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Wind Farm Development: Efficiently Capturing Governmental Incentives in Project Contracts

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One key to the profitable development of wind energy projects is getting the maximum benefit out of available governmental incentives. Despite the incredible increase in wind energy development in the U.S. in the past decade, the industry has not developed standard processes to capture these incentives through contractual requirements. This is a result not only of the uncertain and ever-changing regulatory environment that characterizes the U.S. wind industry, but also of the complex array of government requirements that developers must navigate at federal, state, and local levels in order to benefit from incentives. Even after applicable incentives are identified, developers must often follow complex procedures to claim them on a timely basis. Frequently, this will require significant cooperation from a project contract counterparty. If any of these procedures are not incorporated into project documents and necessary cooperation is not secured in a timely fashion, incentives may be permanently lost. This article highlights the nature of some key incentives and suggests efficient approaches in project contract negotiation to enable companies involved in the U.S. wind industry to harness these benefits in an efficient manner.

Federal Incentives

Under the current regulatory regime, some of the key federal incentives (as set forth in the American Recovery and Reinvestment Act of 2009) include the Production Tax Credit, the Investment Tax Credit, and the Cash Grant option. These types of federal incentives are often temporary in nature and, as a result, contain deadlines that have to be met in order to claim the benefits. Whether deadlines are tied to wind farm "in-service" dates or have optional deadlines relating to commencement of construction or the related expenditure "safe harbor" rule (in the case of the Cash Grant option), owners and developers should identify them as early as possible, ideally prior to contracting with major project counterparties. Though relatively straightforward, the process of identifying key deadlines often occurs late in the development process as developers weigh competing incentives against anticipated construction schedules.

Once applicable deadlines have been identified, developers should carefully identify all project counterparties whose cooperation is necessary to ensure the deadlines are met.

- If a developer's goal is to meet the in-service deadline for one of the federal incentives, the relevant project participants are likely to be the project engineer, the turbine supplier, the balance of plant contractor, and/or the transportation and installation contractors (if separate entities). Each of these parties contributes directly to the overall project schedule and, thus, to the ability of a developer to achieve any deadline tied to a federal incentive. Moreover, their completed work is often a prerequisite for the completion of work by other contractors. As a result, a delay in their respective portions of the work is likely to have ripple effects on other contractors at the site.

- If a developer's goal is to commence construction by the specified deadline under the Cash Grant option, the key counterparties are likely to be the project engineer, the balance of plant contractor, and/or the turbine supplier. Under current Treasury Department guidelines, for example, construction is deemed to have begun once physical work of a significant nature begins. For wind farm development, this includes on-site tasks such as those relating to foundation construction or certain off-site activities such as the manufacture of wind turbines for on-site delivery and assembly. In these cases, the focus is on when certain activities are commenced, not when the eligible project is placed in service.
- Finally, if the goal is to qualify under the Cash Grant option's "safe harbor" expenditure rule (which states that construction will be seen as having commenced once more than 5 percent of the total cost of the eligible facility has been paid or incurred), the key counterparties are likely to be the turbine supplier and balance of plant contractors. They typically hold the "big ticket" project contracts with the highest total value and are also the most likely to have front-loaded payments sufficient to reach the 5 percent threshold.

Once the relevant incentives, deadlines, and counterparties have been identified, the corresponding project contracts should be carefully structured, and the parties should be incentivized appropriately to take the steps needed to obtain the incentives. This structuring should involve several steps:

- An owner/developer should communicate the applicable incentive and deadline to each relevant project counterparty as soon as possible. All too often this is done in a cursory manner without careful thought as to how the deadline may impact certain key terms such as the contractor's schedule, payment structure, and bonus and liquidated damages rates. This can result in inaccurate bid responses, inefficient contract negotiations and increased costs and delays as the project progresses.
- Often incentives require compliance with very specific regulatory paperwork and procedures. When an owner/developer needs a project counterparty to assist in or be responsible for compliance, the requirements should be clearly detailed. It is useful to involve legal counsel early to avoid any missteps in documenting the requirements.
- Furthermore, in circumstances where guidance from federal entities is forthcoming or may be modified, flexibility should be provided in the project contract for updates to incentive rules and procedures. If new rules or procedures are issued after the execution of the contract, and they materially increase contractor cost or schedule obligations, change orders should be provided as appropriate, but contractors should be held to a binding commitment to follow the procedures even as they may change over the course of a project.
- Owners/developers and their counsel should draft forms of certifications or similar documentation that they need project counterparties to submit to a governmental authority, and those should be attached to contracts when

possible. Providing clarity on this topic up front can not only avoid misunderstandings (and corresponding delays) over what is required from contractors but can also help the counterparty accurately schedule and price its work to meet such deadline.

