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AMERICAN BAR ASSOCIATION -- SECTION OF TAXATION

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TITLE: Monetizing Production Tax Credits From Alternative and Renewable Energy Projects

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COMMITTEE: Energy and Environmental Taxes

Monetizing Production Tax Credits from Alternative And Renewable Energy Products

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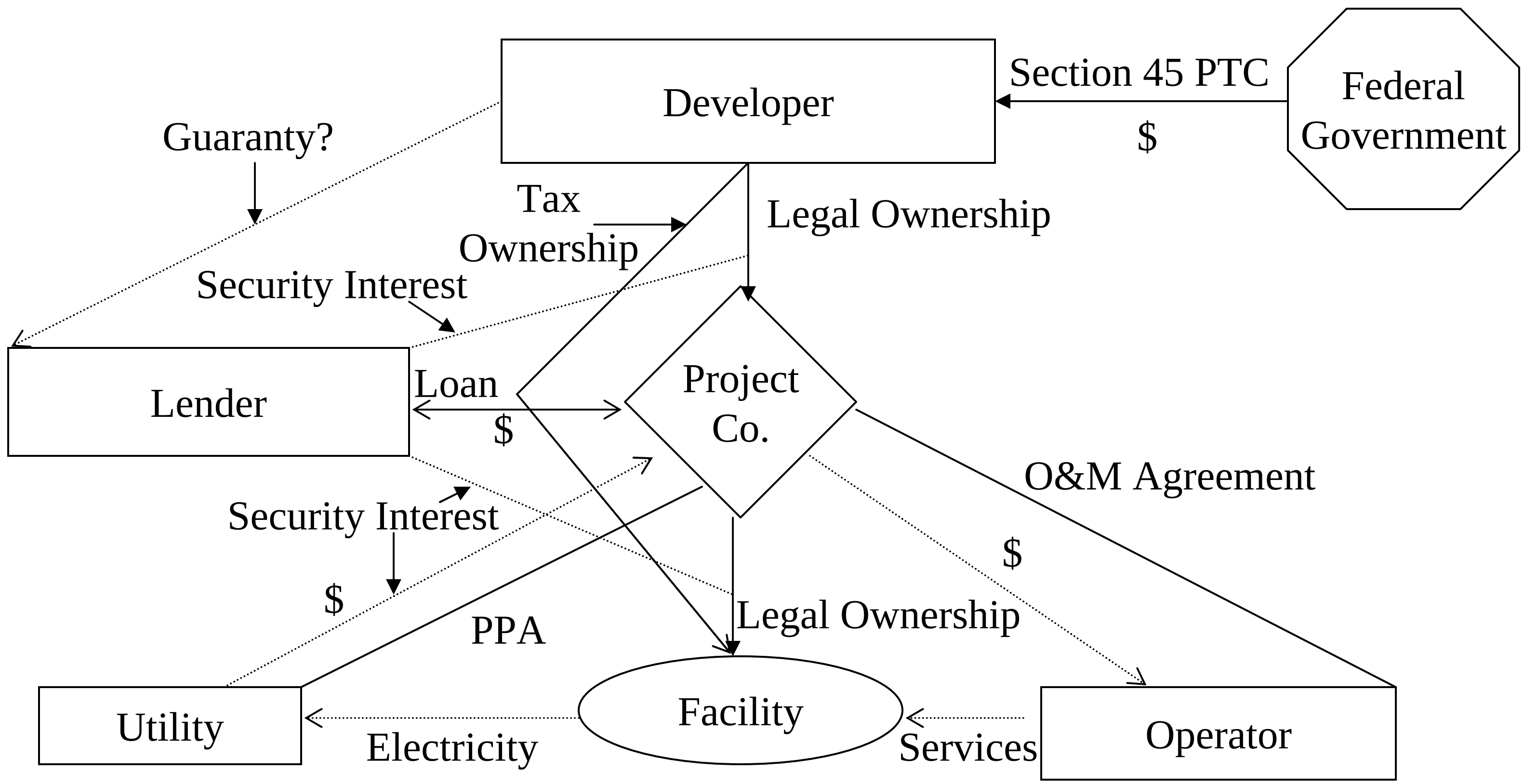
Typical Electrical Generation Project



The Opportunity

- Federal government provides tax credits to qualifying facilities that produce electricity from certain alternative and renewable energy sources (IRC § 45)
- Developer may not be able to use the credits currently or in the foreseeable future
- Lenders often looking for additional cash flow to support project debt

The Opportunity (cont'd)

- Tax benefits (depreciation and credits) may provide 60%+ of total project value
- Monetization allows parties to capture and share this value

What Energy Resources Qualify?

