATT) are sufficient to ensure just and reasonable transmission rates. On May 16, 2013, FERC issued an order concluding that the MISO and individual transmission owners' formula rate protocols are not sufficient to ensure that transmission rates are just and reasonable, and ordered MISO and 37 transmission owners in MISO to file revised protocols within 60 days. While FERC did not break new ground in the kind of provisions for increased transparency, opportunity for participation and ability to challenge formula rate implementation that it has directed MISO and the transmission owners to incorporate into their formula rate protocols, the May 16 Order is notable for its requirement that previously approved protocols must be updated to conform to current "best practices," and its recognition that FPA Section 206 rights alone are not sufficient to protect ratepayers where protocols do not incorporate those best practices.

FERC first accepted MISO's formula rate protocols in 1998, one of the first protocols accepted by FERC. As FERC recognized in the May 16 Order, modern formula rate proposals have changed significantly since then, generally permitting greater opportunities for review and participation in formula rate proceedings by a broader range of stakeholders, and also containing specific procedures for stakeholders to challenge the transmission owner's implementation of a formula rate. These protections were not in the MISO formula rate protocols that were the subject of FERC's investigation.

The May 16 Order requires revisions to the MISO formula rate protocols in order to (1) permit all interested parties to be eligible to participate in formula rate information exchange and review processes; (2) make revenue requirements, inputs, calculations and other information publicly available, providing interested parties with the opportunity to review that information; and (3) afford parties the opportunity to engage in informal and formal challenge processes regarding implementation of the formula rate. FERC stated that it seeks to provide a "balance between allowing timely recovery of costs incurred to provide jurisdictional transmission service through the use of formula rates, and providing open and transparent rate making to ensure that the rates ultimately charged are just and reasonable as well as consistent with the transmission owner's filed formula rate."

The May 16 Order is noteworthy because FERC required transmission owners to revise their formula rate protocols to reflect changes in the best practices for protocols that have developed since their protocols were approved, without relying on any change specific to each transmission owner's situation or condition as justification for such revision. FERC broadly took notice that "circumstances surrounding any approved formula rate protocol have not remained fixed" and asserted its authority under Section 206 of the FPA to ensure that formula rate protocols remain just and reasonable. In so doing, FERC rejected arguments that protocols previously approved by FERC should be immune from "further evaluation" in light of best practices and conventions adopted since such protocols were approved. Thus, all transmission owners with formula rate protocols on file with FERC should take note of the possibility that FERC may require prospective revisions to their protocols absent any changes in the transmission owners' condition. To avoid such action, transmission owners should take proactive measures to track trends in formula rate protocols and intervene and participate in proceedings where necessary.

FERC also concluded that "[i]n failing to set forth specific challenge procedures, the MISO formula rate protocols effectively require interested parties to traverse an ad hoc system of procedures to raise issues with transmission owners' annual updates." Certain transmission owners argued that interested parties have sufficient avenues to address concerns, including challenges to formula rates under Section 206 of the Federal Power Act (FPA), submission of questions to MISO or the relevant transmission owner, or referral of issues to FERC's hotline or ADR service. However, FERC concluded that these procedures "alone are inadequate in this context." In particular, FERC recognized

that Section 206 of the FPA "imposes significant informational and financial obstacles that interested parties must overcome in order to raise issues with a transmission owner's implementation of its formula rate. Such a burden could be particularly onerous for smaller entities. Further, such impediments could discourage interested parties from raising issues of less financial significance, even when their concerns are valid." FERC's recognition of the limitations and burdens to obtaining review under Section 206 of the FPA is also noteworthy; in other contexts, such as approval of market-based rates for merchant transmission providers, FERC has relied on Section 206 rights to bolster initial findings of justness and reasonableness under Section 205 of the FPA. In the formula rate protocol context, however, FERC has signaled that transmission owners have a continuing obligation to ensure that their formula rates comply with FERC requirements (transparent, stakeholder access to information and right to challenge rates) and that prior acceptance of a formula rate coupled with a lack of changed company circumstances does not discharge that obligation.

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