

Moving Toward Efficient Risk-Sharing For Wind Farms

Law360, New York (December 22, 2011, 1:56 PM ET) -- Despite recent economic, technical and regulatory challenges, the wind energy industry in the United States has grown tremendously over the past decade.

Even with this growth and the accumulation of much experience, one frequent hurdle to launching new projects quickly is late-starting, long-lasting and inefficient negotiation of design and construction contracts.

Parties often begin negotiations after design and/or construction work is already underway, leaving everyone in a difficult negotiating position. As a result, difficult negotiations may produce ad-hoc documents that are inappropriate for the particular project.

In addition, contracts end up bearing little similarity from project to project, which can present conflicts, increase costs and complicate efforts to obtain financing and investment.

A primary roadblock to making this process more efficient is the difficulty in allocating certain risks between owners and their contractors.

This article highlights key risk-sharing areas and offers suggestions to proactively address these areas in negotiations, thereby increasing efficiency in the contracting process, and ultimately, in the development of wind farms.

Efficient Risk Allocation

Efficient and fair risk allocation can speed development of a wind-power project. In this respect, wind farm development is no different than any complex project in any sector, such as infrastructure, traditional power, oil and gas, transportation or telecom.

Some key design- and construction-related risks that tend to dominate contract negotiations include the following:

- Schedule and delay risk;
- Risk of variance between design/construction assumptions and reality;
- Liability/indemnity risk;
- Tax/permit risk; and
- Safety risk.

Owners and contractors address these risks in the negotiation of any design/engineering contracts for a wind-power project. Agreeing on fair positions quickly can speed development and save costs.

However, the array of parties performing work at each project site, including, just to name a few, surveyors, engineers, construction contractors, electrical contractors, specialized subcontractors, turbine installers and turbine suppliers can make this more complex.

Sometimes construction-related tasks are performed by only one or two contractors; sometimes they are each performed by a separate contractor.

Moreover, there is wide variation in expertise among owners. Some owners have the know-how to perform certain major design and construction tasks in-house, while others rely almost exclusively on contracted expertise.

Due to this variation in parties and capabilities, it takes a deliberative process and experienced legal counsel to efficiently and effectively allocate design and construction risk for a wind-power project.

And as projects vary widely from one another, the hard-fought contractual arrangements for one project are unlikely to be a perfect fit for another project if the constellation of parties and capabilities differ significantly. As a result, negotiating parties must pay careful attention to the various contractors who will be working at the site and the unique nature of wind power projects.

In particular, critical negotiation topics include the following:

Schedule and Delay Risk

One of the most visible risk-allocation issues relates to the schedule for development of the wind power project.

From the owner's perspective, timing is of course critical. As described above, there can be many parties performing work at the project site. In most cases, the success and efficiency of the work to be performed by these parties is highly dependent upon timely completion of work performed by other parties or the owner.

One objective is to create a schedule for the overall development of the project and identify critical milestones at the "interface points" between the schedules of each individual party.

Another concern for both owners and contractors is attaching certainty to each party's schedule obligations.

For a variety of reasons, owners want to be sure that schedules are met. Contractors also want certainty to ensure that their exposure is known and limited, and also to make sure that they are not held responsible for the delays of the owner or other contractors.

As a result, reasonable liquidated damages should be negotiated for contractor milestones that are “critical path” to the completion of the wind-power project, and the amount of such damages should be carefully calculated based on projected actual harm, not simply pulled out of the air or based on dissimilar projects.

Depending on the business deal and on the value of early completion, reasonable schedule bonuses can also be an efficient way to advance the agreed project schedule. Contractors should also receive an equitable schedule adjustment for any material and adverse delays directly caused by milestones missed by other parties not under their control.

Due to the highly interactive nature of wind farm construction, however, immaterial delays and interactions among parties should be expected and tolerated without schedule adjustment.

Design and Construction Assumptions

Another key to successful wind farm development is ensuring what looks good on paper matches reality at the project site. Assumptions are often made at the planning level that turn out to differ from actual conditions at the site. This is particularly true for design and construction assumptions.

Most design and construction assumptions originate from development studies performed for the wind farm. A first step, therefore, is determining who will be responsible for performing these studies.

Some are traditionally provided by owners, such as site plans and archaeological and environmental studies, while others are usually contractor-performed, such as surveying and labor/materials investigations. Finally, there are a group of studies that may be performed by either party, such as geotechnical investigations and wind turbine transportation studies.

When deciding who will undertake the various studies, the parties need to also agree who else can rely on them and with what effect.

In general, owners are hiring contractors as design and construction professionals. As a result, owners in these situations should be entitled to rely on contractor-performed studies and hold contractors accountable for any inaccuracies contained therein.

Moreover, owners should also be able to require contractors to review owner-provided studies and, where necessary, conduct further investigations reasonably necessary to confirm the assumptions contained therein.

There are many circumstances, however, in which it is more efficient and appropriate for contractors to rely on owner-provided studies, performed by the owner or other contractors.

Regardless, the owner’s expectations should be made clear in requests for bids, so that contractors know what is expected, and can price and schedule for the task requested of them.

Finally, once these issues have been negotiated or clarified, the parties should determine how to handle situations where actual site conditions differ from the base assumptions.

