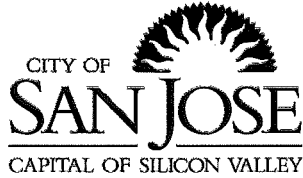


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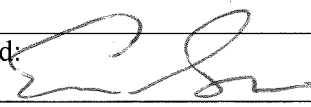
Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Betsy Shotwell

SUBJECT: SEE BELOW

DATE: November 7, 2012

Approved:  Date: 11/7/12

SUBJECT: PATTON BOGGS 2012 POST-ELECTION ANALYSIS: "A NARROWLY DIVIDED ELECTORATE HAS SPOKEN – HOW WILL THE PRESIDENT AND THE CONGRESS RESPOND?"

INFORMATION

The City's federal lobbyist firm of Patton Boggs, LLP, has provided the attached analysis of the 2012 Presidential and Congressional elections. It previews the upcoming lame duck session, to begin the week of November 12, and whether it will lead to an agreement to avert across the board budget cuts ("sequestration") and clear the way for comprehensive tax reform. The report includes an analysis of what issues may dominate the nation's political agenda for the next two-years beginning, January 2, 2013 when the 113th Congress convenes, and how it may affect local governments. The entire report is at: <http://www.pattonboggs.com/2012postelectionanalysis/>

This information and analysis will assist the City as we carry forward San Jose's 2013 Federal Legislative Priorities and develop strategies to work effectively with the Administration and the 113th Congress.

BETSY SHOTWELL
Director, Intergovernmental Relations

Attachment:

Patton Boggs' post-election analysis: "A Narrowly Divided Electorate has spoken – How will the President and the Congress respond?"

2012 POST-ELECTION ANALYSIS

A NARROWLY DIVIDED ELECTORATE HAS SPOKEN

HOW WILL THE PRESIDENT AND THE CONGRESS RESPOND?

NOVEMBER 7, 2012

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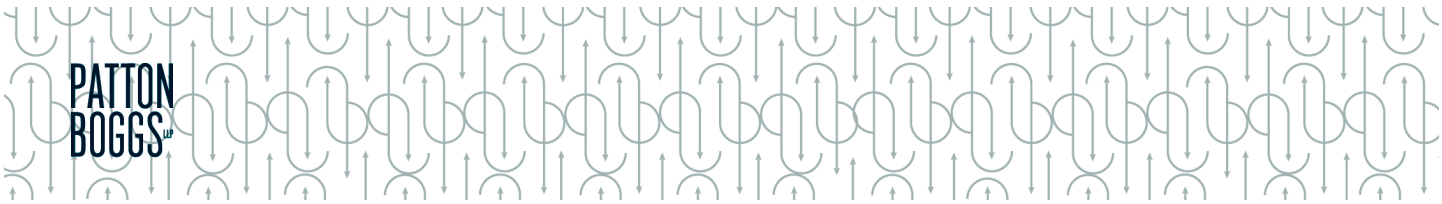


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INTRODUCTION

With President Barack Obama having been reelected and the Senate and the House having stayed in Democratic and Republican hands, respectively, attention now will turn to the lame duck session that will formally get underway the week of November 12 but won't likely get down to business until the week of November 26. Based on past experience, we expect to hear sleigh bells before the 112th Congress leaves town. Since so much that will happen next year will be driven by what happens in the next two months, we principally focus this introduction on the challenges facing the President and the Congress in the lame duck session.

To put matters in perspective: Unless current law is amended, all of the Bush tax cuts will expire at the end of the year, as will various other temporary tax provisions (e.g., AMT relief for middle class Americans, extension of estate tax relief, and a variety of tax credits that are enjoyed by individuals, as well as the R&D tax credit and a host of other tax credits relied upon by the business community, some of which need to be extended retroactively to the beginning of 2012). Congress and the Administration also must decide how to protect physicians serving Medicare patients from sustaining steep cuts in reimbursement rates and whether to extend enhanced unemployment insurance for the long-term unemployed. In addition, decisions need to be made whether to extend, replace, or allow to lapse the two percentage point payroll tax cut for all working Americans. Finally, \$109 billion in across-the-board spending cuts ("sequestration") mandated by the Budget Control Act of 2011 will begin to kick in on January 2. Half of the automatic spending cuts will hit the Pentagon, while the other half will reduce spending by the rest of the government, with most agencies facing funding cuts of 8.2%. In popular parlance, the United States will fall off a fiscal cliff with potentially no safety net in place unless the President and the Congress agree to amend current law.

