

CEO View on Washington: Much to Be Done

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In February, I had the privilege of chairing a panel of wind energy chief executive officers at the American Council on Renewable Energy RETECH 2010 conference in Washington, DC. The panelists were Eddie O'Connor, CEO of Mainstream Renewable Power, a European developer engaged in offshore and onshore wind (and commencing activities in the States); Peter Duprey, CEO of Acciona North America, a European owned wind and solar developer in the US; Paul Gaynor, CEO of First Wind, a private equity backed wind developer in North America; John Langdon, CEO of Viryd a small wind technology company; and Bruce Bailey, CEO of AWS Truwind, a well-known engineering and consulting firm.

Given the conference was in Washington, the discussion focused on policy and regulation. Two headline issues for these chief executive officers were: 1. the need for improved incentive programs for wind and other renewable energy projects; and, 2. the need for improved transmission and grid integration regulation.

Eddie O'Connor laid the groundwork with a comparison of the European incentive programs. Major European wind nations have provided cash-based incentives such as the German feed-in tariff or the UK renewable energy certificate regime. Peter Duprey highlighted the feed-in tariff transmission and permitting regime in Ontario as being a good North American model. The advantage of the feed-in tariff is in its simplicity: wind projects are paid a set price in cash for production (which may vary offshore versus onshore). Wind, therefore, is not taking the risk of fossil fuel cost variability (i.e. being competitive in high, natural gas price periods and less competitive in low-price periods), nor is the subsidy hidden and potentially skewed as with tax based incentives. The feed-in tariff is very financeable with a broad

range of sources and has proven to permit the use of a high level of low cost debt—making the overall cost of project capital cheaper.

The US federal incentive system is largely tax based, using production or investment tax credits, as well as accelerated depreciation. Though the incentives are beneficial, they can only be used by developers that are large, public companies with US tax liabilities. The tax equity market developed to monetize tax benefits for all the other developers that cannot use them. These developers are both large, non-US companies, as well as smaller, US-based developers. In those tax equity transactions, wind developers sell interests in renewable energy projects to investors with the price, taking into account the value of the tax benefits allocated to the investor. United States tax rules restrict the use of tax benefits to large, tax paying companies and, within that universe, not all companies are interested in the energy sector. As a practical matter, the tax equity market has been limited to financial institutions, life insurance companies, and utilities. Because of the relatively limited number of investors, the cost of tax equity is relatively expensive when compared to debt, and the transactions are relatively expensive to document.

The financial crisis in the US significantly reduced the amount of tax equity. Concern over the inability to finance renewable energy projects was in part addressed by Section 1603 of the American Recovery and Reinvestment Act of 2009. Section 1603 permits a wind project developer to elect to receive a Treasury grant for 30% of eligible costs in lieu of an investment tax credit or production tax credit. This program has resulted in over \$2.4 billion being paid to renewable energy projects. But, the program is only available for projects commencing construction by the end of 2010. The question then is: what's next? The

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tax equity market is still not fully recovered. Congress is being asked to consider an extension of the grant. Congressman Earl Blumenauer, together with cosponsors from the House Committee on Ways and Means recently introduced H.R. 4599, the “Renewable Energy Expansion Act of 2010.” Under this bill, the Treasury grant would be replaced by a refundable investment tax credit that would apply to projects commencing construction in 2011 and 2012, and include a number of features applicable to the Section 1603 grant program. The RETECH panelists expressed concern over the changing terms of, and potential delay in extending, the incentive program. The result of delay may be that developers will be compelled to accelerate projects in 2010 that might otherwise have been brought to construction in the following year. This outcome might be good for jobs in 2010, but this approach will increase costs given the impact of accelerated demand on equipment, people, and capital.

In summary, the US historically has used tax-based incentives for renewables. That approach was changed in light of the financial crisis. A period of uncertainty is approaching where the current grant program may expire or be subject to extension. The chief executive officers emphasized the need for consistent and long-term incentive policies with a preference for cash-based incentives. Changing the rules every year does not work. But there is a hope that in the next year or so there will be the opportunity for improvement in the federal incentive regime. Though a feed-in tariff might be preferred to a tax-based incentive system, such a system at the federal level has yet to gain legislative traction. On the other hand, a national renewable portfolio standard, which should result in renewables pricing competitively against similar technology (over time resulting in pricing that is not fossil fuel based), is a possibility, as it was included in the Waxman Markey bill passed in the House and versions of the Senate energy bills proposed last year. A national RPS and a phase out of tax incentives should result in the longer term with power purchase agreement pricing correlated to renewable energy production costs (including cost of capital), which pricing would provide a financeable cash flow stream similar to a feed-in tariff.

Transmission was a theme running through all the presentations. Bruce Bailey summarized the results of the NREL Eastern Wind Integration and Transmission Study (EWITS), published in January 2010. The study examined the feasibility of penetration of 20% to 30% of wind in the Eastern Interconnect—approximately 225,000 to 330,000 MW of wind. The conclusions included that wind integration at that level was feasible, but transmission investment was key. The ability to bring wind from the western part of the Eastern Interconnect, as well as from offshore installations, would mean that a high penetration of wind would be feasible and include the benefits of geographic diver-

sity of wind resources. The study indicated a high penetration of wind might include a cost of intermittency of about \$5/mWh (but as one speaker noted this might be set off against the value of wind as a hedge against fossil fuel volatility, not to mention greenhouse gas reduction).

The challenge of transmission is that it is difficult to license, expensive, and politically charged. It takes much longer to plan and build a transmission project than it does to do the same for wind farms. Trans-state or regional transmission lines face even more complicated permitting and political hurdles. As a consequence, wind farms get built but are curtailed (as has been the case in West Texas), or they cannot obtain financing because of the curtailment risk. To achieve 20% wind by 2030, the federal government needs to act as decisively as it did with the National Highway System, and treat national transmission development as a national priority and not a matter of local convenience.

The development of interconnection policy will aid both large- and small-wind projects. Permitting and interconnection rules and costs remain a challenge to the growth of distributed generation, as well as utility scale projects. The clear goal for the wind industry is to support a coherent national policy on transmission siting and permitting, including federal licensing with the power of eminent domain. Add federal funding and guarantees, and the country will see transmission construction proceed at a record pace. However, industry leaders are also aware of the complicated politics around transmission, and recognize that the desired goals may not be politically achievable.

The panel concluded with a question on the opportunities for offshore wind in the US. The EWITS study includes an aggressive case with up to 79 GW of offshore wind. The developers on the panel were not especially optimistic about offshore wind given the strong onshore resources and markedly lower costs of construction. But, the development of the best onshore resources depends on the ability to access load centers, and one’s assessment of the likelihood, timing, and cost of major national transmission development. The competitiveness of offshore wind very much depends on the assumptions made about the ability to construct a transmission superhighway, and to deal with congestion into load centers in the Northeast specifically. To the extent that national transmission policy does not evolve, and transmission is not built, then the window for offshore wind may be open. Although this might not be the view taken by this panel of executives, the continued development of projects by Cape Wind, Bluewater, and others tells us there is another point of view.