

Minerals Management Service's Federal Regulatory Scheme for Offshore Renewable Energy

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The Obama Administration's 2010 budget and the American Recovery and Reinvestment Act¹ stimulus plan passed in February 2009 represent a strong federal government commitment to renewable energy production. The American Clean Energy and Security Act² (the Waxman-Markey Bill) passed by the U.S. House of Representatives in June 2009 has a similar emphasis on significant programs to encourage renewable energy production for reduction of greenhouse gas emissions.

The new federal Minerals Management Service (MMS) framework for developing renewable power projects on the outer continental shelf (OCS) is yet another element in this "green" energy emphasis, giving utilities and energy project developers a roadmap for planning, permitting, and building wind, solar and hydrokinetic energy projects in the off-shore waters of the United States. It is uncertain how the new MMS rules will apply to individual projects, many of which (especially in the Northeast) face organized opposition. Even so, developers now have a starting point to pursue projects in premium lease areas that have significant energy potential and that are near electricity demand centers.

I. What is the OCS?

The OCS generally refers to the offshore ocean and gulf territory under the administration of the federal government, which extends seaward from the immediate offshore territory of the coastal states to the point at which U.S. jurisdiction ends, which can be anywhere from 60 to 350 nautical miles offshore (see below map, courtesy of the MMS).



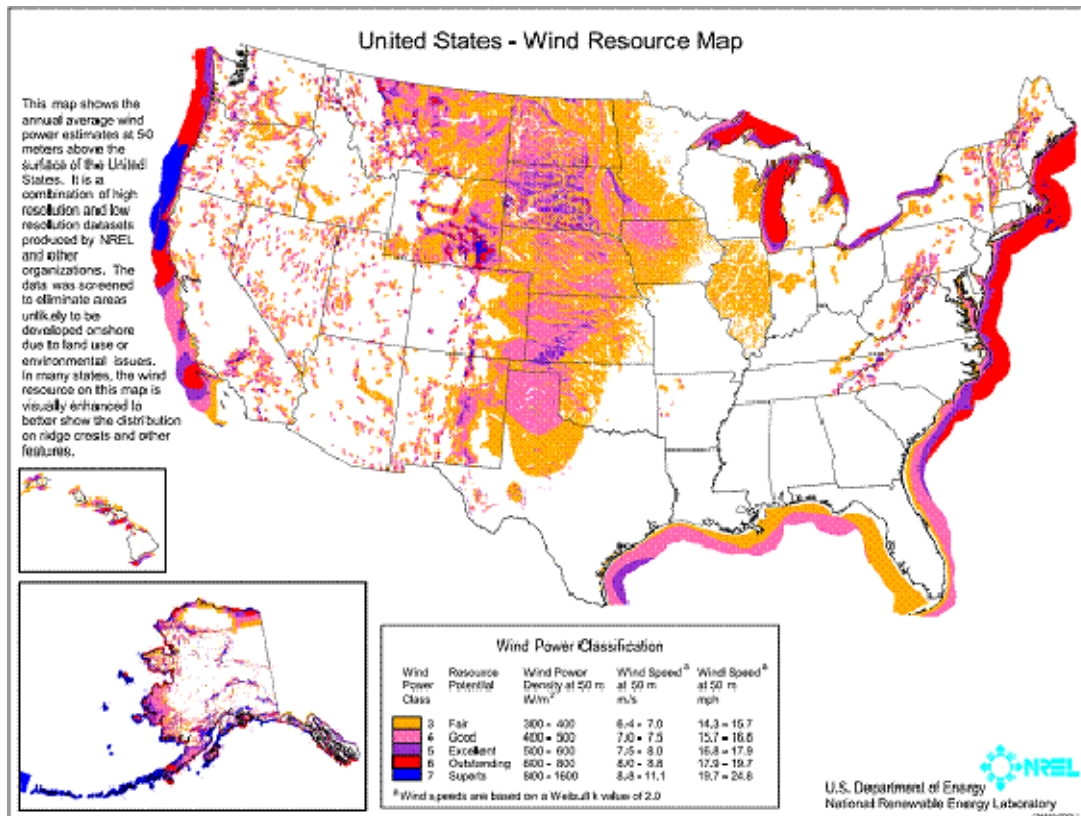
Outer Continental Shelf Areas

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In addition to providing the nation with energy in the form of crude oil and natural gas, the OCS holds renewable energy potential that has remained virtually untapped due to legal and regulatory uncertainty. As the map below demonstrates, the nation's most abundant wind resources are generally located on the OCS and the Great Lakes.



