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Client Advisory

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Analysis of the TARP: Challenges and Opportunities for Your Business

On October 3, 2008, the Emergency Economic Stabilization Act of 2008 (the Act) was enacted, giving the Secretary of the Treasury (Secretary) the authority, among other things, to implement the Troubled Asset Relief Program (TARP). The TARP allows the Secretary to purchase and insure troubled assets from a range of financial institutions, including, but not limited to, insurance companies and securities brokers and dealers, in order to restore liquidity and stability to the U.S. financial system. The Secretary has published the first requests for proposals for financial agents to perform services to administer the TARP and the first asset purchases are expected to occur soon. More recently, the Secretary has indicated that Treasury will use the Act to invest in financial institutions to bolster their capital levels in order to boost confidence in the stability of the U.S. financial system.

The following is an analysis by Katten's TARP Task Force of the Act and the TARP that provides insight into the specific challenges and opportunities which the TARP creates for clients in different industries and with respect to different issues, including structured finance and securitization; real estate; residential mortgage banking; loan trading; banking; energy; executive compensation; and tax considerations.[1] Although this analysis has been divided into sections separately addressing each of those areas, it should be noted that opportunities and challenges presented in any of those areas may have related effects in other areas, and, therefore, clients are advised to consider each subsection below as part of an integrated holistic discussion.

Structured Finance and Securitization

Purchasing Loans vs. Purchasing Securities

Recently, Senator John McCain and others have proposed that the government purchase up to $300 billion of troubled mortgages and then refinance those mortgages. The Act already gives the Treasury the authority to take that action. The broad definition of "troubled asset" allows the Treasury to purchase mortgage loans,[2] and Sections 109 and 110 of the Act require the Secretary to take a number of steps to use their authority under the Act to avoid foreclosures and to assist homeowners.[3] This proposal, however, does raise the question of whether

1 *A separate Client Advisory, "Summary of Final Legislation – Emergency Economic Stabilization Act of 2008 (EESA) / Troubled Asset Relief Program (TARP)", which summarizes key provisions of the Act and the TARP, is also being published concurrently with this Client Advisory and is available upon request from any member of Katten's TARP Task Force.*

2 *The definition of "troubled asset" under the Act allows the Treasury a great degree of flexibility to purchase either (i) residential or commercial loans, (ii) "securities, obligations, or other instruments that are based on or related to such mortgages" (in each case, as long as those assets were originated or issued on or before March 14, 2008), or (iii) any other financial instrument that the Secretary, in consultation with the Federal Reserve Chairman, determines is necessary to purchase to promote financial stability.*

3 *Section 109 requires the Secretary to (i) implement a plan to maximize assistance for homeowners, including encouraging servicers to utilize the HOPE for Homeowners refinance program to avoid foreclosures, (ii) to coordinate with the FDIC to improve the modification and restructuring process and (iii) to consent to reasonable loan modification requests. Section 110 applies similar requirements to any "federal property manager" which includes the FHFA as conservator of Fannie Mae and Freddie Mac, the FDIC and the Federal Reserve Board, all to the extent that they hold, own or control mortgage loans, mortgage-backed securities or related assets.*

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Treasury should or will focus on loan purchases or security purchases. The Treasury has submitted requests for proposals for financial institutions to act as asset managers for both types of assets, but the answer to this question is unclear. To the extent that loans are purchased that are currently securitized, the related mortgage-backed securities will be impacted in different ways, depending on the particular payment and loss allocation priorities, among other considerations.

Valuation of TARP Assets

Significant questions remain about how assets to be purchased by the TARP will be valued, and how that value will be determined. Section 113(b) of the Act requires the Secretary to make purchases under the Act "at the lowest price that the Secretary determines to be consistent with the purposes of this Act" and to "maximize the efficiency of the use of taxpayer resources by using market mechanisms, including auctions or reverse auctions, where appropriate." However, if the Secretary determines that the use of a market mechanism under Section 113(b) to purchase assets is not feasible or appropriate, the Secretary can make "direct purchases" of assets.

