

The 2012 Elections



An Analysis by
Cornerstone Government Affairs
November 8, 2012



INTRODUCTION AND DISCLAIMER

The 2012 elections will surely have a significant impact on the nation's politics and policies. Defining that impact exactly is challenging in the immediate hours after the election and will likely take many years to be realized.

In order to begin a dialogue with our clients to better understand the initial implications of the 2012 elections, Cornerstone Government Affairs has assembled the following report, with contributions from our 45 professionals.

We understand that information in this report may quickly become dated which will have an effect on the validity of some of our forecasts. We offer this report to our clients as our best effort to enable you to “look around the corner” with us to see the challenges and opportunities that we will assist you in navigating in the months ahead.

We look forward to discussing these issues with you.

November 8, 2012 (Ver. 1.2, 2:00 pm)

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Election Results

Overview

KEY TAKEAWAYS

- President Obama reelected with at least 303 Electoral College votes
- Democrats continue to control Senate with net gain of two, but Republicans retain filibuster power in Senate
- Republicans continue House majority but lose about seven seats

“It’s clear that with our losses in the presidential race, and a number of key Senate races, we have a period of reflection and recalibration ahead for the Republican Party. While some will want to blame one wing of the party over the other, the reality is candidates from all corners of our GOP lost tonight.”

—Sen. John Cornyn (R-TX)
Chair, National Republican
Senatorial Committee

In the wake of the Nov. 6 elections, one must wonder why—after two years of inflamed rhetoric, endless politicking, and a combined \$6 billion in campaign spending—Americans went to the polls and essentially endorsed the status quo. President Obama won reelection with at least 303 electoral votes, Republicans lost seven seats but still maintained a strong grip on the House, and Democrats added two seats to their majority in the Senate.

To be sure, officials in the White House, Congress and party headquarters are dissecting polling data and election results in an effort to determine what influenced voters, what engaged voters, what brought people to the polls, and—perhaps most important—why in the face of a lagging economy and record-low congressional approval, there wasn’t more volatility and turn-over. It is clear the public was interested... but why, then, did little change? What motivated the electorate to maintain the current balance of power?

In many ways the elections will be viewed in the context of party politics. How do the results affect the President’s ability to lead a divided government and a polarized electorate? Did the public endorse staying the course, or was it simply a matter of demographics, a more effective campaign and/or better candidates? Did the Republicans miss an opportunity, and if so why? Was the rise of the Tea Party in 2009-2010 merely an anomaly?

Although election officials in some states are still counting votes and several congressional races remain too close to call, post-election review and analysis is well underway. Discerning the root of a voter’s decision is a complicated effort, one watched closely by the policymakers and campaign strategists. Equally important, especially in the current environment, is a real understanding of who voted and from where?

Was the rise of the Latino vote the deciding factor in swing states like Nevada and Colorado? Was it social issues more than economic issues that pushed independents one way or the other? Was population growth and changing demographics in places like Northern Virginia and Miami-Dade County, Florida a huge factor in those areas? Answers to those questions will undoubtedly exert considerable influence on the development of legislative and political agendas for both Republicans and Democrats.

However, in the short-term, the bigger question is how will the interpretation of yesterday’s results be viewed in the Halls of Congress and how will that impact the environment surrounding the pending lame duck session.



The 2012 election results do nothing to make us think the highly partisan and politically-charged environment, one which has dominated the 112th Congress and resulted in unwillingness to compromise, an inability to govern, and general gridlock, will change. It seemingly can't get much worse—the 112th Congress, which convened on January 5, 2011, will go down as the least productive in a generation, passing approximately 200 public laws (well below the infamous “do-nothing Congress” of 1947–1948, which enacted 906 laws).

Congress returns to work on November 13. But with minimal working days on the congressional calendar in November and December, the outlook for progress, especially in the wake of the Nov. 6 electoral results, is uncertain at best. This is unfortunate, because Congress has a long laundry list of unfinished business. For instance, Congress has yet to pass a single FY 2013 appropriations bill. (The House has cleared six appropriations bills but the Senate none.) In September, Congress extended current funding for federal departments and agencies (at generally their FY 2012 levels) through March 2013, delaying tougher, longer-term spending decisions until a later date.

Unlike typical years, this post-election Congress faces a deadline of December 31 for coming up with a solution to the looming problem of \$500 billion in tax increases and \$110 billion government spending cuts take effect on January 2, 2013. This “fiscal cliff” will have far-reaching and extensive impacts on all Americans. The decisions made in the coming weeks will shape the debate, policy, and political choices over the next two years.

On December 31, 2012, the 2001 and 2003 tax rates and a host of business tax provisions are scheduled to expire. And one of the least discussed items, expansion of the Alternative Minimum Tax, threatens to significantly increase the tax burden for millions of middle-income Americans unless Congress can find a solution. In addition to the expiration of the 2001 and 2003 tax rates, automatic spending cuts that came out of the August 2011 budget deal are also scheduled to go into effect.

While jubilant Democrats happily envision another four years for President Obama and Republicans begin to huddle to figure out how to broaden their base and position the party for another run at the White House, the debate and decisions made during the coming weeks will be the first indication if the 2012 elections result in a new era of compromise or a continuation of partisan confrontation and legislative gridlock.

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The Presidential Election

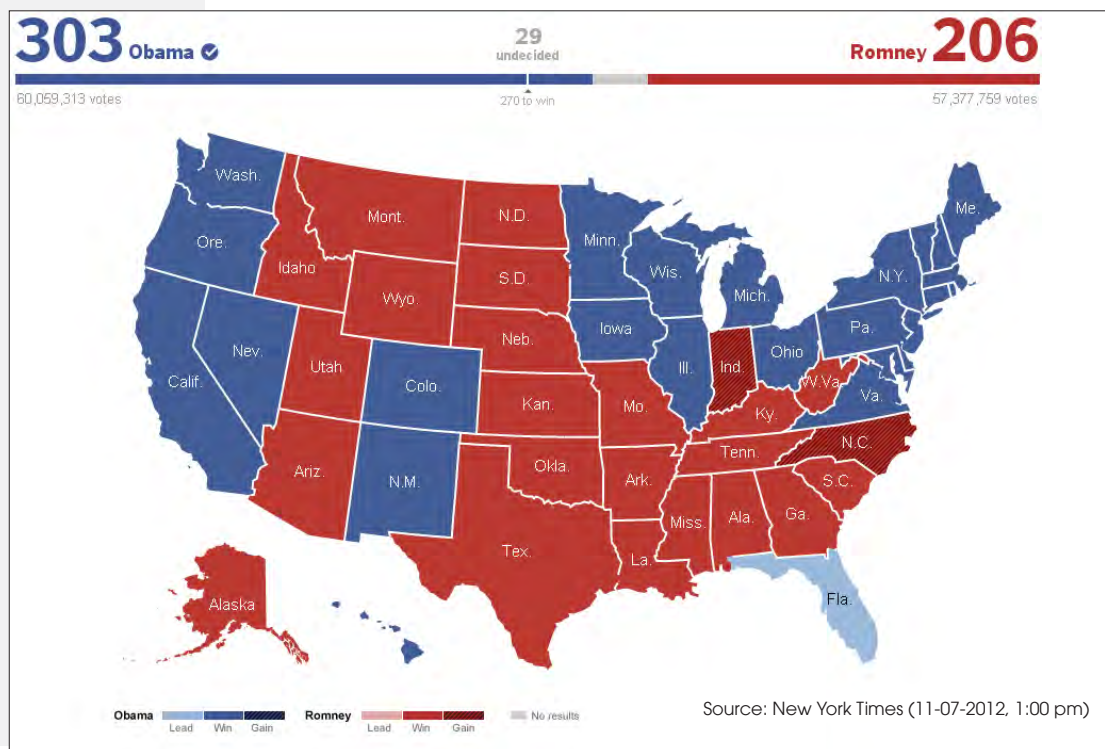
KEY TAKEAWAYS

- President wins Electoral College handily (97+ votes)
- All “battleground states” except North Carolina end up in President’s column
- Popular vote is closer with President beating Romney by just two percent (50% to 48%)
- Florida remains “undecided” but President leads there by 47,000+ votes
- Florida victory would leave final Electoral College count at 332 to 206

The most expensive presidential campaign in American history came to an end in the early hours of Wednesday, Nov. 7 when GOP nominee Mitt Romney, trailing in 10 of the 11 key swing states, conceded to President Barack Obama. At time of writing the President has captured at least 303 electoral votes, with Florida still uncalled. Save for North Carolina, the President won every battleground state en route to a decisive victory in the Electoral College.

That said, President Obama’s mandate will assuredly be challenged by a House of Representatives that remains in firm Republican hands and a gridlocked Senate that has proven itself capable of little over the last four years. A wave of compromise and reconciliation is not likely to wash over Washington.

The tone of Obama’s victory speech (“we are not as divided as our politics suggests”) was offset in a matter of hours by Senate Republican Leader Mitch McConnell (“voters have not endorsed the failures or excesses of the president’s first term”). Obama, McConnell, Senate Majority Leader Reid, Speaker Boehner, and others will soon have the opportunity to decide whether or not the parties are as divided as they seem. And if the deep divisions that marked the last two years of Obama’s first term act as an accurate



predictor of the next two, the President will need to immediately build a broad consensus within his own party in order to find a solution to the stark fiscal dilemma that binds both ends of Pennsylvania Avenue.

The President's success or failure in finding a solution to the Fiscal cliff and deficit matters will set the tone for the next four years—if not serve to define his entire presidency. The issues that comprise the looming Fiscal cliff debate also comprised the campaign: economic growth, fiscal prudence, job creation, debt reduction and revenue generation.

Despite not pronouncing a clear political plan for his second term, the President has been clear about his position on deficit reduction—each cut in spending should be offset with a gain in revenue. Whatever political capital the President gained from his decisive win will likely be used to build a strong coalition of allies on the Hill to sell a comprehensive solution that addresses the fiscal cliff and the deficit, so the remainder of his term should be devoted to issues that can only be addressed by a President free from the stress of reelection.

THE RACE

The yearlong presidential campaign painted large, expensive and contrasting portraits of the two candidates and their parties. In the end, the race ended up being about more than the economy and about more than change. The contrasts in vision were as stark as the agendas were ill-defined.

In a role reversal from 2008, Romney and the Republicans were the purveyors of change in this election with a narrative that sought to focus on the economy, job creation, budget cuts, and a strong defense. Romney was unfettered by a prior presidential term and boasted solid private and public sector credentials. In contrast, Obama—as the incumbent—was forced to defend a slow-growing economy and stimulus spending that harvested inconclusive results. The President was, however, able to tout incremental improvements in job growth and a handful of legislative accomplishments. Obama was able to reach back beyond his first term, however, and stand on a platform of continued 'hope' and 'change' while pleading with voters to give him another four years to accomplish his initial goals.

Each candidate, the press and the parties will painstakingly dissect the campaign for successes and failures, but several narratives can already be identified in the 2012 race:

- **Demographics and the Electoral Map.** As in 2008, President Obama relied on a diverse coalition of voters to join with the working class, rust belt backbone of the Democratic vote. As the demographics of the nation and Sun Belt states have changed, so have the party's overtures to Hispanics, African Americans, women and college-educated men. Despite attempts



to enlist support within those groups, the Republican ticket did not prevail. The GOP will assuredly debate their demographic approach in the months and years to come.

- **Ground Game.** Both parties invested millions of dollars and man-hours in pinpointing voters down to a given block of a given street in a given precinct of a given state. Both parties are sophisticated, but the highly mechanized operation of Obama for America appears to have beaten expectations predicated on the 2008 voter turnout model. Look for this data-driven voter turnout model (“micro-targeting”) to become increasingly important in future races.
- **Spending Impact.** With a combined price tag of over \$6 billion, the candidates, the parties and their correlated-but-not-controlled outside groups (Political Action Committees, 527s and SUPER PACs) have spent over \$100 for each and every vote cast in the 2012 elections. After the ‘Citizens United’ Supreme Court decision, the lure of unlimited corporate, personal and union spending was hard to resist, and both parties raised and spent millions outside of the traditional campaign structures. But the independent expenditures appear to have a nominal net effect in spite of the massive dollars thrown at down ticket, ‘cheaper’ races. At the end of the day, fundamental strategic planning and fundraising at the campaign and candidate level still holds the day in American politics.
- **October Surprise.** Pundits and poll watchers love a last-minute surprise that adds spice to an already piquant mix, and Hurricane Sandy played that role in 2012. While the storm had drastic impact on turnout in states where the result was never in doubt (NY, NJ, DE, CT), Sandy did dominate the airwaves for a matter of days, allowing Obama to appear decisive, compassionate and presidential while Romney was left fielding questions about his support of FEMA while missing critical campaign and fundraising events.
- **The Debate.** Neither Romney nor Obama are likely to ever forget their standoff in the first Presidential debate of 2012 in Denver, CO. Governor Romney shellacked an unwitting President Obama, and the polls reflected his powerful performance. The Romney campaign, however, was unable to parlay the post-debate bounce last through the two subsequent debates and into the election.
- **The Primaries.** Romney had the distinct disadvantage of having to run two campaigns in one. Romney endured a long series of attacks from his party’s as he ran to the right in order to gain his base’s approval. After tacking to the center for the general, the damage from his own party (Newt Gin-



grich, Rick Santorum, Rick Perry) may have hampered the candidate and enhanced the preconceived notion of Romney as a political opportunist.

THE WHITE HOUSE AND CABINET

If Obama follows prior presidential trends, his core White House team will evolve, yet will not endure wholesale change (for example, unlike Nixon, who asked his entire cabinet to resign at the beginning of his second term, the success of which needs no further discussion). Within the President's close circle of advisers there are several additions and omissions that are notable.

Positions for near-term change (potentials in parenthesis):

- WH Press Secretary: Jay Carney (Josh Earnest, Jennifer Psaki)
- Communications Director: Dan Pfeiffer (Jennifer Palmieri)
- Senior Strategist: David Axelrod (John Podesta)
- Secretary of State: Hillary Clinton (John Kerry, Susan Rice, Tom Donilon)
- Secretary of Defense: Leon Panetta (Michel Flournoy, Richard Danzig, Chuck Hagel)
- Attorney General: Eric Holder (Governor Deval Patrick (MA), Senator Klobuchar (MN), Senator Sheldon Whitehouse (RI), Attorney General Lisa Madigan (IL), Secretary Janet Napolitano)

Positions for longer-term change (potentials in parenthesis):

- WH Chief of Staff: Jack Lew (stays for near term. Valerie Jarrett, Ron Klain)
- Director of National Intelligence: James Clapper (John Brennan)
- Central Intelligence Agency: Gen. David Petraeus (John Brennan)
- National Security Adviser: Tom Donilon (Denis McDonough, Michele Flournoy)
- Secretary of Homeland Security: Janet Napolitano (Ray Kelly, Bill Bratton, Thad Allen)
- Secretary of the Treasury: Tim Geithner (Jack Lew, Erskine Bowles)
- Office of Management and Budget: (Douglas Elmendorf, Gene Sperling, Jeff Zients, Rob Nabors)
- Secretary of Commerce: Ron Kirk, Fred Hochberg, Karen Mills
- Secretary of Energy: Steven Chu (Senator Byron Dorgan, Dan Reicher, John Podesta)
- Secretary of Health and Human Services: Kathleen Sebelius (Lois Quam, Nancy-Ann DeParle)
- Secretary of Housing & Urban Development: Shaun Donovan (Carol Galante)



- Secretary of Interior: Ken Salazar (Christine Gregoire, John Berry)
- Secretary of Labor: Hilda Solis (Seth Harris, Maria Echaveste, George Miller, Marcy Kaptur, David Bonior)
- Secretary of Agriculture: Tom Vilsack (Blanche Lincoln)
- Secretary of Transportation: Ray LaHood (Ed Rendell, Steve LaTourette)
- Secretary of Education: Arne Duncan
- Environmental Protection Agency: Lisa Jackson (Bob Perciasepe, Heather Zichal, Bradley Campbell, Mary Nichols)
- Federal Reserve Board: Ben Bernanke (Janet Yellen, Donald Kohn, Larry Summers)
- Supreme Court: Merrick Garland, Senator Amy Klobuchar (MN), Governor Jennifer Granholm (MI), Attorney General Kamala Harris (CA)

POSSIBLE 2016 PRESIDENTIAL CANDIDATES

REPUBLICANS: Gov. Chris Christie (NJ), Sen. Marco Rubio (FL), Gov. Bob McDonnell (VA), Rep. Paul Ryan, (WI), Gov. Bobby Jindal (LA), Gov. Nikki Haley (SC), Sen. Rand Paul (KY), and Sen. Rob Portman (OH).

