PATTON BOGGS LLP

PATTON BOGGS ANALYSIS

THE STATE OF THE UNION IN 2013

FEBRUARY 13, 2013

“[THE PRESIDENT] SHALL FROM TIME TO TIME GIVE TO THE CONGRESS INFORMATION OF THE STATE OF THE UNION,

AND RECOMMEND TO THEIR CONSIDERATION SUCH MEASURES AS HE SHALL JUDGE NECESSARY AND EXPEDIENT;”

Article 2, Section 3
U.S. Constitution

INTRODUCTION

Last night, President Barack Obama delivered his fourth State of the Union Address before a joint session of the 113th Congress. Not since 1887, when President Grover Cleveland faced a divided 50th Congress, has a Democratic President been confronted (again) with the challenge of doing so, in this case a Republican House and a Democratic Senate. In words that still ring true 125 years later, President Cleveland "earnestly invoke[d] such wise action on the part of the people's legislators as will subserve the public good and demonstrate . . . its ability and inclination to so meet the people's needs that it shall be gratefully remembered by an expectant constituency." (*President Grover Cleveland's December 6, 1886 Second Annual Message to the United States Congress.*)

In setting forth his priorities aimed largely at advancing the interests of the middle class in a speech in which he made reference to the economy and jobs 62 times, President Obama called on the 113th Congress to, among other things, enact legislation to avoid the automatic spending cuts otherwise set to hit on March 1, to produce comprehensive immigration reform legislation, to "pursue a bipartisan, market-based solution to climate change," to make preschool universal and adopt other educational reforms, to adopt cyber security legislation to address issues beyond those that he could implement through executive action, and to adopt a variety of other measures that would create jobs and grow the economy. In addition, he made an emotional appeal for Congress to vote on gun control measures. He pledged that the war in Afghanistan would be over by the end of next year. And closer to home, he announced the formation of a non-partisan commission to "improve the voting experience in America," which we are proud to say will be co-chaired by one of our partners, Ben Ginsberg.

In the Republican Response, Senator Marco Rubio (R-FL) offered a fundamentally different perspective on how to address many of the major issues that divide Congress and the two parties, while at the same time stressing as did the President the need to address the concerns of middle-class Americans.

We offer our perspective below on some of the major issues confronting the country, including how fundamental tax reform—legislation that could potentially affect every business in America—could play out in the context of the fight over sequestration and funding the government.

But first some perspective on the November elections and the public's perception of their elected representatives. When the 113th Congress gathered last night, the approval rating of the institution remained at near-record lows. In late January, in a Rasmussen Reports national telephone survey, Congress received good or excellent marks on its job performance from only 9 percent of the public. In Gallup polls, the 112th Congress's approval rating ranged from an average of 11 percent in its first term to 18 percent in its second term, including a record low 10 percent last August.

Clearly, the American public is fed up with the status quo. By casting their votes in November, we have a sense the public wants the 113th Congress to get something done, to address the big issues that confront the country. Ironically, though, the voters elected a Congress that may be even more partisan than the 112th Congress, making it even harder for Congress to find common ground. As a result of the elections, only 25 of 435 House Members represent districts where a majority of voters preferred the presidential candidate of the other party. In voting for divided government, the American public has continued a pattern that now spans decades. No two-term President since Franklin D. Roosevelt has presided over a Congress controlled by his own party for the entire duration of his Presidency. In fact, President Jimmy Carter was the last to enjoy even four years of complete party control in Congress. Like Bill Clinton and George W. Bush, President Obama lost control of at least one chamber.

Divided government and divided control of Congress have consequences. When the first session of the 112th Congress adjourned in 2011, for example, it had come close to producing the fewest number of bills signed into law since Congress formally began keeping track in 1947. When the second session adjourned earlier this year, the 112th Congress had maintained its second place finish for the fewest number of bills enacted since World War II. (Only President Bill Clinton and the Republican-controlled 104th Congress were less productive, generating a total of 233 public laws.) Of the 283 public bills enacted during the 112th Congress, 30 bills merely extended current law (*e.g.,* four separate bills kept the Federal Aviation Administration operating for a short period of time and others kept the federal government open), 55 bills named a post office or a court house, and at least 21 bills were of a commemorative nature or provided for service appointments. These alone accounted for nearly 40 percent of the output of the 112th Congress.

