

V&E Energy Industry Series

Economic Stimulus Package: Impact on the Energy Industry

American Recovery and Reinvestment Act of 2009

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February 27, 2009

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Clean Energy/Renewables

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Clean Energy/Renewables

- **Tax Incentives and Grants**
- **Tax Exempt Financing**
- **Loan Guarantees**

Energy Tax Incentives

American Recovery and Reinvestment Act ^{V&E}

- The American Recovery and Reinvestment Act of 2009 (“ARRA”)
 - provides significant new tax incentives related to the deployment of
 - renewable energy
 - clean energy
- President Obama said when he signed the bill:

“Because we know we can’t power America’s future on energy that’s controlled by foreign dictators, we are taking big steps down the road to energy independence, laying the groundwork for new green energy economics that can create countless well-paying jobs. It’s an investment that will double the amount of renewable energy produced over the next three years.”

Pre-ARRA Renewable Energy Subsidies

- Current electricity prices will not support development of renewable energy projects
- Federal tax benefits are an essential component of an investor's return on investment
- Typical “tax equity” investor – large financial institution with predictable and stable taxable income
- In today's market, few if any investors have a need for tax benefits and are unable to predict their future tax capacity
- As a result, the pool of potential investors has dried up

ARRA Tax Subsidies Fund Renewable Energy Projects

- President Obama's plan is to double renewable energy production within three years
- Existing subsidies will not spur the required development
- ARRA expands the types of subsidies available and thereby the pool of potential investors
- ARRA expands the 30% ITC to wind projects
- ARRA provides for direct nontaxable grant as a substitute for the ITC

Placed-In-Service Deadlines

- Placed-in-service deadlines for claiming production tax credits (“PTCs”) extended for three years
 - New deadlines
 - Before January 1, 2013 for wind facilities
 - Before January 1, 2014 for other section 45 facilities (biomass, geothermal, landfill gas, waste-to-energy, certain hydropower, marine and hydrokinetic facilities)
- Deadline for 30% investment tax credit (“ITC”) for solar property (before January 1, 2017) remains the same
- Extended deadlines should promote stable growth of industry

Option to Elect Investment Tax Credit Instead of PTCs

- Taxpayer may elect to claim 30% ITC with respect to qualified property that is part of a facility otherwise eligible for PTCs
 - Election is irrevocable once made
 - Property must be placed in service before
 - January 1, 2013 for wind facilities
 - January 1, 2014 for other section 45 facilities
 - As under existing law, ITCs may be available for progress expenditures incurred for certain property that has not been placed in service
 - To be eligible, normal construction period for property must exceed 2 years

Option to Elect Investment Tax Credit Instead of PTCs (cont.)

- Section 45 property eligible for ITCs
 - Must be tangible personal property or other tangible property (not including buildings or structural components)
 - Must be depreciable or amortizable
 - Property must be used as an integral part of the qualified facility
 - **Example:** For wind facilities the ITC will be available for property eligible for 5-year MACRS

Option to Elect Investment Tax Credit Instead of PTCs (cont.) V&E

- ITC rules (such as recapture, sale/leaseback) apply
 - Recapture rules
 - 100% of ITC is recaptured if sale occurs within 1 year of placed in service date, 80% if disposition is within 2 years, etc.)
 - Recapture applies to dispositions by upper-tier owners of passthrough entities and to significant reductions in a partner's share of profits
 - Sale/leaseback rules: Lessor in sale/leaseback transaction within three months of place-in-service date may claim ITC

Optional Grants for Renewable Energy Property V&E

- ARRA makes grants available in lieu of PTCs or ITCs
 - Responds to the concern that current market conditions have made it difficult for many renewable projects to find financing due to uncertain tax positions of potential investors
 - Available for property placed in service
 - In 2009 or 2010, or
 - Before applicable placed-in-service deadline (January 1, 2013 for wind, January 1, 2014 for other section 45 property, and January 1, 2017 for solar property) if construction begins during 2009 or 2010

Optional Grants (cont.)

- Grant program will be administered by the Treasury Department (not by the Department of Energy)
 - Treasury must extend a grant within 60 days of the later of
 - Date of application for grant
 - Date property is placed in service
 - All grant applications must be made before October 1, 2011
 - The legislation appropriates to Treasury “the funds necessary to make the grants”
 - Prompt guidance from Treasury will be crucial to establish application process

Optional Grants (cont.)

- Grant generally equals 30% of basis of eligible property
 - 10% grant applies to qualified microturbines, combined heat and power, and geothermal heat pumps
 - Basis will be determined using general tax principles
- Property eligible for grants
 - ITC rules apply
- Property that receives a grant will be ineligible for PTCs or ITCs

Optional Grants (cont.)

- Non-taxpayers are ineligible for grants
 - Federal, state or local governments (including their subdivisions, agencies or instrumentalities)
 - Tax-exempt organizations described in 501(c)
 - Pension funds do not appear to be ineligible
 - Electric cooperatives or clean renewable energy bond (CREB) lenders
 - Partnerships or passthrough entities if any of the foregoing hold equity or profits interests in the entity
 - Foreign persons do not appear to be ineligible, as income from renewable energy projects will be ECI
- Tax-exempt and foreign persons may invest in renewable energy through C corporations

Optional Grants (cont.)

- Grants are excludible from gross income
 - Basis of property for depreciation purposes must be reduced by half of the grant amount
- Congressional intent is that the grant provision mimic the ITC
 - Grants will be recaptured if property is disposed of, or otherwise ceases to qualify for grants, within 5 years
 - Rules similar to those in section 50 will apply
 - **Example:** Sale-leaseback rules

