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# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Betsy Shotwell

**SUBJECT:** SEE BELOW

**DATE:** November 3, 2010

Approved: 

Date: 11/3/10

**SUBJECT: PATTON BOGGS POST-ELECTION ANALYSIS: "PRESIDENT BARACK OBAMA AND THE CLOSELY DIVIDED 112<sup>TH</sup> CONGRESS -- AN ANGRY ELECTORATE HAS SPOKEN -- NOW WHAT?"**

## INFORMATION

The City's federal lobbyist firm of Patton Boggs, LLP, has provided the attached comprehensive analysis of the mid-term elections. The report includes an overview of the lame-duck session to begin on November 15, as well as an analysis of what issues may dominate the nation's political agenda for the next two-years beginning, January 3, 2011, when Congress convenes for the next session, and November 6, 2012, when the voters mark their Presidential ballot. Also included are Patton Boggs' review of major policy areas that will drive the agenda in Washington for the next two-years and how they may affect local government. The link provided here by Patton Boggs will also allow you to view updated versions of the memo over the next few days as more election returns come in: <http://www.pattonboggs.com/news/detail.aspx?news=1306>

This information and analysis will assist the City as we carry forward San Jose's 2011 Federal Legislative Priorities and develop strategies to work effectively with the Administration and the 112<sup>th</sup> Congress.



BETSY SHOTWELL  
Director, Intergovernmental Relations

Attachment:

Patton Boggs' report: "President Barack Obama and the Closely Divided 112<sup>th</sup> Congress – An Angry Electorate Has Spoken – Now What?"

# **President Barack Obama and the Closely Divided 112<sup>th</sup> Congress**

## **An Angry Electorate Has Spoken**

### **Now What?**

**Patton Boggs LLP**

**November 3, 2010**

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## Prologue

This country was settled by people seeking greater opportunity. It's a nation built on hope, optimism, and the belief that our children and grandchildren will have a better life than we do. But Americans don't believe that now. Whether it's because of the financial turmoil we are experiencing or because of America's challenge to remain competitive in a rapidly changing world, we're troubled.

On Tuesday, for the third consecutive election cycle, voters will behave violently, venting their wrath on Democrats just as they punished Republicans not so long ago. There's no reason to think that this violent conduct is behind us.

--Charlie Cook  
The Cook Report  
National Journal (Oct. 30, 2010)

## Introduction

With Republican candidates having made significant gains in the mid-term elections by capturing the House and increasing their share of the Senate, President Barack Obama faces a starkly different legislative environment as he seeks to advance the balance of his policy agenda and as he runs for reelection in 2012. The President has already accomplished two of his most ambitious legislative goals on which he campaigned—health care reform and financial services reform, but two remain unfulfilled—energy/climate change legislation and immigration reform. And now, notwithstanding the need to create jobs and further stimulate the economy, he will likely add deficit reduction as a third one. Will he go for comprehensive bills or will he try for incremental reform? Will he choose confrontation or compromise at the outset? Will he give up on Congress and try to accomplish as much as possible through regulatory action? And how will action in the courts and international events, including the war in Afghanistan, the situation in Iraq, ongoing developments in Iran, and terrorist threats, limit his domestic agenda?

With this analysis, we offer our initial thoughts on these and other issues that will dominate the nation's political agenda for the next two years, beginning January 3, 2011, when Congress convenes for the first session, and November 6, 2012, when the voters next make their judgment known through the ballot box. But first some historical perspective (as well as some trivia) on mid-term elections and presidential politics: Mid-term elections are a referendum on a sitting President, especially when his party controls Congress. When voters are given a chance to vent, the party in power has historically lost congressional seats, forcing past Democratic and Republican presidents to alter their tactics and to reconsider their policy ambitions. The President's party lost an average of 28 House seats and four Senate seats in the seventeen mid-term elections between 1942 and 2008. Facing a difficult economic environment and spurred on by tea party activists, the American public really vented yesterday. As a result, the 2010 losses suffered by the President and his party were historic in the House--the largest swing since 1938.

Some other interesting bits of history: Since World War II, the House has changed parties six times (1946, 1948, 1952, 1954, 1994, and 2006). Every time the House flipped, the Senate did so as well. Thus, the 2010 election is an anomaly. 2012 could be another odd political year as the House could flip back to Democratic control, especially if President Obama is reelected and Republicans are unable to demonstrate that their approach to government creates jobs and economic recovery, while the Senate is quite likely to move to Republican control (as of today, nearly two dozen incumbent Democratic (and Independent) seats will be up for grabs in 2012, including many of the most vulnerable moderates who won in the 2006 Democratic wave election, while only 10 Republican seats--held by Senators who survived the wave election--will be at risk). We're not sure what to make of it, but it does suggest that something odd was occurring this year and that trend could continue through the 2012 election. In fact, we may be returning to something like the decade that followed World War II, in which control bounced back and forth between the parties in four out of five election cycles.

Just before House Republicans lost 26 seats in 1982 (but no Senate seats), President Ronald Reagan's approval rating had fallen to 41% and just before the 1994 elections in which Democrats lost the House for the first time since 1954, President Bill Clinton's approval rating had fallen to 44%. In 1994, Democrats took a drubbing comparable to this year (54 House seats; 8 Senate seats). In recent polling by The New York Times and CBS News, President Obama's approval rating

had fallen from 62% when he took office to 45%. It thus remains marginally higher than either Reagan's or Clinton's numbers at a comparable point in their terms. Given the losses suffered by Democrats this year, the President thus faces a future that looks much like the one President Clinton confronted two years before his reelection bid.

One final bit of trivia: In modern times, no sitting President has lost a bid for reelection when he did not face a serious primary challenger. Presidents Jimmy Carter and George H.W. Bush lost reelection bids even though their party had suffered only relatively modest mid-term election losses two years earlier. Carter faced a serious primary challenge from Senator Ted Kennedy, while President Bush confronted a primary challenger in Patrick Buchanan and a de facto primary challenger in third party candidate Ross Perot, who drew 18.9 percent of the popular vote, much of it from Republican-leaning voters. By contrast, Clinton suffered substantial party losses, just as Obama suffered yesterday. Does Clinton's experience suggest having someone else to blame (*e.g.*, the party in control of one or both Houses of Congress) strengthens a President's position going into his reelection?

Faced with the loss of control of Congress, two of President Obama's predecessors chose fundamentally different approaches—one chose confrontation, the other compromise. They both were reelected two years later. After Democrats lost control of the House and the Senate in 1946, President Harry S. Truman spent the next two years running against the "do nothing" Congress and was reelected in 1948. Almost 50 years later, after Democrats lost control of Congress in 1994, President Bill Clinton eventually dropped his more ambitious and controversial plans, such as health care reform, and instead worked with Republicans over the next two years on a more modest legislative agenda that appealed to middle-class Americans. But before doing so, he first seized an opportunity and stared down the new House Republican leadership over shutting down the federal government (including, most helpfully for him, federal parks, which made the potential impact real for the American public). As part of a makeover, Clinton adopted four tactics: (1) he built policy initiatives around a strategy of "triangulation" that politically positioned the White House between the extremes of both parties; (2) he adopted a more fiscally conservative tone, message and proposals; (3) he sought to achieve consensus on "small-ball" bipartisan legislative proposals that connected with the American public (*e.g.*, welfare reform, school uniforms) rather than complex and controversial measures (*e.g.*, healthcare); and (4) he used his Executive power to implement other elements of his agenda through Executive Orders and regulations (*e.g.*, firearms control) when he could not get Congress to act. He then cruised to reelection in 1996.

The dilemma has faced the Republican Party as well. In 1954, for example, Republicans lost control of the House and Senate. But President Dwight D. Eisenhower had no problem being reelected two years later in large part because he enjoyed broad personal approval ("I Like Ike"). A reluctant partisan, Eisenhower adopted an "above the fray" approach to legislative leadership leading up to his 1956 election. That model won't work now.

The 2012 Presidential election will be about Barack Obama. He can't remain above the fray. He needs to engage. In voting yesterday, the public expressed their displeasure with his stewardship of the economy and his legislative priorities. His reelection will hinge on these challenges: (1) rebuilding personal approval and admiration for the job he has done as President; (2) altering public perception about the central achievements of his first two years in office, especially the public's perception of the stimulus legislation and healthcare reform; (3) creating a track record of measures

that materially contribute to an economic recovery; and (4) passing popular legislation that would allow the President to show he has adjusted his ambitions to meet the needs of the voters.

The President will face further challenges as a result of Gubernatorial and other state legislature elections yesterday. Republicans took over the Governor's mansions in key swing states, including Ohio, Pennsylvania, Michigan, Wisconsin, New Mexico, and Iowa, and the GOP picked up House seats yesterday in every one of those states but Iowa. More significantly, Republicans appear to have picked up at least 19 statehouse chambers, including statehouses that have had one-party rule for more than 100 years (Alabama and North Carolina), marking a shift of hundreds of state legislators. Republicans will use those state-level gains in the congressional redistricting process to try and lock in long-term some of the sixty-plus new House seats won last night and put still other seats in play for 2012. More importantly, those swing states will now be tougher challenges for President Obama in 2012 because Republican turnout operations will be helped by control of the Governor's mansion and statehouses.

As he seeks to address these issues and these electoral changes, the President will face an enormous challenge in addressing both the budget deficit and the need to stimulate the economy in the near term. Beyond what he can do personally to re-connect with voters, he needs to help them understand how the world is changing as China's economic power continues to grow and the dollar is threatened as a reserve currency for the world. Creating jobs through green energy initiatives, for example, may provide a way to demonstrate that good days still lie ahead, that the United States still can make things in factories by people who have good-paying jobs, but only if the United States seizes the initiative.

In any event, the President's success will ultimately depend in large measure on whether and to what extent the economy recovers. And other factors beyond his control could have a real impact. Beyond the war in Afghanistan, developments in the Middle East, in particular in Iran, and ongoing terrorist threats, could have a profound impact. President Obama and his Administration have invested enormous resources into marshalling support for sanctions that have continued to isolate Iran, while also pursuing policies to support Middle East peace efforts. Unfortunately, external events have a way of altering the best-laid plans.

As further discussed below, we anticipate that President Obama will seek to emulate President Clinton's approach in his second term. He will likely pursue an approach in which he can compromise with Republicans on issues important to middle class voters. But we anticipate as well that he will seek to exploit an opportunity through confrontation, as well as to seek a major deal on a signature issue, such as immigration reform. Like Clinton, he may need to confront Republicans before he cooperates with them. For Clinton, welfare reform came nearly a year after the confrontation over shutting down the government. If the Republicans were to go too far in their efforts to gut health care next year, for example, they might provide the President with just such an opening. If he can seize the right opportunities, he should be able to work with Republicans on trade policy, entitlement reform, a long-term recalibration of defense programs, and further education reform.

Notwithstanding the perceived benefits of confrontation, both the President and Congress have an incentive to work together, Republicans perhaps more so. They both will be under pressure to show they get it, that they can find a way to create jobs and grow the economy (but of course without adding to the deficit). The latest views from the Congressional Budget Office provide a

sobering assessment of the challenge they will face: At a time when the nation's fiscal debt relative to the size of the economy is higher than it has been in more than 50 years, the economic recovery will proceed "at a modest pace, leaving unemployment above 8 percent until 2012."

In 2012, the President and the 112<sup>th</sup> Congress will face a voting public that seems to have less tolerance for failure. That knowledge should create a special urgency for the new Republican House Majority. In the modern era, the Democrats controlled the House for 48 of the 50 years from 1944 to 1994 (with the exception 1947-48); Republicans then enjoyed a twelve-year run (1995-2006). Now Democrats have been thrown out of the House after just four years (2007-10) but the margin of Republican control is small enough to suggest that new majority could lose control in 2012 if the American public concludes they failed to produce results. With Independents having shown their willingness to move back and forth to support candidates of one party or the other over the last few election cycles, the leaders of the party that connects first with them by demonstrating that their party can get things done will go into the 2012 election enjoying a substantial advantage.

The 24-hour media cycle, the power of the Internet to deliver information directly to voters, and the rise of social media have contributed to make voters more knowledgeable and active, at the same time their attention span appears to be shorter. Hence, a likely demand for legislative results that will be louder, creating an incentive for Congress to deliver more immediate results. Voters aren't interested in five-year plans. They want results now. Republicans thus would be wise to run the House with the knowledge they will need to point to some fundamental successes by 2012 or risk losing control to President Obama, who will blame Republicans for policy failures and a lack of solutions to fundamental societal challenges.

In this environment, the Republican leadership will face particularly difficult challenges. In the House, presumed Speaker Boehner will preside over a far more liberal Democratic minority (owing to losses of Blue Dogs in particular), while managing a far more conservative conference of his own. Moreover, many in his caucus with strong support from the tea party have developed a strong national cable television following and have used a variety of media outlets successfully to develop support for repealing health care, cutting the deficit, and refusing to compromise on anything with the President. The new majority may thus be much more difficult to lead. At the same time, by calling for repeal of health care or refusing to increase the debt limit early in 2011 and thus potentially setting up a major confrontation with the President, they may be handing the President an opportunity much like the one President Clinton seized when challenged by then-Speaker Gingrich.

Representative Boehner would be the first Speaker since former Speaker Tom Foley (D-WA) to have previously served as a committee chairman. (Foley chaired the Agriculture Committee; Boehner the Education and Labor Committee.) In fact, he would be the first Republican Speaker who previously served as a committee chair since Representative Joe Cannon (R-IL), who led the House from 1903 to 1911. Unlike Speaker Gingrich, he will not abolish any committees. Moreover, he is likely to defer to committee and subcommittee chairs, who will have greater autonomy in drafting legislation.

On the Senate side, Minority Leader Mitch McConnell (R-KY) will also face real challenges in managing his caucus and trying to decide when to fight and when to compromise. Many tea party-supported Senators have made it clear that they are coming to Washington not to compromise on anything. Period. That will make it harder to find common ground with the President and the



Democratic majority, especially when moderates in his caucus want to demonstrate their ability to get things done on a bipartisan basis. Given the experience their colleagues faced in challenges from the right in primaries this year, many may be more reluctant than in the past to support a compromise that could be used against them in primary challenges in 2012. Thus, while McConnell will have the power to block anything the Democratic majority wants, he will face enormous challenges when he sees opportunities to work with the President to get something done on issues important to middle class voters going into the November 2012 elections.

One final note on the 112<sup>th</sup> Congress, triggered by yesterday's election results: pressure will increase for the Senate to operate more like the House, where majority rule is essentially absolute. As the last few years have demonstrated, not much meaningful can be done in the Senate without 60 votes to overcome a filibuster (or even the threat of one). With more former House Members having been elected yesterday to their first terms in the Senate, nearly one half of the Senate will now be comprised of former House Members. Many may long for the power of majority rule, but those in the minority may in fact see the greater value of being in a body in which one determined individual can block bad ideas from becoming law. Inevitably, pressure will increase to modify the current filibuster rules of the Senate, to move it closer to majority rule. But we don't expect any changes to the rule in the 112<sup>th</sup> Congress, not least because two thirds of the Senate would have to agree.

Many policy issues will be driven by other institutions. The courts, for example, could play a pivotal role on immigration reform and implementation of health care reform. By next year, for example, cases will have reached the appellate stage on the various challenges to the health care reform legislation enacted this year. When Congress passed the legislation that makes up the health care reform package, it did not include a "severability" clause, a standard provision that says that if one part of a bill is found to be unconstitutional the other parts of the bill are "severable" and thus would not be struck down as well. In the absence of such a provision, a court could strike down the entire law if it were to conclude, for example, that the individual mandate provision is unconstitutional. Given that Justice Elena Kagan would likely have to recuse herself from considering the case should it reach the Supreme Court, the country could face a 4-4 split on whether the Obama health care bill is upheld or struck down.

In the absence of legislation, states as well may drive policy decisions. Over the past few years, for example, states have taken the lead on renewable energy initiatives. The states also have been active on consumer protection aspects of financial services regulation and home mortgage and foreclosure issues, and are increasingly playing a role in online privacy and net neutrality policy debates. Republicans may generally be strong supporters of states rights, but may yet see the benefit of setting rules applicable in all 50 states as a means of promoting business certainty and spurring economic growth nationwide.



In the following pages, we offer our thoughts on major policy areas that will drive the agenda in Washington for the next two years and how they might affect you. In the pages that follow, we sketch out our sense of what is in store in the areas of agriculture policy, appropriations and further earmark reform, defense and national security, energy and environmental policy, financial services, food and drug policy, health care, homeland security, Native American affairs, tax policy, technology and telecommunications policy, trade policy, and transportation and infrastructure.

As a firm with deep public policy roots, we are proud of our ability to help clients exercise a right enshrined in the U.S. Constitution by petitioning their government. We have been at it since 1965, when Jim Patton encouraged a young White House aide named Tom Boggs to help him build a different kind of law firm, one that understood that all three branches of government could provide solutions to challenging problems. By combining political know-how, legislative experience, and substantive knowledge of the law, they had a vision for helping clients achieve success. For our paying and pro bono clients alike, we look forward to helping them achieve their legislative objectives as President Obama engages with the 112<sup>th</sup> Congress.

## Table of Contents

	<b>Page</b>
Agriculture Policy .....	8
Appropriations and Earmark Reform .....	15
Defense and Foreign Policy .....	18
Energy and the Environment .....	23
Financial Services.....	31
Food and Drug Policy.....	31
Health Care.....	39
Native American Policy.....	47
Tax Policy.....	50
Technology and Communications.....	54
Trade Policy.....	63
Transportation and Infrastructure .....	68

## Agriculture Policy

The “Farm Bill” is the major agricultural and food policy tool of the federal government. The current Farm Bill, the Food, Conservation, and Energy Act of 2008, is set to expire in 2012. In an attempt to avoid the delays in passage that have characterized consideration of previous Farm Bills, Representative Collin Peterson (D-MN), Chairman of the House Committee on Agriculture, began work early on the legislation, starting this past spring with a series of “listening sessions” across the country to take the pulse of stakeholders. The Senate also began hearings early in the summer in preparation for the 2012 Farm Bill. Despite this early start, Republican control of the House could delay consideration of the Farm Bill. Representative Frank Lucas (R-OK), who is expected to assume the chairmanship of the House Agriculture Committee, reportedly does not share Chairman Peterson’s desire to have the Committee complete its consideration of the bill by spring 2011.

Although the Democrats retained control of the Senate, the Senate Agriculture Committee will also have new leadership, as Senator Blanche Lincoln (D-AR) was defeated by Republican John Boozman. Senators Debbie Stabenow (D-MI), Ben Nelson (D-NE), and Kent Conrad (D-ND) have been mentioned as potential successors to Senator Lincoln.

Despite changes in committee leadership, both panels are expected to continue work on the Farm Bill next year. Budgetary concerns are likely to loom large as the committees work to reauthorize the various programs in the bill, with price supports and direct payments likely to garner unusually close scrutiny. In a conference call with reporters in April, Chairman Peterson--generally a staunch advocate of farm subsidies--invited a debate on the wisdom of the traditional price support system, asking that “we put everything on the table” to see if “there [is] a more productive way of providing a safety net.”

### *Major Issues on the Agenda for Next Year*

Given the popularity in the agricultural community of spending programs included in the Farm Bill, cutting costs is easier said than done. In its early listening sessions, the House committee evinced openness to reconsideration of key programs, including price supports and elements of the crop insurance program. Many farmers, however, are deeply invested in the continuation of subsidy programs in their current form.

The concept of protecting farm income has historically garnered bi-partisan support. With control of Congress divided, it is unlikely that radical cuts in agricultural support programs will be enacted--even in the face of current budget pressures. However, numerous factors will influence the debate. Congress will consider farm support programs under the backdrop of rising demand for U.S. agricultural exports. According to U.S. Department of Agriculture data, in the first eight months of 2010, U.S. agricultural exports increased 14 percent, to \$69.8 billion, from the same period a year earlier. Expect Members of Congress with a free trade, or export-based orientation to raise concerns regarding international criticism of U.S. subsidy programs based on associated market distortion and compliance with the World Trade Organization (WTO) rules. Republicans have historically pushed harder for policies promoting free trade and were instrumental in limiting some export support programs in the 1990s.

The Obama Administration has focused on rural renewal initiatives and bio-fuels development. And, in the wake of renewed public consciousness regarding conservation and environmental issues spurred by the Deepwater Horizon oil spill in the Gulf of Mexico, concerns regarding those issues will also figure into the debate. Food and nutrition issues will also be a principal legislative focus. Funding for the Supplemental Nutrition Assistance Program (SNAP)--colloquially referred to as 'food stamps'--constitutes two-thirds of Farm Bill spending, putting the program squarely on Congress' agenda for the next session, along with legislation reauthorizing the National School Lunch Program and the Special Supplemental Program for Women, Infants, and Children (WIC) currently pending in Congress, if it is not enacted during the lame duck session.

**Crop Insurance, Subsidies, and Price Supports.** A 2009 ruling by the WTO in favor of Brazil on U.S. cotton subsidies will put pressure on Congress to restructure or reduce current subsidy programs to comply with increasingly stringent WTO limits on Aggregate Measurements of Support (AMS). The U.S. agreement with Brazil will place focus on restructuring of the cotton subsidy system, and may spill over to put pressure on subsidy programs for other commodities. Such pressures can be expected to meet resistance from Members skittish about altering popular programs without explicit rulings from the WTO.

To protect farmers, outgoing Chairman Peterson has expressed a preference for crop insurance, as opposed to price supports, contending that crop insurance is more in line with the safety net function of the federal subsidy program. He has suggested that elements of the current crop insurance program should be reconsidered and has expressed interest in moving toward a system based on whole farm revenue to encourage crop diversification.

Chairman Peterson has also hinted at considering the Average Crop Revenue Election (ACRE) pilot program as a model for change, while acknowledging the need to reexamine some elements of the program. The ACRE program is likely to be a major component of the 2012 Farm Bill debate. Authorized in the 2008 Farm Bill, the ACRE pilot program seeks to address the unitary focus of traditional crop insurance on commodity prices by including low state yields as an additional trigger for payments. In this way, ACRE is intended to protect farmers during years in which prices are high but yields are low as well as in years in which prices are low.

Still, many stakeholders have pointed to problems with the ACRE program. Participation by farmers has been relatively low, reportedly in part because of the administrative difficulties associated with enrolling in the program. Farmers have also objected to calculations of yields on the state level, arguing instead for payments based on county yields or historic farm records, which would account for variations in crop conditions within states. Such calculations, however, could increase program costs. The ACRE program is criticized by others as too generous. The program now ties compensation for low prices to 2008 commodity prices, which were relatively high, thus enabling farmers to qualify for ACRE programs in years when prices are not extraordinarily low. ACRE may, however, provide an advantage over traditional Federal Crop Insurance, which has been criticized as being overgenerous to less productive producers.

ACRE might also raise WTO concerns in years when many farmers receive payments if it qualifies as an "Amber Box" program--a WTO classification that includes almost all domestic support measures considered to distort production and trade, including price supports and subsidies directly related to production quantities. Programs that fall within the Amber Box are limited to a specified percentage of a country's agricultural production. Because the definition of Amber Box

programs includes subsidies related to quantity of production, some critics believe it includes ACRE, even though payments are not only triggered by low prices.

**Dairy Farmers.** The 2008 Farm Bill extended both the dairy support program, in which the federal government buys milk at a specified price, and Milk Income Loss Contracts (MILC), which provide direct payments to farmers if milk prices fall below a target level. Despite these programs, dairy farm income has been affected by high price volatility and losses in commercial exports. Moreover, both programs fall within the WTO's Amber Box and have contributed substantially to the U.S. AMS.

With traditional subsidy programs falling short of protecting dairy farmers from recent price fluctuations, the structure of dairy subsidies are being reconsidered. Some in the dairy industry, including the National Milk Producers Federation (NMPF), have proposed replacing or supplementing current programs with a margin insurance program, a type of support that would pay farmers if the difference between feed prices and milk prices exceeds a certain level. A similar concept can be found in Livestock Gross Margin (LGM) insurance, a program currently available to dairy producers that has attracted little enrollment. This insurance program is self-financed with premiums paid by farmers, although the government makes direct payments to insurers to subsidize their overhead. The plan proposed by NMPF would use different benchmarks than the LGM program to determine when payouts would be made, and would be administered by Farm Service Agency offices, rather than private insurers. Unlike LGM insurance, the NMPF proposed plan would include a free base-level insurance program, with premiums assessed for higher levels of protection.

While the NMPF proposal would likely be more expensive than the current Livestock Gross Margin insurance program, it could potentially produce substantial savings over the current subsidy program. Moreover, it might avoid Amber Box classification, since it is not triggered directly by low milk prices. By addressing both cost savings and trade policy concerns, while appealing to the interests of dairy farmers, this program can be expected to receive serious consideration during debate on the 2012 Farm Bill.

**Trade.** Export programs, including export subsidies, export market development, export credit guarantees, and foreign food aid, have been very popular with farmers and have helped develop important international markets for U.S. agricultural products. While such programs have come under fire from economists for distorting the world market, the presence of similar programs in the European Community makes it difficult for the U.S. to reform the world market by unilaterally removing its subsidies.

Despite the popularity of export programs, their tension with WTO rules could place pressure on Congress. Particularly in light of the WTO ruling against U.S. cotton subsidies, export programs could be a subject of debate in the 2012 Farm Bill. Export credit guarantees were already substantially reduced by the 2008 Bill, but critics doubt whether the reductions were sufficient to bring the U.S. into compliance with WTO rules. Compliance with AMS limits may also call for limiting U.S. spending on subsidies and market development. Nevertheless, pressure on Congress to leave popular subsidy programs intact is strong. Absent specific WTO rulings, as in the case of cotton, Congress can be expected to be reluctant to limit or restructure subsidy programs. Despite their popularity with farmers, sugar tariffs and dairy export subsidies have also raised the hackles of

free trade proponents, consumer advocates, and food manufacturers who are troubled by the upward pressure they impose on the prices of sugar and milk.

