Election 2016 and its impact on energy policy
October 2016
November will bring change to Washington, DC and across the United States. What will it mean for companies in the energy industry?

Energy companies in the three major sectors – oil and gas, power and utilities, and mining and metals – have experienced tremendous upheaval over the past several years. Rapidly changing dynamics in supply and demand and the need for constantly evolving energy solutions are transforming these industries, often with wrenching consequences. Now more than ever, it is vital that the United States develop a cohesive, integrated, long-term energy policy that can provide a foundation for future economic growth.

With elections looming, many in the energy industry are asking: what can we expect in terms of energy policy legislation and financial or environmental regulations that impact industry?

Throughout the primaries and into the first months of the presidential campaigning, it is widely acknowledged that this election has been unconventional and unprecedented in modern times.

In general, however, the Democratic nominee, Hillary Clinton, appears to promise a continuation of President Obama’s policies. She favors renewable energy over traditional hydrocarbons and tightening restrictions on emissions through regulation. The Republican nominee, Donald Trump, has said he will work to repeal many of the regulatory initiatives promulgated during President Obama’s two terms and promote domestic resource development in coal, crude oil and natural gas.

Despite their rather stark policy differences, there is still a great deal of uncertainty as to how successfully either a Clinton or Trump Administration would interact with Congress on energy and environmental legislation and implement regulatory priorities.

For energy company executives, the election adds complexity to an already challenging market environment.
Energy policy

Trump has staked out an “America first” stance that is pro-resource development and anti-federal regulation. He has vowed to repeal significant regulations implemented by the Obama Administration and to “cancel” the Paris climate agreement. He has also pledged to revoke regulations that affect wetlands, lift moratoriums on energy development on public lands and remove obstacles to domestic oil and gas development. From an environmental standpoint, he has stated his administration will focus on what he calls “real environmental problems,” such as clean water.

Trump’s focus regarding fossil fuel development is US-centric; he supports the Keystone XL Pipeline as long as the United States is given a “significant piece of the profits.” He has also expressed disdain for the Organization of Petroleum Exporting Countries. Under his administration, he says, the United States will produce enough oil and gas domestically to be energy-independent.

Trump’s support for renewable energy appears to be conditional. He has said that renewables should not be favored “to the exclusion of other forms of energy.” During the primaries, he opposed the repeal or phase-out of the Renewable Fuel Standard (RFS) mandates for biofuels, but more recently, at a petroleum conference in North Dakota, he said he was willing to look at modifications to the RFS.

The robust primary challenge from Senator Bernie Sanders caused Clinton to move to the left on some energy-related issues; for example, she now opposes the Keystone XL Pipeline. But she has stopped short of endorsing his views on other matters, such as a carbon tax.

During her eight years of service in the Senate, Clinton’s voting record on energy and environmental issues received an 82% “lifetime” score from the League of Conservation Voters (LCV), an organization that also endorsed her for president in November 2015.

Influential Clinton advisors on energy, environmental and climate issues include presidential campaign chairman John Podesta, who served as Chief of Staff to former President Bill Clinton, and Carol Browner, who was Clinton’s Environmental Protection Agency (EPA) Administrator. Podesta and Browner also did stints as senior policy advisors to President Obama.

Consistent with key policy themes during the Obama administration, Clinton has prioritized climate change and proposes to “make America the world’s cleanest energy superpower” by promoting renewable energy production and energy efficiency and reducing oil consumption. Her policy positions include a US$60 billion “clean energy challenge” to partner with states and localities to go beyond federal mandates to cut carbon emissions and expand clean energy.

Climate change represents perhaps the starkest contrast in positions between the two candidates, as Trump called global warming “a total hoax” and “pseudoscience.” Clinton proposes to “reform,” but not ban, oil and gas leasing on public lands. She also seeks to “end wasteful subsidies for oil and gas companies” in order to make clean energy investments. Her observation that “we’re going to put a lot of coal miners and coal companies out of business” has generated controversy, especially in coal-producing regions; however, the broader context of her remarks included a US$30 billion plan to revitalize coal communities.

