

Building Green Energy Producing Facilities with Government Incentives in 2009

Legal Alert

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On Tuesday, February 24, 2009, upon signing the American Recovery and Reinvestment Act into law, President Obama spoke to a joint session of Congress. He described the Act as saving or creating 3.5 million jobs in the United States. He further stated that 90 percent of those 3.5 million jobs will be in the private sector, "rebuilding our roads and bridges, constructing wind turbines and solar panels, laying broadband and expanding mass transit." Exactly how much of that 90 percent will fall into wind and solar projects is not yet known. At a minimum, the administration has confirmed its intention to encourage alternative energy production projects.

One might question how this is different from what President Bush called for in May 2001 when he unveiled his energy plan calling for 1,300 to 1,900 new energy-producing facilities to be built by 2021. The answer is on our daily news broadcasts. This administration must quickly demonstrate success in improving the economy and putting people back to work and there is no better or more efficient way to do that than providing compelling incentives for projects that not only meet the need for jobs but also address environmental concerns such as global warming.

Although the incentives must be adequate to overcome the cost differences inherent to producing renewable energy as compared with producing energy using traditional facilities (coal, gas and nuclear), the fact is that renewable energy production will also facilitate compliance with cap and trade programs like the Regional Greenhouse Gas Initiative ("RGGI"), designed to trigger an increase in the price of carbon-based electricity resulting in a comparative reduction in the cost to produce renewable energy.

To answer the call, federal, state and local governments have made numerous incentives available to encourage businesses to rapidly secure financing, tax credits and grants for construction of renewable energy facilities. It can reasonably be expected that government will eagerly support builders by registering, funding and certifying such projects.

In taking advantage of these government incentives, appropriate safeguards should not be overlooked or relegated to back seat positions. All project objectives can easily fail if responsibilities are not properly allocated among the owners, contractors, construction managers, consultants, design professionals, insurers, sureties, suppliers and subcontractors who are actually in the trenches completing the projects. The responsibilities and protections for these parties are housed in the project contracts.

Government Incentive Programs for Renewable Energy

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To prepare the project contracts, the drafters must know the applicable government incentive programs. Incentive programs are available on both the federal and state level and can be accessed through internet websites such as the US Department of Energy (<http://www.energy.gov/>) and its state analogs (see e.g. <http://www.njcleanenergy.com/renewable-energy/programs/renewable-energy-incentive-program>). There are also third-party sources available such as the Database of State Incentives for Renewables and Efficiency (DSIRE), sponsored by the Interstate Renewable Energy Council (<http://www.irecusa.org/index.php>). Furthermore, new legislation is pending in all levels of government designed to encourage green energy production. As recently as April 1, 2009, Governor Jon Corzine of New Jersey signed three measures designed to implement the state's Energy Master Plan, which includes incentives for renewables.

Federal incentives available in 2009 include production tax credits, investment tax credits, \$800 million in renewable energy bonds, tax write-offs for certain facilities, incremental production tax credits for certain fuels, conditional and limited tax exemptions, \$800 million in tax credit bonds to finance state and local initiatives, deductions per foot for certain energy efficient commercial buildings, tax credits for energy efficient homes, manufacturing tax credits for production of energy efficient appliances, accelerated depreciation for certain electrical equipment, and bonds for green and sustainable designs.

As anyone familiar with these projects knows, many of these incentives are tied to specific dates. To take advantage of some production tax credits, wind turbines, for example, must be placed in service by January 1, 2010. Other generating facilities such as biomass, geothermal and wave and tidal facilities must be in service by January 1, 2011. Each of the programs and incentives are tied to different deadlines and before a project begins, all the parties involved must be aware of the tight time frames that must be met to realize the benefits.

Contract Terms to Consider in Preparing Construction Agreements Compliant with Government Incentive Programs

In light of the program requirements, the abiding theme for project contracts should be allocating responsibility for ensuring that the constructed facilities enter service to an acceptable level of production and in a timely manner. Compliance with other federal and state laws may be required if the project is to receive government funding including, without limitation, Occupational Safety and Health Administration regulations, the prevailing wage laws that emerged from the Davis-Bacon Act of 1931, and the requirements associated with the Equal Opportunity Act. In order to ensure that the project is able to secure the benefits of the incentives provided by the government, the individual incentive program must be carefully reviewed and the contracts altered to conform to its requirements. The registration and funding applications for the individual programs should specify the prerequisites so that the builder will know what federal or state laws, codes, regulations and standards apply. Booklets and manuals are often available to guide a builder through the process. (See e.g. New Jersey's Clean Energy Program Renewable Energy Incentive Program Guidebook for 2009 available at njcleanenergy.com).

