Date: February 19, 2009

To: Interested Persons

Re: Energy Provisions of the American Recovery & Reinvestment Act of 2009

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the "**Act**"). This $787 billion stimulus package, which is comprised of approximately $575 billion in spending and $212 billion in tax relief, was approved by Congress largely along party lines. The measure passed in the U.S. House of Representatives by 246 to 183 votes with no Republican support and picked up three Republican votes in the Senate to pass by a margin of 60 to 38. Reflecting its support in the business community, the legislation was endorsed – despite some reservations – by both the National Association of Manufacturers and the U.S. Chamber of Commerce.

The new law provides for significant government investment in the renewable energy and energy efficiency industries, and proponents expect that it will jump-start businesses in those and related industries through an infusion of additional private sector investment. Over $40 billion in direct spending is included for such energy initiatives as smart grid infrastructure development, advanced battery systems and energy efficiency. The law also grants approximately $20 billion in renewable energy and energy efficiency tax incentives.

As the legislation was primarily designed to create and preserve jobs as quickly as possible, much of the spending is routed through existing programs rather than used to develop new programs. Therefore, many of the initiatives will already be familiar to the energy industry. However, understanding how the government has prioritized its renewable energy and energy efficiency spending and tax initiatives may help companies assess their own strategies as they navigate the coming changes in the regulatory and technological landscape of the energy sector. In addition, with respect to the direct governmental spending described herein, companies may be able to position themselves to benefit from particular project funding. Several of the significant energy-related provisions are described below:

Appropriations

- *Energy Transmission and Smart Grid Infrastructure*. The Act provides $4.5 billion to modernize the U.S. electricity delivery system, with funds to be spent on research and development, pilot projects and federal matching programs with a focus on reducing energy consumption in the existing grid, enhancing security and reliability of energy infrastructure and facilitating recovery from disruptions in the energy supply. The term "smart grid" does not indicate any specific technology but rather, as explained by the House Appropriations Committee, is an

approach to operating the nation's electrical grid using advanced digital technology to save energy and cost, employ storage technologies and allow for demand response mechanisms.

The law also increases the borrowing authority of two of the Department of Energy's five power marketing agencies (the Western Area Power Administration and the Bonneville Power Administration) by $3.25 billion each. Congress expects that the additional loans will help the two agencies upgrade their infrastructure to promote energy efficiency and expand the distribution of energy from renewable power sources.

- *Renewable Energy and Energy Efficiency Research and Development*. The Department of Energy receives $2.5 billion for applied research, development, demonstration and deployment activities in the fields of renewable energy and energy efficiency. Of those funds $1.2 billion is directed toward biomass and geothermal technologies, which receive $800 million and $400 million respectively. While not made explicit in the Act, the House Appropriations Committee report on the legislation contemplated that the remaining funds would be used in part to research and demonstrate water power, solar power and commercial and industrial efficiency projects, including combined heat and power facilities.

- *Innovative Technology Loan Guarantee*. The Act includes $6 billion for the cost of guaranteeing loans for proven renewable energy and transmission technologies. This loan guarantee program is in part a response to the contraction in the credit markets, which has slowed many renewable energy and energy transmission projects. The appropriated funds are expected to support more than $60 billion in loans to construct new renewable energy generation projects and make improvements to the nation's transmission system.

- *Advanced Battery Manufacturing and Alternative Fuel Vehicles*. The domestic advanced vehicle battery manufacturing industry receives a $2 billion infusion in the form of grants from the Department of Energy. The Act specifically identifies advanced lithium ion batteries, hybrid electrical systems, components and software as eligible for grant awards. Currently, advanced battery manufacturing takes place primarily overseas. Together with other incentives outlined in the Act, these grants are expected to foster the future growth of the industry in the United States.

  The Act also provides:

  - $300 million in grants for up to 30 geographically dispersed projects intended to encourage the use of plug-in electric drive vehicles or other

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emerging vehicle technologies. The funds granted may be used for the acquisition of alternative fueled vehicles and for the acquisition and installation of infrastructure necessary to support such vehicles.

  - $400 million in grants to states, local governments and metropolitan transportation authorities for electric transmission projects that reduce emissions, such as shipside electrification of vehicles, truck stop electrification, airport ground support equipment and cargo handling equipment.

  - $300 million for procuring energy efficient vehicles for the federal government. Specifically, the law allows for expenses necessary to acquire motor vehicles with high fuel economy, including hybrid vehicles, electric vehicles and commercially available plug-in hybrid vehicles, and related capital expenditures.

- *Fossil Energy*. While renewable energy certainly received much of Congress' attention, $3.4 billion is included for the Fossil Energy Research and Development program, which promotes the development and use of environmentally and economically superior technologies for supply, conversion, delivery and use of fossil fuels. Included in this sum are $1 billion for research and development, $800 million for clean coal demonstration projects, $1.52 billion in grants for industrial carbon capture and energy efficiency improvement projects, $50 million in grants for geologic site characterization and $20 million in grants for geologic sequestration training and research.

  Although not explicitly mentioned in the law, it is expected that a significant portion of this funding will be used to revive FutureGen, the clean coal demonstration project located in Illinois that was defunded by the Department of Energy last year due to cost overruns.