DEMOCRATS: Secretary of State Hillary Clinton, Vice President Joe Biden, Gov. Martin O'Malley (MD), Gov. Andrew Cuomo (NY), Sen. Mark Warner (VA), Sen. Tim Kaine (VA), Sen. Kirsten Gillibrand (NY), Sen. Amy Klobuchar (MN).



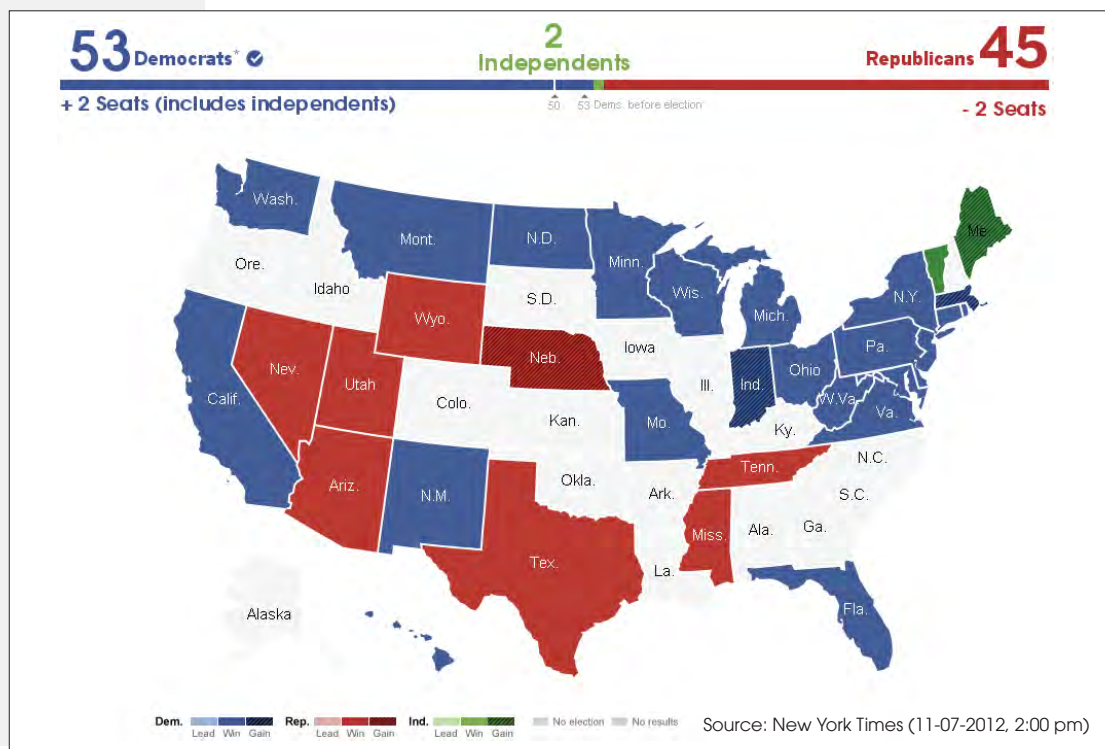
United States Senate

KEY TAKEAWAYS

- Democrats win several key races (Indiana, Maine, Mass.), increasing their majority
- Republicans, however, still have filibuster power (it takes 60 votes to end a filibuster)
- Two independent senators, Bernie Sanders (VT) and Angus King (ME) expected to caucus with Democrats
- Counting Sanders and King, the Democrats will have 55 senators and the Republicans 45
- Democratic and Republican leadership elections during week of Nov. 12

Needing just a few seat changes to grab the majority, and with prime takeover opportunities in Nebraska, North Dakota, Missouri, Montana, Wisconsin, and Virginia (and second-tier takeover opportunities in Connecticut, Florida, Hawaii, Michigan, New Mexico, Ohio, Pennsylvania, and West Virginia), Republicans began the 2012 election cycle heavily favored to control the Senate in the 113th Congress. The 23 Democratic seats up for reelection (including seven retirements) left the party scrambling for candidates in moderate and traditionally red states. It appeared the GOP would atone for the 2010 election cycle, when, placed in a similar situation, Republicans missed an opportunity to seize the majority by rejecting sure-thing candidates and nominating flawed candidates in Delaware, Colorado, Connecticut, and Nevada.

And yet, as polls closed on Nov. 6, the Democrats increased their majority. What happened? In short, lightning struck twice. As *Politico* penned on Nov. 4: “In two consecutive elections, the [Republican] party had a clear shot at a majority and blew it—blew it because the party bosses in Washington have lost control over nominating contests in swing states and seem impotent in engineering the selection of the most electable candidates.” Poor candidate selection and campaign mistakes in Indiana and Missouri cost Republicans a GOP-held seat and a pickup, respectively. A Republican pickup in Nebraska



was countered by additional Democratic pickups in Maine (Senator-elect Angus King, an independent, is expected to caucus with the Democrats) and Massachusetts, and Democrats exited the 2012 elections holding a 55-45 advantage.

The winds began to shift toward the Democrats earlier this year, when the unexpected retirement of Sen. Olympia Snowe (R-ME) created a Democratic pickup opportunity in a blue-leaning state. Sen. Richard Lugar's loss to Indiana State Treasurer Richard Mourdock in a GOP primary—and subsequent comments from Mourdock about rape victims and abortion—produced another unexpected outcome. The Missouri race, thought to be a sure flip for Republicans, turned in August when GOP nominee Rep. Todd Akin weighed in on pregnancy and “legitimate rape.” Add in primary-battered GOP candidates in Connecticut and Wisconsin, disappointing candidates in Florida and Michigan, the amount of resources devoted to unexpectedly close races in ruby red Arizona and North Dakota, and Elizabeth Warren's victory over incumbent Sen. Scott Brown in Massachusetts, and an increased Democratic majority is the result.

LEADERSHIP

There are no significant changes anticipated among Senate Democratic leaders. Majority Leader Harry Reid (NV) remains atop a caucus buoyed and unified by the electoral outcome. Sen. Patty Murray (WA), currently fourth in Democratic leadership, returns with a heightened credibility after stepping up (when no other caucus member would take the job) to lead the Democratic Senate Campaign Committee for a second time. She is being lauded for her efforts to recruit candidates, target states, and ensure candidates had the resources required to win.

As Assistant Majority Leader, Sen. Richard Durbin (IL) spent considerable time on the road raising money and serving as a surrogate for Democratic members of the caucus and candidates, particularly Sens.-elect Tammy Baldwin (WI) and Joe Donnelly (IN). His close personal relationship with the President as well as his work helping Illinois elect new Democratic members in the House will prove invaluable to the caucus. Sen. Chuck Schumer (NY) maintains his outsized presence in the caucus having served important roles in the election of a number of Senate Democrats, including Senators-elect Chris Murphy (CT) and Mazie Hirono (HI).

On the GOP side, Sen. Mitch McConnell (KY) is likely to remain Republican Leader. Sen. Jon Kyl (AZ) is retiring, vacating his position as Minority Whip. That spot is expected to go to current National Republican Senatorial Committee Chair Sen. John Cornyn (TX), but watch out for a challenge from Sen. John Thune (SD), the current GOP conference chair. Sen.



Richard Burr (NC), who contemplated a run for Whip, could throw his hat in the ring for conference chair if Thune looks to move up from his No. 3 spot. Sens. John Barrasso (WY) and Roy Blunt (MO) are third and fourth in the pecking order, respectively, and are expected to remain in their current roles in the 113th Congress. Sens. Jerry Moran (KS) and Rob Portman (OH) will vie for the NRSC position.

EFFECT ON SENATE DIRECTION

The 113th Congress will feature 12 new Senators (8 Democrats, 3 Republicans, and 1 independent) and, after three consecutive high-turnover cycles, 36 first-term members. Of the incoming Republicans, one comes from the House of Representatives and two come from state government. All are expected to provide solid support for GOP leadership. Of the incoming Democrats, five come from the House, one is a former governor and DNC chair, one is a former Attorney General (North Dakota), and the other, Elizabeth Warren of Massachusetts, is a Harvard professor who helped start up the Consumer Financial Protection Bureau. The independent, Angus King of Maine, is a former governor and—while he has yet to make an official announcement—is expected to caucus with the Democrats.

Newcomers Hirono, Murphy, Baldwin, Tim Kaine (VA), and Martin Heinrich (NM) will provide steady and reliable support for the current Democratic leadership. Given his state and campaign promises, Donnelly will look to carve his own path, but should be with leadership when necessary. Given the makeup of her state, Heidi Heitkamp (ND) is also likely to carve her own path. Warren, an outspoken liberal and a fiery critic of the financial sector, will look to advance a more progressive agenda and can be expected to occasionally push issues that will present a challenge for the Democratic caucus.

IMPACT ON 2014

The nature of elections in this era of micro-targeting and nearly unlimited outside spending may cause a handful of senior Senate Democrats to think twice about running again in 2014. This list, which includes—but is not limited to—Sens. Jay Rockefeller (WV), Carl Levin (MI), Tom Harkin (IA), Mary Landrieu (LA), Frank Lautenberg (NJ), and Tim Johnson (SD)—will start to present itself in the coming months as senior members start to realize the differences between a 2014 election and a 2008 election. Retirements will change the way these members look at their committees and their time in office.

At least five of the Republicans up for election in 2014 are expected to face primary challenges from their right—Sens. Lamar Alexander (TN), Saxby Chambliss (GA), Susan Collins (ME), Lindsey Graham (SC), and McConnell. Undoubtedly these members will draw lessons from Bob Bennett (UT) and Lugar's recent losses in GOP primaries. Mindful of Bennett's defeat, Sen. Orrin Hatch (UT) moved rightward in an aggressive effort to claim



LIKELY SENATE CHAIRS AND RANKING MEMBERS — 113TH CONGRESS

Senate Committee	Chair	Ranking Republican Member
Agriculture, Nutrition, and Forestry	Stabenow (MI)	Roberts (KS) or Cochran (MS)
Appropriations	Inouye (HI)	Shelby (AL)
Armed Services	Levin (MI)	Inhofe (OK)
Banking	Johnson (SD)	Crapo (ID)
Budget	Murray (WA)	Sessions (AL)
Commerce	Rockefeller (WV)	DeMint (SC)
Energy and Natural Resources	Wyden (OR)	Murkowski (AK)
Environment and Public Works	Boxer (CA)	Vitter (LA)
Finance	Baucus (MT)	Hatch (UT)
Foreign Relations	Kerry (MA)	Corker (TN)
Health, Education, Labor, and Pensions	Harkin (IA)	Alexander (TN)
Homeland Security and Govt. Affairs	Carper (DE)	Coburn (OK)
Indian Affairs	Cantwell (WA)	Barrasso (WY)
Intelligence	Feinstein (CA)	Chambliss (GA)
Judiciary	Leahy (VT)	Grassley (IA)
Rules and Administration	Schumer (NY)	Blunt (MO)
Small Business and Entrepreneurship	Landrieu (LA)	Risch (ID)
Veteran Affairs	Brown (OH)	Isakson (GA)

the conservative element of his party. Lugar, on the other hand, did not react that way and fell victim to a spirited challenge. These outcomes are not lost on those members up for reelection in 2014. McConnell, for instance, hired Jesse Benton as a campaign adviser (Benton was Sen. Rand Paul's campaign manager in 2010 and worked as a spokesman on Rep. Ron Paul's presidential campaign). Other moderate Republicans are expected to broaden and further relationships with top conservative groups and Tea Party operatives.



House of Representatives

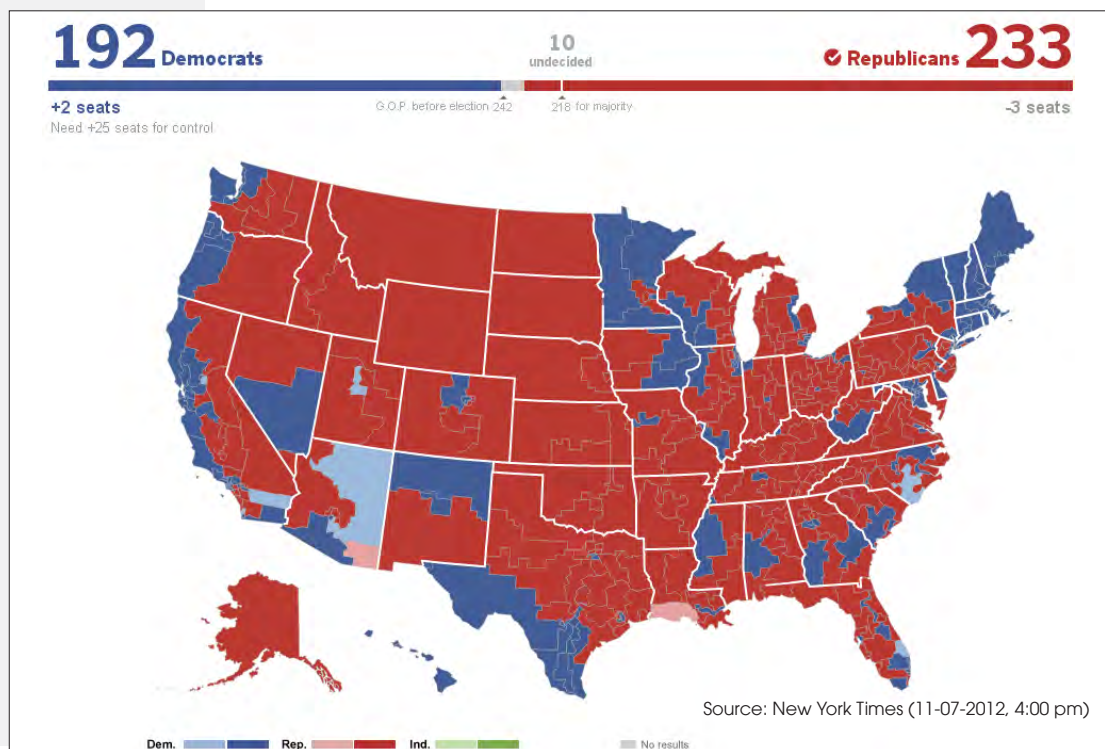
KEY DEVELOPMENTS

- Republicans retain control but Democrats gain about seven seats
- With Presidency and Senate in Democratic control, divided government continues
- Minority Leader Nancy Pelosi (CA) may step down or retire
- Redistricting appears to have little net effect on balance of power
- In 113th Congress, Democrats will be first “majority-minority” caucus in history.

In the weeks following the August 2011 high-profile fight over the debt ceiling, the Gallup organization released a poll regarding congressional approval. The poll found a record-low 10 percent of Americans had a favorable opinion of Congress. That left many pundits wondering if 2012 would be a repeat of 2010, when a massive anti-incumbent wave helped Republicans pick up a record 63 seats and regain control of the House of Representatives. Minority Leader Nancy Pelosi (D-CA) went so far as to predict “a quick return to the majority.”

Republicans headed into Election Day 2012 with 242 seats in the House—Democrats controlled 193. Pre-election analysis listed nearly 70 seats that were either in the “leaning” or “toss up” columns. Many of the 87 House GOP freshmen elected in 2010 faced challenges by Democrats eager to not let them grow stronger under the power of incumbency. With 11 races still too close to call, it appears that Democrats will win a handful of seats (perhaps as many as 10) but fall well short of grabbing the 25 seats needed to realize Pelosi’s objective.

One factor having a significant impact on this year’s House races traces its roots back several years. In 2010, Republicans took control of 29 governor’s mansions and 26 state legislatures. Faced with redrawing Congressional lines after the 2010 Census, many of these GOP legislatures placed a premium on



drawing lines that would help protect many of those 87 House Republican freshmen. (A NRCC memo said that redistricting made approximately 17 “endangered” GOP-held seats safer.) Even in states with divided legislatures, Republican governors served as a check against political “gerrymandering” that might have given Democrats a greater chance to take back the House.

Two extreme examples of this happened in Illinois and North Carolina. The Democratic-controlled legislature in Illinois crafted lines that endangered four House Republicans. The opposite was true in North Carolina, where subsequent retirements of incumbent Democrats exacerbated the new lines. Notwithstanding Illinois and North Carolina (which cancelled each other out), many of the redrawn district boundaries helped new incumbents in 2012 rather than hurt them.

Even in the face of dismal performance ratings (such as cited above), and with mostly “safe” district boundaries, the old adage of “I don’t like Congress, but I like my Congressman” appears to have again been corroborated in this year’s elections. Only a handful of incumbents lost their bids for another term in the primaries (seven House Democrats lost primaries; six House Republicans lost primaries). The lack of significant primary losses was notable on the Republican side of the aisle, particularly considering the lingering effects of the 2010 Tea Party movement. But, like many of the third party movements of the early 20th Century, the movement’s principals were largely co-opted by House Republicans in short order, resulting in ever-diminishing influence as a separate entity.