Additional factors must be considered in negotiating and preparing project contracts including the following:

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1. Identifying and then expressly allocating the appropriate level of responsibility for the project's various elements and phases, including design, planning, financing, registration, approvals, scheduling, bidding, sourcing, shipping, pricing, temporary services and utilities, supervision, integration, coordination, documentation, compliance (especially with the mandates of the project's chosen government incentive programs so that credits, funds or other incentives are not inadvertently lost), project accounting, site safety and maintenance, training, testing and verification, to the appropriate parties;
2. Identifying exactly what documents comprise the contract documents (primary contracts, drawings, specifications, general conditions), establishing their order of precedence and detailing the conditions under which the contracts can be altered, amended, modified or changed;
3. Identifying appropriate mechanisms for reviewing, approving, tracking, processing, documenting and implementing changes to the project scope;
4. Allocating legal liability and responsibility to the appropriate parties (as well as limiting liability in accordance with the parties' intentions), including without limitation, intellectual property rights and products' liability issues relating to the project's components;
5. Expressly stating when certain obligations (especially inherently contingent obligations like defense and indemnity clauses) are triggered (e.g. are obligations to defend and indemnify triggered at the time a claim is made or only at the end after an award is entered);
6. Delegating responsibility for and ensuring appropriate insurance and bond coverage;
7. Creating payment structures that allow for compensation while concomitantly providing for appropriate retainage;
8. Incorporating contingencies for situations that do not go according to plan, including, without limitation: unavailability of required components; delays in shipping of components; disputes between the parties; dispute resolution; changes in applicable codes; standards; laws and regulations; failure of certain components prior to, during or just after testing; inadequate production levels of the final assembled facilities and equipment; scheduling failures; sequencing failures; latent or patent defects in constructed elements; weather delays; wildlife or habitat issues or other force majeure events;
9. Expressly defining and detailing the consequences of every level of default under the applicable contracts (including capping, limiting, expanding or liquidating damages for certain events of default), as well as particularizing corresponding notice obligations and opportunities to cure (after a default, how much time should a contractor be given to cure the default especially in light of the tight time frames?); and
10. Expressly assigning and detailing all post construction obligations that survive the completion of the contracts such as warranties, maintenance and service obligations. Special attention should be paid to the equipment used in new technologies as they may be untested and are often shipped from overseas. Service and warranty obligations must take into account the source of the components. Also, of critical importance are terms for the sale for the energy produced that may be required by applicable law and/or for funding purposes.

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Although many of these points are common to all construction, they require different language for a renewable energy projects. A pricing provision for renewable energy is different from a pricing provision for a pharmaceutical facility as the applicable laws are different. Sales of units of energy are far more structured than sales for pharmaceuticals because, at a minimum, you must contend with geographical, equipment and transmission limitations, as well as applicable regulations.

Context, Examples and Cautions Driven by Increased Government Incentives for Renewable Energy Projects

On January 8, 2009, President Obama stated as part of his program to improve the ailing U.S. economy, that "we will double the production of alternative energy in the next three years. . . [putting] Americans to work in new jobs that pay well and can't be outsourced - jobs building solar panels and wind turbines; constructing fuel-efficient cars and buildings; and developing the new energy technologies that will lead to even more jobs, more savings, and a cleaner, safer planet in the bargain."

Under the new administration, and given the state of the economy, both federal and state governments have been given access to funds ear-marked for large alternative energy projects. By way of example, on March 20, 2009 the United States Department of Energy offered Solyndra, Inc., a \$535 million low interest loan guarantee to construct a commercial-scale manufacturing plant for its proprietary solar photovoltaic panels (a second and much larger panel plant for Solyndra). The corresponding loan would be conditionally funded by the American Recovery and Reinvestment Act of 2009, which is published as having been created to provide billions of dollars in loan guarantee authority to "build a new green energy economy." The Department of Energy's Secretary Steven Chu is on record as wanting to make dispersing existing and newly available loans a high priority, creating procedures within the Department of Energy for efficient and expeditious evaluation, processing and approval.

Similar wind turbine loans can safely be anticipated as long as the appropriate applications are completed and submitted in a timely manner. Although wind turbine technology is aging, advances in the induction generators, rotor and blade materials and manufacturing processes and control systems could result in a need for domestic manufacturing facilities similar to Solyndra's. Contracts involved in construction of plant's such as Solyndra's would involve all the standard concerns articulated in the preceding sections of this article. Contracts for such facilities should consider certain global issues with renewable energy projects.

For example, alternative energy technologies require specialized technicians to both build and maintain. It has been estimated that a 200 megawatt wind farm requires approximately 300 people to erect and 20 technicians to maintain. A rapid increase in production of these types of facilities will likely drain the already taxed available pool of trained technicians. A reduced labor supply could impact critical scheduling concerns. Contracts for these projects should take training and labor issues into account.

Another umbrella issue relates to account management for government credits or renewable energy certificates ("RECs"). Different programs have different means and methods for calculating and keeping track of the credits awarded to a successful facility. Moreover states have initiated quotas that will need to be accounted for and satisfied, and created a corresponding market for RECs. In certain instances credits can be transferred and owners should be aware of their options in this regard and account for them in the contracting process. Accordingly, the project contracts should consider valuation and sale of the energy

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produced and the associated RECs.

Furthermore, certain programs provide incentives upfront and others do not realize benefits until the project is completed and placed in service. Other incentives place restrictions on the sale of the resulting energy production. Project budgets should take these issues into account.

Conclusion

Renewable energy projects have never had greater government support. In light of the lessons learned after the recent "housing" and ".com" bubbles, advancing into these markets or expanding already existing energy endeavors should be done with the appropriate amount of caution. There is no better way to proceed and succeed than to create proper governing contracts.