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U.S. INCENTIVES TO PROMOTE CLEAN ENERGY

U.S. Incentives To Promote Renewable Energy

The American Recovery and Reinvestment Act of 2009 (ARRA) was passed in response to the worldwide economic crisis of 2008-2009 and contains various direct spending programs, tax incentives, grants, loans, loan guarantees, and bond programs to develop renewable and clean energy technologies. The ARRA is $787 billion overall, with more than $50 billion devoted to clean and renewable energy. This article describes two of the ARRA's key provisions: amendments to the Loan Guarantee Program established in the Energy Policy Act of 2005 (EPACT) and the cash grant program for qualified renewable energy power facilities.

Cash Grants in Lieu of Tax Credits

Production Tax Credit

One of the ARRA's key provisions is a new cash grant program for qualified renewable energy power facilities. First, some background. Businesses that generate electricity from wind, geothermal energy, and "closed-loop" biomass (using dedicated energy crops) are eligible for a production tax credit (PTC) under Code Section 45, which provides an income tax credit of 2.1 cents per kilowatt-hour (kWh) (adjusted annually for inflation) of electricity produced for the first 10 years of a renewable energy facility's operation. Other technologies, such as "open-loop" biomass (using farm and forest wastes rather than dedicated energy crops), incremental hydropower, small irrigations systems, landfill gas, and municipal solid waste, receive a lesser credit of 1.0 cent per kWh.

Investment Tax Credit

The investment tax credit (ITC) under Code Section 48 allows businesses and individuals a one-time upfront tax credit equal to a certain percentage of the tax basis of certain types of renewable energy property placed in service during the year. Certain solar energy property, small wind energy property, and qualified fuel cell property are eligible for a 30% credit. Other energy property, such as qualified microturbine property, geothermal power production property, geothermal heat pump property, and combined heat and power system property, are eligible for a lesser 10% credit.

ITC in Lieu of PTC

Code Section 48(a)(5), added by the ARRA, allows taxpayers to irrevocably elect to take the ITC in lieu of the PTC for certain renewable energy facilities placed in service after December 31, 2008 and before December 31, 2013 (2012 for wind facilities). Some eligible taxpayers undoubtedly will find the upfront ITC to be an attractive alternative to the PTC. For more information on making this election, see our June 19, 2009 advisory, "IRS Provides Guidance on Election Investment Tax Credit in Lieu of Production Tax Credit."

Cash Grants in Lieu of PTC and ITC

One significant change under Section 1603 of the ARRA allows taxpayers to receive a cash grant (a "Section 1603 grant") in lieu of the PTC or ITC for investment in certain renewable energy property. Subject to some exceptions, Section 1603 grants are available to any person, whether individual or entity, who is the original user of "specified energy property" (see below). The original user may be the first owner of the property, or under some circumstances, a lessee.

Some persons, however, are not eligible for a Section 1603 grant:

- Federal, state, or local governments
- Tax-exempt organizations
- Clean renewable energy bond lenders, cooperative electric companies, or governmental bodies
- Partnerships or other pass-through entities having an equity owner who is described above, unless the ineligible person owns its interest through a C corporation
- Foreign persons or entities, unless more than 50% of the foreign person or entity's gross income derived from the specified energy property is subject to U.S. federal income tax

"Specified energy property" for a Section 1603 grant is energy property otherwise eligible for ITC, including "PTC-type" property that can now elect ITC. The amount of the grant is the same amount otherwise available under ITC, which is 30% of the cost of most projects and 10% of the cost of others (see table below).

Receiving a Section 1603 grant is subject to certain project deadlines. Construction must begin by the end of 2010. If construction began before 2009, the property must be placed in service by the end of 2010. If construction begins in 2009 or 2010, the property must be placed in service by the dates listed in the table below.

"Construction begins" on a property when "physical work of a significant nature" begins, either directly by the owner or on the owner's behalf by a third party under a written binding contract. Preliminary activities, such as planning, designing, or securing financing, do not constitute physical work. Generally speaking, property is "placed in service" when it is ready and available for its intended use, *i.e.*, the project is substantially complete and ready to produce energy. See our July 19, 2009 advisory, "Grants in Lieu of Tax Credits—New Guidance on Eligibility and How To Apply," for a table summarizing the types of property eligible for a Section 1603 grant, the placed-in-service deadline if construction begins in 2009 or 2010, and the amount of the grant as a percentage of cost.

ARRA's Amendments to the Loan Guarantee Program

Another key component of the ARRA is its amendments and expansion to loan guarantee programs. Section 1703 of Title XVII of EPAct, as expanded by EISA, authorizes loan guarantees for renewable energy and certain other projects that employ "new or significantly improved" technologies. Section 1705, added by the ARRA, authorizes loan guarantees under the Financial Institutions Partnership Program (or FIPP) for renewable energy projects that employ "commercial" technologies.

DOE Section 1703 Loan Guarantees

Section 1703 authorizes loan guarantees for renewable energy and certain other projects that employ "new or significantly improved" technologies rather than commercial technologies. The phrase "new or significantly improved technology" is defined as not more than two substantially similar technologies in commercial operation in the U.S. in the past five years. Eligible projects must also "avoid, reduce or sequester air pollutants." Eligible projects include alternative fuel vehicles; efficient electricity transmission; distribution and storage; energy efficiency projects; solar, wind, biomass, hydro and geothermal power technologies; and advanced biofuels production facilities. Section 1703 does not specify a deadline by which projects must be constructed. Eligible recipients for Section 1703 loan guarantees include private borrowers and project sponsors, but not private lenders.

