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February, 2009: MSCI Advocacy Newsletter

Welcome to the February Advocacy Newsletter, a monthly medium through which MSCI aims to keep its members updated with relevant information on federal legislative and regulatory issues of importance to the metals industry. Washington has been busy in the first two months of 2009, enacting legislation worth hundreds of billions of dollars and considering new spending and tax proposals worth trillions more. Industry leaders are working overtime to assess the impact of Washington's decisions on the vitality of their businesses for years to come. The following issue covers a number of broad topics that will affect the metals industry and builds a framework upon which details can be added in the coming months. For additional information on these and other law-related topics, go to www.winston.com and click on "Publications" under the "Resources" tab.

Economic Stimulus

On Tuesday, February 17, 2009, President Obama signed the American Recovery and Reinvestment Act ("ARRA") into law, a \$787 billion "stimulus" package. The package received zero Republican votes in the House and 3 Republican votes in the Senate. The \$787 billion provided under the ARRA is broken down into a spending section and a tax section, benefiting public, private and federal actors alike. While there are too many specific provisions to cover in this newsletter, the following represents a summary of particularly relevant provisions for the metals industry.

I. Spending Provisions

- ❖ **Infrastructure.** The ARRA includes many substantial infrastructure spending provisions, including \$27.5 billion to states for supplemental highway, bridge, and transit projects, \$9.3 billion for rail transportation, and over \$33 billion for various energy efficiency and renewable energy programs, including research and modern electric grid development and further incentives for wind turbine deployment and solar panel distribution.



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- ❖ **Department of Defense Facilities.** Billions of dollars are provided for defense facilities, including: \$1.3 billion for new construction to provide state-of-the-art medical care to service members and their families (Medical Facilities); \$4.2 billion to invest in energy efficiency projects and to repair and modernize Department of Defense facilities of which \$400 million will be used to improve military medical facilities and \$153 million will be used to restore Army barracks; \$890 million to improve base housing for our troops and families; \$240 million for new child development centers; \$100 million for new construction to support Guard and Reserve units across the country with operations and training facilities and utilities infrastructure; and \$150 million for Grants for Construction of State Extended Care Facilities. The **Department of Veterans Affairs** will also receive \$1 billion for veterans' medical facilities repairs.
- ❖ **Federal Buildings.** \$5.5 billion is provided to the General Services Administration (GSA) for construction, renovations and repairs of federal buildings and courthouses. Projects are to be selected based upon their ability to be awarded within 120 days so that construction can begin as soon as possible, and the emphasis is on energy efficiency.
- ❖ **Health Care Facilities.** Several billion dollars are provided for health care infrastructure, including: \$500 million, part of which is designated for building Public Health Service Health Centers; \$1.5 billion for renovation and repair of existing health centers; \$1.3 billion in grants and contracts to renovate or repair existing non-federal, university research centers; \$500 million for the National Institute of Health building repairs and improvements; and \$360 million for the construction and renovation of research science buildings.
- ❖ **Education Facilities.** \$39.5 billion of the "State Fiscal Stabilization Fund" is designated for distribution by states to local school districts, part of which may be used for school "modernization" and other purposes. Additionally, \$8.8 billion is designated to states for high priority needs, including modernization, repairs, and renovations of public school facilities and institutions of higher learning. Also, \$15 million is provided for the renovation and preservation of buildings on certain Historically Black College and University campuses.
- ❖ **Housing.** The ARRA provides \$4 billion to the Department of Housing and Urban Development (HUD) for repairs and construction of public housing units, \$2.25 billion to the HOME program to rehabilitate and construct low income housing, and \$3 billion in Community Development Block Grants to enable state and local governments, in partnership with community-based organizations, to acquire, construct, and rehabilitate affordable housing. Additionally, \$5 billion is provided to expand the number of households eligible for assistance under the Department of Energy's "Weather Assistance Program". This program provides grants to states to assist low income households with the purchase and installation of materials that improve energy efficiency.
- ❖ **The Department of Interior – Bureau of Indian Affairs** will receive \$450 million for construction, repairs and replacement of schools, detention facilities, roads, bridges, employee housing and maintenance.



