

Legal Alert:

Congress Approves Creation of Clean Renewable Energy Bonds

August 10, 2005

On August 8, President Bush signed into law the Domenici-Barton Energy Policy Act of 2005 (the "Act"). The Act creates a new category of tax credit bonds called Clean Renewable Energy Bonds ("CREBs"). H.R. 6, 109th Cong. (2005) (enacted) § 1504. These bonds will give electric cooperatives access to incentives comparable to the conventional tax incentives Congress has provided to the for-profit sector to provide clean and renewable generation.

We expect the market for CREBs to be strong. CREBs follow the model of Qualified Zone Academy Bonds ("QZABs"), which have been available for several years. QZABs are issued by state and local governments, who allocate the proceeds to schools for such purposes as renovating facilities and training teachers. The QZAB program has been well received by issuers and financial institutions. Established by the Taxpayer Relief Act of 1997, the QZAB program was originally available only in 1998 and 1999. Congress has since extended the program several times because of its popularity.

The creation of CREBs in the Energy Policy Act of 2005 is a significant development for electric cooperatives. Long advocated by NRECA (among others), CREBs will allow cooperatives to invest in renewable generation facilities at a level comparable to that of for-profit utilities.

The Act establishes a national aggregate limitation of \$1 billion of CREBs that the Secretary of the Treasury may allocate, as it sees appropriate, to qualified projects. CREBs are available for issuance beginning January 1, 2006. The authority to issue CREBs is currently set to expire on December 31, 2008.

The extraordinary capital costs required to install new renewable generation capacity led Congress to provide federal production tax credits to investor-owned utilities and for-profit companies for the development of renewable generation. Electric cooperatives, as non-profit entities exempt from federal income tax, cannot take advantage of these tax incentives. Thus, a

different mechanism is needed to incentivize cooperatives to develop renewable generation. The CREBs provide this mechanism, essentially providing cooperatives with interest-free loans to finance qualified energy projects.

CREBs may be issued by any “qualified issuer,” which includes governmental bodies; the TVA; mutual or cooperative electric companies (either described in Section 501(c)(12) or Section 1381(a)(2)(C) of the Internal Revenue Code); not-for-profit electric utilities which have received a loan or guarantee under the Rural Electrification Act; and “clean energy bond lenders” (such as the National Rural Utilities Cooperative Finance Corporation). At least 95% of the proceeds from the sale of the bonds must be used to finance capital expenditures incurred by a “qualified borrower” on one or more “qualified projects.” Qualified borrowers include mutual or cooperative electric companies, governmental bodies, and the TVA. Qualified projects are defined as projects that would otherwise qualify for the Section 45 renewable electricity production tax credit.

In lieu of the qualified issuer paying interest to the bondholder, the federal government will give the holder of a CREB a tax credit. The amount of the credit will be determined by multiplying the bond’s credit rate by the face amount of the holder’s bond. The credit rate on the bonds will be determined by the Secretary of the Treasury and will be a rate that permits issuance of CREBs as an interest-free loan – that is, without original issue discount and at a zero percent interest rate. The credit will be includable in gross income (as if it were an interest payment on the bond) and can be claimed against regular income tax liability and alternative minimum tax liability.

The use of the bond proceeds is subject to a number of conditions, which mirror similar restrictions applicable to proceeds of tax-exempt bonds. At least 95% of the proceeds from the sale of CREBs must be spent on qualified projects within 5 years of the date of issuance, unless the Secretary of the Treasury allows an extension of such period for reasonable cause. An issuer who fails to comply with the five-year requirement will have to redeem all of the nonqualified bonds within 90 days of the end of the period. Further, within six months of the date of issuance, there must be a binding commitment with a third party to spend at least ten percent of the proceeds. The qualified projects must be completed with due diligence. CREB proceeds may be used to reimburse a qualified borrower for expenses incurred on qualified projects after the enactment of the Act, but only if both the qualified issuer and the qualified borrower adopt official intents to reimburse the expenditures with proceeds of CREBs.



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