One of the Act's stated purposes is to "restore liquidity and stability to the financial system of the United States." However, another important stated purpose is to "maximize overall returns to the taxpayers of the United States." There is a certain amount of conflict, however, inherent in these stated purposes. Depending on the particular asset type, there is currently a significant spread between the so-called "fire-sale price" of a troubled asset (loosely defined as the price being offered by prospective purchasers of such assets) and the so-called "hold-to-maturity" price (loosely defined as a reasonable price which a purchaser of the asset should be willing to pay, assuming the purchaser is willing to hold the asset to maturity, and assuming reasonable projections about expected future losses).

If the Secretary were to purchase troubled assets through a reverse auction or through a direct purchase at the "fire-sale price," the goal of maximizing overall return to taxpayers would be advanced, but the financial system might be further destabilized, since financial institutions, which are already unwilling to sell, would be forced to realize substantial losses with respect to their positions in troubled assets to the extent they had not already done so. If this approach is adopted, it remains to be seen whether the Secretary will proceed to replenish lowered capital levels of the affected institutions; recent reports have indicated that the Secretary will consider buying preferred stock or perhaps subordinated debt of ailing financial institutions. (Though the authority in the Act for such investments is less clear than the authority to purchase troubled assets, a colloquy between floor leaders has been cited as providing evidence of Congress' intent to confer such investment authority on the Secretary.) Similarly, if the Secretary were to purchase troubled assets at a price close to the "hold-to-maturity" price, the goal of stabilizing the financial system would be furthered (by effectively subsidizing financial institutions), but taxpayers' overall returns would be diminished.

Or an intermediate course might be followed, with the Secretary aiming to achieve a price someplace between the fire sale and hold-to-maturity prices. The key question, of course, is exactly how far up the sliding scale that price will be. The hope is that once a baseline price for certain assets is achieved, other market participants will begin to have confidence in that price, thereby reestablishing a liquid market in these assets, and relieving the government of the need to shoulder a disproportionate responsibility of the need to purchase these assets or to inject capital into financial institutions.

Exit Strategies for TARP Assets

Public/Private Joint Ventures

One possible exit strategy for TARP assets is the sale of assets through joint ventures between private investors and the government. Section 113(a) of the Act requires the Secretary to "encourage the private sector to participate in purchases of troubled assets, and to invest in financial institutions, consistent with the provisions of this section." It is possible that the Treasury Department may attempt to comply with the mandate of Section 113(a) by entering into joint-venture transactions similar to those entered into by the Resolution Trust Corporation (RTC) during the savings and loan crisis.

During that crisis, Katten represented the RTC in the structuring and disposition of the RTC's National Land Fund, which was formed to dispose of billions of dollars of highly illiquid, difficult to value defaulted mortgage loans and REO properties related to undeveloped land. In the first joint-venture transaction done by the RTC, Katten advised the RTC to structure the sales of these assets as a joint venture, pursuant to which the RTC contributed the assets to a limited partnership of which the RTC was the 75% limited partner, and a private investor, chosen through a competitive bidding process, was selected as the 25% general partner. Based upon the winning bid for the 25% general partner interest, the RTC extrapolated the value of the 75% limited partner interest retained by the RTC. The partnership agreement provided that the investor general partner would dispose of the assets as the investor determined (other than pursuant to a bulk sale) and that the proceeds of the sales would be distributed 75%/25% to the RTC and the general partner, respectively, until the initial investment of the parties had been returned, after which the proceeds were shared 50/50, so as to provide an incentive for the investor general partner to pay quickly to the RTC the value of the 75% limited partner interest.

Transactions modeled on the type of joint-venture arrangement described above may be an attractive option for the Treasury as it contemplates possible exit strategies for TARP assets, since they would allow assets to be sold to the private sector on a levered basis, while allowing taxpayers to enjoy a portion of any possible increase in asset value.