Contractors should generally be entitled to an equitable schedule and/or cost adjustment for the impact of the difference unless the difference should have been reasonably foreseen. Otherwise, contractors will need to correct any work at their own cost and schedule risk.

Indemnifications and Liability Caps

A key goal of each party to a wind farm design or construction contract is to limit its risk exposure. Two ways of doing so are indemnifications and liability caps.

The appropriate scope of indemnifications is dependent upon the nature of work to be performed and the various roles of parties working at the site. Indemnifications for wind farm projects usually cover a wide variety of topics, such as those relating to third-party bodily injury and property damage, intellectual property, hazardous materials and title/liens.

These indemnifications should allocate risk to the party in the best position to minimize such risk, thereby reducing the overall risk profile of the project and heightening the chances of success.

All too often, however, indemnification provisions are seen as “form” or “boilerplate” language that cannot or should not be changed, regardless of the circumstances on the ground.

A more efficient approach would recognize the fact-specific nature of these indemnifications and their exclusions and carefully allocate risk in a way best suited to the individual project.

In addition, risk exposure is often limited by liability caps. These caps can be, for example, sub-limits on certain liquidated damages or provide an overall limit on all liability under the contract. While the negotiation of the actual limit is primarily a commercial decision, the legal issue is the nature of any carve-outs to such limits.

In other words, while liability caps enhance certainty by limiting exposure, there are still some risks for which a party should nevertheless remain fully responsible.

At a minimum, for example, parties should not be entitled to limit liability stemming from fraudulent or unlawful acts, gross negligence or willful misconduct, or that is covered by their indemnification obligations relating to third-party bodily injury or property damage.

In many cases, depending on the outcome of the indemnity discussions mentioned above, it may be appropriate and fair to exclude additional indemnities from the overall liability cap. Negotiating which risks can be limited and which should remain unlimited can be a difficult task, but one that is necessary to successfully allocate and mitigate risk.

Taxes

Another important contracting element in wind farm development is allocating the responsibility for taxes. Although tax responsibility is an issue in many types of contracts, it is of particular importance in the wind sector due to the myriad applicable taxes, exemptions and credits, particularly at the state and local level.

First, contracts — and bid requests, to the maximum extent possible — should identify and allocate responsibility for anticipated taxes and remedies associated with an inability to achieve expected tax benefits and treatments.

Failure to openly discuss and allocate taxes can result in a contract price that does not reflect the true cost of performing the work. In some instances, this can be a significant and costly oversight, leading to disputes.

Second, all relevant tax exemptions should be disclosed as early as possible, and, at a minimum, should be clarified in the relevant contracts. Taxing authorities frequently encourage renewable energy development with sales tax exemptions, use tax exemptions and/or enterprise zone programs, among others.

The procedures required to secure such exemptions can often be detailed and, in some cases, difficult to identify with full certainty. This is particularly true if the exemption is provided to the owner of the project but it is a contractor who is procuring relevant exempt materials.

If materials aren't purchased using the appropriate procedures and documents, the exemption may be permanently waived. To avoid this, the relevant contract should clearly list the exemptions and required procedures. To the extent work begins before a contract is signed, such exemptions and procedures should be disclosed in writing to the contractor.

If the contractor follows the procedures, it should not have any liability for the owner's failure to secure the exemption for any other reason. If not, however, the contractor should bear the financial responsibility for any lost exemption.

Finally, in addition to typical taxes and tax exemptions, any tax credits or other incentives should be addressed in a proactive manner. It is important to recognize the conditions surrounding tax credits and incentives and how each party's obligations are tied to such conditions.

In particular, careful attention should be paid to scheduling so as to ensure construction has commenced and/or wind turbines are placed in service, as appropriate, before any relevant federal incentive expiration date, and that proportionate remedies are negotiated for missed deadlines or any failure by a party to follow procedures necessary to achieve beneficial tax treatments.

Safety

Allocating responsibility for site safety is a key issue for ensuring the successful completion of a wind project. Safety responsibility can give rise to both contractual and regulatory, e.g., Occupational Safety and Health Administration, consequences.

As mentioned above, there are often multiple entities engaged in construction or development activities at the site. At any given time, for example, there could be construction activity at the site by the owner and its subcontractors, the turbine supplier, the turbine erector, the transportation company, the utility and the balance of plant contractors.

Primary safety responsibility can rest with one party or can be divided among multiple parties. If there is a true "balance of plant" contractor, i.e., one performing most of the work at the site, it should take responsibility for the entire project including developing — with owner review — and implementing a site safety plan.

In such instance, the owner should require its employees and any separate contractors, including the turbine supplier, to follow such a plan.

If the project work is instead divided among multiple contractors, each should be required to cooperate at the owner's direction and devise a plan for allocating safety responsibility and control across the site at different times in the project schedule.

Either way, there should be clear terms in all applicable contracts that ensure allocation of safety responsibility and compliance with federal, state, local and project-site safety regulations.

Moving Toward Efficient Risk Sharing

Wind-energy development will continue to grow in the United States, particularly if economic, technological and regulatory challenges are addressed in a proactive manner.

As is always the case, each project will present new issues and hurdles.

Efficient and fair negotiations that proactively address risk-sharing challenges can speed the development of wind projects and save money, thereby benefiting owners and contractors alike.

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