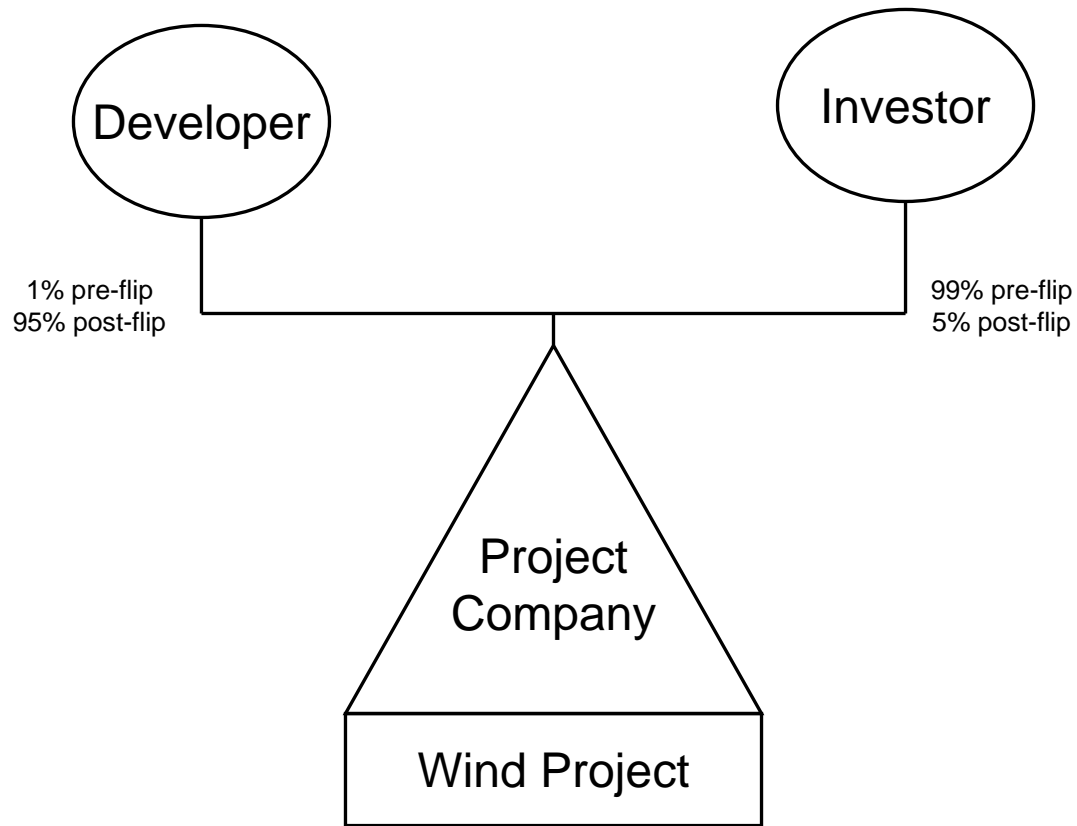
Repeal of Certain Limitations on ITCs

- Prior-law limitations on ITCs for energy property have been eliminated
 - Reduction of ITCs for property financed with subsidized energy financing or private activity bonds
 - Eliminated effective December 31, 2008
 - Transition rule applies to pre-2009 costs
 - Pre-ARRA limitations remain in place for projects claiming PTCs (but not if ITC is elected)
 - Credit cap of \$4,000 per year on qualified small wind energy property also eliminated

Bonus Depreciation

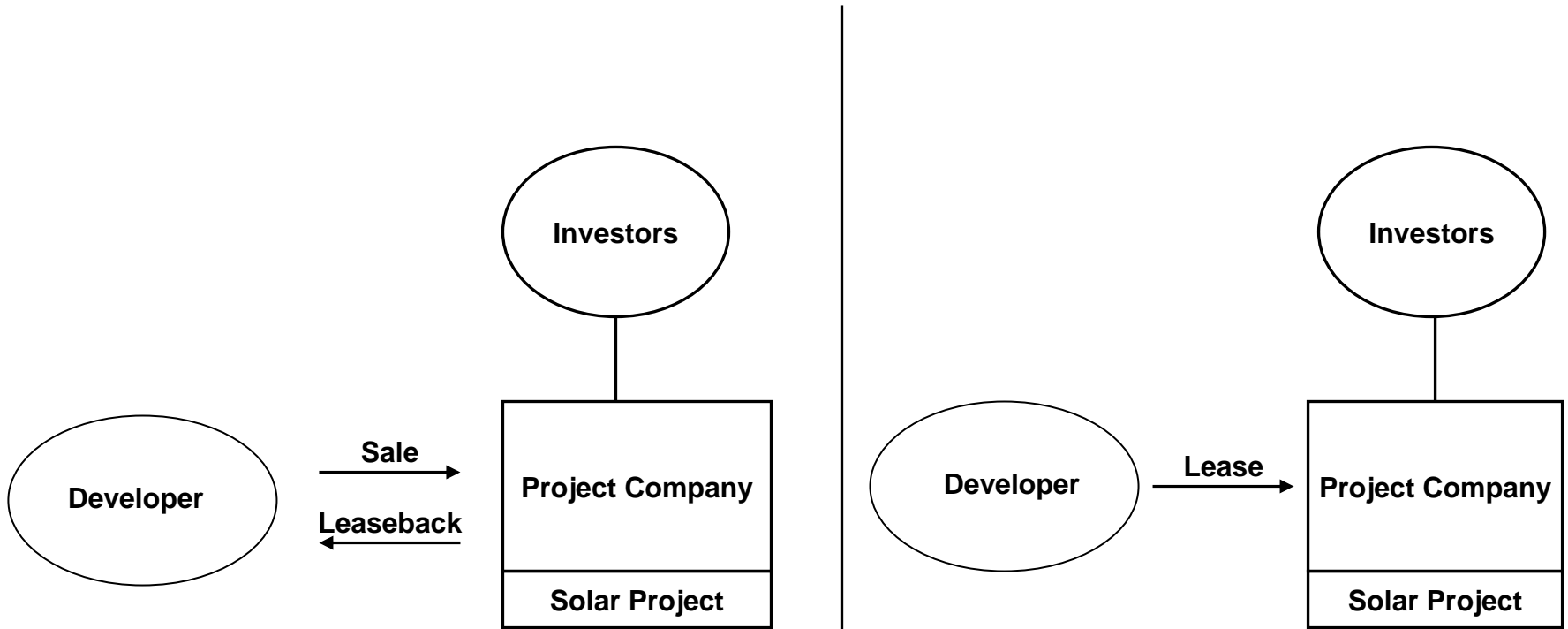
- ARRA extends 50% bonus depreciation allowance to property placed in service in 2009
 - Bonus depreciation also available for 2009 costs with respect to certain property with long production period placed in service in 2010
 - Property eligible for 5-year MACRS (wind, solar and geothermal property) not eligible for this exception
 - For ITC or grant property, basis must be reduced before calculating bonus depreciation
 - Taxpayers may elect to accelerate alternative minimum tax credit and research credit in lieu of bonus depreciation

Partnership Flip Structure



- PTCs/ITC and depreciation shared in pre-flip ratio

Sale/Leaseback Structure



- Investors receive depreciation
- Developer or Investor may receive ITC/grant

- Developer receives depreciation
- Developer or Investors may receive ITC/grant

- ARRA authorizes issuance of an additional \$1.6 billion of new clean renewable energy bonds (“CREBs”)
 - CREBs are tax credit bonds issued to finance renewable energy facilities owned by public power providers, governmental bodies and cooperative electric companies

Qualified Energy Conservation Bonds

- ARRA authorizes an additional \$2.4 billion of qualified energy conservation bonds
 - Provision also clarifies that capital expenditures to implement green community programs include grants, loans and other repayment mechanisms
 - Bonds can be issued to finance retrofits of existing private buildings through loans and/or grants to individual homeowners or businesses
 - Repayment mechanisms may include periodic fees on utility bills that approximate energy savings
 - Bonds used for these purposes will not be treated as private activity bonds (“PABs”) for purposes of the requirement that 70% of allocations within a state or local government not be used for PABs

Credit for Investment in Advanced Energy Property

- New 30% credit for investments in depreciable property used in a “qualified advanced energy manufacturing project”
 - Projects must be certified by the Treasury Department (in consultation with the Department of Energy)
 - Treasury may allocate a total of \$2.3 billion in credits
 - Taxpayers must apply for certification within 2-year period beginning on the date Treasury establishes the program
 - ARRA specifies selection criteria to be used
 - After certification, taxpayer has 5 years to place the project in service, or Treasury may reallocate credits

Credit for Investment in Advanced Energy Property (cont.)