Structured Finance/Covered Bonds

Another possible exit strategy for TARP assets would involve the use of special purpose vehicles to issue obligations backed by the TARP assets in a structured finance or covered bond transaction. Section 101(c)(4) of the Act states that the Secretary is authorized to establish "vehicles that are authorized, subject to supervision by the Secretary, to purchase, hold, and sell troubled assets and issue obligations." Although it is unclear exactly how the Secretary might exercise authority under Section 101(c)(4), the plain language of the statute would allow the Secretary to create special purpose vehicles, transfer assets to those vehicles, and issue securities backed by payments on those assets – they very definition of a structured finance transaction. Presumably, the Treasury Department would be mindful of the need to address many of the perceived deficiencies of previous structured finance transactions, such as insufficient transparency, moral hazard caused by originators not retaining enough "skin in the game", and overly complex structures. Notably, covered bonds issuances, popular in Europe and recently promoted by the Treasury Department and FDIC in recent regulatory guidance, squarely address many of these issues. Although such regulatory guidance would need to be expanded, or replaced by a broader statutory framework, in order to allow covered bonds issuances with troubled assets purchased under the TARP plan, it is possible the Treasury Department might look to do so as a way of "issuing obligations" through "vehicles" holding troubled assets.

While it is too early at the present time to predict with assurance the form that such asset sales will take, the structures discussed above and other structures may be utilized to sell troubled assets. It also is interesting to consider whether the government will be competing with itself should the TARP find itself selling assets at the same time the FDIC sells assets in connection with the failure of banks and savings associations.

Residential Mortgage Banking

The Act has far-reaching effects on the residential mortgage banking industry, including loan originators, servicers and investors. Financial institutions electing to participate in the TARP by selling or auctioning mortgages and/or mortgage-related assets to the Treasury will be subject to increased oversight and restrictions, including, among other things, the limits on executive compensation discussed herein. The Act creates the Financial Stability Oversight Board, a Comptroller General, and a Special Inspector General (SIG), each of which have broad oversight over the TARP. However, financial institutions need to be aware that through participation in the TARP, this oversight will extend to the institution as well. For example, the Financial Stability Oversight Board is required to monitor and report any suspected fraud, misrepresentation or malfeasance to the SIG or Attorney General. This function could give the board direct oversight and review of a financial institution's representations with respect to a sale of its assets under the TARP.

Additionally, the market transparency mandated by the Act includes much more than mere disclosure of the Secretary's actions under the TARP. Section 114 of the Act requires the Secretary to disclose to the public a detailed description of any assets acquired under the TARP within two business days of acquisition. This could include information specific to each participating financial institution, including the terms of the purchase and the value achieved by the seller. The Secretary is further required to evaluate whether current disclosures to the public concerning the financial position of participating financial institutions – including information related to off-balance sheet transactions, derivatives instruments, contingent liabilities and other sources of potential exposure – provide a true picture of the institution's financial condition. Upon a determination that additional disclosures are necessary, the Secretary must make a recommendation for supplementary disclosure requirements to the respective regulators.

One of the main goals of the Act – a goal which was repeatedly emphasized by trade organizations and during the Congressional hearings preceding the bill's passage – is foreclosure mitigation for residential mortgage loans. Section 109 of the Act makes it clear that, if at all possible, the Secretary should facilitate loan modifications in order to prevent foreclosures. Further, the Secretary is *required* to consent to "reasonable" requests for loan modifications (where appropriate) under existing investment contracts. The foreclosure mitigation efforts are further extended under Section 110 to "federal property managers," which includes the FHFA as conservator of Fannie Mae and Freddie Mac, the FDIC as receiver and the Federal Reserve. The Act requires these entities to engage in loan modifications and to channel loans, where possible, through the HOPE for Homeowners Program created under the recently enacted Housing and Economic Recovery Act of 2008. The Act also expands the number of borrowers eligible to participate in the HOPE for Homeowners Program (which conceivably will be the target for the vast majority of whole loans acquired by the Treasury) by loosening the debt-to-income ratio requirement and providing the HOPE for Homeowners Board with the authority to increase the maximum loan-to-value ratio permitted under the program, which is currently set at 90%.