By comparison, the 80th "Do Nothing Congress" that President Harry Truman campaigned against in 1948 produced 906 public laws—passing more in its second year (511) than the 112th Congress did over the entirety of two years. Republican President Dwight D. Eisenhower and the Democratic

84th Congress set the record for productivity by enacting 1,028 laws. More recently, President Ronald Reagan worked with the Democratic House and Republican Senate of the 98th Congress in the final two years of his first term to enact 623 laws over 3,653 hours that that Congress was in session; the divided 112th Congress was in session roughly 100 hours longer but produced 340 fewer laws. Finally, President George W. Bush and the Republican 108th Congress ended his first term by reaching agreement on 498 laws and he and the Democratic 110th Congress found common ground with 460 bills enacted into law.

In 2011, President Obama became the first President to use an autopen—a device principally used to sign mass mailings—to sign bills into law from a distant location. Most recently, the President directed his staff to use an autopen to sign the legislation averting the "fiscal cliff" at the beginning of the year because he had already returned to Hawaii to finish his Christmas vacation when the bill was presented to him. (President George W. Bush's legal advisors concluded in 2005 that the use of an autopen was constitutional, as long as the President had not delegated the authority to decide whether or not to sign a bill into law.) The President also reportedly directed the use of an autopen while he was in Europe at the time the Patriot Act was enacted and in Indonesia when an emergency spending bill reached the White House.

In the coming year, as in prior years, the President is likely put his pens to work issuing Executive Orders as a means of encouraging congressional action and addressing issues Congress will not or cannot address. Last year, for example, he issued an Executive Order when Congress hadn't acted on the DREAM Act. Earlier this year, he issued a series of measures addressing gun control without waiting for Congress to act. Yesterday, the President issued an Executive Order on cyber security that calls for the creation of voluntary standards to enhance the security of critical infrastructure and improve the government's ability to deter attacks, while again urging Congress to adopt a more comprehensive legislative approach. Should progress in Congress stall on other issues, we expect him to act unilaterally again. He was quite explicit, for example, in saying that if Congress did not address climate change, he would "direct my Cabinet to come up with executive actions we can take, now and in the future, to reduce pollution, prepare our communities for the consequences of climate change, and speed the transition to more sustainable sources of energy." President Obama also will likely again use Executive Orders (and waivers) to push his preferred solutions for elementary education reform if Congress fails to adopt legislation. This might manifest itself most clearly in efforts to provide incentives for state leaders to improve existing achievement gaps, as the

Administration reviews waivers already approved for 34 states plus the District of Columbia as they come up for renewal after two years.

So where do things go from here? In our view, the political environment for solving major problems could hardly get worse. But we remain optimistic that the pendulum will swing back, that Congress and the President will find common ground on some of the most pressing issues of the day. We saw glimmers of it in the 112th Congress. Working with the Administration, the 112th Congress agreed to MAP-21, a major surface transportation bill to support highway construction and mass transit projects; it adopted the RESTORE the Gulf Coast States Act of 2012 to allocate up to $20+ billion in Clean Water Act fines from the Deepwater Horizon spill to restore the environment and the economic health of the Gulf Coast region; it reached agreement on the FAA Modernization and Reform Act, which provided the agency with $63.4 billion through 2015, including approximately $11 billion to fund the agency's Next Generation air traffic control system; and, as further discussed below, it addressed the fiscal cliff and staved off a massive increase in middle class taxes before it adjourned.

With many new and returning Members focused on legislating rather than obstructing, we remain optimistic that Congress will return to the era in which it accomplished big things for the sake of the country. But some rough patches in the road loom ahead. To that we now turn.

SEQUESTRATION AND FUNDING THE GOVERNMENT

At 2:00 a.m. on January 1, the Senate by a vote of 89-8 passed the American Tax Relief Act hastily negotiated by Vice President Biden and Senate Minority Leader Mitch McConnell (R-KY). At 11:00 p.m. that night, the House by a vote of 257-167 also approved the measure, clearing it for the President, who "signed" it into law on January 2. While the Senate vote was overwhelmingly bipartisan, only 85 House Republicans—including, most notably, Speaker John Boehner (R-OH) and Budget Committee Chairman Paul Ryan (R-WI)—voted to support the bill. Among other things, the bill permanently extended the "Bush marginal tax rates" on income up to $400,000 for single filers and $450,000 for married couples filing a joint return; made permanent the maximum 15 percent long-term capital gains and qualified dividends rate for those with income up to $400,000 (singles)/$450,000 (married), with a 20 percent rate for both taxpayers above the threshold; made permanent the $5,120,000 per individual estate tax exemption and set the maximum estate tax rate at

