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Federal Stimulus Funding, Incentives and Policies for the Biofuels Industry

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Agenda

- Introduction
- Department of Energy Loan Guarantee Program for Biofuels
- Department of Agriculture Programs for Biofuels
- Tax Credits and Other Tax Financing Options
Introduction – Michael Best

- Background of Michael Best
  - Midwest-based law firm – approximately 220 attorneys
  - Represent renewable energy projects in more than 20 states
  - Represent major investors in renewable energy companies
  - Handle all aspects of renewable energy projects
DOE Loan Guarantee Program

- Loan Guarantee Program is administered by the DOE:
  - Section 1703 to Title XVII – passed under Energy Policy Act of 2005
  - Section 1705, amendment to Title XVII – passed under ARRA
  - DOE issued a new solicitation for loan guarantee applications on July 30, 2009 – applies to biofuels
DOE Loan Guarantee Program – Section 1703

Section 1703

- Authorizes loan guarantees for projects that:
  - Reduce greenhouse gases, and
  - Employ new or significantly improved technologies
DOE Loan Guarantee Program – Section 1703

- Finance and Ownership
  - Face value of guarantee no more than 80% of the total project costs, but guarantee can cover 100% of total debt
  - Borrower and other principals must have made or will make a significant cash equity investment in the project
  - Must be a “reasonable” prospect of repayment by the borrower of the guaranteed portion of the obligation and other project debt
DOE Loan Guarantee Program – Section 1703

- Finance and Ownership (cont’d)
  - Must demonstrate sufficient funds from all sources to finish the project
  - Project cannot use funds, personnel or property of any federal agency, instrumentality, personnel or affiliated entity (with certain exceptions)
  - Foreign ownership of project is permissible so long as project is in the U.S. or a U.S. territory
  - Cost of Credit Subsidy Cost is born by applicant (could be significant)
DOE Loan Guarantee Program – Section 1705

- Section 1705
  - Key addition with Section 1703:
    - Credit Subsidy Cost is born by DOE
    - $6 billion allocated to cover Credit Subsidy Cost to support approximately $50 billion in loan guarantees
    - No “innovative technology requirement”
    - Applies to Leading Edge Biofuels Projects
Leading Edge Biofuels Projects means:

- Projects that use technologies performing at the pilot or demonstration scale, which
- Secretary of DOE determines (i) technology is likely to become commercial and (ii) will produce transportation fuel that substantially reduces life-cycle greenhouse gas emissions compared to other transportation fuels
  - “substantially reduces” means DOE will consider the project’s emissions reduction/gallon of gasoline or diesel equivalent replaced and the greenhouse gas reductions/$ loan value and total project costs
  - DOE will use a “comprehensive life-cycle inventory approach”
DOE Loan Guarantee Program – Section 1705

- Other Requirements of Section 1705 Projects
  - Commence construction on or before September 30, 2011
    - “Commence construction on or before September 30, 2011” means:
      - Borrower has received all necessary licenses, permits and local and national environmental clearances necessary to proceed,
      - Borrower has completed all pre-construction design and prototype testing, and
      - Borrower has engaged all required contractors and ordered all necessary essential equipment and supplies so that physical construction of such project has commenced or may commence on or before September 30, 2011

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DOE Loan Guarantee Program – Section 1705

- Labor
  - Project must create or retain jobs in the U.S.
  - Must report number of jobs created and retained by the project ten days after the end of each calendar quarter
  - All laborers and mechanics employed in performance of project, including those employed by contractors and subcontractors, will be paid wages at rates not less than those prevailing on similar work in the locality of the project
DOE Loan Guarantee Program

- Commercialization
  - Should clearly demonstrate that the project is ready to proceed to commercialization

- Site Location
  - Applicants must show that a site has been selected for the named project and that the applicant possesses control of the site (ownership, option to purchase land or lease)

- Lien Priority
  - Proposed change via amendment August 6, 2009
  - No first priority lien requirement, pari passu allowed, Secretary of Energy will decide appropriate collateral
DOE Loan Guarantee Program