The Act discusses principal reduction, rate reduction and term extensions as loan modification alternatives, but the Act is silent with respect to appropriate thresholds for modification. Although the Secretary is directed to take steps to prevent "avoidable" foreclosures, the Act also does not provide insight into the intended scope of this provision. Further, the Act fails to address problems related to loan modification in the event the borrower's residence also is encumbered by a subordinate lien. While the absence of specific loan modification terms may provide the Secretary and federal property managers with increased flexibility in negotiating loan modifications, the language also could be used to justify failed modification discussions which result in foreclosures. Finally, the Act does not specify any type of holding period, during which the Secretary must attempt to modify a loan or work with a borrower to refinance a loan through the HOPE program. Instead, the Secretary has the authority to dispose of an asset immediately upon acquisition under the TARP. Thus, it has yet to be seen how effective the foreclosure mitigation provisions of the Act will be.

A potential issue that did not receive much coverage in the Act concerns a borrower's rights with respect to the original mortgage obligation and certain claims or affirmative defenses related thereto. Pursuant to Section 119, the terms of any residential mortgage loan purchased by the Secretary shall remain subject to all claims and defenses that would otherwise apply, notwithstanding the exercise of authority by the Secretary under the Act. As a result, if the Secretary were to move forward with enforcement of the mortgage instrument, through foreclosure or otherwise, a borrower could assert any applicable defenses to the Secretary's actions. Stated differently, the Secretary would be subject to claims and defenses typically raised by a borrower in an attempt to derail or slow down a foreclosure action (e.g., alleged rescission of the loan based on a violation of the Truth in Lending Act). Section 119 also provides that "any exercise of the authority of the Secretary pursuant to this Act shall not impair the claims or defenses that would otherwise apply with respect to persons other than the Secretary." Arguably, this provision could create continued exposure for a financial institution for consumer claims despite sale of the related asset to the Treasury.

Real Estate

Commercial Property Owners

The TARP does not directly provide any benefits to owners of commercial property (i.e., property other than single family homes and multi-family housing) regarding the refinancing of existing mortgage debt. The TARP may help to reopen the credit markets by providing a mechanism for financial institutions to dispose of troubled assets including securities issued as part of residential or commercial mortgage-backed securities (MBS) and MBS collateralized debt obligations, thereby freeing up resources for new loans. Credit is, however, likely to remain tight and significantly more expensive than over the past five years, with lenders imposing lower loan to value and higher debt service coverage requirements and thus inhibiting the ability of property owners to refinance the full amount of their existing mortgage debt as it matures over the next two to three years. Compounding this problem, with an economic slowdown likely for most of 2009, leasing activity for all property classes is likely to be at a much slower volume and at lower net rentals to property owners, with lower base rent and increased rent concessions and work letter payments. If a property owner's existing financing has not been securitized, and the existing financing is not otherwise in default, the holder of the existing financing will likely be amenable to short term (1-2 years) extensions of the existing financing, with the payment of extension fees and an increase in interest rate. This is especially likely given the limited prospects for a full refinancing and since the foreclosure process is time-consuming and will not necessarily lead to a recovery of the outstanding debt. A loan that has been securitized, however, will be more difficult to work out given the limited ability of the special servicer under the pooling and servicing agreement to effect a workout prior to the maturity date of the loan. In addition, because the securitization documents frequently provide the bondholders and the special servicer the right to purchase a securitized loan at a fair market value (based upon an appraisal), some bondholders and special servicers may see an opportunity to obtain the underlying property at a favorable price. Furthermore, even if a special servicer were to consider a workout, the special servicer may want to seek consent from the bondholders in order to avoid any claims by bondholders that the special servicer inappropriately effected a workout. Given these conditions, property owners may be forced to seek additional equity investments in order to repay existing financing. If the loan is not performing or the underlying property requires investments in tenant improvements or capital expenditures, any workout will be more difficult without the infusion of additional equity.