Tax policy

While bipartisan agreement remains elusive, leaders of the tax writing committees in Congress are increasingly focused on comprehensive tax reform aimed at lowering corporate rates and encouraging US-based investment.

Reaching consensus on a new methodology for corporate taxes will not be easy. For example, enthusiasm for eliminating existing energy tax preferences in exchange for overall rate reductions is tempered by concern about fostering additional economic challenges and job losses, particularly for the oil and gas and coal industries.

So while there is an appetite for comprehensive tax reform – one that also simplifies corporate taxes – the challenge...
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Will tax reform be revenue-neutral? How will Congress handle industry preferences without impacting the economy?

One lever of compromise might be a carbon tax, which, proponents argue, has the advantage of advancing environmental goals through market price incentives rather than regulatory mandates and is also a means of raising revenue to offset tax reform rate reductions and, possibly, support infrastructure investments to spur economic growth.

The two presidential candidates are both calling for changes to the tax code. Trump proposes a 15% corporate income tax rate, with individual tax rates of 12%, 25% and 33%, in line with the Tax Reform Blueprint developed by House Republicans (GOP Blueprint), which Trump has not specifically endorsed but appears to favor. Trump’s plan would “reduce or eliminate corporate loopholes that cater to special interests,” as well as eliminate deductions made unnecessary or redundant by his new lower tax on corporations. Trump has no stated position on tax rules surrounding the use of derivatives.

Clinton has called for “a more progressive, more patriotic tax code that puts American jobs first,” including, but not limited to, the following: ending the ability of corporations to write off the cost of job outsourcing and production; clawing back tax breaks if corporations outsource; and establishing an exit tax for inverting companies. Under her approach, she would not change personal rates, but would add a 4% surtax on annual income over US$5 million, and a minimum 30% tax rate for income over US$1 million.

Clinton, too, has called for business tax reform, but has not come out in favor of cutting corporate income tax rates. In fact, she plans to use additional revenue generated through business tax reform for infrastructure spending.

Her plan would require that derivative contracts be marked to market annually. She also plans to eliminate any tax incentives aimed at fossil fuel development.

Financial regulation

Clinton has outlined a number of financial reform proposals designed to build upon the Dodd-Frank Act and has said as president, she would veto any legislation that aims to weaken the 2010 law. For example, she intends to improve upon Dodd-Frank’s Form PF reporting rules for private funds, such as hedge funds or private equity firms. She also plans to impose a high-frequency commodity trading tax aimed at strategies that involve “excessive levels of order cancellations” and would call upon the Securities and Exchange Commission (SEC) to pursue reforms that would expand access to market data. In addition, she will seek to add a number of new enforcement and penalty measures for individuals and corporations that break the law.

Trump’s public statements on financial services issues have been limited. But he has said he supports a “close to dismantling” of Dodd-Frank, saying it has made it difficult for businesses to create jobs. However, he has also said there are aspects of Dodd-Frank that he believes should be left in place, without being specific.

Trump has been highly critical of executive compensation, but he has not delivered any specific proposals for changing related rules.

Current balance of power, House and Senate

House*

246 Republicans

186 Democrats

Speaker: Ryan
Majority Leader: McCarthy
Majority Whip: Scalise
Democratic Leader: Pelosi
Democratic Whip: Hoyer
Assistant Democratic Leader: Clyburn

Senate

54 Republicans

46 Democrats†

Majority Leader: McConnell
Majority Whip: Cornyn
GOP Conference Chair: Thune
Democratic Leader: Reid
Democratic Whip: Durbin
Democratic Conference Vice Chair: Schumer
Strategic policy adviser, Democratic Policy And Communications: Warren

*Three vacant seats (1 Republican, 2 Democrats)
†Includes two independents
The Financial Accounting Standards Board (FASB) has issued final guidance that requires lessees to recognize most leases on their balance sheets. Energy entities will need to change certain lease accounting practices when implementing the new leases standard, Accounting Standards Codification (ASC) 842, Leases, issued by the FASB. For example, applying the definition of a lease and allocating consideration between lease and non-lease components of contracts will require judgment by oil and gas and mining and metals entities, while power and gas entities will be affected by power purchase agreements. For calendar-year public business entities, the guidance is effective in 2019 and interim periods within that year. For other calendar-year entities, it is effective in 2020 and interim periods in 2021. Early adoption is permitted for all entities.

