

American Recovery and Reinvestment Act of 2009: Key Energy Provisions

February 16, 2009

Fueled by President Obama's strong sense of urgency and a relatively unified majority voting bloc of Congressional Democrats, Congress quickly moved the American Recovery and Reinvestment Act of 2009 ("ARRA") out of a joint conference session to passage by both chambers, meeting President Obama's ambitious President's Day deadline.

I. Highlights of Certain Energy Provisions in ARRA

Congressional leaders calculate that the ARRA is comprised of approximately 65 percent appropriations provisions and 35 percent tax incentives, and the energy provisions appear to be generally in line with the ARRA's overall spending/tax relief ratio: energy expenditures are expected to total roughly \$38 billion over a ten-year period, whereas the effect on federal revenue from the energy tax incentives is estimated at approximately \$18 billion over the same period.

Production and Investment Tax Credits

While the ARRA's energy tax incentive provisions may have a smaller total dollar value than the appropriations provisions, these tax incentives may provide much needed assurance to investors. The ebb and flow of tax equity transactions over the past several years in renewable energy projects has been tied to availability of tax credits; uncertainty as to tax credit availability has often hindered investor confidence in wind, solar and other renewable project development. Recognizing this fact, Congress and the White House have tried to reinvigorate renewable energy investments through the ARRA by expanding, extending and strengthening current tax incentives.

The ARRA extends the existing production tax credit ("PTC") for wind facilities placed in service on or before December 31, 2012. The PTC is also extended for facilities of the following types that are placed in service on or before December 31, 2013: closed- and open-loop biomass, geothermal, trash and landfill gas, hydropower, and marine and hydrokinetic facilities. The PTC is claimed over a ten-year period.

Currently, solar facilities are eligible for a 30 percent investment tax credit ("ITC"). The ARRA expands this provision to give wind facility owners the option of electing to claim a 30 percent ITC on costs of new equipment in lieu of the PTC for facilities placed in service between January 1, 2009 and December 31, 2012. Owners of solar, biomass, landfill gas, trash, geothermal, marine and incremental hydropower facilities may elect to

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claim the ITC on costs of new equipment in lieu of the PTC for facilities placed in service between January 1, 2009 and December 31, 2013.

A facility owner who elects the ITC option must reduce the depreciation basis for the facility by half the amount of the credit (i.e., 85 percent of the cost of the facility may be depreciated). The facility owner may make the ITC election on a project-by-project basis; however, the election cannot be made by another party on behalf of the owner.

Geothermal facilities were previously eligible for a 10% ITC, which has now been increased to 30% under the ARRA's ITC provision. This provision allows for wind, biomass, trash/landfill gas, marine, and incremental hydropower facilities, which previously did not qualify for the ITC, to be financed through leveraged leases, which is not an option when the PTC is being claimed due to the requirement in Section 45 of the Internal Revenue Code that the taxpayer be the producer of electricity.

Historically, extensions of renewable energy tax credits have coincided with a sharp uptick in the development of qualifying renewable facilities, spurred largely by institutional investors that could offset their tax liability while providing needed equity through sale-leaseback, lease pass-through, and partnership flip financing structures. The Senate Finance and House Ways & Means Committees recognized, when conferring on the final draft of this provision, that “[b]ecause of current market conditions, it is difficult for many renewable projects to find financing due to the uncertain future tax positions of potential investors in these projects.” While the ARRA gives some certainty by extending availability of the PTC and ITC for many renewable project types, it is notable that the “placed-in-service” deadline extension is generally more favorable for projects with shorter lead times or projects that may be incrementally installed (such as wind turbines). Projects that may require lengthy regulatory approvals or other time-intensive activities prior to construction (e.g., hydropower facility expansions and marine/hydrokinetic projects subject to Part I of the Federal Power Act) will call for particular attention to process management and activity coordination to meet applicable in-service deadlines. Planning for these projects, if it is not already in progress, will likely need to commence promptly if the credit regime is to be achievable.