- Credit is available for projects that equip, expand, or establish a manufacturing facility for the production of:
 - Property designed to produce energy from sun, wind or geothermal deposits or other renewable resources
 - Fuel cells, microturbines, or energy storage system for use with hybrid-electric motor vehicles
 - Electric grids to support transmission of intermittent resources of renewable energy (including storage)
 - Property designed to capture and sequester CO₂
 - Property designed to refine or blend renewable fuels (but not fossil fuels) or to produce energy conservation technologies (including energy efficient lighting or smart grid technologies)
 - Property designed to manufacture new plug-in electric drive motor vehicles and components designed especially for such vehicles

Modification of Carbon Capture Credit

- Modifies 2008 provision that provides a \$10 credit per metric ton of CO₂ captured and used as a tertiary injectant in an enhanced oil or gas recovery project
 - CO₂ must be sequestered in secure geological storage in order to qualify for the credit
 - For this purpose, secure geological storage includes storage in oil and gas reservoirs

Other Energy Provisions

- Amendments to existing provisions
 - Credit for alternative fuel refueling property
 - Credits for purchase of qualified energy efficiency improvements to existing homes
 - Credits for purchase of residential energy-efficient property (e.g., solar, geothermal heat pump, small wind energy property, fuel cells)
 - New qualified plug-in vehicles

Opportunities for Renewable Energy Projects to V&E Combine Tax-Exempt Financing and Energy Tax Credits

- Private-sector owners of renewable energy facilities (solar, wind, biomass, etc.) that can qualify for production tax credits or investment credits and that might also benefit from some type of tax-exempt financing were put to a choice under pre-ARRA rules. Those rules reduced the tax credits if tax-exempt financing was used.
- ARRA does away with the “anti-double dip rule” for the investment credit, and allows facilities that qualify for the production credit to elect to take investment credits instead.
- This presents the opportunity for a renewable energy project owner to combine tax credits with tax-exempt financing for facilities that commence post-2008.

Three Principal Types of Tax-Exempt Financing “Techniques” are Potentially Available for “Renewable” Energy Facilities V&E

- Certain categories of tax-exempt “private activity bonds”
- “Prepay” transactions in which a state or local government-owned utility issues tax-exempt bonds to prepay for electricity
- Certain “tax-credit” bonds designed to give rise to 0% interest rate debt

Tax-Exempt Private Activity Bonds (“PABs”)

- PABs are conduit financings in which state and local governments issue bonds repayable solely from project loans made to project owners on which the government’s tax-exempt borrowing rate is passed through to the project owner – i.e., credit of project/project owner (with or without owner-provided credit enhancement) is sole credit behind state and local bonds.
- Two principal types of tax-exempt PABs to consider for “renewables”
 - Recovery Zone Facility Bonds
 - “Disaster Area” Bonds

Recovery Zone Facility Bonds (RZFBs)

- RZFBs are a new category of tax-exempt PABs created by ARRA that can be issued in 2009 and 2010 to construct or acquire almost any type of nonresidential depreciable property
- National limit of \$15 billion allocated among States (and counties and large municipalities within States) based on 2008 employment decline
- Renewable projects have to compete with other projects for State allocation of RZFBs

“Disaster Area” Bonds

- Commencing with the 9/11 tragedy, Congress has a pattern of allowing tax-exempt PABs to be used as economic development tools in areas that have suffered catastrophic losses – e.g., Liberty Zone bonds and GO Zone Bonds
- These tax-exempt PABs for “disaster areas” can be used for almost any type of “nonresidential real property” (which should include most types of “nonmovable property”)
- Some Midwestern states (e.g., Indiana, Illinois, Iowa) have as much as \$2+ billion of “disaster area” PABs available in the aftermath of this summer’s floods
- The Texas gulf coast will have \$1.8 billion of “Ike Bonds” available when the State determines allocation criteria
- Renewable projects have to compete with other types of projects for State allocation of these “disaster-area” PABs

“Prepay Transactions”

- State and local government-owned electric utilities can issue tax-exempt bonds to prepay for a supply of electric energy so long as that energy is consumed within the utilities’ service areas
- The economics of these “prepay” transactions generally pass through to the prepaid seller some of the benefits of the lower borrowing costs implicit in the municipal prepaid buyer’s ability to issue tax-exempt bonds
- Prepaid sellers will need to analyze income tax accounting questions attendant to their receipt of the prepayment

“Tax Credit” Bond Opportunities

- Qualified Energy Conservation Bonds (“QECCBs”)
 - Available for facilities that qualify for production tax credits (i.e., facilities that produce electricity from wind, biomass, geothermal, landfill gas, etc.)
 - Up to \$960 million available for PAB projects (allocated among States based on population)
- Clean Renewable Energy Bonds (“CREBs”)
 - Available for renewable projects undertaken by cooperative electric companies, public power providers, or governmental bodies
 - National limit of \$2.4 billion allocated to projects by the U.S. Treasury Secretary

Innovative Technology Loan Guarantee Program V&E

- **Appropriation: \$6 billion**
 - Supports \$60 billion in loans
 - Up to 80% of investment cost may be guaranteed
 - Construction must commence by September 30, 2011
- **Eligible Projects**
 - **Renewable energy systems that generate electricity or thermal energy, including incremental hydroelectric projects and manufacture of related components**
 - **NOTE: No requirement to use “innovative technology”**

Innovative Technology Loan Guarantee Program ^{V&E} (cont.)

- **Eligible Projects (cont.)**
 - Electric power transmission systems (discussed below)
 - “Leading edge” bio-fuel projects
 - Must be likely to become commercial technologies
 - Must produce commercial fuel that substantially reduces life-cycle greenhouse gas emissions compared to alternative fuels
 - Capped at \$500 million of the \$6 billion

Innovative Technology Loan Guarantee Program ^{V&E} (cont.)

- **Who will be administering?**
 - Department of Energy
 - www.energy.gov
- **How will it be administered?**
 - Through existing Loan Guarantee Program
 - www.lgprogram.energy.gov
 - Program started under Energy Policy Act of 2005
 - Solicitation Process
 - Applications required

DOE's Recent Public Statements

- Will streamline and simplify Loan Guarantee process
- Established Advisory Team led by Matt Rogers from McKinsey & Co.'s San Francisco office
- Plans to “start cutting checks” for first loan guarantees (already pending) by end of April or beginning of May
- Begin offering loan guarantees under new legislation by early summer
- Plans to disperse 70 percent of the investment from new legislation by end of 2010

Existing Solicitation Process

- **DOE Posts Solicitation Announcement**
 - Description of projects solicited
 - Eligibility information
 - Detailed Application Instructions
 - Detailed description of expected process
 - Deadlines
- **Applications due by announced deadline**
- **DOE conducts evaluations**
- **Meetings with DOE possible**
- **DOE announces selected applications**
- **Negotiations for Loan Guarantee begin**

Types of Information DOE Will Seek

- **Project Description**
 - Time Lines
- **Technical Information**
 - Engineering and Construction Plans
 - Operation and Maintenance Plans
 - Permits and Approvals
 - Independent Engineer's Report
 - Environmental Report
- **Business Plan**
 - Financial Analysis
 - Market Analysis
 - Contracts
 - Management Plan
 - Operational Risks & Mitigation Strategies

Types of Information DOE Will Seek (cont.)