Governments around the world are developing tax legislation and reconsidering their interpretations of existing tax law to address concerns that multinational companies are shifting profits to jurisdictions with lower tax rates. These efforts are often based on recommendations the Organisation for Economic Co-operation and Development (OECD) issued in its base erosion and profit shifting (BEPS) project. Multinational energy companies need to make sure they have processes and controls in place to track developments in countries that are significant to their operations and address any accounting implications in the appropriate period.

On 4 April 2016, the US Treasury Department and the Internal Revenue Service (IRS) released proposed Treasury regulations (REG-108060-15) under Section 385 (the Proposed Regulations). If enacted as currently drafted, the Proposed Regulations would:

- Treat as stock certain related-party interests that otherwise would be treated as indebtedness for federal tax purposes
- Authorize the Commissioner of the IRS (the Commissioner) to treat certain related-party interests in a corporation as indebtedness in part and stock in part for federal tax purposes
- Establish extensive documentation requirements in order for certain related-party interests in a corporation to be treated as indebtedness for federal tax purposes, among others

The Proposed Regulations would have far-reaching consequences for corporations that issue debt instruments to related corporations and partnerships. Because energy companies operate domestically, internationally or a combination thereof, and because most companies use a variety of approaches in investment and operational capitalization, the Proposed Regulations could have far-reaching impacts. Analyzing the impact of both the enactment of and compliance with final regulations under Section 385 could be burdensome on energy companies throughout the energy spectrum.
Intangible drilling costs

Under current law, independent oil and gas producers can deduct 100% of intangible drilling costs (IDCs) in the year they are incurred; integrated producers can deduct 70% of IDCs the first year and amortize the remaining 30% over five years.

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The GOP Blueprint includes a policy change that appears to allow both independent and integrated oil and gas companies to deduct 100% of IDCs in the year incurred. In other words, the Republicans’ proposal would not directly alter the economics associated with oil and gas wells for independent producers. However, it would increase the discounted cash flow and the rate of return on oil and gas wells drilled by an integrated producer.

By equalizing the tax treatment of IDCs among independent and integrated producers, the GOP Blueprint removes the economic advantage that independent producers have and may make them less competitive over time, especially since large integrated producers may have lower borrowing costs.

Similarly, the GOP Blueprint provides for the immediate expenses of all capital expenditures, significantly altering the current cost recovery mechanisms effected mostly through depreciation. By providing for immediate expensing of capital costs, the GOP Blueprint treats all energy companies on equal footing with other industries. The ability to deduct all capital expenditures as incurred can significantly alter, and likely improve, project and operational economics.

Country-by-country reporting

Another item of interest for oil and gas companies that do business in multiple countries involves country-by-country (CbC) reporting. In June, the IRS and the Treasury Department released new CbC regulations that require the parent entities of US multinational enterprises (MNEs) to file Form 8975 with their income tax returns, if they have reached the reporting threshold of US$850 million. Energy companies that have operations or investments outside of the United States should make certain they are reviewing the regulations and their own reporting processes to ensure compliance.
Resource extraction issuers payment disclosure

Also of note is the adoption by the SEC of a final rule that requires resource extraction issuers (REIs) to disclose payments they made to foreign governments or the US federal government by type and total amount for each project related to the commercial development of oil, natural gas or minerals. REIs must report the payments in an annual Form SD filed with the SEC within 150 days of their fiscal year-end. The rule, which was mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, also requires REIs to disclose the type and total amount of payments made to each government for all projects. The rule is effective for fiscal years ending on or after 30 September 2018.

