# STIMULUS PACKAGE TARGETS ENERGY INDUSTRY

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To Our Clients and Friends:

On February 17, President Obama signed the economic stimulus package into law. The American Recovery and Reinvestment Act of 2009 (the "Act") contains various tax and spending provisions aimed at countering the effects of the contraction in the credit and tax equity markets on the renewable energy sector. While the Act is billed as a short-term stimulus measure, various provisions target long-term development and expansion of the renewable energy sector. The following are some highlights:

- Revised tax credit provisions expand financing options for renewable energy projects;
- Expanded tax credit bond provisions increase access to tax advantaged financing for clean energy and energy conservation projects;
- $6 billion has been appropriated to fund federal loan guarantees for renewable energy, transmission and biofuel technologies;
- Billions are appropriated for modernizing the electric grid;
- Tax credits are available for manufacturers of renewable energy equipment;
- Investments are weighted towards efficiency and conservation; and
- Increased grants are allocated for research and development.

## PRODUCTION AND INVESTMENT TAX CREDITS

The current financial crisis has placed a significant strain on the tax equity market, which had been a vital source of funding for many renewable energy projects to date. In order to provide additional financing options, the Act extends the renewable electricity production credit ("PTC") for three years and creates two alternate funding avenues.

First, the Act allows taxpayers to elect a 30% investment credit ("ITC") in lieu of the PTC for certain renewable energy facilities. The option provides an immediate tax credit equal to 30% of the qualified cost of the facilities. This is, in effect, a federal subsidy of 30% of the cost of such facilities and unlike other ITC provisions, only one-half of this ITC reduces the taxpayer's basis in such property.

Furthermore, the Act provides for cash grants from the Treasury Department of up to 30% of the cost of such facilities, which can be claimed in lieu of either the ITC or PTC. The grants are generally not includible in gross income, but they otherwise have a similar effect as the ITC on the taxpayer's basis in such property. The grants are expected to enable developers to bypass the dormant tax-equity financing market; however, implementation of the grant program remains subject to future rulemaking.

## ACCESS TO INCREASED BOND FINANCING

The Act expands the national limitation for two existing tax credit bonds. Tax credit bonds are similar to traditional tax-exempt bonds except that – in lieu of paying tax-exempt interest – they provide holders with credits that can be used to offset their federal income tax liability. Consequently, the bonds provide qualified issuers with what is, in effect, an interest-free source of capital that they may use to finance specified projects.

The annual limitation on the amounts of New Clean Renewable Energy Bonds ("New CREBs") and of Qualified Energy Conservation Bonds ("QECBs") that may be issued is increased by $1.6 billion and by $2.4 billion, respectively. State and local governments, public power providers and cooperative electric companies may issue New CREBs to assist the financing of facilities that generate electricity from renewable resources, such as wind or geothermal energy. State and local governments may issue QECBs to help finance projects aimed at energy conservation and reduction of greenhouse gas emissions.

## FEDERAL LOAN GUARANTEE PROGRAM

The Act seeks to improve access to funding for early stage energy technologies through an expanded federal loan guarantee program. The Department of Energy ("DOE") was already authorized to issue loan guarantees to support borrower obligations in financing advanced technologies in certain transmission and energy projects pursuant to Title XVII of the Energy Policy Act of 2005. The Act expands the program with a temporary initiative to guarantee loans for renewable energy systems and component manufacturers, electric power transmission systems and pilot biofuel projects and provides $6 billion in funding so that credit subsidy costs do not have to be funded by borrowers.

## MODERNIZING TRANSMISSION

The Act includes targeted spending for developing smart grid technology and constructing and upgrading transmission lines to modernize the electric grid. Such measures include a $4.5 billion appropriation for DOE's Electricity Delivery and Energy Reliability Program for research and development, worker training, enhanced transmission and implementation of smart grid technologies. This appropriation will also fund grants of up to 50% of costs of qualifying advanced grid technology investments under the Smart Grid Investment Matching Grant Program, replacing the 20% reimbursement of costs under the existing program.

Additionally, the Act authorizes a $6.5 billion increase in borrowing capacity by two power marketing administrations within the DOE, for the construction of new transmission facilities and updates to the existing grid.

### INVESTMENT IN MANUFACTURING

Prior to the stimulus package, there were no direct tax credits encouraging manufacturing of the components (*e.g.*, wind turbine blades) used in the production of renewable energy. To encourage production, the Act provides that manufacturers of such components may earn ITCs from investments in new or expanded manufacturing facilities. The manufacturing facilities must produce certain specified components, such as equipment designed to generate renewable energy, electric grids to support transmission and storage of renewable energy and property designed to capture and sequester carbon dioxide. The Treasury and Department of Energy are tasked with designing the new program to award up to $2.3 billion of such tax credits nationally through a competitive bidding process.

Additionally, the Act allocates $2 billion in funding to the DOE for grants to advanced battery and component manufacturers in the U.S.

### ENERGY EFFICIENCY AND CONSERVATION

The Act makes $6.3 billion in grants available to state and local governments for programs to reduce emissions and energy use and increase efficiency. It also contains numerous tax provisions to encourage investment in energy conservation at both the commercial and consumer levels, including, *inter alia*, expansion of the credit for installation of alternative fuel pumps, removal of the $4,000 cap on credits for qualified small wind energy properties and expansion of the non business energy property credit for energy-efficient improvements to existing homes.

The Act could mark a shift in the regulatory environment for utilities in certain states. In what some consider a win for power companies advocating the decoupling of energy usage and utility profits, certain efficiency and conservation grants to states are conditioned on the governor giving written notice to the Secretary of Energy that state regulators will seek to implement rate design modifications that could result in utilities being compensated for conservation and efficiency improvements through higher rates. Proponents argue that these modifications will encourage utilities to promote efficiency because utility profits will be preserved even when consumer demand for energy decreases.

## RESEARCH AND DEVELOPMENT

A number of provisions in the Act provide funds for early stage research and development. The largest single appropriation is $3.4 billion allocated for DOE's Fossil Energy Research and Development program, which supports initiatives, such as carbon capture and sequestration, to reduce emissions from coal-fueled electricity generation.

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The Act's focus on energy reflects a broad shift in attention toward the energy industry, in particular renewable energy, in U.S. legislation. The Obama administration has promised that it has a "comprehensive plan" to invest in alternative and renewable energy and address global climate change. Many of the provisions relating to the renewable energy industry seem to be intended as the Obama administration's first step in implementing a long-term transition to a greener economy. The Act likely precedes legislation establishing national renewable energy standards and further climate change legislation aimed at regulating the emission of greenhouse gases. If implemented, these legislative actions will shift the landscape of incentives, federal mandates and programs that shape the energy industry.

The full text of the Act is available at: www.recovery.gov, the Obama administration's new website for tracking spending under the Act.

Please feel free to contact us with any questions.

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