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about $35 billion for states that have hired financial advisors and taken the step really to move. It is important to watch the legislation. Our job continues to be education and, as often as we can, to speak to policy makers about what the implications are and also the benefits.

MR. ANDERSON: Let's take advantage of the building pool of precedents, of successful stories that we have. Ontario is not that far away. Ontario has a big, robust PPP program. It is a bit of a blind spot for Americans not to look outside US borders. We are not as integrated in North America as we probably should be. There are some good stories there that we can share with state officials.

MR. RYAN: We are encouraged anecdotally by what we see in terms of PPPs being taken seriously and being thoroughly analyzed, which was not happening two years ago. Interest in PPPs is more systemic.

MS. MOSHIASHVILI: We all talk about uncertainties, but these uncertainties create opportunities. People are more focused in the US, and it is a pretty exciting time. ◎

California Rules Worry Out-Of-State Generators

by William A. Monsen and Briana Kobor with MRW & Associates, LLC in Oakland, California

California is tightening the rules on how utilities can use electricity products, including unbundled renewable energy credits, from power projects in neighboring states toward meeting state targets for renewable energy use. The new rules could end up in court over whether they impede interstate commerce in violation of the US Constitution. In the meantime, development of some projects in nearby states has slowed and valuations for such projects have fallen.

The new rules apply to renewable electricity and RECs sold under contracts signed with California utilities after June 1, 2010. Amending an older power contract could subject the revised contract to the new rules.

California's regulations for meeting renewable energy goals are continuing to evolve amidst controversy. A bill the governor signed in April 2011, called SB 2 (1X), increased the amount of electricity from 20% to 33% that utilities and other load-serving entities in the state are required to supply from renewable sources by 2020. Renewable energy currently accounts for 21% of electricity delivered by California's investor-owned utilities to their customers.

SB 2 (1X) reworked the state renewable portfolio standard or RPS program to divide renewable energy products into three categories.

Category 1 is largely electricity from sources inside California or that can be delivered to California. The category includes renewable electricity that is directly connected to a California balancing authority (CBA). Examples of CBAs are the California Independent System Operator, the Sacramento Municipal Utility District and the Los Angeles Department of Water and Power. Category 1 also includes energy that can be directly scheduled from the generator into the CBA without substituting electricity from another source, meaning that the seller must obtain transmission service from its first point of interconnection to a CBA. While firm transmission rights are not required to be considered as a category 1 resource, such transmission rights would make the out-of-state renewable resource more attractive to purchasers in California. Finally, category 1 also includes electricity delivered under an agreement for dynamic transfer to a CBA. Category 1 is aimed at ensuring that electricity generated by the RPS-eligible resource is consumed in real time by California customers.

Category 2 is output from renewable energy resources that has been firmed and shaped prior to being delivered into a CBA. An example of a resource that provides firmed and shaped power would be a wind generator that delivers energy to a third party and then the third party delivers energy at a different time or with a different pattern than the original generation to the ultimate purchaser in California. Even though these types of transactions usually involve out-of-state renewable generation, this is not a requirement for such an arrangement. Since the firmed and shaped energy is delivered with a pre-determined pattern, this product can provide firm energy to the purchaser if the delivering entity obtains firm transmission rights to the CBA.

Category 3 includes unbundled RECs as well as electricity that does not fit in the first two categories.

The following table summarizes the three resource categories:

Breakdown of California Renewable Resource Categories	
CATEGORY 1	Direct connection, scheduling without substitution, or dynamic transfer to a California balancing authority
CATEGORY 2	Firmed and shaped resources delivered to a California balancing authority
CATEGORY 3	Other resources and unbundled RECs

SB 2 (1X) places different limits on the percentage of energy supplied by resources from each category during three compliance periods.

In the early years of the program, SB 2 (1X) allows utilities to meet a larger percentage of their RPS compliance obligations with category 2 and 3 resources such as unbundled RECs or firmed and shaped generation from out-of-state resources. However, the percentage of renewable electricity that must come from category 1 sources, generally sources inside California or that deliver to a CBA directly, increases over time. The three compliance periods are: prior to 2014, from January 1, 2014 through December 31, 2016, and January 1, 2017 and beyond. The figure on page 12 shows the targets for each category for each of the compliance periods.

The level of category 2 and 3 resources — in which most out-of-state resources are expected to fall — declines from 50% of total RPS compliance by the end of 2013 to 25% by the beginning of 2017. Category 3 resources get hit the hardest: an individual utility (such as Pacific Gas & Electric) can meet no more than 25% of its RPS obligations in 2013 from category 3 sources, and this level shrinks to 10% for 2017 and beyond.

