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Energy Insights

An Update from the First Quarter of 2015

In this edition of Seyfarth Shaw's Energy Insights Newsletter our Energy and Clean Technologies team covers important developments in Q1 2015 for the energy industry including 1) the IRS's one year extension to construction commencement date to claim PTC and ITC credit, 2) the compromise fracking restriction that passed the Texas legislature, 3) the EPA's new plan for methane controls in the oil and gas industry, and 4) the alternatives to reductions in force that may be better for energy employers.

IRS Grants One Year Extension to Construction Commencement Date to Claim PTC or ITC Tax Credit

By Robert S. Winner, A. Donald Lepore III

On March 11, 2015, the Internal Revenue Service (IRS) issued Notice 2015-25 (Notice), which extends by one year, from January 1, 2014 to January 1, 2015, the date by which construction on a qualifying renewable energy facility must have "begun" in order to be eligible for the production tax credit (PTC) or, alternatively, the investment tax credit (ITC). In order to be eligible, a taxpayer must establish that construction has begun by either (1) starting physical work of a significant nature (Physical Work Test) or (2) paying or incurring five percent or more of the total cost of the facility (Safe Harbor). While the "begin construction" criteria have not changed, the date by which developers had to have commenced construction has been extended by one year, a welcome relief to those taxpayers whose projects had not commenced construction under the prior deadline. In addition, the completion date for pre-2015 facilities has been extended by one year to January 1, 2017. Notably, the IRS extension of the construction tests for the PTC and ITC does not apply to Section 1603 Grants, which have independent eligibility requirements.

The PTC provides qualifying renewable energy projects (e.g., wind, geothermal, biomass and municipal solid waste) with a tax credit of approximately $0.023/kWh for energy generated and sold to a third party. The tax credit can be claimed for the 10-year period following commercial operation of the project and often is used in tax equity transactions to offset some of the capital costs of constructing qualifying renewable energy facilities. Alternatively, taxpayers can elect to receive the ITC in lieu of the PTC for certain qualifying facilities (e.g., solar installations). The ITC provides a one-time tax credit equal to 30 percent of the tax basis of the qualifying facility, which is set to step down to 10 percent at the end of 2016 for commercial and utility scale solar power systems. While President Obama's 2016 budget calls for permanent extension of the ITC and PTC, it is unclear what, if anything, Congress will ultimately approve.

Compromise Fracking Restrictions Pass Texas Legislature

By Robert S. Winner, A. Donald Lepore III

On March 30, 2015, a Texas House committee approved an amended bill, known as H.B. 40, that prevents, and expressly pre-empts, local governments from imposing their own fracking restrictions, subject to certain exceptions. H.B. 40 expressly preempts regulation of oil and gas operations by municipalities and other political subdivisions, except that "a municipality is authorized to enact, amend, or enforce an ordinance or other measure that regulates only surface activity that is incident to an oil and gas operation, is commercially reasonable, does not effectively prohibit an oil and gas operation, and is not otherwise preempted by state or federal law." A "commercially reasonable" measure is one that "permits a reasonably prudent operator to fully, effectively, and economically exploit, develop, produce, process, and transport oil and gas." It is unclear, however, whether this language will be sufficient to satisfy critics of the proposed law who are seeking to pre-empt all local government fracking restrictions, such as the plaintiffs challenging the restrictions previously passed by the City of Denton, or whether the plaintiffs will abandon their callenge as a result of the new law.

The legal challenges made to the City of Denton's regulations, and the city's counterarguments, centered primarily on questions under Texas state constitutional law, principally the city's ability and authority to enact measures of this type and scope, versus the state's constitutional ability to pre-empt such regulation, and in the latter case whether such local regulations had in fact been pre-empted. States such as Colorado, New York, West Virginia and Pennsylvania have seen similar challenges to regulations at the municipal and local level, with the decisions in such cases essentially split evenly between those courts preserving the local municipality's ability to regulates and those courts finding that such regulations are pre-empted by the laws at the State level. Given the unprecedented oil and gas production in the United States, and the backlash to the methods by which those hydrocarbons are extracted from the ground, the battle of state preemption over local oil and gas regulations is expected to continue.