Another push toward a free trade regime may come if Congress approves the U.S.-Korea free trade agreement. Although the Bush administration signed the agreement in 2007, its ratification has been stalled by a Democrat-controlled Congress, which wanted additional access to the Korean market for U.S. cattle farmers and carmakers. Nevertheless, President Obama breathed new life into the agreement in June, and the two governments are working to resolve outstanding differences before next week's G-20 Summit in Seoul. If the two parties are able to reach agreement, we expect the Obama Administration will submit the agreement for congressional approval early next year. A reworked agreement will likely remove some restrictions on U.S. beef exports to South Korea. The agreement will also reduce tariffs on other agricultural products, which would be a boon to U.S. farmers seeking new markets. Although the U.S. imports few agricultural products from Korea, the agreement might also require the liberalization of some U.S. trade policies, which could add to the trade-related pressure on Congress to reconsider some subsidy and import programs in the Farm Bill.

During the same G-20 summit at which President Obama announced his intention to resolve outstanding differences on the South Korea FTA, world leaders failed to commit to completing the delayed Doha world trade negotiations. Because the Doha negotiations are likely to increase the stringency of international requirements to liberalize U.S. trade and subsidy policies, the longer they are delayed the less pressure there will be on Congress to reconsider the portions of these programs contained in the Farm Bill.

Consideration of foreign food aid programs is likely to be characterized by a tension between the tightening U.S. budget and rising global hunger. Budget constraints may push the U.S. to impose cutbacks on its foreign food aid, but the impact on the developing world of the global economic crisis may make such cuts seem too harsh.

**Rural Renewal.** Some observe that commodity-based subsidies have done little to combat migration away from rural America. With its Regional Innovation Initiative, USDA is trying another tack. Announced in 2010, the initiative will focus on (1) developing infrastructure, particularly expanding the availability of Broadband Internet; (2) developing economic alternatives, through investment in renewable energy and biofuels; and (3) enhancing regional food systems and supply chains, as well as by supporting environmental protection, through forest restoration and private land conservation and through ecosystem market incentives. The Initiative envisions funding for regional pilot projects, and technical assistance and support, and coordination of regional development activities already in place.

Republicans, however, argue that with this initiative the Administration is focusing on non-farm programs and attempting to convert rural America into a series of "bedroom communities," instead of supporting the revitalization of American agriculture. A Republican House may reduce funds for these programs, thus cutting a budget item without significantly alienating the farm lobby.

**Biofuels.** In the context of political instability in some oil-producing foreign countries, unstable fuel prices, and concern over fossil fuel dependence and pollution, the 2008 Farm Bill provided substantial support for research and development of biofuels. The bill provided for tax credits and loan guarantees to support producers of biomass fuels, including cellulosic ethanol, and



encouraged farmers to produce biomass crops, such as switchgrass, through biomass establishment payments covering a portion of their costs until the crops are established. Biofuels have proved very popular with farmers, who have seen the demand for corn rise in response to its use in ethanol production. Rising corn prices, though, have been associated with rising food costs and food scarcity globally and have caused problems for livestock producers, who have seen feed costs rise substantially. The 2008 Farm Bill responded to these anticipated concerns by encouraging research on and production of cellulosic ethanol. These programs have also held appeal for farmers, some of whom have been able to shift to production of low-cost crops like switchgrass, and some of whom have found a new source of income in cellulose-containing agricultural residues, as well as for residents of rural areas where location of ethanol refineries may create new job opportunities.

Although the success of biofuels programs in moving the U.S. away from its dependence on fossil fuels is open to substantial debate, their popularity with farmers and the appeal of their potential to provide new energy possibilities weigh against any major cuts, especially in a divided Congress and in the context of ongoing tensions with oil-producing nations in the Middle East and Latin America and the Deepwater Horizon spill.

**Conservation.** Fallout from the Deepwater Horizon oil spill placed more emphasis on environmental issues in the 111<sup>th</sup> Congress. This, combined with agriculture-related issues such as soil erosion, deforestation, and greenhouse gas emissions, is likely to lead to discussion of sustainable agriculture and related conservation issues. Programs like the Environmental Quality Incentives Program (EQIP) and the Conservation Stewardship Program (CSP), which provide incentives to farmers to adopt environmentally-friendly practices, the Conservation Reserve Program (CRP) and the Wetlands Reserve Program (WRP), which provide for retirement of agricultural land, and the Farmland Protection Program (FPP), which provides for agricultural land preservation, are popular with the farmers who receive payments under the programs and non-rural constituents concerned with environmental protections.

Environmentalists are pressing for more land retirement, greater watershed infrastructure, and the harmonization of pollution standards for agriculture with those of other industries. Agricultural coalitions do not oppose existing programs, but want to keep land retirement and easement programs voluntary and to maintain compliance requirements at their current levels. With Republicans in control of the House, environmental issues will not be ignored, but they are not likely to receive the kind of attention a Democratic House would have given them.

**Food and Nutrition.** The majority of funds authorized by the Farm Bill go not to agricultural programs, but to nutrition programs—including the Supplemental Nutrition Assistance Program (SNAP), which provides food benefits for qualifying recipients. Of note is that the economic recession has left more individuals eligible for SNAP, increasing the cost of the program. As the economy recovers, these expenditures could be mitigated. Nevertheless, the market recovery has yet to trigger the significant employment gains that would help to move families off food benefits, so an organic drop in SNAP expenditure might be an unrealistic expectation. SNAP is likely to remain a major driver of costs associated with the next Farm Bill.

Some discussion at the Agriculture Committee's listening sessions has centered on the relationship between SNAP and the obesity epidemic. Testimony by Professor Paarlberg, proposing restrictions on the types of food that could be purchased with SNAP benefits, attracted attention on the Hill and in the media. He suggested that his proposal would not hurt the poor, since their



absolute level of SNAP benefits would remain the same. A pilot program of this nature might attract some Congressional support as a furtherance of the push for preventive health care emphasized in the debate on the recently-enacted health reform overhaul legislation.

Legislation to reauthorize and expand child nutrition programs, including the Richard B. Russell National School Lunch Program and Special Supplemental Program for Women, Infants, and Children (WIC), is pending this year, but it has been stalled in the House by disagreements regarding its funding. . In August, the Senate approved S. 3307, the Healthy, Hungry-Free Kids Act, sponsored by outgoing Senate Agriculture Committee Chairwoman Lincoln. The bill expands funding for the school lunch program, establishes categorical eligibility criteria, sets stricter nutrition standards for meals, expands access to summer food services, and tasks the Department of Agriculture with regulating the types of foods available in school vending machines.

Speaker Pelosi declined to bring the bill to the floor in the House prior to adjournment for the elections because many Democrats objected to the Senate bill's reduction in SNAP benefits originally provided through the stimulus bill. The Continuing Resolution enacted prior to the recess provides temporary funding for the government includes a temporary extension of the school lunch program through December 3<sup>rd</sup>. Because the legislation is a primary component of the White House's anti-obesity campaign, look for the White House to push for passage of the legislation during the lame duck session.

In the absence of comprehensive reauthorization this year, Congress is almost certain to extend this temporary stopgap until the 112th Congress can address the issue, perhaps as part of the Farm Bill. In addition, if Congress waits until next year to tackle the legislation, which it will have to introduce anew, Republicans may propose substantive changes to the existing proposals, such as restricting the generous eligibility requirements for WIC and the school lunch program.

**Climate Change.** Not seen as a core agricultural issue, climate change legislation has important implications for the agriculture sector. The Committee on Agriculture shares jurisdiction over such legislation with other committees. While lawmakers debated the net effect of cap and trade on the economy, the nonpartisan Congressional Budget Office concluded that the proposal would result in higher prices for many products, such as fertilizer and gasoline. Farming is an energy-intensive industry, so farms will feel the effects of these potentially higher energy prices more than other businesses. Supporters of cap and trade legislation counter that farmers and ranchers have opportunities to benefit financially by taking advantage of offset programs, such as reforestation of unused acreage.

Republicans in the House and Senate have criticized cap and trade as a national energy tax that would harm agricultural business and weaken the rural economy. Presumptive Chairman of the House Committee on Agriculture Representative Frank D. Lucas (R-OK) declared that “cap and trade promises to cap our incomes, our livelihoods and our standard of living, while it trades away American jobs and opportunities.” As further discussed in the Energy and Environment section of our analysis, we do not expect an economy-wide cap-and-trade climate change bill to pass the 112<sup>th</sup> Congress.

**Financial Industry Reform.** The recently-enacted Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) enhances oversight of financial markets, increases transparency in derivatives trading, and strengthens enforcement of trading rules. It has the potential

to significantly affect agriculture by regulating the way in which large agriculture businesses engage in transactions. Many commentators attribute recent volatility in global food prices to excessive speculative trading of commodities derivatives. Accordingly, the new law aims explicitly at centralizing regulation of all transactions involving financial derivatives, by requiring all “over-the-counter” trades to be disclosed to the Commodity Futures Trading Commission (CFTC) and cleared by that body. (For a further discussion of the Dodd-Frank Act, please see the Financial Services portion of our analysis.)

There are exemptions from some of the more onerous clearance and reporting requirements for “end users” and those trading in futures to hedge a legitimate commercial risk. However, Congress delegated authority to the CFTC to define these all-important categories. The Commission also has the authority to determine whether to extend similar exemptions to farm credit institutions and other non-large financial entities. For these reason, agriculture-minded lawmakers and lobbyists will be closely tracking the law’s implementation.

Public opinion polls show that Americans are divided over the new law. Although there is opposition to certain elements, such as the expansion of federal bureaucracy, the majority of Americans support reforming Wall Street. Some Republicans campaigned on repeal of the new law, but it remains unclear what policies they would institute in its place. As further discussed below in the Financial Services section of our analysis, a more Republican Congress may seek to revise the new law, but it is unlikely any wholesale revisions would gain the President’s support or, in the alternative, garner the votes needed to override a Presidential veto. If the new law is not amended, attempts to alter the new structure of financial regulation could emerge in the context of CFTC reauthorization.

The CFTC is a “sunset agency,” originally created in 1974, that was set to expire in 2005. As part of the 2008 Farm Bill, Congress reauthorized the Commission with appropriations through the end of fiscal year 2012. Wall Street Reform substantially increased the responsibilities of the CFTC, but did not extend funding beyond its current 2012 expiration. Either as part of the next Farm Bill, or separately, Congress will have to reauthorize the CFTC.

Republicans may opt to include CFTC reauthorization and amendments to Dodd-Frank in the Farm Bill in order to attach amendments to legislation that President Obama will not want to veto. Some Republicans have questioned the value of the CFTC. In fact, former President George W. Bush opposed its reauthorization. But given the recent controversies surrounding unstable food and energy prices attributed to speculative trading, Republicans may not want to deregulate derivatives before 2012. Therefore, the CFTC’s reauthorization is probable. But the length of its extension, its enforcement structure, and other changes to its authority will take a different shape now that Republicans are in control of the House.

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## Appropriations and Earmark Reform

Deficit reduction and the overall economic health of the nation will remain primary concerns in the 112<sup>th</sup> Congress. Partisanship over spending levels and funding priorities will continue to affect the budget process and create an even more challenging appropriations environment. If the bipartisan National Commission on Fiscal Responsibility and Reform can reach agreement by December 1--which is open to question--its final report will provide substance for debate in the beginning months of the 112<sup>th</sup> Congress. The report is intended to outline recommendations to improve both the short-term and long-term fiscal health of the nation, and to balance the budget by 2015.

This year, for the tenth consecutive year, Congress was unable to complete the appropriations process and, in fact, did not pass any FY 2011 spending bills prior to the start of the federal fiscal year on October 1. Instead, Congress passed a Continuing Resolution (CR) funding the federal government at FY2010 levels through December 3. Moreover, Congress did not pass a budget resolution for FY 2011 and therefore each chamber set its own discretionary funding caps. The House adopted a \$1.121 trillion spending limit. Nonetheless, the Republican top-line figure of \$1.08 trillion will likely prevail in the Senate (the President's budget requested \$1.128 trillion). A budget resolution sets overall spending caps for the appropriations committees, which limits debate over funding limits. Friction over these top line numbers was a significant factor in the FY 2011 process delays.

The lame-duck session will begin on November 15. Because Congress is unlikely to have enough time to decide how to resolve the FY 2011 appropriations process before the CR expires on December 3, Congress will probably adopt another short-term extension. There are three probable scenarios. First, Congress could roll all of the appropriations bills into one omnibus bill. This measure would likely include earmarks, but in order to gain the Republican support required for it to pass, there would also likely be significant overall funding reductions. Second, Congress could enact another CR that extends into the new year, leaving the process in the hands of the new Congress to resolve either through a year-long CR or by beginning the regular process anew. Third, the lame duck Congress could simply extend the CR until the end of FY 2011. If this happens, the measure would likely exclude earmarks and instead allocate those funds directly to the respective federal agencies under which the earmarks were pending. This would be similar to the CR enacted in FY2007.

In March, the House Republican Conference adopted a unilateral year-long moratorium on all earmarks and the House Democratic Caucus banned earmarks directed to for-profit entities. Senate Republicans, particularly appropriators, were reluctant to embrace an outright ban on earmarks and Senate Democrats maintained that recent transparency and reporting reforms were sufficient to eliminate inappropriate earmarks. Therefore, only House and Senate Democratic and Senate Republican earmarks are pending in the FY 2011 appropriations bills. Democratic leaders would prefer to wrap up the FY 2011 appropriations process in the lame duck session with the passage of an omnibus package, while Republicans, particularly non-appropriators in the House, would like to push the process into the next Congress in which their majority will enable them to force additional spending cuts and push for changes in the appropriations process, particularly with regard to earmarks.

## *Appropriations Committee Changes*

The number of committee seats designated to each party is negotiated at the beginning of each new Congress, based on the overall party ratio of the Congress and past precedent. The new Republican Majority in the House and overall Republican gains in the Senate will significantly shift the number of party seats in the committees in each chamber, though obviously to a greater degree in the House. Incoming freshmen and current Members will have the opportunity to vie for open seats. Ironically, Members who have long opposed earmarks may pursue positions on the appropriations committees in order to push for reduced spending. This could change the traditionally bipartisan nature of the committees.

With no challengers, Senator Daniel Inouye (D-HI) is expected to retain his post as Chairman of the Senate Appropriations Committee. Some seats opening at the end of the year may be absorbed by junior Members. Those most vulnerable to losing their seats next year include Senators Sherrod Brown (D-OH), Jon Tester (D-MT), Mark Pryor (D-AR), and Ben Nelson (D-NE). On the Republican side, Ranking Member Thad Cochran (R-MS) is also expected to retain his position while five Republican Members currently serving on the committee will be leaving the Senate this year. According to Republican Conference rules, Senate Minority Leader Mitch McConnell (R-KY) will assign half of the open slots and the remainder will be offered to Senators based on seniority. Minority Leader McConnell has already promised a seat on the committee to the incoming Senator from North Dakota, John Hoeven. Accounting for Members who have previously declined positions on the committee and those who are prohibited from serving by conference rules, the top three in seniority are Saxby Chambliss (R-GA), Lindsay Graham (R-SC), and Richard Burr (R-NC). Only slightly farther down the seniority list are Tom Coburn (R-OK) and Jim Demint (R-SC), both staunch “anti-earmarkers.”

Three Republican Members are leaving the House Appropriations Committee at the end of this Congress and Republicans will gain five to twelve additional seats due to their majority position. Pursuant to House Rules, the Republican Steering Committee will nominate the Committee chair and additional Members who must then be ratified by the full Republican Conference. Ranking Member Jerry Lewis (R-CA) is not eligible for the chairmanship due to conference rules on term limits, but could be granted a waiver to regain the position he previously held from 2005 to 2007. If he is not granted a waiver Hal Rogers (R-KY) is in position to serve as Chairman. Committee Chairman David Obey (D-WI) is retiring and Norm Dicks (D-WA) is next in line to serve as Ranking Member of the Committee, though he may face a long-shot challenge from Chaka Fattah (D-PA). In addition to Chairman Obey, at least eight other Democratic Members are leaving due to retirement, a run for other office, or election defeat. These seats will likely be absorbed by the shift in majority.

## *Forecast for the 112<sup>th</sup> Congress*

The “Pledge for America” proposed by House Republicans during the campaign includes a guarantee to reduce the federal budget by \$100 billion in the next year. While it does not address earmarks specifically, it proposes several procedural changes that will have an impact on the appropriations process, such as publishing bill text three days prior to a vote; allowing amendments on spending bills to reduce funding; and advancing bills individually and not as a package, preventing the attachment of unpopular provisions to “must pass” legislation. Allowing

amendments to appropriations bills may actually enable earmarking to continue, as requiring on-the-record votes may serve to dissuade Members from making controversial earmark requests.

Minority Leader John Boehner (R-OH) has identified several additional reforms he would undertake as Speaker of the House: increasing congressional adherence to its oversight of existing federal programs and spending; implementing a “cut as you go” rule which would require authorizers to reduce or terminate an existing program within the same bill in which they create a new program subject to appropriations; and separating the twelve annual appropriations bills into individualized department or agency bills. Minority Whip Eric Cantor (R-VA) recently wrote an op-ed piece in which he called for a Republican-led House to eliminate earmarks altogether.

The anti-earmarking momentum leading up to the election will continue in the 112<sup>th</sup> Congress. There will be efforts by energized Republicans, especially tea party influenced candidates, to reduce government spending and reform the congressional budget process. However, establishing a consensus on how to achieve this will be challenging. There is a strong divide among House Republicans on the role of earmarking in the appropriations process, causing a heated “End It vs. Mend It” debate in the House Republican Conference regarding elimination of earmarks versus continued reform. Noting that efforts “must not be focused on the fraction of a percent of the federal budget represented by these projects,” Ranking Member Lewis recently expressed his intention to support party leaders in decisions to continue the earmark moratorium.

Members of the House Republican Leadership have abstained from submitting earmark requests for several years and led the charge for the one-year moratorium, but a formal position going forward has not yet been adopted. There are a number of House Republicans who strongly oppose earmarks and view them solely as wasteful government spending. They will soon be joined by an influx of new Members who equate earmarks with an out-of-control budget and support a complete elimination of earmarks. However, there are also many who favor earmarks because they believe Congress is in a better position to make funding decisions for its constituents and that it is their responsibility, as mandated in the Constitution, to allocate funds and not leave those decisions entirely to the Administration. As a whole, House Republicans want to reduce domestic spending to FY2008 levels--or further. To do so will require substantial cuts and possible elimination of some domestic programs.

Senators Coburn and DeMint again will push for, and may succeed in securing, a Republican Conference vote on earmarks, although it is unlikely Senate Republicans will adopt an outright ban. Some Senate Democrats, such as Claire McCaskill (D-MO), may also oppose earmarks. Despite these efforts, the Senate is likely to continue its existing practice of earmarking--although likely with strengthened eligibility criteria and public disclosure requirements. That may dampen enthusiasm for the House Republicans to continue an outright ban on earmarks.



Hence, the earmark debate will become even more heated in the 112<sup>th</sup> Congress and there will be an increased number of Republican Senators and Representatives voluntarily abstaining from submitting earmark requests. There is likely to be a continued ban on earmarks directed to for-profit entities and additional transparency on the front end of the process. It is possible that earmarking will continue in a format that is more limited than in the past, with an emphasis on directing funding to units of local government, public education institutions, and not-for-profit entities. However, it's also possible there will be an elimination of the earmarking process altogether.

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## Defense and Foreign Policy

### *Defense Issues*

**Budget Pressures.** The defense issue that will consume Congress in the next year is the size of the Pentagon budget. After 10 years of exponential growth to support the wars in Afghanistan and Iraq as well as to develop advanced intelligence, surveillance and reconnaissance systems and to train and equip counterinsurgency forces, there will be tremendous pressure to reduce the size of the defense budget in order to contribute to reducing the federal deficit.

Secretary Gates, who will leave his position sometime in mid-2011, announced at the end of the summer a "Savings and Efficiency" campaign to identify \$108 billion over the next 5 years' defense budgets that could be cut by reducing overhead and improving business operations as well as eliminating unneeded or redundant programs and capabilities. Gates did not propose a cut to the defense budget. Instead, his goal is to free up \$108 billion to reallocate to higher-priority programs in research and development and in procurement.

As an example, Secretary Gates announced the proposed dis-establishment of the Joint Forces Command located in Norfolk, VA. This would eliminate about 500 military positions and some 3,000 civilian jobs, mostly held by support contractors. Additionally, the Secretary announced an across-the-board reduction in the number of support contractors utilized by the military departments and defense agencies. These moves were immediately met by loud cries of protest from Virginia federal and state elected officials from both sides of the aisle. Senator Jim Webb (D-VA) has promised to block all Defense Department nominations for political appointees and flag and general officers until Secretary Gates provides all internal documents regarding these cuts. The Virginia delegation has vowed to stop these reductions.

This reaction can be expected from other delegations whose bases and defense contractors are threatened by such reallocations in defense spending. The priorities of the Secretary of Defense will not be the priorities of the Senators and Representatives whose districts would suffer job cuts. It remains to be seen how much the Secretary of Defense can actually reallocate through his Savings

and Efficiency proposal. It is also open to question whether his successor can get through the confirmation process without promising to relook at the Gates plan.

Even if the Gates plan identifies savings and efficiencies, there is the stark reality that the deficit cannot be tackled if defense spending is off the table. The forecast is that defense spending will come down due to the end of combat operations in Iraq and the beginning of the Afghan withdrawal in the summer of 2011. Republicans in the House and Senate will not want to be seen as cutting defense, and they will have strong support for that portion in the defense industry. The reality is that the United States cannot afford all the programs in the Future Years Defense Program. The question is whether the 112<sup>th</sup> Congress will accept that reality and come up with a solution.

### **Committee Developments.**

*Senate Armed Services Committee.* The Senate Armed Services Committee will see retirements by four Democrats: Senators Evan Bayh (D-IN), Ted Kaufman (D-DE), Carte Goodwin (D-WV), and Roland Burris (D-IL), and one Republican, Senator George LeMieux (R-FL). Senator Bayh's departure leaves open the Chairmanship of the Readiness and Management Support Subcommittee, and Senator LeMieux's departure leaves the Ranking Member seat on the Emerging Threats and Capabilities Subcommittee. Senator Carl Levin (D-MI) and Senator John McCain (R-AZ) are expected to retain the Chairman and Ranking Member positions on the full Committee.

*Senate Appropriations Committee.* The Defense Subcommittee will lose several Senators as well. Senator Christopher Bond (R-MO) and Senator Sam Brownback (R-KS), active supporters of Boeing's defense interests, are retiring, as are Senator Judd Gregg (R-NH) and Senator Robert Bennett (R-UT). On the Democratic side of the Subcommittee, Senator Arlen Specter (D-PA) and Senator Byron Dorgan (D-ND) are leaving the Senate. Meanwhile, the top Democrat and Republican on the full Committee, Senator Daniel Inouye (D-HI) and Senator Thad Cochran (R-MS), are expected to serve in the same capacity on the Defense Subcommittee, as they did in the 111<sup>th</sup> Congress.

*House Armed Services Committee.* Republican Representative Howard "Buck" McKeon (R-CA) is expected to remain as the committee's top Republican. All Republicans who served as Subcommittee Ranking Members in the 111<sup>th</sup> Congress are expected to return in the 112<sup>th</sup> Congress. The top four Democrats on the committee all lost their elections yesterday, which will open up new leadership slots on the committee.

*House Appropriations Committee.* There also will be some turnover on the House Appropriations Committee's Defense Subcommittee (HACD). With the retirement of full Committee Chairman David Obey (D-WI), the subcommittee's top Democrat, Representative Norm Dicks (D-WA), is likely to become the top Democrat on the full committee. Subcommittee Members Carolyn Cheeks Kilpatrick (D-MI) lost a primary battle and Todd Tiahrt (R-KS) is retiring. Representative Bill Young (R-FL), a senior member of the committee, is likely to continue to serve as the top Republican.

### *Foreign Policy Issues*

Many foreign policy issues will occupy the attention of the 112<sup>th</sup> Congress. Military action continues in Iraq and Afghanistan, despite the withdrawal of U.S. combat troops from Iraq. The



new Congress will quickly confront the July 2011 deadline for the beginning of troop withdrawal in Afghanistan, where U.S. Ambassador Karl Eikenberry and General David Petraeus, the U.S. Commander in Afghanistan, have pointed to recent military progress. In addition, the new Congress will still have to confront the nuclear development programs of Iran and North Korea, and the daunting challenges of the Middle East Peace Process, including the newly strained relationship between Turkey and Israel. Changes to the makeup of the U.N. Security Council add to the uncertainty for some. Tensions also remain high between India and Pakistan, as U.S.-Pakistan cooperation is essential to the United States' strategy in South Asia.

**U.S. Military Action in Afghanistan and Iraq.** Democrats remain divided over the shorter- and longer-term aspects of Afghanistan policy. After a long fight over supplemental funding for the U.S. military actions in Iraq and Afghanistan, in the summer of 2010 the House and Senate passed additional funding for the Afghanistan troop escalation that began in December 2009. Although the bill did not contain a formal timetable for withdrawal, there was significant support for such an amendment among House Democrats--153 Democrats, including Speaker Nancy Pelosi, voted for the measure. However, many anti-war Democrats voted against the additional funding, and have questioned subsequent civilian assistance because of the lack of timetable in the bill, insufficient progress in their minds on civilian reconstruction and anti-corruption efforts in Afghanistan, or because of their opposition to any continued U.S. military action in Afghanistan. Still, many Democrats point to the President's announced July 2011 target date for the beginning of U.S. troop withdrawals from Afghanistan as a balanced approach. As President Obama and General Petraeus have stated, the July 2011 date will be "the beginning of a long process."