These definitions and targets mark a significant departure from California's previous approach. Under the prior RPS rules, there was no required minimum amount of directly connected or dynamically scheduled resources. Also, firmed and shaped resources (now category 2) were key tools for utilities to meet their near-term compliance obligations.

On the other hand, the new RPS law does not present much of a change in the ability of utilities to use unbundled renewable energy credits, called "TRECs," for RPS compliance, at least through the end of 2014. TRECs are renewable attributes associated with generation from renewable resources. However, unlike bundled renewable transactions, / continued page 11

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party to the chargeable transaction is a financial institution established, or deemed to be established, in the European Union. However, at the end of April, the EU Economic and Monetary Affairs Committee proposed that the charge be expanded to include transactions between non-EU parties if the securities being traded are issued by a company in a member state that has opted for FTT. So, by way of example, a securities trade between a US institution and one established in, say, Japan would be subject to the FTT if the traded securities were issued in France. Support for the new proposal within the committee was far from unanimous, but the resolution was eventually passed by 30 votes to 11.

The picture remains confused. Prior to the French elections, Mr. Sarkozy indicated that France might go it alone in introducing a form of FTT later this year, and EU policy makers have been looking to expand the 2011 original proposals.

At the same time, there has been significant lobbying from the financial sector against any form of FTT, and the EU member states with most to lose continue to oppose it.

What is certain is that even if it does go ahead there are many problems still to be resolved: not least the question of how the tax would be enforced where neither party is established in an EU state that has introduced the FTT.

The 2011 proposals provide for joint and several liability so that the EU party to a trade would be liable for the non-EU party's failure to account for FTT, but if neither party is established in a state that has elected to charge FTT, it is difficult to see how the tax could be effectively collected.

RESCISSIONS remain under study.

The US tax authorities have generally let the parties to a transaction rescind it as long as the rescission occurs in the same tax year and the parties are restored to the same position economically as if the transaction never occurred. / continued page 13

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the purchaser of TRECs does not also take delivery of the physical electricity generated by the renewable generator. Until now, the policy of the California Public Utilities Commission has been to allow utilities to use TRECs to meet up to 25% of their RPS compliance obligations through 2013. SB2 (1X) did not change this. However, it did extend restrictions on TREC usage for RPS compliance after 2013. (For a full discussion of California TRECs, see "Using Tradable Renewable Energy Credits in California," by Laura Norin and Heather Mehta of MRW & Associates in the March 2011 *Project Finance Newswire*.)

Help For California Projects?

Among other things, SB 2 (1X) has proven controversial because of the legislation's clear preference for resources from category 1 and the inherent difficulty for out-of-state generators to meet category 1 requirements.

Some opponents of the new RPS rules claim that the law's clear preference for category 1 resources creates an unfair advantage for generators located within (or in close proximity to) a CBA. Indeed, some entities claim that category 1 resources are three times more valuable than category 2 resources and are as much as 40 times more valuable than category 3 resources.

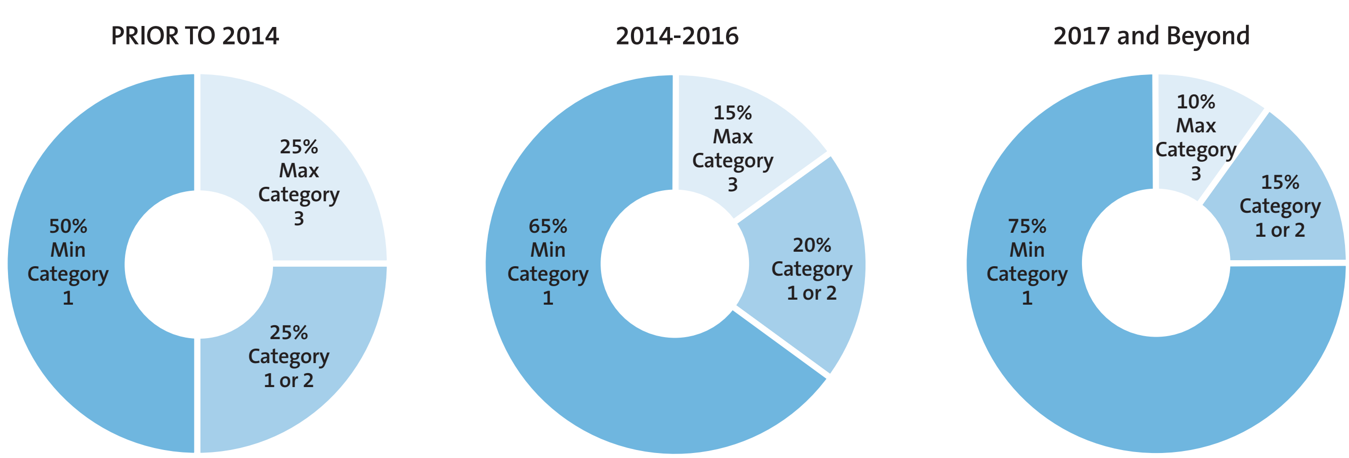
While generators located within or near CBA boundaries would have little trouble meeting category 1 requirements, more distant generators will need to meet the more nuanced requirements for scheduling without substitution or dynamic scheduling in order to qualify for category 1.