- **Financial Plan**
 - Legal Structure
 - Financial Statements
 - Credit History
 - Litigation
 - Financial Model
 - Applicant's proposed sources and uses of funds
 - Letters of Intent
 - Collateral
 - Preliminary Credit Assessment

- **DOE will offer applicants opportunity to pay fees as part of loan at closing**
- **Loan Guarantee Credit Subsidy Cost**
 - Energy Policy Act requires DOE to receive either
 - An appropriation for the credit subsidy cost of a loan guarantee or
 - A cash payment of such cost from applicant
 - Nonrefundable, paid at or before closing
 - Net present value of the estimated long-term cost to the U.S. Government of the loan guaranteed as determined under the Federal Credit Reform Act of 1990
 - Applicant cannot finance payment through funds obtained from federal government or through loan guaranteed by federal government
 - Now, DOE indicating that they will restructure credit subsidies so they are paid over the life of the loan

Fees (cont.)

- **DOE also expects three types of additional fees from Applicants:**
 - Application fee
 - Facility fee
 - Maintenance fee
- **For Nuclear Solicitation:**
 - Application Fee – \$800,000
 - Facility Fee – $\frac{1}{2}$ of 1% of Guaranteed Portion of Guaranteed Obligation
 - Maintenance Fee – Expected to be in range of \$200,000 to \$400,000 per year

Fees (cont.)

- **For most recent non-nuclear solicitation:**
 - Application Fee – ranged from \$75,000 to \$125,000 based on loan guarantee amount
 - Facility Fee – varied, based on amount sought, from 1% of guaranteed amount to \$1,625,000 + 0.50% of guaranteed amount
 - Maintenance Fee – \$50,000 to \$100,000 per year

What Can Potential Applicants Do Now?

- **Establish knowledgeable team**
 - Technical Experts with knowledge of proposed project
 - Engineering
 - Operations
 - Environmental
 - Finance Experts
 - Legal Experts (Finance and Regulatory)
- **Determine what projects are potentially eligible**
- **Monitor DOE's progress**
- **Begin preparation of application materials that will likely be needed**

Transmission and Smart Grids

Steve Angle, partner – *Washington*

Jo Ann Biggs, partner – *Dallas*

Transmission and Smart Grids

- **Innovative Technology Loan Guarantee Program**
- **Electricity Delivery and Energy Reliability Grant Program**
- **Borrowing Authority for Federal Power Marketing Agencies**

Innovative Technology Loan Guarantee Program

- **Features as discussed above (80%, construction by 9/30/2011)**
- **Eligible projects**
 - **Electric power transmission systems, including upgrading and projects to install new conductors on existing lines**
 - **NOTE: No requirement to use “innovative technology”**
 - **DOE must evaluate**
 - **Viability of project without guarantees**
 - **Availability of other federal/state incentives**
 - **Reliability impact**
 - **Effect on state/regional environmental and energy goals**
- **Practical considerations – same as above**

Electricity Delivery and Energy Reliability Grant Program

- **Appropriation: \$4.5 billion for grants for smart grid demonstration projects**
 - \$80 million to analyze, in consultation with FERC, future electricity demand and related transmission requirements
- **Administered pursuant to an existing program under the Office of Delivery and Energy Reliability**
 - Maximum funding level increased from 20% to 50% of project costs
- **Eligible projects**
 - Support delivery and reliability measures and serve to modernize the electric grid
 - Includes demand responsive equipment
 - Improve the security and rehabilitation of energy infrastructure
 - Support energy storage research, development and deployment

Electricity Delivery and Energy Reliability Grant Program (cont.)

- **Smart grid projects (including both transmission and advanced metering) are to be promoted in urban, suburban, and rural areas, with the policy applicable to both tax-exempt funded and investor-owned entities**
- **Procedural requirements**
 - **DOE must act to implement new rules by April 18**
 - **Notice of intent and subsequent solicitation**
 - **DOE must develop specific procedures by which applicants can obtain grants**
 - **Demonstration projects must utilize open protocols and standards if available and appropriate**

Grant Proposal Solicitation Process

- **Unknown at this point**
- **DOE will post Grant Proposal Solicitation Announcement & issue press release**
 - Description of eligibility requirements
 - Proposal Instructions
 - Deadlines
- **Grant Proposals due by announced deadline**
- **DOE will conduct evaluations**

Who Will Be Seeking Grants?

- **Appliance manufacturers**
- **Large industrial and commercial users**
- **Electric Utilities**
- **Retail sellers and marketers of electricity**
- **Entities that operate regional electric grids**
- **Owners of distributed generation**
- **Makers of hybrid-electric vehicles**
- **Anyone who can document expenditures related to purchasing and implementing Smart Grid Functions in “such other cases as the Secretary shall identify”**

What Can Potential Applicant Do Now?

- **Establish knowledgeable team**
- **Determine what projects are potentially eligible**
- **Monitor DOE's progress**
- **Begin preparation of proposal materials that will likely be needed**

Borrowing Authority for Federal Power Marketing Agencies

- **Appropriation: \$6.5 billion**
 - **Bonneville Power Administration and Western Area Power Authority may increase their borrowing by up to \$3.25 billion each**
- **BPA**
 - **Use of funds: construction, acquisition, and replacement of transmission plant *and to implement other authority* granted to BPA under its authorizing statute**
 - **BPA has a discrete territory in which it controls a significant portion of generation and transmission capacity**
 - **BPA is unlikely to seek joint participation**

Borrowing Authority for Federal Power Marketing Agencies (cont.)