40 percent; extended through 2013 most of the business and individual tax "extenders," as passed by the Senate Finance Committee in early August (two years for provisions that expired 12/31/2011; one year for those that expired 12/31/2012); and delayed the spending sequester for two months fully offset by $12 billion in revenue increases and $12 billion in spending cuts.

Notwithstanding the desire of Republicans, the legislation did not address entitlement reform. Moreover, notwithstanding the request of the President, it did not address the debt ceiling. Congress has since addressed that issue through enactment of legislation suspending the debt ceiling through May 18, at which time it will automatically reset to take into account debt issued since the end of the year, thereby giving the Treasury Department flexibility through the use of "extraordinary measures" that should carry it until some point into this summer before the debt limit would be breached in the absence of further debt ceiling legislation.

Before turning back to the debt ceiling, Congress and the White House now must focus on the automatic spending cuts ("sequestration") that will begin on March 1 and funding the government later in the month (since the current Continuing Resolution expires on March 27). In signaling his desire to work towards a solution, the President last night urged the Members to "set party interests aside, and work to pass a budget that replaces reckless cuts with smart savings and wise investments in our future. And let's do it without the brinksmanship that stresses consumers and scares off investors."

In his address, the President underscored the importance of reaching $4 trillion in deficit reduction over the next ten years, which is the amount most economists consider necessary to stabilize long-term debt as a share of the economy. Excluding the pending sequester, which, with interest savings, accounts for an additional $1.2 trillion in deficit reduction, discretionary spending reductions and tax increases agreed to over the last two years will reduce the deficit by $2.5 trillion. The President again urged Congress to finish the job and, in an economic plan released last night as well, called for the remaining $1.5 trillion in savings to come from a mix of $900 billion in spending cuts and $600 billion through tax reform that closes "loopholes for the wealthy" and reforms "corporate taxes to strengthen America's competitiveness." In the meantime, absent an agreement on comprehensive legislation, the Administration will continue to advocate for targeted tax increases and spending cuts to delay implementation of the sequester.

Republicans hope to use this process to reach agreement on further substantial deficit reduction before agreeing to an additional, longer increase in the debt ceiling. The House Republican leadership has set the topline discretionary spending cap at the sequestration amount that otherwise will kick in on March 1, meaning that for their purposes sequestration can only be avoided through an equal amount of spending cuts. (The House will likely adopt a Continuing Resolution to fund the government at the $1.043 trillion level, as agreed to in the Budget Control Act of 2011, but including language making clear that the sequester remains unchanged, effectively setting discretionary spending at $974 billion, a position likely to be rejected by the Senate and the White House.) In addition, the House Republican leadership has agreed to work towards a balanced federal budget within ten years. The budget resolution that will be put forward by Budget Committee Chairman Ryan will likely reflect that decision, and thus be far more potentially draconian than his last budget, which provided thirty years to achieve balance but nonetheless was scorned by Democrats as cutting too deeply.

Although Republicans would like to keep the focus on cutting spending to reduce the deficit, Democrats will use the coming debate to again urge raising taxes to forestall the spending sequester and for deficit reduction generally, in particular by seeking to implement higher taxes on upper-income individuals (perhaps by seeking to implement the so-called "Buffett Rule" on those with income above $1 million), while also proposing to eliminate tax preferences enjoyed by the oil and gas industry, hedge funds, corporate jet owners, and U.S. based multinational corporations operating on a global basis.

Even though the Senate will vote in late February on competing proposals to delay the onset of the spending sequester, we nonetheless anticipate that sequester will begin to be implemented as scheduled on March 1. With the Continuing Resolution having to be addressed by the end of the month, we may see a flurry of negotiations aimed at addressing both issues, opening the door as well to potential tax and entitlement reform.