In Afghanistan, U.S. and NATO troops have made recent progress fighting the Taliban and other extremist elements around Kandahar and elsewhere in the southern part of the country. As a result, especially when combined with the Republican gains in the House and Senate, upcoming funding of U.S. military action in Afghanistan is likely to be less contentious. Republican gains will also result in less support for withdrawal timetables. As the July 2011 date looms closer, look for vocal Republicans on the issue, such as Senator John McCain (R-AZ), to oppose the deadline. At the same time, if recent military progress in Afghanistan stalls, Republicans will be quick to question President Obama and the Democratic Party's commitment to bringing the war effort to a successful conclusion.

**Iran.** The Obama Administration will most likely continue its approach of multilateral diplomatic engagement, including the enforcement of strengthened extraterritorial sanctions, in its relations with Iran. Having successfully increased pressure on Iran, the White House now appears to be close to finding common ground with the United Kingdom, France, Germany, China, and Russia on a potential offer to make to Iran to further induce it to reduce its nuclear reprocessing efforts. Last week, as it has so many times before, the Iranian Government indicated that it was prepared to return to the bargaining table, perhaps as early as next week. With sanctions tightening, it has more of an incentive to stay at the table this time.

Like the Clinton Administration, the Administration has been willing to work with Congress to put in place and then implement a new sanctions regime. Retiring Senator Chris Dodd (D-CT) and Representative Howard L. Berman (D-CA) spearheaded the effort to enact the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, which passed with overwhelming bipartisan support, including from the Obama Administration. The Administration is likely to consider more proactive enforcement of these new sanctions, while seeking to use tools provided by

Congress to avoid having to impose sanctions as long as multilateral efforts to curtail Iran's nuclear ambitions remain on track. (Neither the Clinton Administration nor the Bush Administration ever imposed sanctions under the prior law.) As part of a larger effort to encourage multilateral efforts, for example, the State Department recently used authority included in the legislation to decline to investigate prior investments after receiving satisfactory assurances that major European oil companies were already winding down those investments and otherwise were significantly curtailing trade with Iran.

Both parties are very committed to curtailing the growth of Iran's nuclear capabilities, as evidenced by the near unanimous passage of the enhanced sanctions legislation in June. But with a House Republican Majority, there may be a push to further curtail the President's waiver authority going forward. President Obama will continue to court international cooperation on Iran while keeping open the option of direct dialogue with the regime, at least on targeted issues. In the near term, it is unlikely the Administration's foreign policy will consider direct or indirect military force in Iran or tangible support of opposition forces to attempt to spur a regime change.

**Korean Peninsula.** The sinking of the South Korean naval ship, the Cheonan, in March 2010, was one of North Korea's most belligerent actions since the end of the Korean War. The Director of the Central Intelligence Agency, Leon Panetta, publicly linked the sinking to an internal succession struggle, with North Korean leader Kim Jong-il demonstrating a show of force in order to help secure the succession to power of his youngest son, Kim Jong-un. Tensions between South and North Korea are high, with the North cutting off all communications and banning South Korean ships and airplanes from their territorial waters and airspace. The United Nations adopted a unanimous resolution condemning the sinking of the Cheonan, but facing a possible veto at the Security Council, failed to officially name North Korea as the source of the attack.

In June 2010, the Obama Administration renewed through 2015 the agreement guaranteeing that the U.S. would take control of all military forces in South Korea during any military conflict with North Korea. South Korean President Lee Myung-bak called for the extension, despite the longer-term desire of both governments to turn over wartime operational control to South Korea. At the same time, as further described below in the Trade Policy section of our analysis, President Obama voiced his intention to work out the remaining differences with the pending U.S.-South Korea free trade agreement.

As with the treatment of Iran, both Houses of Congress are committed to impeding the growth of North Korea's nuclear capabilities and furthering instability in Northeast Asia.

**Middle East Peace Process.** A more Republican Congress likely will pressure the Administration to align itself increasingly closely with Israeli Prime Minister Benjamin Netanyahu's right-of-center government on issues related to the Middle East Peace Process, including on the pace and extent of Israeli settlements in the West Bank. Many Republicans appreciate Prime Minister Netanyahu's wary geopolitical outlook on issues such as Iran and his free market-oriented approach to domestic policy. Some also recall favorably Mr. Netanyahu's previous term as Prime Minister in the late 1990s, including his policies designed to slow implementation of the Oslo Accords. At the same time, leading Republicans on foreign policy generally share the views of their Democratic counterparts on the desirability, and even the necessity, of working with Palestinian President Mahmoud Abbas, including as a counter to Hamas in Gaza.

In the wake of the May Israeli raid on the flotilla bringing aid to Gaza, Turkish-Israeli relations, previously a bright spot in Israel's relations with the Islamic world, remain strained. Turkey demanded an apology and has barred Israeli military flights from Turkish airspace and has indefinitely recalled its ambassador. As a voting U.N. Security Council member, Turkey, along with Brazil, voted against the recent Iran sanctions package, favoring instead their own arrangement to exchange Iranian enriched uranium for nuclear fuel for medical isotopes. Turkey views itself as a key intermediary with Iran. With its vote against multilateral sanctions, Turkey signaled it will not always follow U.S. strategy on regional issues.

**India-Pakistan Relations.** The U.S. Government remains highly invested in the state of India-Pakistan relations. Both countries are nuclear powers with a history of conflict. Both have suffered losses as a result of the fight against global terrorism, and India, particularly, is an emerging powerhouse in the global economy. From the early days of his Administration, President Obama emphasized the need for robust support and continued cooperation with Pakistan, including its democratic government under President Zardari. In 2009, Congress showed its support for Pakistan's economic recovery by committing \$1.5 billion annually, through 2014, in non-military funding. In 2011, Congress is likely to debate heavily the Administration's proposed multi-year, multi-billion U.S. security assistance package. Meanwhile, President Zardari has called China Pakistan's "all-weather friend." China and Pakistan are moving forward on a deal for China to construct and run two \$2 billion nuclear reactors. The Three Gorges Dam Corporation, also of China, has slated a \$100 billion investment in Pakistani hydroelectric facilities as well.

The U.S. Government will remain most concerned with Pakistan's efforts to combat terrorism in its northwest border area, including ensuring U.S.-Pakistani cooperation along the border with Afghanistan. Some in Congress doubt the depth and breadth of the Pakistani government's commitment to combat terrorism. Some areas in the border provinces of Swat and South Waziristan effectively have become safe havens for extremists, as Pakistani military action has been inconsistently effective. Some lawmakers, such as Senator Carl Levin (D-MI), Chairman of the Armed Services Committee, have called for some militant groups with alleged links to some elements of the Pakistani government to be officially categorized as terrorist organizations.

India emerged from the world economic crisis relatively unscathed, and the Administration, with support from Congress, eyes India as an important global economic partner. President Obama hosted Indian Prime Minister Manmohan Singh for his first state dinner at the White House and has scheduled a visit to India later this week as part of a multi-nation trip that concludes with the G-20 summit in South Korea. While working to strengthen this relationship, India-Pakistan relations continued to be tested over violence in the Kashmir region and over unresolved issues surrounding the November 2008 Mumbai attacks. Still, relations are improving. Leaders of both countries met on July 15, 2010 for the first time since the Mumbai attacks to begin dialogue on their shared issues.

**U.N. Security Council Developments.** The Administration and Congress are generally pleased with the results of the U.N. General Assembly elections in October 2010 for five non-permanent seats on the U.N. Security Council for 2011-2012. Germany and Portugal, both NATO allies, will fill the two open seats in the "Western Europe and Others" category, replacing Turkey and non-NATO member Austria. India will replace Japan and Colombia, a strong U.S. ally, will replace Mexico. South Africa will take the place of Uganda for the African Groups. In addition to the five permanent members of the Security Council, and the five newly-elected non-permanent members, Bosnia-Herzegovina, Brazil, Gabon, Lebanon, and Nigeria retain their seats through 2011.

## **Committee Developments.**

*Senate Foreign Relations Committee.* Senator John Kerry (D-MA) and Senator Richard Lugar (R-IN) will remain as the top Democrat and the top Republican, respectively, on the committee. The rest of the committee will undergo some changes, as Senator Chris Dodd (D-CT), Chairman of the Western Hemisphere Subcommittee, and Senator Ted Kaufman (D-DE), will retire.

*Senate Appropriations Committee.* On the Senate Appropriations Committee's State Department/Foreign Operations Subcommittee, all but one Republican Member, Senate Republican Leader Mitch McConnell (R-KY), is retiring. A new top Republican on the subcommittee will come from elsewhere on the Appropriations Committee, possibly even a Senator newly appointed to the Committee. Senator Patrick Leahy (D-VT) is expected to remain as the top Democrat on the State Department/Foreign Operations panel.

*House Foreign Affairs Committee.* Representative Howard Berman (D-CA) and Representative Ileana Ros-Lehtinen (R-FL) are likely to continue as the top Democrat and the top Republican, respectively, on the House Foreign Affairs Committee (HFAC). The departure of Representative Bill Delahunt (D-MA) will leave open the top Democratic seat on the Subcommittee on Europe.

*House Appropriations Committee.* The top two Members of the House Appropriations Committee's State Department/Foreign Operations Subcommittee (HACFO), Representative Nita Lowey (D-NY) and Representative Kay Granger (R-TX), have worked well together and are expected to remain in place in the 112<sup>th</sup> Congress.

## **Energy and the Environment**

In 2008, then-candidate Barack Obama made enactment of comprehensive energy/climate change legislation a core part of his proposed policy agenda. He often spoke of combating global climate change as a moral imperative and as essential to addressing the nation's energy challenges in the 21<sup>st</sup> century.

Notwithstanding the hype at the time, we said this in our 2008 election analysis: "While we anticipate intense legislative action in the 111<sup>th</sup> Congress, . . . we do not believe final action on climate change legislation is likely until at least 2011 at the earliest given the overall health of the nation's economy, lingering questions about low-carbon technological capabilities and the adequacy of research and development efforts to date, uncertainty in the international community about emission reduction targets ahead of the next round of negotiations of the Kyoto treaty in Copenhagen next winter, and unresolved empirical questions about the underpinnings, assumptions, and regulatory infrastructure of a national and international carbon market."

The Obama-Biden "New Energy for America" plan, if enacted, would have invested \$150 billion over ten years to create five million new "green" jobs, put one million plug-in hybrid cars on the road by 2015, substantially increased corporate average fuel economy standards for cars and trucks, developed new low-emission coal plants, created an advanced biofuels infrastructure, and developed commercial-scale renewable energy projects. In addition, the plan would have mandated

that ten percent of electricity be produced from renewable energy sources by 2012 and by 25 percent by 2025, and would have implemented many other elements of the House Democratic agenda from the 110<sup>th</sup> Congress, such as forcing the industry to “use or lose” existing oil and gas leases. In addition, the Obama-Biden plan envisioned Congress implementing an economy wide cap-and-trade program to reduce greenhouse gas (GHG) emissions by 80 percent by 2050. Of course, none of this was enacted into law. (The Administration did achieve its goal of imposing higher corporate average fuel economy standards, but only because it could do so administratively with the consent of the auto industry after GM and Chrysler had been rescued. Just recently, it proposed new standards for large trucks and buses, which likewise can be implemented without enactment of legislation and likewise appears to have the support of the affected industries, including engine manufacturers.)

We continue to believe that the President can achieve large parts of his energy and climate change agenda, but only if he reaches out to the new Republican Majority in the House and works with moderates in the Senate. Recognizing the problem of advancing a comprehensive, 1,000+ page bill (such as the Waxman-Markey bill approved by the House last year), the President has recently begun talking about trying to enact smaller, more manageable elements of his broader agenda. As further explained below, we believe he will be able to enact much of his agenda, though the climate change portion may be limited to just the electric utility sector. Coupled with the new transmission siting authority for power lines, a new clean electricity standard that promotes nuclear energy and clean coal, and perhaps a new financing mechanism to encourage clean energy development here rather than abroad, a more modest bill could be enacted into law with strong, bipartisan support.

#### *Committees of Jurisdiction*

In the House, a range of committees had jurisdiction over energy and climate change legislation over the past two years, including the Energy and Commerce Committee, the Natural Resources Committee, the Transportation and Infrastructure Committee, the Ways and Means Committee, and the Agriculture Committee. In the 112<sup>th</sup> Congress, however, we anticipate that the Energy and Commerce Committee--as it has done historically--will dominate the debate on energy and environmental policy. We expect either Representative Fred Upton (R-MI) or Representative Joe Barton (R-TX) to hold the top seat on the committee. Barton is term limited according to GOP rules. He has petitioned the Republican Steering Committee to clarify whether the Republican Party’s six-year term limit is applicable to time served in the minority. Without a waiver, he will not be able to serve as chairman. Current Chairman Henry Waxman (D-CA) is expected to serve as Ranking Member.

In the Senate, Senator Jeff Bingaman (D-NM) will continue to chair the Energy and Natural Resources Committee. Assuming she wins her race, which may not be decided for weeks, Senator Lisa Murkowski (R-AK) would continue on as Ranking Member. On the Environment and Public Works Committee, we anticipate that Senator Barbara Boxer (D-CA) will continue as Chairman and Senator James Inhofe (R-OK) as Ranking Member, respectively. As in the House, other committees may attempt to assert their interests over climate change and energy legislation, most notably the Finance, Banking, Commerce, Appropriations, and Agriculture Committees. But the debate will be driven by the Energy and Natural Resources Committee. We anticipate a potential realignment of the balance of power in the climate debate in the Senate. The Environment and Public Works panel, which has exclusive jurisdiction over the Clean Air Act, is unlikely to dominate the debate as it did this year.



Moreover, the changing composition of the Senate will give more power to moderate Democrats and Republicans, especially from heavy industry manufacturing and coal producing states. In the Senate, as in the House, policy will no longer be framed in terms crafted by the environmental community. Things will only get done where a business case underlies them.

*New Climate in the House (and Senate)*

If the 111<sup>th</sup> Congress taught us anything it is that the Congress cannot tackle multiple pieces of comprehensive domestic policy legislation in any given session of Congress without deep political repercussions. This especially was the case for comprehensive energy and environmental legislation, when considered at the same time health care legislation was being developed and financial services reform was in the offing. That the 111<sup>th</sup> Congress could not adopt a comprehensive climate change/energy bill should not have come as a surprise to the White House and its allies in the environmental community. In the last decade, Congress has only passed two comprehensive pieces of energy and environmental legislation (the Energy Policy Act of 2005 and the Energy Independence and Security Act of 2007), and then only after lengthy committee deliberation and months of consideration on the Senate floor. In addition, there was real bipartisanship in developing those bills, even with divided government in 2007. Finally, the economy wasn't reeling at the time, and thus Congress had more flexibility in drafting legislation with a broad impact on many sectors of the economy.

On energy policy, we anticipate the 112<sup>th</sup> Congress taking more targeted ("bite size") efforts to address the various and nettlesome policy issues facing the nation's energy infrastructure and security. Senator Lindsey Graham (R-SC) recently suggested that this is an area in which Congress and the White House should be able to work together to get something done. The major issues on which consensus should be achievable include electric energy generation (fossil fuels, nuclear, and renewables); expanded transmission siting authority to move renewables from where they are to where they are needed; expanded on shore and off shore oil and gas production, including in the Gulf of Mexico; energy-efficiency; alternative-fueled vehicles; energy finance (DOE Loan Programs, tax policy); smart-grid and cyber security; water policy; recycling; and mining reform (rare earth metals). At least initially, we do not expect to see a single comprehensive piece of legislation addressing both energy and environmental policy, such as the "Waxman-Markey" bill from this Congress. Pressure will inevitably grow, however, to address most of these issues in a single bill, where regional and policy tradeoffs will be easier to accomplish. Some issues of critical importance, such as cyber security, may move separately given cross-jurisdictional interests, such as homeland security.

We also don't anticipate an economy-wide climate change bill anything like Waxman-Markey or the various versions that emerged this year in the Senate. As part of the "Pledge for America" put forward by House Republicans, they indicated that they would "oppose attempts to impose a national 'cap and trade' energy tax." But Republican control of the House doesn't mean Congress can't or won't legislate using some version of cap and trade (starting with a new name, such as one that uses "growth" and "dividend"). In fact, we see great potential for legislation that would address GHG emissions in a meaningful way with the support of affected industries.

A bit of history: In 1987, President Reagan endorsed and encouraged the Senate to adopt the Montreal Protocol, an international treaty that ultimately led to enactment of a cap-and-trade system to reduce the use of ozone-depleting chemicals. With the President's support, the Protocol was

ratified by the Senate by a vote of 87-0 and implemented through regulations. (The Protocol was also implemented by China and other countries, without any apparent adverse economic impact on U.S. industry.) Three years later, President George H.W. Bush signed into law the Clean Air Act Amendments of 1990, which included his proposed cap-and-trade system to reduce sulfur dioxide emissions from power plants as a means of addressing acid rain. That bill cleared the Senate by a vote of 89-10 and the House by a vote of 401-25, with the support of Representatives Newt Gingrich (R-GA), Joe Barton (R-TX), Jim Inhofe (R-OK), and Fred Upton (R-MI). When signing the bill into law, President Bush said: “By employing a system that generates the most environmental protection for every dollar spent, the trading system lays the groundwork for a new era of smarter government regulation, one that is more compatible with economic growth than using only the command and control approaches of the past.” President George W. Bush then included a cap-and-trade mechanism in his “Clear Skies” bill, which would have amended the Clean Air Act. Recalling the success of his father’s legislation, he said: “The 1990 Clean Air Act Amendments have significantly reduced air pollution, especially through the innovative ‘cap-and-trade’ acid rain control program. . . . [It] has been a resounding success, cutting annual sulfur dioxide emissions in the first phase by 50 percent below allowed levels. Emissions were reduced faster than required, and at far less cost.”

Another example of Democrats and Republicans working together, more recently at the state level: Since becoming governor in 2006, Democratic Colorado Governor Bill Ritter has signed 57 bills that will increase the use of renewable energy and provide incentives to rural electric associations and homeowners to use more renewables. As he recently put it in explaining his success and sharing it with others, “I’ve worked with fairly conservative Republican governors who say, ‘OK, take climate off the table. . . . Make it about energy diversity and make it about job creation, and we’re still a country better off if we move in that direction.’” It can happen here too.

With many utilities seeking certainty about what the future holds, Republicans have been presented a golden opportunity to co-opt the legislative high-ground from Democrats by making the “business case” for a bill that would address climate change, grow the economy, and provide dividends to the American public. Any bill would on its face be less ambitious (*e.g.*, it would likely cover electric generators only). It would likely have a strong nuclear title, to encourage greater use of nuclear energy, without which the United States cannot meet the President’s GHG emissions reduction target by 2050. It would likely allow the private sector to figure out what the best technologies are to meet the emission caps/standards. In addition, the bill is likely to encourage greater use of natural gas by encouraging coal-fired plants to convert to it. And to avoid the charge that consumers are being forced to bear the brunt of the cost of reducing GHGs, the bill could refund all or most of the proceeds from allowance auctions/sales directly back to consumers, such as in the “cap and dividend” approach embodied in the CLEAR Act proposed by Senators Maria Cantwell (D-WA) and Susan Collins (R-ME). The bill would not need to address the kind of carbon market issues that were so controversial in this Congress since they have largely been rendered moot by enactment of the Dodd-Frank Act. Finally, any such bill would undoubtedly preempt the Environmental Protection Agency (EPA) from moving forward on other GHG-related regulations and would block as well state and regional GHG systems (*e.g.*, AB 32 in California and the Regional Greenhouse Gas Initiative in the Northeast).

We believe that regulation of GHG emissions is inevitable; the only question is what form the regulation will take (legislative or regulatory “command and control”). As further explained below, the EPA continues to move forward under regulatory authority from the Supreme Court’s



holding in *Massachusetts v. EPA*, and the agency's subsequent endangerment finding, the combined effect of which have placed GHGs among the "pollutants" to be regulated by EPA under the Clean Air Act. Rather than allow the agency to create its own regulatory structure under an Act that Congress never intended as a mechanism for regulating GHG emissions, the 112th Congress might conclude that the time is right for a legislatively driven, market-based, approach. Thus, perhaps ironically and contrary to conventional wisdom, we believe that the prospects for legislation to regulate GHG emissions have actually increased as a result of the shift to a Republican Majority in the House and Republican gains in the Senate. We expect to see a significant transition in the debate as the impetus for congressional action switches from a primarily environmental imperative to more of a business and economic justification.

With the United States losing the clean technology race internationally, the new Republican Majority in the House and moderates in the Senate have an opportunity to reframe the debate, so that it is not about capping emissions by taxing the American public, but instead is about regaining our leadership by giving businesses the incentive to invest in creating jobs here. Although most international investors prefer to invest here because of greater certainty and protections of our legal and financial systems, the amount of money being invested in China and Europe, including by U.S. companies, is exponentially larger. This is an ominous development. With less capital being invested here, Congress will increasingly become concerned about our nation's ability to be an innovation leader. Moreover, as the price of energy and commodity feedstocks inevitably rise, Congress will grow concerned that our national energy security will be increasingly at risk.

In this environment, many of the regulated entities that would bear the burden of meeting any GHG emission-reduction standards would prefer to have both the predictability and business certainty in order to make twenty-year capital investment decisions that would come with legislation. They will want the flexibility of deciding how best to meet those standards. Given the choice, they will want the rules of the road set not by unelected bureaucrats but instead by individuals with certificates of election. By changing the labels used and recalibrating the scope and reach of a bill, the 112<sup>th</sup> Congress and President Obama may yet find the common ground to achieve meaningful legislative reform--like Ronald Reagan and George H.W. Bush accomplished in addressing the major air pollution challenges of their day.

### *Beyond Climate*

Notwithstanding the Deepwater Horizon oil spill, we don't expect "Big Oil" to be the focus of tax legislation of the kind routinely put forward by Democrats in the 110<sup>th</sup> and 111<sup>th</sup> Congresses, none of which could be enacted because there were never 60 "yes" votes in the Senate. With yesterday's returns now in, Republicans should have little problem blocking tax legislation that would discourage domestic oil and gas production or that would seek to re-open settled areas of law, such as with respect to leases issued in 1996-2000 to promote oil and gas development in the deep waters of the Gulf of Mexico.

We believe it is possible to write a bill that updates the Oil Pollution Act of 1990 (OPA 90) to address lessons learned from the spill. When Congress adjourned for the mid-term elections, a total of 115 bills had been introduced to respond to the spill, but only one making a technical change to OPA 90 had been enacted. The House approved a comprehensive bill, but it was dead on arrival in the Senate, in large part because it went well beyond responding to the spill to promote aspects of the House Democratic energy agenda, including taxing the oil and gas industry and

eliminating the cap on damages under OPA 90. As evidenced by the efforts that led to the bill produced by the House Energy and Commerce Committee this year (which was then incorporated into the larger House spill-response bill), it is possible for committed legislators to work on a bipartisan basis to write something meaningful. It took Congress eighteen months to respond to the Exxon Valdez spill. It is thus not surprising that nothing substantial has been enacted into law so far. It should be possible to address safety measures and the damages cap in a meaningful way, but only if undertaken on a bipartisan basis.

Pressure will grow next year as well to address hydraulic fracturing, especially as more and more land is devoted to developing the huge reserves of natural gas that could fuel the country for decades. Notwithstanding efforts by the environmental community, we see no likelihood that Congress will give EPA authority to regulate an activity that historically has been regulated at the state level. Moreover, we see little likelihood in the near term of Congress mandating that service providers make public the chemicals used in their fracturing systems. Rather, the greater threat to the economics of hydraulic fracturing is likely to come at the state level, as legislators look at imposing a severance tax as a means of capturing part of the value of the new shale plays and closing gaping budget deficits.

With respect to mine safety, Senator Jay Rockefeller (D-WV) and Representative Nick Rahall (D-WV) previously announced they will seek to move pending legislation during the lame duck session. Because we consider it unlikely the legislation will move, we think the issues they have raised are likely to be on the agenda again next year.

Without question, we anticipate much greater scrutiny of the Administration's energy policy, especially by House committees. Perhaps most aggressively, the Committee on Oversight and Government Reform (which will be led by Representative Darrell Issa of California) will likely launch a series of investigations focused on the energy and environmental policies of the Obama Administration, starting with EPA's greenhouse gas reduction agenda and the Department of Energy's implementation of the stimulus bill. Similarly, Representative Joe Barton has made it clear that, working through the House Energy and Commerce Committee, he will seek to investigate why the EPA has not adequately taken into account potential job losses here as a result of its climate change and other green energy regulatory initiatives. Representative Issa also has said that he will pursue an investigation into a controversy over e-mails from the Climate Research Unit of the University of East Anglia. He also has expressed concern about the Department of Interior's Minerals Management Service (now renamed the Bureau of Ocean Energy Management, Regulation and Enforcement). In a recent interview, he criticized Congress for not demanding reform of the agency when allegations surfaced about an alleged "cozy relationship" between the regulators and oil and gas companies.

In conjunction with the congressional oversight activity, we anticipate that the House will attempt to use the annual appropriations process to potentially "defund" or restrict executive branch agencies from using appropriated funds for certain policy initiatives. This may range from GHG emissions, increased fuel-economy standards for all classes of vehicles, and various "interagency" task forces that have been established by the Administration to address climate and sustainability policy initiatives. We also anticipate the use of Resolutions of Disapproval in the Congress under the Congressional Review Act (CRA) as another legislative tool to be used to abrogate or stymie Administration policies. A preview was afforded earlier this year in the Senate when Senator Lisa

Murkowski (R-AK) successfully introduced and attracted six Democratic Senators to her resolution disapproving EPA's GHG "endangerment finding." What makes these resolutions potentially difficult to handle for the President and Congressional Democrats is that they are considered "privileged" in the Senate, which procedurally gets around the potential for a filibuster and requires only a simple majority (51 votes) to pass. While any resolution that successfully passes the Senate would need to be passed in the House as well, we don't anticipate the House balking at passing something that got off the Senate floor. As a result, President Obama may be forced to veto any number of resolutions coming to his desk that seek to undermine his agenda.

