



ORRICK, HERRINGTON & SUTCLIFFE LLP
WASHINGTON HARBOUR
3050 K STREET, N.W.
WASHINGTON, D.C. 20007-5135
tel 202-339-8400
fax 202-339-8500
WWW.ORRICK.COM

MEMORANDUM

To American Public Power Association Members

FROM Edwin G. Oswald

DATE December 15, 2005

RE Treasury Department Releases Additional Guidance Regarding Clean Renewable Energy Bonds

On December 12, 2005, the Treasury Department released Notice 2005-98 (the “Notice”), providing issuers of clean renewable energy bonds (“CREBs”) with additional guidance following the enactment this past July of the Energy Tax Incentives Act of 2005 (the “Act”), which permits State and local governments, cooperative utilities and Indian Tribal governments to issue CREBs to finance certain renewable energy and clean coal facilities.

A CREB is a tax credit bond (a relatively new type of debt instrument) in which interest on the bonds is paid in the form of tax credits by the Federal government. Thus, a CREB provides an issuer the opportunity to borrow at a 0% interest rate. Members of Orrick’s Tax Department worked closely with a coalition of clean energy proponents in drafting the legislation, which included addressing both technical and tax policy considerations related to the bonds presented by Federal regulators. The Notice provides issuers with additional guidance in the areas of applying for CREBs volume cap authority, the allocation of such volume authority, the maximum term of and the credit rate for CREBs, applicable reporting requirements, as well as a glimpse at additional guidance that may be forthcoming from the Treasury Department.

Below, in question and answer format, is a summary of the Act and the Notice.

Who May Issue CREBs?

- State and local governments
- District of Columbia
- CoBank, ACB
- Mutual or cooperative electric companies described in Internal Revenue Code Section 501(c)(12) or 1381(a)(2)(C)
- U.S. territories and possessions
- Indian tribal governments
- National Rural Utilities Cooperative Finance Corporation
- A not-for-profit electric utility which has received a loan or loan guarantee under the Rural Electrification Act



ORRICK

What Types of Projects Qualify for CREBs Financing?

- Wind Facilities
- Open-Loop and Closed-Loop Biomass Facilities
- Small Irrigation Power Facilities
- Trash Combustion Facilities
- Geothermal or Solar Energy Facilities
- Landfill Gas Facilities
- Refined Coal Production Facilities
- Qualified Hydropower Facilities

How Do Qualified Issuers Obtain Authority to Issue CREBs?

In order to issue CREBs, qualified issuers must obtain an allocation of bond volume authority from the Secretary of the Treasury. The Act provides for a national maximum volume cap of \$800,000,000, with the amount of cap allocable to governmental bodies¹ not permitted to exceed \$500,000,000. The bonds can be issued no earlier than December 31, 2005 and no later than December 31, 2007.

Pursuant to the Notice, an application for an allocation of bond volume authority must be submitted by a qualified issuer no later than April 26, 2006. Each application must:

- identify the qualified borrower expected to own the project (for these purposes, a qualified borrower is a mutual or cooperative electric company described in Internal Revenue Code Section 501(c)(12) or 1381(a)(2)(C), or a governmental body¹);
- if any of the bonds are expected to be issued as pooled financing bonds, demonstrate that the qualified issuer will enter into a written loan commitment with each qualified borrower prior to the issue date of the bond issue;
- describe, in detail, the project to be financed with the proceeds of the bonds, including the location of the project, the dollar amount of CREB allocation requested for the project, the plan to obtain all necessary federal, state and local regulatory approvals, and the expected placed in service date of the project;
- demonstrate that the project will constitute a qualified project, and contain a certification by an independent, licensed engineer that the project will both be a qualified project and technically viable; and
- contain a detailed description of the plan of financing.

How Will Bond Volume Authority be Allocated?

Bond volume authority will be allocated to qualified projects for which applications meeting the requirements of the Notice have been filed with the Internal Revenue Service. Qualified projects will be allocated volume authority on a non-discriminatory basis based on the full amount of bond volume authority requested. Volume authority will be allocated beginning with the project(s) for which the smallest dollar amount of volume authority has been requested, and continuing with the project(s) for which the next smallest dollar amount of such limitation has been requested until the

¹ Governmental bodies include any State, U.S. territory or possession, the District of Columbia, Indian tribal governments and any political subdivision thereof.