- **WAPA**
 - **Use of funds: construction of transmission facilities to deliver renewable energy**
 - **WAPA is authorized to operate in 15 western states, does not own generation, and has built transmission facilities and provides transmission service in widely dispersed regions.**
 - **The ARRA provides that WAPA may use the funds to pay for its share of projects jointly developed with other entities. WAPA has previously entered into joint development projects with investor-owned entities.**

Other Energy Appropriation/ Policy Provisions

Steve Angle, partner – *Washington*

Other Energy Appropriation/Policy Provisions

- **Energy Efficiency and Renewable Energy**
- **National Electric Transmission Study**

Energy Efficiency and Renewable Energy

- **Appropriation: \$16.8 billion**
 - **\$2.5 billion for R&D (\$1.25 billion specified)**
 - **\$3.2 billion for block grants to state and local governments**
 - **\$5 billion for weatherization assistance**
 - **\$3.1 billion for the “State Energy Program” under the Energy Policy and Conservation Act**
 - **\$300 million for the Alternative Fueled Vehicles Pilot Grant Program**
 - **\$400 million for Transportation Electrification**
 - **\$300 million for the Energy Efficient Appliance Rebate program**
 - **\$2 billion for the manufacturing of advanced batteries and components**

National Electric Transmission Study

- **Biennial study created by EPAct 2005**
 - Identifies National Interest Electric Transmission Corridors
 - Serves as predicate for exercise of FERC backstop authority for transmission siting
- **2009 study must include**
 - Analysis of the potential sources of renewable energy that are constrained in accessing appropriate markets by lack of adequate transmission.
 - Findings of the reasons for failure to develop adequate transmission capacity and recommendations to achieve adequate transmission capacity.
 - Analysis of the extent that legal challenges at state and federal level have delayed construction of transmission needed to access renewable energy.
 - Explanation of the assumptions and projections made, including those related to energy efficiency improvements in each load center, the location and type of new generation capacity, and the deployment of distributed generation.
- **This provision, along with Harry Reid's siting bill, shows momentum toward preemptive federal legislation to regulate siting of transmission.**

Stimulus Bill Funding for Carbon Capture & Sequestration (CCS) and Major Environmental Programs

Larry Nettles, partner – *Houston*

Carbon Capture & Sequestration (CCS) Funds

- What does CCS involve?
- Current federal programs
 - DOE loan guarantees and cost-sharing contracts
 - Tax credits
- New stimulus programs and funds

Understanding CCS

CCS drivers:

- **Global climate change**
(temperature increases due to rising CO₂ and other greenhouse gas emissions)
- **Global energy demand**
(going up due to population growth and emerging economies which, given current fuel choices, means more CO₂ emissions)
- **Coal-fired electricity generation**
(50% in U.S. and approximately 40% worldwide)



Understanding CCS (cont.)

- Capture – CO₂ is captured from power plant or industrial source, compressed into liquid state, and transported to geologic site
- Sequestration - injection into a geologic formation for permanent storage



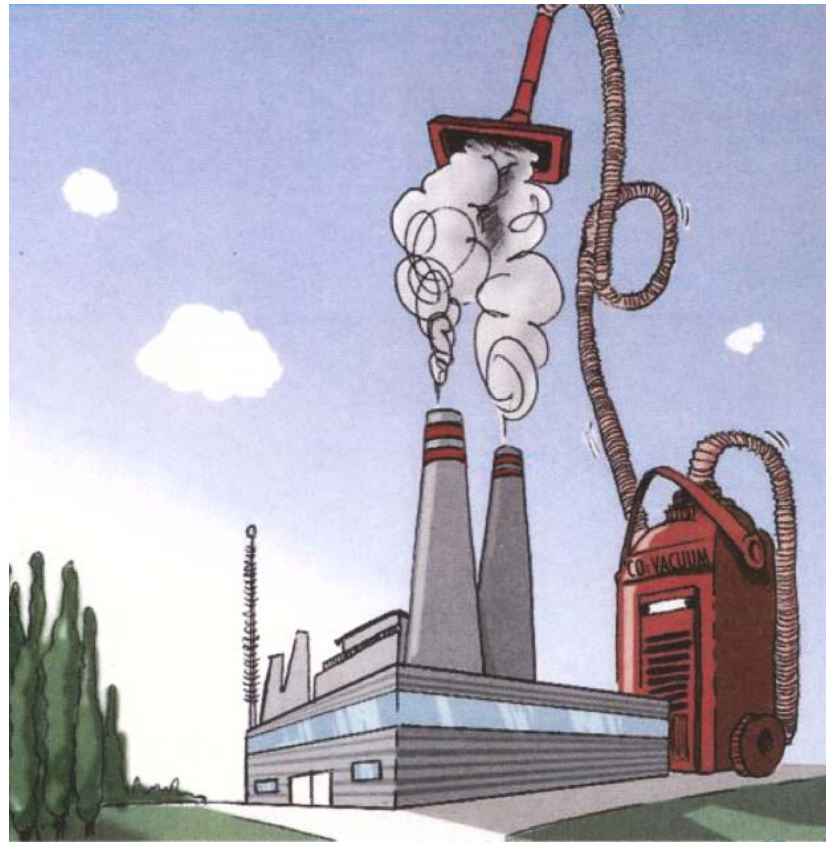
Carbon Capture

- Capture is most costly component
- CO₂ sources are mostly large power plants, but also industrial sites (gas processors, fertilizer plants)
- Three approaches for capture
 - Pre-combustion systems
 - Oxyfuel systems
 - Post-combustion systems