### *EPA's Regulatory Agenda.*

In its first two years, the Obama Administration has accomplished part of the President's clean energy agenda through agency action, without the need for legislation. That could well continue, which is one more reason we anticipate a push for legislation that would provide business certainty and eliminate the risks inherent in an agency writing rules of the road based on a statute designed to address different issues over 20 years ago.

With action stalled in Congress in 2009 and early 2010 and facing increased pressure from the environmental community, EPA and other agencies began to move forward aggressively to implement aspects of the President's green energy agenda, in particular with respect to regulating GHG emissions. Through three coordinated actions, EPA set the legal framework for regulating GHG tailpipe and stationary source emissions in the absence of action by Congress.

First, EPA and the National Highway Traffic Safety Administration set GHG emission and fuel economy standards for motor vehicles for model years 2012-2016. For the first time, standards will be based on both miles per gallon and carbon output per gallon. (As noted above, EPA has just commenced a rulemaking that would potentially establish carbon-based standards for heavy-duty trucks and buses.)

Second, on December 7, EPA made related findings pursuant to *Massachusetts v. EPA*. The agency announced these two findings:

**Endangerment Finding:** The Administrator finds that the current and projected concentrations of the six key well-mixed greenhouse gases--carbon dioxide (CO<sub>2</sub>), methane (CH<sub>4</sub>), nitrous oxide (N<sub>2</sub>O), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF<sub>6</sub>)--in the atmosphere threaten the public health and welfare of current and future generations.

**Cause or Contribute Finding:** The Administrator finds that the combined emissions of these well-mixed greenhouse gases from new motor vehicles and new motor vehicle engines contribute to the greenhouse gas pollution which threatens public health and welfare.

With those findings having been made, the agency has now established the legal predicate for addressing climate change under the Clean Air Act, without waiting for Congress to do anything further.

Finally, EPA has issued a rule (the “tailoring rule”) that would require entities emitting more than 25,000 metric tons of GHGs per year to account for their emissions when obtaining construction and operating permits under the Clean Air Act. Applications for permits must demonstrate the use of best available control technologies and energy efficiency measures to minimize GHG emissions when facilities are constructed or significantly modified. The agency estimates that approximately 14,000 large industrial entities would be subject to the rule, 3,000 of which would be subject for the first time to the rules governing Clean Air Act operating permits. (Strictly read, the Act should have been applied to entities emitting as little as 250 tons per year, but the agency has wisely delayed for at least five years lowering the threshold that low--and may yet face a lawsuit from environmentalists for failing to implement the law.)

To supplement these efforts, beginning on January 1, 2010, EPA for the first time is now requiring that fossil fuel and industrial GHG suppliers, motor vehicle and engine manufacturers, and facilities that emit 25,000 metric tons or more per year report GHG emissions data to EPA annually. This new program will cover approximately 85 percent of the nation’s GHG emissions. The first annual reports for the largest emitting facilities, covering calendar year 2010, must be submitted to EPA in 2011. Vehicle and engine manufacturers outside of the light-duty sector will begin phasing in GHG reporting with model year 2011.

The agency also has issued a new proposed set of regulatory proposals under the Clean Air Act that address emissions from boilers, process heaters, and certain solid waste incinerators. These rules would significantly cut emissions of pollutants that are of particular concern for children--mercury and lead. The proposed rules would also reduce emissions of other pollutants including cadmium, dioxin, furans, formaldehyde, and hydrochloric acid, which the agency is concerned can cause cancer or other adverse health effects in adults and children. Based on EPA’s estimate, the proposed rules would cut mercury and other air toxics emissions from nearly 200,000 units across the country.

Finally, EPA has proposed a stricter standard for smog-causing pollutants, replacing one set by the Bush Administration in 2008. The agency is proposing to set the “primary” standard, which protects public health, at a level between 0.060 and 0.070 parts per million measured over eight hours. The agency also is proposing to set a separate “secondary” standard to protect the environment, especially plants and trees. The agency has projected that complying with the new primary standard alone would cost between \$19-90 billion per year by 2020, a cost that will be borne principally by refiners, manufacturers, and utilities. This effort to take into account the impact of smog on vegetation, not just people, is part of the Administration’s larger climate change adaptation agenda. Other agencies, such as the U.S. Fish and Wildlife Service, also are likely to soon propose or implement policies as part of a broader strategic climate change adaptation plan.

In addition, the President has issued Executive Order 13514, which requires Executive Branch agencies to set targets to reduce GHG emissions by 2020. As part of the effort to reduce emissions, agencies will be expected to reduce petroleum consumption, adopt energy efficiency measures, reduce water consumption, recycle construction and demolitions materials, and the like. This single action may have a greater impact than any other proposed by the President because it will essentially require businesses wishing to do business with the government to demonstrate that they are reducing their carbon footprint and adopting more sustainable approaches to energy use.

As a related matter, White House Council on Environmental Quality Chairman Nancy Sutley has announced that CEQ is preparing to issue guidance to federal agencies on the incorporation of climate change considerations into environmental impact analyses. Her agency administers the National Environmental Policy Act of 1969, which governs all major federal actions that could have an effect on the environment.

In the near term, much of EPA's green energy agenda will be fought out in the courts. For example, litigation has been filed in multiple jurisdictions challenging the agency's "endangerment finding" under the Clean Air Act. In addition, the "tailoring rule" is on appeal to the U.S. Court of Appeals for the D. C. Circuit. As long as litigation is pending, business will continue to face uncertainty, providing an additional incentive for a more business friendly Congress to step in to the fray.

Without action in Congress (or the in the courts), more proposed agency initiatives can be expected as the President and his Administration seek to implement his green energy agenda. All the more reason for industry to find ways to work with Congress to achieve business certainty through enactment of legislation that provides flexibility and promotes economic growth.

For additional insights about likely policy developments, please feel free to contact the authors of this section, Jeffrey L. Turner, at 202-457-6434 or by email at [jturner@pattonboggs.com](mailto:jturner@pattonboggs.com); Joshua C. Greene, at 202-457-5204 or by email at [jgreene@pattonboggs.com](mailto:jgreene@pattonboggs.com); or Tanya M. DeRivi, at 202-457-6504 or by email at [tderivi@pattonboggs.com](mailto:tderivi@pattonboggs.com).

## Financial Services

President Obama's signing of the Dodd-Frank Act on July 21, 2010 represented the Democratic Party's last major legislative victory before mid-term elections. The Dodd-Frank Act was designed as a response to the 2008 financial crisis that led to a near collapse of the entire financial system and the worst recession since the Great Depression. The Dodd-Frank Act provides stricter oversight of financial institutions to detect and manage risk more effectively. The new law provides a regulatory structure for many previously unregulated or lightly regulated financial products and markets (*e.g.*, derivatives and asset-backed securities), market participants (*e.g.*, hedge funds), and activities (*e.g.*, proprietary trading). The law also provides greater consumer protections and establishes an independent regulatory body to ensure information transparency for consumers. However, while the Dodd-Frank Act established many new requirements and responsibilities, it deferred many significant policy decisions to federal regulators, including the Securities and Exchange Commission (SEC), the Federal Reserve, the Federal Trade Commission, and the Commodity Futures Trading Commission (CFTC). This regulatory rulemaking process is well underway.

During the 112<sup>th</sup> Congress, with Republicans controlling the House and narrower margins in the Senate, we expect financial services legislative activity to focus on extensive and potentially intensive oversight of the regulatory process arising out of the Dodd-Frank Act to ensure that regulators stay with the "intent" of the Congress. In areas where the new Congress believes either (1) the regulators are misreading their authority or (2) the Dodd-Frank Act went too far, the new Congress may legislatively modify the Dodd-Frank Act (including technical corrections). For example, we expect House Republicans to closely monitor the establishment of the new Consumer



Financial Protection Bureau, as that part of the Dodd-Frank Act engendered significant opposition throughout the House debate and remains a contentious issue with many members of the new House leadership.

We do not believe there will be a serious effort to “repeal” the Dodd-Frank Act, although there may be efforts to restrict the funding of the various regulatory agencies in implementing the new law. Furthermore, since many Republicans voted against the Dodd-Frank Act because they said it did nothing to address the problems they saw created by Fannie Mae and Freddie Mac, the new Republican House of Representatives can be expected to prioritize addressing the reform of government-sponsored enterprises (GSEs). Since such an effort cannot happen in a vacuum, GSE reform will be very difficult to enact until the private mortgage market can get restarted. Therefore, also high on the agenda will be serious discussions of the future of mortgage finance, including exploring various options, like covered bonds. Furthermore, on the issue of the Dodd-Frank Act and GSE reform, even if legislation could pass the House of Representatives, the continued, albeit smaller Democratic majority in the Senate will require bipartisanship and compromise for anything to reach the White House. It remains to be seen to what extent the willingness to compromise will be evident in this new environment.

Regulatory agencies will remain focused on implementation of the Dodd-Frank Act in 2011. The newly created regulatory agencies (Consumer Financial Protection Bureau, the Office of Financial Research, the Financial Stability Oversight Council, and the Federal Insurance Office) will play an important role in the carrying out of the Dodd-Frank Act. These new agencies, along with existing agencies that are currently in the midst of the rulemaking process, could find themselves under the scrutiny of a Republican House intent on significantly increasing congressional oversight of Dodd-Frank Act implementation.

#### *Committees of Jurisdiction*

With Chairman Christopher Dodd (D-CT) leaving office at the end of this Congress, Senator Tim Johnson (D-SD) is considered the leading candidate to assume the chairmanship of the Senate Banking Committee. Senator Jack Reed (D-RI) can also be expected to play a very significant role in the leadership of the committee under a Johnson Chairmanship. The committee will be at the forefront of Dodd-Frank Act oversight, GSE reform, and discussions regarding foreclosures and the Obama Administration’s foreclosure mitigation programs. In fact, the Senate Banking Committee has already scheduled a hearing on November 16 to investigate allegations of improper and fraudulent mortgage servicing and foreclosure processing.

Ranking Member Spencer Bachus (R-AL) has stated his intention to assume the chairmanship of the House Financial Services Committee, with Ed Royce (R-CA), Scott Garrett (R-NJ), Jeb Hensarling (R-TX), and Kevin McCarthy (R-CA) as other possible candidates for committee leadership positions. While Barney Frank (D-MA) will surely serve as a vocal Ranking Member of the committee, the failed reelection bid of Paul Kanjorski (D-PA) means there will be a new Democrat serving as Ranking Member on the Capital Markets Subcommittee. Carolyn Maloney (D-NY) is one likely candidate to assume that role. The committee has already held numerous hearings on GSEs and will likely continue focusing on GSE reform in the 112<sup>th</sup> Congress. Along with overseeing the Dodd-Frank Act implementation, the Committee will focus on efforts to stabilize housing markets and study various proposals to reorganize the GSEs.

The Senate and House Agriculture Committees will play a significant role in the implementation of the Dodd-Frank Act, as these committees oversee the CFTC and were central to the debate on regulating over-the-counter derivatives markets. For a further discussion of the Senate and House Agriculture Committees and the 112<sup>th</sup> Congress, including changes in leadership due to Senator Lincoln's defeat, please see the Agriculture Policy portion of our analysis.

### *Major Issues Next Year*

**Financial Regulatory Reform Agency Implementation.** Prior to midterm elections, the CFTC and the SEC held various public meetings regarding proposed rulemakings to move forward in the implementation of the Dodd-Frank Act. At these open meetings, a large number of the proposed rules mandated by the Dodd-Frank Act have been published for public comment in an effort to complete many of these obligations before the July 2011 deadline. Because these meetings will continue during the lame duck period, additional regulations will be proposed and promulgated in the upcoming months. During the 112<sup>th</sup> Congress, we can expect the House Republican majority to promote an implementation mindset for financial regulatory reform rulemaking that follows the principles of (1) individual choice over government supervision and (2) private-sector solutions over a "government only" approach. This can be expected to come into conflict with the perspective of the Obama Administration and the heads of the principal regulatory agencies involved in Dodd-Frank Act rulemaking.

**Financial Regulatory Reform Technical Corrections.** During the 112<sup>th</sup> Congress, we can expect to see House Republicans and Democrats pursue issues identified by relevant regulators as needed, formal, "technical corrections." In any lengthy piece of legislation, technical errors, omissions or other mistakes are bound to occur, and thus need to be corrected with subsequent legislation. Such an effort could be a platform for discussions about total or partial "repeal" of the Dodd-Frank Act. However, we believe that while the new Congress will seek to review and make changes to financial regulatory reform efforts, given the split chambers of Congress, it is more likely that successful Dodd-Frank Act-related legislation will focus on technical corrections or slight modifications to the legislation, as opposed to a "repeal."

**GSEs.** Most notably Fannie Mae and Freddie Mac among them, GSEs were not addressed in the Dodd-Frank Act. The Treasury Department, the Federal Reserve, Congress, the Federal Housing Finance Agency (FHFA), and the Department of Housing and Urban Development will all dedicate significant resources to the reform effort in 2011. These reform efforts will follow the FHFA's recently released projections of the financial performance of Fannie Mae and Freddie Mac, which estimate costs between \$221 billion and \$363 billion through 2013. To date, the GSEs have drawn \$148 billion from the Treasury Department.



**Insurance Reform.** Eighteen months after passage of the Dodd-Frank Act, the Federal Insurance Office (FIO) must report to Congress on how to modernize the regulation of the insurance industry. After this report is submitted, Congress will likely address insurance reform in proposed legislation. The FIO report will consider systemic risk regulation, capital standards, and the relationship between capital allocations and liabilities. The report will also look at consumer protection and gaps between States, the degree of national uniformity of State insurance regulation, and the regulation of insurance companies and affiliates on a consolidated basis. Finally, the report will study the international coordination of insurance regulation and the impact of foreign insurance laws on potential federal regulation. The FIO is to be led by a Director appointed by the Secretary of the Treasury. No appointment has been made yet.

The Patton Boggs Financial Services Group is closely tracking these and other legislative and regulatory developments. For additional information, please contact Micah Green ([mgreen@pattonboggs.com](mailto:mgreen@pattonboggs.com)), Todd Cranford ([tcranford@pattonboggs.com](mailto:tcranford@pattonboggs.com)), Vincent Frillici ([vfrillici@pattonboggs.com](mailto:vfrillici@pattonboggs.com)), Matthew Kulkin ([mkulkin@pattonboggs.com](mailto:mkulkin@pattonboggs.com)), Travis Seegmiller ([tseegmiller@pattonboggs.com](mailto:tseegmiller@pattonboggs.com)), Lindsey Weber ([lweber@pattonboggs.com](mailto:lweber@pattonboggs.com)), or Matthew Dunn ([mdunn@pattonboggs.com](mailto:mdunn@pattonboggs.com)).

## Food and Drug Policy

The 2010 mid-term election, resulting in a strong Republican Majority in the House, is likely to significantly affect the relationship between FDA and Congress during the 112<sup>th</sup> Congress. Even prior to the swearing in of the 112<sup>th</sup> Congress, however, we expect the election to have an impact on the upcoming lame duck session where we believe the political dynamic is likely to make passage of any FDA-related bills, particularly the bi-partisan food safety reform bill, far more challenging.

President Obama's 2009 appointment of Dr. Margaret Hamburg to serve as FDA Commissioner and Dr. Joshua Sharfstein to serve as the Principal Deputy Commissioner--both of whom have public health backgrounds--signaled a shift in regulatory philosophy at the agency. Under their leadership, FDA has generally adopted a more interventionist regulatory stance than was seen during the Bush Administration. Under Commissioner Hamburg, FDA has been far more aggressive from an enforcement perspective, and has supported legislation that would grant the agency increased regulatory power. The 111th Congress has, for the most part, been supportive of FDA's legislative requests and has generally worked cooperatively with the agency for the past two years. The Democratically controlled 111<sup>th</sup> Congress also significantly increased appropriations to the FDA based upon complaints that the agency lacked sufficient resources to protect the public health--particularly in those areas, such as food/dietary supplement regulation, not funded by industry user-fees.

Once the 112<sup>th</sup> Congress is sworn in, we anticipate a significant change in congressional perspective, and agency oversight, as contrasted with the current Democratic-controlled Congress. Specifically, we expect the House Republican leadership to engage in more vigorous oversight of FDA during the 112<sup>th</sup> Congress, be far less likely to support increased funding, and be far less likely to support dramatic expansions of FDA regulatory power. An instructive analogy may be the relationship between Commissioner David Kessler, FDA Commissioner during the Clinton Administration, and the newly elected Republican Majority in 1994 during the 104<sup>th</sup> Congress.

During that period, Republicans (particularly in the House) held numerous oversight hearings questioning whether FDA was being too activist and anti-industry. A similar dynamic between the Obama Administration's FDA and House Republicans in the 112<sup>th</sup> Congress seems likely.

Regardless of the political dynamic in Congress, high-profile FDA regulatory issues will continue to emerge and FDA will remain in the spotlight during the coming years. It is estimated that FDA-regulated products account for more than 25% of all consumer spending in the United States, which not only includes food, dietary supplements, drugs, biologics, medical devices, cosmetics, and radiological products, but now also includes tobacco. In recent years, high-profile events included recalls and safety issues associated with peanut-containing products, pet food, produce, heparin, eggs, and certain pain-relieving drugs, that have focused congressional attention on various perceived weaknesses in the FDA regulatory regime--particularly those associated with increasingly international supply chains. Unfortunately, similar events will likely influence the regulatory and Congressional agenda in the coming years.

Accordingly, despite the new Congressional leadership, we do not anticipate any significant changes in FDA strategic goals/priorities. The agency recently identified a variety of broad strategic priorities to advance regulatory science and innovation, strengthen the safety and integrity of the global supply chain, strengthen compliance and enforcement activities, and expand agency efforts to meet the needs of special populations. To accomplish these broad strategic priorities, FDA also identified key priorities specific to each area of FDA's regulatory focus. In the near term, these key priorities include action in response to expanded statutory authorities, such as the development of the regulatory framework for the regulation of follow-on biologic products, tobacco regulation, and the regulation of chain-restaurant menu labeling. FDA also expects to address longstanding areas of regulatory concern, such as increasing food safety measures and reform of the medical device 510(k) clearance process.

Although we do not anticipate significant changes in FDA's strategic priorities, the speed with which FDA may be able to accomplish certain goals, as well as the scope of FDA congressional initiatives, may be significantly affected by the new political reality and potential decreases or flattening of the resources made available by the new Congress.

Finally, we believe FDA is likely to give greater consideration to the creative use of its existing regulatory authorities to accomplish its goals if the agency perceives that the new Congress will be less likely to grant the agency increased statutory authority. The creative use of its regulatory authorities, however, will clearly be subject to Congressional oversight, and the outcome of such efforts are therefore difficult to predict.

#### *Likely Legislative and Regulatory Developments*

**Resources and Oversight.** The new House Republican Majority--many of whom campaigned on platforms opposing "big government" and deficit spending--is not expected to support an increase in FDA's appropriated funding. As FDA is a "people-intensive" agency (*i.e.*, more than 80 percent of its appropriations are spent on personnel and related costs), flat or decreased funding could have significant negative impacts on the agency, resulting in hiring freezes, furloughs, or potentially even lay-offs. Accordingly, even if FDA's strategic goals are unchanged, FDA may be forced to triage and make difficult decisions from an enforcement and resource perspective.

**Legislation.** The Democratically controlled 111<sup>th</sup> Congress demonstrated its willingness to expand FDA's authority by enacting sweeping legislation, such as the Family Smoking Prevention and Tobacco Control Act, that authorized FDA to regulate tobacco products. Although the Tobacco Act was bipartisan, most observers do not believe it would have been enacted by a Republican-controlled Congress. We do not expect this type of sweeping FDA reform initiative to emerge from the 112<sup>th</sup> Congress.

*Drugs.* As the statutory authority for the Prescription Drug User Fee Act (PDUFA) is set to expire in September 2012, the 112<sup>th</sup> Congress must consider legislation authorizing FDA to continue collecting user fees for the prescription drug program. Although Congress has typically granted FDA increased authorities during past PDUFA reauthorizations, we anticipate that the 112<sup>th</sup> Congress, with its closely divided Senate and Republican-controlled House, will be more reluctant to expand FDA's regulatory authority in the 2012 reauthorization. The 2012 PDUFA reauthorization battle may include efforts by the pharmaceutical industry to recapture ground lost in the last reauthorization.

In September, 2010, Representatives Henry Waxman (D-CA) and John Dingell (D-MI) released draft language for a drug import safety bill that would give FDA various new authorities (including mandatory recall authority and the ability to demand the confiscation and destruction of pharmaceuticals at the border), and would authorize FDA to collect fees from drug manufacturing facilities and importers to fund the bill's safety programs. The discussion draft stems from the FDA Globalization Act (H.R. 759), introduced by Representative Dingell last year, which covered food, drugs, devices, and cosmetics. Although we do not anticipate passage of this type of comprehensive reform bill during the 112<sup>th</sup> Congress, recent allegations associated with a potentially contaminated drug supply, arising out of FDA's ongoing heparin investigation, could lead Members of Congress to consider aspects of this bill as part of PDUFA reauthorization.

*Medical Devices.* The Medical Device Excise Tax, which was passed as part of healthcare reform earlier this year, has drawn much attention and criticism from industry. Industry groups have engaged in efforts to persuade Congress to repeal the tax provision before it takes effect in 2013, or to add a small-business exemption. We expect this issue to be revisited during the 112<sup>th</sup> Congress. As the statutory authority for the Medical Device User Fee and Modernization Act (MDUFMA) is set to expire in September 2012, the 112<sup>th</sup> Congress must also consider legislation authorizing FDA to continue collecting user fees for the program. This could provide the vehicle for other statutory adjustments to the medical device regulatory scheme.

*Conventional Foods and Dietary Supplements.* Although the House passed the Food Safety Enhancement Act of 2009 (H.R. 2749), in July 2009, Senate leadership has struggled to advance its food safety reform bill, which was overshadowed by health care and financial services reform. Although Democratic Majority Leader Harry Reid (D-NV) filed cloture on the Food Safety Modernization Act (S. 510) before the election recess, sixty Senators must vote for cloture in order to debate the bill during the lame duck session.

Even if the Senate debates and passes S. 510 during the lame duck session, there will not be sufficient time for conference to reconcile the differences between the House and Senate versions. Enactment of food safety reform legislation in the 111<sup>th</sup> Congress will therefore occur only if the Senate passes S.510 and the House agrees to accept the Senate version without change. We believe

the House leadership will reluctantly do that if the Senate is able to pass the bill. We believe the political dynamics of the above events make this scenario improbable during the lame-duck session, although it cannot be entirely ruled out. In addition, if food safety reform is not enacted during the lame-duck session, we also believe the political dynamics would make passage during the 112<sup>th</sup> Congress extremely challenging.

The dietary supplement industry has also been under intense scrutiny during the 111<sup>th</sup> Congress, particularly with regard to outlier companies who allegedly spike their supplements with unapproved drugs, or use unlawful ingredients by bypassing requirements applicable to “new dietary ingredients.” Although we expect Congressional interest in this issue to continue, we do not anticipate a reopening of the Dietary Supplement Health and Education Act (“DSHEA”) during the 112<sup>th</sup> Congress--although more modest legislative initiatives may be considered.

*Cosmetics.* Representative Jan Schakowsky (D-IL) introduced the Safe Cosmetics Act (H.R. 5786) in July 2010, to impose stricter requirements for cosmetics such as mandatory registration of manufacturers, packers, and distributors, safety testing requirements, and full ingredient disclosure on product labeling. There has been little activity on this bill during the 111<sup>th</sup> Congress. We also believe there is virtually no chance for the bill to be considered during the lame duck session, and consideration during the 112<sup>th</sup> Congress is also highly unlikely.

**Regulations.** As discussed above, we anticipate that over the next two years FDA will forge ahead with the development of regulations and other agency efforts designed to achieve its key strategic priorities, with a possible emphasis on strengthening the safety and integrity of FDA regulated products, and strengthening compliance and enforcement activities. The dynamic between Republican congressional leadership and the FDA as this unfolds will be fascinating to observe.

*Food Regulation.* In the area of food regulation, FDA has indicated that it is prepared to embrace new approaches to food safety, focusing on preventative controls from production to consumption and building an integrated food safety system with other federal, state, and local food regulatory bodies. In addition, if food safety reform legislation is not enacted, we expect FDA to give consideration to the creative use of its regulatory authority to accomplish many of the objectives subsumed within the House and Senate bills. Much of the conventional food industry is expected to be conceptually supportive of these initiatives, while working to dilute them during the administrative process.

Additionally, we expect FDA to pursue efforts aimed at providing clear and timely nutrition information to consumers. This effort will necessarily include the development of regulations to implement the menu labeling provisions of the Health Care Reform Act. These regulations are potentially costly to restaurants (especially small businesses), and we would expect House Republicans to interact with FDA in an effort to lessen some of the requirements and delay implementation to reduce costs.

*Drug Regulation.* In the area of drug regulation, FDA has developed a plan to improve consumer access to safe and effective drugs. Such efforts may include new methods to secure the global supply chain, additional quality oversight, and expanded public awareness strategies. The agency also may engage in efforts to promote development of new scientific methods, improve the drug review process, and further develop programs like REMS and post-market surveillance to promote safe use of marketed drugs.

*Biological Product Regulation.* A key issue in the area of biologics will be the implementation of the generic or “follow-on” biologics provisions of the Health Care Reform Act. The Health Care Reform Act created a statutory pathway for approval of generic/follow-on biologic drugs, and FDA must develop the regulatory framework associated with this new approval pathway. This highly controversial initiative is likely to require substantial agency resources.