LEADERSHIP

House Republicans will hold leadership elections the week of November 12. This ensures that the current leaders will cut off the amount of time possible challengers might use to mount a takeover bid. News that Minority Leader Nancy Pelosi issued a directive for House Democrats not to hold their leadership elections until November 29-30 might just be a harbinger of the rumors floating around Washington, DC, that she will step aside as the top Democrat.

Unlike the Senate, which empowers individual senators, the House is run by a strict set of rules and the majority holds clear sway in setting those rules and dictating the policies and issues to be debated and voted upon. The power over that majority rests heavily in the Speaker, Majority Leader, and Whip’s offices, albeit only through the consent of those members who elected them to lead. While much has been made of the perceived conflict between Speaker John Boehner and Majority Leader Eric Cantor, as they jockeyed back and forth in the early stages of the 112th Congress to shore up support among the House Republican Conference, those differences have faded quite a bit. Potential races exist for Republicans at the Conference Chairman, Vice Chairman, and Secretary positions.



Among Democrats, the focus will zero in on Minority Leader Pelosi, and whether she intends to seek the Democrats' top position yet again. Democratic Leadership watchers say that if Pelosi steps down, the current Minority Whip Steny Hoyer (MD) would be a shoe-in for the top spot. However, the 2012 election for the House, while not resulting in big apparent changes, did make history in one important aspect. For the first time in our nation's history, one party's representation will not be dominated by white males. In the 113th Congress, the House Democratic Caucus will have more than half of its Members comprised by women and minorities. Handing over the top spot to Hoyer may in fact happen, but do not be surprised if concessions are demanded for an additional leadership spot. This happened two years ago, when Pelosi crafted a new position for Rep. James Clyburn (SC) in order to ensure that the Congressional Black Caucus had a seat at the leadership table. Expect Rep. Debbie Wasserman Schultz (FL), whose term as chair of the Democratic National Committee is coming to an end, to compete for any leadership position that may come open.

The following is a projection of Republican and Democratic leadership in the 113th Congress:

REPUBLICANS:

- Speaker: Rep. John Boehner (OH)
- Majority Leader: Rep. Eric Cantor (VA)
- Majority Whip: Rep. Kevin McCarthy (CA)
- Chief Deputy Whip: Rep. Peter Roskam (IL)
- Conference Chairman: Reps. Cathy McMorris Rogers (WA) or Tom Price (GA)
- Vice Chair: Reps. Martha Roby (AL) or Lynn Jenkins (KS)
- National Republican Congressional Committee: Rep. Greg Walden (OR)
- Conference Secretary: Reps. Greg Harper (MS), Virginia Foxx (NC) or Jeff Denham (CA)
- Policy Committee: Rep. James Lankford (OK)

DEMOCRATS:

- Minority Leader: Reps. Nancy Pelosi (CA), Steny Hoyer (MD) or James Clyburn (SC)
- Minority Whip: Reps. Steny Hoyer (MD) or James Clyburn (SC)
- Assistant Democratic Leader: Reps. James Clyburn (SC) or John Larson (CT)
- Caucus Chair: Rep. Xavier Becerra (CA)
- Vice Chair: Reps. Joe Crowley (NY), Barbara Lee (CA) or Jared Polis (CO)



LIKELY HOUSE CHAIRS AND RANKING MEMBERS — 113TH CONGRESS

House Committee	Chair	Ranking Democratic Member
Agriculture	Lucas (OK)	Peterson (MN)
Appropriations	Rogers (KY)	Lowey (NY) or Kaptur (OH)
Armed Services	McKeon (CA)	Smith (WA)
Budget	Ryan (WI)	Van Hollen (MD)
Education and the Workforce	Kline (MN)	Miller (CA)
Energy and Commerce	Upton (MI)	Waxman (CA)
Ethics	Bonner (AL)	Linda Sanchez (CA)
Financial Services	Hensarling (TX)	Waters (CA)
Foreign Affairs	Royce (CA), Smith (NJ), or Chabot (OH)	Sherman (CA) or Engel (NY)
Homeland Security	Miller (MI), Rogers (AL), or McCaul (TX)	Thompson (MS)
Intelligence	Rogers (MI)	Ruppersberger (MD)
Judiciary	Goodlatte (VA)	Conyers (MI)
Natural Resources	Bishop (UT)	Markey (MA)
Oversight and Government Reform	Issa (CA)	Cummings (MD)
Rules	Hastings (WA) or Sessions (TX)	Slaughter (NY)
Science, Space, and Technology	Smith (TX)	Johnson (TX)
Small Business	Graves (MO)	Velazquez (NY)
Transportation and Infrastructure	Shuster (PA)	Rahall (WV)
Veterans Affairs	Miller (FL)	Brown (FL)
Ways and Means	Camp (MI)	Levin (MI)

EFFECT ON HOUSE DIRECTION

House Republicans closed the final months before the election with a solid majority in the House of Representatives with 242 Members. This number was well out of reach of even the most generous Democratic pickup predictions for the 2012 election. Even with final results in most House races, Republicans maintain a significant majority (roughly 235 members). House Republicans continue to believe they are the check and balance on the Obama Administration and Democratic-controlled Senate. The GOP will use this year's election results as validation for that view.

With regard to the more than 35 new Republicans coming into Congress, look for attention to returning Reps. Matt Salmon (AZ-5) and Steve Stockman (TX-36). Stockman, a one-term member of the 104th Congress, was



highly controversial during his previous stint in the House. Of the new members, look for Ann Wagner (MO-4) as a bright star due to her extensive background and personality. Other members of note should include Thomas Massie (KY-4) and George Holding (NC-13).

There will be at least 44 new Democratic members. Returning members include former Reps. Dan Maffei (NY-24), Bill Foster (IL-11), Alan Grayson (FL-9) and Carol Shea-Porter (NH-1). A few notable new members include Tammy Duckworth (IL-8), Tulsi Gabbard (HI-2), Joe Kennedy III (MA-4), and John Delany (MD-6).

IMPACT ON 2014

The 2010 House elections were clearly a “wave election.” The 2012 races, by comparison, were barely a ripple. A continued trend of retirements by older, senior members will likely continue. Expanding the field or mitigating voluntary departures will, in large measure, depend on a variety of factors. Chief among them will be the overall political climate, and whether one party or the other feels the wind at their backs going into the early part of 2014. That plays a significant role in encouraging safe incumbents to stay in office, helps recruit top-tier challenger candidates, and often dictates the financial resources available to pay for ever-increasingly expensive campaigns for the House.

Another critical issue will be if President Obama puts his expansive political resources to bear on changing the make-up of the House, and expanding a majority in the Senate, or will he be weakened come 2014 due to continued economic woes, international issues, or just plain gridlock in Washington? While it is too early to tell, many of the decisions Congress and the White House make in the near term as it deals with tax and spending issues will begin to set the stage for elections two years from now.



Key Gubernatorial Races

KEY TAKEAWAYS

- Democrats won five and lead in two of the 11 races
- Republicans, however, added another seat (their 30th)

Democrats won five and lead two more of the 11 gubernatorial races held Nov. 6, but could not prevent the GOP from collecting its 30th governorship. Republicans grabbed a seat in North Carolina and held seats in Indiana, North Dakota, and Utah. Democrats held seats in Delaware, New Hampshire, Missouri, Vermont, and West Virginia. Races in Montana and Washington remain too close to call.

Just two years ago, massive change was the theme as Republicans took away 11 new governorships, while Democrats grabbed five back from the GOP, and an independent took previously GOP-held Rhode Island. This year, the competition featured fewer states as only Montana, New Hampshire, North Dakota, and Washington offered close contests for state executive going into election day.

After President Obama sailed to election in 2008, Democrats held 29 governorships to 21 for the Republicans. Changes in 2009 brought the parties closer together (26 for the Democrats, 24 for the Republicans) and the massive upheaval in state elections in 2010 gave the GOP a decided advantage of 29 to 20 (one independent). 2011 was a status quo election with just four races on the ballot and no party control changes. This marked the return to GOP gains with their majority of state executives climbing to at least 30, with control in North Carolina switching hands and Washington's outcome uncertain. That figure represents the first time in over a dozen years that either party has had so many governorships. For context, Republicans control the legislatures in 26 states, while Democrats control both chambers in 15 states.

Democrats pointed to holds in West Virginia and Missouri, even in the face of Mitt Romney carrying those states at the top of the ticket. North Carolina Republican candidate Pat McCrory found his second race for the governor's mansion to be the charm, easily dispatching current Lt. Governor Walter Dalton after losing four years ago. Dalton may have been hamstrung by the late decision of incumbent Bev Perdue (D) to not seek another term due to low polling numbers. McCrory, the former long-time mayor of Charlotte, had almost a year head start and held a significant advantage in funding down the stretch. Most important, with North Carolina suffering from massive unemployment, McCrory was able to hang the state's economic woes around Perdue's second in command.

A big effort by the Democratic Governor's Association and labor unions made the race for Indiana's top spot much closer than most observers predicted, but ultimately Republican Rep. Mike Pence's advantages and the political climate were too much to overcome for Democratic challenger John Gregg.



Democrats easily held onto incumbents in Delaware, Vermont, and Missouri, while Earl Ray Tomblin's margin of victory in West Virginia was smaller due to a strong GOP vote in the Mountain State. Similarly, Republicans kept Utah Governor Gary Herbert and North Dakota Governor Jack Dalrymple in place, with both coasting to strong wins.

Republicans had high hopes for picking-up New Hampshire, but GOP nominee Ovide Lamontagne could not overcome the attacks of Democratic former state Senate majority leader Maggie Hassan for the job currently held by Gov. John Lynch.

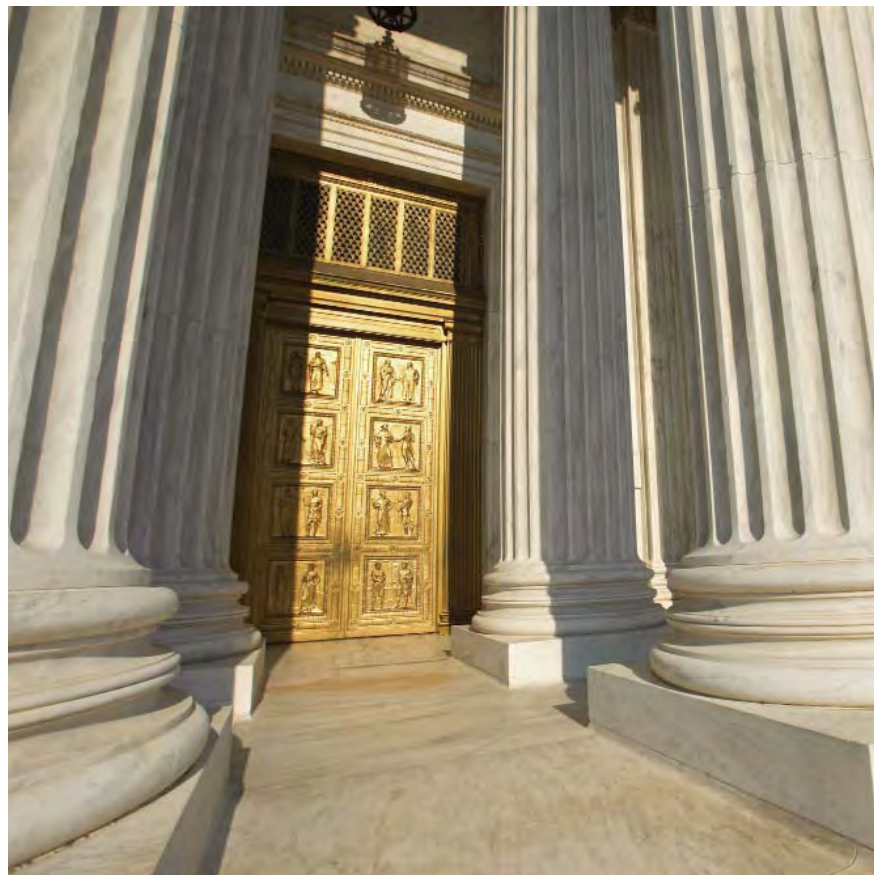
In Washington state, Republicans still hope that state Attorney General Rob McKenna will become the first GOP governor in 30 years, but former Democratic Rep. Jay Inslee appears to have a slight advantage as votes continue to be counted due to extensive mail-in balloting. The Republican Governor's Association, seeing a key pick-up opportunity went all in on the race, dumping more than \$12 million into the race. McKenna focused much of his attention on reforming the education system and championing the cause of greater spending in the classroom. Inslee opened up a decided advantage in King County, making McKenna's task to secure even higher vote margins in more rural counties to overcome the gap that much more difficult.

With Montana's popular Democratic Governor Brian Schweitzer is stepping aside due to term limits, Democratic Attorney General Steve Bullock led Republican Rick Hill, a former congressman, in early returns. The campaign featured issue fights including abortion, public employees pay, and property and sales taxes. Republicans also viewed this race as a good opportunity for a pick-up, but it appears Bullock has the edge as counting continues at this writing.

While the presidential candidates sparred repeatedly on jobs and economic figures, many of this year's governor's races turned on issues closer to home. In Washington, education may have been the dominant theme, while public employee benefits and pension funding garnered quite a bit of attention in New Hampshire. Energy resource and transportation issues found top billing in Montana.

Look for increasing focus on governors and state legislatures as more policy gets decided at the federal level but implemented in the states (i.e., insurance exchanges under the healthcare reform act).





Lame Duck Session

The Lame Duck Session

KEY TAKEAWAYS

- Expect Congress to use stopgap measures in the lame duck to delay the fiscal cliff
- Expiring tax provisions and sequestration will likely be delayed until the third quarter of FY 2013 or beyond
- FY 2013 appropriations bills may be completed

Despite adjourning in September, the 112th Congress has many items to address before the end of the year. Members of Congress, including those who were defeated on Tuesday or did not run for reelection, will return for a lame duck session beginning on November 13. The lame duck session is likely to last at least through December 21. Many believe, however, that key decisions will be delayed until next year.

UNFINISHED BUSINESS

There are several unfinished authorizing bills, which set federal agencies' policies in the coming year that need to be completed. Congressional leaders and the Administration have expressed the desire to consider legislation related to the Foreign Intelligence Surveillance Assistance Act, cybersecurity, government transparency, the Medicare "doc fix," hunting on public lands, trade relations with Russia, various treaties, as well as several agency authorization bills.

The most notable bill on this list is the Department of Defense authorization bill, which appears likely to be completed during the lame duck. Consideration of the 2012 Farm Bill, which sets the nation's agriculture policy, is underway but stalled in the House of Representatives. During the lame duck session Congress could enact a five-year farm bill, a temporary extension of current law, or simply let current law expire and farm policy revert to archaic "permanent law" authorities. However, it is expected that the final version of any long-term Farm Bill reauthorization will include between \$23 billion and \$35 billion in budget savings, which Congress could use to offset needed spending increases or tax cut extensions—either in the lame duck legislation or at the beginning of the next Congress.

In the aftermath of Hurricane Sandy, some Members are discussing the need for emergency funding to ensure FEMA can continue response and relief efforts. Congress did not complete any of the twelve appropriations bills that fund the various federal government departments in fiscal year 2013 before the election. Instead, Congress passed a Continuing Resolution, which allows current FY 2012 levels of spending to continue through the end of March 2013. Congress may attempt to pass some of the separate appropriations bills in the lame duck. The bills funding the Departments of Defense and Homeland Security (which includes FEMA) are the most likely prospects, while other appropriations bills could be wrapped into an omnibus or deferred until the 113th Congress is sworn-in. However, it is also possible that an omnibus appropriations bill containing all twelve bills will be enacted.



FISCAL CLIFF

In addition to outstanding authorization and appropriations bills, Congress will be faced with a series of tax and policy expirations collectively known as the “fiscal cliff” (which are detailed below). Many economists predict that another economic downturn will take place if Congress does not avert the Fiscal cliff by extending expiring tax cuts, raising the debt ceiling and stopping sequestration from taking effect. However, serious differences between the parties and their leadership about how to address the various components of the fiscal cliff will hinder agreement in the lame duck.

Republicans are unwilling to allow any tax rate increases to occur, and many are pushing for at least a one-year extension of the Bush tax cuts. With regard to sequestration, many congressional Republicans, especially in the House, prefer a permanent solution that guarantees the \$1.2 trillion in savings is achieved over 10 years through spending cuts. They do not want to see a temporary delay in spending cuts/sequestration unless it is tied to a matching extension of expiring tax cuts. Republicans will also push for spending cuts to accompany any proposal to raise the debt ceiling. However, consideration of an increase in the debt ceiling is not likely during the lame duck.