Distressed Property/Equity Investors

Because the TARP by itself may not provide sufficient liquidity in the credit markets, investors in distressed property will have the opportunity to provide preferred equity or mezzanine financing to property owners that need cash to refinance properties – whether to refinance the portion of the principal that cannot be refinanced in the current market or to provide funds for tenant improvements or capital expenses, or both. In addition, distressed property investors will be able to purchase loans or foreclosed property from the TARP, but these opportunities may be limited at first because Section 113(a)(2) of the Act requires the Secretary of the Treasury to hold assets to maturity or for resale in a market and at prices

that maximize the value for taxpayers and maximize the return on investment for the government. Given these restrictions, the TARP may be reluctant at first to sell assets so as to avoid criticism from Congress and the oversight authorities. Over time, however, as the fees of the asset managers and custodians and other carrying costs begin to mount, the Secretary may be able to justify selling assets prior to maturity. In addition, as loans held by the TARP approach maturity, the TARP, like private holders of loans, will be faced with the inability of borrowers to refinance their loans. Rather than deal with numerous workouts, the TARP may elect to sell the loans to distressed asset investors. Note also that Section 113(a)(3) of the Act requires the Secretary to encourage the private sector to purchase troubled assets, and, if a private market does in fact develop, then distressed asset investors may have an opportunity to purchase troubled assets directly from financial institutions under Section 113(c) of the Act.

Multi-family Property Owners/Operators/Residential Real Estate

Because the Act encourages keeping residential tenants who are current in their leases in their homes, the Secretary may be inclined to provide favorable workouts to owners of multi-family properties that are well run. The Secretary also may decide to sell loans secured by troubled multi-family properties to companies that are capable of taking over the properties from existing owners and injecting the needed capital in the properties. In addition, certain members of Congress are proposing the creation of public-private partnerships that could purchase foreclosed residential real estate with the stated purpose of stabilizing home prices in communities with high concentrations of foreclosed residential real estate. Companies, investors and other market participants that have the expertise and staff to manage residential real estate may have opportunities to enter into such ventures.

Tenants of Commercial Properties

The TARP does not provide any direct benefit to tenants of commercial properties, but given the economic slowdown and the lack of any direct benefits to the owners of commercial properties, strong tenants will be in a good position to enter into new leases or renew leases at favorable rents, with a greater concession package of free rent and tenant improvement allowances. In addition, if a commercial property is foreclosed, the lender is unlikely to evict any tenants that are current in their leases (even tenants that do not have non-disturbance agreements), given the difficulty in securing new tenants.

Financial Institutions/Mortgage Lenders

Financial institutions will have the opportunity to sell their troubled assets to the TARP, but the TARP does contain disincentives to participation in the program. For example, the Act places limits on executive compensation and imposes requirements for warrants or preferred debt to be issued to the Treasury. Another risk faced by a financial institution is the mark to market “loss” that may be sustained by the financial institution in selling its assets to the TARP, although this risk may be mitigated by the provisions of the Act authorizing the SEC to suspend and study the mark to market accounting rules. If a private market develops in troubled assets (and the Act requires the Secretary to encourage the private sector to purchase troubled assets), financial institutions may have the ability to sell troubled assets to private sector purchasers and avoid the limits on executive compensation and the requirements for warrants or preferred debt.

Loan Trading

At this stage, the impacts of the TARP on the loan trading markets appear to be indirect and changes resulting from the promulgation of the Act may take some time to be recognized. Over the past several months, leveraged loan prices have dropped precipitously, driven by the deleveraging of market participants and the resulting lack of liquidity in the markets. Further, banks are still holding loans on their books from the end of the private equity leveraged buyout boom, adding to and exacerbating illiquidity concerns. Although the Secretary technically has the ability to purchase such loans, subject to a determination that it is necessary to do so in order to promote market stability, it remains unclear as to whether such loans actually will be purchased by the TARP.

