

Production Tax Credits for the Mother Ann Lee Hydroelectric Station

The Mother Ann Lee Hydroelectric Station is considered "New Capacity" because it was retired and an application was made to FERC to surrender the FERC License for the Plant and tear it down by the previous owners, Kentucky Utilities Co. Had we not stepped in and purchased the plant, it would have been torn down and this capacity lost forever. When we purchased the plant, it had been abandoned for a number of years, the equipment was in very bad condition, and it could not be operated without extensive rehabilitation.

FERC will not officially certify the project as "New Capacity", since Congress only charged them with the responsibility of certifying hydro additions and incremental hydro due to efficiency improvements. In Spring of 2007, I attempted to get FERC to officially state that our project was classified as new capacity, but the best I could get was an "unofficial" opinion from Mohammad Fayyad, the FERC person in charge of the production tax credit program. I have attached his e-mail below where he states that in his opinion, we should pursue the production tax credits through "Option #3", which you can see in my e-mail below was calling our project new capacity, since at the time we took the project on, it was no longer capacity available, and without our efforts, it would have been torn down and lost forever. In the FERC Production Tax Credit document, Mr. Fayyad is listed as the contact for questions about the hydro production tax credit. I then asked Mr. Fayyad who at the IRS was knowledgeable about the hydro production tax credit program, and he told me no one was.

In the Summer of 2007, I next discussed this with an attorney at an expensive law firm on K Street in Washington D.C., Nancy Skancke of GKRSE, and she gave me some contacts at the IRS and suggested that I try and get a Private Letter Ruling, though she said it was a long-shot. I spoke to Susan Reaman at the IRS, who bounced me to Tina Hill (202) 283-9774 at the IRS in Washington who deals with tax credit programs. She then referred me to Tim Jones (202) 622-3701, the IRS Chief in Washington that is over the Production Tax Credits. Mr. Jones told me that because of our unique situation, that the IRS would never issue a Private Letter Ruling, since there are not other projects (because of our unique situation) that could use this as a precedent, and thus it was not worth the IRS's time fooling with this. The final suggestion (unofficial of course) from the IRS was to just file for the credits as new capacity and it should go through because of our tiny size (again it is not worth the IRS's resources to even check into it).

We next sought Green-e certification as "New Capacity" explaining our unique situation, and past conversations with the FERC and the IRS, described above. In February 2008, Alex Pennock at the Center for Resource Solutions provided us with Green-e Certification as "New Capacity" on a provisional basis, stating that if the IRS should rule in the future that our plant is not considered as "New Capacity", that our Green-e certification as New Capacity would be revoked at that time.

Thus everyone we talk to "unofficially" agrees that we should be considered "New Capacity", yet there is really no government mechanism to certify that, and of course no one is willing to state anything "officially", due to the unique situation and tiny size. Our only other

option is to hire an expensive attorney to fight this out and eventually force someone to state something officially, but the cost of this might outweigh the value of the credits. As such, we will simply take the Production Tax Credits on our tax forms in the future, and defend them ourselves with the information outlined above should the IRS ever have any questions.

Dave Brown Kinloch
President/CEO
Lock 7 Hydro Partners, LLC

Mohamad.Fayyad@ferc.gov>

To: "David Brown Kinloch" <softenergy@juno.com>

Date: Wed, 14 Feb 2007 12:18:43 -0500

Subject: RE: Renewable Energy Production Tax Credits for Hydropower

Message-ID: <7D46D9456892454B9BCE48AFA7F524D2E6A7BE@wdcxhmb6.ferc.gov>

Mr. Kinloch....