EPA’s new methane rule

From a regulatory perspective, the EPA’s new methane rule for the oil and gas industry, issued in May 2016, is a major new development. The rule is designed to reduce the emissions of methane and volatile organic compounds (VOCs) by industry operations that were placed in service since September 2015. The rule reduces the amount of allowable emissions and extends the number of sources that are covered. The rule also requires operators to find and repair leaks on a fixed schedule and requires companies to report a broad range of information to the EPA (for onshore operations only).

The new rule is estimated to cost individual companies between US$320 million and US$530 million through the year 2020. Those anticipated costs have led to a legal challenge against the methane regulations, filed by the Independent Petroleum Association of America (IPAA) in August.

Offshore operation leases

Companies that operate offshore should be paying particular attention to Notice to Lessees (NTL) No. 2016-N01, issued by Bureau of Ocean Energy Management (BOEM), which updates its financial assurance criteria for leaseholders and operators in the Outer Continental Shelf (OCS). This new NTL guidance changes the BOEM’s calculation of financial strength and reliability as well as the amount of liability companies face, especially those related to decommissioning and abandonment.

In most cases, the NTL guidance will require lessees, operators and right-of-way (ROW)/right-of-use and easement (RUE) holders to allocate a great deal more capital to ensure that future financial obligations related to its holdings in the OCS are covered.

To achieve that goal, the BOEM is issuing new determinations of liability to all designated operators and grant holders in the OCS. These calculations will take into account 100% of the operators’ or grant holders’ expected decommissioning costs for every lease, ROW and RUE in which the company holds an ownership interest or provides a guarantee, as well as the financial strength and reliability of the company itself. Unlike in the past, companies will not be able to rely on the financial strength and reliability of co-lessees or co-owners to reduce their own financial security requirements. The NTL guidance also calls for future evaluations to be conducted annually or whenever there is a material change in the lessee or grant holder’s financial strength or performance.

The new NTL guidance will likely have a major impact on all companies that are involved in the OCS.

Cost of compliance – methane rule:

This new rule is estimated to cost individual companies between US$320 million and US$530 million through the year 2020.
Like the oil and gas sector, the power and utilities sector has faced significant challenges in recent years, driven primarily by clean energy policy, the shift toward distributed renewables, and digital technologies that are enabling a smarter grid and new products and services for consumers, including home energy management, electric vehicle charging, and advanced energy storage.

Clean Power Plan

Heading into November, one of the major policy issues facing utilities is the EPA’s Clean Power Plan (CPP). Unveiled by President Obama in August 2015, the CPP is currently being tested in the courts. Its provisions call for reducing carbon emissions from US power plants to 32% below 2005 levels by 2030.1

The future of the CPP remains in doubt. But even without it, the United States is on pace to achieve its 2030 emissions reduction target, thanks to a number of key factors, including:

- Increased energy efficiency by business and consumers and the resulting reduced consumption
- The low cost of natural gas, which has led to increased switching from coal-fired to cleaner natural gas-fired generation, and significant CO2 reductions since 2008
- Other EPA rules such as the Mercury and Air Toxic Standards, which has closed or will close 46 gigawatts of coal-fired capacity between 2012 and 2022²
- The improving economics of renewables such as solar and wind, which have become increasingly competitive against traditional sources of thermal generation
- Federal tax incentives combined with the many state-level portfolio standards that will continue to support the expansion of renewables.

A significant driver behind the continued shift toward renewables was the December 2015 decision to extend the Production Tax Credit for wind and the Investment Tax Credit for solar giving investors confidence that subsidies will remain in place for at least five years. That confidence continues to help drive expansion in renewables with US solar and wind projects earning favorable return on investment versus competing generation sources.

Should CPP survive its court challenges, under a Clinton administration it would most likely accelerate coal-fired power plant closures across the country. On the other hand, if Trump wins the presidency, he has pledged to rescind the CPP regardless of any court decision.