II. Tax Provisions

- ❖ **Extension of Bonus Depreciation.** Last year, Congress temporarily allowed businesses to recover the costs of capital expenditures made in 2008 faster than the ordinary depreciation schedule. Specifically, Congress enacted a provision that would allow businesses to immediately write-off fifty percent of the cost of depreciable property acquired in 2008. ARRA extends this temporary benefit for expenditures in 2009.
- ❖ **Grants in Lieu of Low Income Housing Tax Credits.** Under current law, taxpayers are allowed to claim a low-income housing tax credit for private investments in low-income housing construction, acquisition, or rehabilitation. Current economic conditions have undermined the effectiveness of tax credits. As a result, the ARRA will allow taxpayers to receive a grant from the Treasury Department in lieu of tax credits.
- ❖ **Refundable First-time Home Buyer Credit.** Last year, Congress provided taxpayers with a refundable tax credit that was equivalent to an interest-free loan (for a term of 15 years) equal to 10 percent of the purchase of a home (up to \$7,500) by first-time home buyers. The provision would have expired on July 1, 2009. The credit phases out for taxpayers with adjusted gross income in excess of \$75,000 (\$150,000 in the case of a joint return). The ARRA eliminates the repayment obligation for taxpayers that purchase homes after January 1, 2009 and increases the maximum value of the credit to \$8,000. It expires November 30, 2009.
- ❖ **Five-Year Carry Back of Net Operating Losses.** The ARRA includes a provision that allows businesses (with gross receipts of \$15 million or less) to “carry back” their operating losses in 2008 and 2009 for up to five years, rather than the two permitted under current law. The provision requires that businesses choosing the longer period to reduce their losses by 10%.
- ❖ **Increased Limitation on Expensing Depreciable Assets.** Capital expenditures up to \$125,000 for small businesses will be eligible as write-offs, quickly recovering the cost of such expenses instead of having to wait for them to depreciate over time.
- ❖ **Sales Tax Deduction for Vehicle Purchases.** The ARRA provides all taxpayers with a deduction for State and local sales and excise taxes paid on the purchase of new cars, light truck, recreational vehicles, and motorcycles through 2009. The amount of the deduction is means tested so that taxpayers with adjusted gross income in excess of \$125,000 (\$250,000 in the case of a joint return) receive a lower deduction.
- ❖ **Improve Marketability of Tax Exempt Bonds.** The ARRA will increase the marketability of tax exempt bonds issued by States and by local governments in 2009 and 2010, thereby increasing available financing in four ways: (1) it eliminates the tax exempt interest on tax exempt private



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activity bonds as a preference item of the alternative minimum tax; (2) it increases the market for bonds by expanding the ability of banks and brokers to invest in them; (3) it raises the amount of bonds a small issuer can issue from \$10 million to \$30 million; and (4) it expands the amount of bonds that can be issued by small issuers by applying this limit to each ultimate borrower.

- ❖ **Industrial Development Bonds.** The ARRA will modernize certain tax exempt qualified small issue bonds or “Industrial Development Bonds” (“IDBs”) for facilities that create or manufacture intangible property. The ARRA also will clarify which physical components of any given facility are eligible for such tax exempt financing.
- ❖ **Build America Bonds.** The ARRA will provide State and local governments with a new tax credit bond option for new capital projects. Because the market for tax credits is currently small given current economic conditions, the provision will allow the State or local government to elect to receive a direct payment from the Federal Government equal to the subsidy that would have otherwise been delivered through the federal tax credit for bonds issued in 2009, 2010, and 2011.
- ❖ **Qualified School Construction Bonds.** The ARRA creates a new category of tax credit bonds that can be used for the construction, rehabilitation, or repair of public school facilities. The issuance limit is \$22 billion for 2009 and 2010.
- ❖ **Extension and Increase in Authorization for Qualified Zone Academy Bonds (QZABs).** The ARRA adds more than \$1 billion of QZAB issuing authority to State and local governments in 2009 and 2010. These bonds can be used to finance renovations, equipment purchases, developing course material, and training teachers and personnel at public schools located in empowerment zones or enterprise communities.
- ❖ **Recovery Bonds.** There will be a new type of tax credit bond to finance public infrastructure improvements within national recovery zones that facilitate economic development within that zone. The total allocation will be \$10 billion. Additionally, \$15 billion will go to similar bonds for capital investments in a national recovery zones.