It was nice talking to you and I'm always available for any further discussion. I would like to clarify few points regarding our discussion:

1. Regarding the 3 options you've outlined in your e-mail, I've qualified my position as my personal non-formal opinion. I've said based on your characterization of the situation it seems reasonable to use option #3, and the choice is yours as to which one you want to pursue.
2. I said if you are to pursue option # 3, then FERC has no role to play because we are not mandated to certify addition of capacity at non-hydro dams. FERC certifies only incremental increase in hydropower generation. (Baseline and percentage increase).
3. Regarding FERC's position on the certification process, I explained the information that we require in order to certify the generation baseline and incremental increase in hydropower generation. I said the average generation baseline can't be 0 kwh; it must be estimated based on the manufacturer's design characteristics of the generating units as if they were in normal operating conditions.
4. Regarding the extension of the deadline under the EPAct'05 to Jan 1, 2009, it was signed into law on Dec 20, 2007, as part of the Tax Relief and Health Care Act of 2006 (H.R. 6408).

I hope you find this helpful. I would like to conclude that my expressed personal non-formal opinion is not to be used in any filing or correspondence with the IRS.

Best regards,

Mo Fayyad

202-502-8759

-----Original Message-----

From: David Brown Kinloch [<mailto:softenergy@juno.com>]

Sent: Wednesday, February 14, 2007 11:18 AM

To: Mohamad Fayyad

Cc: bobkatfarm@yahoo.com; dcoyte@juno.com; larryh@srelectric.com

Subject: Re: Renewable Energy Production Tax Credits for Hydropower

Mr. Fayyad,

I want to thank you for taking the time to call me on Monday and respond to my questions with respect to the use of the Renewable Energy Production Tax Credit for our Mother Ann Lee Hydro Electric Station at Lock 7 on the Kentucky River (FERC Project No. 539). In my inquiry to you, which I have attached below, I laid out three options for how our project might apply for this tax credit.

I am writing you to confirm that it is your opinion that our project would not be viewed as an increase in efficiency or capacity at an existing hydro project, since there was no operating or operable hydro at our site at the time we purchased it and the time the legislation was enacted in 2005. As such, Options 1 and 2 that I outlined to you in the inquiry below would not apply. It was your opinion that our site would be considered a "non-hydro dam", since there was no operating or operable hydro at our site at the time we purchased it and the time the legislation was enacted in 2005, and the previous owner had retired the site and had begun the process to surrender the FERC license and tear the facility down. Thus we could apply for the Renewable Energy Production Tax Credit under what I described as Option 3, or adding new capacity to

a non-hydro dam that had a FERC license at the time of the enactment of the legislation. You also told me that applying for the Credit under this option did not require certification by the Federal Energy Regulatory Commission.

You also told me that the deadline for completion of hydro projects that could apply for the Renewable Energy Production Tax Credit was extended in December 2006 by Congress from January 1, 2008 to January 1, 2009.

I think this correctly summarizes our conversation and your opinion on our situation. If I have gotten any of this wrong, please let me know. Otherwise, we will continue to work on the renovation of our project and will apply for Credits as a "non-hydro dam" when we complete our restoration work and get the project on-line. Thank you for your assistance.

David Brown Kinloch

President/CEO

Lock 7 Hydro Partners, LLC

On Fri, 9 Feb 2007 00:22:40 -0500 David Brown Kinloch

<softenergy@juno.com> writes:

> Mr. Fayyad,

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> I am contacting you because you were listed as the contact
> person in the FERC publication with respect to the Renewable Energy
> Production Tax Credits for Hydropower projects. If you are the
> wrong person to be dealing with these questions, please direct me to
> the proper person at the FERC.

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> I am contacting you for some direction on how we would apply
> for certification for our hydro project. I think our situation is
> unique and it is difficult for us to determine if our work would be
> considered an "efficiency improvement", a "capacity addition" at an
> existing facility, or even a "capacity addition" at a non-hydropower
> dam.

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> Our unique situation is this. My company purchased the Lock
> 7 hydroelectric plant from Kentucky Utilities Co. on December 30,
> 2005. The Commission approved the transfer of the license for this
> project (FERC Project No. 539) to my company, Lock 7 Hydro Partners,
> LLC, as well as a change of name of the project to the Mother Ann
> Lee Hydroelectric Station, on November 23, 2005.