O R R I C K

total amount of authority has been allocated. For example, if the smallest dollar amount of volume authority requested is \$10 million for each of 10 different projects, those projects will be granted the full amount of the requested allocation in the total amount of \$100 million, and the remaining cap will be allocated to the next smallest dollar amount projects (and so forth) until the volume authority is exhausted. Under the guidelines set forth in the Notice, large dollar projects may obtain at least partial CREB funding by requesting a small dollar amount of authority. Given that full funding will first be granted to the smallest dollar requests, large dollar projects will presumably be funded from a variety of sources (e.g., CREBs, equity, tax-exempt bond proceeds etc.). For purposes of the allocation rules, all qualified projects located at the same site and owned by the same qualified borrower are treated as a single project.

What Specific Rules and Restrictions Apply to CREBs?

At least ninety-five percent of the proceeds of CREBs must be spent on one or more qualified projects within five years of the date of issue. For this purpose, the Act generally permits issuer reimbursement from bond proceeds for eligible out-of-pocket expenditures incurred after August 8, 2005 and the ability to refinance both taxable and tax-exempt debt issued for qualified projects after August 8, 2005. Under the Act, the arbitrage rebate rules generally applicable to tax-exempt bonds apply to the CREBs.

What is the Maximum Term of a CREBs?

The maximum term of CREBs is determined pursuant to a formula wherein the par amount of the issue is divided by 2 (the “50 percent amount”) and the final maturity is based on how long it takes the 50 percent amount invested at a supplied discount rate to equal par. The Notice provides that a discount rate equal to 110 percent of the long-term adjusted AFR, compounded semi-annually, for the month in which the bond is sold shall be used for this purpose. The maximum term for CREBs will be published daily by the Bureau of Public Debt on its internet website for State and Local Government Series securities at <http://www.publicdebt.treas.gov>. Regrettably, the Act requires that the issuer amortize principal on the bonds in a ratable manner evenly over the term of the issue. A single bullet principal payment at maturity is not permitted.

What is the Credit Rate for CREBs?

For each issue of CREBs, a separate credit rate will apply to each of the level annual repayments of principal of the issue. The credit rates will be determined by the Treasury Department based on its estimate of the yield on outstanding AA-rated corporate bonds of a similar maturity for the business day immediately prior to the date on which the CREBs issue is sold. The credit rate is the applicable clean renewable energy bond credit rate published each business day by the Bureau of Public Debt on its Internet site for State and Local Government Series securities at: <http://www.publicdebt.treas.gov>. The Act provides that the Treasury Department is to set the credit rate that will permit the bonds to be sold at par.



O R R I C K

How do the Credits Flow to Investors?

Owners of CREBs will derive a credit from the Federal government on certain “credit allowance dates”: March 15, June 15, September 15 and December 15. The tax credit will be applied by bondowners to reduce an owners’ Federal income tax liability. The amount of the tax credit is also treated as taxable interest income to the bondowner. For example, if a bondowner who is in the 30 percent tax bracket receives a tax credit in the amount of \$100, the bondowner will have taxable income of \$30 and a tax credit of \$100, resulting in a net credit of \$70 to apply to their taxable income.

What Information Reporting Requirements are Applicable to CREBs?

Issuers of CREBs must submit for each issue Internal Revenue Service Form 8038-G, Information Return for Tax-Exempt Governmental Obligations.

Is Additional Guidance Regarding CREBs Forthcoming?

The Notice states that it is anticipated that Temporary and Proposed Treasury Regulations (the “Regulations”) will be issued in the future addressing certain remedial action rules and arbitrage restrictions.

It is anticipated that the Regulations will provide that, for purposes of the requirement that 95 percent of the proceeds of a CREBs issue be used for capital expenditures incurred by a borrower for a qualified project, proceeds of an issue will not be treated as used for a qualified project to the extent the issuer or borrower takes a deliberate action that causes such proceeds not to be used for such a project. The Notice further provides that the Regulations will provide that an action that causes an issue to fail to meet the 95 percent standard is not treated as a deliberate action if (1) the issuer takes a remedial action described in the Regulations and (2) certain other requirements specified in the Regulations are satisfied.

Pursuant to the Notice, Regulations will likely also be issued to cover certain arbitrage-related aspects of CREBs. Among the more significant points addressed in the Notice, it is anticipated that the Regulations will provide that, for purposes of applying the arbitrage requirements of the Internal Revenue Code, assuming certain requirements are met, CREBs may qualify for a 5-year temporary period and the 2-year exception to the rebate requirement will be available.