- *State and Local Government Energy Grants*. Consistent with the general approach of funding proven programs, $6.3 billion in energy grants is channeled through existing structures to state and local governments: $3.2 billion is provided through the Energy Efficiency & Conservation Block Grants program, and $3.1 billion is included for the State Energy Program. These two initiatives provide funds for a wide range of energy-related projects, including installation of renewable energy technologies at government facilities and improvement of transportation-related energy conservation.

  As a precondition to a state's receiving a certain portion of the state energy grants, the governor of such state must represent to the Department of Energy that its state regulators will implement policies to better align the financial incentives of

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utility companies with energy efficiency goals. While the provision does not use the word "decoupling", this condition is expected to induce additional states to decouple their utility companies' profits from customer demand, effectively guaranteeing profits for the utilities despite any decreased demand due to energy efficiency and conservation measures.

Tax Credits

Under preexisting law, owners of wind facilities and certain other renewable energy facilities could qualify for the production tax credit ("**PTC**"). The PTC is a yearly credit based on the amount of electricity sold to an unrelated person and is available for 10 years after a facility is placed in service. Owners of solar facilities and certain other renewable facilities could qualify for the investment tax credit ("**ITC**"). The ITC is a one-time credit equal to 30% of the cost of the energy-related equipment, subject to recapture if the ownership interest is sold within 5 years.

Frequently, investments in renewable energy facilities have been structured as partnerships so that most of the tax benefits (i.e., the tax credits and accelerated depreciation) have been allocated to "tax-equity investors," which historically have been banks and financial institutions. Current market conditions have reduced investment demand from such traditional tax-equity investors.

The effect of the Act is to increase the flexibility of these credits and expand alternative routes of financing, including the tax-credit bond program and the new direct grant program. The relevant provisions are described below:

- *Extending the Sunset Date of the PTC*. The Act extends the sunset date of the PTC three years so that wind facilities that are placed in service prior to January 1, 2013 (January 1, 2014 for certain other qualified facilities) are eligible for the credit. (The sunset date of the ITC was extended to January 1, 2017 by the Energy Improvement and Extension Act of 2008 and was not further extended by the stimulus package.)

- *Allowing Election to Claim the ITC in lieu of the PTC*. The Act allows taxpayers that own facilities eligible for the PTC to elect to claim the ITC in lieu of the PTC. Upon an election, taxpayers would be eligible for a credit equal to 30% of the basis of depreciable property that is used as an integral part of the qualified facility. The election is available for all facilities placed in service before the PTC sunset date set forth above.

- *Repealing the ITC Haircut Resulting from Subsidized Financing*. The Act repeals the limitation under prior law that reduces the ITC by the percentage of the ITC-eligible property that was financed by subsidized energy financing or private

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activity bonds. For ITC-eligible facilities placed into service after December 31, 2008, taxpayers are able to qualify for the full amount of the ITC regardless of subsidized financing.

- *Providing Direct Grants in lieu of the PTC and ITC*. The Act provides that a taxpayer that begins construction of a PTC/ITC-eligible facility prior to 2011 and places the facility in service by the relevant sunset date can apply to the Treasury Department by October 1, 2011 for a grant equal to 30% of the cost of eligible depreciable or amortizable property used in the facility. The grant would be subject to recapture provisions similar to the ITC. It would not be includible in gross income but would reduce the depreciable basis of the property by one-half of the amount of the grant. The Act does not appear to limit the amount of grants that the Treasury Department can make, and it appropriates amounts "as may be necessary to carry out this section."

- *Establishing a New Tax Credit for Qualified Advanced Energy Projects*. The Act establishes a new tax credit equal to 30% of the cost of tangible depreciable property used in a qualified advanced energy project. Qualified advanced energy projects are projects to expand or establish a manufacturing facility for the production of: (i) equipment related to solar, wind or geothermal facilities, (ii) fuel cells, micro-turbines and energy storage systems, (iii) certain electric grids, (iv) property designed to capture and sequester carbon dioxide and (v) property designed to refine or blend renewable fuels. The Act directs the Treasury Department to develop certification procedures to allocate up to $2.3 billion of such credits.

- *Extending Allowances for Bonus Depreciation*. The Act also extends until January 1, 2011 allowances for bonus depreciation (an additional depreciation deduction equal to 50% of the adjusted basis) of certain property.

- *Expanding New Clean Renewable Energy Bonds*. The Act authorizes issuance of up to an additional $1.6 billion of new clean renewable energy bonds ("**New CREBs**"), a type of qualified tax credit bond. New CREBS can be issued by certain issuers, including public power providers and governmental bodies, to finance qualified renewable energy facilities. Holders of New CREBs are entitled to a tax credit based on the face amount of the bond and the bond's credit rate. The credit rate is set by the Treasury Department at a rate that is 70% of the rate that would permit an issuer to issue an equivalent bond without discount or interest cost.

The above outlined energy initiatives are generally subject to the Act's rigorous oversight, transparency and accountability provisions, which provide visibility into how these funds are disbursed and what specific energy projects are receiving support. For example, the

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applicable oversight board is directed to establish and maintain a website on which will be disclosed, among other things, detailed data on federal contracts awarding funds, printable reports on covered funds obligated by month to each state and congressional district and information about grant competitions and solicitations for contracts to be awarded. Companies may find this information valuable as they seek new business opportunities made possible under the Act.

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