III. Worker Assistance & Trade-Related Provisions

- ❖ **Premium Subsidies for COBRA Continuation Coverage for Unemployed Workers.** The ARRA provides a 65 percent premium subsidy for individuals who lost their jobs after September of 2008 to help cover the cost of COBRA premiums for up to 9 months. The benefit phases out at \$125,000 AGI.
- ❖ **Extension of the Trade Adjustment Assistance (TAA) programs for two years.** The TAA for Workers program provides extended income support and training benefits for workers who lose their jobs because of increased imports or factory shifts to certain countries. The TAA program helps prevent layoffs entirely by assisting trade-distressed companies retool and become more competitive. Specifically, it provides a 160% increase in training funds available to states through 2010.



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- ❖ **Duty Refund Recollection.** The ARRA prohibits U.S. Customs and Border Protection from demanding that U.S. lumber, steel, and other companies repay duties collected from 2001 to 2005 on Canadian and Mexican imports that were subsequently distributed to U.S. companies.

In the coming weeks, the Treasury Department and each of the various agencies responsible for administering the above discussed items will develop guidance, providing detail where the legislative language itself is deficient. In some cases, funds will be released to the States almost immediately and spent at their discretion. Keeping a watchful eye on these developments is essential for manufacturer's wishing to have their products utilized in these unprecedented infrastructure projects. Rumors in Washington, not yet dispelled by the White House, are that the President will propose a "Stimulus II" sometime this year.

Trade

On Wednesday, President Obama nominated former Governor of Washington, Gary Locke, as his third candidate for Commerce Secretary. Two previous choices for the position withdrew due to scandal and differences of policy opinion (Governor Richardson (D-NM) & Senator Judd Gregg (R-NH)). Locke is likely to be confirmed due to his generally clean image and long resume on trade.

"Gary will be a trusted voice in my Cabinet, a tireless advocate for our economic competitiveness, and an influential ambassador for American industry who will help us do everything we can, especially now, to promote it around the world," Obama said.

As governor of Washington, Locke was very active in trade matters, promoting mega businesses such as Microsoft and Boeing around the world. Locke is of Chinese descent, and he has been given credit for doubling the State of Washington's exports to China to over \$5 billion per year.

Next, President Obama's choice for U.S. Trade Representative, former Mayor of Dallas Ron Kirk, will need to be confirmed by the Senate Finance Committee. As of now, the confirmation hearing is scheduled for March 5th. In 2000, Kirk supported the Clinton administration's efforts to normalize trade relations with China, but little else is known of his positions on issues such as workers rights, environmental issues and positions on the various pending Free Trade Agreements left over from the Bush Administration.

"Protectionism" has been the buzz in Washington ever since President Obama took office. Many are arguing that too aggressive of a protectionist stance could isolate the United States, encouraging trading partners to do the same. Of particular interest has been the Government's handling of the auto industry bail out and of conditions imposed on infrastructure funds under the American Recovery and Reinvestment Act.

European members of the WTO have expressed concern that U.S. aid for the "Big Three" auto manufacturers may create unfair advantages for U.S. manufacturers thus violating existing trade agreements. The European Transport Commissioner suggested that he would consider appealing to the WTO if the U.S. incentives prove too protectionist of American jobs and national production.



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More widely covered were world-wide concerns over the "Buy American" provisions in the American Recovery and Reinvestment Act. The House version of the legislation included a requirement that:

- ❖ "None of the funds appropriated or otherwise made available by this Act may be used for a project for the construction, alteration, maintenance, or repair of a public building or public work unless all of the iron, steel, and manufactured goods used in the project are produced in the United States."