>

> The hydroelectric plant we purchased was retired and in very
> bad condition. It has three turbine generators: Unit 1 last
> operated in 1992, Unit 2 last operated in 1994, and Unit last

> operated in 1999. Since each of these units' retirements,
> significant deterioration has taken place. In addition, very little
> maintenance work had been done on this plant in many years.
> Kentucky Utilities Co. had begun proceedings at the FERC to
> surrender the FERC license and tear the plant down on April 1, 2004,
> before we began negotiations to purchase the plant. Had we not
> intervened, this hydroelectric resource would have been torn down,
> and this clean renewable generating capacity would have been lost
> forever.

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> We have been working on restoring this hydroelectric
> generating facility for over a year now. While none of the
> generating units are operational yet, due to the extensive work
> required, we are attempting to get all three units operational by
> January 1, 2008, especially if we can get Renewable Energy
> Production Tax Credits. We have already spent substantial sums of
> money on this project, and expect our investment to be very large in
> 2007 if we are to get the facility operational by the end of the
> year. Receiving Renewable Energy Production Tax Credits would help
> us offset some of these substantial costs and make borrowing money
> for this project easier.

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> Our problem is that we are unsure exactly how to apply for

> Renewable Energy Production Tax Credit certification, since the

> plant is retired and being renovated. Would we:

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> A) Consider our work an "efficiency improvement"? The plant

> at the time of purchase, and at the time of the passage of the

> Renewable Energy Production Tax Credits, can produce no power

> without substantial renovation work. Thus our historic average

> annual generation based on the present condition and taking an

> average of the last 7 years since the plant was retired is 0 kWh.

> If after our renovation work the expected annual output is

> 10,375,000 kWh per year, our efficiency upgrade would be 100%.

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> B) Consider our work an "addition of capacity at an existing

> plant"? The plant at the time of purchase, and at the time of the

> passage of the Renewable Energy Production Tax Credits, had no

> generating capacity that could operate without substantial

> renovation work. The plant was to be torn down by Kentucky

> Utilities Co. before we purchased it. Thus the baseline was 0 KW of

> generating capacity (though licensed for 2,040 KW) since no capacity

> could operate or has operated since 1999. If after our renovation,

> the generating capacity was restored to the 2,040 KW the plant is

> licensed for, our capacity addition would be 100%.

>

> C) Consider our work an "addition of capacity at a
> non-hydroelectric dam". The plant at the time of purchase, and at
> the time of the passage of the Renewable Energy Production Tax
> Credits, had no generating capacity that could operate without
> substantial renovation work. The plant was to be torn down by
> Kentucky Utilities Co. before we purchased it. Thus from the
> perspective of generating capacity, we purchased a plant with no
> generating capacity that was operational, and if we had not
> purchased the plant, this generating capacity would have been lost
> forever. From this perspective, we are adding 2,040 KW of
> generating capacity that our nation would not have unless we took
> the actions that we did. This might be considered a
> non-hydroelectric dam since no generation was possible from this
> site at the time the Renewable Energy Production Tax Credit
> legislation was enacted. The site is licensed (FERC Project No.
> 539), and work on the site will add 2,040 KW of operational
> generating capacity by January 1, 2008. Thus our renovation will
> provide 2,040 KW of additional generating capacity to a dam that had
> no working hydroelectric project.

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> As you can see, our project could fall under any of these
> three categories, depending on how "efficiency improvement" and how

> "additional capacity" at an "existing" or "non-hydroelectric dam" is
> defined. Thus we are requesting guidance from the Commission on
> this matter that can assist us in making the appropriate
> Certification application. If you have any questions, need any
> additional information about our renovation of this retired plant,
> or would like to discuss the project further, please contact me at
> (502) 589-0975. Thank you for your assistance.

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>

> David Brown Kinloch

> President/CEO

> Lock 7 Hydro Partners, LLC