FUNDAMENTAL TAX REFORM

Over the last two years, the possibility of comprehensive reform of the Tax Code, last accomplished in 1986, had progressed from chatter among tax policy leaders to seeming near inevitability. But that was before the debate over the fiscal cliff at the end of last year and the resulting political fallout that made compromise on anything, even establishing a timeline for consideration of tax reform, seem a remote possibility. Nonetheless, House Ways and Means Committee Chairman Dave Camp (R-MI) reportedly is talking privately with his colleagues about moving a *revenue neutral* tax reform bill and, on January 17, Budget Committee Chairman Ryan emphasized the commitment of House Republicans to reforming the U.S. tax system, asserting that they will take on the issue in 2013. Earlier in the week, Representative Sander Levin (D-MI), Ranking Member of the House Ways and Means Committee, had indicated that he was hopeful, but not confident, Congress would accomplish fundamental tax reform this year. But as opposed to a revenue neutral approach, the President and congressional Democrats view tax reform as a way to simplify the Tax Code and to increase net revenues.

Last night, the President made it clear that he supports the effort to simplify and restructure the Tax Code, saying: "Now is our best chance for bipartisan, comprehensive tax reform that encourages job creation and helps bring down the deficit. The American people deserve a tax code that helps small businesses spend less time filling out complicated forms, and more time expanding and hiring; a tax code that ensures billionaires with high-powered accountants can't pay a lower rate than their hard-working secretaries; a tax code that lowers incentives to move jobs overseas, and lowers tax rates for businesses and manufacturers that create jobs right here in America. That's what tax reform can deliver. That's what we can do together."

At this point, the fate of comprehensive tax reform may in part depend upon agreement between the President and Congress on the appropriate mix of spending cuts and revenue increases moving forward as a means of replacing the spending sequester which, if implemented, has the potential of bringing both parties to the bargaining table.

As the debate continues about how to achieve further deficit reduction, we still see an opportunity for the bipartisan reform that has eluded the President and congressional negotiators to date. Both parties want the tax reform process to begin, though they have not yet agreed to a revenue target that is critical for reform to become a reality. Because of where the line recently was drawn for what constitutes "upper income" ($400,000 individual/$450,000 family), which was lower than most Republicans wanted, there may be a bit more "wiggle room" to horse trade credits, deductions, and exclusions to not only raise net revenue, but also to potentially lower rates in the context of comprehensive tax reform. It is worth noting that, despite the rhetoric from both sides, the parties are not too far apart: Last summer, Speaker Boehner offered the President $800 billion in tax revenue to be achieved through tax reform that lowers rates. Since the fiscal cliff deal was worth $620 billion in new revenue, there may be some room left to meet some of the President's demand for an additional $600 billion in revenue in exchange for the right combination of entitlement reform and spending reductions. While agreement has eluded them so far, both parties now may see the value in negotiating with renewed urgency once the sequester begins.

If an agreement on a basic framework is reached by the President and congressional leaders, the tax writing committees will begin work later this year on the very important details of how to restructure the tax code. Those details will be difficult to agree upon, but much work has already been done. In fact, serious discussions have been ongoing for the better part of two years. As a result, they would not be starting anew.

Last year, the Administration released a Framework for Business Tax Reform in which the President advocated reducing the top corporate rate from 35 to 28 percent, while providing manufacturers with additional tax preferences that would effectively lower their tax rate to 25 percent, with even lower rates for firms engaged in "advanced manufacturing." In addition, the Framework would expand, simplify, and make permanent the R&D tax credit. The Administration proposed revenue raisers to offset the cost of these changes. Specific items include repeal of Last In First Out (LIFO) accounting; limitations on tax preferences allowed for the purchase of insurance products, and by insurance companies; taxation of carried interest as ordinary income; and new rules that change the depreciation schedule for corporate jets from five to seven years.

Since those changes alone do not come close to "paying for" the proposed tax rate reduction, the Framework also includes a menu of options that, while short on detail, suggests the types of additional corporate tax base "broadeners" the Administration will pursue during tax reform. These include lengthening depreciation schedules; limiting the deductibility of interest as an ordinary and necessary business expense; and encouraging greater parity between large corporations and "large non-corporate counterparts" (presumably by subjecting some large pass-through entities to entity-level taxation). As part of this debate, we continue to expect the President and many Democrats on Capitol Hill to push for elimination of tax preferences enjoyed by integrated oil and gas companies as part of comprehensive tax reform if those measures are not considered even earlier as part of the fight over the budget for the rest of the year.