EPA Plan for Methane Controls in Oil and Gas Industry

By Philip L. Comella and Craig B. Simonsen

In another move to implement the President's Climate Action Plan, the Obama Administration today announced a new goal to cut methane emissions from the oil and gas sector by 40 to 45 percent from 2012 levels by 2025. According to EPA, methane emissions accounted for nearly ten percent of U.S. greenhouse gas emissions in 2012, with nearly thirty percent of that coming from the production, transmission, and distribution of oil and natural gas. To achieve this goal, and building on five technical white papers issued last spring, EPA will initiate a rulemaking to set standards for methane and VOC emissions from new and modified oil and gas production sources, and natural gas processing and transmission sources. EPA plans to issue the proposed rule in the summer of 2015, with a final rule 2016. Law360 reported that Dan Utech, the Special Assistant to President Barack Obama for Energy and Climate Change, said that to implement the Administration's goal, this new set of new rules will first target new sources such as hydraulic fracturing operations, under section 111(b) of the Clean Air Act. Utech estimated that the rules will save up to 180 billion cubic feet of gas that would otherwise be "wasted." "The overall plan will also include efforts to reduce volatile organic compounds, and a voluntary component for industry."

EPA expects that other actions under this new goal may also include:

- New Guidelines to Reduce Volatile Organic Compounds.
- Enhancing Leak Detection and Emissions Reporting.
- Lead by Example on Public Lands.
- Reduce Methane Emissions while Improving Pipeline Safety.
- Drive Technology to Reduce Natural Gas Losses and Improve Emissions Quantification.
- Modernize Natural Gas Transmission and Distribution Infrastructure.
- Release a Quadrennial Energy Review (QER).
- Expand the Natural Gas STAR Program.

RIF Alternatives May Provide Better Results

By Brian A. Wadsworth and Dennis A. Clifford

In the wake of the precipitous oil price drop of the last half of 2014 and beginning of 2015, energy companies have implemented various methods to balance the ledger, to include the popular cost-saving reduction-in-force ("RIF"). However, while a RIF may provide immediate cost savings, it has attendant legal risks and may have a negative impact on the company in the long run. There are a number of alternatives to a RIF that may generate the same desired cost-savings, while avoiding the legal risks and other negative consequences, such as: (1) mandatory time off without pay; (2) pay freezes; (3) job sharing; and (4) voluntary separation plans. These alternatives, as a shared sacrifice, are less likely to harm employee morale than a RIF and will result in lower legal risks. In addition, these alternatives send a stronger message to the marketplace that a company is committed to its workforce in the long term.

To take advantage of a mandatory time off plan, employers must first determine whether the affected employees are at-will or employed pursuant to an employment contract or collective bargaining agreement. Employers are generally free to mandate that at-will employees take unpaid time off. However, contracts will generally require renegotiation to implement mandatory time off without pay. Under a pay freeze scheme, an employer freezes employee pay for a specified period of time, such as a calendar year or fiscal year. While certainly not ideal, a pay freeze is easier for employees to accept than a RIF. Another option available to employers is a job-sharing scheme. This alternative can be implemented in a number of different ways, such as converting full time employees to part time to fill the same position, or consolidating two positions into one. Lastly, employers should also consider a voluntary separation plan. Voluntary separation plans allow employers to offer separation benefits for a voluntary exit from the company. This cost-saving measure provides employers with flexible and creative solutions. A voluntary separation plan can be made available to all employees in an organization; or, alternatively, the plan can be crafted to target particular employees based on non-discriminatory characteristics, such as years of service, department, or job category. For any alternative selected, an employer must make sure laws are complied with, including the Fair Labor Standards Act. Please consult your advisors before implementing any plan.

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