*Medical Device Regulation.* In the area of medical device regulation, we anticipate that FDA will continue its review and assessment of the 510(k) device clearance process. FDA can expect close scrutiny from Congress as the agency considers modification of the 510(k) review process in response to a recent report from the Institutes of Medicine and internally generated recommendations. Medical device regulation is another area where FDA and the Republican congressional leadership are likely to have vastly differing perspectives.

*Tobacco Regulation.* The agency will continue to be active in the area of tobacco regulation. FDA gained regulatory authority over tobacco products after passage of the Family Smoking Prevention and Tobacco Control Act of 2009. In the coming months and years, FDA is required to establish a comprehensive regulatory framework for tobacco products, including issuance of substantial regulations, guidance documents, and development of a tobacco-related enforcement strategy. FDA activity in this area is also expected to be highly controversial, and many observers anticipate industry-generated litigation challenging certain aspects of FDA’s new regulatory regime. The tobacco industry is likely to be able to identify some allies in the House who may believe that FDA’s implementation of the tobacco legislation is overly restrictive.

*Enforcement and Compliance.* Finally, we believe FDA will continue to pursue the active compliance and enforcement strategy that has been embraced by the current FDA leadership. FDA enforcement efforts can be expected to follow Commissioner Hamburg’s new enforcement policy, as discussed above, intended to intensify FDA’s enforcement activities. In line with this policy, FDA officials have recently indicated that the agency will stop sending Warning Letters to repeat offenders, moving more quickly to judicial enforcement actions. Additionally, FDA officials have also revealed that the agency plans to start pursuing more strict liability misdemeanor charges against CEOs and other responsible corporate officers for FDA violations. The expanded use of such authority may also be expected to result in significant Congressional oversight.

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## Health Care

After months of debate and considerable political maneuvering, President Obama signed the Patient Protection and Affordable Care Act (H.R. 3590/P. L. 111-148) into law on March 23, 2010. On March 30, 2010, the President signed into law the Health Care and Education Reconciliation Act of 2010 (H.R. 4872/P. L. 111-152), which made select changes to H.R. 3590. Together, these laws, known as the Affordable Care Act (ACA), are designed to expand health insurance coverage to 32 million Americans who are currently uninsured, while reining in rapidly growing health care costs. Health care spending is the fastest growing line item in the federal budget. Health care premiums have doubled in the last decade and have been an increasing burden to employers and employees, as well as State and local governments.

During the 112<sup>th</sup> Congress, Members will focus their attention on implementation of the new law. The Republican gains, expanding the bloc of conservative Republicans, resulting in the control of the House and narrower margins in the Senate will bring about a focus on repealing or modifying the Affordable Care Act.

Other forces will be at play, beyond the political makeup of Congress, that may affect the trajectory of health care reform implementation. For example, in a Florida U.S. District Court, a judge allowed a lawsuit to challenge parts of the new health care reform law brought by 20 states, the National Federation of Independent Business, and two private citizens to move forward. The plaintiffs argue that the Affordable Care Act's mandate that individuals purchase health care insurance and the Medicaid expansion violate the Commerce Clause of the Constitution. A summary judgment hearing where both the plaintiffs and defendants will have the opportunity to argue the merits of their case is scheduled for December 16. The lawsuit is likely to be heard by the Supreme Court in the next two years. A successful challenge would be a victory for Republicans and could result in major restructuring of the law.

While there are many factors at play, the core provisions of health care reform, namely the establishment of state insurance exchanges and premium subsidies, are likely to remain intact in the law. In addition, given the enormous fiscal pressures, many of the Centers for Medicare and Medicaid Services's cost-cutting initiatives are likely to move forward, despite attempts to modify or repeal the reform law. Other provisions of the law, such as the creation of the Independent Payment Advisory Board, are more likely candidates for repeal. Notwithstanding Republican gains yesterday, we expect the battles regarding the health care reform law to continue up to and through the 2012 elections.

### *Committees of Jurisdiction*

Current House Ways and Means Committee Chairman Sandy Levin (D-MI) is expected to retain the top Democratic post on the committee, serving as the Ranking Member of the full Committee in the 112<sup>th</sup> Congress. Ranking Member Dave Camp (R-MI) will assume the Chairmanship. Representative Pete Stark (D-CA) will serve as Ranking Member of the Health Subcommittee. Representative Wally Herger (R-CA) is in line to serve as the Subcommittee Chairman; however, Representative Charles Boustany (R-LA) may contend for the position.

House Energy and Commerce Committee Ranking Member Joe Barton (R-TX) is term limited according to GOP rules. He has petitioned the Steering Committee to clarify whether the Republican Party's six-year term limit is applicable to time served in the minority. Unless he is given a waiver, Representative Fred Upton (R-MI), a moderate, would likely hold the top seat on the committee. Current Chairman Henry Waxman (D-CA) is expected to serve as the full Committee Ranking Member. Health Subcommittee leadership will not change. Representative Frank Pallone (D-NJ) will retain the top Democratic seat and Representative John Shimkus (R-IL) will serve as the Chairman of the Subcommittee. If elected chairman, Representative Upton has signaled that he will seek to repeal the health care reform law and prioritize passage of legislation that would permanently prevent federal funds from being used for abortions. In addition to continued oversight of health care reform, the committee will also consider Food and Drug Administration (FDA) user fee and reform legislation.

Senate Finance Committee Chairman Max Baucus (D-MT) will retain his position. However, leadership changes are expected on the Republican side of the aisle. Senator Orrin Hatch (R-UT) will serve as Ranking Member if, as expected, Senator Chuck Grassley (R-IA) moves to the Judiciary Committee to be the top Republican.

In addition to monitoring health care reform implementation, Senate Finance Committee Republicans will continue to call for a hearing with the Centers for Medicare and Medicaid Services (CMS) Administrator Donald Berwick, who was sworn in on July 13. Dr. Donald Berwick is a pediatrician and professor at Harvard University and the founder the Institute for Healthcare Improvement. He launched the "100,000 Lives" campaign to reduce the number of deaths attributable to medical errors in hospitals. He previously served as Vice Chair of the U.S. Preventive Task Force, member of the Board of Trustees of the American Hospital Association, Chair of the National Advisory Council of AHRQ. President Obama appointed Dr. Berwick during a recess in the middle of a session, so Dr. Berwick's appointment will expire at the end of the first session of the 112th Congress.

The leadership of the HELP Committee will remain unchanged. Senator Tom Harkin (D-IA), who has served as chairman since the death of Sen. Ted Kennedy (D-MA) in August, will remain chairman. Senator Michael Enzi (R-WY) will continue to serve as the Ranking Member of the Committee. Chairman Harkin recently established a health care investigations staff team, signaling his interest in more actively overseeing FDA policies.

#### *Major Issues Next Year*

**Health Care Reform Implementation.** Prior to the election, House Republican leaders, including Minority Leader John Boehner (R-OH) and Minority Whip Eric Cantor (R-VA), announced their conservative agenda should they win enough seats in the mid-term elections to regain the majority in the House. "A Pledge to America" proposes "to advance policies that promote greater liberty, wider opportunity, a robust defense, and national economic prosperity." The agenda offers a plan to repeal and replace the health care reform law with "common-sense solutions focused on lowering costs and protecting American jobs." Specifically, the Republicans plan to enact medical liability reform, allow purchase of health insurance across state lines, expand tax-free Health Savings Accounts (HSAs), ensure access for patients with pre-existing conditions, expand state high-risk pools and reinsurance programs, reduce cost of coverage, and permanently prohibit taxpayer-funded abortions.



Although the Republicans were not able to regain a majority in the Senate, the new House Republican Majority is likely to pass legislation to repeal or modify the Affordable Care Act. Republicans have acknowledged that fully repealing the health care reform law is unlikely as long as President Obama is in office and Republicans do not have veto-proof majorities in the House and Senate. Furthermore, a Kaiser Family Foundation poll found that only 31 percent of registered voters favor full repeal of the law, making such a move politically unpopular.

While the Senate is not expected to consider legislation to fully repeal the health care reform law, House action will serve to outline the problems with the health care reform law and position the Republicans to articulate market-based solutions. The Republicans will use the next two years to relay to the American public through Congressional hearings and legislative activity that in order for changes to be enacted to the Affordable Care Act, a Republican president must be elected in 2012.

According to a Congressional Budget Office (CBO) analysis, Congress must appropriate more than \$115 billion in 2010-2019 for the Internal Revenue Service (IRS) and Department of Health and Human Services (HHS) administrative costs associated with implementation, as well as explicit authorizations of discretionary funding. Republicans will certainly use the appropriations process to try to slow implementation of reform and to continue the debate about health care reform and its merits.

**Health Care Reform Technical Corrections.** A legislative package to correct provisions of the Affordable Care Act is expected to be introduced in the 112th Congress. Although House Republicans will not be successful in repealing health care reform in its entirety, Republicans in both the House and Senate may be able to modify provisions for which popular support could be garnered:

*1099 Reporting Requirement.* One provision that may be included in such a legislative package would repeal or modify the requirement that all businesses issue Form 1099 to vendors from which they purchase \$600 or more of goods annually and file the information report with the IRS. The requirement is effective for payments made after December 31, 2011. The requirement was included in health care reform as a revenue raising provision that will generate \$17.1 billion over 10 years. Congress considered proposals during this session to either repeal or modify the requirement. Republicans are expected to focus on this requirement as a way in which the Affordable Care Act burdens small businesses.

*Independent Payment Advisory Board.* The 15-member board will make recommendations to Congress to reduce excess Medicare cost growth and improve quality of care for Medicare beneficiaries. If Medicare costs are projected to be unsustainable in any given year, the Board's recommendations will take effect unless Congress passes an alternative measure that achieves the same level of savings. Republicans have proposed eliminating the authority for the Board. Liberal House Ways and Means Committee Health Subcommittee Chairman Pete Stark (D-CA) has agreed that it is a "dangerous provision" and has pledged "to work tirelessly to mitigate the damage that will be caused by IPAB."

*Patient-Centered Outcomes Research Institute.* The Affordable Care Act requires the establishment of a private, non-profit institute to identify national priorities and conduct comparative

effectiveness research. Republicans have decried that such research will result in government refusal to provide coverage of more costly treatment options.

*Community Living Assistance Services and Support (CLASS) Program.* The law authorizes the establishment of a long-term disability insurance program for adults who have at least two functional dependencies. After a five-year vesting period, the program will provide those insured under the program with a cash benefit to purchase nonmedical services, such as home modifications, assistive technology, accessible transportation, homemaker services, respite care, personal assistance services, home care aides, and nursing support. Republican Senators have introduced legislation to repeal the program and moderate Democrats voiced opposition to the program during the health care reform debate. Senate Finance Committee Chairman Baucus has indicated that he is “no fan of the CLASS Act.”

*Prevention and Public Health Fund.* The law authorizes a prevention and public health investment fund to provide an expanded and sustained national investment in prevention and public health programs. Republicans have called the fund a \$2 billion-per-year slush fund that supports local government projects such as building jungle gyms. Earlier this year, Senate Republicans unsuccessfully tried to use the rollback of the prevention and public health fund to offset the cost of repealing the 1099 reporting requirement.

**Medicare Physician Payment “Fix.”** Earlier this year, Congress passed the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010, which extended the Medicare physician fee fix through November 30, 2010. Without further Congressional action, physician payments will be cut by 23 percent beginning on December 1 and reduced by an additional 6.1 percent beginning January 1, 2011. The American Medical Association has called for Congress to extend the fix for an additional 13 months through 2011. If Congress elects to move a short-term patch, Members will be forced to act again in the 112<sup>th</sup> Congress.

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## Homeland Security

The ever-present threat of terrorism--from the recently discovered air cargo bombs from Yemen to the "Christmas Day" bomber to the "Times Square bomber" and the recently foiled scheme to bomb the Washington DC metro system--dictates that homeland security concerns will remain front and center in 2011. Next year also brings the 10<sup>th</sup> Anniversary of 9/11. As a result, there will be increased scrutiny on what the U.S. Department of Homeland Security (DHS) and the Administration have done to implement the 9/11 Commission Act. Suffice it to say that the homeland security agenda in the 112<sup>th</sup> Congress will be a robust one and may, on a bipartisan basis, bring the first serious challenges to the leadership of DHS and the Obama Administration on key security matters.

Cyber security issues have dominated the landscape for the last few months, from debate over which agency has the lead on non-civilian cyber security (OMB tapped DHS)--to command and control issues over privately owned critical infrastructure sectors--to adequate staffing and research and development on cyber capabilities. The existence of "homegrown terrorism" is also of major concern and both the House and the Senate want the Administration to do more to address this problem. These issues tend to morph into broader concerns over immigration and border security issues. In addition, whereas the DHS appropriations bill has always been considered a "must pass" bill, it fell victim to the Congress's inability to move appropriations bills in general this year. The great difficulty in moving any type of large bills has caused all of these issues to be put on the backburner, but each will be debated in full early next year.

### *Committees of Jurisdiction*

*House Homeland Security Committee.* With control of Congress moving to the Republicans, Representative Pete King (R-NY) will likely once again take over as Chair of the Homeland Security Committee, a position he is well familiar with. It is expected that King will work quickly to try and consolidate core jurisdictional authority in his committee to avoid the current logjam created by the nearly 100 committees and subcommittees that assert jurisdiction on homeland security matters. In addition to his role as chairman, he will also become the second most senior Member on the House Financial Services Committee--that, coupled with his role on the House Permanent Select Committee on Intelligence and his service on the President's bi-partisan deficit reduction commission, may bring a formidable strength to his ability to move key pieces of legislation in the House.

Republicans, led by Representative King, have remained very concerned over the effectiveness of current security systems and the "vigilance" of DHS itself. During the 111<sup>th</sup> Congress, Representative King was a vocal critic of what he believed to be a lack of focus by the committee on key issues, including the rise of "homegrown terrorism" in the U.S. and the continued vulnerability of surface transportation. These concerns are shared by Representative Charlie Dent (R-PA.), incoming Chairman of the Subcommittee on Transportation Security and Infrastructure Protection. The recent news over foiled plans for the use of cargo carriers and an attack on the Washington, D.C., metro underlines these concerns and moreover, recent close calls such as the failure of bombs to detonate an aircraft over Detroit and on Christmas Day in Times Square, confirm Republicans in their belief that there are still too many vulnerabilities.

As a result, expect increased scrutiny and oversight hearings, both at the full and subcommittee levels, on the Transportation Security Administration (TSA), Customs and Border Protection (CBP), and Federal Emergency Management Disaster Agency (FEMA) among others. Representative King

will continue to support keeping the prison camp at Guantanamo Bay open, and will use the upcoming ten-year anniversary of 9/11 to focus on what DHS has done implementing the 9/11 Commission Act, including the security of our mass transit and rail systems and a review of the 100% scanning mandate for all maritime cargo coming into the United States.

*Senate Homeland Security and Governmental Affairs Committee.* With Democrats keeping control of the Senate, Senator Lieberman (I-CT) will retain the chairmanship with Senator Collins (R-ME) remaining as Ranking Member. Both Senators share similar interests and have a history of working collaboratively. Key issues will be similar to those in the House: cyber security (working with the Commerce and the Intelligence Committees,) border security, chemical plant security, homegrown terrorism, and maritime and port security. The make-up of the committee will also vary somewhat, which could affect the nature of the debate--there are a number of Republican retirements including Senators Voinovich and Bennett, leaving Senators Coburn, McCain, Ensign and Graham leading the charge along with Ranking Member Collins and relatively new Senator Scott Brown.

*House Judiciary Committee:* With Republicans taking over the House, Representative Lamar Smith (R-TX) will chair the House Judiciary Committee, with current Chairman John Conyers (D-MI) to become Ranking Member. Representative Louie Gohmert (R-TX) is expected to take over as Chairman for the Crime, Terrorism, and Homeland Security Subcommittee and Representative Bobby Scott (D-VA) will become the Ranking Member. Representative Steve King (R-IA) will take over as chair of the Immigration, Citizenship, Refugees, Border Security and International Law Subcommittee, and Representative Zoe Lofgren (D-CA) will become the Ranking Member.

The Republican takeover of the House will most likely shift the focus of the committee from immigration reform to greater focus on border security. Representative Smith has expressed an increased interest in immigration enforcement, especially as it relates to section 287(g) of the Immigration and Nationality Act, which authorizes DHS and Immigration and Customs Enforcement (ICE) to delegate federal immigration enforcement authorities to state and local law enforcement agencies.

*Senate Judiciary Committee (Immigration, Refugees, and Border Security Subcommittee, Terrorism, Technology and Homeland Security Subcommittee).* With Democrats keeping the Senate, leadership of the Senate Judiciary Committee is not expected to change with Senator Patrick Leahy (D-VT) remaining as Chairman. On the Republican side, current Judiciary Committee Ranking Member Jeff Sessions (R-AL) is slated to become the Ranking Member of the Senate Budget Committee. His move comes under an agreement reached last year with Senator Chuck Grassley (R-IA), who will likely become Ranking Member of the Judiciary Committee. It is expected that Senator Schumer will remain as chair and Senator Cornyn (R-TX) as Ranking Member on the Immigration, Refugees, and Border Security Subcommittee. Senator Cardin and Senator Kyl will remain, respectively, Chairman and Ranking Member of the Terrorism, Technology and Homeland Security Subcommittee.

At the outset, we noted that immigration reform remains one of President Obama's principal unfulfilled large-scale legislative goals. With the Republicans controlling the House, it is unlikely that they will pass any immigration bill that would be acceptable to the Senate during the 112<sup>th</sup> Congress. Without the business community developing the "business case" for reform, the chasm between the two bodies will likely remain unbridgeable.

*House Appropriations Subcommittee on Homeland Security.* With Republican control in the House, Representative Harold Rogers (R-KY) will again take over as the Chairman of the Homeland Security appropriations subcommittee with Representative Price (D-NC) serving as the Ranking Member. Historically, there has been a bipartisan approach on the committee that is expected to continue. The appropriators have raised several issues with DHS's ability to spend funds and in various instances have reduced funds in the FY 2011 bill because of a backlog of funds unspent from prior years. The committee has also expressed concerns over DHS's stewardship over key procurements like SBI.net. Key issues like border security may see increased funding for personnel and physical barriers, some of which may come from SBI.net, as a way to deal with immigration issues. Perennial issues remain in the agenda such as overall readiness issues and first responder grant funding.

*Senate Appropriations Committee (Subcommittee on Homeland Security).* Democrats will need to decide who will take over the leadership of the committee on a permanent basis. Senator Lautenberg (D-NJ) took over as Chairman this year after Senator Byrd (D-WV) passed away. Senator Landrieu (D-LA) has expressed some interest in the chairmanship. On the Republican side, the retirement of Senator George Voinovich (R-OH) tees up Senator Thad Cochran (R-MS) as the Ranking Member. Interestingly, there are a host of Republican Member retirements that may set the stage for a significant re-shuffling of committee and subcommittee slots.

One change we may expect in the coming Congress is a shift in funding priorities in the homeland security appropriations bill. We anticipate reduced funding for homeland security grants in favor of more funding for border and immigration enforcement. Debate over readiness is expected to intensify as Senators focus on the 10<sup>th</sup> anniversary of 9/11.

#### *Major Issues Next Year*

**Cyber Security.** During the 2008 Presidential campaign, cyber security was a key issue for then-Senator Obama's homeland security plan. Since that time, there has been much debate within Congress and the Administration on the importance of this issue. Many fear that terrorists, criminals and nation states are turning to cyber-warfare as an alternative to physical attacks.

As a result, hundreds of bills were introduced in the 111<sup>th</sup> Congress related to cyber security. The main focus for comprehensive cyber security legislation is now on a combined version of two bills in the Senate, S. 773, the Rockefeller-Snowe Cyber Security Act, and S. 3480, sponsored by Senators Lieberman (I-CT) and Collins (R-ME). Understanding the importance of these issues, Senate Majority Leader Harry Reid (D-NV) brought together these Members and the Intelligence Committee to create a "combined" draft. This draft seems to take most of the Lieberman-Collins language, giving the President broad emergency powers over critical infrastructure in the event of a cyber emergency and establishing DHS as the lead for all civilian government agencies and private industry cyber security planning and response. The bill would establish a White House Office for Cyberspace Policy and a National Center for Cyber Security and Communications at DHS. Key issues remain over the protection of civil liberties, intellectual property and business proprietary information.

The House has passed a host of bills focusing on education needs for a 21<sup>st</sup> century cyber workforce as well as promoting increased research and development into cyber security. At the same time, DHS is working through issues related to its internal cyber plans, organization and workforce. A recent DHS-DOD Memorandum of Agreement lays out a structure for information



and technology sharing for the agencies to manage the cyber threat that confronts both civilian and non-civilian assets.

**Aviation Security.** We should expect a renewed focus on air cargo security after last week's attempted bombings of two all-cargo aircraft. Over time, TSA has struggled to meet the August 2010 Congressional deadlines for screening cargo on passenger aircraft, but did end up meeting the deadline for all domestic and outbound international and most inbound international flights. Yet in September 2010, DHS' own Inspector General raised a series of concerns over existing vulnerabilities in the TSA system. Now, just months after DHS announced it had met the deadline, it appears as if terrorists attempted to exploit the vulnerability posed by the lack of existing mandates to screen for cargo shipped on all-cargo flights. The General Accounting Office raised this issue at a hearing before the House Homeland Security Committee in July, but focused primarily on security issues on passenger aircraft. It is clear that the Members will be focusing on these issues and it is likely that there will be legislation imposing deadlines for 100 percent screening of cargo on all-cargo aircraft similar to those in place for cargo on passenger aircraft.

With the Christmas Day attempted bombing of a Northwest Airlines plane over Detroit, some Members are also concerned that TSA has become too lax and that there remains a systemic lack of coordination within the intelligence community. While DHS has made some strides addressing that issue, the 10<sup>th</sup> anniversary of 9/11 could bring a renewed focus on aviation security and the intelligence reforms mandated by the 9/11 Commission Implementation Act. On the House side, incoming Chairman of the Transportation Security and Infrastructure Protection Subcommittee, Representative Dent, is a vocal supporter of DHS' ongoing, but controversial, deployments of Advanced Imaging Technology (AIT) "body scanners" at airport checkpoints, provided sufficient privacy protections remain in place, and is focused on trying to expedite deployment of the machines nationwide. The advent of "enhanced," more intrusive pat-downs for those who prefer alternative screening measures or who trigger an alarm will likely enliven this debate in the new Congress.

**Border Security.** In a divided Congress unable to pass a comprehensive immigration reform bill next year, border security may become the lowest common denominator that can be defined as success in a divided Congress. The current debate over immigration reform has morphed into a focus on the need for increased border security to stem the flow of illegal immigrants into the country. The search for a balance between technology-based security measures like SBI.net, which has failed on a grand scale, and traditional physical security such as barriers and patrols, will most likely be resolved in favor of an increased Border Patrol work force tactical infrastructure. The Administration is claiming a measure "victory" on the South West Border based on the fact that: (1) Crime is falling on the U.S. side of the border despite the dramatic violence on the Mexican side; (2) Ciudad Juarez may be the murder capital of the world, but El Paso, just across the river in Texas, has one of the lowest crime rates in the nation; and (3) last year there were a record number of illegal aliens deported while, at the same time, apprehensions of illegal border crossers continue to fall, which the Administration see as evidence of dramatically fewer attempted illegal entries. Despite these successes, it is unlikely to be able to convince the congressional leadership that the border is "secure" and so the time is right for comprehensive immigration reform.

DHS also continues to focus on improved screening capabilities at our international ports of entry to prevent terrorists and criminals from successfully entering our borders. Congress has long



mandated that DHS implement a system that tracks individuals as they enter and leave the country, and is growing increasingly impatient with the Department's slow progress toward this goal.

**“Homegrown Terrorism.”** Both the House and Senate have expressed concerns over “homegrown terrorism” issues. The need for greater coordination of intelligence and integrating counterterrorism expertise has been a constant refrain of both parties and will be a matter of the highest importance for all the committees. Incoming House Homeland Security Chairman King has been a vocal critic of the Obama Administration's lack of focus and information sharing on what is currently being done and wrote to Secretary Napolitano, questioning DHS efforts. He was joined on the letter by incoming Subcommittee Chairman on Intelligence, Information Sharing and Terrorism Risk Assessment, Michael McCaul (R-TX), along with Representatives Sue Myrick (R-NC) and Frank Wolf (R-VA).

**Critical Infrastructure Protection.** The protection of critical infrastructure, including ports, transit, chemical, nuclear and conventional power plants, and iconic buildings remains a high priority. Chemical plant security is another key issue that the 111<sup>th</sup> Congress could not come to closure on and will be on the front burner in the 112<sup>th</sup> Congress. Some Members in the House and Senate are concerned that DHS' Chemical Facility Anti-Terrorism Standards (CFATS) do not go far enough. Both the House and Senate remain concerned over the seeming lack of progress on surface transportation security, specifically around mass transit and rail. Nevertheless, in an environment fraught with concerns over the deficit, there may be serious challenges from the new tea party members over increased funding for any programs.

**Cargo and Port Security.** The 9/11 Commission Recommendations Act included the mandate to screen all U.S.-bound cargo containers at the port of shipment. Over the last few years, both DHS and industry have testified that the current technology is not at the point for that goal to be met. Both the Senate Homeland Security and Government Affairs Committee and the Senate Commerce Committee are looking at this issue and have introduced bills, which range from removing the mandate for 100% scanning of all maritime cargo to simply extending the deadline. Expect these bills to be put on hold in the lame duck session and reintroduced and reevaluated in the 112<sup>th</sup> Congress.

