

Byline

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New Coal Ash Standard May Reignite Tax-Exempt Bond Market

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In December 2014, as part of its long-awaited federal standards to regulate the storage and disposal of coal ash,¹ the Environmental Protection Agency issued rules making clear that coal ash would be regulated as a solid waste rather than as a hazardous waste. For utilities and other owners of coal-fired generation plants, the EPA's new standards clarify their ability to finance the disposal or recycling of coal ash through tax-exempt bonds.

Tax Analysis for “Solid Waste” Tax-Exempt Bonds

As a general background, the Internal Revenue Code of 1986, as amended, and related tax regulations provide that tax-exempt bonds can be issued to finance a number of “exempt facilities,” including solid waste disposal facilities. A solid waste disposal facility generally includes any land, building or other property functionally related and subordinate to such facility. In 2011, the Treasury Department issued regulations that redefined a “solid waste disposal facility” to be a facility that processes solid waste in a qualified solid waste disposal process, performs a preliminary function to solid waste disposal, or is functionally related and subordinate to such a facility.

Under the regulations, a facility qualifies as a solid waste disposal facility if it is used in a qualified solid waste disposal process, which includes final disposal, energy conversion or recycling, employing any engineering, industrial or technological method. “Final disposal” specifically includes placing the solid waste in a landfill, including spreading the waste over land in an environmentally compliant manner with no intent to remove it, the incineration of the waste or containment with a reasonable expectation as of the date of issue of the bonds that the containment will continue indefinitely.

A recycling process is one that reconstitutes, transforms or otherwise processes solid waste into a useful product. The recycling process begins at the point of the first application of a process to reconstitute or transform the solid waste into a useful product, such as decontamination, melting, repulping, shredding or other processing of the solid waste to accomplish this purpose.

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The recycling process ends at the point of completion of production of the first useful product from the solid waste.

Because the EPA has now classified coal ash as solid waste, some or all of any facility that is acquired and constructed either to dispose of the coal ash or to recycle it into a different product is eligible for tax-exempt bond financing as a solid waste disposal facility.

Initial Steps Necessary to Issue “Solid Waste” Tax-Exempt Bonds

In order to issue tax-exempt bonds to finance a solid waste disposal facility, the coal plant owner (the “borrower”) must identify a governmental issuer (typically a local or statewide industrial or economic development authority) that would issue the bonds and lend the proceeds to the borrower. In order to preserve its ability to issue tax-exempt bonds and reimburse itself for costs incurred for such a facility prior to the issuance of the bonds, the tax regulations require the governmental issuer to adopt a reimbursement resolution or otherwise indicate its intention to allow the borrower to reimburse itself for costs previously paid out of the proceeds of an eventual tax-exempt bond issue.

Borrowers should consider obtaining such a reimbursement resolution or other expression of official intent to reimburse from the governmental issuer in order to preserve the ability to issue tax-exempt bonds, even if it ultimately decides not to use them. Such an official intent remains valid until 18 months after the facility financed is placed in service or three years after the expenditure is made, whichever occurs sooner.²

Solid waste disposal bonds also require an allocation of volume cap under the tax regulations. Each state has a limit of the total amount of tax-exempt bonds that can be issued for a variety of exempt facilities and industrial development bonds in each calendar year. That limit — or “volume cap” — is calculated under the tax regulations each year.³

Volume cap can either be used in the current year, or, if the state allocation agency permits it, can be carried forward for as much as three years for a particular purpose. Although there is some competition for the volume cap for single-family mortgage bonds and affordable housing, in many states, much of the volume cap goes unused by the end of the year. Therefore, borrowers should consider working with the appropriate governmental issuer to obtain an allocation of volume cap for solid waste disposal bonds to be used to finance disposal or recycling facilities for coal ash.

Most coal plant owners will want to coordinate with experienced bond counsel to accomplish these two initial (and crucial) steps.

Conclusion

Although the EPA’s coal ash regulation has been hailed as a victory for coal-fired utilities and industries that rely on coal, the final rule is nevertheless expected to be costly for many coal plants. The final rule, which becomes effective 180 days following publication in the Federal Register, establishes a comprehensive set of requirements for the management and disposal of coal ash from coal-fired power plants. The final rule, among other things, mandates regular inspections of surface impoundments, establishes technical requirements for landfills, sets out

record-keeping and reporting requirements, and requires closing of certain facility sites that are either structurally deficient or are polluting groundwater.

The EPA's promulgation could have a material impact on capital expenditures relating to coal ash. While reviewing and analyzing the implication of the final rule in detail, coal plant owners should be aware that the final rule provides certain financing benefits by clarifying the ability to finance certain coal ash facilities with tax-exempt bonds. Owners of facilities should consider steps that will preserve their ability to utilize such financing in the future.

¹ "Coal ash" is residue, including fly ash, bottom ash, and boiler slag, that remains after power plants burn coal to generate electricity.

² Those limitations do not apply to preliminary expenses such as architectural, engineering, surveying, soil testing and similar costs incurred prior to the commencement of construction, up to 20 percent of the aggregate issue price of the bond issue.

³ For 2015, that limit is the greater of \$100 multiplied by a state's population (determined on the basis of the most recent census estimate released by the Bureau of Census before the beginning of 2015) or \$301,515,000. Thus, every state will have volume cap ranging from as little as \$301,515,000 for smaller states to as much as \$3.7 billion for California.