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The Renewable Energy, Electric Transmission, Energy Tax and Other Infrastructure Provisions of the American Recovery and Reinvestment Act of 2009

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The landmark economic stimulus package at the core of President Obama's recovery plan passed through both the House and Senate on February 13, and was signed into law by President Obama on February 17. The end result is a slightly leaner, trimmer version of the original House bill, H.R.1, with tax cuts and spending totaling approximately $787 billion, down from nearly the $900 billion proposed by the House.

The bill, entitled the "American Recovery and Reinvestment Act of 2009," (the "Act") apportions approximately $37.5 billion of new energy tax cuts and spending. Although from a big picture perspective the Act is similar to the original House bill H.R.1, the provisions affecting the energy sector sustained several notable revisions. A significant provision left out of the Act was a proposed increase in loan guarantee commitment authority of $50 billion for the Department of Energy ("DOE") under its existing loan guarantee program for innovative technologies. Even though Congress did not keep this provision in the final version of the Act, the new loan guarantee program for renewable and transmission projects is still in place, although appropriations for the program have been truncated by $2 billion from the House version and $3.5 billion from the Senate version of the bill. The new loan guarantee program, like the existing loan guarantee program for innovative technologies, will be administered by the DOE. For a more in depth analysis of the DOE loan guarantee program, please see the Paul Hastings StayCurrent "Stimulus Bill Creates More Than $60 Billion of Loan Guarantee Opportunities – Including for Previously Ineligible Renewable and Transmission Projects".

The emphasis on both renewable energy and transmission projects is significant because many desirable solar and wind project sites are far from the existing transmission grid, so a considerable investment in interconnection facilities and network upgrades will be needed to make those solar and wind sites viable. The Federal Energy Regulatory Commission ("FERC") also has undertaken initiatives to encourage more transmission line construction under its authority under the Energy Policy Act of 2005 ("EPAct 2005"). Such focus on electric transmission under the Act and FERC's parallel path initiatives can help enhance the reliability and expansion of the nation's transmission grid.

The tax provisions of the Act are a victory for the renewable energy sector, providing $20 billion in incentives for renewable energy and energy efficiency over the next ten years. In addition to

other provisions, renewable energy developers will be able to obtain grants in lieu of tax credits - a move touted by many as essential for solar and wind development due to the current state of the renewable investor market – and the Code Section 45 production tax credit ("PTC") was extended for three years. The Act also establishes a new 30 percent investment tax credit for manufactures of clean energy technologies. Certain tax proposals by the House and Senate were excluded from the final Act, including extending the carryback period for net operating losses and general business credits to five years for most businesses, a 20 percent energy research credit, and shortening the depreciable recovery period for smart meters.

It will be interesting to see the impact of two of the new tax provisions, namely the ability (1) for qualified facilities to elect to take Code Section 48 investment tax credits ("ITC") in lieu of Code Section 45 PTCs; and (2) for a qualifying project to receive a non-taxable grant in lieu of PTCs.

By allowing the ITCs to be taken rather than PTCs, the risk that the project will produce energy is eliminated. Further, the ITCs are taken in the first year the project is placed in service, rather than over a ten-year period like the PTC. Finally, the length of time that an investor needs to remain in an ITC investment is shorter than a PTC investment (five to seven years versus ten years). These characteristics of ITC investments may improve investor yields if the election is made.

While the grant option provides an alternative source of funds instead of tax credit equity, the benefit of this provision will most likely depend on the particular circumstances of the developer and/or the economics of the project. For instance, without a tax credit investor, the developer will either need to be able to absorb the depreciation deductions from the project or find an investor willing to invest in the project mainly for depreciation deductions. In addition, if the grant option is selected, the project will most likely still have a funding gap requiring the developer to inject equity into the project or to find a willing financing partner in order to complete the project.

The following is not an exhaustive summary of all the provisions of the Act. Rather, this client alert is intended to focus on the energy, tax and other infrastructure provisions of greatest interest to our clients.