Democrats seem unwilling to allow any tax breaks for those making over \$250,000 a year to continue. Indeed, President Obama has indicated he will not sign any tax bill that doesn’t raise tax rates on the wealthiest earners. While most Democrats prefer to avoid sequestration (indeed President Obama promised it would not happen), the loudest push-back on the across-the-board cuts has come from defense circles.

Though it is unlikely that Congress will allow the country to “go over the cliff,” many rank-and-file members and their staff (on both sides of the aisle) argue that doing so temporarily increases the leverage to reach agreement on a more comprehensive solution. For Republicans, allowing sequestration to go into effect shows that they are unwilling to back-down on controlling spending. Allowing tax rates to rise on the wealthiest Americans would put Congress in the position of “cutting” taxes in the context of a deal on taxes next year. President Obama has said he sees the cliff as “a forcing mechanism” to address the country’s tax and spending issues. However, there does not appear to be much appetite among Congressional leadership for such a confrontation in the lame duck.

LIKELY OUTCOME

A much more likely scenario is that Congress will extend expiring tax cuts and delay sequestration, pushing decisions on the fiscal cliff issues into 2013. President Obama and Speaker Boehner, as well as various other leaders, are on-record recently stating that they believe a temporary or “bridge”



solution will be reached in the lame duck that allows the new Congress to address the fiscal cliff situation in 2013. The legislation would require the relevant Committees agree on a set of targeted results by a date certain. The President has said he will work with Congress to achieve agreement within six months, and would presumably be agreeable to such legislation. In this scenario, Congress would address expiring Bush tax cuts in 2013. Sequestration would be handled in a similar manner delaying the across-the-board cuts from taking effect for a specified period.

Action is likely, however, on those tax extenders that expired at the end of 2011, including the AMT patch. It is also likely that an extension of the SGR doc fix will be addressed in the lame duck by extending the provisions that expired in 2011. However, support for continuing the payroll tax holiday and extension of unemployment benefits is waning, which leads us to believe that those provisions may be allowed to expire.

Whatever happens the election results did nothing to moderate the views on either side of the aisle about allowing tax cuts to expire on those making above \$250,000, and it is clear that extending tax cuts on the wealthiest Americans will be at the center of the debate on the fiscal cliff.

THE FISCAL CLIFF INCLUDES:

- **Reaching the debt ceiling.** The amount of debt the federal government can incur is set in statute. When the Treasury warns that the government could reach the statutory debt ceiling, Congress must act to raise the statutory limit and keep the Treasury from defaulting. The Treasury is predicting that the debt ceiling will be reached before the end of the year, but says it can employ some shifting of funds to postpone a potential default until early 2013.
- **Sequestration takes effect.** On January 2, 2013, an indiscriminate, across-the-board cut of \$109 billion from defense and domestic programs is scheduled to occur. Though this cut is scheduled to happen in 2013, savings (in the form of lower base budget numbers) of \$1.2 trillion are expected over 10 years. The sequester will take effect unless Congress intervenes.
- **Expiration of Bush tax cuts.** Allowing tax cuts to expire and income tax rates to go back up would add about \$380 billion to the Treasury. Individual marginal tax rate brackets would increase from 10 percent, 25 percent, 28 percent, 33 percent and 35 percent to 15 percent, 28 percent, 31 percent, 36 percent and 39.6 percent respectively.
- **Expiration of the payroll tax holiday.** The temporary two-percentage-point reduction in the employee's share of the Social Security payroll tax expires at the end of 2012 and would bring \$120 billion back into the Social Security Trust Fund.



- **Increase in dividend and capital gains taxes.** Beginning in 2013, dividend taxes would increase from 15 percent to income tax rates up to 39.6 percent. Capital gains taxes would rise from 15 to 20 percent.
- **End of AMT patch.** The alternative minimum tax (AMT) is increasingly hitting middle income Americans in addition to those attempting to avoid taxes at the upper income range, which it was designed to target. The AMT patch, which indexes the AMT exemption for inflation, expires at the end of 2012, meaning the AMT could threaten middle income families again in 2013.
- **End of tax extenders.** Several other tax provisions expired at the end of 2011, or are scheduled to expire at the end of 2012, the largest of which is the expiration of bonus depreciation (end of 2012). Also included in the fiscal cliff are expensing provisions for small business and other “extenders,” a series of temporary provisions that are normally reinstated whenever they expire affecting a range of businesses and individuals.
- **End of Unemployment Insurance extension.** The temporary extension of up to 53 weeks unemployment benefits, instead of the usual 26 week maximum, will expire at the end of 2012.
- **End of SGR doc fix.** Each year payments to physicians under the Medicare Sustainable Growth Rate (SGR) have been overridden on a temporary basis—referred to as the “Doc Fix.” Because the reduction in physician reimbursement compounds, doctors would receive a cut to their Medicare payments of almost 30 percent in 2013 unless Congress acts.





Issue Area Perspectives

Agriculture

The status quo election results threaten to reach the level of *déjà vu* in the case of the House and Senate Agriculture Committees, and the agriculture agenda for the 113th Congress. The House and Senate Agriculture Committee leadership in the 113th Congress will likely look as it did in the 112th. If work on the 2012 farm bill is not completed during the lame duck session, the Agriculture Committee agendas for 2013 will look remarkably similar to their agendas for 2012.

All indications are that the House Committee on Agriculture's top leadership will be the same in the 113th Congress as it was in the 112th Congress. Current Chairman Frank Lucas (R-OK) will continue to serve as chairman, while Ranking Member Collin Peterson (D-MN) will continue in that capacity. In the context of the 2012 farm bill, Chairman Lucas has worked hard to produce a bill that includes farm program provisions that are workable for all areas of the country. Peterson has focused on maintaining viable sugar and dairy programs that are important in Minnesota and across the country.

As of this writing, retirements or election losses create at least eight vacancies on the 46-member committee, including two subcommittee chairs (Rep. Tim Johnson (R-IL) and Rep. Jean Schmidt (R-OH)) and four ranking members (Reps. Tim Holden (D-PA), Leonard Boswell (D-IA), Joe Baca (D-CA), and Dennis Cardoza (D-CA)). Notably, only one of the 16 committee freshman Republicans went down to defeat (Rep. Bobby Schilling (R-IL)), a testament to the work of Chairman Lucas and other committee leaders to protect these new members. How productive the committee will be in the 113th Congress remains to be seen. So far, in the entire 112th Congress, only five committee bills have been enacted into law.

It is expected that newly reelected Senator Debbie Stabenow (D-MI) will continue in her role as chairwoman of the Senate Committee on Agriculture, Nutrition, and Forestry. Current Ranking Republican Senator Pat Roberts (R-KS) could continue in that role, if none of the more senior Republicans on the committee opt to take the position. For example, Senator Thad Cochran (R-MS) is term-limited in his service as the ranking Republican on the Senate Appropriations Committee, and could opt to serve as the ranking Republican on the Senate Agriculture Committee in the 113th Congress. As a former chairman of the committee, Cochran is well aware of the benefits and burdens of serving in leadership there.

The election has left three vacancies on the committee as of this writing, with the retirements of Sens. Kent Conrad (D-ND) and Ben Nelson (D-NE), and the primary election defeat of Sen. Richard Lugar (R-IN).

AGRICULTURE APPROPRIATIONS

In the past, the annual agriculture appropriations bill has become a venue for debates on agricultural policy matters which arise between periodic farm bills, or when issues are not dealt with to the satisfaction of some during a farm bill.



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The retirement of Senator Herb Kohl (D-WI) will bring a new chair to the Agriculture Subcommittee. Like most positions, the choices made by the most-senior members on a committee can have domino effects. The most likely candidate for this post is Senator Mark Pryor (D-AR). The ranking Republican is expected to remain in the hands of Senator Roy Blunt (R-MO).

The outlook for the House subcommittee is unclear on the Republican side due to term limits, retirements and the associated changes in chairmanships. Republicans primarily use full committee seniority in determining chairmanships, versus the Democrats subcommittee seniority model. The current subcommittee chairman, Rep. Jack Kingston (R-GA), is term limited. Subcommittee members, Reps. Tom Latham (R-IA), Jo Ann Emerson (R-MO) and Robert Aderholt (R-AL) currently hold other subcommittee chairmanships and might opt not to take the Agriculture slot. Current ranking Democrat Rep. Sam Farr (D-CA) is expected to remain in his position.

Like most other appropriations bills, completion of the FY 2013 Agriculture Appropriations bill will not be the decision of the subcommittee leadership (and perhaps not the full committee leadership). The allocations to the subcommittees for FY 2013 vary from the FY 2012 enacted level by \$1.375 billion. We expect that the conference allocation will allow for level funding of most programs, with the possibility of modest increases in a few, high-priority programs.

AGRICULTURE LEGISLATION AFTER THE ELECTION—LAME DUCK

Now that the dust is settling on the elections, Congress is still faced with business left undone—specifically reauthorization of the farm bill. When Congress adjourned in October for the November elections, the Senate had passed in June, S. 3240, the Agriculture Reform, Food, and Jobs Act of 2012, by a vote of 64-35. The House, however, had only approved in committee its version of the 2012 farm bill in July, H.R. 6083, the Federal Agriculture Reform and Risk Management Act of 2012, and filed the report in September where it currently waits on the Union Calendar. To further complicate the situation in the intervening time, the House had also approved H.R. 6233 the Agriculture Assistance Act of 2012 (providing limited disaster assistance), after another version—H.R. 6228 (providing a one-year extension of the farm bill and disaster)—was determined to be not politically viable.

There are basically three major options open to Congress when it returns after the November elections:

1. Pass a full (five year or more) reauthorization of the farm bill;
2. Pass a short term farm bill extension (most likely one year); or
3. Do nothing and allow the farm bill to expire (least likely option).

While any of these outcomes are possible, there are many procedural paths Congress can utilize to achieve the desired outcome which will be discussed below. At this point, given the time and nature of a lame duck, a short term extension is a slightly more likely outcome than a full reauthorization. Although, allowing the farm bill to expire is the least likely outcome, even that scenario is conceivable in this political climate. As in the past, the Obama Administration will play a



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limited role in the formulation of the 2012 farm bill. However, a disproportionate or draconian cut to the Supplemental Nutrition Assistance Program (a.k.a. Food Stamps) would energize the Administration into action. Senate Democrats are unlikely to allow this.

FULL FARM BILL REAUTHORIZATION

If a full reauthorization of the farm bill is attempted there are still major outstanding issues that must be resolved before the House and Senate can agree. The major issues are as follows:

- Aggregate savings level which will be largely determined by House and Senate leadership (House version of the farm bill has \$35 billion in reductions: \$16.1 billion from nutrition, \$6.1 billion from conservation, and \$14.1 billion from commodities, while Senate version has \$23 billion in reductions: \$4 billion from nutrition, \$6.4B from conservation, and \$14.1 billion from commodities).
- Amount and policy to achieve Nutrition (SNAP/Food Stamp) savings.
- Commodity Program construct (the House option of Price Loss Coverage and Revenue Loss Coverage versus Senate on-farm and county-wide revenue programs) and complications from Cotton STAX and extending disaster programs.
- Mandatory funding for no/little baseline titles/programs such as rural development and energy.

While these major issues remain we note that the House and Senate bills have bipartisan support for building on the pest and disease and specialty crop provisions that were started in the 2008 farm bill.

The most favorable climate for passing a full reauthorization of the farm bill is one in which House and Senate Leadership decide to avoid the looming fiscal cliff and counteract sequestration (requiring at least \$65 billion in savings). There is a strong likelihood that this exercise will also include other issues requiring spending offsets such as the Medicare reimbursement “Doc Fix” or an extension of Unemployment Insurance (increasing needed savings to over \$100 billion). There are many procedural paths to achieve this end. They all involve conferencing (either formally or informally) a Senate and House farm bill that results in \$23-35 billion in savings which is then included in a larger legislative package to offset spending or revenue reductions.

There are many issues that will need to be resolved in order for this to occur, such as the difference between the 10 year farm bill savings versus the one year savings needed to offset sequester. It is generally expected that the farm bill savings will need to total between \$23-35 billion. The \$23 billion in savings was agreed to earlier by the House and Senate Agriculture Committee leadership (four principals) in the 2011 “Super Committee” process. Roughly the same \$23 billion in savings would be achieved by the Senate-passed farm bill (S. 3240). Savings of \$35 billion were identified in the farm bill passed by the House Agriculture Committee. It is likely that savings closer to this greater amount will be needed in order to be included as offsets in any larger legislative package during the lame duck.

Whether the House and Senate Agriculture Committees would informally conference the Senate passed farm bill with the House Committee passed bill, or whether House politics would require the House to pass a farm bill and then formally conference a House and Senate passed



farm bill is unclear. This would be determined by the political will of Congress to draw out or modify the process subject to time remaining, which will be greatly influenced by any opposition fueled by the inability to fully consider under regular order a major piece of legislation spending nearly \$1 trillion. Of course, the Senate could also move H.R. 6233, the House disaster bill, insert the Senate passed farm bill and call for a conference with the House. The end result is all the same: a House and Senate informal “conference” with the “conference agreement” included in a larger package needing budgetary offsets.

SHORT TERM FARM BILL EXTENSION

Chairman Frank Lucas (R-OK) on July 30 introduced H.R. 6228 to provide a one-year extension of the Food, Conservation, and Energy Act of 2008, with certain modifications and exceptions and to make supplemental agricultural disaster assistance available for fiscal years 2012 and 2013, among other purposes. To pay for disaster assistance, the bill made cuts to popular conservation programs such as the Environmental Quality Incentives Program and limited enrollment in the Conservation Stewardship Program to 11 million acres for FY 2013. Although it was determined not to be politically viable at the time, it is an alternative that may become increasingly more viable as the need for budget offsets decreases. In addition, non-political Department of Agriculture (USDA) employees indicate that at this late date it will be impossible to implement some of the provisions of the commodity title, such as Cotton STAX or the Supplemental Coverage Option, for the 2013 crop year. Therefore even if a full reauthorization is enacted, the 2013 crop year implementation issue will need to be addressed (most likely resolved by the inclusion of a one-year extension of the current commodity programs).

If a one-year extension is enacted, it will most likely include some disaster assistance, extension of Milk Income Loss Contract (MILC) payments, other miscellaneous provisions politically required, and any offsets needed not only to cover their costs but also possibly an additional amount to demonstrate fiscal discipline, although any bicameral effort to pass an extension may achieve savings in a different manner than H.R. 6228. A one-year extension would be portrayed as merely a routine exercise in order to allow more time for policy development and funding decisions. This option will become increasingly more viable as time runs out on a lame duck session and Congress has been unable to reach an accord to prevent the fiscal cliff. It would be compelled by the realization that in the near future USDA will have to implement archaic and expensive “permanent law” programs.

It should be noted that an extension of less than one year is unlikely, even if it included an extension of MILC, disaster assistance, and needed offsets. USDA generally implements commodity programs on a crop year basis, so anything less than one year would be of little use. In addition to budgetary uncertainties, implementation uncertainties would abound.

Although allowing the farm bill to expire is considered to be the least likely path Congress will take, it cannot be discounted given the current political climate. If Congress decides to ignore addressing the fiscal cliff during the lame duck session, one can easily envision that the associated political turmoil will render any reauthorization of the farm bill the proverbial “pimple on the rear of the elephant.”



113TH CONGRESS

Congressional agricultural leadership has always been able to come together even in the direst political times and compel the “powers that be” to address reauthorization of farm policy. It is expected that they will once again be able to duplicate this feat, although a one-year extension is becoming a slightly more likely outcome than a longer term reauthorization. Given the issues that will face the new Congress, experienced lawmakers see the benefit of completing a full reauthorization of the farm bill that encompasses reform and budgetary savings during the lame duck session. However, current political dysfunction may prevail.

In any event, inaction or a one-year extension will ensure that one of the first items on the Congressional agenda during the new 113th Congress will be farm bill reauthorization. The Administration will continue to play a minimal role in influencing farm bill policy (even if a desire to do so exists). If there is a budget reconciliation process, certainly farm bill reauthorization is a likely candidate for inclusion even though there are many procedural obstacles (such as the Byrd rule) for many of the provisions. Even if a full reauthorization is enacted during the lame duck session with major reform and budgetary savings, there will continue to be pressure (albeit lessened) to extract savings from agriculture in any future legislative process involving budget reductions, given our current dire fiscal condition.