- Application Submissions and DOE Due Diligence
  - Applications are broken into two parts: Part I and Part II
  - Application submission dates roll forward
    - Part I for current submission is due no later than 11:59 p.m. E.T. on September 14, 2009; next is October 22, 2009
    - Part II for current submission is due no later than 11:59 p.m. E.T. on November 13, 2009; next is January 15, 2009
      * Last submission date August 24, 2010 and December 31, 2010
  - Applicants may be required to provide oral presentations with each written submission
  - Review by DOE will include significant due diligence by DOE and outside consultants and legal advisors
DOE Loan Guarantee Program – DOE Criteria

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<tr>
<th>Factors</th>
<th>Detail</th>
<th>Weighting</th>
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<tbody>
<tr>
<td>Technical</td>
<td>Technical Relevance and Merit</td>
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<td>Applicant Capabilities, Technical Approach and Work Plan</td>
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<td>Environmental Benefits</td>
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<td>Construction Factors</td>
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<td>Legal and Regulatory Factors</td>
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**TOTAL:** 100.0%
DOE Loan Guarantee Program

Suggestions for a Strong Application (from DOE)

- Financial Attributes
  - Supply and Off-take Agreements finalized
  - EPC Contracts finalized
  - Detailed Construction Budgets
  - Identification of input and feedstock needs and sources
  - Permit and environmental requirements in project timeline
  - Demonstrate access to necessary IP for project including by creditors in the event of default
  - Demonstrate equity is readily available from creditworthy sources which equity is not contingent upon milestones, including obtaining debt financing
  - Have control over project site
  - Prepare a detailed and thorough working financial model
  - Demonstrate how tax credits and certificates can either be used or monetized
  - Provide detailed discussion of markets and competitors
DOE Loan Guarantee Program

Suggestions for a Strong Application (from DOE) (cont’d)

- Technical Attributes
  - Pilot/demonstration plant data – submit a minimum of 1,000 to 2,000 hours of operating data
  - Engineering reports – submit reports that evaluate the technology in the context of the proposed project
  - Technological advantages (for 1703) – submit reports that explain how the technology constitutes a new or significant improvement over existing competing technologies
  - Mitigation of technology risk – discuss how to mitigate the risk that the technology won’t work as intended including alternative scenarios
  - Key staff – clarify roles of key staff, submit biographies explaining experience and skills of staff who uniquely contribute to success of project
USDA 2008 Farm Bill Programs for Biofuels

- USDA 2008 Farm Bill Programs for Biofuels Include:
  - Biomass Crop Assistance Program
  - Repowering Assistance Program
  - Bioenergy Program for Advanced Biofuels
  - Rural Energy for America Program
USDA Biomass Crop Assistance Program – Background

- Assists agricultural and forest land owners and operators with Collection, Harvest, Storage and Transportation (CHST) of Eligible Materials for use in CHST-qualified Biomass Conversion Facilities (BCFs).
- Matching payment of $1 for each $1 per dry ton paid by the BCF
  - Maximum of $45 per dry ton
  - 2-year payment duration
- Not more than 20% of funds utilized will be for matching payments to eligible material owners for the CHST of crop residue from commodities eligible to receive payments under Title I of the 2008 Farm Bill
Eligible Material means renewable biomass, with the following exclusions:

- Harvested grains, fiber or other commodities eligible to receive payments under Title I of the 2008 Farm Bill
- Animal waste and animal waste byproducts, including fats, oils, greases and manure
- Food waste and yard waste
- Algae
USDA Biomass Crop Assistance Program – Qualifying BCF’s

- Facilities that produce or have the potential to produce either of the following:
  - Heat, power, advanced biofuels or bio-based CHST products at the facility itself
  - Fuel or other CHST bio-based products from eligible material, for subsequent sale or transfer to other facilities. Facility agrees to purchase eligible material only on a dollar per dry ton weight equivalent basis
- Facility agrees to purchase eligible material only on a dollar per dry ton weight equivalent basis
- Facility allowed to sell eligible material to other CHST-qualified BCF’s if the facility representative determines the material to be unsuitable for their uses and the transaction is arm’s length
- Facility prohibited from selling it to a third party for subsequent resale back to the same BCF to allow the third party to qualify for CHST matching payments
- Facility allowed to use biomass from own sources of noneligible material biomass or purchasing other noneligible material biomass from other sources for use along with CHST eligible material in the conversion process
USDA Repowering Assistance Program