In addition to wind resources, the OCS provides excellent potential to produce power from such hydrokinetic sources as wave, ocean current and tidal forces. For instance, the total average wave energy on the OCS alone is estimated to be 2,100 Terawatt-hours (TWh) per year.³ To put this in context, the entire electricity consumption of the U.S. in 2007 was approximately 3,892 TWh.⁴ Despite this potential, jurisdictional uncertainty and other regulatory factors have stood as major obstacles to the development of such resources.

II. The OCS Alternative Energy Program

In an effort to spur offshore renewable development, Congress included in the Energy Policy Act of 2005⁵ a provision placing the jurisdictional authority over offshore renewables in the hands of MMS. Under this provision, the MMS obtained discretionary authority to regulate the production, transportation and transmission of renewable energy on the OCS. The agency responded by undertaking an extensive rulemaking proceeding to create a renewables program from whole cloth. This process culminated in the issuance of a Final Rule on April 22, 2009,⁶ in which the MMS introduced its OCS Alternative Energy Program and regulations for the development of renewable energy generation on the OCS.

The agency also recently inked a Memorandum of Understanding with the Federal Energy Regulatory Commission (FERC) to resolve a jurisdictional tussle over the actual sale of power and the licensing of hydrokinetic facilities (as opposed to wind and solar).⁷ The MOU between FERC and MMS established a two-step process for approval of hydrokinetic facilities. An applicant must first obtain a lease from the MMS to conduct renewable energy activities on the

desired tract of the OCS and subsequently acquire an exemption or license from the FERC to undertake the construction and operation of the hydrokinetic project. Both the MMS and the FERC strongly recommend that applicants coordinate with both agencies at the beginning of the process to inform the agencies of the applicant's interest in hydrokinetic development.

The MMS's new regulations focus on the development of individual offshore wind and solar projects from conception through decommissioning. These regulations address:

- Procedures for issuing an OCS renewable energy lease, including the types of leases the MMS will issue, the bidding and award process, and the lease terms;
- The process for granting rights-of-way, rights-of-use and easements for renewable energy generation and transmission;
- Renewal, assignment, suspension, termination and relinquishment of an OCS renewable energy lease or grant;
- Payments and financial assurance requirements, including revenue sharing and rents;
- Information and planning requirements, including site assessment plans, construction and operations plans and general activities plans;
- Approval and procedures with respect to facility design, fabrication and installation;
- Requirements for environmental and safety management, inspections and assessments, including necessary safety management systems, maintenance procedures, inspection and incident reporting;
- Facility decommissioning; and
- Rules and procedures for obtaining "Alternate Use Rights-of-Use and Easements," enabling currently existing facilities to be used in connection with the generation of renewable energy.

The MMS will issue two types of leases—commercial and limited. Commercial leases give developers access and operational rights to produce, sell and deliver power on a commercial scale. This power may be sold through spot market or long-term power purchase agreements. Further, the MMS explained that there will be no limit on the amount of power that may be produced and sold under a commercial lease. The MMS expects commercial leases to be issued for periods extending up to 30 years, with the opportunity for renewal. Commercial leases also grant developers preferential rights to project easements on the OCS for purposes of installing transmission and distribution facilities to connect their generators to the grid. Leases may cover one kind of renewable source (e.g., for wind only) or may grant authorization to develop facilities for various resources.

Limited leases will be issued for shorter periods (e.g., five years) and convey the right to conduct activities such as site assessment and technology research and testing. While a limited lease will not authorize holders to produce and sell power on a commercial scale, the provisions of an individual lease may allow for the sale of electricity produced in the course of testing and site assessment activities (e.g., five megawatts). The lease terms will also indicate whether a limited lease conveys to the holder additional weight for consideration by the MMS in a subsequent competitive process for a commercial lease.

The MMS encourages renewable energy applicants to seek commercial leases. Even applicants unsure if a particular renewable energy technology is commercially feasible should seek a commercial lease because it reserves the full right to commercially develop the OCS site. The technology testing can be conducted during the site-assessment phase of the lease (discussed below). The lessee is not obligated to fulfill the full lease term if the technology proves to be unsuitable for commercial production. Alternatively, smaller entities unable to undertake expensive long-term commercial leases can still pursue renewable energy activities on the OCS under a limited lease.

III. The Lease Issuance Process

In the newly promulgated rule, the MMS outlines a lease process, indicating several major milestones, patterned after procedures already used for the MMS's oil and gas lease program. The MMS is currently drafting a guidance document to provide details on the process by which the agency will issue commercial and limited leases. According to the MMS estimates, project developers should plan on a period of one to two years for commercial leases, and six months for limited lease applications. The commercial lease is more costly and time-consuming, in part, because it requires an environmental analysis under the National Environmental Policy Act (NEPA).⁸ The nature of the lease will define the time and cost needed for issuance, and developers should allow for additional time in the early stages of this new program. For applicants interested in projects that involve intensive site assessment, the MMS plans to allow simultaneous applications for a limited and commercial lease on the same tract. The simultaneous application will be detailed in a later guidance document and the process will allow the lessee to begin site assessment work while the commercial application is pending.

a) The Call and Area Identification

When the MMS decides to initiate a lease issuance process, either on its own accord or in response to an unsolicited request by a potential lessee, the agency will issue a Call for Information and Nominations (Call) to notify the public about the area under consideration. Prospective bidders have 45 days to indicate areas and levels of interest. Also, other interested parties will have an opportunity to submit comments and present issues warranting special consideration. The MMS also expects to announce the process it will employ to comply with NEPA.