A final priority for the 113th Congress is reauthorization of the Commodity Futures Trading Commission (CFTC). The authorization of the CFTC expires September 30, 2013 as provided in the Commodity Exchange Act (CEA). The House Agriculture Committee passed at least five bills during the 112th Congress to amend CEA provisions enacted as part of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. None of these five bills were enacted in the 112th Congress. But this activity acts as evidence of the legislative battles that may be ahead in connection with any legislation to reauthorize the CFTC. It remains to be seen whether legislation to reauthorize the CFTC will be a simple “one-line” bill—or if a larger vehicle bogs down in controversial and partisan attempts to rewrite Dodd-Frank’s requirements of the CFTC.



Budget and Appropriations

KEY DEVELOPMENTS

- With a status quo Congress and White House, the chance of finishing FY 2013 appropriations bills improves as there is no incentive to wait for a January shift in party control.
- The chance of sticking to the discretionary spending limits of the Budget Control Act improves with a Democratic Senate and White House, and the drive for deeper domestic spending cuts will be softened.
- Now that the election is over, consideration on how to deal with an approaching sequestration will occur.

Currently, none of the FY 2013 appropriations bills have been completed and the government is operating on a Continuing Resolution (CR) that expires on March 27, 2013. The House Appropriations Committee has reported 11 of 12 bills with the Labor, HHS, and Education bill being the outlier, and the full House has passed seven of those measures. Across the Capitol, the Senate Appropriations Committee has likewise reported 11 of 12 bills, with the Interior and Environment bill being the exception. However, the Senate has yet to take up an individual appropriations bill on the floor, causing potential procedural difficulties for any proposed omnibus bill.

Ten year caps on discretionary spending were enacted last year as part of the Budget Control Act of 2011 (P.L. 112-25) and the deal to raise the debt limit. Those caps achieve over \$1 trillion dollars in the next 10 years:

**Discretionary Spending Limits by Fiscal Year
Enacted Budget Control Act
(Dollars in Billions)**

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1,043	1,047	1,066	1,086	1,107	1,131	1,156	1,182	1,208	1,234

While the House budget resolution and subsequent House appropriations bills were capped overall at \$1.028 trillion, \$19 billion below the Senate, the CR uses the Budget Control Act level of \$1.047, making it likely that the higher number will ultimately be agreed to by both chambers.

NEXT STEPS

While members have been out campaigning, House and Senate Appropriations Committee staffs have been working to put together possible conference agreements for each of the 12 bills, with the hope that an omnibus appropriations bill can be enacted during the lame duck session. The level of effort toward putting together conference agreements seems to vary among subcommittees but by all reports they have been working towards a November 13 deadline.

It is important to note that while House and Senate leadership have not formally sanctioned the effort to move appropriations bills during the lame duck, House leadership is fully aware and supportive of the Appropriations committee's ongoing efforts. In addition, the pressure for supplemental appropriations in response to Hurricane Sandy is growing daily, providing additional impetus to complete the FY 2013 bills. However, a legislative vehicle is required to carry any potential Omnibus/supplemental package, which



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means the Senate would have to pass one of their FY 2013 bills between now and December. The next two weeks will determine the fate of the FY 2013 appropriations process in the lame duck session.

With the CR already in place and Congress not needing to act on the regular appropriations bills until the end of March when the CR expires, the fallback position is of course to wait for the 113th Congress to be seated and finalize appropriations in the larger context of dealing with the fiscal cliff. If the appropriations bills are postponed until January, the chances increase for converting the current six-month CR into a full-year bill. One scenario being discussed is the possibility of passing less controversial spending bills such as defense and homeland security, while letting the other bills wait for January.

With the election now over, there is an expectation that decisions about what legislation will move in a lame duck session to be decided in the coming days as members return to Washington, including what to do about appropriations. The budget is also impacted by the threat of a looming 8-10 percent sequestration in 2013, and this issue is discussed in the lame duck section of this document.

FULL COMMITTEE LEADERSHIP

Sen. Thad Cochran (R-MS) is term limited as ranking member of the Senate Appropriations Committee. Sen. Richard Shelby (R-AL) is expected to take over, although Sen. Mitch McConnell (R-KY) has the right of first refusal given his seniority, if he chooses to exercise it. On the House side, the big change is on the Democrat side of the aisle where Ranking Member Rep. Norm Dicks is retiring. Both Reps. Nita Lowey (D-NY) and Marcy Kaptur (D-OH) have expressed an interest in filling this seat. (Common consensus has Nita Lowey as the front runner, but Kaptur has seniority.)

SUBCOMMITTEE LEADERSHIP

In the House, two subcommittee chairmen are term limited and one retired. Since the Republican process for selecting a subcommittee chair is not a direct line of ascension, it creates an endless possibility of scenarios, including requests for waivers. Reps. Bill Young (R-FL) and Jack Kingston (R-GA) have reached their six-year term limits on defense and agriculture respectively, and Rep. Denny Rehberg's (R-MT) departure from Labor HHS chair to run for Senate creates the opening for at least one new chairman.

Reps. John Carter (R-TX) and Rodney Alexander (D-LA) are next in line for yet to be determined subcommittees. One final hurdle is required prior to naming new subcommittee chairmen; they are required to be approved by the Republican Steering Committee and Conference. Chairman Rep. Hal Rogers (R-KY) will prepare and present his slate of proposed chairmen in late November or early December, although that could slip until January if Congress adjourns *Sine Die* earlier than expected.

On the minority side, the next in line on a subcommittee moves up and provides more predictability. Rep. Norm Dick's (D-WA) retirement on defense means that Rep. Peter Visclosky (D-IN)



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moves up to the ranking member slot. Because Rep. John Olver's (D-MA) retirement leaves open transportation, and Visclosky's moving to defense opens up Energy and Water, Rep. Ed Pastor (D-AZ) coincidentally is next in line for both subcommittees and has his pick. If Pastor takes transportation, then Rep. Chakah Fattah (D-PA) gets Energy and Water. If Pastor takes Energy and Water, then Rep. Kaptur gets transportation.

In the Senate, the retirement of Sens. Herb Kohl and Ben Nelson opens the chairmanship of both the Agriculture and Legislative Branch subcommittees. The retirement of Sen. Kay Bailey Hutchinson (R-TX) opens the ranking member slot on the Commerce, Justice, Science, and Related Agencies subcommittee. These vacancies will be filled according to seniority on the full committee and a number of scenarios are possible.

Meanwhile, the Administration is moving forward internally to develop the FY 2014 President's Budget, which is normally sent to Congress on the first Monday in February. With the President being elected to a second term, it seems likely that the budget request would comport to the spending limits in the Budget Control Act which is a \$19 billion or 1.8 percent increase for discretionary spending. However, given the extent of revenue changes on the table, the necessity of raising the debt ceiling, and sequestration and other legislation, expect further downward pressure on discretionary spending.



Defense

Defense and national security policy issues will bring immediate challenges to the leadership in both the executive and legislative branches. Continuing forward with the policies set in place during the first term of the Obama administration will implement strategic re-focus toward the Pacific region while continuing the drawdown of forces deployed to Afghanistan. An increased presence in the Pacific theatre will initiate a new scramble within the Pentagon for resources as the military services vie for new roles and missions.

In Afghanistan, the challenge will be to adhere to announced timelines for withdrawal as the capabilities of the host nation to assume the mission are reassessed. Overshadowing our forces overseas are the unresolved issues surrounding sequestration and its impact on budgets in the out years. Not only will major programs again be under scrutiny for possible termination, but the funding axe would fall equally across all budget lines and program elements. The flexibility to manage those reductions against priority lists will be absent.

High among the must-do tasks in the lame duck session of Congress will be to delay, if not undo, sequestration and avoid the disastrous impacts predicted across the board by the senior leaders of the Department of Defense. Also, resolving the challenges associated with operating under a continuing resolution in the current fiscal year must be addressed. Only in the overseas contingency operations accounts does the Pentagon currently have normal budget authority to move funding to meet unforecast requirements.

Looking at the changes occurring on the defense oversight committees in Congress, we see modest changes that are driven more from retirements than from election losses. In the House, the stability of the current majority assures minor change to committee panels on the Armed Services Committee. Most significant is the departure of Rep. Roscoe Bartlett (R-MD), second in seniority, who is vacating his position as chairman of the HASC's Tactical Air and Land Forces subcommittee following his loss in the election.

Other incumbent HASC members who were defeated in the election are Reps. Larry Kissell (D-NC), Mark Critz (D-PA), Bobby Schilling (R-IL) and Betty Sutton (D-OH). HASC members whose race is still too close to be called include Rep. Mike McIntyre (D-NC), ranking member on the Seapower and Projection Forces subcommittee, and freshmen Reps. Allen West (R-FL) and Ron Barber (D-AZ). Rep. Silvestre Reyes (D-TX), second in seniority on the minority side, was previously defeated in the primary election. Rep. Martin Heinrich (D-NM) successfully sought higher office and was elected to the Senate, while Rep. Todd Akin (R-MO) was unsuccessful in his bid for a Senate seat.

On the House Defense Appropriations Subcommittee, the most notable departure is the retirements of Rep. Norm Dicks (D-WA), the long serving ranking minority member. Also retiring is Rep. Jerry Lewis (R-CA) a former chair of both the subcommittee and the full committee. A likely successor to Dicks could be found in Rep. Peter J. Visclosky (D-IN). Rep. Jim Moran (D-VA) is



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also presumed to have an interest in that position. Should the majority not grant a second term limits waiver to current Chairman Bill Young (R-FL), causing both top positions to turn over, Rep. Rodney Frelinghuysen (R-NJ) is seen as a likely successor to lead the panel.

In the Senate, four Armed Services members are retiring: Sens. Daniel Akaka (D-HI); Joe Lieberman (I-CT), chairman of the SASC's Airland Subcommittee; Ben Nelson (D-NE), chairman of the SASC's Strategic Forces Subcommittee; and Jim Webb (D-VA), chairman of the SASC's Personnel Subcommittee. The only member facing reelection to not return is Rep. Scott Brown (R-MA), who was ranking member of the Airland Subcommittee. Senator Jim Inhofe (R-OK) is presumed to be the new Ranking Member of the full committee, as Senator John McCain (R-AZ) is term limited. It is also widely acknowledged that Senator Bill Nelson (R-FL) plans to return to the committee following his successful reelection bid.

The Senate Defense Appropriations subcommittee will have the least turmoil of any defense oversight panel. The retirement of Senator Kay Bailey Hutchison (R-TX) is the only known departure from the current membership of the Defense Appropriations Subcommittee.



Education

ELECTION TAKEAWAYS

- A second term for President Obama should mean a second term for Education Secretary Arne Duncan, who has made clear his desire to remain at his current post.
- Sen. Tom Harkin (D-IA) will continue to lead the Health, Education, Labor, and Pensions (HELP) Committee. Current ranking member Sen. Mike Enzi (R-WY) is term-limited, so Sen. Lamar Alexander (R-TN), a former Secretary of Education, is expected to grab the ranking Republican spot.
- Rep. John Kline (R-MN) held on to his seat and will remain chairman of the Education and the Workforce Committee. Rep. George Miller (D-CA) should continue in his role as the committee's ranking Democrat. The overwhelming majority of committee Republicans sought and won re-election, but only 11 of 17 committee Democrats will be back for the 113th Congress.

Outside of action this summer to extend the 3.4 percent interest rate on subsidized Stafford Loans for a year, the 112th Congress, mired in gridlock, remained mostly silent on key education issues. Authorizing committees in the Democratic-controlled Senate and Republican-controlled House completed work on long-awaited legislation to reauthorize the Elementary and Secondary Education Act, but the bills failed to attract requisite support and did not receive floor consideration.

Controversial moves by the Department of Education, however, somewhat negated the need for urgent reauthorization of the law commonly known as “No Child Left Behind.” The administration last fall announced states could “request flexibility” from NCLB, but only if they agreed to implement a series of reforms that “prepare all students for college and career, focus aid on the neediest students, and support effective teaching and leadership.” So far the Department has granted waivers to 34 states and the District of Columbia; 10 additional waiver requests remain outstanding. The Department’s decision to bypass Congress drew derision from House Education and the Workforce Chairman John Kline, who said the Obama administration’s action was “unlawful” and sought to pick winners and losers. Through waivers and the reforms associated with the Race to the Top initiative, the administration has basically pushed through its vision for an overhaul of K-12 education, making ESEA reauthorization less of a necessity. We expect Congress to revisit ESEA reauthorization in the 113th, although partisan quarrels may again doom this effort.

In recent years Congress has taken to advancing higher education policy goals through the annual appropriations process, and the 112th Congress was no different. Last year’s Budget Control Act altered the Pell and Direct Stafford loan programs, infusing Pell with \$17 billion in supplemental mandatory funding and eliminating in-school interest subsidies on student loans for graduate and professional students and on-time repayment incentives for direct loans issued after July 1, 2012. The final FY 2011 spending measure eliminated year-round Pell, while the FY 2012 omnibus made a number of changes to the Pell program, including: raising the minimum award for eligibility to 10 percent of the maximum award; requiring students to have a high school diploma or GED or to have completed school in a home setting to be eligible for the program; lowering the gross income level at which a student automatically qualifies for a maximum grant under the zero expected family contribution calculation from \$30,000 to \$23,000, and; lowering, from 18 to 12, the number of semesters a student may be eligible.



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These changes come in advance of House and Senate consideration of the Higher Education Act, which governs all federal student aid programs. Work should begin in earnest this year (the latest iteration of the HEA expires in 2013—if a reauthorization is not passed by the end of the year, the law is automatically extended through 2014). With most of the main players—Secretary of Education Arne Duncan, HELP Chairman Tom Harkin, and Kline—expected to remain in their current roles, Congress could get to work on a HEA reauthorization sooner rather than later; however, considering the amount of time ESEA has gone without reauthorization, don't hold your breath.

The administration's priorities for higher education include a continuation of current college-related tax credits, a doubling of the number of work-study jobs and the creation of incentives for colleges to keep tuition down. Harkin's priorities for higher education should remain as they are now—the HELP panel is likely to focus on abuses within the for-profit sector and private student loan industry, college cost and affordability, and increased college access for the lower and middle class. Kline's priorities include cost and accountability, decreased federal spending, fewer regulations, and diminished federal intervention into the private sector.

Other education-related issues facing the 113th Congress include the reauthorization of the Workforce Investment Act, the looming Pell shortfall, general student aid, immigration and visa reform, and, of course, sequestration. The Department could continue its activist streak by promulgating another round of gainful employment regulations. The agency is expected to finalize rules on teacher preparation and fraud later this year.



Energy and Environment

Despite record high gas prices and continued public concern over the threat of global warming, energy and environmental issues played a second or third-tier role in this year's political campaigns. With an electorate still largely divided, it will be difficult to find common ground on costly reform proposals.

Successful tea party opposition to candidates embracing the need to address climate change was made especially poignant in the defeat of Republican Congressman Bob Inglis (GA) in the 2008 elections. Since then, proponents of climate change legislation have been unable to create the bipartisan coalition necessary to move legislation, and national politicians of both parties have avoided the issue in their 2012 campaigns. We expect energy policy in the 113th Congress to be driven more by the tax writing committees than by those committees with the word energy in their names. However, some legislative issues especially with respect to distinct energy sources and energy efficiency may find a path forward.

IS NATURAL GAS THE NEW COAL?

The politics of energy and climate change were largely dominated by the geography of coal production in the 112th Congress. Expect these issues to be addressed in the 113th Congress in the context of two important new developments: 1) the lack of political will to place a price on greenhouse gas emissions, and 2) the unprecedented low price of natural gas brought on by new hydraulic fracturing technologies. While some hold out hope for the prospect of a carbon tax, in the wake of a failed effort to pass cap and trade legislation environmental groups continue to pin their hopes on successful use of existing authorities under the Clean Air Act to limit greenhouse gas emissions, as well as on further development of clean sources of renewable energy and increased efficiency standards.

Although a cleaner alternative than coal (under currently deployed technologies) low-priced natural gas is a relatively easy transition fuel for many electricity producers currently using coal. That said, the prospect of significant natural gas exports in the near future limits the ability of natural gas users, including electricity producers and chemical manufacturers, to make long-term capital investments based on low cost fuel and feedstock. Moreover, the current low cost of natural gas depresses the cost of electricity at a level which prohibits renewable technologies from being cost-competitive without government support. As a result of this complicated matrix of impacts, the continued development of natural gas supplies, and the issue of export licensing will play center stage in the energy debates of the 113th Congress.

DEPARTMENT OF DEFENSE DRIVES TECHNOLOGY ADOPTION

With the likely stalemate on Capitol Hill over investments in new energy technologies, companies seeking assistance from the federal government to gain a place in the market will need to continue to look to the large government operations and vehicle fleets. The Republican controlled House oversight committees and the current fiscal situation will dramatically limit the ability of the Department of Energy to resource green energy development. The Defense De-



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partment, meanwhile, is being forced to adopt energy saving systems and technologies to achieve policy goals, as well as to limit fuel costs through the deployment of energy efficiency programs.