Additionally, the ARRA makes minor adjustments to the carbon dioxide sequestration credit that was enacted late last year. The carbon dioxide sequestration tax credit is a credit of \$10 to \$20 for every ton of carbon dioxide that is captured and sequestered in secure underground geologic formations. Prior to the ARRA, only the Environmental Protection Agency (“EPA”) was required to develop regulations governing the sequestration and storage of carbon dioxide. Now the EPA, Department of Energy (“DOE”), and Department of Interior have such regulatory authority.

Grants in Lieu of Production and Investment Tax Credits

Although stronger and more reliable tax provisions provide an avenue for renewable investment from remaining institutional investors, development may continue to be slowed by reluctant credit markets and diminished opportunities for monetization of PTCs and ITCs. The ARRA includes provisions to fill the private credit void by making cash available for renewable projects in the form of government grants to spur investments in renewable energy.

The ARRA provides for the Department of the Treasury to issue grants of up to 30 percent of the basis of “qualified facilities,” which include: wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, landfill gas, municipal solid waste, incremental hydropower production attributable to efficiency improvements or additions to capacity, marine and hydrokinetic renewable energy, and certain fuel cell facilities. Microturbine and cogeneration facilities may be eligible for grants of up to 10 percent of the facility’s basis.

The grants may only be accepted in lieu of PTCs or ITCs and apply to (1) facilities placed in service in 2009 or 2010, and (2) facilities that initiate construction in 2009 or 2010 and are completed by the “credit termination date,” which ranges from January 1, 2013 to January 1, 2017 depending on the type of facility. The grants generally would be payable upon achievement of the commercial operation date for the applicable facility. It is intended that the Secretary administer the grant program by implementing rules similar to those governing the ITC.

DOE Clean Energy Programs

The ARRA also channels significant DOE spending to both pilot and commercial renewable/low-emissions energy projects. Approximately \$3.4 billion is appropriated to DOE for allocation to “Fossil Energy Research and Development” projects, which include the development of emission reducing technologies such as carbon capture and sequestration demonstrations to help develop the technologies needed by the nation’s current energy infrastructure to respond to public health and climate change concerns. An additional \$2.6 billion will be spent on renewable energy and energy efficiency demonstration and deployment activities (including biofuels, hydrokinetics, geothermal, wind and solar projects).

Loan Guarantees for Existing Transmission and Renewable Technologies

Near-term stimulus is intended through this expansion of a loan guarantee program that was originally enacted under Title XVII of the Energy Policy Act of 2005 (“EPAct 2005”) to spur the development and deployment of innovative energy technologies. The

program expansion provides \$6 billion of loan guarantees for certain renewable energy systems, leading edge biofuel projects and electric power transmission facilities that are important in meeting reliability needs and have a positive effect on a state's or region's environment (including climate change) and energy needs. Perhaps most troubling is that the loan guarantees are limited to projects that commence construction by September 30, 2011. Only a very small number of transmission projects, particularly new projects, could meet this requirement due, among other things, to the typical lengthy siting proceedings.

Under the expanded Title XVII, "renewable energy systems" include those that generate electricity or thermal energy (or manufacture component parts of such systems). Leading edge biofuel projects are limited to those that are likely to become commercial technologies and will produce transportation fuels that substantially reduce life-cycle greenhouse gas emissions compared to other transportation fuels. Loan guarantee funding is limited to \$500 million per biofuel project. The limited guarantees may help speed the development and commercialization of alternatives to corn-based ethanol, such as cellulosic ethanol.