Recognizing the dangers to the economy, the Administration reportedly is analyzing the extent to which it could use existing authority to buy additional time to reach an agreement with Congress early next year, such as by freezing the amount of money taken out of payroll checks by not updating tax withholding tables to reflect expiration of the Bush tax cuts on December 31. The Administration also could seek to delay to later in the year automatic spending cuts that otherwise would begin on January 2. We do not expect the Administration to make its plans public any time soon, not least because identifying an escape hatch early could create the very outcome it hopes to avoid. And, in any event, it doesn't have to come to this.

A great deal was accomplished in the lame duck session of 2010, in large part because Democrats and Republicans agreed to compromise. Both sides recognized that the economy needed a boost and that, by working together, they could resolve issues that until then had eluded resolution. In that environment, the President agreed to extend all the Bush tax cuts, as well as to extend other expiring or expired tax provisions, such as AMT relief. He also succeeded in pushing a major arms control treaty through the Senate. We expect a comparable effort this time as well, though the details on the tax policy side will likely be subject to intense negotiations, particularly on whether to limit extension of the Bush tax cuts to a particular income threshold.

To date, Congress has been unable and unwilling to agree to do anything, in part because of intransigence by both parties over whether to impose an income limit on an extension of the Bush tax cuts and in part because the "cost" of extending current law has been well beyond what Congress has been willing to "pay." As one example, a two-year extension of an AMT patch for middle-class families plus routine extension of expired and expiring tax provisions would cost \$205 billion. In addition, delaying sequestration for an additional year would require \$109 billion in new revenues or cuts to non-targeted programs (unless, of course, Congress punted by forcing nine years of cuts into eight, increasing the pain in future years).

Over the last year, there has been bipartisan agreement that the fiscal cliff must be avoided and that a comprehensive overhaul of our tax code is necessary. Nonetheless, the parties have fundamentally disagreed about how to approach these issues, with President Obama and Congressional Democrats arguing for significant tax increases as a means of deficit reduction and Governor Romney and Congressional Republicans rejecting the idea that any direct tax increases are necessary, preferring that any new revenue come from assumed economic growth once tax reform is enacted.

The result has been a continued legislative stalemate, with a heavy dose of political posturing by both sides. But even close elections can be clarifying. A narrowly divided electorate now having spoken, we expect discussions to begin anew with some urgency in the lame duck session. Given major philosophical differences on tax policy issues between the parties, it remains to be seen whether these discussions will lead to an agreement to avert the fiscal cliff while, at the same time, clearing the way for comprehensive tax reform. In our view, it is likely both will occur in the lame duck session (or shortly thereafter), beginning with agreement on a Bush tax cut extension coupled with a broad framework for a tax reform agreement, with the hard work of tax reform to span across 2013. Although there are a range of possible outcomes in the lame duck session and beyond, one thing is certain: in stark contrast to the last year, over the next few months we will finally see the parties undertake a serious discussion about tax policy.

In the lame duck session, for example, Congress might agree to legislation that would extend all (or most) expired and expiring tax breaks for six months to a year, tied to fundamental tax reform generating some agreed-upon amount in the hundreds of billions of dollars (or more) in overall deficit reduction over the next decade, with the threat of greater deficit reduction if the 113th Congress were to fail to act by then. Democrats will likely raise eliminating or modifying some tax measures, including those aimed at the oil and gas industry, to help offset the cost of forestalling the spending sequester or to make a "down payment" on future deficit reduction. Such an agreement also could mandate some further level of deficit reduction by seeking to compel the 113th Congress to reform entitlement programs such as Medicare and Medicaid next year.

Forcing hard decisions as a means of achieving deficit reduction of course is what the Budget Control Act of 2011 was supposed to accomplish by establishing the "Super Committee" and creating the threat of sequestration next year if Congress failed to agree to legislation reducing the deficit by at least \$1.2 trillion over a decade. And it is precisely that failure that has the nation confronting the fiscal cliff. Many Senators and Representatives recognize the irony that the best way to prevent going over the fiscal cliff this year is to cut a

deal that merely creates a bigger cliff that would arrive in another six or twelve months. But doing so would at least keep us at the precipice.

