US Renewable Energy Policy Outlook

Keith Martin
kmartin@chadbourne.com

CHADBOURNE & PARKE LLP

New York • Washington • Los Angeles • Mexico City • São Paulo • Beijing • Almaty • Moscow • Kiev • Warsaw • Istanbul • Dubai • London

The United States is not immune to the same pressures that have led governments in Spain, France, Germany, the United Kingdom and the Czech Republic to scale back subsidies. Renewable energy is facing strong political headwinds at the national level. State policy has largely held firm, with some forward progress in California and some backtracking in New Jersey.

The renewable energy agenda has been largely set aside at the national level until after the 2012 election. It is difficult to secure long-term contracts with utilities. A national renewable energy standard or a price on carbon might have helped, but both are dormant. Many House Republicans who took office in 2009 think that support for renewable energy started with the Obama administration.

wild card

All eyes are on deficit reduction, with the "super committee" of 12 members of Congress struggling to agree by November 23 on at least $1.2 trillion in deficit reduction. Congress has until January 15 to act before automatic spending cuts are set in motion. They would not take effect until 2013. It is not clear whether any such spending cuts would affect Treasury cash grants for renewable energy projects since they have an open-ended appropriation.

Gridlock in the US political system means preservation of the status quo. The Congressional investigation into the DOE loan guarantee to Solyndra is currently more noise than substance. Secretary Chu will testify on Thursday. The real issue is conceptual: is the notion now dead that the US government should help companies move new technologies through the "valley of death"?

The industry is assuming the Treasury cash grant will not be extended, despite heavy lobbying. The wind industry is pressing for a four-year extension of production tax credits and lobbying on MLPs. Broad corporate tax reform in 2013 or 2014, or possibly earlier as part of a deficit reduction deal, is a longer-term threat to tax subsidies.

The utility MACT rule is a potential bright spot. It is expected to lead to retirements of more than 10,000 megawatts of coal-fired generation. The Environmental Protection Agency has until December 16 to define what pollution control will be needed at such power plants to control mercury. The new controls must be in place by 2015.

FERC conference

The trade complaint that SolarWorld and six other US solar panel manufacturers filed in October could lead to anti-dumping or countervailing duties on Chinese solar cells starting this fall at the earliest, but more likely after a date in the spring or summer. The petitioners are claiming dumping margins as high as 233%. The duties cannot be reimbursed by the seller.

The cost of capital is about to get more expensive. Capital is an important element in the price at which renewable energy companies are able to sell electricity. CFOs stack capital from least to most expensive. The two least expensive tiers are being pulled away.

Five capital tiers from least to most expensive:

Section 1603 payments
Government-guaranteed debt
Straight debt
Tax equity
True equity

The tax equity market has recovered in terms of deal volume. Tax equity yields are 220 to 245 basis points higher than in 2007. There are 18 active tax equity investors, with several others on the verge of entering the market. The market will need to increase significantly in capacity to cover the same volume of transactions after the cash grant expires. There are numerous deal structures.

Treasury appears to be considering in more cases whether part of the basis claimed in a project should be allocated to intangible assets like power contracts, interconnection agreements and extended warranties. The market is putting the basis risk on developers. The IRS suggested in an internal memo in October that it can audit cash grants that have already been paid on projects.

The Treasury said in June that it used a benchmark of $4 to $7 a watt for judging whether solar developers were claiming too high a value for projects put in service in the first quarter this year. Solar module prices have been falling since then.

Federal bank regulators released 298 pages of regulations in October to implement a "Volcker rule" that is supposed to bar banks from engaging in proprietary trading and taking equity positions in private equity and hedge funds. The regulations are not expected to knock banks out of the tax equity market.

Roughly 30 banks are active in the project finance market. However, some French banks have put their project finance loan books up for sale. The potential for a Greek default is already starting to be felt in "market flex" provisions. Basel III is expected to turn banks eventually into bridge lenders with the loans moving eventually to institutional lenders. Interest rates are 225 to 275 basis points above LIBOR. Tenors are shortening to 7 to 10 years for bank debt, but they remain much longer for institutional debt.

Projects that are in line for section 1703 DOE loan guarantees still have time to close. A pool of another $3.5 billion in new loan guarantee authority remains. Access to roughly half of it will require paying credit subsidy costs. No new solicitations have been announced. A USDA loan guarantee program remains an alternative for projects in rural areas.

Companies are rushing to take delivery of equipment this year in order to qualify for Treasury cash grants on projects built after this year. Some of these plans cross a line. The Treasury does not want to see trafficking after 2011 in stockpiled inventory.

The IRS ruled privately that a large battery at a wind farm qualifies for the same tax subsidies as the rest of the wind farm.   Another ruling is imminent. The agency is still working out where to draw the line on tax subsidies for storage devices more broadly.

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