International tax issues will be a significant focus in the tax reform debate, potentially affecting international operations of U.S. businesses and the treatment of inbound investment. In contrast to the congressional Republican view that corporate reform should also be used to transition from a worldwide system of taxation toward a territorial system, the President's proposal would establish a minimum tax on U.S.-based multinational corporations' foreign earnings, eroding the use of "deferral" of foreign-source income. The Administration punctuates its position by stating that a "*pure* territorial system could aggravate, rather than ameliorate, many of the problems in the current tax code" (emphasis added). However, should corporate reform negotiations take place, it is likely this would be a point of negotiation with the Congress rather than a hard-and-fast view; rejecting a "pure" territorial system still leaves plenty of room for discussion with those who are seeking to move towards a territorial system, as most countries have neither pure territorial nor pure worldwide systems of taxation, but rather combine elements of both.

For their part, House and Senate Republicans will continue to push for a lower target corporate rate of 25 percent, working from a corporate tax reform draft proposal tabled in late 2011 by Ways and Means Committee Chairman Camp, who supports moving towards a territorial system. While that document focused on international taxation and did not spell out which revenue raisers might be utilized to buy down the corporate rate, there will assuredly be points of overlap between congressional Republicans and President Obama on this front, including lengthening depreciation schedules. As a sign of his continued interest in moving forward on a rate-lowering comprehensive bill later this year, Chairman Camp on January 24 released a detailed financial products discussion draft on which he expects feedback from stakeholders. The proposal seeks to modernize tax rules by altering the tax treatment of a broadly defined class of derivatives, as well as other financial products. In addition, Chairman Camp is contemplating forming several bipartisan working groups, composed of Members of the Committee on Ways and Means, to tackle different aspects of fundamental reform.

In addition to the corporate tax provisions that have long been targeted by the Administration (*e.g.,* LIFO accounting and energy industry tax preferences), numerous tax deductions, credits and preferences will be thoroughly examined during the tax reform process. For example, while Republicans will be willing to examine various preferences enjoyed by the oil and gas industry, they will certainly want to include in their examination tax incentives for renewable energy. In addition, they will consider whether the Section 199 deduction for domestic manufacturing should be eliminated to pay for lowering the corporate rate for all taxpayers, and whether current depreciation schedules should be lengthened with the resulting revenue used to lower tax rates for businesses.

COMPREHENSIVE IMMIGRATION REFORM

While Republicans and Democrats, employers and workers, and members of the public have long recognized that the U.S. immigration system is broken, comprehensive immigration reform has been one of the most elusive and contentious policy issues faced by Congress for more than a decade. Building on the efforts of Senators John McCain (R-AZ) and Ted Kennedy (D-MA) in 2005, Majority Leader Harry Reid (D-NV) introduced a comprehensive immigration reform bill in 2007 crafted by a "Gang of 12" Senators that included Senators McCain and Kennedy, as well as Jon Kyl (R-AZ), Dianne Feinstein (D-CA), and Lindsey Graham (R-SC). President Bush publicly backed the bill and was intimately involved in its progress, but was unable to persuade a sufficient number of Republicans in the Senate to vote for its passage. Since that failure to pass comprehensive immigration reform in 2007, only a few legislative measures addressing immigration issues have passed both chambers to become law.

During the 2008 election campaign, then-candidate Barack Obama built a new Democratic coalition, drawing Latino and Asian voters into his campaign with a commitment to finally bring comprehensive immigration reform to fruition. But for a variety of reasons, President Obama also was not able to find a legislative path forward.

Shortly after the November 2012 elections, the race to set markers for a comprehensive immigration reform bill began anew. With a new urgency and bipartisan commitment, Administration officials and bipartisan groups in the Senate and in the House each began convening to agree upon principles and legislative language. After the Sandy Hook tragedy and Vice President Biden's recommendations on gun control, the White House advised Congress that the President would make a speech calling for immigration reform on February 5, 2013. The "Gang of Eight" Senators—Senators Charles Schumer (D-NY), Robert Menendez (D-NJ), Richard Durbin (D-IL), Michael Bennet (D-CO), John McCain (R-AZ), Lindsey Graham (R-SC), Marco Rubio (R-FL), and Jeff Flake (R-AZ)—moved ahead of the President and announced their agreement on principles for immigration reform in a February 4th press conference. The President followed by outlining his principles for reform in a speech in Las Vegas the next day. Soon thereafter, news of a bipartisan working group in the House-

-one including Representatives Mario Diaz-Balart (R-FL), John Carter (R-TX), Sam Johnson (R-TX), Raul Labrador (R-ID), Zoe Lofgren (D-CA), Luis Gutierrez (D-IL), and Xavier Becerra(D-CA)--became public. Last night, the President reinforced his commitment to work with Congress to enact comprehensive legislation this year.