SENATE ENERGY & NATURAL RESOURCES COMMITTEE

Sen. Ron Wyden (D-OR) is expected to take the gavel of the Senate Energy Committee for the 113th Congress, with Sen. Lisa Murkowski (R-AK) maintaining her position as Ranking Member. Sen. Wyden has publically indicated his support for utilizing a wide array of energy sources including fossil fuels, but is a strong proponent of the development and deployment of renewable energy technologies. He seems to enjoy collegial relationships with his colleagues on both sides of the aisle. Although he has shown both willingness and ability to negotiate issues with his Republican colleagues successfully, Wyden often sides strongly with the environmental community. Expect the committee to focus attention on natural gas, science and technology development (especially as it relates to efficiency and renewable energy), and an expanded interest in natural resources and parks.

SENATE ENVIRONMENT AND PUBLIC WORKS COMMITTEE

Barbara Boxer (D-CA) will maintain her role as chair of the committee in the 113th Congress. We expect Sen. David Vitter (R-LA) to ascend to the ranking member position. Although it is unlikely that the committee will find the bipartisan formula to allow passage of major environmental legislation, movement on the public works side of the committee's jurisdiction is within reach.

HOUSE ENERGY & COMMERCE COMMITTEE

On the House Energy and Commerce Committee, current Rep. Fred Upton (R-MI) will continue as chair of the committee. The majority had two retirements and both Reps. Mary Bono-Mack (R-CA) and Brian Bilbray (R-CA) lost their races. As a result of his retirement, the majority will need to replace Rep. Cliff Stearns (R-FL) chair of the Subcommittee on Oversight and Investigations. The other five subcommittee chairs were re-elected and are expected to retain their positions. On the Democratic side, Rep. Henry Waxman (D-CA) had a tougher race than many anticipated but held on to win and is expected to remain as ranking member. The Democrats had three retirements, another member ran for the Senate and another for governor, opening up at least five seats on the committee. While this will result in a few new (or returning) faces on the committee, we do not expect any changes to the ranking member positions on the subcommittees.

HOUSE NATURAL RESOURCES COMMITTEE

The current chair of the House Natural Resources Committee, Rep. Doc Hastings (R-WA) is expected to make a play for chair of the Rules Committee. If Hastings is successful, and Rep. Rob Bishop (R-UT) is expected to take the chairmanship. Rep. Doug Lamborn (R-CO) continues as chair of the Energy and Mineral Resource Subcommittee which has jurisdiction over energy production on federal land, both on and off shore.

Rep. Ed Markey (D-MA) will continue in his role as ranking member and should have six openings for new Democratic members on the committee. Markey will continue to raise the issue of climate change at every opportunity. Rep. Rush Holt (D-NJ) will likely continue as ranking



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member on the Energy and Mineral Resources Subcommittee where he will be joined by at least four new Democratic subcommittee members.

APPROPRIATIONS COMMITTEES

Sen. Dianne Feinstein (D-CA) and Sen. Lamar Alexander (R-TN) will maintain their positions as chair and ranking member, respectively, on the Senate Energy and Water Subcommittee. Expect the committee to play a major role in forcing the direction taken by the national laboratories, and nuclear waste disposal options. Both senators are also working on a major initiative to reform the process by which Corps of Engineer navigation projects are authorized, funded, constructed, and maintained.

In the House of Representatives, the 113th Congress may well see a new chair and ranking member on the Energy and Water Appropriation Subcommittee. Current chair, Rep. Rodney Frelinghuysen (R-NJ) will move to the Defense Appropriations Subcommittee if current chair Rep. Bill Young (R-FL) does not receive a term limit waiver. Since the Republican process is not a direct line of ascension, it creates an almost endless possibility of scenarios for the next subcommittee chair. On the Democratic side, Rep. Visclosky (D-IN) will move to Defense to replace the retiring ranking member, Rep. Norm Dicks (D-WA), and either Reps. Ed Pastor (D-AZ) or Chaka Fattah (D-PA) should take the ranking member position.



Financial Services

President Obama's re-election, combined with the Senate remaining in Democratic hands, is likely to limit the range of potential outcomes for events in D.C. that are likely to affect financial services firms in the coming Congress. The implementation of the Dodd-Frank Act of 2010, which will continue into 2013 and beyond, is largely in the hands of the regulators. And a still-divided Congress means that significant weakening of Dodd-Frank (which some Republicans would like to see) or strengthening (as some Democrats have called for) is unlikely.

Rep. Spencer Bachus (R-AL) will step down as Chairman of the influential House Financial Services Committee at the end of this year due to party-imposed term limits. Rep. Jeb Hensarling (R-TX), Vice Chairman of the Financial Services Committee, is considered the leading candidate to replace Bachus. Hensarling has been a consistent critic of Dodd-Frank. He believed Dodd-Frank should have required Fannie Mae and Freddie Mac to be wound down, and has continued to call for an aggressive approach to government-sponsored enterprise (GSE) reform.

Hensarling has also argued that Dodd-Frank did not address the "too-big-to-fail" problem of large banks. He has proposed an alternative to the resolution authority granted to the federal government in Dodd-Frank that would instead require large financial institutions that fail to go through the bankruptcy process. We would expect Hensarling to continue to push these positions as Chairman, though his plans for the GSEs are likely to face strong opposition from Democrats.

Ranking House Financial Services Committee member Rep. Barney Frank (D-MA) is also leaving the Committee as he is retiring. Rep. Maxine Waters (D-CA) is the most senior Democratic member of the Committee and is likely to be named Ranking Member. Waters has been a vocal critic of the financial-services industry, particularly as it relates to treatment of mortgage borrowers in the wake of the financial crisis and other consumer-finance issues. We would expect Waters to continue this criticism of the financial sector from her new post, though we would note that her power will remain limited in the still-Republican controlled House.

Senate Banking, Housing, and Urban Affairs Committee Chairman Sen. Tim Johnson (D-SC) was not up for re-election and will continue to head the Committee. Sen. Richard Shelby (R-AL) was not up for re-election and will remain on the Banking Committee, but will step down as Ranking Member due to party-imposed term limits. Shelby is likely to be replaced as Ranking Member by Sen. Mike Crapo (R-ID). Like his House counterpart Hensarling, Crapo opposed Dodd-Frank, and has encouraged plans to reform the GSEs and encourage private capital to return to the mortgage market.

TOP AGENDA ITEMS IN THE 113TH CONGRESS

The bailout of the financial-services sector was a frequent topic in the Presidential race, with President Obama commenting in numerous campaign stops that Washington must continue to hold Wall Street's feet to the fire. So what does his re-election mean to the sector? Not much.

We are exaggerating for effect to a degree. The occupant of the White House is an important



voice in the debate over financial-services regulation. But we do believe that President Obama's re-election, combined with the Senate remaining in Democratic hands, is likely to limit the range of potential outcomes for events in D.C. that are likely to affect financial-services firms in the coming Congress.

Key developments likely to affect the financial-services industry in 2013 and beyond include the final version of the Volcker Rule, implementation of the Basel III standards and reform of the residential mortgage market. Continuing in the backdrop of all these discussions is the still-simmering debate over whether some U.S. banks are still "too big to fail" and what to do about it if they are, a conversation in which Congress will play a role.

The Volcker Rule is one of the most controversial elements of Dodd-Frank. It sharply limits the level of investments bank holding companies can make in private-equity funds and hedge funds, and restricts banks from making certain proprietary investments. Putting the second provision into place has proven complicated. For instance, if a bank buys bonds from one client, then profits from those bonds before selling to another client, is that proprietary trading?

The November 2011 proposed rule laying out the details of the Volcker Rule was thought to be onerous for the banks. The five regulatory agencies (led by the Federal Reserve) responsible for finalizing Volcker have haggled with the banks and each other for months over how to define what market-making and hedging activities are permissible under the Rule. We believe regulators are nearing the end of their deliberations, and that the Volcker Rule is likely to be finalized in the coming weeks (possibly by year-end). We believe the final Volcker Rule will be much more accommodating toward market-making and hedging activities than the proposed rule. But however it shakes out, Volcker is sure to have a significant impact on banks, brokers and the capital markets in which they operate.

The negotiations among international bank regulators for the Basel III standards began even before the financial crisis of 2007 and 2008, but have been greatly affected by the havoc the crisis wrought on the global banking system. In response, the Basel III standards set much more conservative capital and liquidity standards for banks in the developed world than have ever existed before.

To give banks ample time to prepare, implementation of the Basel standards is scheduled to take place in phases from 2013 through 2019. But critics on both sides of the Atlantic have pushed back on both the specifics of the rules and the timeframe. Some in Europe say the higher capital and liquidity requirements would hurt the already fragile state of Europe's banks and economy. In the U.S., many regional and community banks argue the international standards should only apply to large, systemically important banks, and that requiring small banks to comply with Basel III (as the proposed U.S. version of the rule recommends) will cause them to provide less credit to homeowners and businesses.

At the same time, other opponents on both sides of the aisle say the Basel III standards do not go far enough for large banks. This critique has been best captured by two recent letters co-authored by Sens. David Vitter (R-LA) and Sherrod Brown (D-OH), who argue that Basel III



should be delayed and the capital requirements for large banks further increased. In the coming weeks, the Fed is likely to announce its final rule on Basel III.

Despite the recent criticism, we do NOT expect the Fed to delay its implantation of Basel III, either to exempt smaller banks or to raise the requirements for their larger counterparts. Many inside and outside the Fed feel U.S. bank regulators have done more than their counterparts around the world to improve the health of the banking system since the crisis, helping the U.S. economy and capital markets, and they do not wish to lose the advantage by delaying a rule that would likely take years to rewrite. Nevertheless, we expect the pressure on the Fed to remain elevated even after the election, and will watch closely to see what changes regulators will allow in the final rule.

Leading voices on both sides of the aisle seem to agree that the current state of the U.S. mortgage market—in which the government guarantees nearly 90 percent of all new mortgages—is unsustainable. Most analysts agree that the mortgage market needs to reduce its dependence on Fannie Mae and Freddie Mac. The question is how, and how fast. Some conservatives argue the GSEs should be wound down quickly—with specific targets for both companies to sharply reduce their mortgage portfolios, reduce the size of loans they can guarantee, increase fees related to their guarantees and exit their status as government-owned entities.

Importantly, two advocates of this aggressive approach should have prominent leadership positions in the next Congress—Hensarling and Crapo. Their opponents argue that moving too fast to shrink Fannie and Freddie would halt the nascent recovery in the housing market. Others say the government will still be required to backstop the mortgage market in some way, and/or provide a structure to restart the private securitization market. Some argue mortgage reform is too big a problem for Congress and the Administration to tackle in 2013 given other fiscal priorities.

We think the terms of the debate over GSE reform will begin to form in earnest in 2013, and legislation mandating some structure to shift capital from the GSEs back to the private sector could move in the next Congress particularly if the housing market continues to improve.



Health

The priorities within the Department of Health and Human Services (HHS) will not greatly change with the reelection of President Obama. It is widely expected that HHS Secretary Kathleen Sebelius will remain for the President's second term. Her number one priority will be to continue overseeing the implementation of the Affordable Care Act (ACA). Additionally, the Secretary is likely to maintain an active focus on issues laid out in the Secretary's "Strategic Initiative."

Again, the focus of the next year will be the implementation of the coverage provisions in the ACA. First up is a November 16 deadline by which states have to decide whether they will operate their own insurance exchange or defer to the federal government to operate one for them. The rules and regulations governing the insurance exchanges are expected imminently, and the Secretary will remain very actively engaged in this particular area until the exchanges are operational in January 2014. There is a backlog of other rules and regulations governing various aspects of the ACA, such as what type of health care services have to be covered by insurance plans, remaining at HHS. We fully expect a slow release of these materials now that the election is over, with the first release possible even later this week.

A Republican-controlled House of Representatives is likely to continue closely monitoring implementation of the ACA. It is near certain that the House will vote to repeal the ACA at the start of the 113th Congress. However, this will be a largely symbolic vote, as the bill will not pass the Democratic-controlled Senate and, certainly, would not survive the President's veto pen. As such, it could be that the House moves to consider other bills that would repeal smaller sections of the ACA, such as the device tax.

There is also a chance that some legislation could be considered to fix parts of the ACA. The most obvious issue to be examined surrounds the Medicaid expansion. The Supreme Court ruled that states could not be compelled to expand their Medicaid programs through threats of lost federal dollars, despite the fact that ACA assumed that all states would have to come up to 100 percent of the federal poverty level and then get the super match to cover individuals up to 138 percent of the federal poverty level.

Given the Court's ruling that states have an option on Medicaid expansion (expansion is no longer a requirement of participation in the underlying Medicaid program as the ACA anticipated), at least half of the states have not decided whether to expand their Medicaid programs to match the ACA's requirement to cover all individuals living at or below 138 percent of the federal poverty level (FPL). This is problematic for a subset of the very poor, namely single, childless adults. The ACA only provides subsidies to purchase insurance in the exchanges for people whose income is between 100 percent and 400 of FPL. Since many states do not already provide Medicaid coverage to all people living below 100 percent FPL, there are a large number of people who may find themselves ineligible for both Medicaid and exchange subsidies.



Fixing this issue will not be easy. Many Republicans in the House do not have an appetite to fix the ACA and certainly would not favor a legislative fix that would further expand an entitlement program such as Medicaid. Additionally, a legislative fix to this problem is likely to come with a costly price tag. In the House, Republican members have insisted that all legislation be offset, which could further complicate matters.

Outside of this Medicaid issue, the House is expected to conduct a lot of oversight of the ACA, as the Administration moves forward with implementation. Hearings are likely in the House Education and Workforce, Energy and Commerce, Oversight and Investigations, and Ways and Means Committees; all of which have jurisdiction over parts of the ACA. Topics to be examined could include: the impact of the law on employers and individuals; impact on the Medicare and Medicaid programs and patients access to care; and even a close look at how the rules and regulations governing the law are released and how much time, if any, is given for public comment.

In the short term, Congress will have to address a looming 27 percent cut in Medicare payments to physicians, known as the Sustainable Growth Rate (SGR) or Medicare “doc fix”. Over the past several years, Congress has postponed this automatic cut on an annual basis. We expect this will be addressed in the lame duck session of Congress in December. While Members have long supported a permanent solution to this problem, we anticipate another short-term fix, most likely a one year freeze. Even a one year freeze carries a hefty price tag of \$20–25 billion, which will have to be offset. The most likely source of those pay-fors are cuts to other Medicare programs and providers.

Efforts are underway to find a long-term solution to the recurring problem with the physician payment system. It is likely in both the House and Senate that the committees with jurisdiction over the Medicare program (House Energy and Commerce, House Ways and Means, and the Senate Finance Committee) could spend considerable time in the next Congress looking for a permanent replacement to the current physician payment system.

HHS appropriations priorities are not expected to change dramatically. There will continue to be downward pressure on programs, especially those that provide clinical care services to low income populations such as Ryan White, breast and cervical cancer screening, and immunizations and other services that may be reimbursed by Affordable Care Act coverage in 2014 and beyond. Big operating divisions such as NIH will continue to struggle to obtain significant increases given the multi-billion dollar price tag associated with the those efforts in a constrained fiscal environment.

In general, following the Secretary’s Strategic Initiatives, other priority areas include health disparities, prevention and wellness, disabilities and community living, improving food safety, reducing obesity, reducing tobacco use, early childhood development, emergency response, and HIV/AIDS among others.

Here are some specific health-related prognostications:

- A second term for President Obama should mean that the Affordable Care Act implementation moves forward and a second term for Health and Human Services Secretary Kathleen



Sebelius, who most expect will remain at her current post.