Banking

Definition of “Financial Institution”

It is important to understand that the term “financial institution,” which in the banking world usually means a bank, savings association or credit union, is more broadly defined in Section 3 of the Act to also include securities brokers and dealers and insurance companies. Also, a “financial institution” for purposes of the Act is one that is “established and regulated” under the laws of the U.S. or any State (including its territories and possessions) and has “significant operations” in the U.S.

Misuse of FDIC Name; False Advertising

Section 126(a) of the Act sets forth prohibitions governing the misuse of the FDIC name and further prohibits false advertising in connection with a representation or implication that a financial instrument is FDIC-insured or guaranteed when in fact it is not. The appropriate federal banking agency, as the case may be, has the power to enforce the prohibition, and the FDIC has back-up enforcement power if the appropriate federal banking agency does not take action within 30 days

of the FDIC's recommendation to take action. The Act also provides jurisdictional clarifications and allows the banking agencies to issue temporary orders and civil money penalties for the purpose of enforcing these prohibitions.

Unenforceability Of Certain Agreements

Section 126(b) of the Act states that no provision contained in any agreement that "affects, restricts, or limits the ability of any person to offer to acquire or acquire, or prohibits any person from offering to acquiring or acquiring, or prohibits any person from using previously disclosed information in connection with any such offer to acquire . . . insured depository institution, in connection with a transaction in which the FDIC exercises its authority under Section 11 or 13 of the FDI Act, shall be enforceable or impose any liability. . . ." Though not free from doubt, it seems that this "no standstill" provision would be limited to situations where the FDIC is seeking to assist with issues facing a bank in distress, as opposed to two healthy financial organizations.

FDIC Insurance of Accounts

A temporary increase in FDIC insurance of accounts, increasing the amount of insurance from $100,000 to $250,000 until December 31, 2009, is set forth in Section 136 of the Act. The FDIC is barred from using this temporary increase for purposes of setting assessments for insured institutions, although it should be noted the FDIC has proposed higher assessments to insured banks pursuant to a recently announced Restoration Plan. Further, the FDIC may request from the Treasury, and the Treasury must approve, loans to the FDIC for purposes of insuring deposit accounts. The borrowing limitations have been eliminated until December 31, 2009. Similar changes were put into place for credit unions.

Executive Compensation

Section 111 of the Act imposes various limits upon executive compensation for financial institutions that sell assets under the TARP, which are generally applicable only to senior executive officers. Some of these limitations are created through modifications to existing compensation rules, such as Sections 162(m) and 280G of the Internal Revenue Code, which govern the deductibility of certain compensation paid by public companies and the tax treatment of change in control "golden parachutes." For TARP participants subject to the executive compensation provisions of the Act, these modifications broaden the rules in several respects by reducing the deductibility threshold to $500,000 (and disallowing an exemption for certain performance-based compensation, such as stock options, from this threshold), expanding the deductibility limits to private companies, and encompassing involuntary severance payments in the scope of "golden parachutes." In other cases, these limitations are being built upon an entirely new framework, such as the ban on incentives involving "unnecessary and excessive risks."

It is not clear whether the executive compensation provisions in Section 111 of the Act will have a significant impact on the financial industry's, or any other industry's, executive compensation and corporate governance practices. Arguably, the Act attempts to target certain perceived abusive or "unfair" compensation practices, such as payment of excessive compensation and overly generous severance packages, particularly when such payment structures do not require outstanding corporate or executive performance. However, it remains to be seen as to how many institutions will ultimately be covered by the Act's executive compensation provisions.

Not every financial institution that participates in the TARP will necessarily be subject to the Act's executive compensation rules. Moreover, not all of the Act's executive compensation provisions will apply to every covered TARP participant. For example, the prohibition on incentives that permit "unnecessary and excessive risks" and the incentive repayment (or "clawback") provisions only apply when assets are acquired under the TARP direct purchase method. In addition, we do not yet know what the penalty will be for providing "risky" incentive compensation or, for that matter, what will constitute risky incentive compensation. Until further guidance is issued, institutions participating in a direct purchase under the TARP should be cautious in structuring their incentive compensation programs.