- Wind
- Solar/Geothermal
- Biomass – Closed- and Open-Loop
- Municipal Solid Waste – Trash and Landfill Gas (LFG)
- “Small” Irrigation Power
- Hydropower – old dams with new or increased generation capacity

How Much is the Credit?

- 1.9¢/kWh in 2006 (1.0¢/kWh for open-loop biomass, small irrigation power, LFG, trash and hydropower)
- 10 years for all new facilities (5 years for some "interim" facilities and through 12/31/09 for pre-existing open-loop biomass facilities)

Limitations

- Project Company/New Holdings must produce the electricity (not lessees or operators – except open-loop biomass)
- Placement in service date restrictions
- Tax Investor must be a partner

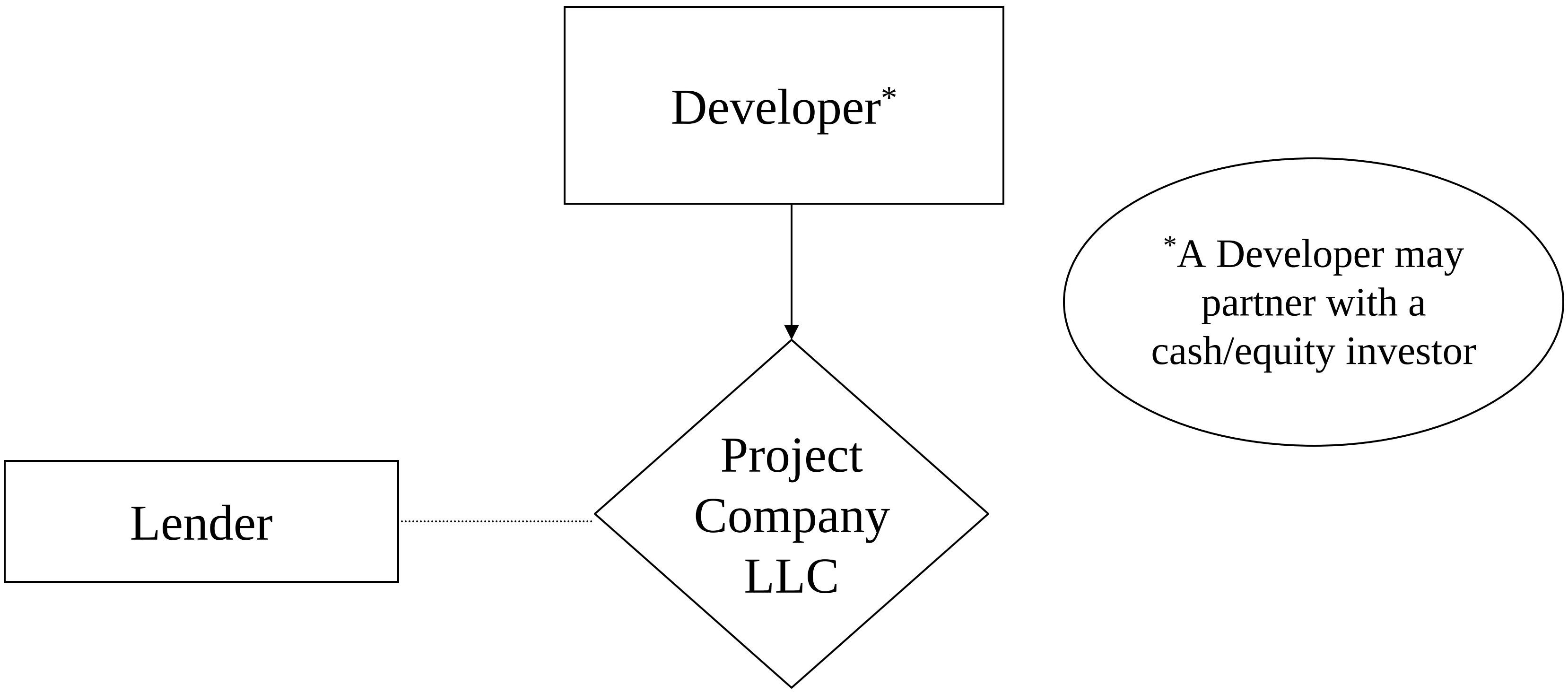
Limitations (cont'd)

- Phaseout based on market prices (not imminent)
- Up to 50% reduction for grants, tax-exempt financing, subsidies (not guarantees) and other federal tax credits
- No "double-dipping" with § 29/45K (LFG)