At the conclusion of the 45-day comment period, the MMS will determine whether the bid process will be competitive or noncompetitive. The general rule is to use a competitive lease process. The MMS may issue a lease through a noncompetitive process upon making a determination that no competitive interests exist, but only if no party responds to a Call. The noncompetitive process will be modeled after the process currently used to convey OCS sand and gravel leases, which involves a simple review of the applicant's planned usage of the tract. Alternatively, the competitive process will resemble the process currently used to convey offshore oil and gas leases. Using information obtained from the Call, the MMS will determine the geographic area for the proposed lease, any alternatives to the proposed action and any mitigation measures. This process will generally result in a press release identifying the area proposed for leasing, a fact sheet and a map of the area.

b) Environmental Analysis and Notices of Sale

Once a lease area is identified, the MMS will begin preparing the documents necessary to comply with the environmental requirements of NEPA and the Coastal Zone Management Act (CZMA).⁹ Offshore renewable activities on the OCS will require more intensive environmental studies and compliance procedures with the NEPA and CZMA. The applicant must pay all MMS costs to complete the necessary environmental assessments. NEPA requires that MMS conduct either an Environmental Impact Statement (EIS) or a less expensive and less time consuming

Environmental Assessment (EA). These environmental reviews must be conducted for each Site-Assessment Plan (SAP) and Construction and Operation Plan (COP) related to a tract. The MMS believes that at the outset of the OCS Alternative Energy Program, the more expensive EIS will likely be required for competitive lease sales. However, the MMS also stated in the commentary to the rule that it is possible, especially as the program matures, that the less intensive NEPA analysis, an EA, may become appropriate for competitive leases once the MMS goes through the EIS process several times.

Concurrent with preparing an EIS or EA, the CZMA requires that the MMS complete a Consistency Determination (CD) relative to each State potentially affected by the planned OCS activity. The CD must include a review of the potentially affected State's coastal zone management plan, analysis of the potential impacts of the proposed lease sale in relation to the program requirements, and assessments of the consistency with the enforceable policies of each State's plan. As with the NEPA review, the CZMA review period's length and cost will correlate with the complexity and scope of the proposed activity on the leased site.

Once the MMS completes the NEPA documentation and the CD, it will issue a public notice announcing the terms and conditions of a proposed competitive lease, likely four to six months in advance of a proposed sale date. Also, concurrent with this notice, the MMS will submit a letter to affected tribal, state and local authorities describing the proposal. These authorities have 60 days to comment. Upon consideration of any comments submitted by tribal, state or local authorities, the MMS will decide whether to continue with the lease sale. If so, at least 30 days in advance it will issue a Final Sale Notice indicating the date, time and place of the sale; the blocks available for lease; stipulations and any other measures; bidding rules and lease terms; and other pertinent information.

c) Bid Process, Evaluation, and Award

In a competitive process, the MMS will begin accepting bids from applicants after the Final Notice period. The type of bid and method of bidding will reflect the auction format chosen by MMS and published in the Final Notice. MMS established four auction formats from which they can choose on a case-by-case basis:

- (1) Sealed bidding. Under the sealed bidding process, each applicant will submit one sealed bid of the amount they are willing to pay for the lease. The MMS will open all bids at once and award the lease accordingly.
- (2) Ascending bidding. An ascending bidding auction entails a continuous bidding process where applicants will be informed of other bids and be allowed to submit multiple bids until the auction closes. The sale procedures for ascending auctions could differ substantially from the customary OCS sealed bid model if the ascending bidding auction becomes the preferred auction format.
- (3) A two-stage bidding process that combines sealed bidding and ascending bidding formats. Under this format, the auction will be an ascending bidding format until only two bidders remain and those two bidders will submit sealed bids to determine who is awarded the lease.
- (4) An auction format that considers multiple factors. As a result of significant comment from interested parties during the rule making process, the MMS created a multiple-factor auction format. In awarding a lease under this format, the MMS will balance several factors, including: technical merit; timeliness; financing and economics; environmental considerations; public benefits; compatibility with State and local needs and the proposed cash bonus; rental rate; and operating fee rate.