Energy – Section B, Title VII and Authorization of Funding – Energy and Water (Section A, Title V)

The Act infuses existing "Energy Efficiency and Renewable Energy" projects with an additional $16.8 billion, which the DOE will allocate. This is a decrease from the $18.5 proposed by H.R. 1. This figure includes funding for the following:

- An additional $2.4 billion for "Fossil Energy," for necessary expenses to demonstrate carbon capture and sequestration technologies as authorized under section 702 of the Energy Independence and Security Act of 2007.
- An additional $4.5 billion for "Electricity Delivery and Energy Reliability," for expenses necessary for electricity delivery and energy reliability activities to modernize the electric grid, enhance security and reliability of the energy infrastructure, energy storage research, development, demonstration and deployment, and to facilitate recovery from disruptions to the energy supply, and for implementation of programs authorized under title XIII of the Energy Independence and Security Act of 2007.
- $3.2 billion for the Energy Efficiency and Conservation Block Grant (EECBG) program, instead of the $3.5 billion proposed by the House and the $4.2 billion proposed by the Senate.
- $3.1 billion for the State Energy Program. To gain access to the competitive grants

under this provision, governors must notify the Secretary that they will try to ensure that their state regulatory commissions implement policies to reward efficiency.

- $2.5 billion for applied research, development, demonstration and deployment activities to include $800 million for projects related to biomass and $400 million for geothermal activities and projects.

- $5 billion for the Weatherization Assistance Program.

- $2 billion for Advanced Battery Manufacturing grants to support the manufacturing of advanced vehicle batteries and components. The Advanced Battery Manufacturing loan guarantee program included in H.R. 1 has been taken out by the Committee agreement.

- $300 million for the Alternative Fueled Vehicles Pilot Grant Program.

Renewable Energy and Electric Power Transmission Loan Guarantee Program

A temporary loan guarantee program has been added to stimulate development of renewable energy and electric power transmission projects. To be eligible, the projects must commence construction no later than September 30, 2011. The authority of the Secretary of Energy ("Secretary") to enter into guarantees will expire on September 30, 2011. The program has been appropriated $6 billion in new budget authority, which will support roughly $60 billion in loan guarantees for:

- Renewable energy projects, including incremental hydropower projects.

- Electric power transmission systems – this includes upgrading and reconductoring projects. The Secretary will allocate the loan guarantees by taking into consideration the viability of the project without guarantees; the availability of other Federal and State incentives; the importance of the project in meeting reliability needs, and the effect of the project in meeting a State's or region's environment (including climate change) and energy goals.

- Biofuel projects in the pilot program stage – this is limited to projects that the Secretary deems likely to become commercial technologies that will produce transportation fuels that substantially reduce lifecycle greenhouse gas emissions, compared to other transportation fuels. Funding for biofuel projects shall not exceed $500 million.

Renewable Electricity Transmission Study

With regard to the transmission congestion studies that DOE was required to prepare pursuant to EPAct 2005, the Secretary will complete the 2009 National Electric Transmission Congestion Study and determine:

- Whether potential sources of renewable energy are constrained in accessing market areas because of inadequate transmission capacity.

- Adequate transmission capacity has not been developed in those areas and to what extent Federal and State legal challenges burden the construction of this capacity.

- An explanation of assumptions and projections made in the Study, including energy efficiency improvements in each load center; the location and type of projected new generation capacity and projected deployment of distributed generation infrastructure.

- Recommendations for achieving adequate transmission capacity.

Smart Grid Technology

- $11 billion for energy initiatives such as a new, smart power grid, advanced battery technology, and energy efficiency measures.

The Secretary will allocate these funds to electric utilities and other parties for the development of smart grid demonstration projects. The Secretary will pay up to 50 percent of the documented costs of advanced grid technology investments made by electric utilities or other parties in carrying out these demonstration projects.