Developers working on projects outside of California are concerned that the shrinking percentage of resources from categories 2 and 3 that can be used to meet future RPS compliance will undercut their development efforts.

The Cowlitz County Public Utility District in Washington state suggested to the CPUC in a recent filing that most out-of-state generators will be unable to sign contracts that qualify for category 1 treatment. It said the new rules discriminate against out-of-state generators and, as such, violate the Commerce Clause of the US Constitution.

California is making it harder for power projects in neighboring states to supply renewable electricity and RECs to California utilities.

California RPS Compliance Targets by Category



Commerce Clause

The Commerce Clause bars states from erecting unfair barriers to interstate commerce.

Several groups are supporting the request by the Cowlitz Public Utilities District to the CPUC for a rehearing or reexamination of how the CPUC is implementing SB 2 (1X). The groups are the Western Power Trading Forum, the Alliance for Retail Energy Markets, the Retail Energy Supply Association, and Marin Energy Authority. Two groups are opposing the request: the Independent Energy Producers Association and The Utility Reform Network.

Much of the controversy boils down to whether SB 2(1X), with its limits on different categories of electricity, discriminates based on state lines and, if so, whether any discrimination can be justified by reasons other than economic protectionism. While California generators are more likely to be located in or near a CBA, the boundaries of the CBAs are not drawn on state lines and include interconnection points that extend into parts of Oregon, Nevada, Utah and Arizona. Proponents of the program argue that this means the new rules do not discriminate against out-of-state generators. Opponents say that the requirement for a renewable resource to deliver to a CBA in order to be a category 1 resource is a burden in practice for renewable generators outside California.

Opponents also point to a statement by California Governor Jerry Brown when he signed SB 2 (1X): "This bill will bring many important benefits to California, including stimulating investment in green technologies in the state, creating tens of thousands of new jobs, improving local air quality, promoting energy independence, and reducing greenhouse gas emissions." Many believe that the California legislation is ripe for a challenge based on the Commerce Clause.

Bust for Northwest Renewables

The uncertainty surrounding the new RPS rules in California has helped wreak havoc on renewable energy development in the Pacific Northwest. Between 2005 and 2011, installed wind capacity in the Northwest grew from 1,000 megawatts to roughly 6,000 megawatts. Randall Hardy, a former administrator of the Bonneville Power Administration, said the rush has cooled since California enacted SB 2 (1X). He sees "little or no [regional] renewables development in the next two, three years. There just aren't any buyers out there." With the advantages the California program gives to in-state renewables, developers of renewable resources in

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The IRS may now be having second thoughts about this policy.

It is no longer issuing rulings to taxpayers who want to rescind transactions, and it committed in its annual business plan to issue new guidance by the end of June. However, that guidance is now proving difficult to write.

There is sympathy at the IRS for giving taxpayers the ability to fix mistakes by rescinding transactions, but a subjective test that requires an IRS agent to determine the intention of the parties is hard to administer. There is little sympathy for letting companies do retroactive tax planning.

The IRS associate chief counsel for passthroughs and special industries — the part of the IRS that deals with partnerships and the energy industry — issued five private rulings between 2002 and 2008 allowing rescissions. The associate chief counsel for corporate taxes issued at least 15 rulings between 2005 and 2011. The most recent was in June 2011.

The rescission doctrine dates to a 1940 US appeals court decision in Penn v. Roberston *and a 1980 ruling, Revenue Ruling 80-58.*

TAX-EXEMPT STATUS proved elusive for a solar company.