- The Supreme Court decision to make Medicaid expansion optional may require a new look at whether non-Medicaid eligible individuals below 100 percent of the federal poverty level can have access to subsidies under the exchange program.
- Budget and policy priorities should continue to align with the Secretary's Strategic Initiatives that have already been laid out.
- Most HHS agency heads are expected to continue at HRSA, CDC, NIH, SAMHSA, AHRQ, ACL, IHS, FDA, and OASH. Less clear is the fate of Marilyn Tavenner, Acting Administrator of the Centers for Medicare and Medicaid Services. Some think she may not be confirmable due to her tenure under the controversial previous CMS Administrator Don Berwick, but she has maintained an open line of communication with members on both sides of the aisle, and that combined with her experience may allow her to get the nod.
- Sen. Max Baucus (D-MT) will continue to lead the Finance Committee. Current ranking member Sen. Orrin Hatch (R-UT) will retain the ranking Republican spot.
- Rep. Dave Camp (R-MI) held on to his seat and will remain chairman of the Ways and Means Committee. Rep. Sander Levin (D-MI) should continue in his role as the committee's ranking Democrat.
- There will be some shake-up on the Ways and Means Subcommittee on Health with the retirement of the current chairman Rep. Wally Herger (R-CA). The subcommittee chairmanship is Rep. Kevin Brady's (R-TX) for the taking if he wants it.
- Rep. Fred Upton (R-MI) held onto his seat and will remain chairman of the Energy and Commerce Committee. Rep. Henry Waxman (D-CA) will remain the committee's ranking Democrat. There are no changes expected in leadership at the Energy and Commerce Subcommittee on Health.
- With his unsuccessful bid for the Senate, Rep. Denny Rehberg (R-MT) opens up the chair of the Labor, HHS, and Education Appropriations Subcommittee. Reps. Jack Kingston (R-GA) and Rodney Alexander (R-LA) have expressed interest, and Kingston who is more senior is term-limited on his current chairmanship of the Agriculture Subcommittee. Alexander does not currently chair a subcommittee, but is a contender given his full committee seniority.



Homeland Security

Homeland Security priorities are unlikely to dramatically change during the President's 2nd term and 113th Congress. This is true for several reasons. First, threats remain the same and major programs continue to collect broad bipartisan support—cyber security; aviation security; cargo inspection; and disaster response and recovery. Second, there is unfinished business that both the Administration (and some in) Congress want to tackle, not the least of which are cyber security and immigration reform. Despite these steady state priorities, remember the devil is always in the detail. What will be different? The degree to which the federal government involves itself in issues, such as cyber security and the size of government involvement.

The 112th Congress has yet to complete its work on major (or even minor) cyber security legislation. While there was a lot of pre-election talk that a pending executive order on cyber security was being reviewed/finalized, the reality is there are never any executive orders issued immediately preceding a Presidential election. With that behind us, and assuming Congress does not get its ducks in a row over the next few weeks to pass its own version of cyber legislation, we can expect to see an executive order shortly. With a divided government, the main sticking points in passing a cyber security bill (defining the role of government and the responsibilities of the provide sector), will not change.

The second major shift within homeland is “size.” Where homeland security in general, and the Department of Homeland Security (DHS) in particular, has enjoyed significant support from Congress and the Administration over the past 11 years, fiscal realities will temper efforts to “super size” everything homeland security related. Homeland security is no longer immune to belt tightening, as observers are seeing as the 112th Congress winds down its work on the fiscal year 2013 appropriations bills. Both the House and Senate DHS spending bills are below the fiscal year 2012 enacted levels and DHS will be subject to the across the board sequester scheduled to go into effect on January 2, 2013. The challenge for decision makers is how to cut or reduce programs in a way that will not have either an immediate impact on daily operations or a longer term impact on homeland security. This will be difficult when the country continues to face direct threats to domestic security—i.e. the recently disrupted plots to bomb the Federal Reserve in Manhattan, the Washington Metro system and the United States Capitol complex.

Of course, all the talk about belt tightening did not necessarily consider the wrath of Hurricane Sandy. While it is way too early to predict the financial impact of this major event and the federal cost, we do know efforts are underway to calculate what FEMA might need as the East Coast continues to recover. The Budget Control Act of 2011 allowed for emergency spending but ultimately this spending will only contribute to the deficit and the challenges of dealing with fiscal cliff. Whether or not a supplemental for Hurricane Sandy provides an opportunity to move other appropriations bills forward (particularly homeland) will certainly be an item for discussion over the next few weeks.



The 113th Congress will see changes in leadership for both House and Senate Homeland Security authoring committees, with retirements and term limits playing into new committee assignments. Senate Homeland Security & Government Affairs (HSGAC) Chairman Joe Lieberman (I-CT) is retiring. His replacement is likely to be Sen. Tom Carper (D-DE). Carper is currently Chairman of the Subcommittee on Federal Financial Management. A major focus for him during the 112th Congress was on gathering support for the Lieberman/Collins cybersecurity bill and finding operational savings in federal agencies overseen by HSGAC. On the minority side Sen. Susan Collins (R-ME) is term limited as Ranking Member. Sen. Tom Coburn (R-OK) is next in line, a conservative with strong views on deficit reduction, immigration reform, and privacy.

House Homeland Security Chairman Peter King (R-NY) is term limited and three Members are in a race to succeed him: Mike Rogers (AL) (Transportation Security Chair); Candice Miller (MI) (Border and Maritime Security Chair); and Mike McCaul (TX) (Oversight, Investigations and Management Chair). The incoming chairman could focus on a number of legislative priorities including: a full reauthorization of the Department of Homeland Security, an authorization for the Transportation Security Administration (TSA), TSA screening and equipment, border and port security and DHS acquisition and management. Committee Chairs most likely will not be decided until early to mid-December. Rep. Bennie Thompson (D-MS) is expected to remain ranking member of the committee.

Within the Committees on Appropriations, although there are known changes at the full committee, the trickledown effect for subcommittee assignments remains to be seen. None of the key Homeland Security Subcommittee members are term limited so we might expect the line up to remain the same (Senators Landrieu and Coats as Chair and Ranking Minority Member in the Senate and Congressmen Aderholt and Price as Chair and Ranking in the House).



International Affairs

It is likely that there will be few, if any, significant pieces of foreign aid related legislation reaching the floor of the House or Senate in the next Congress. However, the granting of Permanent Normal Trade Relations (PNTR) to Russia and the ratification of the Law of the Sea Treaty may come up during the lame duck session. While the granting of PNTR is expected to pass both Houses, the actual vote has been postponed several times already. The measure enjoys broad support from the business community as US business would be significantly disadvantaged by failure to act. The Law of the Sea Treaty faces Republican opposition in the Senate, which is likely to doom its chances for ratification in the lame duck.

The renewal of the President's Emergency Plan for AIDS Relief, or PEPFAR, which has been in effect since 2003 and was successfully renewed in 2008, may come up for consideration next year. However, its prospects remain dim given the tight budget scenario and continued strong disagreement on family planning related issues. While the House Foreign Affairs Committee did attempt to develop legislation in this Congress on a number of topics, no major foreign aid legislation was considered on the House floor. Expect a similar result in the new Congress.

Few expect that the Congress will address the rewrite of the Foreign Assistance Act in order to "reform" our foreign assistance programs, given that the Administration has completed its own internal reforms pursuant to the finding of the Quadrennial Diplomacy and Development Review and the Presidential Study Directive. It is possible that the SFRC will address discreet elements of foreign aid reform in separate legislation.

Major changes are expected in the leadership of both the House Foreign Affairs Committee and the Senate Foreign Relations Committee (SFRC). In the House, both the chairman and ranking member slots will have new faces due to the six year term limit rules for Republicans, and the election loss of current Ranking Member Rep. Howard Berman (D-CA). Despite the fact that Rep. Chris Smith (R-NJ) is next in line for the chair, and is seeking the job, he is not likely to get the nod from Republican leadership. Most speculation centers on Reps. Ed Royce (R-CA) and Steve Chabot (R-OH) as the top contenders with most favoring Royce's chances over Chabot. On the Democratic side the top candidates are Reps. Brad Sherman (D-CA), Eliot Engel (D-NY), and Gregory Meeks (D-NY) with most favoring Engel's chances.

In the Senate, if Sen. Kerry (D-MA) becomes Secretary of State in the new Obama Administration, the chairmanship would likely be assumed by Sen. Robert Menendez (D-NJ). Sen. Bob Corker (R-TN) will become the new ranking member due to the departure of Sen. Richard Lugar (R-IN). There will be two vacancies on the Democratic side and one on the Republican side of the committee that will be filled with new members.

There are no changes anticipated in the chair or ranking member positions of the State, Foreign Operations (SFOPS) subcommittees of either the House or Senate Appropriations Committee. Reps Kay Granger (R-TX) and Nita Lowey (D-NY) will remain as chair and ranking Member respectively. Lowey is likely to become the new ranking member of the House Appropriations



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Committee barring a rules change within the Democratic Caucus. This is unlikely, thus she will likely occupy both positions simultaneously. Granger is likely to remain as chair as she is still within the six year term limitation for the position. Rep. Ander Crenshaw (R-FL), the head of the Foreign Aid Effectiveness Caucus, has expressed a desire to rejoin the SFOPS subcommittee.

Prior to FY 2012, international affairs spending increased steadily for the prior five years due to the combination of significant investments in the security of US personnel overseas, the rebuilding of Iraq, Pakistan and Afghanistan, increases in our commitment to fight HIV/AIDS, tuberculosis and malaria, and the expanded initiative in global food security. Between 2008 and 2011, total expenditures increased from approximately \$42 billion to approximately \$55 billion.

In 2012 international spending fell to \$53.5 billion, and in 2013 it is likely to fall again to approximately \$51 billion. These decreases are largely due to our decreasing security costs and investment in Iraq, Afghanistan and Iraq. Those decreases will continue, as our troops complete the withdrawal from Afghanistan. US support for these areas of conflict will continue, but at a reduced rate, and total foreign aid spending is likely to flatten out at \$48 billion to \$49 billion annually as a result.

Despite expectations that the Republican-controlled House would seek large decreases in non-security related foreign aid, those programs have enjoyed level funding or slight increases in the past two years. Global Health programs in particular has enjoyed bipartisan in the past two years, and it appears that the US will continue to invest approximately \$8 billion per year for the next few years. Similarly, the Food Security Initiative is likely to receive approximately \$1 billion per year.

Given reduced needs in conflict countries and continued implementation of various reforms in health and development programs, the overall request for foreign assistance is likely to decrease slightly in FY 2014. Core programs in support of Israel and Egypt will continue. However, expect pressure in the House to reduce funding of the United Nations and its affiliated organizations, International Financial Institutions, family planning, and environmental programs.



Tax Policy & Tax Reform

The outlook for tax policy and the prospects for meaningful tax reform remain muddled in light of an election that leaves in place the existing divided Congress.

What happens prior to the end of the year when lawmakers attempt to deal the approaching fiscal cliff will set the stage for tax reform. Congress will convene in a lame duck session over the next six weeks principally to address the coming fiscal cliff—the budget sequester, expiring tax cuts and the like. With regard to the lame duck session beginning next week, it is important to note that Congress will not rewrite the Internal Revenue Code over the next few weeks.

While it remains to be seen how this plays out over the coming weeks, there are some conclusions to be drawn with the elections behind us. By most accounts, any agreement struck by Congress and the administration during lame duck or immediately after will likely extend most if not all the expiring Bush tax cuts into if not through 2013. If that's the case, there will be significant tax reform implicit and explicit implications. An agreement to temporarily extend the 2001 and 2003 tax cuts in and of itself will establish some context as well as a budget baseline for a comprehensive tax reform debate in 2013.

Congress will likely include a legislative road map for tax reform in the form of expedited process and timeline to facilitate passage of a bill in the next Congress. The House passed one such measure earlier this year. With the election results maintaining a relatively slim Democratic majority in the Senate and a Republican majority in the House, some sort of fast track legislative similar to a modified budget reconciliation process may be the only way Congress can conceivably pass major tax legislation through both chambers in the next Congress.

A temporary extension of the Bush tax cuts would naturally establish a deadline for tax reform legislation, probably at the end of 2013. Absent an agreement on tax reform the fiscal cliff scenario plays out all over again next year. It is hoped that this may provide enough incentive to work productively toward an agreement on comprehensive reform.

With respect to the actual content of tax reform clearly the Obama and Romney campaigns had vastly different definitions of tax reform. We are not likely to see fundamental changes to the tax system in Obama's second term relative to what a Romney administration would have put forward.

Although the smoke has yet to clear, winners in terms of tax policy include the renewable energy sector which as seen mounting criticism of targeted tax break designed to jumpstart the industry. Many of those tax credits are set to expire. Tax provisions favoring the manufacturing sector such as the research credit will continue to receive support from this administration. Conversely, oil and gas provisions targeted by Obama during the campaign will be in play as a way of paying for other tax breaks or addressing mounting budget deficits deficit. U.S. corporations with overseas operation will continue to be forced to defend against the perception that competition in the international marketplace comes at the expense of U.S. jobs.



To the extent that any major tax policy changes are ultimately made permanent, in the long run businesses will benefit from by certainty in the tax laws. U.S. businesses have been hampered by a tax code teeming with temporary and expiring provisions. We expect a great deal of focus on eliminating temporary tax provisions from the code if they can't be made permanent.

IMPLICATION FOR BUSINESS

U.S. businesses, large and small, need to be engaged in discussions with lawmakers surrounding inevitable changes in tax policy. The status quo election may have narrowed the scope of tax reform options, but the most substantive debate over tax policy in decades will take place in the next Congress whether or not legislation is signed into law.

Large businesses will have to come to terms with the idea that, for example, a reduction in the corporate tax rate will come at a cost. Under Obama, international tax policy will be viewed more through the prism of deficit reduction and compliance rather than competitiveness and simplification. U.S. multinationals will find little clarity in this area as a result of the election.

Small businesses, especially pass-through entities like partnerships, S Corporations and sole proprietorships, will inevitably get swept up in debate over individual tax rates. Under Obama, the top individual tax rates—those paid by pass-throughs—will be reduced and are likely to increase for those in the top brackets. That said, any reduction in the corporate rate brings into play numerous business tax benefit affecting both corporations and small business pass-throughs. Certain small business ownership structures such as master limited partnerships will also face scrutiny.

Businesses in general need to frame the discussion over tax reform in terms of economic recovery before tax policy decisions are made lawmakers in the context of deficit reduction and higher taxes. Tax reform will inevitably involve winners and losers and if there is a takeaway from the election the list of winners in the business sector got shorter while the list of losers may have gotten longer.

NEW TREASURY SECRETARY

Treasury Secretary Timothy Geithner announced his intention to leave the administration at the end of Obama's first term. The choice of Geithner's successor will send an important signal for how high a priority tax reform will be in the president's second term. Comprehensive tax reform, and for that matter any major tax legislation, is virtually impossible without presidential support and leadership. In the run up to 1986, the last major rewrite of the tax code, Treasury played a critical role throughout a process that began with plan drafted by President Reagan's treasury secretary at the end of his first term in 1984.

Speculation over President Obama's pick for Treasury Secretary in his second term has centered around two contenders, White House Chief of Staff Jack Lew and Erskine Bowles (who co-chaired the president's bipartisan deficit reduction panel). By many accounts, Lew has an inside track. Lew served the president as director of OMB. In 2010, Lew served as one of Obama's key negotiators when the Bush tax cuts were temporarily extended. His role in the failed budget negotiations in the summer of 2011 (the so-called "Grand Bargain") drew sharp criticism



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from congressional Republicans. Consequently, a nomination to Treasury Secretary may not be viewed as a post election olive branch when it comes to tax reform.

In contrast, if Obama were to nominate Bowles as Treasury Secretary, it would be a sign the president intends to prioritize tax reform during his second term. The president's deficit panel, the so called Simpson Bowles Commission, laid out several options for comprehensive tax reform though the report was largely ignored by the administration. Bowles enjoys good relationships with members of Congress on both sides of the aisle by virtue of his time on the committee. Interestingly, Bowles has had kind things to say about Paul Ryan's budget plan which passed the Republican controlled House earlier this year.

We expect President Obama to make tax reform a centerpiece of his State of the Union address in February and to use the occasion to instruct his new Treasury Secretary to draft a comprehensive tax reform proposal.

Either way, the Treasury Secretary must be confirmed in the Senate and face a confirmation hearing before the Senate Finance Committee chaired by Sen. Max Baucus (D-MT). We can assume tax reform will be at the center of the debate regardless of the nominee for Treasury Secretary.

TAX WRITING COMMITTEES

Neither the House Ways and Means and Senate Finance Committees are expected to see dramatic changes in the ratios of Republicans to Democrats. The Ways and Means Committee chaired by Rep. Dave Camp (R-MI) will have a handful of vacancies, most notably 20-term Rep. Pete Stark (D-CA) who was defeated by fellow Democrat, 31-year-old Eric Swalwell. Former committee members Rep. Chris Van Hollen and Allyson Schwartz (D-PA) are reportedly jockeying for seats.

The Senate Finance Committee will again be chaired by Baucus with Sen. Orrin Hatch (R-UT) serving as ranking Republican. Four committee members retired (two Democrats and two Republicans). No remaining members lost their bids for reelection. Democrats vying for vacant seats are reported to be Sens. Michael Bennet (D-CO), Bob Casey (D-PA) and Mark Warner (D-VA). Among Republicans, Sens. Johnny Isakson (R-GA), Jim Demint (R-SC), Pat Toomey (R-PA), and David Vitter (R-LA) are said to be interested.