When the Senate took up its own version of the bill, it chose to water down the requirement by requiring that the "Buy American" provisions are applied consistent with United States obligations under international agreements. Additionally, the Senate included conditions under which the provisions would not apply at all. Specifically, Section 1604(b) of the final package states that the Buy American provisions will not apply:

- ❖ "in any case in which the head of the Federal department or agency involved finds that—“(1) applying subsection (a) would be inconsistent with the public interest; (2) iron, steel, and the relevant manufactured goods are not produced in the United States in sufficient and reasonably available quantities and of a satisfactory quality; or (3) inclusion of iron, steel, and manufactured goods produced in the United States will increase the cost of the overall project by more than 25 percent.”

The effect is likely to exclude products from China, India and other countries who are not party to the WTO, NAFTA or other trade agreements with the United States. The above noted exceptions are more complex than they appear, however, and expert counsel will be necessary for contractors to comply with the law should they choose to use non-American materials.

Finally, U.S. law requires that the U.S. Trade Representative file a report by March 1 each year to outline the nation's trade agenda. Since a Trade Representative has not yet been confirmed by the Senate, a staff-written outline was submitted to Congress on Friday that avoids detail on some of the more controversial issues. However, the report did indicate that the President will move first on the U.S.-Panama Free Trade Agreement while waiting until "benchmarks for progress" are established before moving on similar agreements with Colombia and South Korea. The report also indicated that the President may seek to re-instate "fast-track" trade negotiating authority to minimize amendments by the Congress. Fast-track authority, in the past, has been very controversial.

Budget

On Thursday of last week, President Obama sent a summary of his proposed FY 2010 budget to the Congress, indicating that he would provide a more detailed draft in April. According to the outline document, President Obama anticipates a Federal budget of more the \$3.6 trillion over the next ten years, a number that accounts for tax increases on businesses and wealthier individuals, tax cuts for lower income workers, and



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comprehensive health care and climate change policy. Light on detail and full of proposed policy changes, the budget document has raised many questions on both sides of the aisle and across a broad range of disparate interest groups. Between now and April, this proposal is sure to bring various industries, individuals, charities, and small businesses together in unusual coalitions for and against President Obama's proposals.

I. Taxes - Generally

The \$3.6 trillion package includes about \$1.3 trillion in tax increases on high income households, overseas operations of multi-national companies, corporate polluters, and a range of other corporate interests. Republicans argue that a closer look at the proposal will reveal up to \$2 trillion in tax increases if you consider the impact of a yet to be enacted federal cap and trade scheme. Obama assumes \$646 billion in revenue from such auctions while Republican leadership argue that cap and trade is actually a hidden tax that will indirectly drive up the cost of gasoline, home heating, and groceries.

President Obama's Budget Proposal would raise taxes on married individuals making over \$250,000 annually and single individuals making over \$200,000 annually (but not until 2011 when President Bush's tax cuts expire). Specifically, it would (1) reinstate 36% and 39.6% marginal income tax rates; (2) reinstate the personal exemption phase-out and limits on itemized personal deductions, including capping the charitable deduction and mortgage interest deduction at 28%; and (3) impose a 20% tax rate on capital gains and dividends. In the way of an example, an analysis by Deloitte Tax estimates that an individual earning \$500,000 would see a tax increase of more than \$19,000 under this proposal. And more generally, a \$100 charitable contribution would now be worth \$28 rather than \$32 or \$35 for high income individuals.

These tax increases will be extremely controversial, particularly since many small business owners may indirectly be affected by higher marginal income rates. Additionally, many charities are concerned that curbing the charitable deduction will result in additional hardship for them. This has prompted leading Democrats in both the House and the Senate to question the viability of the approach.

The package also includes tax cuts of \$2.3 trillion over ten years, primarily targeted toward middle and lower income households. For households below the \$250,000 income level, capital gains and dividends rates will be reduced. Additionally, the budget proposes to permanently patch the alternative minimum tax and freeze the current estate tax exemption at \$3.5 million. Finally, the budget proposal would permanently extend a number of provisions recently enacted in the American Recovery and Reinvestment Act, including President Obama's middle class "Making Work Pay" tax credit and other credits and deductions for child care, earned income, and college tuition.