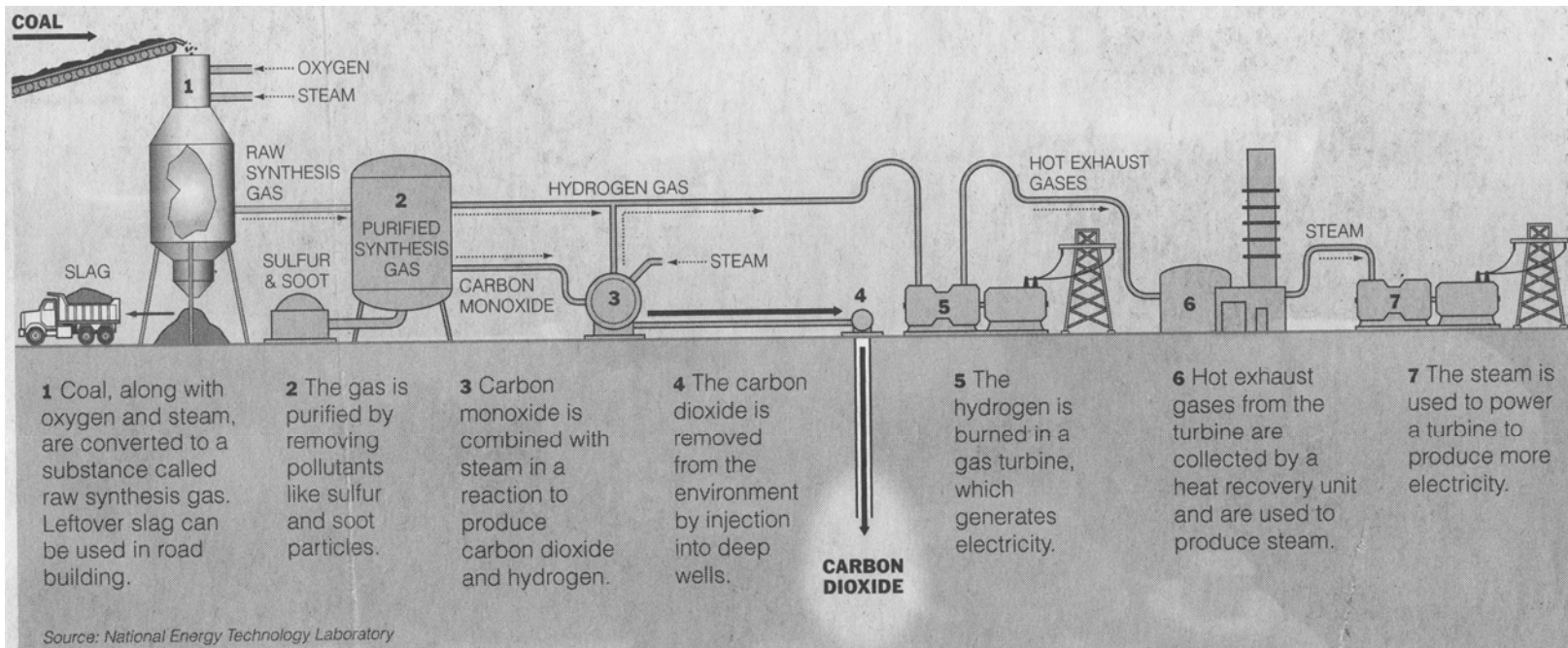
CO₂ Capture — Post-Combustion

Caution: Not as easy as it looks



CO₂ Capture Pre-Combustion

Coal-to-Gas-to-Electricity, minus the CO₂.



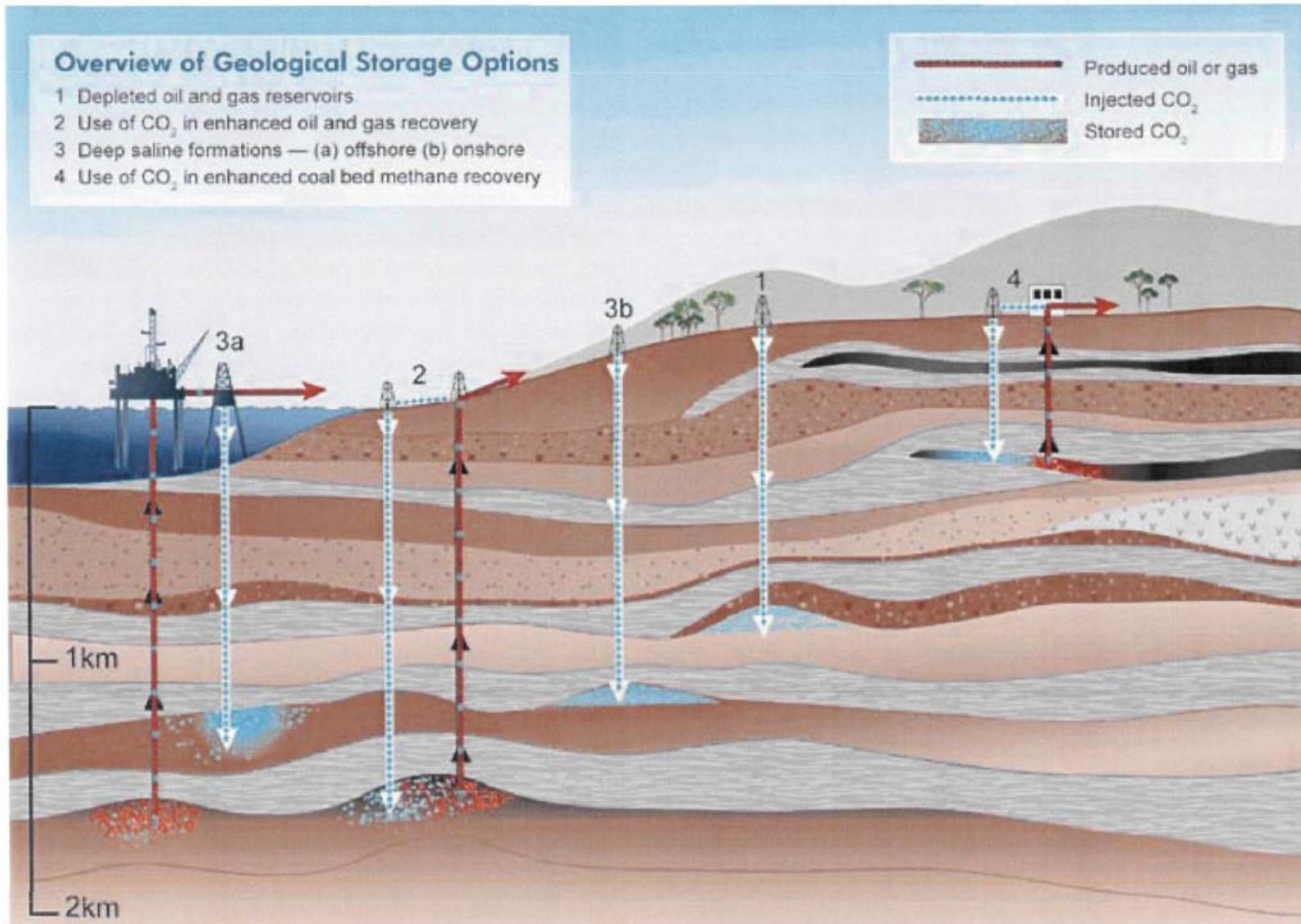
Schematic of Integrated Gasification Combined Cycle (IGCC) Electric Generating Plant With CCS.

Carbon Sequestration

- Injection technology has been developed by oil and gas industry for using CO₂ for EOR
- Three types of geologic storage probably most viable
 - Deep saline formations
 - Unminable coal beds
 - Depleted oil and gas reservoirs