Energy Policy Modernization Act

Another key development that the power and utilities sector will be watching is the progress of the Energy Policy Modernization Act (EPMA), which was passed by the Senate in April 2016 and is currently in conference with the House of Representatives. As

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proposed, it requires significant upgrades to lines, transformers and other electrical grid components, along with investments in large-scale electricity storage systems. The bill has support from a number of different industry groups but whether a compromise can be reached that will result in legislation being signed by the President remains uncertain.

Future passage of EPMA would require the Federal Energy Regulatory Commission (FERC) to oversee licensing and siting of new transmission projects. Since FERC is an independent authority with commissioners appointed by the President, the outcome of the election could have repercussions for the commission, which comprises five commissioners, no more than three of which can belong to the same political party. Three Democrats currently sit on the commission and are generally supportive of efforts to expand and improve the bulk power grid. Other appointees may seek to roll back such efforts or take a more aggressive position on grid expansion.

FERC also has authority to oversee the reliability of the bulk power system, including the authority to approve mandatory cybersecurity reliability standards developed by the North American Electric Reliability Corporation (NERC).

The modernization of the US grid with the proliferation of smart meters and digital devices has led to an exponential rise in data volumes, which increases the system’s vulnerability to cyber attack. Concern over cybersecurity has led to major updates to NERC’s Critical Infrastructure Protection (CIP) Reliability Standards with an expansion in the scope of cyber systems and critical assets protected by the standards.

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Distributed generation and net metering

While not necessarily an issue that will be decided at the federal level, the growth in distributed generation and net metering is certainly one that is impacting the power and utilities sector. There has been exponential growth in so-called “rooftop solar” panels installed by individual consumers or businesses, and this distributed generation is turning the traditional rate-based utility model upside down. Consumers can even sell excess electricity back to the grid or receive a credit on future electricity bills through “net-metering” arrangements with the local utility.

Utilities across the country are wrestling with the financial impacts of net metering and the need to develop a workable business model that takes into account the costs incurred by utilities to maintain the grid and provide reliable backup power to rooftop solar owners. Many in the industry believe that net metering is overly generous to these consumers and that a disproportionate burden is placed on remaining consumers without solar PV systems to share the fixed costs of maintaining the grid. This conflict can be seen playing out in numerous states, including Arizona, Nevada and California. In late 2015, Hawaii became the first state to end its retail rate net metering program.

In New York, an evolving regulatory model known as Reforming the Energy Vision (REV) shows great promise in developing new innovation and technology platforms that incentivize utilities and third parties to invest in new products and services including distributed generation and energy efficiency projects.

With REV, utilities are better placed to respond to evolving consumer demand for cleaner energy and enhanced customer experiences. While still in its infancy, REV is being closely watched by regulators and utilities across the country as they seek to leverage lessons learned for transitioning to a future energy system.

Capital in focus

Finally, and similar to policies used by the oil and gas and mining and metals sectors, the GOP Blueprint would provide for immediate expensing for capital expenses, which may increase the rate of return on new projects.
At the same time, EIA forecasts show that natural gas will supply 34% of US electricity in 2016, with coal falling to just 30% — a dramatic change from just a decade ago, when coal provided about 50%.\(^4\)

**Federal regulations**

The question that remains is how much of the decline in coal — and growth in gas — is due to market conditions and a change in public perception, and how much is the result of federal regulations.

Still, regulatory and legislative attempts to reduce emissions have created concerns for the entire mining and minerals sector, primarily because there is fear of “collateral damage” as policies aimed at coal or oil could hurt companies involved in aggregates or precious metals.