With this momentum, congressional action on one or more bipartisan bills on comprehensive immigration reform is a virtual certainty in 2013. Whether this effort will result in a new law this year, however, is another matter altogether. The Gang of Eight and the President have both outlined, through their principles, the key components of a comprehensive system they would put into legislation:

(1) creating an earned path to citizenship,
(2) reforming the legal immigration system for employment,
(3) addressing the family visa system to eliminate the backlog and unify families,
(4) securing the southern border and enhancing border security mechanisms, and
(5) expanding and implementing an effective employment verification system to prevent the hiring of unauthorized workers.

The Gang of Eight's principles call for a system to address future flow of workers, most likely a guest worker program or revisions to the current temporary worker visas. The President's principles also call for a crackdown on U.S. employers who hire undocumented workers by increasing penalizing fines. The bipartisan House coalition has not yet put forward their principles.

In his State of the Union Address, President Obama reiterated the broad principles that he believes should guide the debate in achieving what he described as "real reform" to current law: "strong border security, [building] on the progress my Administration has already made—putting more boots on the southern border than at any time in our history, and reducing illegal crossings to their lowest levels in 40 years . . . a responsible pathway to earned citizenship—a path that includes passing a background check, paying taxes and a meaningful penalty, learning English, and going to the back of the line behind the folks trying to come here legally . . . [and] fixing the legal immigration system to cut waiting periods, reduce bureaucracy, and attract the highly-skilled entrepreneurs and engineers that will help create jobs and grow our economy."

In the Republican Response, Senator Rubio did not offer a comparable proposal, but nonetheless indicated in broad terms: "We can also help our economy grow if we have a legal immigration system that allows us to attract and assimilate the world's best and brightest. We need a responsible, permanent solution to the problem of those who are here illegally. But first, we must follow through on the broken promises of the past to secure our borders and enforce our laws."

Pitfalls to final passage of a comprehensive immigration bill may arise in either chamber. These could include disagreements on whether undocumented immigrants can become citizens under any conditions, provisions allowing LGBT Americans to sponsor immigrant partners, the inclusion and features of a guest worker program, benchmarks—such as declaring the borders secure—that would trigger a legal path to citizenship, efforts to increase overall visa numbers, and revisions of who can come to the U.S. as a family member of a U.S. citizen or resident. These tensions have led to interesting shifts within the Republican Party, particularly in the House. Some Members of the House have recently voiced growing opposition to a path towards citizenship for undocumented immigrants. In the same week, Majority Leader Eric Cantor (R-VA) espoused a more lenient view of long-term immigration benefits for undocumented children brought here by their parents. Because this bill will inevitably include a host of other immigration law fixes and revisions, there is potential for other stumbling blocks that could derail the bill as well.

We expect to see bills introduced in both chambers within the next month or so. The House bipartisan group had been rumored to be readying a bill for introduction before the State of the Union, but that did not happen. The leadership of both chambers has pledged to move immigration bills by regular order. The House took an initial step last week by holding its first hearing on comprehensive immigration reform in the House Judiciary Committee. Although they had no comprehensive reform bill before them to debate, the Members focused on the need to reform the visa system to allow more high skilled workers into the country, especially in STEM fields—science, technology, engineering and math. Some Democrats highlighted the need to reform the family-based visa system to eliminate 20-year waiting periods for immediate family members of U.S. citizens and residents. Some Republicans indicated that while they wanted to solve the problem of having 11 million undocumented immigrants in the country, they did not favor a path to citizenship, suggesting a long term or permanent legal residence with no path to or option for citizenship. This idea was opposed by Democrats, including hearing witness Mayor Julian Castro of San Antonio, who raised concerns about creating a permanent underclass with second-class status. Today, the Senate Judiciary Committee will hold its first hearing on immigration reform.