Given the speedy action that will be required to issue loan guarantees for renewable energy and transmission projects that will commence construction by September 30, 2011, DOE will be constrained in its ability to engage in time-consuming rulemaking. Thus, DOE's current loan guarantee regulations, issued by final rule on October 4, 2007, are likely to influence strongly how DOE solicits, evaluates, approves, and monitors its expanded renewable and transmission project loan guarantee program. Under the existing regulations, DOE may guarantee up to 100 percent of a loan, provided that the loan is issued by the Treasury Department's Federal Financing Bank. Loans from private lenders can be guaranteed, provided that the guarantee is for less than 100 percent of the loan amount. Greater weight will likely be given to applications that rely upon a smaller guarantee percentage. Of note, DOE likely will issue a loan guarantee only where the project sponsors make a significant equity contribution toward the project cost. Under the current regulations, loan guarantees will not be issued unless the credit subsidy cost and administrative fees have been paid, which will most likely be the responsibility of the borrower. The preliminary credit subsidy cost estimate is to be made available to the borrower when the term sheet is provided to the project sponsor.

That regulations are in place for the existing loan guarantee program does not provide great assurance that transmission and renewable project loan guarantees will be rapidly approved and disbursed. At this time, DOE has not approved and disbursed a single loan guarantee under the innovative technology program established by EAct 2005. However, during DOE Secretary Steven Chu's confirmation hearings, he committed to reform DOE to speed up the loan guarantee process. In a later interview with *The Wall Street Journal*, Secretary Chu stated that he expects the guarantees to start being made within five months of the enactment of the stimulus package and that he would like DOE

to spend half of its total appropriations within one year. He also indicated that in order to get more money to the private sector, he will streamline the review process and give less scrutiny to each loan guarantee application.

Smart Grid Development

The appropriations for activities related to smart grid development are among the largest of the energy appropriations in the ARRA, totaling approximately \$11 billion. Within this amount, DOE will receive \$4.5 billion for investment in “smart grid” technologies. The DOE Smart Grid investment is intended to set up digital technologies in the transmission grid that will modernize the electric grid and save energy and costs, as well as facilitate recovery from disruptions to the energy supply. Of the \$4.5 billion that DOE will receive, \$100 million will be available for worker training activities and \$80 million will be allocated to conduct a resource assessment and an analysis of future demand and transmission requirements after consultation with the Federal Energy Regulatory Commission. DOE is also directed to provide financial assistance to utilities of up to 50 percent of the costs of qualifying advanced grid technology investments.

New Borrowing Authority for WAPA

The Western Area Power Administration (“WAPA”) is provided authority under the ARRA to borrow money directly from the Treasury. In addition to retaining the appropriations from DOE that it currently receives, the bill permits WAPA to maintain \$3.25 billion in outstanding repayment balances to the Treasury at any one time. WAPA’s Administrator may allocate the borrowed funds to: (i) constructing, financing, and studying new or upgraded electric power transmission lines and related facilities; and (ii) facilitating the delivery of power from renewable energy resources that are constructed or reasonably expected to be constructed in the future.

Expanded Borrowing Authority for BPA

For the past 35 years, the Bonneville Power Administration (“BPA”) has had the authority to borrow funds directly from the Treasury. The ARRA expands the amount of Treasury debt BPA is authorized to have outstanding at any one time from \$4.45 billion to \$7.8 billion. The bill instructs BPA to use the funds borrowed to assist in financing the construction, acquisition and replacement of its transmission system. After President Obama signs the stimulus bill, BPA will have around \$5.5 billion of unused borrowing capacity.

In the past two years, WAPA and BPA each have received over 100 requests for interconnection to the grids that they operate. Many otherwise viable wind projects were cancelled or suspended because of problems with accessing the WAPA and BPA grids.

As the WAPA and BPA service areas encompass some of the nation's prime areas for the development of large-scale wind and solar energy projects, these entities will have significant influence on domestic renewable generation investment. WAPA's new and BPA's expanded borrowing authorities are expected to enable a greater level of grid access for potential renewable project developments.