In the case of a qualifying auction purchase (i.e., a purchase that exceeds $300 million) under the TARP, only new arrangements providing for golden parachutes in the event of an involuntary termination, bankruptcy, insolvency or receivership are prohibited by the Act, and this prohibition only lasts for the duration of the TARP. In addition, existing golden parachute arrangements appear to be grandfathered under the Act, parachutes payable due to retirement seem to be excluded, and it is not clear how a constructive or "good reason" termination would be treated in this scenario. While the deduction limitation provisions applicable to an auction purchase appear to be more expansive, the loss of a corporate deduction may not be particularly relevant to a financially-troubled company, or it may willingly be foregone by an institution either tied into preexisting arrangements or that views it as a necessary cost to the company to attract or retain talented leadership. Further, there are no restrictions on the ability of these institutions to provide tax gross-ups to executives who become subject to the additional 20% excise tax for receipt of certain golden parachute payments specified under the Act.

Energy

Included as Division B of the Act is the Energy Improvement and Extension Act of 2008 (EIEA). EIEA provides energy-related tax incentives intended to encourage the development and production of clean energy, and includes several provisions and incentives related to advanced coal technologies. Specifically, EIEA includes $1.5 billion in new or increased tax credits intended to spur the creation and deployment of advanced coal electricity projects and certain coal gasification projects that demonstrate the greatest potential for carbon capture and sequestration (CCS) technology. Of the $1.5 billion in tax credits, $250 million is reserved for coal gasification projects and the remaining $1.25 billion is reserved for advanced coal electricity projects, including integrated gasification combined cycle (IGCC) projects. These tax credits are to be administered and awarded by the Treasury Department through an application process that give highest priority to applicants that demonstrate the greatest carbon dioxide (CO_2) sequestration percentage. In order to qualify to apply for a credit, a coal electricity project must capture and sequester at least 65% of the facility's CO_2 emissions, and a coal gasification project must capture and sequester at least 75% of the facility's CO_2 emissions.

Another advanced coal technology-related provision in EIEA is a new CO_2 capture credit. Under the CO_2 capture credit provision, a qualifying facility will receive (i) a $10 credit per metric ton of CO_2 captured and transported from an industrial source for use in enhanced oil recovery and (ii) a $20 credit per metric ton of CO_2 captured and transported from an industrial source for permanent storage in a geological formation. In order to qualify for this credit, which applies only to CO_2 used or stored in the United States, a facility must capture a minimum of 500,000 metric tons of CO_2 per year.

The tax credits described in the preceding paragraphs are intended to provide positive incentives to encourage investment in clean coal technologies. It is probable that an array of business and investment opportunities could result for companies and investors involved or interested in advanced coal technologies, such as CCS and IGCC. Merger and acquisition activity within the coal industry, the development of new coal fields, and equity and debt investment in coal-fired electric generating plants may all, in the future, be affected in part by the extent to which cost-efficient clean coal technologies are able to be successfully deployed as global warming and other environmental pressures impact the use of coal as a future source of energy feedstock.

Tax Considerations

Beginning in 2007, tax return preparers were subjected to a more rigorous standard than their clients for purposes of penalties for positions taken on tax returns without special disclosure that results in an understatement of tax liability. Penalties for preparers were significantly increased. Further, proposed regulations have been issued elaborating how "non-signing" practitioners giving advice with respect to items representing a substantial portion of a return can also be penalized. To help ameliorate some of the concerns this raised in the tax profession, Section 506 of the Act provides that a tax return preparer, like the taxpayer, need only have "substantial authority" with respect to any undisclosed position taken on tax returns to avoid return preparer penalties where tax shelters and reportable transactions are not involved.

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