- The Secretary will establish a smart grid information clearinghouse to make data about smart grid demonstration projects available to the public. Participation in this information clearinghouse is a condition of receiving funds under this program, but proprietary information will be protected.
- The Secretary will also institute open Internet-based protocols and standards to be used by electric utilities or other parties as a condition of receiving funds, as well as maintaining public records of grants made.

Weatherization Assistance Program

The Act amends the Weatherization Assistance Program by increasing the levels of funding in the following two ways:

- It increases the number of people who will be eligible for weatherization assistance by changing the definition of "low income" to those persons that are at or below 200 percent of the poverty level, from the previous level of 150 percent.
- It doubles the assistance available per dwelling unit from $2,500 to $5,000, for a total amount of $5 billion for the program.

Nuclear Power

- The $50 billion loan guarantee program for nuclear and "clean coal" plants has been removed from the Act.
- $390 million will be provided for the Uranium Enrichment Decontamination and Decommissioning Fund, as proposed by the Senate.

Miscellaneous Energy Provisions

- $400 million for the Advanced Research Projects Agency-Energy authorized under section 5012 of the America COMPETES Act.
- $10 million in non-reimbursable funds and $3.25 billion in borrowing authority for construction, rehabilitation, operations, and maintenance for the Western Area Power Administration (WAPA).
- And increase of $3.25 billion in the borrowing authority ceiling for the Bonneville Power Administration.
- Technical corrections to redesignate two paragraphs of the Public Utility Regulatory Policies Act of 1978, as proposed by the Senate.

In sum, these energy provisions of the Act may appear moderate in scope and reach. The success of the loan guarantee program for renewable energy and transmission projects will be based in part upon the timing and scope of DOE's implementation of this program. Transmission projects take years to develop, and the loan guarantee application and approval process will need to move in parallel path in order for the Act to yield benefits as soon as possible in this area.

Tax Provisions (Division B, Title I)

Extension of the Section 45 Renewable Electricity Production Tax Credit

- The Act extends for three years (generally through 2013; through 2012 for wind facilities) the period during which qualified facilities producing electricity from wind, closed-loop biomass, open-loop biomass, geothermal energy, municipal solid waste, and qualified hydropower may be placed in service for purposes of the Section 45 PTC.
- The Act extends for two years (through 2013) the placed in service period for marine and hydrokinetic renewable energy sources.

Election of Investment Credit in Lieu of Production Tax Credits

- The Act allows the taxpayer to make an irrevocable election to have certain qualified facilities placed in service during the duration of the PTC extension period (generally through 2013; through 2012 for wind facilities) be treated as energy property eligible for a 30 percent ITC under Code Section 48.
- For this purpose, qualified facilities are facilities otherwise eligible for the Section 45 PTC (other than refined coal, Indian coal, and solar facilities) with respect to which no Section 45 PTC has been allowed.
- A taxpayer electing to treat a facility as energy property under Section 48 may not claim the Section 45 PTC.

Grants for Specified Energy Property in Lieu of Tax Credits

- The Act authorizes the Treasury Department to provide a grant to each person who places in service during 2009 or 2010 energy property that is either an electricity production facility otherwise eligible for the Code Section 45 PTC or qualifying property otherwise eligible for the Code Section 48 energy credit.
- The grants are also available to otherwise eligible property that is not placed in service in 2009 or 2010 so long as construction begins in either of those years and is completed prior to 2013 (in the case of wind facility property), 2014 (in the case of other renewable power facility property eligible for the PTC), or 2017 (in the case of any specified energy property described in Code Section 48).
- In general, the grant amount is 30 percent of the basis of the property. For qualified microturbine, combined heat and power system, and geothermal heat pump property, the amount is ten percent of the basis of the property. The basis of the property is reduced by 50 percent of the amount of the grant, and some or all of each grant is subject to recapture if the grant eligible property is disposed of by the grant recipient within five years of being placed in service.
- If a grant is paid, no Section 45 or 48 credits may be claimed with respect to the property.
- The grants will not be considered taxable income to the recipients.