II. Specific Appropriations for Energy-Related Projects

- *Fossil Energy Research and Development: \$3.4 billion*

Taking note that the current energy infrastructure in the country is reliant on fossil fuels and that the transition to renewable energy will not occur overnight, the ARRA makes \$3.4 billion available for "Fossil Energy Research and Development." The DOE's Fossil Energy Research and Development program issues grants for the development of emission reducing technologies, including carbon capture and sequestration projects.

- *Transmission Upgrades and Smart Grid Investments: \$11 billion*

An amount of \$4.5 billion is appropriated for research and development, pilot projects and federal matching funds to modernize the electricity grid. To promote smart grid technology, matching grants for smart grid demonstration projects would be increased to 50 percent of investment costs from the previous 20 percent.

The ARRA also stipulates that the Office of Electricity Delivery and Energy Reliability, in coordination with the Federal Energy Regulatory Commission, will provide technical assistance to the North American Electric Reliability Corporation, the regional entities, the states, and other transmission owners and operators for the formation of interconnection-based transmission plans for the Eastern and Western Interconnections and ERCOT.

- *New Borrowing Authority for WAPA and BPA*

WAPA may now have \$3.25 billion in Treasury debt outstanding at one time, and BPA may have \$7.8 billion outstanding. The ARRA directs these power-marketing administrations to allocate the borrowed funds to projects that expand and update their transmission lines and also to projects that will facilitate the transmission and delivery of electricity generated by renewable energy projects. The ARRA also provides that WAPA's Administrator is responsible for achieving the personnel staffing levels that are necessary to cost-effectively and efficiently address WAPA's obligation and new mandates.

- *Efficient and Renewable Energy: \$2.5 billion*

An additional \$2.5 billion is appropriated for renewable energy and energy efficiency research, development, demonstration and deployment. Biomass and geothermal projects

have been marked for special treatment, receiving \$800 million and \$400 million, respectively. Remaining funds go to research and demonstrations for additional renewable energy technologies, including water power and solar energy, and industrial and commercial energy efficiency demonstrations. Finally, within available funds, \$50 million is directed to support research to increase the efficiency of information and communications technology.

- *Renewable Energy and Transmission Loan Guarantee: \$6 billion*

An appropriation of \$6 billion in loan guarantees is expected to support more than \$60 billion in loans for renewable energy systems, incremental hydropower and transmission technologies (through amendment of EPACT Title XVII) that will commence construction prior to September 30, 2011. Upgrades to existing transmission systems will be eligible for the loan guarantees, as will “leading edge” biofuel pilot or demonstration projects (up to \$500 million in funding).

III. Specific Tax Incentives for Energy-Related Projects

- *Renewable Energy Production Tax Credit: \$13.143 billion*

The current version of the PTC is extended for wind facilities placed in service on or before December 31, 2012. The existing PTC is also extended for the following facilities placed in service on or before December 31, 2013: closed- and open-loop biomass, geothermal, solar, trash and landfill gas, qualified hydropower, and marine and hydrokinetic facilities.

- *Temporary Substitute Election of the Investment Tax Credit: \$285 million*

Wind facility owners may elect to claim a 30 percent ITC on costs of new equipment in lieu of the PTC for facilities placed in service between January 1, 2009 and December 31, 2012. Owners of biomass, landfill gas, trash, geothermal, marine and incremental hydropower facilities may elect to claim the ITC on costs of new equipment in lieu of the PTC for facilities placed in service between January 1, 2009 and December 31, 2013.

A facility owner who elects the ITC option must reduce the depreciation basis for the facility by half the amount of the credit (i.e., 85 percent of the cost of the facility may be depreciated). The facility owner may make the ITC election on a project-by-project basis; however, the election cannot be made by another party on behalf of the owner.