For further information or a deeper discussion of these issues, please contact the Co-Chairs of the Homeland Security, Defense and Technology Practice Group: Norma M. Krayem at 202-457-5206 or by email at [nkrayem@pattonboggs.com](mailto:nkrayem@pattonboggs.com) and Stephen J. McHale at 202-457-6344 or by email at [smchale@pattonboggs.com](mailto:smchale@pattonboggs.com), as well as the other co-authors of this section: Neil Potts at 202-457-5613 or by email at [npotts@pattonboggs.com](mailto:npotts@pattonboggs.com); Scott Thompson at 202-457-6110 or by email at [sthompson@pattonboggs.com](mailto:sthompson@pattonboggs.com); and Sara Vilms at 202-457-5248 or by email at [svilms@pattonboggs.com](mailto:svilms@pattonboggs.com).

## Native American Policy

The 2010 elections likely will have a significant impact on Native economic development initiatives.

The return of Senate Majority Leader Harry Reid (D-NV) and Senator Barbara Boxer (D-CA), coupled with the arrival of newly elected Senator Richard Blumenthal (D-CT), suggests that

pressure on the Department of the Interior to slow or cease the processing of fee-to-trust applications for gaming-related economic development could continue (although we expect that increasing support from other sectors in Congress could balance that pressure).

Two of the three Senate races that still have not been decided are of concern to Indian Country. Senator Patty Murray (D-WA) has a history of strong, productive relationships with Indian Country, and in particular has been a strong supporter of the Small Business Administration's "8(a)" program (discussed below), which has spurred meaningful economic development for Native governments and Native business entities. The importance of her return to the Senate for Indian Country would be underscored if fellow Washington State Senator Maria Cantwell assumes the Chairmanship of the Senate Indian Affairs Committee. In Alaska, the Native American community would retain a significant ally if Senator Lisa Murkowski holds the lead she had as of this morning. As with Patty Murray, Senator Murkowski's leadership on the 8(a) issue would continue to be significant if she returns to the Senate.

Finally, although the Democrats will continue to be the majority party in the Senate, the Senate Committee on Indian Affairs nevertheless will have new leadership since current Chairman Byron Dorgan (D-ND) has announced his retirement. Senators Maria Cantwell (D-WA) and Jon Tester (D-MT) are the most likely candidates to replace him. Should Senator Tester take the chairmanship, we anticipate a greater emphasis on federal recognition issues.

On the House side, the change to Republican control obviously will result in a change of leadership for the Natural Resources Committee (which has jurisdiction over most Native issues), with the chairmanship most likely moving to the current Ranking Member Representative Doc Hastings (R-WA). His assumption of the chair may result in a noticeable change in issues on which the Committee is focused. In particular, current Chairman Nick Rahall (D-WV) has been a staunch supporter of a legislative fix to counter the effects of the Supreme Court's decision in *Carcieri v. Salazar*, which if left uncorrected will effectively create two classes of tribes (those that are eligible for the benefits of the all-important Indian Reorganization Act, and those that are not, see discussion below.) Representative Hastings may not have the same interest in pursuing the *Carcieri* fix. Further, it is possible that Mr. Hastings will be interested in revisiting possible amendments to the Indian Gaming Regulatory Act which would further limit the Secretary's authority and/or tribal authorities, something Mr. Rahall had declined to do. The House side also features an unresolved race of importance to Indian Country. Representative Raul Grijalva's (D-AZ) race had not been decided at press time. Mr. Grijalva has been a strong supporter of Indian initiatives, and is a senior member of the House Natural Resources Committee.

Because federal funding is of such significant importance to tribes with limited economic resources, the makeup of the relevant appropriations committees is of particular importance to Indian Country. Senator Dianne Feinstein (D-CA) reportedly is stepping down from her position as Chair of the Interior, Environment and Related Agencies Subcommittee of the Senate Appropriations Committee. Her departure from that subcommittee could release some of the pressure on the Administration's implementation of federal statutes relating to acquiring land in trust for Indians and its implementation of related gaming statutes, as she has used that position to exert pressure on the Department of the Interior. Also important for Indian Country is the make up of the House Interior, Environment and Related Agencies Appropriations Subcommittee. The change in party leadership means that current Subcommittee Chair Jim Moran (D-VA) likely will be

replaced by current ranking minority member Mike Simpson (R-ID), with Mr. Moran continuing on as Ranking Minority member.

This election could also have an impact on staffing at the Department of Interior, as it is not uncommon for executive branch personnel shifts to occur after elections. Indeed, potential Democratic losses in the midterm elections could further spur such shifts if the President wishes to signal a change in direction. Personnel shifts either could further delay review of several remnant Indian policies that are still pending from the Bush administration, or could mean quicker, more decisive review and action. Conversely, the National Indian Gaming Commission (“NIGC”) has a full compliment of new leadership that should not be much affected by the outcome of the elections. A new Chair (Tracie Stevens), Vice Chair (Steffani Cochran) and Associate Commissioner (Daniel Little) all have been appointed relatively recently, and all serve for a specified term of years.

Finally, gubernatorial elections will have an impact on ongoing economic development initiatives that involve Indian gaming. Term limits prevented Governors Arnold Schwarzenegger (R-CA), Theodore Kulongoski (D-OR), and Bill Richardson (D-NM) from running for reelection; therefore, California, Oregon, and New Mexico (all states with significant tribal populations) have elected new governors who likely will have new approaches to relevant Indian economic development issues their states. In Oregon, as of this morning after the election the gubernatorial race between John Kitzhaber (D) and Chris Dudley (R) is still too close to call. In California, Jerry Brown (D) appears to have won a very close election (although Republican opponent Meg Whitman has not yet conceded the race). In New Mexico Susana Martinez (R) won that gubernatorial race. Also important because of the potential impact on tribal economic development initiatives in those states was the race in New York, by which Andrew Cuomo (D) will replace current Governor David Patterson, and the race in Arizona, in which incumbent Jan Brewer (R) (who is adamantly opposed to the expansion of gaming-related economic development for tribes) was returned to office.

#### *High Profile Pending Issues*

**Native “8(a)” Contracting.** Special federal contracting incentives under the U.S. Small Business Administration’s 8(a) Program for Alaska Native Corporations (ANCs), Indian Tribes and Native Hawaiian Organizations (NHOs) will continue to face attacks, principally from Senator Claire McCaskill (D-Mo). In early October, Senator McCaskill vowed to introduce legislation in the lame duck session effectively aimed at ending these programs. Federal contracting has become a vital component of many ANC, Tribal and NHO economic development programs and we expect the Native American community vigorously to contest Senator McCaskill’s efforts. As discussed in greater detail above, the Native American community is waiting to hear whether it has retained or lost significant champions in Lisa Murkowski (R-AK) and Senator Patty Murray (D-WA).

**Carcieri Fix/Amendments to IGRA.** Senator Byron Dorgan’s legislation, S. 1703, and House companion versions H.R. 3742 and H.R. 3697, would affirm the Secretary of the Interior’s authority to take land into trust for all tribes, regardless of when they were recognized by the federal government. This language constitutes the legislative fix to the Supreme Court’s decision in *Carcieri v. Salazar*. The Senate and House bills were the subject of full Committee hearings, and it is possible the language of those bills may be included in an FY 2011 omnibus appropriations bill.

However, it is also possible that the Carcieri fix language will be amended to include new limitations on the Secretary’s authority to take land in trust for Indian tribes. These new limitations

have not been the subject of public hearings, and as of the date of this writing the exact substance of those proposed limitations is not clear. The proposed new limitations could have devastating effect on poor and disadvantaged tribes.

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## Tax Policy

The composition of the 112<sup>th</sup> Congress will have significant near-term consequences for the direction of federal tax policy.

Any effort to advance tax legislation during the lame duck session will be highly contentious, especially given the Republican Senate pick-ups. The ability to secure at least 41 votes to preserve a filibuster has been a critical procedural tool for the Republican minority. Now, with their substantially increased ranks, Senate Republicans will have measurably more leverage in preventing passage in 2010 of any tax legislation they deem overly partisan in nature. Moreover, if past is prologue, lame duck sessions have historically not been conducive to legislating as the party gaining seats in the election tends to defer action until their new members are sworn in. That said, we think there is real potential for action on a comprehensive tax bill before the end of the year.

**Bush Tax Cuts.** The single most significant item congressional leaders might consider in the short term is the looming expiration of the tax cuts passed in 2001 and 2003 (the Bush tax cuts). These cuts, which affect marginal, capital gains and dividend tax rates, as well as a host of other provisions, will expire and revert back to pre-2001 levels should Congress not affirmatively take action to extend them by December 31, 2010. Thus, absent congressional action:

- All individual marginal tax rates will rise, with the highest marginal tax rate rising to 39.6 percent;
- The tax rate on qualified dividends will rise from 15 percent to a maximum rate of 39.6 percent;
- The maximum rate on long-term capital gains will rise from 15 to 20 percent;
- The estate tax will be restored, with a \$1 million exemption and a 55% top rate;
- Limitations on itemized deductions and personal exemptions will be reinstated for high-income individuals;
- The child tax credit will be reduced from a maximum \$1000 per-child credit to a maximum \$500 per child credit; and
- The marriage tax penalty will be restored.

The Obama Administration and most Democrats in Congress have proposed permanently extending the Bush tax cuts only for those deemed to be “middle income” taxpayers, defined as those with adjusted gross income below \$250,000 a year (\$200,000 for single filers). Congressional Republicans counter that allowing tax rates to return to the pre-2001 levels for upper-income taxpayers is tantamount to a massive tax increase that would affect half of all small business income generated. And Congressional Republicans do not seem to be interested in a deal that some in the

Administration have quietly suggested, which would extend or make permanent the lower rates for middle income taxpayers while “decoupling” the upper income rates by extending them for a shorter period of time.

If the Administration and Congressional Democrats, who will still control majorities in both the House and Senate during the lame duck session, are unwilling to move a full extension of all the Bush tax cuts, it is likely nothing will pass before January 2011, at which point Republicans expect to have more leverage in the next Congress to push a straight extension. However, there remains a possibility that voter anger over tax uncertainty, coupled with the specter of increased income tax withholding rates in January 2011 on many middle-class taxpayers, may prompt Democratic leaders to signal support for a one- or two-year extension of existing rates for upper income taxpayers, thus removing what has been a major obstacle to a bi-partisan package.

**Tax Extenders.** Both the individual and business tax provisions that routinely are extended each year, but which lapsed at the end of 2009, continue to confound Senate Democratic leaders. Because the Senate was unable to act on the extenders package during its September 2010 work period, Senate Finance Committee Chairman Max Baucus (D-MT) will likely attempt to move a bill during the lame duck session, possibly as part of a larger tax package extending the Bush tax cuts.

The House has already passed earlier in the year a version of tax extenders (H.R. 4213), including extensions of the active financing exception; deductions of state and local general sales taxes for individuals; current law look-through treatment for payments between related controlled foreign corporations; the R&D tax credit and the Build America Bonds program. However, one of the major revenue offset provisions in the House bill--foreign tax credit reforms targeted at U.S.-based multinational companies--has since been enacted to offset temporary increases in funding for Medicaid and education.

In order to make changes necessary to garner 60 votes, Chairman Baucus introduced in September a new version of the extenders legislation (Job Creation and Tax Cut Act of 2010) which includes substantially the same provisions as the House-passed version. However, the Baucus bill includes several changes as compared to earlier versions that appear intended to garner Republican support. For example, the latest draft would not impose self-employment payroll taxes on the pass-through income of S corporation shareholders and would delay certain tax increases on corporations from the date of enactment until 2011. However, not one Senate Republican has publicly committed to supporting the new bill.

Offsets include an increase in the Oil Spill Liability Trust Fund excise tax from 8 cents per barrel to 78 cents per barrel, 29 cents more than proposed in previous versions of the bill, and a compromise “carried interest” provision whereby income tied to assets held by a private equity or hedge fund for less than five years would be taxed as 75 percent ordinary income/25 percent capital gains, while income derived from assets held for five years or more would be taxed as 50 percent ordinary income/50 percent capital gains.

Despite the controversies associated with the offsets, tax extenders could be considered by the Senate during the lame duck session, particularly as a part of broader legislation extending the Bush tax cuts, should such legislation be brought to the floor. It is probably less likely that tax extenders will move as a stand alone bill during the lame duck session.



**Estate Tax.** Another significant item yet to be resolved is the estate tax. Under the Economic Growth and Tax Relief Reconciliation Act of 2001, the estate tax was gradually phased down during the years 2002 to 2009, and temporarily repealed in 2010. However, absent Congressional action this session, the estate tax is scheduled to return in 2011 to its pre-2001 level of a 55 percent top rate and a \$1 million exemption.

The House has passed legislation making permanent the 2009 estate tax exemption level and rate (\$3.5 million per spouse and 45 percent, respectively). However, partisan divisions on the issue have prevented any action to date in the Senate. Senate Finance Committee members Jon Kyl (R-AZ) and Blanche L. Lincoln (D-AR), have proposed gradually reducing the estate tax over 10 years from a 45 percent top rate to 35 percent, an approach that would cost significantly less over the budget window than moving directly to a 35 percent rate in 2011. However, there is to date no consensus as to how to proceed, and as with the other Bush tax cuts, one late session option may be a simple extension of 2009 levels for a one or two-year period.

**Bank Tax.** Also still under discussion is the so-called “financial crisis responsibility fee” (or bank tax). While the political impetus for such an idea has waned with the wind down of TARP, the Administration may still seek to target the tax on those institutions that were significant TARP beneficiaries as a means of paying for other tax or spending policies. However, the chances of inclusion of such a fee in legislation to be considered during the lame duck session is dwindling based on significant opposition to the policy by Congressional Republicans, as well as lack of consensus among Democratic tax on how to apply it.

### *Looking Ahead*

The “Pledge to America,” a governing agenda released by the House Republicans that includes tax principles that will guide them during both the lame duck and into the 112<sup>th</sup> Congress, categorically opposes the expiration of any of the 2001 and 2003 tax cuts and states that President Obama’s tax plan would raise taxes on roughly half of all small business income.

In addition to permanently extending the 2001 and 2003 tax cuts, the Pledge to America would provide a tax deduction to small businesses equal to 20 percent of their business income, and would eliminate the provision enacted in healthcare reform legislation that requires reporting on Form 1099 for all annual payments to a single recipient greater than \$600. The Pledge would also repeal various aspects of the healthcare reform law, including what it calls “at least a dozen violations of President Obama’s pledge not to raise taxes on middle-class families,” such as the individual health insurance mandate.

With the Republican takeover of the House, it is widely anticipated that the current Raking Minority Member, Representative Dave Camp (R-MI), will chair the House Ways and Means Committee, and that Representative Paul Ryan (R-WI) will assume the helm of the Budget Committee. Under Chairman Camp, we expect the Way and Means Committee to make every effort to advance the principal component of the Republican’s tax platform--extending, and ultimately making permanent, all of the Bush tax cuts. Adding to this agenda, Representative Ryan has already made public in his “Roadmap for America’s Future” that would scrap the current tax exemptions for employer-sponsored health benefits in favor of individual tax credits and permit workers under the age of 55 to put a portion of their Social Security taxes into private accounts.



The Senate will remain under Democrat control in the 112<sup>th</sup> Congress, but not only will the majority's margin be smaller, but also many of the more conservative, pro-business Senate Democrats, including several on the Finance Committee, are up for reelection in states that either tend to favor or voted for Republicans this year. Of the approximately three dozen seats in cycle in 2012, approximately two dozen will be seats held by Democrats, which may shift committee and floor vote counts in favor of more conservative tax and fiscal policies.

Senator Baucus will remain Chairman of the Senate Finance Committee, while Senator Orrin Hatch (R-UT) will likely assume the Ranking Minority Member position (if Senator Grassley moves over as expected to become Ranking Member on the Judiciary Committee). Chairman Baucus already has a history of working on a bi-partisan basis with his Republican colleagues on the Committee, and it is expected that he face increased pressure from Senate moderates to pursue a more conservative tax policy agenda.

Comprehensive overhaul of the tax code is unlikely, but mounting deficit pressures will continue to force the Administration and a closely divided Congress to consider a broad range of revenue generating corporate and international tax reforms, including rules to tighten deferral and transfer pricing, especially if an across-the-board reduction in the domestic corporate rate remains a priority of the business community. Such reforms, at least for next two years, will occur within the structure of the current income-based system, as opposed to wholesale replacement of the Code with an alternative approach, such as a national retail sales tax, value-added tax or consumption tax. The end result could thus be a replay of the 1986 tax reform act, in which lower tax rates were combined with a significant broadening of the tax base through the scaling back, or elimination, of deductions.

The bi-partisan "National Commission on Fiscal Responsibility and Reform," established by President Obama earlier this year, is scheduled to release its findings in December on a range of options to balance the federal budget by 2015, which would require roughly \$240 billion in annual savings. In addition to defense cuts and social security reform, the Commission is actively considering scaling back tax credits that historically have not been vulnerable, including the mortgage interest deduction. The final report will provide a set of recommendations supported by at least 14 of the 18 Commission members, and while it remains to be seen whether such consensus can be reached after the mid-term elections, some or all of the tax-related revenue measures in the Commission's report could find their way into the President's FY 2012 Budget proposals. Such proposals will likely not receive a warm reception from the Republican-controlled House, setting up a larger debate heading into the 2012 Presidential and Congressional elections on the best method to achieve deficit reduction by 2015.

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## Technology and Communications

Over the past two years, despite the press of other issues of national importance, President Obama, together with Congress and a number of agencies, took steps to encourage building a 21<sup>st</sup> Century information infrastructure that will improve nationwide broadband access, enable healthcare information technology (health IT) systems, and modernize the electric grid. While working to implement the President's vision, the Federal Communications Commission (FCC) also took on an activist regulatory agenda, including the fight over net neutrality, which was a significant distraction and without resolution.

Congress passed the American Recovery and Reinvestment Act (ARRA) in 2009, which authorized federal funds for health IT, smart grid, and \$7.2 billion specifically directed to improve broadband Internet access nationwide. As of September 30<sup>th</sup>, the Department of Commerce and the Department of Agriculture had granted or loaned these funds and construction of new broadband systems is underway to serve rural, remote, unserved, and underserved areas. The ARRA also directed the FCC to develop a comprehensive plan for achieving nationwide broadband service. The FCC delivered the National Broadband Plan (the Plan) to Congress in March of 2010. The Plan sets the agenda for the FCC for the next 10 years on an array of broadband issues, some of which Congress will need to address. The President also ordered the FCC to make 500 MHz of new spectrum available over the next 10 years for mobile and fixed wireless broadband, which the FCC incorporated in the Plan. Progress is being made to identify spectrum and promulgate rules for operation. Progress also was made in 2010 on bonus depreciation and tax matters which should benefit companies that are building wired and wireless communications infrastructure, including towers. In late September, the President signed the Small Business Jobs Act which contains a one year extension of a 50% bonus depreciation through 2010. This measure allows communications companies, and others, to write off substantially greater equipment costs and cap-ex this year. The allowable deduction for start-up business expenses also was increased, and mobile communications devices were removed from the listed property obligations under Section 280F of the tax code.

Despite these actions, the FCC has been criticized for not doing enough while Democrats were in control of Congress. While the Commission advanced a number of priorities under the National Broadband Plan, little progress was made on the most contentious issues, and the shift in control of the House now means that forward movement will be difficult. Expect more gridlock on broadband issues, similar to what occurred in recent months over the public safety D-block spectrum and the open Internet debate--all of which occurred while Democrats controlled the Senate, the House, the White House, and the FCC. Shifting control in Congress means that Democrats and public interest groups will push the FCC to become more activist in its agenda. But increased vigor from the FCC will be met by greater oversight and increased scrutiny by the House. Chairman Genachowski may find GOP allies on some issues, such as the wireless spectrum agenda. But this issue may be one of the few on which the Administration, the two chambers, and the FCC find common ground.

### *Leadership Changes*

We expect some change in eighth-floor leadership at the FCC during this next Congress. Republican control over the House also means significant change in leadership of the House committees with jurisdiction over communications and technology issues. This change, alone, is

likely to have an appreciable impact on congressional and FCC priorities for the communications sector. No significant change is expected in the relevant Senate committees.

## *FCC*

It has been rumored for months that Chairman Genachowski may wish to be replaced at the FCC, but these rumors have been flatly denied. Even assuming Genachowski remains at the helm, term expirations for Commission Members will be an issue for the next Congress. Commissioner Michael J. Copps (D) has been serving since June 30, 2010 under an expired term. The term for Commissioner Meredith Atwell Baker (R), expires on June 30, 2011. Baker is serving the remainder of the unexpired term of former Chairman Kevin Martin. Commissioner Mignon Clyburn (D) only has a year and a half left in the term she took over from former Commissioner Deborah Tate. There are rumors that Copps may not seek re-nomination. Both parties may look for a package deal to consider Baker's re-nomination and Copps' potential replacement. Baker is well-liked on the Hill and has a good relationship with Chairman Genachowski. She is also a Texan and has the support of Senator Kay Bailey Hutchison (R-TX), Ranking Republican on the Senate Commerce Committee.

## *Committees of Jurisdiction*

House Energy and Commerce Committee Ranking Member Joe Barton (R-TX) is term limited according to GOP rules. He has petitioned the Steering Committee to clarify whether the Republican Party's six-year term limit is applicable to time served in the minority. Unless he is given a waiver, Representative Fred Upton (R-MI), would likely hold the top seat on the committee. Current Chairman Henry Waxman (D-CA) is expected to serve as the full Committee Ranking Member. Communications, Technology and Internet Ranking Member Cliff Stearns (R-FL) will likely assume the Subcommittee chair from Representative Rick Boucher (D-VA). With Mr. Boucher having lost his bid for reelection, the technology industry will lose an important voice on the committee and major legislative initiatives with which he was involved, such as privacy legislation, are likely to be derailed or move in a different direction. In addition, the committee is losing many other Members: Representatives Bart Gordon (D-TN), Bart Stupak (D-MI), Zack Space (D-OH), Baron Hill (D-IN), John Shadegg (R-AZ), Steve Buyer (R-IN), George Radanovich (R-CA), all of whom are retiring or were defeated yesterday, Charlie Melancon (D-LA), who ran unsuccessfully for the Senate, and Representative Roy Blunt (R-MO), who won his bid for election to the Senate.

Ranking Member Lamar Smith (R-TX) is expected to take control of the Judiciary Committee from its current Chairman, John Conyers (D-MI). This shift in power also may mean a shift in priorities for the full committee, where Conyers has closely guarded IP issues, such as performance rights and patent reform, while delegating antitrust issues to the Courts and Competition Policy Subcommittee. In 2008, Conyers created this new subcommittee to address antitrust issues, which until that point had been under the purview of the full committee. As the new chairman, Smith may flip these issues, raising antitrust issues to the full committee level and sublimating patent reform and performance rights to the new Subcommittee chairman. Ranking Member Howard Coble (R-NC) is likely to assume this leadership post, switching roles with current Subcommittee Chairman, Representative Hank Johnson (D-GA).

In the Senate, the current chair of the Senate Commerce Committee, Senator Rockefeller will retain his post, as will Ranking Member Hutchison. Chair of the Communications, Technology

and Internet Subcommittee, John Kerry (D-MA), also will keep his position. The rest of the committee should remain largely unchanged.

Similar to the Senate Commerce Committee, expect to see the status quo for Judiciary Committee leadership. Patrick Leahy (D-VT) will continue to lead the committee. Ranking Member Sessions is expected to move to the Budget Committee, which would open the post to Senator Grassley.

### *Major Legislative Issues*

**Net Neutrality/Reclassification.** One of the most contentious and consequential communications issues facing the FCC and Congress is net neutrality. During the 2008 election, President Obama argued for new and more stringent net neutrality rules. The issue has gained higher priority since the 2008 election because of a 2010 decision of the U.S. Court of Appeals for the D.C. Circuit, in which it found that the FCC had failed to show that it has the authority to enforce its net neutrality principles under Title I of the Communications Act. Since that decision, the Commission has been actively exploring the prospect of reclassifying broadband as a Title II telecommunications service in order to restore its ability to preserve an open Internet. There is widespread bi-partisan opposition to this proposal.

Congressional efforts to achieve a bipartisan compromise on net neutrality were stalled in September when Republicans would not support a proposal by House Energy and Commerce Committee Chairman Waxman that would have authorized the Commission to take enforcement action against broadband providers found to be blocking lawful transmissions or unreasonably discriminating against legal content but also barred the FCC from reclassifying broadband as a Title II service for two years. As a result of this development, increased pressure was placed on the FCC this fall by public interest groups and some congressional Democrats to move ahead with reclassifying broadband as a Title II service.

We believe the election results have diminished the likelihood that Congress will forge bipartisan legislation giving the FCC any authority to enforce net neutrality principles. Moreover, since most Members of the next Congress appear to oppose reclassifying broadband as a Title II service, we believe it is doubtful the FCC will move forward with that proposal. Indeed, we expect Republicans in Congress will attempt to remove the Commission's authority to reclassify broadband, either through substantive legislation or an appropriations rider. Instead of reclassifying broadband, we believe the Commission may attempt to adopt net neutrality rules under its Title I authority, notwithstanding the D.C. Circuit's 2009 decision casting doubt on its ability to do so. Individual states also may seek to exercise jurisdiction over net neutrality.

**NPR Funding.** In the wake of National Public Radio's (NPR's) decision to fire news analyst Juan Williams for comments he made about Muslims while appearing on "The O'Reilly Factor" on Fox News, many congressional Republicans have called for federal funding of NPR to be eliminated. Senator Jim DeMint (R-SC), for example, has stated that he will introduce a bill in the Senate to end federal funding for the Corporation for Public Broadcasting (CPB), which funds both NPR and the Public Broadcasting Service (PBS), and Representative Doug Lamborn (R-CO) has already introduced similar legislation in the House. Moreover, many members of the Republican congressional leadership, including Senate Republican Leader McConnell, recently have spoken out against continued federal funding for public broadcasting.