- Encourages existing biorefineries to replace fossil fuel boilers
- Eligible biorefinery defined as a production facility for bio-based, liquid transportation fuels
- Section 9004 requires USDA to make payments to biorefineries for the installation of new systems that use renewable biomass or for the new production of energy from renewable biomass
- Maximum award is lesser of $5 million or 50% of project costs
USDA Bioenergy Program for Advanced Biofuels

- Program to encourage greater production and use of advanced biofuels including lower-carbon biodiesel and cellulosic ethanol – “advanced biofuel” is defined as fuel derived from renewable biomass, other than corn kernel starch and does include animal waste
- USDA to make payments to advanced biofuel producers to support and ensure an expanding production of advanced biofuels
- Biofuel producers must enter into contract with USDA for production of advanced biofuels and provide records of fuel production
- $300 million in mandatory funding 2009-2012
  - $55 million in mandatory funding provided in 2009
  - Cap – no more than 5% of this funding available to biofuel producers whose facilities have total refining capacity of over 150 million gallons per year
USDA Rural Energy for America Program (REAP)

- Provides loan guarantees, grants or a combination of both to agricultural producers and rural small businesses to help purchase renewable energy systems and/or make energy efficiency improvements
- Includes grants for audits and feasibility studies
- 2009 deadline expired but could be good financing option for 2010
New Federal Tax Initiatives for Biofuels

- New Market Tax Credits
- Tax Credits/Grants to Produce Electricity
- Bonus Depreciation
- Manufacturing Tax Credit
New Markets Tax Credit Financing

- 39% tax credit available to lenders to a biofuels project located in a low-income census district
- The tax credit allows lenders to reduce the interest rate charged
- Loans are typically structured as a 7-year interest-only loan with a fixed interest rate
- Available for financing to any type of biofuels project
Tax Incentives for Production of Electricity

- There are three main federal tax incentives for the production of electricity:
  1. Production Tax Credit
  2. Investment Tax Credit
  3. U.S. Department of Treasury Grants
Tax Incentives for Production of Electricity

- These incentives are relevant to a biofuel producer as a way to fund part of the cost of constructing a facility to burn waste biomass material to generate electricity.

- Production Tax Credit (PTC)
  - Based on electricity produced over 10 years
  - 2.1 cents per kilowatt in 2008 (adjusted annually)
  - Available for projects completed by the end of 2013

- Investment Tax Credit (ITC)
  - Equal to 30% of certain costs of project
  - Credit claimed in the year the project is completed, as long as the project is completed by the end of 2013
Tax Incentives for Production of Electricity

- Treasury Grant
  - A cash payment equal to 30% of certain costs
  - Payment is made in the year the project is completed, as long as the project is completed by the end of 2013
  - Grant application must be submitted by October 1, 2011
Bonus Depreciation

- **Cellulosic Biofuel Plant Property**
  - Businesses can depreciate 50% of the cost of depreciable property placed in service before January 1, 2013
  - The property must be used in the U.S. to produce cellulosic biofuel
  - “Cellulosic Biofuel” is defined as any liquid fuel produced from lignocellulosic or hemicellulosic matter available on a renewable or recurring basis (e.g., switchgrass, corn stalks, etc.)
Bonus Depreciation

- Other Property
  - Businesses can depreciate 50% of the cost of depreciable property placed in service before January 1, 2010
  - Depreciated on regular schedule
Manufacturing Tax Credit

- **Overview**
  - Federal income tax credit equal to 30% of tax basis of property used in certain manufacturing projects
  - Eligible projects are those that re-equip, expand or establish a manufacturing facility for the production of certain properties (including, but not limited to, property to refine or blend renewable fuels)

- Total credits issued to all applicants is $2.3 billion
- Application deadline is September 16, 2009 for first round of credits
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