II. Business Taxes

On the business side of the ledger, there are some positive tax proposals in the Obama plan. First, it proposes making the research & development tax credit permanent. Second, the plan would eliminate capital gains taxes for small businesses. And finally, the plan proposes to expand the net operating loss ("NOL") carry back to larger businesses. The President pushed for this NOL expansion in the recently enacted stimulus package,



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but the Congress pared it down due to cost considerations. The result was a 5 year carry back, but only for businesses with less than \$15 million in gross receipts. This budget proposal includes \$9 billion to extend similar treatment to much larger businesses.

A number of other proposals raise red flags for industry. Of particular significance to the metals industry is the inclusion of "Last-In, First-Out" ("LIFO") repeal as a revenue raiser in the budget. Unfortunately, the President did not provide any explanatory information on this proposal. Instead "LIFO Repeal" is simply listed in a budget chart as raising \$61 billion over ten years. The chart indicates that the repeal will not take place until 2012. This provides the many industries that rely on LIFO, including retailers, manufacturers, and mining and energy companies with the opportunity to mount a vigorous opposition to the repeal. MSCI opposes the repeal of LIFO and continues to be actively involved in coalition efforts to educate Congress and the Administration on the importance of LIFO to our industry.

Other FY 2010 budget proposals affecting the metals industry include: (1) codifying the economic substance doctrine, which is currently used by the courts to prevent corporations from engaging in transactions that have no other purpose but to avoid taxation; (2) reinstating \$17.2 billion in taxes on corporations to fund cleanup of hazardous waste sites (Superfund sites) effective in 2011; (3) certain unspecified international tax enforcement measures (effective 2011), and (4) "tax reform" policies that would affect the way U.S.-owned multinational companies currently defer taxation on the profits of their overseas operations until the money is brought back to the United States. Unfortunately, there are few details to accompany these proposals. We will seek to fill in the blanks in the coming month(s).

III. Health Care & Climate Policy

Both health care reform and climate change policy figure prominently in this budget proposal. The budget includes \$630 billion for health care reform over ten years, an amount that is merely a down payment on the true cost of reform. Senior White House officials have been quoted as saying that health care reform is in many ways the solution to our long term budget problem in that reform now will bring substantial savings in the out years.

Paying for the \$630 billion marker is the controversial part. According to the Obama plan, about \$318 billion will come from the above discussed limits on high earner income tax deductions, including limitations on charitable deductions and mortgage deductions. Even those close to the health care reform debate, including Senate Finance Committee Chairman Max Baucus (D-MT), stopped short of endorsing this approach, indicating that the Congress may look for alternative means to pay for health care reform given sensitivities to minimizing tax deductions.

In addition to tax increases, President Obama would raise an additional \$316 billion by cutting Medicare reimbursements to health providers and insurers. Specifically, the budget proposes to eliminate "overpayments" to Medicare Advantage plans. Medicare Advantage is a program through which private insurers provide Medicare benefits instead of the government. To do so, the plans are paid 14 percent more



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per patient than government plans. President Obama proposes changing this to bring reimbursements more in line and thus save \$177 billion over ten years.

Finally, the Obama proposal assumes: (1) \$9 billion in savings by ensuring an approval system for generic versions of "biotech" drugs similar to the system currently in place for synthetic pharmaceutical drugs; (2) nearly \$20 billion in savings through greater discounts by drug manufacturers who sell to Medicaid; (3) and \$38 billion by changing the way Medicare pays hospitals in certain circumstances and requiring hospitals to meet new performance measures. The coming month(s) will tell whether Senator Baucus and other key reform players are willing to adopt these approaches.

As mentioned above, the budget also assumes that Congress will enact cap and trade legislation this year to reduce greenhouse gas emissions, including carbon dioxide. The timeline is ambitious considering the complexity of such legislation and the amount of other emergency measures currently on the desk of congressional leaders. That said, according to the budget proposal, cap and trade would result in \$646 billion in new revenue over the next ten years, accounting for almost half of all new revenue raised over that period.