Modification of Energy Credit

- The Act eliminates the $4,000 credit cap applicable to qualified small wind energy property.
- The Act also removes the rule that reduces the basis of the property for purposes of claiming the credit if the property is financed in whole or in part by subsidized energy financing or with proceeds from private activity bonds.

New Credit for Investment in Advanced Energy Property

- Previously, numerous tax credits were available to taxpayers to encourage renewable energy production and energy conservation, but no credit was specifically designed to encourage the development of a domestic manufacturing base to support such industries.
- The Act establishes a 30 percent credit for investment in qualified property used in a qualified advanced energy manufacturing project.
- A qualified advanced energy manufacturing project is a project that re-equips, expands, or establishes a manufacturing facility for the production of: (1) property designed to be used to produce energy from the sun, wind, or geothermal deposits; (2) fuel cells,

microturbines, or an energy storage system for use with electric or hybrid-electric motor vehicles; (3) electric grids to support the transmission of intermittent sources of renewable energy; (4) property designed to capture and sequester carbon dioxide; (5) property designed to refine or blend renewable fuels (but not fossil fuels) or to produce energy conservation technologies); (6) any new qualified plug-in electric drive motor vehicle or a specified vehicle (as defined by Code Section 30D(f)(2)) or any component designed specifically for use with such vehicles; or (7) other advanced energy property designed to reduce greenhouse gas emissions as may be determined by the Secretary.

- Qualified property must be tangible depreciable property used in a qualified advanced energy manufacturing project. The construction, reconstruction, or erection of such property must be completed by the taxpayer after October 31, 2008 or, if purchased, the original use of the property must commence with the taxpayer after such date. Qualified property does not include property designed to manufacture equipment for use in the refining or blending of any transportation fuel.

- The basis of qualified property must be reduced by the amount of credits received.

- Credits are available only for qualified advanced energy manufacturing projects certified by the Treasury Secretary in consultation with the Energy Secretary. The Treasury Secretary must establish a certification program no later than 180 days after the date of enactment and may allocate up to $2.3 billion in credits. Upon certification, the applicant has three years to place the project in service.

Additional Clean Renewable Energy Bonds

- The Act authorizes the issuance of up to an additional $1.6 billion of new clean renewable energy bonds. The Emergency Economic Stimulus Act of 2008 previously authorized $800 million of new clean renewable energy bonds to finance facilities owned by governmental bodies, public power providers, and cooperative electric companies generating electricity from wind, closed-loop biomass, open-loop biomass, geothermal or solar energy, small irrigation, landfill gas, trash combustion, qualified hydropower, and marine renewable energy sources.

Additional Qualified Energy Conservation Bonds

- The Act authorizes the issuance of an additional $2.4 billion of qualified energy conservation bonds. Previously, there was a national limitation of $800 million on qualified energy conservation bonds.

Temporary Increase in Credit for Alternative Fuel Vehicle Refueling Property

- Prior to the Act, taxpayers could claim a 30 percent credit under Code Section 30C, not to exceed $30,000, for the cost of installing qualified clean-fuel vehicle refueling property to be used in the taxpayer's trade or business.

- For property placed in service in 2009 or 2010, the Act increases the maximum credit available to $200,000 for qualified hydrogen refueling property and to $50,000 for other qualified refueling property.

- Additionally, the Act increases the credit rate to 50 percent, except in the case of hydrogen refueling property.

Modification of Credit for Carbon Dioxide Sequestration

- Under present law, a credit of $10 per metric ton is available for qualified carbon dioxide that is captured by the taxpayer at a qualified facility and used by such taxpayer

as a tertiary injectant in a qualified enhanced oil or natural gas recovery project.

- The Act clarifies that carbon dioxide used as a tertiary injectant and otherwise eligible for the $10 per metric ton credit must be sequestered by the taxpayer in permanent geological storage in order to qualify for such credit.
- The provision also clarifies that the term "permanent geological storage" includes oil and gas reservoirs in addition to unminable coal seams and deep saline formations.
- This provision is effective for carbon dioxide captured after the date of the Act's enactment.