- If a project counterparty has critical path obligations to achieve a deadline for an incentive, that contractor should be incentivized beyond traditional default remedies. Though there is a wide range of contractual possibilities, some common tools are the use of bonuses, liquidated damages, indemnifications, insurance, contingencies, and/or other security structures. The amount at stake should be reasonable and proportionate to the materiality of the critical path obligation at stake. Delay liquidated damages, for example, have been common in turbine supply agreements and construction contracts for a long time. It is rare in the current market, however, to find liquidated damages carefully tied to a federal incentive in amounts that are proportional to the value of such incentive. Many will recall the time when owners held contractors responsible for Production Tax Credit liquidated damages if PTCs were not received as the result of the contractor's delay. A similar concept (perhaps coupled with corresponding bonuses and/or in lieu of more traditional delay liquidated damages) may help achieve greater efficiency in today's market. Some developers have already been mulling these options for use on future projects.
- If the developer is seeking funds under the Cash Grant option, careful consideration should be given to construction schedules (in the case of balance of plant contractors), manufacturing schedules (in the case of turbine suppliers), and payment schedules (in the case of the safe harbor rule). If such work or payments will occur near or after the deadline for applying for the Cash Grant option, consideration should be given to alternate schedule and cost structures, as well as related concepts such as title and risk of loss.

State and Local Incentives

In addition to incentives available at the federal level, state and local governments offer a vast array of programs promoting wind farm development within their jurisdictions. Although these vary greatly from jurisdiction to jurisdiction, some of the more common incentives include:

- sales/use tax exemptions;
- state corporate tax credits;
- property tax incentives;
- rebates, grants, and loans; and
- renewable portfolio standards and production incentives.

Due to the variation in each state and locality, owners/developers and their counsel and accountants should identify available incentives as early as possible in the development process. Ideally, these would be identified even before starting the bid process for consultants, suppliers and contractors. Major counterparties will be somewhat familiar with the range of federal incentives available. Most will not, however, be intimately familiar with those at the state and local level for a specified project unless they have already been part of a properly structured project in that particular area. As a result, careful attention should be paid to any incentives that will require some level of action or participation from project counterparties. Developers can save delays and extra costs down the road if they are able to disclose and describe requirements for state and local incentives (and any contractor-related requirements that often accompany them) in bid documents.

In addition to identifying applicable state and local incentives to counterparties early on, project contracts should provide the detailed procedures such contract counterparties must follow in order to secure them. For example, sales and use tax exemptions often require contractors to present specific certificates (and perform related procedures) at the time of purchase of qualifying materials. In some states, if such procedures are not followed at the time of purchase, it can be costly and difficult, if not impossible, to later secure tax exemptions. As a result, developers should provide step-by-step instructions in the applicable contract and contractors should bear the impact of failing to follow such steps. Because many counterparties are national firms operating in many states and are often not familiar with local incentives, they should be entitled to rely on the procedures set forth in the contract by the developer and should not be responsible for any errors or omissions contained in such procedures.

Finally, many state and local incentives require extensive interaction with governmental officials and sensitivity to state and local issues. Special permits, certifications, and periodic reporting are often required by state and local governmental authorities. Sometimes these actions can be performed by owners, but often it makes sense or may be required for contractors to be involved. Often many of these requirements need to be met long before a counterparty begins its work on a project. Developers should be mindful of these requirements and include them in bid packaging and contracts and require cooperation from the contractors at all phases of the project, as appropriate. It is often important, however, to require all contractors to communicate with government officials through the owner or a project manager to avoid confusion or inconsistencies.

Efficiently Contracting for Incentives

Developing a wind farm is a complex process requiring the integration of a number of third parties such as engineers, contractors, and turbine suppliers/erectors. Fully capturing available federal, state, and local incentives will require communication, cooperation and some flexibility. Owners and developers should not rely on ad hoc solutions after bids are placed and contracts are signed, because that will increase transaction costs and the risk that certain incentives will be permanently lost. Anticipating and proactively taking industry-standard approaches to documenting deadlines and procedures and motivating all parties involved to comply can increase efficiency and return in wind farm development.

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