Passage of an immigration bill in the House will be far more difficult. The key will be agreement on a Republican plan which House Democrats can largely support. Undoubtedly, Democrats will have to compromise on some key provisions to get a bipartisan bill through the House, and they are likely to do so knowing that Senate Democrats, with support of the White House, could have a better chance at restoring those provisions, or ensuring they pass into law, when the bills are conferenced. Another possibility is that a bipartisan bill will not succeed in the House, forcing that chamber to try instead to move a series of bills on individual subjects or ultimately to respond to the Senate (as the House essentially did in the 112th Congress when it was not able to move a surface transportation bill initially).

The concepts of immigration reform touch deeply within the American psyche. From the politics of the next election, to whether voters feel comfortable with new immigrant residents in their communities, to American families wanting to reunite with children overseas or give their children security and opportunity in the only country they have known, to employers wanting to hire the best STEM graduates or legally keep employing their farm workers, immigration policy is personal for many voters. Because it triggers extremely different views, immigration reform will be politically hard to achieve. That said, we remain optimistic that comprehensive immigration reform law will pass at least one House in the 113th Congress, and may well become law.

ENERGY LEGISLATION

Congress has not passed a major energy bill since 2007, in part because nothing has been advanced since then that could get 60 votes in the Senate and in part because the House in recent years has, without success, principally sought to block the Environmental Protection Agency from pursuing the President's climate change agenda, as well as to force the President to approve the Keystone XL pipeline. (We expect that the President--not the Secretary of State—will ultimately issue the required Presidential Determination that will authorize the Keystone XL pipeline to be built, taking that issue off the table as an obstacle to legislating a bipartisan bill.)

Last night, the President called on Congress to pursue "a bipartisan, market-based solution to climate change," citing the earlier work of Senators John McCain (R-AZ) and Joe Lieberman (I-CT). He also urged Congress "to encourage the research and technology that helps natural gas burn even cleaner and protects our air and water . . . [and] to use some of our oil and gas revenues to fund an Energy Security Trust that will drive new research and technology to shift our cars and trucks off oil for good." He also set a goal of cutting "in half the energy wasted by our homes and businesses over the next twenty years."

Notwithstanding the differences that would appear to divide them, we have become increasingly optimistic that the Senate and the White House can find common ground on energy legislation. We still see major challenges ahead in the House, but that dynamic could change once the President demonstrates that he will continue to use existing legal authority, confirmed by the Supreme Court in *Massachusetts v. EPA,* to advance much of his climate change agenda without Congress being able to stop him.

Why the optimism? Given that energy legislation historically has been a nonpartisan issue and that more States are becoming "energy states" as a result of the shale boom and expanding onshore and offshore cleaner energy projects, the number of Senators who are "pro-energy" is likely to continue to increase and thus the challenge of developing a bill that could garner 60 votes will get easier over time. In addition, Senators Ron Wyden (D-OR) and Lisa Murkowski (R-AK), the Chairman and Ranking Member of the Energy and Natural Resources Committee, respectively, have a good working relationship and share common goals in writing legislation that can enhance our energy security, create more jobs, and address climate change.

Consider how much has changed in roughly a decade as a result of the shale revolution, when conventional wisdom held that the United States would soon become a net importer of liquefied natural gas. The unconventional oil and gas boom that has occurred has changed not only our energy landscape, but the politics of energy as well. Some highlights from Daniel Yergin of IHS CERA about what has changed thanks to hydraulic fracturing and horizontal drilling technologies: "Shale gas has risen from two percent of domestic production a decade ago to 37 percent of supply, and prices have dropped dramatically. U.S. oil output, instead of continuing its long decline, has increased dramatically—by about 38 percent since 2008. Just the increase since 2008 is equivalent to the entire output of Nigeria, the seventh-largest producing country in OPEC." Remarkably, given the current pace of increasing U.S. production of oil and other liquid hydrocarbons, the United

States is on pace to soon surpass Saudi Arabia (11.6 million barrels per day of crude) as the top producer in the world.