With the elections behind them, the President and the 112th Congress have an opportunity to succeed where they have failed before. Assuming Congress is willing to support legislation putting off the day of reckoning for an additional six months to a year, we expect the President to ask for an increase in the debt ceiling as part of the final negotiations. (As a result of increased tax receipts, the Treasury Department now anticipates that the debt ceiling will not be reached until early in the first quarter, with action to address the problem probably necessary by late February or early March.) Whether the President can secure congressional support for an increase by the end of the year will be a matter to be negotiated and ultimately will depend on the magnitude of whatever deal is reached. The President will not want to ask Congress to increase the debt ceiling early next year in a situation in which House Republicans would be in a very strong position to extract additional concessions without having to give up something meaningful. For them, the trade off in the lame duck session might be a one-year extension of the Bush tax cuts, including for married couples making more than \$250,000, tied to an agreement to pursue fundamental tax and entitlement reform next year. Even that might be a stretch. Given the election results, Congressional Republicans may have to accept an income limitation for any Bush tax cut extension, if not at \$250,000 then at \$500,000 or \$1,000,000.

What else beyond addressing the fiscal cliff can we expect Congress to accomplish during the lame duck session? Unfortunately, not much. Majority Leader Harry Reid (D-NV) intends to bring some form of cybersecurity legislation to the Senate floor, but we have our doubts that a bill can get through two houses and to the President by the end of the year. The leadership of the Armed Services Committees will endeavor to move a defense authorization bill that would not be subject to contentious amendments on the floor. Beyond that, a backlog of noncontroversial bills has been building for a long time, but most if not all of them will have to move in the Senate by Unanimous Consent.

When it adjourned for the elections, the 112th Congress had approved only 196 bills that were enacted into law, well below the output of the 104th Congress, which produced legislation resulting in 333 public laws. Along with many others, we will be pressing to get things done in an environment we hope will be more hospitable to legislating than the first 22 months of the 112th Congress.

In our State of the Union Analysis this past January, we pointed out that "[t]he first session of the 112th Congress is likely to be remembered as one of the least productive in decades." When the President signed the National Defense Authorization Act for FY 2012 on New Year's Eve, it became Public Law No. 112-81. Having fallen seven short of the 88 bills enacted in 1995, the first session of the 112th Congress produced the fewest number of public laws since Congress formally began keeping track in 1947. With a flurry of signatures on January 3, however, the President helped this Congress eke out of last place with a total of 90 bills signed into law in the first session. Having barely picked up the pace since then, the 112th Congress is now on track to be the least productive ever as measured by bills enacted into law. Congressional Republicans would argue that the slow pace of legislation is the natural and desired result of divided government. But the public's record low approval

rates for this Congress no doubt reflect the perception that partisan activity has prevented necessary legislation from becoming law.

What else can we expect in the next few months? With the President having won re-election, we anticipate that many major rules will soon be published in final form, which will likely trigger a political reaction on Capitol Hill as Republicans invoke the Congressional Review Act in an effort to block them from becoming law. The EPA, for example, has many major rules on track to become final later this year or early next year. In addition, dozens of rules required under the Dodd-Frank Act are in the works. Finally, the President's re-election puts his Administration in a commanding position to finalize numerous rules that solidify the regulatory framework for implementing the Affordable Care Act. Republican efforts to invoke the Congressional Review Act later this year and next year are unlikely to succeed in the Democratic-controlled Senate. Even if one or more do, a certain Presidential veto virtually ensures forthcoming rules will stand unless struck down by the courts.

In its next term, the Administration is likely to face high Cabinet turnover, beginning early in 2013, not least because so many senior officials have been in position so long. (Turnover to date has been historically low for the post-World War II era.) In addition to moving forward with his regulatory agenda, the President may be able to effectuate long-lasting policy changes through Supreme Court and lower-court appointments as well. Four Supreme Court Justices, for example, are in their mid to late 70s and could opt to retire prior to the end of the President's second term.

