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Wind Industry Faces Uphill Climb Without Tax Credit

By **Keith Goldberg**

Law360, New York (November 07, 2013, 6:23 PM ET) -- It's looking increasingly likely that the federal renewable energy production tax credit won't be renewed at year's end, and experts say that would deal a blow to the long-term prospects for a U.S. wind industry that's become viable thanks to the subsidy but isn't competitive enough with other types of energy yet to flourish without it.

Since it was first enacted in 1992, the PTC has expired five times, only to be brought back from the dead and temporarily extended. The latest resurrection came in January, when it was extended for one year as part of a broader congressional deal to avoid the "fiscal cliff."

But there's no broad congressional deal on the horizon this year, and deep divisions over the credit remain. Some Republicans in Congress have sought to kill it, while the president wants to make it permanent.

"I think there's about a zero chance it will be extended this year, but it continues to have broad bipartisan support," said Jeff Davis, a Mayer Brown LLP tax partner and co-head of the firm's renewable energy group. "I do expect that we'll get an extension sometime next year, and if history is any guide, the extension will be retroactive to the beginning of the year."

That's what the wind industry has to hope for, because history has shown that when the credit is allowed to expire, wind project development grinds to a halt. The latest expiration lasted only two days, yet only 1.6 megawatts of wind power was commissioned in the first half of 2013 before the industry rebounded, according to the American Wind Energy Association.

"I don't see much interest in looking at projects that aren't PTC-eligible," said Phil Tingle, who leads McDermott Will & Emery LLP's energy tax practice. "At least with power prices the way they are and how wind is priced in the market [compared to] other power generation sources, I'm not very optimistic that you're going to see what's been going on in the last three or four years."

While the PTC has spurred development and technological innovations that have steadily lowered cost of the wind power, wind is still expensive compared to conventional power sources. That price disparity is even more acute given the recent U.S. shale boom, which has led to a glut of natural gas at rock-bottom prices.

"[Wind] has definitely moved a lot closer to the goal line, to function without any props," said Keith Martin, the co-head of Chadbourne & Parke LLP's project finance group. "But the goal line has moved in two respects: With gas prices so low, the distance the industry has to go to be competitive without these props is longer, and second, it has been so hard to get utilities to enter into long-term power contracts."

That's why the credit, which has been vital in securing financing for new wind projects, would be difficult to replace, experts say. The credit effectively provides a cheap source of capital through tax equity financing, which allows investors to offset their federal tax bills by investing in clean energy.

"There's been talk of other financing vehicles, such as real estate investment trusts and master limited partnerships, but those are different animals," Davis said. "The PTC is a subsidy, there's direct dollars associated with that — a credit that offsets tax liabilities, that can essentially be monetized through tax equity financings."

Experts say the wind industry won't feel an immediate pinch from the PTC's expiration because it has rushed to put plenty of projects in the pipeline, thanks to several tweaks made to the credit this year. The first tweak came with the credit's renewal in January, when Congress specified that it applies to projects that begin construction by the end of the year, whereas previously it had covered only projects that had started delivering power to the grid.

Then in April, the IRS announced that certain renewable energy projects would be eligible for the credit in 2014 if developers perform significant construction work this year or spend more than 5 percent of the project's total cost in 2013. Five months later, the agency clarified that project developers wouldn't have to show continuous efforts toward construction work after this year to stay eligible for the credit, as long as the projects will have been in service by Jan. 1, 2016.

"Even if it expires at the end of the year, there are a lot of projects underway or that will be underway at the end of the year and that will still be eligible for the PTC," Davis said. "As a result, we won't have the precipitous drop-off in new capacity that we saw in previous years when the credit expired."

And with major companies such Google Inc. investing in wind projects for their own energy needs, the financing picture for wind developers post-PTC might not be completely grim, according to Skip Rankin, who chairs Baker & McKenzie LLP's global renewable energy and clean technology practice group.

"They want the tax equity, but they're also making corporate statements that it's an energy sector they want to support," Rankin said. "I think these companies will continue to invest in the sector even if the tax credit isn't there."

Still, the wind industry's progress will eventually stall in a post-PTC world, experts agree, and any major efforts to compensate for its absence will have to come from the government.

One way would be to finally enact federal legislation allowing renewable projects to be structured as master limited partnerships — which are taxed as partnerships rather than corporations, but have publicly traded ownership interests — just like oil, gas and coal projects. Renewable energy MLPs would benefit from the lower cost of capital that comes with eliminating the corporate-level tax on profits.

Another is the expanded use of so-called renewable portfolio standards, which force utilities to draw a certain percentage of their power from renewable sources by a certain date. Currently, 29 states have RPS programs in place, and Senate Democrats recently introduced legislation that would create a federal program.

"If you don't use the carrot, you have to use the stick," Davis said. "In other words, if you take away the carrot — the PTC — a lot of these projects won't get built unless someone uses a stick — the RPS."

However, the chances of MLP parity and a federal RPS getting through the current edition of Congress are iffy at best, and they still wouldn't fully make up for the absence of the PTC, experts say. That's why if the credit goes away at year's end, the push to resurrect it will cross party lines.

"We've got wind manufacturing companies in a lot of red states," said Adam Umanoff, who co-chairs Akin Gump Strauss Hauer & Feld LLP's global project finance practice. "I think the debate is a challenging one, especially with the current position of the House Republicans, but I think there's more to play out in the next couple of years. There's too many jobs at stake."

--Editing by Kat Laskowski and Richard McVay.