- *Treasury Grants for Specified Energy Property in Lieu of Tax Credits*

Treasury grants are available for solar, wind, biomass, fuel cell, geothermal, trash, landfill gas, incremental hydropower, and marine energy facilities placed in service in 2009 or 2010 and for geothermal, solar, qualified fuel cell, qualified microturbine, combined heat and power system, qualified small wind energy, and geothermal heat

pump property placed in service in 2009 or 2010, in amounts of up to 30 percent of the tax basis of such facilities or property. In addition, so long as construction begins in 2009 or 2010 and the grant application is received before October 1, 2011, the grants will be available for wind facilities placed in service by January 1, 2013; for biomass, trash or landfill gas, hydropower, and marine and hydrokinetic facilities placed in service by January 1, 2014; and for geothermal, solar, qualified fuel cell, qualified microturbine, combined heat and power system, qualified small wind energy and geothermal heat pump property placed in service by January 1, 2017. The grant program is limited to recipients that would otherwise qualify for an ITC election (including through the election to claim the ITC in lieu of the PTC) and is not available to governmental or tax-exempt entities, clean renewable energy bond lenders or cooperative electric companies. Those projects and facilities that receive Treasury grants in lieu of tax credits would not be able to claim the PTC or ITC and any previously claimed ITCs would be recaptured. The grant provision is intended to mimic the operation of the ITC, including that grant money received would generally not need to be reported as taxable income and the depreciable basis of facility equipment would be reduced by half the amount of the grant.

- *Repeal of Certain Credit Limitations*

The \$4,000 cap on the ITC applicable to qualified small wind energy property is eliminated. In addition, the rule limiting the amount of credit for property financed by subsidized energy financing or private activity bonds is repealed.

- *New Clean Renewable Energy Bonds*

An additional \$1.6 billion is provided for bonds for certain renewable energy facility capital expenditures incurred by governmental bodies, public power providers or cooperative electric companies. Holders of such bonds may claim a tax credit equal to the product of their bond's credit rate and the face value thereof.

- *Qualified Energy Conservation Bonds*

An additional \$2.4 billion is provided for bonds related to capital expenditures incurred by state and local governments for qualified energy conservation purposes (i.e., programs and initiatives that reduce greenhouse gases). Holders of such bonds may claim a tax credit equal to the product of their bond's credit rate and the face value thereof.

- *Refueling Property Credit Expansion: \$54 million*

The ARRA provides for an increase in the alternative fuel vehicle refueling property credit for property placed in service during calendar years 2009 and 2010, including property relating to ethanol, natural gas, compressed natural gas, liquid natural gas, liquid petroleum gas, biodiesel, hydrogen and electricity.

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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- *Credit for Investment in Advanced Energy Facilities: \$1.647 billion*

A new investment credit, in the amount of 30 percent, is established for facilities engaged in the manufacture of advanced energy property. “Advanced energy property” includes technology for the production of renewable energy, energy storage, energy conservation, efficient transmission and distribution of electricity, and carbon capture and sequestration. To be eligible for the credit, a project must be certified by the Secretary of Treasury, in consultation with the Secretary of Energy, through a competitive bidding process. The certification program must be established by the Secretary of the Treasury no later than 180 days after the date of enactment. Up to \$2.3 billion may be allocated under the program.

- *Depreciation Bonus: \$5.074 billion*

A 50 percent “depreciation bonus” is available for capital expenditures related to new equipment placed in service within the United States in 2009 and is not specific to energy-related expenditures. This bonus is only available to taxpayers that were not committed to the investment prior to January 1, 2008. When claiming the bonus, a taxpayer would be able to depreciate 50 percent of the cost of equipment placed in service for year 2009 (or a lesser percent if the taxpayer also elects the ITC), and would then follow the regular depreciation schedule for following years.

- *Net Operating Losses: \$947 million*

The maximum carryback period for net operating losses is extended to five years for losses in 2008 or 2009, for businesses with gross receipts up to \$15 million. This is a dramatic turnaround from the provision in both the Senate and House bills, which would have applied to all businesses that were not beneficiaries of the Troubled Assets Relief Program.

For more information please contact your Dewey & LeBoeuf relationship attorney.