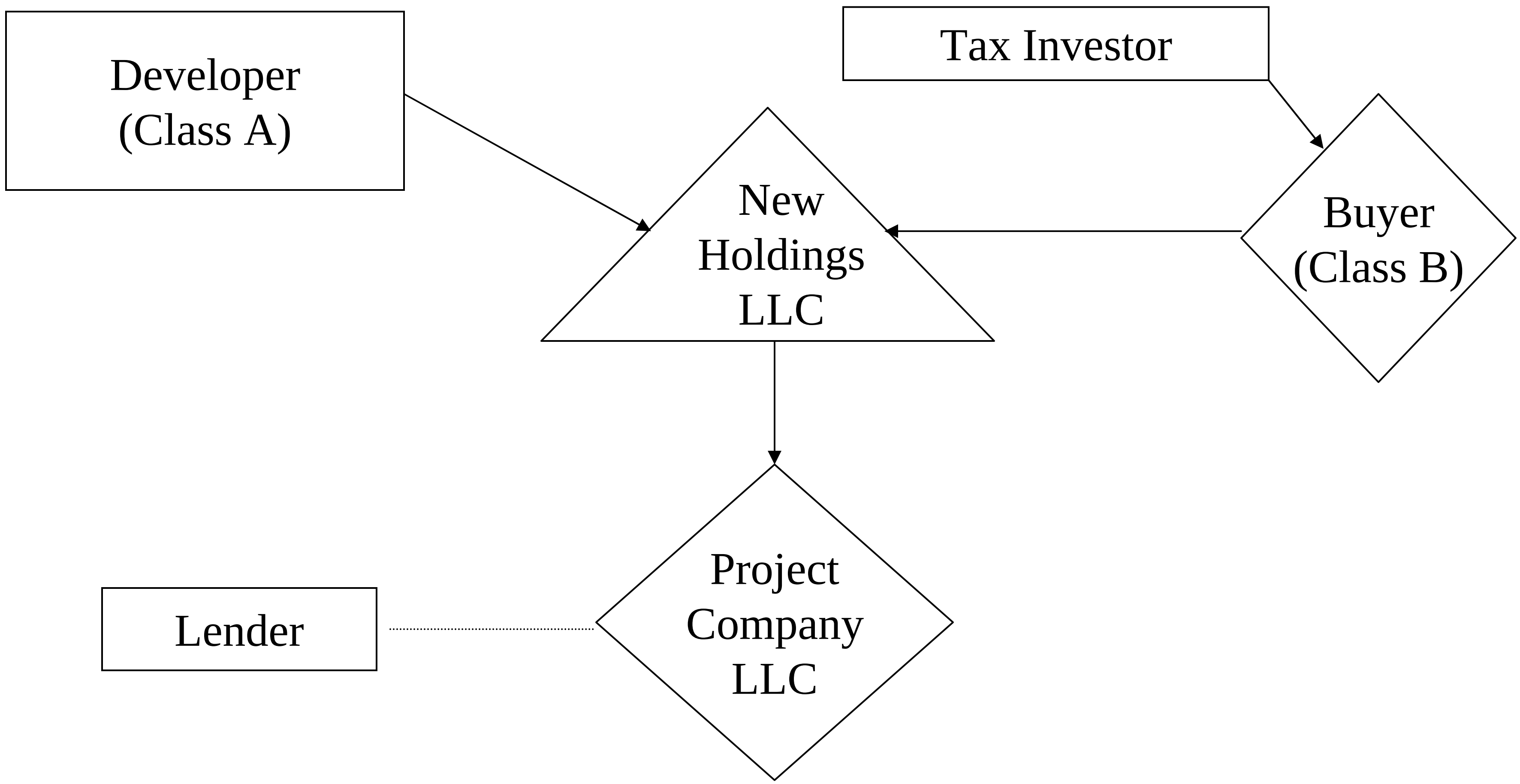
Limitations (cont’d)

- Alternative Minimum Tax (after 4 years)
- Passive activity rules

Basic Deal Structure – Pre-Monetization



Basic Deal Structure – Post-Monetization



What Does Tax Investor Buy?

- New entity
- Class B Interest
- Up to 99% of electricity revenues and production tax credits
- Not RECs or other income streams (but what if bundled in PPA?)

How Does Tax Investor Pay?

- Upfront payment
- Fixed deferred payments for tax credits
- Variable deferred payments for tax credits
- Deferred payments for cash
- IRS 50/50 test

Purchase and Sale Agreement

- Basic transaction is an asset sale (asset may be a partnership interest)
- Escrow for PLR or other events?
- Tax indemnification

Operational Issues

- Developer still runs day-to-day
- Major Decisions
- Lender's rights

Unwind

- Date certain vs. rate of return
- Is it possible to change partners' interests?
- Developer may have call right

Summary of Major Issues

- Section 45 and general tax limitations
- Partnership tax accounting rules
- Pricing
- Cash flow
- Tax indemnity
- Unwind

RATH YOUNG PIGNATELLI

THANK YOU