For example, any tax legislation that removes the percentage depletion allowance could be extremely damaging to the aggregates industry, which makes significant investments to buy land decades in advance of needing it in order to provide reliable supply to growing areas. Under current federal income tax law, a taxpayer in the mining industry may claim percentage depletion to recover its capital investment in a mineral property, subject to certain limitations. Because percentage depletion is based upon the taxpayer’s income and not the cost of the mineral property, over time a taxpayer may claim a cumulative percentage depletion deduction that exceeds the cost of the mineral property, also known as excess percentage depletion.\(^6\) Removing that ability would reduce the rate of return and cash flow of any mineral property.

**Capital in focus**

Under the GOP Blueprint, the percentage depletion allowance would be eliminated. But it would be offset by the immediate expensing of capital equipment, a significant benefit.\(^7\)

Interestingly, tax measures designed to eliminate so-called subsidies for traditional oil and gas and coal-mining companies could backfire on the Democrats’ goal to invest in infrastructure, which requires large amounts of aggregate for roads and concrete. Clinton has called for increasing infrastructure spending by US$275 billion over a five-year period, focusing on bridges, roads, airports, ports and more, as a means to providing good-paying jobs.\(^8\)

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\(^4\) Chris Mooney, “Dear Donald Trump: This is what is really dismantling the coal industry,” The Washington Post, 9 August 2016.

\(^5\) Ibid.

\(^6\) Report on recent US international tax developments, EY, 12 August 2016

\(^7\) Ibid.

\(^8\) Trump vs. Clinton: policy perspectives, EY, August 2016.
The future of policy

Regardless of the outcome of November’s elections, there is little doubt that government’s impact on the energy industry will continue to require diligence in the areas of accounting, tax and operational policy.

Issues such as corporate tax reform, financial regulations and climate change will likely drive the agenda in Washington, DC, for the next four years and have major implications for companies in energy.

Staying abreast of new developments is critical for ensuring compliance and competitiveness.

How EY can help

EY professionals can help you understand the current developments, provide updates, information and analysis, and help you evaluate and adopt leading practices for managing compliance and competitiveness.

Through our closely linked Assurance, Tax, Fraud Investigation and Dispute Services, Financial Accounting Advisory Services, Transactions Advisory Services and Advisory service teams, coupled with our global team of more than 10,000 industry professionals, EY is equipped to provide independent support and advice to our clients to help them grow in a changing landscape.
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How EY’s Global Mining & Metals Network can help your business
With a volatile outlook for mining and metals, the global mining and metals sector is focused on margin and productivity improvements, while poised for value-based growth opportunities as they arise. The sector also faces the increased challenges of maintaining its social license to operate, balancing its talent requirements, effectively managing its capital projects and engaging with government around revenue expectations.

EY’s Global Mining & Metals Network is where people and ideas come together to help mining and metals companies meet the issues of today and anticipate those of tomorrow by developing solutions to meet these challenges. It brings together a worldwide team of professionals to help you succeed – a team with deep technical experience in providing assurance, tax, transactions and advisory services to the mining and metals sector. Ultimately it enables us to help you meet your goals and compete more effectively.

How EY’s Global Oil & Gas Sector can help your business
The oil and gas sector is constantly changing. Increasingly uncertain energy policies, geopolitical complexities, cost management and climate change all present significant challenges. EY’s Global Oil & Gas Sector supports a global network of more than 10,000 oil and gas professionals with extensive experience in providing assurance, tax, transaction and advisory services across the upstream, midstream, downstream and oil field subsectors. The Sector team works to anticipate market trends, execute the mobility of our global resources and articulate points of view on relevant sector issues. With our deep sector focus, we can help your organization drive down costs and compete more effectively.

About EY’s Global Power & Utilities Sector
In a world of uncertainty, changing regulatory frameworks and environmental challenges, utility companies need to maintain a secure and reliable supply, while anticipating change and reacting to it quickly. EY’s Global Power & Utilities Sector brings together a worldwide team of professionals to help you succeed – a team with deep technical experience in providing assurance, tax, transaction and advisory services. The Sector team works to anticipate market trends, identify their implications and develop points of view on relevant sector issues. Ultimately, this team enables us to help you meet your goals and compete more effectively.

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