Section 1703 Guaranty Fees and Costs

Section 1703 loan guarantees are subject to several fees and costs:

- Application fee ranging from $75,000 to $125,000, depending on the size of the loan (25% of the fee submitted with Part I of the application; 75% of fee submitted with Part II).

Loan Guarantee Amount	***Total Fee Amount***
$0- $150,000,000	*$75,000*
$150,000,000-$500,000,000	*$100,000*
Above $500,000,000	*$125,000*

- Facility fee (20% of fee payable upon execution of Term Sheet; 80% of fee payable upon closing of the Loan Guarantee Agreement).

Loan Guarantee Amount	***Total Fee Amount***
$0-$150,000,000	*1% of guarantee*
$150,000,000-$500,000,000	*$375,000,000 + 0.75% of guarantee*

Above $500,000,000	*$1,625,000 + 0.50% of guarantee*

- Maintenance fee of $50,000 to $100,000 per year during the life of the loan guarantee. Payable either (i) each year in advance, commencing upon the closing date of the Loan Guarantee Agreement, or (ii) as an one-time fee at the closing in a lump sum amount equal to the aggregate sum of such annual fees specified in the Loan Guarantee Agreement for the entire term of the loan guarantee, discounted to net present value.
- Attorneys/Consultants fee: DOE is entitled to payment for additional internal administrative costs and related fees and expenses for its independent consultants and outside counsel.
- Credit Subsidy Cost: The Credit Subsidy Cost is the net present value of the estimated cost to the U.S. government of the loan guarantee as determined under the applicable provisions of the Federal Credit Reform Act of 1990, as amended (FCRA).

Application Deadlines

Applications are due in two parts, roughly two months apart, with seven rounds of deadlines available:

Round	Part I	Part II
1	Sept. 16, 2009	Nov. 13, 2009
2	Oct. 22, 2009	Jan. 15, 2010
3	Dec. 23, 2009	Mar. 12, 2010
4	Feb. 18, 2010	May 14, 2010
5	Apr. 22, 2010	July 19, 2010
6	Jun. 24, 2010	Sept. 17, 2010
7	Aug. 24, 2010	Dec. 31, 2010

DOE Section 1705 Loan Guarantees

Section 1705 authorizes loan guarantees for three specific types of projects: (1) renewable energy systems; (2) electric power transmission systems; and (3) leading edge biofuel projects. Examples of eligible projects include wind, closed-loop and open-loop biomass, geothermal, landfill gas, trash-to-energy, hydropower, solar, and advanced or leading edge biofuels production facilities. Eligible projects must meet the following requirements:

- Involve renewable energy generation in the United States.
- Use a “commercial technology.”

- Commence construction by September 30, 2011.
- Have a credit rating equivalent to a "BB" from Standard & Poor's or Fitch, or "Ba2" from Moody's.

"Commercial technology" is defined as "a technology in general use in any commercial marketplace" (*i.e.* worldwide) that "has been in operation in each such commercial project for a period of at least two years" from the commercial operations date of that project.

Applications must be filed by a private lender or a "lead lender" representing a consortium of lenders, and not by the borrower. An "eligible lender" is any person or legal entity engaged in the business of lending money, including:

- Commercial banks and investment banks.
- Savings and loan institutions.
- Insurance companies.
- Factoring companies.
- Institutional investors, venture capital and private equity firms.

Construction must commence by September 30, 2011, and is defined as the borrower having:

- Completed all pre-construction engineering and design
- Received all necessary licenses, permits and local and national environmental clearances
- Engaged all contractors and ordered all essential equipment and supplies
- Begun or resumed physical construction at the primary site of the project.

Section 1705 Fees

Section 1705 loan guarantees are subject to the following fees payable to the DOE:

- Application Fee: $50,000 (25% payable with Part I; 75% payable with Part II)
- Facility Fee: 1/2 of 1.0% of guaranteed portion of Guaranteed Obligation (20% payable upon the signing of a Term Sheet; 80% payable at closing)
- Maintenance Fee: Expected to be in the range of $10,000 to $25,000 per year and payable by the Borrower; the amount and payment due dates to be specified in the Loan Guarantee Agreement
- Attorneys/Consultants Fee: DOE shall be entitled to payment for additional internal administrative costs and related fees and expenses for its independent consultants and outside counsel
- No Credit Subsidy Cost for Section 1705 loan guarantees

Application Deadlines

Part I applications may be filed at any time prior to filing a Part II submission and will be reviewed on a continuous basis. Part II application due dates are as follows:

Part II Submission Rounds	
1. November 23, 2009	6. July 8, 2010
2. January 7, 2010	7. August 23, 2010
3. February 22, 2010	8. October 7, 2010
4. April 8, 2010	9. November 22, 2010
5. May 24, 2010	10. January 6, 2011

Comparison of Sections 1703 and 1705 Loan Guarantees

- Section 1705 projects must employ "commercial technologies."
- Section 1703 projects must employ "new or significantly improved technologies."

- Section 1705 projects must commence construction by Sept. 30, 2011. The ability to implement a project expeditiously takes on greater importance.
- Section 1703 projects have no construction deadline.

- Section 1705 projects must comply with the Davis-Bacon Act, which requires payment of "prevailing wage" to all laborers.
- Section 1703 has no such requirement.

- Section 1705 projects are not required to pay the "credit subsidy cost" of a loan guarantee, which is the cost to the federal government of assuming the risk of a default on a loan.
- Section 1703 requires the borrower to pay the credit subsidy cost at closing for loan guarantees on qualified projects.