A US solar company tried to persuade the IRS to treat it as a tax-exempt entity on grounds that it installs rooftop solar systems and provides electricity to low-income people. If the company had succeeded in persuading the IRS, then it would not have had to pay income taxes and anyone making contributions to it would have been able to deduct them. The solar company planned to keep any revenue from selling excess electricity from the systems into the grid.

The solar company kept changing the description of what it planned to do during talks with the IRS. It started with a plan to deal solely with people earning less than $30,000 a year but then changed this to people earning up to 120% of the area median income. The IRS said it did not see how the solar

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the Northwest may see limited opportunities for new power contracts to sell electricity into California. The fact that most utilities in the Pacific Northwest have already procured enough renewables to meet their own states' RPS obligations through 2016 is just another blow to developers in that region.

Some of the more dire predictions regarding the impact SB 2 (1X) might have on renewable generators located far from California may be borne out if the results of the ongoing request for offers from renewable generators by the California utilities are indicative. The most recent news from the Pacific Gas and Electric Company renewable solicitation is that PG&E has decided to remove all proposals to sell PG&E unbundled renewable energy credits from the shortlist. PG&E also removed from its shortlist two offers from out-of-state generators who did not propose direct connection to the California grid.

Market Outlook

To the extent that the new rules restrict the supply of RPS-eligible resources, economic theory suggests that projects that qualify under category 1 will be worth more and there will be a disincentive to develop new projects whose output falls under categories 2 and 3. Even in cases where out-of-state projects can qualify under category 1 or 2, the increased costs of firm or non-firm transmission rights to ensure that these resources qualify may make these projects uneconomic. If prices increase for renewable electricity from out-of-state projects, then this could run afoul with another element in SB 2 (1X): a still-to-be defined cost containment mechanism.

While it is unclear what will happen with the controversy over California's alleged Commerce Clause violation, the new legislation is already affecting the market for out-of-state renewables. California appears to be counting on in-state renewable projects to carry the state's needed renewable requirements, but even the future of these projects remains uncertain due to issues with project viability, interconnection and permitting. ◎

New Debt Instrument Helps Infrastructure Financings in Peru

by Carlos Albarracín and Augusto Cáceres, in New York

Public infrastructure projects are being financed in Peru by bringing in private parties to build, operate and eventually transfer them to the government, but with a special form of debt instrument backed by payment obligations from the Peruvian government that ensures the private party repayment of its construction costs.

The private party is also assured of receiving its operating and maintenance costs over time if revenue from the project falls short of the amount needed to cover costs.

The government experimented with the concessions it awards private developers of large-scale public infrastructure projects for more than a decade before it found a form of concession that works. All of the projects use a build-operate-transfer or BOT model under which the project is eventually transferred to the government after the private developer has been able to get his capital back plus a return.

Experimentation

Peru has been one of the most active and innovative countries in Latin America in terms of developing essential infrastructure through the use of public-private partnerships.

According to data published by Proinversion, a government agency, for the period 1995 through 2011, Peru awarded 73 concessions to private developers for infrastructure projects involving investment commitments of approximately US$14 billion. More than 60% of the projects have been completed and are currently operating. Peru's success in attracting private sector investments to develop public infrastructure projects has been credited by many to the introduction in the early 1990s of pro-market economic policies and a well-designed privatization and deregulation program by former President Alberto Fujimori and the continuation of these policies by Fujimori's successors, Alejandro Toledo and Alan Garcia.

As recently as the early 1990s, substantially all of Peruvian infrastructure and services were owned and operated by state-owned companies, which were poorly managed and lacked funding. These companies had no funding other than govern-

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coal-fired units will need to be idled temporarily in the next few years during installation of pollution controls. The average age of the plants in jeopardy is more than 50 years.

Utility MACT is projected to increase the cost of electricity nationwide by 3%.

Opponents Down But Not Out

Thirty lawsuits have now been filed challenging the utility MACT standards for power plants, including lawsuits by 24 states and various industry groups.

EPA sets limits for each individual pollutant under utility MACT based on the performance of the 12% of US facilities that emit the smallest quantity of the particular pollutant. Critics argue that no single power plant can meet MACT standards set in this way because the standards do not represent the actual emissions reductions achieved by any real plant. In other words, the rule uses a pollutant-by-pollutant approach on a shifting group of best-performing units. Previous efforts to challenge MACT applications in other industries were thrown out on procedural grounds. ◎

— *contributed by Sue Cowell and Andrew Skroback in Washington.*

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