On Capitol Hill, there will be a great deal of turnover, in particular among Republicans currently serving in committee leadership positions. This will provide the Administration with an opportunity to forge some new relationships in the 113th Congress. In the Senate, Republican caucus rules limit time served as a Ranking Member to six years (and time served as a Chairman to an additional six years). While most current Ranking Members have time left to serve as chairmen, many of them are completing their sixth year as the Ranking Member, which will lead to a significant reshuffling of the decks for the 113th Congress.

As a result of House Republican Caucus term limit rules, we expect to see as well a great deal of turnover among Republicans chairing House committees. In fact, of the Members who are completing six years of service, House Budget Committee Chairman Paul Ryan might be the only Member to secure a waiver to serve an additional two-year term.

Except for changes triggered by retirements, all Senate Democratic Chairmen will maintain their gavels in the new Congress since they are not subject to term limit rules. Only the Budget Committee, the Energy and Natural Resources Committee, the Homeland Security and Governmental Affairs Committee, and the Veterans' Affairs Committee will likely have new leaders. Among House Democrats, there will be a similar level of continuity, with little turnover among Members serving as Ranking Members.

With the balance of this analysis, we offer our thoughts on major policy areas that will drive the agenda in Washington for the next two years and thus how potential developments might affect you. Given the still narrow margin enjoyed by Senate Democrats, not much will get through the Senate unless each party commits to putting aside partisan differences to get

something done on the deficit, fundamental tax reform, and a host of other pressing national issues. Under Republican control, the House leadership will be in a strong position to move whatever their membership supports. But bills written with only the interests of one party in mind stand virtually no chance of moving in the Senate, as House Republicans have seen over and over again in the 112th Congress.

Ironically, the voters have elected a 113th Congress that may be even more partisan than the 112th Congress, at least on paper. Both chambers will have a substantial number of new Members, in part because of redistricting and because so many Senators and House Members have thrown in the towel over their dismay that so little gets done anymore. (The House, for example, had 62 Districts in which an incumbent was not on the ballot.) By casting their votes, we have a sense the public wants the 113th Congress to get something done, to address the big issues that confront the country, and to do so working together.

Now that the voters have spoken, will the 113th Congress keep in mind Thomas Jefferson's advice and make more of an effort to cross ideological divides, compromise, and solve the major policy challenges that confront our nation? As Jefferson recognized, major policy changes demand broad support to be successful. Addressing the deficit, for example, is too important and too big an issue for one party to hope to dictate the outcome to the other. We thus remain optimistic that the President and the Congress will work together in the lame duck session and establish the framework by which they can continue to work together next year.

In the pages that follow, we sketch out our sense of what is in store in the areas of agriculture policy, budget and sequestration, defense and national security, education, energy and environmental policy, financial services, food and drug policy, foreign investment in the United States, government contracts, health care, homeland security, Native American affairs, tax policy, technology and telecommunications policy, trade policy, and transportation and infrastructure policy.

Among the big issues likely to be addressed by the President and the 113th Congress is one we think worth mentioning here: immigration reform. There is broad support in the business community for Congress to finally address the issue. Leaders of the high-tech community, for example, have been calling on Congress for years to adopt legislation that would help them attract skilled engineers and software programmers, especially those who have graduated with advanced degrees from American universities and then are forced to return to their home countries. Moreover, the demographics of the voting population is changing so dramatically that neither party can risk failing to address the issue before the next Presidential election. In an interview with the Des Moines Register last month, the President signaled that he wants to take up the issue once the deficit has been addressed. He made the case for reform on both substantive and political grounds, saying in part: "I am fairly confident that [Republicans] are going to have a deep interest in getting that done." As part of this effort, we expect there to be a renewed focus on the DREAM Act, which removes certain barriers to access for undocumented children who wish to attend college. Senator Marco Rubio (R-FL), who has expressed great interest in crafting a compromise, may lead the Republican effort, possibly joined by two incoming Republican Senators from Southwest border states—Ted Cruz of Texas and Jeff Flake of Arizona. As in addressing the deficit and

fundamental tax reform, both parties will need to compromise to get something meaningful done. A policy change of this magnitude simply cannot be forced on a slender majority.