In addition to creating jobs and revenues here, this dramatic change in domestic production will likely have profound geopolitical ramifications as well. U.S. exports of liquefied natural gas, for example, could give the U.S. Government leverage over Russia, which has long used its power as the world's top natural gas exporter in advancing its foreign policy agenda. Skyrocketing demand elsewhere in the world will have other significant consequences. The United States, for example, is no longer the world's largest energy consumer and will soon be eclipsed by China as the largest consumer of crude oil as well. As the world's largest consumer, China will exert greater influence over world oil prices than the United States. Perhaps as important, as the United States reduces its dependence on OPEC suppliers, our interests in the Middle East are likely to change as might those of countries that replace us as a major purchaser.

Taking into account these fundamental changes in the energy landscape, Chairman Wyden and Ranking Member Murkowski have begun to sketch out their priorities for the coming year. Chairman Wyden, for example, has indicated that the committee's "first order of business will be natural gas: how it's produced, how it's used and how much of it the U.S. should use here or send abroad." He also intends to advance his vision of a low-carbon economy by focusing on producing more renewable energy and more efficient use of the energy we produce. Senator Murkowski has released a comprehensive discussion document, *"Energy 20/20: A Vision for America's Energy,"* in which she put forward ideas in seven broad areas: producing more, consuming less, clean-energy technology, energy delivery infrastructure, effective government, environmental responsibility and "an energy policy that pays for itself." Of particular interest, Senator Murkowski will be seeking to refocus attention on, as she put it, reducing "the cost of 'cleaner' sources of energy, not rais[ing] the cost of existing sources. Too often, 'clean' is treated as an absolute, but it is better regarded as a comparison. A better definition of clean is: '*less intensive in global lifecycle impacts on human health and the environment than its likeliest alternative.*'" If Democrats are willing to give on some pro-production measures and Republicans are willing to accept some pro-conservation measures, the Senate is likely under their leadership to be able to coalesce around a bill that would have the support of at least 60 Senators.

Given the makeup of the House, we are not optimistic that something comparable will emerge, at least initially. With Republicans having maintained control of the House, they are likely to continue to focus the bulk of their attention on their pro-development, anti-EPA agenda (other than moving more limited legislation focused on encouraging hydroelectric development in the Pacific Northwest). As during the 112th Congress, none of those anti-EPA measures is likely to be enacted into law because none is likely to enjoy the support of 60 Senators and, in any event, would be vetoed by the President. Last year, for example, the EPA proposed strict new greenhouse gas emissions (GHG) for new power plants, effectively making new coal-fired plants uneconomic. A House effort to block the proposed rule died in the Senate. Last night, the President made it clear that his Administration will use existing authorities to move the country towards what he considers to be a more sustainable energy economy. In that connection, he will now turn his attention to GHG emissions emitted by existing coal-fired plants, which will trigger a similar response from House Republicans and a likely similar fate in the Senate as well.

At some point later this year or early next year, House Republicans may find that they will be reacting to Senate action, rather than driving the debate. (The same dynamic occurred last year, when the Senate took the lead in fashioning a major surface transportation bill that enjoyed broad bipartisan support. Because the House Republican leadership was unable to agree on anything that could clear the House floor initially, the House was effectively forced to react to the Senate. As a result, the Senate largely dictated the outcome of the debate.) And thus House Republicans may come together, working with Democrats, to produce a House counterpart to a Senate energy bill should it emerge.

MISCELLANEOUS LEGISLATION

As the President made clear last night, he hopes the 113th Congress will work with him on a variety of other national issues, including gun control and initiatives to create jobs, rebuild aging infrastructure, and revive domestic manufacturing. Congress will undoubtedly address these issues, as well as the Marketplace Fairness Act, cyber security legislation (to address issues unresolved by the Executive Order the President issued yesterday), higher education reauthorization legislation, the No Child Left Behind Act, the surface transportation bill (MAP-21), the Affordable Care Act, and reauthorization of major agricultural programs (including the food stamp program). By year end, it also must decide whether and how to reauthorize the Terrorism Risk Insurance Act and will consider reauthorization legislation for the Commodity Futures Trading Commission and the Ex-Im Bank. Although the President did not make financial services reform or changes to the Dodd-Frank Act the focus of his address, he voiced support for a legislative mortgage refinance program to help homeowners. We expect financial regulatory reform implementation to remain a priority objective of the Administration. The importance and breadth of these issues were exemplified this morning at Treasury Secretary nominee Jack Lew's confirmation hearing.

We will be following all of these legislative and regulatory developments closely and will be providing regular updates on them as well.

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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, regulatory expertise, 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 now engages with the 113th Congress.