For the past 25 years, decisions to fund CPB have been made two fiscal years ahead of the fiscal year in which funding is allocated. During FY 2010, the CPB received \$420 million in appropriations from Congress, and approximately \$90 million of that sum went to NPR and public radio stations. In FY 2011, the CPB is scheduled to receive \$430 million and that number is scheduled to increase to \$445 million in FY 2012.

Notwithstanding increased Republican influence in the 112<sup>th</sup> Congress, we do not expect federal funding for NPR or public broadcasting will be eliminated. When the Republicans last controlled Congress, efforts to eliminate funding for public broadcasting were not successful because supporters of popular programming rallied to defend the CPB's appropriation, and we expect a similar outcome next year. Moreover, as the firing of Juan Williams recedes into the past, the amount of effort devoted to defunding NPR should diminish. It is important to note that the Obama Administration will strongly oppose eliminating funds for public broadcasting. While funding for the CPB is not likely to be ended, we do believe that future appropriations for public broadcasting may be reduced from present levels, as they were in the early years of the last Republican Congress.

**Retransmission Consent.** As retransmission consent disputes between broadcasters and multichannel video programming distributors (MVPDs) have increased in frequency, both the FCC and Congress have devoted greater attention to reforming the retransmission consent process. In March, fourteen MVPDs and public interest groups filed a petition for rulemaking with the FCC requesting that it amend and supplement its retransmission consent regulations to provide a new mechanism for resolving disputes between broadcasters and MVPDs and to require mandatory interim carriage of broadcast stations while an MVPD negotiates in good faith or a retransmission consent dispute is pending. Broadcasters have opposed this petition, arguing, among other things, that the retransmission consent marketplace is functioning just as Congress intended and that the Commission lacks the authority to require interim carriage while a dispute is pending. In October, after News Corp. broadcast stations were pulled from Cablevision systems in New York, New Jersey, and Connecticut, Senator Kerry introduced legislation that would give the FCC a greater role in resolving retransmission consent disputes, including the authority to require the parties to submit to binding arbitration under certain circumstances.

We believe that the election results make it unlikely that the next Congress will enact retransmission consent reform legislation. Congressional Republicans, as a general matter, are less inclined to favor giving the FCC a greater role in resolving retransmission disputes, a step they view as unwarranted government intrusion into the marketplace. Moreover, Fox Broadcasting, a conservative-leaning network, is a central player in many retransmission consent disputes and is strongly opposed to greater government intervention in this area, which means that Republicans have even less incentive to champion the cause of reforming the retransmission consent process. Perhaps more likely is an FCC effort to reform retransmission consent regulations, but we believe that such reforms are likely to be relatively modest. If, however, the number of high-profile retransmission disputes escalates and results in more broadcast stations being pulled from cable systems, then the likelihood increases that either the FCC or Congress will take significant action.

Watch for how this issue may play out in relation to the Comcast-NBC Universal (NBCU) merger review. Comcast has voluntarily committed to take certain steps to ameliorate the concerns that cable operators and broadcasters have expressed about the effect that the merger



would have on the retransmission consent process. For example, it has agreed to extend the Commission's program access rules to retransmission consent negotiations for NBCU stations and not discriminate against non-NBCU stations in retransmission consent negotiations because of their lack of affiliation with Comcast. At a minimum, we expect the Commission to condition approval of the merger on Comcast adhering to the commitments it has made in this area.

**Consumer Privacy and Data Protection.** Consumer privacy issues, which balance individual rights to protect personal information against market forces that seek to use such information to create a seamless consumer experience, are of interest to both chambers. During this Administration, dozens of privacy initiatives have focused on staunching disclosures of personal information, but none have produced final legislative action. Among other aims, the bills have sought to update a 1986 law related to government access to electronic communications, extend law enforcement surveillance capabilities to the Internet, protect consumers against data breaches and the sharing of personal information in e-commerce exchanges, and establish a "Do Not Track" list of online browsing behavior. Now, with Republicans regaining House leadership and narrowing the margin with Senate Democrats, there is likely to be a shift in favor of fewer privacy protections and greater accessibility to personal information by law enforcement and commercial interests.

Congress has devoted considerable time in 2010 to examining the privacy and data security practices of social networking and search engine sites. Senate Commerce Committee Chairman Rockefeller requested information from Facebook and MySpace about privacy breaches highlighted in recent news reports. For example, Rockefeller wants to know the number of employees Facebook dedicates to monitoring and enforcing compliance with Facebook's privacy policy. Rockefeller asked MySpace to explain why it cannot control third-party applications from retrieving and using member information when other social networks place limits on the use of personal information. In the House, Representatives Ed Markey (D-MA) and Joe Barton (R-TX), asked Facebook similar questions. As co-chairmen of the House Bipartisan Privacy Caucus, Markey and Barton take a similar view of online privacy. In early August, they sought information from 15 top websites on their consumer tracking practices. They also teamed up in May when they asked FTC Chairman Jon Liebowitz about Google's revelation that it gathered information sent over Wi-Fi networks. These issues are likely to extend into the next Congress.

Various members of the Senate Commerce Committee and House Energy and Commerce Committee have proposed measures that would direct the FTC to establish rules aimed at shoring up e-commerce security policies in order to protect personal information. In many cases, the legislation seeks to give consumers greater access to and review of their personal information and to institute disclosure notification policies in the event of a data breach. Other online measures would allow online information to be collected so long as users are provided clear notice about what is being collected and how it is used, and an opportunity to "opt out." These privacy measures will resurface in the next Congress, with a likely emphasis on developing industry self-regulatory programs to be monitored by the FTC. In addition, House Communications Technology and Internet Subcommittee Chairman Rick Boucher (D-VA), who will become Ranking Member next year, said he plans to introduce online privacy legislation early in the new session. Now in draft form, the measure seeks to inform consumers about what personal information is collected by websites, how the information is used, and how consumers can control that information.

Finally, there is consensus among many lawmakers, industry and public interest groups that the Electronic Privacy Communications Act must be modernized to reflect changes in technology,



particularly as it relates to the rising use of cloud computing. The House and Senate Judiciary Committees have explored this issue through several hearings. Industry stakeholders are worried about the growth in cloud computing and law enforcement access to communications. Under current law, law enforcement officials must obtain a warrant before accessing data sent via e-mail, while data stored by a third-party cloud provider only requires a subpoena.

**Cyber Security.** As Congress adjourned for the elections a number of legislative proposals were pending focusing on policies and procedures to help shore up the vulnerability to cyber attacks of critical infrastructure networks relied upon for basic day-to-day activities, including the telecommunications network. Discussion of these initiatives and the import of the election thereon are included in the Homeland Security section of our analysis. However, in light of the bipartisan nature of the legislative efforts to date and the high visibility of the issue, changes in Congress as a result of the election seem unlikely to derail ultimate passage of cyber security legislation.

**Public Safety Spectrum (the “D” Block).** The terms under which the D-block, 10 MHz of spectrum in the 700 MHz band intended for public safety, will be made available for public safety use continues to be debated. The spectrum was originally auctioned by the FCC in January 2008, but failed to attract a bidder willing to pay the \$1.3 billion reserve price. The spectrum has been in limbo ever since. A disagreement between FCC Chairman Genachowski and Senate Commerce Committee Chairman Rockefeller about whether or not to auction the spectrum may mean that gridlock on this issue continues.

The FCC has proposed re-auctioning the D-block for commercial-only use, with the auction proceeds going to finance a public safety network utilizing alternative spectrum. Public safety officials have opposed that plan and called for congressional action to award the D-block to public safety without auction. Chairman Rockefeller proposed legislation (S. 3756) to give the D-block to public safety and fund buildout of the public safety network with proceeds from incentive auctions of broadcast spectrum. Ranking Committee Member Hutchison has said she would support a direct allocation of the spectrum, in lieu of auction, to build a nationwide public safety network. Senators Lieberman (I-CT) and McCain (R-AZ) offered similar legislation. Supporting the Lieberman-McCain bill in the House with companion legislation are Representatives Yvette Clark (D-NY) and Peter King (R-NY). In the next Congress, King is expected to become Chairman of the Homeland Security Committee. There is strong bi-partisan support in both chambers for a no-auction handoff of the D-block to public safety.

However, Democrats and Republican leaders on the House Energy and Commerce Committee favor the FCC’s commercial auction approach. Chairman Waxman supports legislation that would require the Commission to auction the spectrum and fund public safety. We do not believe the mid-term election will materially impact the outcome of this debate, with the possible exception that King will soon be in a better position to advance his no-auction proposal if he ascends to the chairmanship of the Homeland Security Committee.

**Universal Service Reform.** In its National Broadband Plan, submitted to Congress in March 2010, the FCC called for extensive reforms to the Universal Service Fund (USF or Fund) and proposed shifting \$15.5 billion over the next decade from the existing USF high-cost fund, with \$11.5 billion going to a new “Connect America Fund” (CAF) and \$4 billion to a Mobility Fund. The Plan also called for reform of inter-carrier compensation and a broadening of the base of USF sources, potentially including broadband. The Plan ultimately seeks to eliminate the high-cost

program and phase out the per-minute rates for the origination and termination of telecommunications traffic. A central goal of the Commission's Plan is the promotion of 3G/4G service in rural markets for voice and data.

The Plan drew opposition from rural telecommunications carriers that have, for many years, relied upon the USF high-cost program to subsidize the building and maintenance of telephone service in the sparsely populated markets they serve. Those carriers and other telecommunications interests are instead endorsing a bi-partisan bill introduced in the House by Representatives Lee Terry (R-NE) and Rick Boucher (D-VA). The Boucher-Terry Bill would develop a new cost model for USF support, limit USF support in competitive areas, implement competitive bidding for USF funds by wireless carriers, and reform Intercarrier Compensation. The first hearings on the bill were held in mid-September and further hearings are expected during the lame-duck session in November.

Despite some questions from House Commerce Committee Ranking Member Barton and a request for another hearing, Representative Terry said he is confident USF reform legislation will be voted out of committee by the end of 2010. His GOP colleagues have raised concerns about the bill not containing a cap on the fund. The GOP is generally more hostile to USF issues and Republican control of the House means removal of Representative Boucher from his chairmanship of the subcommittee. This move would make broad legislation to reform the Fund unlikely, unless the reform was to reduce and limit use of the Fund.

**Mobile Broadband Spectrum.** While there appears to be bi-partisan support in Congress to facilitate mobile broadband deployment through identifying and authorizing new spectrum, coaxing broadcasters and the federal government to relinquish spectrum for the cause will prove challenging. Mobile broadband has been singled out as a significant contributor to US economic growth by the Obama Administration and the FCC, and has been credited with the potential to improve productivity, create new jobs, and promote US leadership in the global economy. The FCC released a white paper October 21, forecasting a spectrum shortage because mobile data demand is expected to increase by 35 times, and will exceed capacity of wireless networks in the near-term. The FCC notes that growth of mobile technologies such as smart phones, tablet computers and e-books is a significant driver of expected demand and, over the next five years, demand for mobile wireless will create an estimated \$120 billion dollars for the mobile industry.

**Incentive Auctions for Broadcasters.** President Obama issued an executive order in June emphasizing the importance of mobile broadband and directing agencies to work with the FCC to make 500 MHz of commercial and noncommercial spectrum available over the next ten years. The FCC's National Broadband Plan further recommends making 300 MHz available for mobile use within five years, including 120 MHz from broadcast spectrum. Targeting broadcast spectrum generated significant controversy. Broadcasters dispute the notion that there is a looming spectrum crisis, and are weary that the Commission is trying to force broadcasters to involuntarily relinquish spectrum. The FCC proposal relies on incentive auctions which, in concept, would provide carrots and cash to broadcasters for agreeing to relinquish part of their spectrum. FCC Chairman Julius Genachowski announced plans to launch a rulemaking process that would make it possible to quickly implement incentive auctions, and said the rulemaking proceeding would lift technical restrictions so broadcast spectrum can be used for broadband. The FCC will also consider licensing policies that would allow broadcasters to channel-share, which would also free up spectrum.

Incentive auctions to facilitate use of broadcast spectrum for mobile broadband is contingent on legislation. Spectrum auctions, and incentive auctions, have bi-partisan support because of the potential to raise significant revenues for the Treasury. This should remain true regardless of the outcome of the mid-terms, and support could grow with the election of Tea Party supporters concerned with the deficit. President Obama specifically noted that proceeds from auction revenues could be used for deficit reduction. Bills were introduced in both chambers last Congress supporting incentive auctions, but there was disagreement over whether broadcasters would be faced with any “sticks.” Chairman Rockefeller introduced a bill in August that would give the FCC authority to conduct incentive auctions, with voluntary broadcaster participation, in exchange for receiving a portion of the funds collected from the auction. Representatives Boucher and Stearns introduced similar legislation in the House. By contrast, Senators Olympia Snowe (R-Me.) and John Kerry (D-MA) introduced a bill in July that would authorize incentive auctions but would levy a spectrum fee on broadcasters that do not give up spectrum. Broadcasters criticized the Snowe/Kerry proposal as pressuring them to give up spectrum.

**Spectrum Inventory Bills.** Another controversial aspect of President Obama’s spectrum directive and the FCC’s National Broadband Plan is the identification of “underutilized” spectrum for reallocation, particularly federal government spectrum. President Obama called for a publicly available inventory of how spectrum is being used by government and commercial users. Last Congress, bipartisan legislation was introduced with instructions to the FCC regarding how such an inventory should be conducted. On the House side, spectrum inventory legislation passed with a wide majority, but the companion Senate legislation was blocked by Senator Tom Coburn (R-Okla.), who aired concerns about its cost. Because of the focus on the importance of spectrum and the ability to raise Treasury revenues through auctions, it is likely that inventory legislation will be re-introduced regardless of which party controls the House and Senate.

Reallocating government spectrum for commercial mobile use will remain a difficult process. Larry Strickling, head of the Commerce Department’s National Telecommunications and Information Administration (NTIA), announced in October that NTIA is recommending reallocation of 115 megahertz of spectrum now controlled by federal agencies for commercial mobile broadband use, including 100 megahertz currently held by the Defense Department. Another 15 megahertz would come from spectrum used by the National Oceanic and Atmospheric Administration for weather balloons and satellites. Strickling said the agency also examined spectrum in the 1755 band that has been attractive to industry, but he said further examination was necessary before reallocation for commercial use is possible. As of this writing, NTIA’s detailed recommendations are not public, but are under review by Obama Administration officials.

**Consumer Issues--Bill Shock, Truth-in-Billing.** Chairman Genachowski announced in October that the FCC is aggressively pursuing a “Consumer Empowerment Agenda,” with a focus on mobile carrier billing practices that result in unexpected charges and consumer surprise. To that end, the FCC proposed new rules in October addressing “bill shock.” The proposed rules would require mobile service providers to provide usage alerts and related information that will assist consumers in avoiding unexpected charges on their bills. Included in that proposal is the notion that carriers should be required to offer the option of capping usage so that phone service shuts off when a certain limit, set by the customer, is reached. Republican FCC Commissioners expressed reservation, questioning the magnitude of the bill shock problem, and questioning whether additional regulations should be imposed on carriers. Chairman Genachowski intends to hold a

public forum soon on bill shock, and signaled that the Commission will focus on disclosures regarding termination fees and truth-in-billing.

Senator Tom Udall (D-NM) introduced legislation last month that proposes to address bill shock by requiring free customer notification by email or text when customers have used 80 percent of their monthly limits, and customer consent before charging for over-the-limit usage. He has written the FCC to support its separate effort. The European Union already has regulations requiring mobile carriers to notify customers when monthly usage reaches 80 percent of the limit. While these are very popular constituent issues, it is unlikely that the Republican-controlled House would support the passage of bill shock or related legislation. We expect the House will criticize the FCC for any significant new rules on this front.

**Accessibility.** On October 8, 2010, President Obama signed into law the Twenty-First Century Communications and Video Accessibility Act of 2010. This legislation requires smart phones, television programs, emergency broadcast information, and other modern communications technologies to be accessible to people with vision or hearing loss. The FCC issued a public notice in October seeking comment on the implementation of the law. It is likely that the Commission will move forward with rules implementing the statute over the next year. The FCC also opened a proceeding in October to refresh the record in a closed-captioning rulemaking, given technological changes over the past five years. Finally, the FCC opened an inquiry in June to examine the structure and practice of the Video Relay Service Program, with the stated purpose of making the Telecommunications Relay Service fund less susceptible to waste, fraud and abuse. We don't expect changes in Congress to impact progress on these bi-partisan initiatives to improve accessibility.

**Patent Reform.** Despite the compromise Senate Judiciary Committee Chairman Leahy made with Ranking Member Sessions on the two most controversial issues in the patent reform debate (reform on substantive damages and the post-grant review process), it appears that S. 515 may fade in the 111<sup>th</sup> Congress. Senator Leahy and others may seek to have Senator Reid bring the legislation to a floor vote in the lame duck session, but there may be time constraints on bringing any substantive legislation to a vote, particularly where a number of Senators already have a hold on S. 515.

The House has not taken any major action on the Leahy compromise, as members there oppose the Senate version, including the compromise provisions. Current House Judiciary Committee Chairman Conyers and Ranking Member Smith, who is set to replace his colleague with the gavel, have worked together on patent reform issues in the past and are likely to do so going forward. It remains to be seen whether Smith will elevate patent reform to the full committee or leave jurisdiction to the Courts and Competition Policy Subcommittee as Conyers has done. For now, comprehensive patent reform appears to be off the table. At best, Congress may revisit patent reform as part of a smaller package of reforms next year.

*For additional insights about likely policy developments, please contact the authors of this section, the Patton Boggs TechComm team, including Matthew Berry, Paul Besozzi, Nick Allard, Jennifer Cetta, Monica Desai, Carly Didden, Mark Ellison, Kathleen Ireland, Kevin Martin, and Jennifer Richter. Contact information for all of the above can be found at [www.pattonboggstechcomm.com](http://www.pattonboggstechcomm.com).*

## Trade Policy

The 112<sup>th</sup> Congress will be more supportive of free trade than recent Congresses. Not only has the historically pro-trade Republican Party regained a substantial number of seats, but also President Obama has encouraged Congress to work out policy differences and push forward pending Free Trade Agreements (FTAs)--with the South Korea FTA the highest priority--as a way to stimulate export-oriented economic growth and foster trade and diplomatic relations with key partners. We expect these efforts to intensify next year as the President seeks to shift the focus on creating jobs through stimulus measures to instead creating them through measures that can be described as pro-growth “export” and “investment” initiatives. President Obama, for example, hopes to double U.S. exports over the next five years as a way of creating jobs and spurring economic growth.

As a result, Democrats who previously opposed certain trade initiatives, or have been neutral, will face growing encouragement to support trade, urged on by a larger, stronger Republican base within Congress and by the leader of their own party. With many of the remaining Democratic Caucus Members and incoming freshman Republicans representing constituents who view trade skeptically, the President and the leadership of the Republican Party will face significant challenges in moving legislation successfully. Given the commitment to a pro-trade agenda of the Republican Leadership and key Democrats such as Senator Baucus and Representative Steny Hoyer (D-MD), we anticipate a more assertive trade policy to emerge in Washington.

Although several important trade concerns await resolution, three key issues will dominate the trade agenda over the next two years: (1) ratification of the United States-Korea FTA and its implications for other pending agreements; (2) renewal and possible reform of existing trade preference programs; and (3) U.S. trade and economic relations with China, which has overtaken Japan as the world’s second-largest economy.

### *Committees of Jurisdiction*

Senator Baucus will remain Chair of the Finance Committee. However, the top Republican on the panel will likely change. Senator Grassley is expected to move to the Senate Judiciary Committee. If so, Senator Orrin Hatch (R-UT) is likely to fill the top Republican slot on the committee. Senators Baucus, Grassley, and Hatch are generally considered pro-trade and will likely find increased support for key agenda items from a stronger Republican presence in the Senate.

Representative Dave Camp (R-MI) is expected to become Chairman of the Ways and Means Committee, with Representative Sander Levin (D-MI) serving as Ranking Member. Representative Camp is a strong advocate for free trade and will likely push for the ratification of the pending FTAs with Colombia, Panama, and South Korea. However, since Representative Camp is from Michigan, he will not be oblivious to the concerns of the U.S. automobile industry. Representative Levin will take a more cautious approach to trade as he tries to address strong opposition from labor unions while attempting to accommodate the priorities of the Obama administration. While Representatives Camp and Levin do agree that the United States must focus greater attention on ensuring China



adheres to its WTO and other trade obligations--both members, for example, voted in favor of the recently passed House bill aimed at addressing China's exchange rate policy--they differ on how best to do so.

#### *Pending Free Trade Agreements (FTAs)*

More than three years after they were signed by President George W. Bush, the pending Free Trade Agreements with South Korea, Colombia, and Panama may finally be ratified by the 112<sup>th</sup> Congress. The first of these will likely be the South Korea FTA. Earlier this year (at the summer G-20 summit in Canada), President Obama breathed new life into the agreement, directing his negotiators to resolve remaining differences before his scheduled meeting with Korean President Lee at the G-20 summit November 11-12 in Seoul. The Administration hopes to submit implementing legislation in the first half of 2011. The President's affirmative stance on the South Korea FTA has encouraged free trade proponents (particularly Republicans) to promote Congress's consideration of the Colombia and Panama agreements as well. As all three nations pursue trade agreements with American trade competitors such as Canada and the European Union, pressure will build on Congress to pass the U.S. FTAs quickly. We describe each below.

**South Korea FTA.** At the G-20 summit in June, President Obama announced that he had directed U.S. Trade Representative Ron Kirk to resolve outstanding issues before the upcoming G-20 summit. The President's decision to set a timeline marked a significant departure from previous statements by his administration. The FTA is likely to pass with support from both sides of the aisle if the two nations are able to reach agreement on two outstanding issues: U.S. access to the Korean auto and beef markets. Since we do not expect Congress to take up the agreement in the lame duck session, we see it as a potential item for early consideration in the 112<sup>th</sup> Congress, especially to the extent Democrats want to demonstrate a new economic message and Republicans want to display a willingness to work together with the Obama Administration to reach an accomplishment. Because the agreement was signed prior to the expiration of Trade Promotion Authority (TPA), the U.S. Trade Representative expects those provisions to apply once the agreement is presented to Congress. (See discussion of TPA below.)

**Colombia FTA.** Although the South Korea FTA likely will be the first pending trade agreement approved, the United States signed the Colombia FTA first, in 2006. Earlier this year, a group of 39 Representatives--including 20 Democrats--urged the President to support the Colombia FTA. Following the President's G-20 announcement relating to the South Korea FTA, other Congressmen, including Democratic Majority Leader Steny Hoyer, called for the authorization of all three FTAs. Although significant concerns about labor-related violence in Colombia remain, the 112<sup>th</sup> Congress will be more likely than its predecessors to work through these issues to approve the agreement. Pro-trade Republicans have already been vocal in urging speedy consideration of the Colombia FTA.

**Panama FTA.** Viewed by many as the least controversial for U.S. interests, the Panama FTA will also benefit from a stronger pro-trade atmosphere in Washington. Some Members continue to voice concerns about Panama's reputation as a tax haven, but a growing number of Democrats, including Senator Baucus, want to see the FTA passed in parallel with any tax agreement. If the Colombia FTA is approved, the Panama FTA is expected to pass as well.

**Trade Promotion Authority.** Now that President Obama has set a deadline for resolving remaining differences over the South Korea FTA, he is expected to ask Congress to renew TPA (previously known as Fast Track Authority), which now only applies to agreements negotiated and signed prior to July 1, 2007. TPA requires Congress to vote on an agreement within ninety days of its formal submission, with no amendments permitted. TPA still applies to the South Korea, Colombia, and Panama FTAs, which were all signed before TPA expired, but the authority would disappear should the text of any of the agreements substantially change before reaching Congress. Lack of TPA authority is also dampening consideration of negotiating any new bilateral agreement with other countries.

**Trans-Pacific Partnership (TPP).** In 2011, the U.S. Government will continue negotiations on multilateral Free Trade Agreement with nine Pacific Rim countries. The Obama Administration has declared the TPP a key element of the President's plan to double U.S. exports in five years. The negotiations aim to resolve chief concerns, such as the interface between the TPP and existing U.S. FTAs with member-nations Singapore, Chile, Australia, and Peru, as well as the Non-Market Economy status of TPP member Vietnam. Meanwhile, support from Congressional leaders such as Senators John Kerry (D-MA) and Jim Webb (D-VA), who recently issued a statement promoting TPP negotiations, will likely solidify the chance for U.S. participation in the multilateral agreement over the course of the 112<sup>th</sup> Congress.

**Anti-Counterfeiting Trade Agreement (ACTA).** The United States will continue efforts to finalize the Anti-Counterfeiting Trade Agreement (ACTA). The agreement, which is being negotiated by the United States, Australia, Canada, the European Union, Japan, Mexico, Morocco, New Zealand, Singapore, South Korea, and Switzerland, will establish an international framework to combat counterfeiting and piracy. The agreement also would promote international cooperation and enforcement practices to guard against the theft of intellectual property. In October, negotiators concluded the final round of negotiations and released a public draft of the text. Still, there are a small number of outstanding differences that the parties will continue to work out over the coming weeks. Concerns have been raised by the fair use community, for example, about the extent to which earlier versions of the agreement created rights for content owners not available under existing U.S. law. Assuming these and other issues are resolved soon, the U.S. Government may sign the final agreement by the end of 2010. Because ACTA was negotiated as an executive agreement, it does not require congressional approval.