Extension of 50 Percent Bonus Depreciation Allowance

- The Act extends the 50 percent bonus depreciation of qualified property for one year, generally through 2009 (2010 for certain longer-lived and transportation property).
- With respect to property that is manufactured, constructed, or produced by the taxpayer for use by the taxpayer, the taxpayer must begin such process after December 31, 2008, and before January 1, 2010. Property that is manufactured, constructed, or produced for the taxpayer by another person under a contract that is entered into prior to the manufacture, construction, or production of the property is considered to be produced by the taxpayer.
- Property does not qualify for the additional first-year depreciation deduction when the user of such property (or a related party) would not have been eligible for such depreciation if the user (or a related party) were treated as the owner.

Temporary Increase in Limitations on Expensing of Certain Depreciable Business Assets

- In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct such costs under Code Section 179.
- The Act extends the ability to expense up to $250,000 of capital expenditures to taxable years beginning in 2009.
- The $250,000 amount is reduced by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $800,000.

Extension of Election to Accelerate AMT and Research Credits in Lieu of Bonus Depreciation

- The Act generally permits corporations to increase the research credit or minimum tax credit limitation by the bonus depreciation amount with respect to certain property placed in service in 2009 (or 2010 in the case of certain longer-lived and transportation property).

Small Business Five-Year Carryback of Operating Losses

- The Act increases the net operating loss ("NOL") carryback period from two years to five years (or any whole number less than five) in the case of a NOL for any taxable year ending or beginning during 2008, but only for businesses meeting a $15,000,000 gross receipts test. However, the election may only be made with respect to one taxable year.

Infrastructure Provisions

The Act includes $64.1 billion in spending on infrastructure, including highways, transit, rail, aviation, environmental, inland waterways, public buildings and maritime transportation. The following is a closer look at the infrastructure projects that may be of interest to our clients for investment purposes:

General Infrastructure Improvements

- $2.5 billion for grants, loans and loan guarantees for broadband infrastructure in any area of the United States. 75 percent of these funds will be allocated to projects in rural and underserved areas.

- Approximately $1.5 billion for energy efficiency improvements and the modernization of Department of Defense facilities, including Defense Health facilities.

Transportation

- $27.5 billion is included for highway investments. The vast majority of this funding will be distributed as grants using a formula set in current highway authorization law. Eligible activities could also include rail and port infrastructure activities, at the discretion of the states. Within the $27.5 billion for highways, the Act includes the following set-asides:

    - $310 million for grants to Indian tribes for transportation investments.

    - $170 million for transportation improvements at national parks, forests, and wildlife refuges.

- $6.9 billion for investments in public transportation. This funding will be distributed to cities using formulas set in current transit authorization law. This funding includes $100 million for grants to public transit agencies for capital investments that will reduce the energy consumption or greenhouse gas emissions of their public transportation systems.

- $1.5 billion for competitive grants to state and local governments for transportation investments. These grants will go to many different kinds of transportation investments – including highway, transit, rail, or port infrastructure – but the projects must have a significant impact on the nation, a region, or a metropolitan area.

- $1.3 billion for investments in our air transportation system. This amount will be mostly comprised of grants to airports for capital investments, and $200 million will be set aside for repairing the facilities and equipment of the Federal Aviation Administration.

- $8 billion in grants for investments in high speed rail corridors, as well as $1.3 billion for Amtrak and to state intercity passenger rails.

- $100 million for investments in maritime transportation. This includes the building of small shipyards.

Environmental Clean-Up

- Approximately $5.1 billion for environmental cleanup of former weapon production and energy research sites. These short-term projects will decrease the overall site footprint, as well as open the affected land for other economic purposes.

- $4 billion for local clean and drinking water infrastructure improvements, to be distributed between the Clean Water State Revolving Fund and the Drinking Water State Revolving Fund.

- $600 million for the Environmental Protection Agency's nationwide environmental cleanup programs.

- Approximately $1.4 billion for the installation of water and waste disposal facilities in rural areas.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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