The proposal does not provide an enormous amount of detail on the cap and trade program itself, but a few key elements are clearly stated. Specifically, the Obama plan anticipates a cap and trade program that begins to generate revenue by 2012 and reduces greenhouse gas emissions 14% below 2005 levels by 2020 and 83% below 2005 levels by 2050. To accomplish his emission reduction goals, President Obama is proposing a 100% auction of emission credits in the initial years as opposed to giving a certain percentage away for free. This position will be opposed by many in Congress who will argue that the cost is too high for emitters to bear.

Another potentially contentious issue will be the use of funds generated by cap and trade. Obama's plan would direct about \$150 billion of the revenues to clean energy research and development and more than \$500 billion toward making permanent his "making work pay" tax credit for lower and middle income workers. Obama justifies using cap and trade revenues to pay for tax cuts by arguing that the tax cuts are a means of offsetting increased energy costs that ratepayers will see under a fully implemented cap and trade system. We should expect Congress to have its own ideas for how \$646 billion in new funds should be allocated.

Labor

On February 11, 2009, Representative Hilda Solis (D-CA) was confirmed by the United States Senate as President Obama's Secretary of Labor. Her nomination had been delayed due to inquiries into tax controversies associated with her husband and questions about the appropriateness of her serving as Treasurer of "American Rights at Work", a pro-labor organization, while a Member of Congress. Now confirmed, Secretary Solis has a near perfect rating from the AFL-CIO for her Congressional performance, prompting most to believe that she will work to lay the foundation for a very pro-labor regulatory and legislative agenda in 2009 and 2010.



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In January, before her confirmation, the Congress successfully enacted S.181, the Ledbetter Act, into law. That legislation allows workers to file wage discrimination suits within 180 days of each instance of wage discrimination (each paycheck) as opposed to 180 days after the first instance. Most observers believe that this is only the first step for the Congress with the second major bill on the agenda being "The Employee Free Choice Act" ("EFCA") or "Card Check". Card Check seeks to replace secret ballot elections with a public petition process. The legislation enjoys strong support from the Obama Administration and Congressional Democrats.

Many have suggested that "Card Check" has slipped as a top priority given the large agenda before the Congress and the severe economic challenges faced by the President. But the "Service Employees International Union" ("SEIU") recently launched a \$50 million publicity and lobbying campaign called "Change that Works". The campaign is actively supporting health care overhaul and enactment of the Employee Free Choice Act. Additionally, "American Rights at Work", the labor and advocacy organization associated with Secretary Solis, has announced a \$3 million advertising and lobbying campaign to support similar efforts.

Many companies have begun to plan for "Card Check" by developing preemptive strategies, including planning as if they are constantly facing an organizing campaign, articulating to employees why they do not need a third-party representative, and educating employees on the consequences of signing cards without understanding the authority that they are potentially bestowing upon a third party union. The Metals Service Center Institute strongly opposes this legislation and will be working with the National Association of Manufacturers and the Coalition for a Democratic Workplace to organize education and opposition efforts in states with Senators that can be instrumental in defeating this legislation before it reaches President Obama's desk.

Looking Ahead

- **Surface Transportation Reauthorization:** New legislation to reauthorize expiring federal surface transportation programs must be passed this year. The House Transportation & Infrastructure Committee Chairman James L. Oberstar, (D-Minn) hopes that it can be completed by June.
- **Appropriations:** The Congress is now considering an Omnibus Appropriations package to fund the remainder of 2009. Soon after, it will turn its attention to the FY 2010 Budget Reconciliation process. This year's Budget consideration is likely to be the most contentious in years with interest groups of all shades jockeying for a seat at the table.
- **Energy:** Majority Leader Reid (D-NV) and Senate Finance Committee Chairman Baucus (D-MT) have indicated that the Senate will consider comprehensive energy legislation this year, including energy-related tax provisions. Majority Leader Reid recently suggested a three step approach, dealing first with the creation of a renewable energy standard and promotion of additional energy conservation



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measures. Second, he proposes dealing with improving the country's electric grid. And third, he suggests that once those other matters are completed, the Congress will take up comprehensive climate change legislation (Cap & Trade).

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