In each auction format, the MMS will consider power purchase agreements that may affect the proposed lease parcel. The MMS will specify which type of auction will be used in the Final Sale Notice. Each bid should include an amount of a cash bonus and either a constant fee rate or an operating fee rate.

To ensure the bid price is the result of a competitive process, the MMS will publicly set a minimum bid level deemed satisfactory or competitive across certain classes of lease parcels. The Final Sale Notice will publicize the minimum bid to inform auction participants of the smallest bid amount that will be accepted. Additionally, a reservation price, calculated by the MMS, will act as a bidding floor for individual lease parcels. It reflects an unpublished estimate of the value of the parcel, and thus the lowest bid level at which the MMS would award a lease, and will be utilized where bids vary widely due to either asymmetric information about the parcel or dissimilar bidding strategies. The MMS is confident in its ability to calculate the value of renewable energy leases where it does not feel such confidence in calculating the value of a gas or oil lease. This confidence stems from the conceptual difference in the resource risk considerations between the two lease types. Renewable leases will be focused on areas where resource potential can be more accurately assessed before the auction than during the typical oil or gas lease offerings

Upon receipt of bids, the MMS will evaluate each bid for technical and legal adequacy, as well as financial capability. The winning bidder is presented immediately with the lease forms for execution, and has 10 days to file the required financial assurance and pay the remaining bonus bid. The first six months of rent are due to the MMS within 45 days after receipt of executed copies of the lease.

IV. Post-Award Lease Obligations

After the lease is awarded, each lease is executed in phases. The commercial lease has three phases: (1) the preliminary term; (2) the site assessment term; and (3) the operations term. The lessee must submit a SAP before the second phase commences and a COP before conducting operations under the third phase. The limited lease is executed with a six-month preliminary term and a five-year operations term. An owner of a limited lease must submit a General Activities Plan before the operations phase commences.

Participating developers in the new offshore renewable program face fees and other payments. For commercial leases, developers will pay upfront acquisition fees or bonus payments, acreage-based rents during the pre-development phase of the project and a share of the revenues from energy production after the project commences operation. Limited leases will be subject to an acreage-based rent. In addition, operating fees from projects within a certain proximity to state territorial waters must be shared with the affected states.

V. Looking to the Future

Many other issues must still be resolved before we see commercial scale projects operating along our coastline. These include questions concerning the cost, timing and process for interconnection of offshore wind farms, for example, with the existing electricity grid. Here developers may find themselves in a regulatory thicket involving a number of authorities, including: FERC; state utility regulators; and operators of organized markets such as PJM Interconnection, the New York Independent System Operator, ISO-New England and the California ISO. Additionally, the MMS leasing process is untested, and problems may emerge as it is put into practice. Finally, local opposition groups (such as WindStop¹⁰ and the Alliance to Protect Nantucket Sound,¹¹ which were organized to oppose proposed wind energy installations off of Cape Cod) will likely remain vocal. Nonetheless, by providing a roadmap for issuing renewable energy leases on the OCS, the MMS action moves the United States significantly closer to harnessing its renewable resources on the OCS.

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¹ American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2009).

² American Clean Energy and Security Act of 2009, H.R. 2454, 111th Cong. (passed in House June 26, 2009).

³ Minerals Management Service, White Paper, *Wave Energy Potential on the U.S. Outer Continental Shelf*, at 3 (May 2006), available at http://ocsenergy.anl.gov/documents/docs/OCS_EIS_WhitePaper_Wave.pdf.

⁴ Central Intelligence Agency, *The World Factbook*, <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2042rank.html> (last visited July 17, 2009).

⁵ Energy Policy Act of 2005 (EPAct), Pub. L. No. 109-58, 119 Stat. 594 (2005).

⁶ Dep't of the Interior, Minerals Management Service, Final Rule, *Renewable Energy and Alternate Uses of Existing Facilities on the Outer Continental Shelf*, 74 Fed. Reg. 19,638 (Apr. 29, 2009)

⁷ Memorandum of Understanding between the U.S. Dep't of the Interior and Federal Energy Regulatory Comm'n (Apr. 9, 2009), available at <http://www.ferc.gov/legal/maj-ord-reg/mou/mou-doi.pdf>; see also Bloomberg Law Reports – Sustainable Energy, *MMS and FERC Settle Jurisdictional Dispute, Pave Way for Regulation of Renewable Energy Projects on the Outer Continental Shelf* (June 2009).

⁸ See National Environmental Policy Act, 42 U.S.C. § 4321 *et seq.*

⁹ See 16 U.S.C. § 1451 *et seq.*

¹⁰ See Windstop Home Page, <http://www.windstop.org> (last visited July 17, 2009).

¹¹ See Alliance to Protect Nantucket Sound Home Page, <http://www.saveoursound.org> (last visited July 17, 2009).