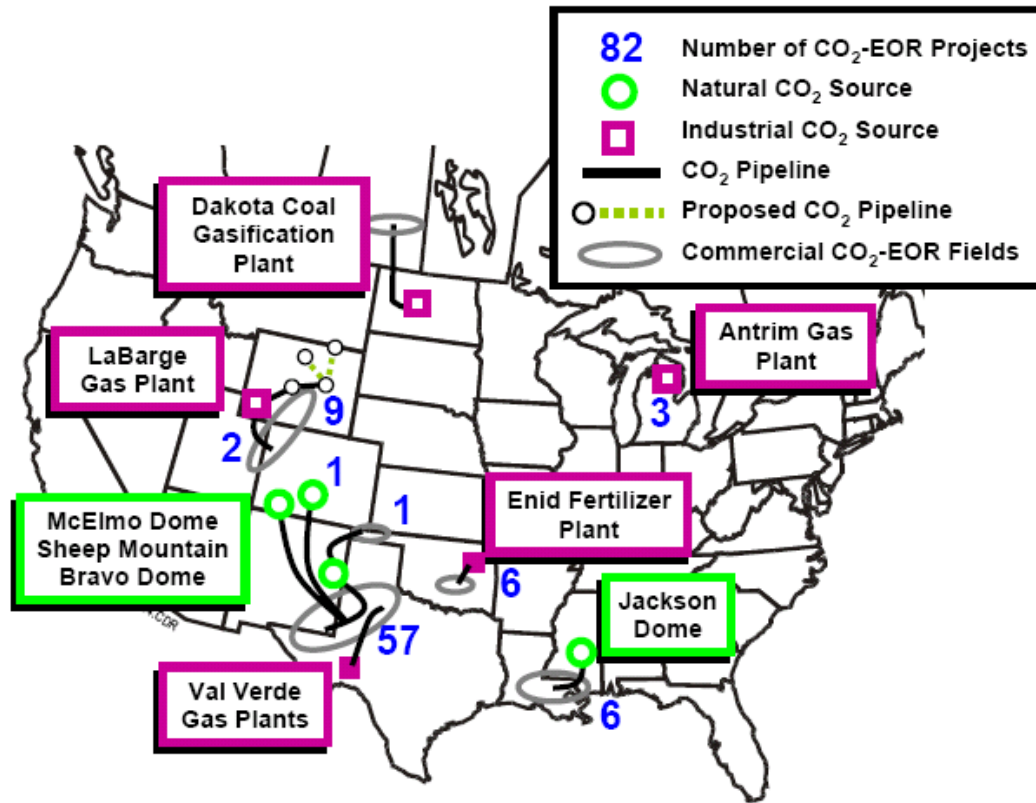
Geologic Sequestration



Source: Intergovernmental Panel on Climate Change (2005)

Opportunities—EOR is a bridge

EOR provides 30 years of experience...



Current Federal CCS Incentives



- Loan guarantees and Co-financing
 - **\$8 billion loan guarantee program** for advanced coal-based and industrial gasification projects with CCS. September 2008 solicitation for applications due December 2008. Prior 2006 solicitation; no guarantees to date.
 - **DOE Clean Coal Power Initiative (CCPI)** provides Cooperative Agreements (up to 50% cost sharing) for new technologies to cut power plant pollution (sulfur, nitrogen, mercury) and CO₂.
 - CCPI's third (August 2008) solicitation (**with \$440 million in funding**) seeks to demonstrate CCS at scale for coal based power systems in a commercial setting (i.e., 90% capture of at least 300,000 tones/yr with <10% increase in electricity prices for IGCC type projects). Program managed by National Energy Technology Laboratory (NETL).

Current Federal CCS Incentives (cont.)



- Tax Credits
 - October 2008 Troubled Asset Relief Program (“TARP”) provides tax credits for large scale projects (500,000+ tons per year) that sequester industrial CO₂ in geological formation (\$20/ton) or for EOR (\$10/ton). No Treasury or EPA guidelines to date.
 - TARP also expanded Master Limited Partnership (“MLP”) opportunities by stating that income from the transportation, storage and marketing of industrial source CO₂ can generate qualifying income for an MLP. Hence, “good” CO₂ for an MLP is no longer limited to CO₂ from the wellhead.

New CCS Programs



- **\$3.4 billion** for the DOE’s “Fossil Energy Research and Development” program allocated as follows:
 - **\$1 billion** for unspecified fossil energy R&D.
 - **\$800 million** in new funding for the August 2008 Clean Coal Power Initiative (CCPI) Round 3 solicitation (now budgeted at \$440 million). This will expand number and scale of Cooperative Agreements. Deadline was January 2009.
 - **\$1.5 billion** to various “industrial carbon capture and energy efficiency improvement projects” per a new competitive solicitation, including a small set aside “for beneficial CO₂ reuse projects.” New solicitation expected 2nd half 2009. Support may mirror CCPI Cooperative Agreements.
 - **\$50 million** for a new competitive solicitation to fund “site characterization activities in geologic formations” (e.g., to assess long-term CO₂ storage suitability).
 - **\$20 million** for geologic sequestration training and research grants.

New CCS Programs (cont.)



- No express FutureGen funding. ARRA excludes the \$2.4 billion proposed by the House for FutureGen commercial CCS demonstration projects authorized under 2007 Energy Act. FutureGen program suspended by DOE in 2008. Some of the \$2.5 billion in new R&D money could go to unfunded FutureGen projects.
- \$1.6 billion for the DOE's science programs which include R&D at over a dozen national labs (Oak Ridge, Los Alamos, Livermore, Berkley, etc.) plus grants to numerous colleges and universities. DOE has very wide discretion in allocating this new tranche of funding and CCS research will likely benefit.

New CCS Tax Provisions



- Modification of carbon capture credit. ARRA amends TARP credit program to make clear that the \$10/ton credit for EOR requires permanent sequestration of CO₂ to qualify.
- New 30% tax credits for investment in qualified “advanced energy manufacturing energy property.” Could include property used to manufacture equipment for CCS (e.g., certain components of an IGCC power plant or the equipment for post-combustion amine-based or chilled ammonia based CO₂ “strippers.”)

Other Environmental Funding



- Focus on clean water infrastructure and site remediation funding with rapid roll out
- New funds channeled into existing programs
- Funds likely to go to backlogged projects
- State funding process may trigger significant new public authority bond issues

Water Quality Programs



- Clean Water State Revolving Funds (“CWSRF”)
 - \$4 billion for grants to support state water quality protection projects such as wastewater treatment, pollution control, and watershed / estuary management
 - 20% designated for green infrastructure (e.g., habitat-based rather than hardscape waste water recycling), water efficiency and other innovative projects, if projects available
- Drinking Water State Revolving Funds
 - \$2 billion for grants to finance infrastructure improvements for state drinking water systems
 - 20% designated for green infrastructure, water efficiency and other environmentally innovative projects as available

Application Process for Water Funds



- Federal government grants funds to state programs based on existing “needs based” formulas with each state generally getting at least 1% of total new funds.
- States choose assistance options to include loans, interest subsidies, refinancing, debt guarantees, bond purchases and insurance
- States can target specific needs / priorities
- Eligible projects vary by state and states set application process

Example Application Process - Texas



- Local authorities were required to submit Intended Use Plans to the Texas Water Development Board by the end of January 2009, with projects selected based on a priority rating system
- Funding options primarily involve subsidizing interest rates on local bonds
- Preference for “shovel ready” projects likely to create jobs including:
 - rehabilitation, replacement, upgrade, or expansion projects;
 - those most likely eligible for an environmental categorical exclusion;
 - and projects that may have been put on hold due to the recent changes in the public finance market

Site Remediation Funding



- EPA allocated ~ \$1.6 billion of new funds for existing, underfunded cleanup projects:
 - Hazardous Substance Superfund gets \$600 million for Superfund remedial programs
 - Leaking Underground Storage Tank Trust Fund Program gets \$200 million for storage tank cleanup activities
 - Brownfields Revitalization Program gets \$100 million for improving industrial sites
- EPA has some discretion in allocating funds but backlogged projects likely to have priority

Additional Tax Provisions

John Lynch, partner – *Houston*

COD Income

- Special Rule for COD Income in 2009 and 2010
- COD Income recognized in 2009 and 2010 not included in income until 2014 -- 5-year grace period for COD Income recognized in 2009 (4-year grace for COD Income recognized 2010).
- Beginning in 2014 deferred COD Income recognized ratably (1/5th each year) over a five-year period
- Deferral of related OID deductions

COD Income (cont.)