Technology/Telecommunications

“Myriad technology and telecom issues remain unresolved as Election Day concludes and the new Congress begins to take shape. Although the House and Senate, with varying degrees of emphasis, have looked at many of these issues, no major pieces of legislation in these areas moved through the 111th Congress (or the 110th Congress, for that matter).”

That paragraph was our opener following the elections in 2010 and truthfully, it serves as the introduction for tech/telecom policy in 2012 as well. The 112th Congress attempted a few targeted approaches to tech/telecom legislation but largely failed to move anything. The highest profile failures included comprehensive cybersecurity legislation, various privacy initiatives, and immigration reform involving H1-B visas.

The 113th Congress is likely to attempt, yet again, to focus on privacy and cybersecurity legislation as well as Science, Technology, Engineering & Mathematics (STEM) initiatives. The elephant in the room is whether the new Congress has the wherewithal to tackle a comprehensive rewrite of the 1996 Telecommunications Act. Generally speaking, industry would love to see a rewrite and as a result, think tanks, media outlets, political pundits, and of course K Streeters are buzzing about the possibilities.

Unfortunately, because the 2012 elections produced a status quo government (Democratic White House, Democratic Senate, Republican House), we are left to wonder and watch for changes in approach and style among the leadership of the respective parties. If they continue to put politics ahead of policy, it is highly unlikely much will move in the tech/telecom world (or any other industry). Already, *Politico* is reporting Senate Republicans are ready to play hardball:

“A senior Senate Republican leadership staffer said, “It’s a status quo election. House re-elected, Senate status quo, Obama re-elected = reset. We’ll start 2011 over again and hope the President engages. The White House has proven they can put together a helluva re-election plan, but they’ve been unable to govern in any way (emphasis added). With no reelection to worry about, it is our hope that he decides to come to the middle to tackle the huge challenges facing the country rather than trade talking points and point fingers for four more years.”

HOUSE OF REPRESENTATIVES

Rep. Fred Upton (R-MI), the Energy & Commerce Committee Chairman, survived a primary challenge and cruised to reelection. Going into his second term as chairman, he will command greater authority among the House Republican Conference and can drive a specific legislative agenda targeted at helping those industries who have a need for fewer regulations and greater flexibility and autonomy. In the past, Upton has been interested in spectrum reform, FCC oversight, cybersecurity and privacy although truth be told, he is more interested in his committee’s jurisdiction over energy policy.



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Rep. Greg Walden (R-OR), the Communications & Technology Subcommittee Chairman, is viewed as extremely knowledgeable on tech and telecom issues with a strong staff and an open door policy. However, it is believed he will take over the National Republican Congressional Committee (NRCC) for the next election cycle and that move likely means his stepping down as leader of the subcommittee. Waiting in the wings among others are Rep. Lee Terry (R-NE) and Rep. Marsha Blackburn (R-TN) both of whom have been extremely active on these issues.

Rep. Lamar Smith (R-TX), the House Judiciary Committee Chairman, who is seen as a friend of the tech industry, is term limited and will likely take over the House Science Committee. Replacing him as chair of Judiciary will be Rep. Bob Goodlatte (R-VA), the longtime co-chairman of the Congressional Internet Caucus who is a member viewed as someone with a “tech vision” and a workhouse willing to take on big issues.

SENATE

Sen. Jay Rockefeller (D-WV) will continue to lead the Senate Commerce Committee. He is considered moderately aggressive and takes a different view on many tech/telecom issues from Upton, Walden, Terry and Blackburn. Last month, for example, he wrote to the CEOs of all the Fortune 500 companies with a detailed questionnaire on their company’s cybersecurity posture. This letter worried most of the recipients as being overly broad and one that encroached on their ability to run their companies in a manner that would not expose them to hackers or other technology “bad guys”. Rockefeller has yet to release the results of his responses.

A big change in the Senate will be at the Homeland Security Committee, where Sen. Joe Lieberman (I-CT), a leader in the cybersecurity debates, has retired. Likely taking his place will be Sen. Tom Carper (D-DE), who has not been particularly active on cyber issues. The Senate Judiciary Committee will continue to be chaired by Sen. Pat Leahy (D-VT).

TELECOM ISSUES

With Universal Service Reform and Intercarrier Compensation mostly resolved for now, Congress and the industry can turn their attention to Comprehensive Spectrum Policy, Special Access Reform, Mobile Interoperability, Emergency Responder Networks, and perhaps a full-on rewrite of the 1996 Telecommunications Act. As mentioned earlier, the prospect for rewriting the Telecom Act really depends on whether House and Senate leadership are willing to focus on policy instead of politics.

At the Federal Communications Commission (FCC) Chairman Julius Genachowski continues to exert his influence over the industry and there are no indications that will change, particularly in light of the inertia in Congress. Although it was believed Rep. Darrel Issa (R-CA), the House Oversight Committee Chairman, would use his authority to put pressure on Genachowski, that notion never really materialized in a significant way in the 112th Congress.

TECHNOLOGY ISSUES

Cybersecurity is up first in the order of technology-related issues despite the fact that the last Congress failed to pass a bill. (Senate Majority Leader Harry Reid (D-NV) stated today that he



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would attempt to again bring up comprehensive cybersecurity legislation in the lame duck session.) However, the Obama administration seems to be poised as soon as next week to release an Executive Order on cyber, which would dramatically change how the Congress handles the issue going forward. Additional tech issues to move front and center include data privacy and data sharing issues, workforce issues including STEM education, H-1B visas and the DREAM Act, and R&D incentive programs.



Transportation

Following multiple short-term reauthorizations and a shutdown of the Federal Aviation Administration, Congress managed to clear authorizations for surface transportation and FAA programs. To manage those programs next year, DOT is expected to see a new Secretary. And, on appropriations and authorizations, new members will assume top positions.

LEADERS

On House Transportation and Infrastructure, Rep. Bill Shuster (R-PA) is expected to assume the chair of House Transportation and Infrastructure. Rep. Nick Rahall (D-WV) will return as ranking member. In the Senate, chairman Rockefeller (D-WV), Boxer (D-CA) and Johnson (D-SD) return as chairmen of Commerce, Environment and Public Works, and Banking, respectively. Big changes, however, occur in the minority with Sens. Richard Vitter (R-LA) and Jim DeMint (R-SC) moving up on EPW and Commerce. On Appropriations, the chairmen, Rep. Tom Latham (R-IA) and Sen. Patty Murray (D-WA) retain the gavel. However, with Rep. Olver (D-MA) and Sen. Susan Collins (R-ME) stepping down, new ranking members assume positions.

SURFACE TRANSPORTATION REAUTHORIZATION

For three years, Congress worked on a surface transportation bill that, in the end, authorized programs for only two years. The Moving Ahead for Progress in the 21st Century Act (MAP-21) provides a nearly level-funded \$118 billion for federal highway, mass transit, rail, safety and research programs through FY 2014. While previous highway reauthorizations provided six years of certainty for surface transportation programs, the fiscal environment and declining highway trust fund limited the final bill to two years.

MAP-21 yielded two other significant changes from previous highway reauthorizations. First, so-called “firewalls” that protected authorized highway spending levels were removed. The practical effect of the change will allow the Appropriations Subcommittees on Transportation to raise and lower spending levels during the annual budgetary process. Second, rules put in place by the 112th Congress eliminated the ability of lawmakers to secure project earmarks. The previous highway reauthorization measure included as many as 6,300 project earmarks.

Due to the relatively short reauthorization period, the 113th Congress is expected to simultaneously conduct oversight on MAP-21 and prepare for a new surface transportation reauthorization. A significant focus of the authorization committees will be reforms to the highway trust fund. With fuel economy improving and an unwillingness to raise federal taxes on gasoline, the system used to finance highway and mass transit programs will continue to experience significant shortfalls. Next year, Congress is also expected to consider authorizations to reform intercity and cargo rail programs in the United States. As always, funding and authority issues related to AMTRAK will be a significant focus.

FAA REAUTHORIZATION

After twenty-three short-term extensions over four years, the 112th Congress passed and the President signed a bill that provides a four-year \$63.4 billion authorization for FAA programs.



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Like the surface transportation reauthorization, the bill maintains current tax rates on jet fuel used to finance the national airspace system. Additionally, the reauthorization maintains the maximum passenger facility charge (PFC). Previous long-term reauthorization proposals would have increased the PFC from \$4.50 to \$7.

With respect to aviation, the 113th Congress is expected to maintain a focus on the implementation of NEXTGEN. While the four-year reauthorization directed FAA to develop an implementation plan on navigation procedures, acceleration and certification of technologies and performance metrics for NEXTGEN, the notoriously expensive and delayed program will remain a top issue of appropriators and authorizers.





Appendices

Appendix 1: New Members

NEW SENATE REPUBLICANS

Ted Cruz, Texas
Deb Fischer, Nebraska
Jeff Flake, Arizona

NEW SENATE DEMOCRATS / INDEPENDENTS

Tammy Baldwin, Wisconsin
Joe Donnelly, Indiana
Martin Heinrich, New Mexico
Heidi Heitkamp, North Dakota
Mazie Hirono, Hawaii
Tim Kaine, Virginia
Chris Murphy, Connecticut
Elizabeth Warren, Massachusetts
Angus King, Maine (Independent)

NEW HOUSE REPUBLICANS

Andy Barr, KY-6
Kerry Bentivolio, MI-11
Jim Bridenstine, OK-1
Susan Brooks, IN-5
Chris Collins, NY-27
Doug Collins, GA-9
Paul Cook, CA-8
Tom Cotton, AR-4
Kevin Cramer, ND-AL
Steve Daines, MT-AL
Rodney Davis, IL-13
Ron DeSantis, FL-6
George Holding, NC-13
Richard Hudson, NC-8
David Joyce, OH-14
Doug LaMalfa, CA-1
Thomas Massie, KY-4
Mark Meadows, NC-11
Luke Messer, IN-6
Markwayne Mullin, OK-2
Scott Perry, PA-4
Robert Pittenger, NC-9

NEW HOUSE DEMOCRATS

Joyce Beatty, OH-3
Julia Brownley, CA-12
Cheri Bustos, IL-17
Tony Cardenas, CA-29
Matthew Cartwright, PA-17
Joaquin Castro, TX-20
John Delaney, MD-6
Suzan DelBene, WA-1
Tammy Duckworth, IL-8
William Enyart, IL-12
Elizabeth Etsy, CT-5
Bill Foster, IL-11
Lois Frankel, FL-22
Pete Gallego, TX-23
Joe Garcia, FL-26
Tulsi Gabbard, HI-2
Alan Grayson, FL-9
Denny Heck, WA-10
Steven Horsford, NV-4
Jared Huffman, CA-2
Hakeem Jeffries, NY-8
Joseph Kennedy III, MA-4



NEW HOUSE REPUBLICANS (CONT)

Trey Radel, FL-19
Tom Rice, SC-7
Keith Rothfus, PA-12
Matt Salmon, AZ-5
Chris Stewart, UT-2
Steve Stockman, TX-36
David Valadao, CA-21
Ann Wagner, MO-2
Jackie Walorski, IN-2
Randy Weber, TX-14
Brad Wenstrup, OH-2
Roger Williams, TX-25
Ted Yoho, FL-3

NEW HOUSE DEMOCRATS (CONT)

Dan Kildee, MI-5
Derek Kilmer, WA-6
Ann Kirkpatrick, AZ-1
Ann McLane Kuster, NH-2
Alan Lowenthal, CA-47
Michelle Lujan Grisham, NM-1
Dan Maffei, NY-24
Sean Maloney, NY-18
Gloria Negrete McLeod, CA-35
Grace Meng, NY-6
Rick Nolan, MN-8
Beto O'Rourke, TX-16
Donald Payne, Jr., NJ-10
Mark Pocan, WI-2
Brad Schneider, IL-10
Carol Shea-Porter, NH-1
Eric Swalwell, CA-15
Mark Takano, CA-41
Dina Titus, NV-1
Juan Vargas, CA-51
Marc Veasey, TX-33
Filemon Vela, TX-34



Appendix 2: Departing Members

SENATE REPUBLICANS

Scott Brown, Mass. (lost general)
Kay Bailey Hutchison, Texas (retiring)
Jon Kyl, Arizona (retiring)
Richard Lugar, Indiana (lost primary)
Olympia Snowe, Maine (retiring)

HOUSE REPUBLICANS

Sandy Adams, FL-24 (lost primary)
Todd Akin, MO-2 (ran for Senate)
Steve Austria, OH-7 (retiring)
Charlie Bass, NH-2 (lost general)
Roscoe Bartlett, MD-6 (lost general)
Rick Berg, ND-AL (ran for Senate)
Judy Biggert, IL-11 (lost general)
Ann Marie Buerkle, NY-24 (lost general)
Dan Burton, IN-5 (retiring)
Francisco “Quico” Canseco (lost general)
Chip Cravaack, MN-8 (lost general)
Geoff Davis, KY-4 (resigned)
Robert Dold, IL-10 (lost general)
David Dreier, CA-26 (retiring)
Jeff Flake, AZ-6 (ran for Senate)
Elton Gallegly, CA-24 (retiring)
Frank Guinta, NH-1 (lost general)
Nan Hayworth, NY-18 (lost general)
Wally Herger, CA-2 (retiring)
Timothy Johnson, IL-15 (retiring)
Steven LaTourette, OH-14 (retiring)
Jerry Lewis, CA-41 (retiring)
Connie Mack, FL-14 (ran for Senate)
Don Manzullo, IL-16 (lost primary)

SENATE DEMOCRATS / INDEPENDENTS

Daniel Akaka, Hawaii (retiring)
Jeff Bingaman, New Mexico (retiring)
Kent Conrad, North Dakota (retiring)
Herb Kohl, Wisconsin (retiring)
Ben Nelson, Nebraska (retiring)
Jim Webb, Virginia (retiring)
Joseph Lieberman, Ind. Connecticut (retiring)

HOUSE DEMOCRATS

Gary Ackerman, NY-5 (retiring)
Jason Altmire, PA-4 (lost primary)
Joe Baca, CA-35 (lost general)
Tammy Baldwin, WI-2 (ran for Senate)
Shelley Berkley, NV-1 (ran for Senate)
Howard Berman, CA-27 (lost general)
Dan Boren, OK-2 (retiring)
Leonard Boswell, IA-3 (lost general)
Dennis Cardoza, CA-18 (resigned)
Russ Carnahan, MO-3 (lost primary)
Ben Chandler, KY-6 (lost general)
Hansen Clarke, MI-13 (lost primary)
Jerry Costello, IL-12 (retiring)
Mark Critz, PA-12 (lost general)
Norm Dicks, WA-6 (retiring)
Joe Donnelly, IN-2 (ran for Senate)
Bob Filner, CA-51 (ran for mayor)
Barney Frank, MA-4 (retiring)
Charlie Gonzalez, TX-20 (retiring)
Martin Heinrich, NM-1 (ran for Senate)
Maurice Hinchey, NY-22 (retiring)
Mazie Hirono, HI-2 (ran for Senate)
Kathy Hochul, NY-27 (lost general)
Tim Holden, PA-17 (lost primary)



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HOUSE REPUBLICANS (CONT)

Thaddeus McCotter, MI-11 (resigned)
Sue Myrick, NC-9 (retiring)
Mike Pence, IN-6 (ran for governor)
Ron Paul, TX-14 (retiring)
Todd Platts, PA-19 (retiring)
Ben Quayle, AZ-3 (lost primary)
Denny Rehberg, MT-AL (ran for Senate)
David Rivera, FL-25 (lost general)
Bobby Schilling, IL-17 (lost general)
Jean Schmidt, OH-2 (lost primary)
Cliff Stearns, FL-6 (lost primary)
John Sullivan, OK-1 (lost primary)
Bob Turner, NY-9 (lost Senate primary)

HOUSE DEMOCRATS (CONT)

Jay Inslee, WA-1 (ran for governor)
Dale Kildee, MI-5 (retiring)
Larry Kissell, NC-8 (lost general)
Dennis Kucinich, OH-10 (lost primary)
Brad Miller, NC-13 (retiring)
Chris Murphy, CT-5 (ran for Senate)
John Olver, MA-1 (retiring)
Donald Payne, NJ-10 (died in office)
Silvestre Reyes, TX-16 (lost primary)
Laura Richardson, CA-37 (lost general)
Mike Ross, AR-4 (retiring)
Steven Rothman, NJ-9 (lost primary)
Heath Shuler, NC-11 (retiring)
Fortney “Pete” Stark, CA-13 (lost general)
Betty Sutton, OH-13 (lost general)
Ed Towns, NY-10 (retiring)
Lynn Woolsey, CA-6 (retiring)



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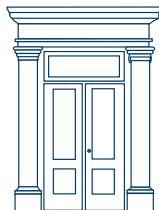
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