#### *Trade Preference Programs and Reform*

Three trade preference programs are set to expire before the end of 2010, prompting further debate about whether to combine regional programs into a single universal regime. Trade preferences, which eliminate tariffs on specific goods from certain countries, are intended to help developing nations succeed in trade, but some criticize the programs as diversions from larger trade initiatives. In the past, Congress has granted these programs one-year extensions, but some now question whether this piecemeal approach is effective. Many private-sector constituents are urging their representatives to adopt a unified trade preference program, which would not favor any one region over another. Alternatively, Representative Camp, Senator Baucus, and other Members wish to continue the existing regional programs, but favor the predictability of a long-term extension for each of them.

**Extension of GSP, ATPDEA, and CBI.** The trade preference programs up for renewal by the end of this year are the oldest and largest trade preference program: the Generalized System of Preferences (GSP), and the Andean Trade Preference and Drug Eradication Act (ATPDEA). Congress extended the Caribbean Basin Trade Partnership Act until Sept. 30, 2020 earlier this year. We expect the lame-duck Congress to act on a short-term extension of these programs into 2011, but also expect a more trade-oriented 112<sup>th</sup> Congress to examine more closely the possibility of a unified trade preference regime, with substantive modifications to the programs affecting “competitive need” limitations and country eligibility.

**African Growth and Opportunity Act (AGOA).** Although not due to expire until 2015, AGOA may also see changes during the 112<sup>th</sup> Congress. While many view AGOA as a success, some see opportunity for improvement. Representative Jim McDermott (D-WA), a Ways and Means Committee Member, will continue to push his “New Partnership for Trade Development Act,” which would extend GSP and AGOA through 2019 and create a new single rule-of-origin for all products traded under AGOA.

### *China-Specific Legislation*

**Currency Valuation.** Shortly before it adjourned for the November elections, the House of Representatives approved, by an overwhelming 348-79 vote, legislation that would allow the Department of Commerce to treat currency undervaluation as a countervailable subsidy. Although the legislation is not China-specific, it clearly targets the PRC’s large foreign reserves that effectively tie the value of the yuan to the U.S. dollar. Critics suggest this policy has prevented natural inflation and unfairly bolstered Chinese exports to the United States. Senator Charles Schumer (D-NY), the chief sponsor of currency legislation in the Senate, has vowed to seek a vote on his bill in the lame-duck session. In addition, Finance Committee Chairman Baucus and retiring Banking Committee Chairman Dodd have also indicated that legislative action may be necessary. Nonetheless, we do not expect the legislation to be adopted in the lame duck session.

Although the Obama Administration has sought to encourage China, through diplomatic measures, to revalue the yuan, Treasury Secretary Geithner has taken a more assertive tone on the issue as the Administration works to build multilateral support to address China’s exchange rate policy. Although China announced in June plans to allow its currency to appreciate, and measured appreciation has occurred since, critics in Congress argue this move is too little and too late. The issue will likely top President Obama’s agenda at the upcoming Strategic and Economic Dialogue (S&ED) and G-20 meetings.

**Indigenous Innovation.** Although a growing number of Members have expressed frustration at what they call protectionist measures by China to limit the importation of foreign technology, we do not expect an emphatic call for legislative action on this issue. Critics suggest that China has implemented unfair licensing and technical requirements designed to favor domestically-manufactured goods. Congress has considered a legislative response, including the proposal of Senator Debbie Stabenow (D-MI) to exclude Chinese-origin products from U.S. government procurement programs, but most analysts agree that legislative measures ultimately would prove superfluous or ineffective, as well as disruptive to U.S.-Sino relations. However, the issue will remain the subject of several bilateral discussions, as well as referenced in Congressional hearings.

**Strategic and Economic Dialogue (“S&ED”).** President Obama will continue to pursue the S&ED he initiated with Chinese President Hu Jintao in 2009. During the S&ED’s second round in Beijing in 2010, both leaders agreed to work together to promote mutually beneficial trade and economic development. President Obama will attempt to persuade Congress that these talks present the best option for resolving U.S. concerns with Chinese policies, but many Members remain skeptical. In advance of the next round of talks, scheduled for 2011 in Washington, look for the 112<sup>th</sup> Congress to pressure the Administration to supplement its China policy with additional steps.

*Other Important Issues*

**Russia’s WTO Bid.** Seventeen years after it first applied, Russia will likely accede to the World Trade Organization (WTO) in the near future. Russia has accomplished critical steps in the past few years, including the completion of bilateral agreements with the United States, the European Union, and other WTO members. Furthermore, Russian President Dmitry Medvedev has seemingly convinced Prime Minister Vladimir Putin to support an active Russian effort to achieve WTO membership, and most U.S. politicians no longer oppose Russia’s entry. Presidents Obama and Medvedev both previously expressed a desire for Russia to join the WTO by the close of 2010, but Russian accession in 2011 looks more likely.

In order for the United States to benefit fully from Russian membership in the WTO, Congress would need to repeal the Cold War-era Jackson-Vanik law, which currently blocks normal trade relations with Russia. The legislation was intended to curtail the then-Soviet Union’s reluctance to allow Jewish citizens to emigrate to Israel in the 1970s, but it has remained in place as U.S.-Russian relations have ebbed and flowed in succeeding decades.

**Brazil-United States Cotton Dispute.** The 112<sup>th</sup> Congress will need to address the implications of the Brazil-United States cotton dispute when drafting the 2012 Farm Bill (discussed further in the Agriculture Policy section of our analysis). In 2004, a WTO dispute settlement panel authorized Brazil to impose \$830 million in retaliatory sanctions against certain features of the U.S. cotton program. Before these sanctions went into effect, however, the two countries negotiated an agreement suspending sanctions until Congressional approval of the next Farm Bill. In the interim, the United States will pay Brazilian farmers \$147.3 million per year. Congress will need to remain sensitive to the terms of this arrangement while drafting the Farm Bill, as Brazil has reserved the right to change course and impose sanctions.

**Doha Round.** Hopes for a revival of the WTO’s Doha Development Agenda, which broke down in 2008, diminished somewhat after the G-20’s June meeting failed to set a timeline to resurrect the talks. President Obama, however, recently identified resurrecting the Doha Round as a key element of his initiative to double U.S. exports. Key trade policymakers in Congress will likely call for further leadership from President Obama to revive and improve the Doha negotiations. Significant progress on this front will also require leadership from leading trade nations such as Japan, China, India, Brazil and the European Union.

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## Transportation and Infrastructure

The 112<sup>th</sup> Congress will continue to grapple with the reauthorization of the nation's aviation and surface transportation programs. Both authorizations have expired and have been extended multiple times, with Congress previously unable to resolve key questions, including fundamental issues of system finance. At the same time, the nation's infrastructure is in a critical state. Existing infrastructure continues to age, and new infrastructure and systems are needed to maintain mobility and competitiveness into the next generation.

There are many ways in which Republican control of the House may increase the chances for both reauthorizations to pass. For aviation, most key differences between the House and Senate in the 111<sup>th</sup> Congress will now be off the table. With surface transportation, a Republican House is likely to tailor a bill to available revenues, and prioritize investment accordingly--although several material differences will have to be worked out with the Administration over funding levels and the President's vision for a national infrastructure bank and his livability and sustainability agenda.

While there are many congressional committees with jurisdiction over transportation and infrastructure programs and funding, the major program authorizing committees are House Transportation and Infrastructure; Senate Environment and Public Works; Senate Commerce, Science and Transportation; and Senate Banking, Housing and Urban Affairs.

Representative John Mica (R-FL) is widely expected to serve as Chairman of the House Transportation and Infrastructure Committee. With Chairman Oberstar (D-MN) having lost his reelection bid, the committee will have a new Ranking Member and the industry will have lost the support of a public servant who has led the committee with distinction. Senator Boxer will continue to chair the Senate Environment and Public Works Committee, with Senator Inhofe staying on as Ranking Member. On Senate Banking, Senator Johnson is in line to become chairman with the retirement of Senator Dodd, and Richard Shelby (R-AL) will return as Ranking Member. For Senate Commerce, Senator Rockefeller will remain chairman and Senator Hutchison will remain the Ranking Member, while Senator Inouye is expected to chair the Aviation Subcommittee with Senator Byron Dorgan's retirement.

### *Aviation*

Congress has yet to reauthorize the Federal Aviation Administration (FAA) programs, including the Air Traffic Control System (ATC), the Airport Improvement Program (AIP), the Research, Engineering, and Development (RED) Program, and the Facilities and Equipment (F&E) Program. The last multiyear bill expired September 30, 2007. Unable to agree on a new bill, Congress has enacted 16 short-term extensions. The current extension expires December 31, 2010.

The House and Senate passed separate reauthorization bills (both H.R. 1586). The Tennessee Senators promised to filibuster the appointment of conferees unless the House agreed to drop a provision making it easier for the Teamsters to organize Federal Express, by moving FedEx ground workers from coverage under the Railway Labor Act to the National Labor Relations Act. The House and Senate negotiated outside of a conference structure and, by all reports, reached agreement on all but a handful of issues. However, Senators were unable to reach consensus on



whether to increase the maximum Passenger Facility Charge (PFC) and whether to authorize additional non-stop flights to and from Reagan National Airport beyond the 1,250 mile perimeter.

The House bill increases the maximum PFC from \$4.50 to \$7.00 (concomitantly making large hub airports ineligible to receive AIP formula funds), while the Senate-passed bill contains no increase. Senate negotiators floated an increase to \$5.50. The House bill adds ten slots (five roundtrips) beyond-perimeter at Reagan National (removing ten inside-perimeter slots at non-peak hours), giving priority to new entrant and limited incumbent carriers. The Senate entertained multiple floor amendments to add beyond-perimeter slots, but ultimately did not include any increase in the bill it passed. A proposal pushed by a bipartisan block of Western Senators would adopt the House provision and raise the ante by allowing airlines to exchange up to 32 inside the perimeter (16 roundtrips) slots to or from a large hub airport for slots anywhere outside the perimeter. While this exchange would result in no net additional operations, the Virginia Senators objected, claiming larger and heavier jets required for long-haul flights would mean more noise and emissions, while the Metropolitan Washington Airports Authority (MWAA) complained that the terminals at Reagan National were not equipped to handle the projected increase in passengers.

A major impetus to move a bill--pilot safety requirements in response to the February 2009 Colgan Air accident--was removed from H.R. 1586 and included in the 15<sup>th</sup> short-term extension. Relatives of the 50 passengers who died had pushed for pilot safety improvements and gave urgency to enacting an FAA reauthorization bill. Once these provisions were enacted separately from the multiyear reauthorization bill, that impetus was gone. A multiyear reauthorization bill could be enacted during the lame duck if Senators agree on a PFC increase and an increase in Reagan National slots, and if the House is willing to drop the FedEx provision. These are big "ifs" and, given other legislative priorities, there may not be enough time or focus to get this bill through. In that case, Congress will need to pass its 17<sup>th</sup> extension of FAA programs before the end of the year.

Thus, it is likely that reauthorization legislation will have to be re-introduced in the new Congress. A threshold question is whether the Administration will submit a proposal next year. Chairman Rockefeller drafted his reauthorization bill as a two-year reauthorization to allow the Administration to submit a proposal. If Congress were to pass a bill during the lame duck session, FAA programs would expire September 30, 2011 under the Senate bill and September 30, 2012 under the House bill, so a new bill will need to be considered sometime in the new Congress.

Representative Mica is expected to introduce a bill early in the Session without the FedEx provision or a provision mandating binding arbitration in FAA-air traffic controller collective bargaining negotiations. He may also drop a provision in the current bill requiring the FAA to adopt regulations governing aircraft rescue and fire fighting equipment and response time, opposed by airports and regarded by FAA as unnecessary, and a provision requiring grants of antitrust immunity to international code sharing agreements to be sunset within three years, subject to renewal, perhaps under stricter standards. In short, the House bill is likely to look more like the Senate version of H.R. 1586. The Senate bill will probably be similar to the bill that passed 93-0 earlier this year. Senate leaders intentionally kept the most controversial House provisions out of its bill to ensure passage. Some increase in beyond-perimeter slots at Reagan National will likely be included, as Chairman Rockefeller clearly was not persuaded by MWAA testimony at a September hearing. Without the labor-friendly provisions, compromise with the House should not prove as difficult.

Some PFC increase is more likely than not. Given the pressure to reduce spending, AIP funding may suffer a significant reduction, leaving commercial service airports more dependent on PFC revenue. The prospects for an expansion of the Airport Privatization Program are likely to improve with a Republican House, especially in the wake of a reduction in AIP funding. The current program is limited to five airports (at least one must be a general aviation airport and no more than one large hub airport).

The major focus in the 112<sup>th</sup> Congress will be on the FAA's transition to the Next Generation Air Transportation System (NextGen), which will modernize the Air Traffic Control System by moving ATC to a satellite-based system, eventually giving pilots the same real time information in the cockpit as controllers will have in the tower. NextGen includes many technically complex and costly components, which have great potential for capacity and efficiency increases, as well as significant reductions in fuel costs and aviation's environmental footprint. Equipping all aircraft, including business and general aviation aircraft, with Automated Dependent Surveillance-Broadcast (ADS-B) technology is the main challenge. While ADS-B Out, which broadcasts data from the cockpit to the ground, has been developed and is available, ADS-B In, which broadcasts data from the ground (and other aircraft) to aircraft, is still under development. Full industry equipage is expected to take many years, even decades.

The current reauthorization bills include several NextGen provisions. The new Congress will need to focus on ensuring NextGen proceeds on course. The twin policy questions are how best to ensure equipage of all aircraft within the next 15-25 years and how NextGen improvements can begin to bear fruit in the intermediate years. The FAA is considering operational incentives, such as giving priority to aircraft with NextGen equipment (Best-Equipped, Best-Served). Congress will need to consider financial incentives. Should Congress provide grants, loans, or loan guarantees? (A Senate proposal to the House reauthorization negotiators in July would provide \$750M in loan guarantees.) Should these incentives be extended to all commercial operators as well as business and general aviation? Should the Federal Aviation Act be amended to allow AIP grant funds to be used for airspace procedures (*i.e.*, RNAV and RNP) that provide significant benefits in the airspace around major airports, because these airspace procedures are the airport infrastructure improvements for the future? Should an airport be permitted to use airport revenue to fund these improvements and to incentivize equipage on aircraft that operate to and from that airport? President Obama's recent \$50 billion infrastructure proposal identified NextGen modernization as a priority. If the 112<sup>th</sup> Congress establishes an Infrastructure Investment Bank, the aviation community will push hard to make NextGen equipment and technology eligible for grants or loans. The FAA is currently studying what flexibility there is in current law and what changes in the law ought to be considered. Depending on the timing of the FAA's report, and a possible proposal from the Administration, the reauthorization bills may include additional NextGen provisions.

The Department of Transportation (DOT) will soon complete its second phase of passenger rights rulemaking. Both versions of H.R. 1586 contain similar provisions. Because they did not generate partisan controversy, and to a large extent have been dealt with by DOT, they may be included in the 112<sup>th</sup> Congress's reauthorization bills. The open question is whether Congress will address ancillary fees, such as charges for checked baggage and additional legroom, which generate billions in revenue for the airlines. Ancillary fees raise two questions. The first is disclosure. In hearings earlier this year the airlines were castigated for inadequate disclosure to the public. DOT's rulemaking includes a disclosure provision, as does the Senate bill. The second issue is whether ancillary fees contribute to a decline in ticket tax revenue, which goes into the Airport and Airway

Trust Fund, which in turn funds FAA programs and a portion of the FAA's operating budget. Ancillary fees are not part of the ticket price that is subject to the 7.5% ticket tax. In baggage fees alone, GAO estimates a loss of \$186 million in Trust Fund revenue.

There has been little discussion in Congress on changing Trust Fund taxes. This was the major issue when the reauthorization debate began in 2006. However, the House never seriously entertained a user fee on non-commercial aviation and the Senate ultimately dropped a proposal to impose a \$25 per operation charge. Neither bill in the current Congress includes a user fee on business or general aviation. Both bills increase fuel taxes. The Administration's budget proposal last year hinted that user fee revenue would be imposed in FY 2012, but they never submitted a legislative proposal. It is doubtful the 112<sup>th</sup> Congress will seek to make major changes to the Trust Fund.

The airline sector has consolidated in recent years, with more consolidation expected in the foreseeable future. A change in an antitrust policy was widely expected when the Justice Department Antitrust Division changed hands in 2009, but no change in the Department's review of airline mergers (or international code sharing agreements) has been apparent. With the Republican takeover of the House, it is not likely that we will see Representative Mica pushing any measure to re-regulate the airline industry (with the exception of passenger rights).

The EU and the International Civil Aviation Organization (ICAO)'s efforts to reduce aircraft greenhouse gas emissions may generate congressional interest. The EU intends by 2012 to include all aircraft operations to and from the EU within its Emissions Trading System (ETS). ICAO announced just 3 weeks ago a resolution to reduce carbon emissions by (1) improving fuel efficiency by 2% each year through 2050; (2) collectively achieving a capping of carbon emissions from 2020; and (3) setting an aircraft engine CO<sub>2</sub> standard by 2013. ICAO committed to adopt a global framework by 2013 based on several principles, including minimizing market distortions, safeguarding the fair treatment of aviation relative to other sectors, ensuring that aviation emissions are not double-counted, and recognizing the past efforts of airlines. The EU remains in discussions with the US about its plans to charge airlines with all the emissions from an international flight, including emissions outside of EU airspace. US airlines and aircraft manufacturers are likely to seek Congressional help, depending on developments at the EU and ICAO.

### *Surface Transportation*

The 112<sup>th</sup> Congress will grapple with the reauthorization of federal surface transportation programs at a critical juncture for federal transportation policy and the nation's transportation system. The current authorization, the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU), expired on September 30, 2009. It has been temporarily extended five times, with the current extension expiring on December 31, 2010.

The fundamental barrier to enacting a multi-year reauthorization remains the question of how to pay for it. Revenues--primarily gas taxes paid into the Highway Trust Fund--continue to decline as automobiles become more fuel efficient and more drivers switch to hybrids and to all-electric vehicles. The gas tax, which Congress has not increased since 1993, has become insufficient to sustain the program at even currently authorized levels. Since 2008, Congress has been forced to transfer \$34.5 billion from the general fund to the Highway Trust Fund to maintain its solvency.

Efforts to reauthorize SAFETEA-LU during the 111<sup>th</sup> Congress stalled due to the lack of consensus on how to finance a long-term bill, with an estimated \$65.5 billion in new revenue needed simply to maintain existing investment levels. In June 2009, Chairman Oberstar released a six year, \$500 billion measure intended to significantly increase federal investment above current baselines while reforming and overhauling the current system. The Oberstar bill offered the House Democratic blueprint for investing in--and reforming--the nation's transportation system for the 21<sup>st</sup> century. The \$500 billion figure was described as the minimum amount needed to maintain the existing system and to begin making improvements for long-term mobility and economic competitiveness. Major policy themes included program consolidation, performance standards, intermodalism, environmental sustainability and a new commitment to high speed rail.

The Oberstar bill devoted significant focus to issues of urban congestion and livability, creating a metropolitan mobility program that provides direct funding and increased decision-making authority for Metropolitan Planning Organizations; and a new Office of Livability to support the integration of transportation and housing decisions to promote smart growth and sustainable commuting patterns. It also set forth a vision for the use and oversight of tolling and public private partnerships. The bill eliminates the current pilot programs for tolling the Interstate, but provides metropolitan regions flexibility to implement variable tolling as part of an approved metropolitan mobility plan. The bill also increases federal oversight of toll agreements and creates new requirements for public private partnership agreements. It establishes a number of offices to achieve its policy objectives, including an Office of Public Benefit to review and approve tolling and public partnership agreements and Office of Expedited Project Delivery to speed project approvals.

With broad opposition to an increase in the gas tax and no consensus on alternative financing options, the Obama Administration and Senate met Chairman Oberstar's proposal with a call for an extension of current law until the 112<sup>th</sup> Congress. In September 2010, President Obama for the first time called for action on a six-year reauthorization bill and asked Congress to provide \$50 billion in immediate funding as a down-payment on a long-term measure. The President proposed paying for the \$50 billion package by ending tax breaks for oil and gas companies and has also said that the long-term bill will be fully paid for, but has not proposed a financing mechanism.

While the Administration has not released a detailed reauthorization proposal, the President outlined a general policy framework based on four major reforms: (1) creating an Infrastructure Bank; (2) integrating high speed rail into the surface transportation program; (3) consolidating federal programs; and (4) expanding investments in areas like safety, environmental sustainability, economic competitiveness, and livability. The President also called for moving away from the formula and earmark debates to focus more on competition and innovation. The Administration's proposal for an Infrastructure Bank appears the main engine in achieving this--and Administration officials have emphasized that it is intended as a complement, and not a substitute, to the regular formula programs. The bank would select projects through performance-based analysis and work across modes, following the model set with the TIGER discretionary grant program. The Administration has indicated it will release its reauthorization proposal with the President's Fiscal Year 2012 budget request.

The 112<sup>th</sup> Congress will face significant pressure to enact a reauthorization bill. The President appears focused on the issue. The period between the seating of the new Congress and the beginning of the 2012 Presidential election cycle offers a window for action. Once the next election cycle begins, it will become increasingly unlikely that a major piece of legislation will be enacted.

Ranking Member Mica has suggested that a bill must be completed before August 2011 to fall into this window. Without a reauthorization bill, state and local authorities will continue to face uncertainty as to funding levels and difficulty in planning future investments, in particular the large, long-term projects that are of greatest significance to the national system. Needed investments in existing and new infrastructure will be deferred, along with structural reforms to the program.

In order to enact a bill, the Administration and Congress will have to decide whether and how to raise additional revenue and what the federal program will look like under various revenue constraints. Several proposals to address basic system revenues have been floated. Representative Pete DeFazio (R-OR), Chairman of the Subcommittee on Highways and Transit, has suggested imposing a per-barrel fee on crude oil and imported gasoline, or instituting a transaction tax on speculative trading of crude oil futures, which has raised concerns of departing from the user fee principle embodied in the gas tax. Chairman Oberstar has discussed issuing Treasury bonds to finance increased funding, to be repaid from subsequent gas tax receipts. It is also possible that the National Commission on Fiscal Responsibility and Reform will address transportation finance if it is able to reach agreement, particularly if the Commission recommends a gas tax increase that is used for deficit reduction.

A recent proposal receiving increasing attention from the American Association State Highway and Transportation Officials (AASHTO) and others is to convert the fixed per-gallon gas tax to a percentage sales tax. Ranking Member Mica floated this concept in August 2010, stating that it would be intended to “stabilize revenue” and would not represent a tax increase. In the first year, the percentage sales tax would be set to yield no net increase in revenue. However, if gas prices increase as projected, AASHTO estimates this change could raise \$43 billion over six years.

There is broad agreement that, under any scenario, basic system revenues will need to be supplemented and leveraged by an array of innovative financing tools. There is strong, bipartisan support for expanding credit assistance under the Transportation Infrastructure Innovation and Finance Act (TIFIA). Public-private partnerships and a National Infrastructure Bank are also receiving increased attention as a means to leverage state and local funds and bring additional private investment into the system. At the same time, the impact of these financing mechanisms is tied to underlying substantive policy decisions, such as ability to toll federal-aid highways and the associated regulatory requirements; or how the Federal Transit Administration’s New Starts program accommodates public private partnerships.

Under Republican leadership, the House is likely to tailor the program to fit available revenues and focus on prioritizing federal investment within that revenue constraint. There will be a focus on the core elements (both highways and transit) of the nation’s transportation system--those with clear and long-standing federal interest. Livability and sustainability are not likely to be part of this vision and will be left up to state and local governments. Urban issues, including congestion, will remain a core focus but are likely to be dealt with by allowing more innovative financing, including congestion pricing and tolling to manage traffic more efficiently, rather than through efforts to redesign communities. There will be strong emphasis on expanding TIFIA and greater acceptance of private solutions and the use of public private partnerships, perhaps with increased oversight, but likely without creating an Office of Public Benefit to oversee and administer tolling and public private partnership agreements. There will also be strong emphasis on expediting the project approval and permitting process through regulatory streamlining.



There are several respects in which this agenda appears to align with the Senate's priorities. It is less of an urban agenda than under a Democratic House, which fits the character of the Senate where rural states have more influence. The Republican House will also be more amenable to public-private partnerships, tolls, and other types of innovative financing. Both Republicans and Democrats on the Senate Environment and Public Works Committee have been supportive of these innovative finance measures. While none of the committees of jurisdiction have yet to produce a draft bill, the Senate has historically used the Administration's proposal as its base bill.

Several differences with the Administration will have to be resolved. Administration officials have called for a bill to be funded above current baselines. As the President remains opposed to a gas tax increase, there are those who are concerned that the Administration may consider new financing models that break from the gas tax user charge concept underlying the Highway Trust Fund. Congressional hearings have also revealed mixed support for a National Infrastructure Bank. There is a view that existing programs such as TIFIA can be expanded to achieve the same goal. There are also those who are concerned that a bank and other competitive programs will result in more project funding decisions concentrated in the Administration. The President also has made livability and sustainability investments a priority and has called for high speed rail to be authorized "on equal footing" with the rest of the surface transportation program.

Ultimately, having a Republican House and Democratic Senate may well be the best scenario for enacting a bill during the 112<sup>th</sup> Congress. There is an expectation that each of the sides will have different priorities and that compromise is necessary--but there is also more common ground on core issues. Another possibility is that Congress considers a shorter bill, such as a two or three year authorization, should it be more manageable under these circumstances and revenue constraints. Ranking Member Mica has affirmed that he is committed to moving a six-year reauthorization bill. However, he has also cautioned that the 112<sup>th</sup> Congress will be among the most conservative in history--elected on the backs of voter discontent with government spending.

Debate on these issues may begin during the lame duck session. President Obama has indicated the Administration will continue to press for action on the \$50 billion in proposed upfront investment, although there are substantial challenges to that proposal. In any event, Congress will at least have to take up and extend the current authorization before it expires again at the end of the calendar year.

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To be continued . . .