- Sources of COD Income
 - Loan Workouts that result in a reduction in principal or accrued interest
 - Debt Buy-Backs: the issuer or a related party acquires outstanding debt of the issuer for less than its face
 - Debt-for-Units Exchanges: COD income is recognized by the issuer equal to the excess of the face amount of the debt and the FMV of the Units
 - Debt-for-Debt Exchanges: COD income is recognized where the issue price of the new instrument is less than the adjusted issue price of the outstanding instrument (typically its face amount)
 - Debt Modifications: changes to the terms of a debt instrument will result in a deemed issuance of a new debt instrument in exchange for the existing debt instrument if the changes constitute a “significant modification” as defined in applicable regulations

COD Income (cont.)

- “Significant Modifications”
 - Change in Yield – a greater than 25 basis point change in yield.
 - Change in Timing of Payments – a material deferral of scheduled payments (note: a regulatory safe harbor may be available for payment deferrals that do not extend more than the lesser of five years or 50% of the original term of the instrument)
 - Changes in the Obligor – (i) a substitution of an obligor on a recourse instrument (other than in connection with certain acquisitions), or (ii) the addition of a co-obligor causing a change in payment expectations
 - Change in Security or Credit Enhancement – a release, substitution, addition or other alteration of the collateral for, a guarantee on, or other form of credit enhancement of a nonrecourse debt instrument or for a recourse debt instrument if the change causes a change in payment expectations
 - Change in Priority – a change in priority of a debt instrument resulting in a change in payment expectations

COD Income (cont.)

- Complications for “Publicly-Traded Debt”
 - For purposes of calculating COD income, if the old debt is “publicly-traded”, the issue price of the new or modified debt will be the FMV of the old debt

 - Definition of “Publicly-Traded” is very broad – includes
 - Exchange-listed notes
 - Notes appearing on a system of general circulation (including a computer listing disseminated to subscribing brokers, dealers, or traders) that provides a reasonable basis to determine fair market value by disseminating either recent price quotations (including rates, yields, or other pricing information) of one or more identified brokers, dealers, or traders or actual prices (including rates, yields, or other pricing information) of recent sales transactions (a quotation medium)

COD Income (cont.)

Existing “Old” Debt

\$100,000,000 @8% for 7 years

Modified “New” Debt

\$100,000,000 @ 12% 10 years

“Significant Modification” in 2009 causes a deemed exchange of Old debt for New debt

Tax Consequences:

- If Old debt is not “publicly traded” = no COD Income
- If Old debt is publicly traded and is trading at \$75,000,000:
 - Issuer is treated as satisfying Old debt for \$75,000,000
 - New debt is treated as issued for \$75,000,000 with \$25,000,000 of OID
 - Old Law: Issuer recognizes \$25,000,000 COD Income in 2009, and begins to accrue OID deductions in 2009
 - New Law: Issuer recognizes deferred COD Income until 2014, then recognizes \$5,000,000 COD Income per year for 5 years beginning in 2014; OID deductions deferred until 2014 deferred and deducted ratably over the 5 years beginning in 2014

COD Income (cont.)

- Treatment of Partnerships
 - Any income deferred under this provision is required to be allocated to those members who were partners immediately before the discharge of the debt.
 - The deferred income will be accelerated if the partner disposes of its interest in the partnership.
 - The provision also includes special rules for accounting for changes in a partner's share of liabilities resulting from the debt discharge.
 - Effect of MLPs

Bonus Depreciation

- Extends Bonus Depreciation for property acquired and placed in service during 2009
- Generally applies to depreciable property with a recovery period of less than 20 years.
- Provides for a deduction equal to 50 percent of the adjusted basis of the property in the year the property is placed in service
- Provides for extended placed in service date (until the end of 2010) for certain property having a production period exceeding one year and a cost exceeding \$1,000,000 (Bonus depreciation only applies to the costs incurred prior to the end of 2009)

Speaker Profiles



Charles Almond, a partner in the Houston office, has built a practice focusing on federal taxation, including tax controversy work and transactional planning, with expertise in the Federal tax treatment of state and local government bonds. He also has extensive experience in a broad spectrum of federal income and excise tax matters in a wide variety of contexts. He regularly represents clients on federal income tax matters under legislative consideration by Congress and regulatory and ruling consideration by the U.S. Department of Treasury and the Internal Revenue Service. Charles can be reached at 713.758.1909 or via email at calmond@velaw.com.



Steve Angle, a partner in the Washington office, represents entities in the electric industry, obtaining approval for transmission rates, advising on strategies to develop new transmission assets, providing assistance in NERC compliance matters, handling FERC enforcement investigations, obtaining services from regional transmission organizations, and assisting in the regulatory review of proposed acquisitions and divestitures. His experience includes thirteen years as the Assistant General Counsel for Electric Litigation at the Federal Energy Regulatory Commission (FERC). Steve can be reached at 202.639.6565 or via email at sangle@velaw.com.



Jo Ann Biggs, a partner in the Dallas office, represents energy clients in the public and private sectors, including counseling and representing clients in connection with regulation of electric and natural gas utilities, federal and state licensing of energy facilities, competition in deregulated and restructured energy markets, and regulatory implications of transactional and corporate matters. She is currently representing a client seeking a DOE Loan Guarantee. She also represents a client engaged in a massive deployment of advanced metering technology. Her practice also includes trial of complex energy-related issues in administrative and civil forums. Jo Ann can be reached at 214.220.7735 or via email at jbiggs@velaw.com.

Speaker Profiles



John Lynch, a partner in the Houston office, has built a practice concentrating primarily on the federal income tax aspects of domestic and international transactions over the last 20 years. This work includes advising clients on the formation of business ventures; mergers and acquisitions; capital restructurings; spin-offs; and asset and stock dispositions. John can be reached at 713.758.1050 or via email at jlynch@velaw.com.



Price Manford, a partner in the New York office, has a broad-based energy tax practice encompassing business transactions, renewable energy, and tax controversy matters before the Internal Revenue Service. Over the last few years, Price has focused on the tax aspects of the acquisition, development, operation, and disposition of a variety of alternative fuel investments, including coal-based synthetic fuel, wind-powered assets, solar, and other renewable energy sources. Price's tax controversy practice encompasses audit, administrative appeals, and various matters before the Treasury Department and the National Office of the Internal Revenue Service. Price can be reached at 212.237.0256 or via email at pmanford@velaw.com.



Larry Nettles, a partner in the Houston office, has been practicing environmental law full-time since 1981 and has an exceptionally broad range of environmental law experience that makes him particularly well suited to advise clients with multi-faceted environmental problems, such as those frequently encountered in large business transactions. Larry currently serves as co-chair of the firm's Energy and Infrastructure Practice Group, and is a member of the firm's Environmental and Climate Change Practice Groups. He is also serving as co-coordinator of the firm's rapidly expanding Carbon Capture and Storage Practice Group. Larry can be reached at 713.758.4586 or via email at lnettles@velaw.com.