

July 9, 2008

MMS Proposes Offshore Alternative Energy Program Regulations

The U.S. Department of the Interior's Minerals Management Service ("MMS") yesterday issued its proposed rule to regulate alternative energy production activities on the Outer Continental Shelf ("OCS"). This rule proposes to establish comprehensive, detailed regulations governing all aspects of renewable energy project development on the OCS. Because the industry is relatively new and the projects often involve novel technology, MMS is seeking comments from all entities, both public and private, with an interest in the proposed regulations. Comments are due no later than September 8, 2008.

Authorized by Congress in the Energy Policy Act of 2005 ("EPAAct"), the OCS Alternative Energy and Alternate Use ("AEAU") Program gave the Department of the Interior new authority to grant leases and easements for the development of offshore energy projects, including wind, wave, current, and solar energy projects. The AEAU Program has already garnered a great deal of attention from project developers of all sizes and, in April 2008, MMS announced nominations for proposed limited alternative energy leases.

Prior to the enactment of EPAAct, there was no clear delineation of federal authority as it pertains to the alternative energy-related projects on the OCS. As a result, and despite industry interest in offshore renewable projects, this lack of certainty deterred significant investment in the sector. MMS is hopeful that the implementation of the AEAU program will spur further offshore renewable energy development.

The Proposed Rule

The proposed rule is detailed and should be examined carefully by any party interested in seeking an MMS alternative energy lease or alternate use of an existing OCS facility. There are, however, several key provisions in the rulemaking that deserve initial attention. This Legal Alert provides a brief overview of: (1) the leasing process and easements; (2) financial obligations; and (3) project plan requirements. In addition to the parameters set forth in the proposed rule, MMS strongly urges developers to engage in preliminary outreach efforts to interested and affected stakeholders to exchange information and receive feedback on their proposed projects.

OCS Access and the Leasing Process

MMS proposes to issue two categories of leases for offshore alternative energy development: commercial leases and limited leases.

Commercial leases would provide access and operational rights to produce, sell, and deliver energy on a commercial basis. Commercial leases would be long-term (i.e., up to 30 years) but could be relinquished by lease holders. Because transmission and/or transportation is essential to make an alternative energy project viable, commercial leases also would convey preferential rights to easements for wires, cables and pipelines necessary for the transmission and/or transportation of the energy to shore.

Limited leases, in contrast, would only grant leaseholders access and operational rights to conduct activities such as site assessments and technology development and testing. Limited leases would be short-term (i.e., up to 5 years, with possible renewals) and could not later be converted to commercial leases. If a holder of a limited lease wished to pursue commercial development on the OCS, it would need to obtain a new commercial lease through the leasing process.

© 2008 Sutherland. All Rights Reserved.

This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.

1

MMS proposes to adopt a two-lease approach in order to allow smaller project developers who may be unwilling to invest in a commercial lease due to unproven technology or unproven return on investment to participate in the program, test new technology and determine commercial viability.

Under the proposed rule, the leasing process for both commercial and limited leases would be similar to longstanding MMS processes for conveying mineral rights (e.g., oil and gas exploration and production leases).

- All leases would be subject to a competitive bidding process unless there is no competitive interest in a given site.
- The competitive process may include auctions of proposed sites, with auction procedures including sealed or other forms of bidding, cash bonuses, reservation prices, and other measures. Specifically, the rule proposes and seeks comment on:
 - Three alternative auction formats (sealed bidding, ascending bidding and two-stage bidding).
 - Alternative bidding systems, including five alternative bid variables.
 - Six alternative methodologies for addressing situations in which lease requests from different project proponents involve overlapping areas.
- Noncompetitive lease sales would be handled similarly to noncompetitive negotiated agreements for the conveyance of OCS sand and gravel.

The proposed rule includes descriptions of the kind of information that potential bidders and lease holders should submit to MMS. For example, in instances where MMS issues a Request for Information or a Call for Information and Nominations with regard to a proposed leasing area, respondents are strongly encouraged to submit market information regarding the electric power markets into which it plans to deliver the electricity generated by the alternative energy project.

MMS proposes to retain discretion with regard to renewal of alternative energy leases and is expressly seeking comments on establishing standard criteria for consideration in lease renewal decisions.

In order to ensure a thorough review of each lease and alternative energy project, the proposed rule also would include a consultative role in the leasing process for coastal state governors and local elected officials in areas potentially impacted by the proposed lease and project.

Financial Obligations

Because the leases issued pursuant to the AEAU Program necessarily involve federal lands, the government must secure revenue for the U.S. Treasury when offshore acreage is used for potentially commercial purposes. Although MMS recognizes the need to generate revenue, it also does not want to discourage the development of offshore renewable resources or dissuade small companies from project investment. Therefore, MMS has proposed initial payments it considers to be modest in order to encourage project development. MMS reserves the right, however, to revise the financial terms for established alternative energy projects based on operational experience and for new project proposals based on prevailing and anticipated conditions in the energy market.

Using a system familiar to the offshore oil and gas industry, MMS is proposing to generate revenue primarily from three sources: lease bids, rental fees, and operating fees (i.e., royalties). The proposed

rule requests that respondents provide input on this delicate issue. In addition to these payments, lessees must provide basic initial financial assurances to be issued a commercial (\$100,000) or limited (\$300,000) lease.

- *Bonus Bids* - MMS is proposing to use a cash bonus bidding system to determine the successful bidder. If there is no competitive interest in the lease, a small acquisition fee may be applied.
- *Rental Fees* - For commercial and limited leases, MMS is proposing to charge lessees \$3.00 per acre per year. This fee is paid annually until the lease enters its operations term. Also, a lessee must pay for project easements and rights-of-way ("ROW") grants.
- *Operating Fees* - Lessees must pay operating fees on a commercial lease during the operations term. The fee will be assessed for activities relating to the generation of electricity. MMS is proposing an operating fee rate of 1 percent in the first two years following approval of an operations plan and 2 percent thereafter.

MMS would also require revenue sharing with states when their interests are impacted.

Required Project Plans

In order to ensure the safe and environmentally responsible development of alternative energy resources on the OCS, according to the proposed rule, a lessee or operator must submit and the MMS must approve a series of development and operations plans.

- *Site Assessment Plan* – A SAP must be submitted for a commercial lease to describe its physical and resource characteristics.
- *Construction and Operations Plan* – A COP describes the lessees construction, operations, and conceptual decommissioning plans for a commercial lease.
- *General Activities Plan* – A GAP outlines a lessees proposed activities for the assessment and development of a limited lease.

Each individual project will require compliance with the National Environmental Policy Act ("NEPA") and with other Federal statutes like the Coastal Zone Management Act ("CZMA") and the individual states' federally approved coastal zone management plans. MMS is seeking comments on the SAP and GAP deadlines and compliance with NEPA and CZMA procedures.



If you have any questions regarding this alert, or the services we provide, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Dorothy Black Franzoni	404.853.8489	dorothy.franzoni@sutherland.com
Keith R. McCrea	202.383.0705	keith.mccrea@sutherland.com
Nathaniel J. Teti	202.383.0868	nathaniel.teti@sutherland.com
Daron T. Threet	202.383.0483	daron.threet@sutherland.com
Thomas H. Warren	404.853.8548	thomas.warren@sutherland.com
David L. Wochner	202.383.0381	david.wochner@sutherland.com