

# Federal Policies and Financing Strategies

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**“I think we worship false idols. I’m in the commercial aviation business. Guess how we got in that business? Because the Department of Defense in WWII paid for military engines. My entertainment business is regulated, my financial services business is regulated, by appliance business is regulated. So for some reason we decide that energy is the one industry where the only policy should be the price of oil?”**

**— Jeffrey Immelt, CEO, General Electric**

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**We take pride in the United States in having a free market economy, and yet think of the percentage of daily news coverage that is devoted to the Bush administration and the national elections. Why?**

**postage**

**table cloth**

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**The US government tends to subsidize investment through the tax code. There are several types of subsidies. Marine energy has been shortchanged, but has been making up ground thanks to the efforts of a number of people in this room.**

**Gucci gulch**

**To give you a sense of how much ground there is to make up, the US government pays 63% of the capital cost of a typical wind farm. It pays 58% of the capital cost of a typical solar project. For investments made during 2008, add another 2.6% due to a “depreciation bonus.”**

**geothermal  
biomass**

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**There are two main tax subsidies for renewable energy: depreciation and tax credits.**

**PTCs of 1¢ or 2¢ a kWh**

**30% solar credit**

**accelerated depreciation**

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**Most ocean energy projects are depreciated on an accelerated basis over seven years, which is worth 27.8¢ per dollar of capital cost. There are two exceptions.**

**hydraulic power — 20 years/17¢**

**offshore wind — 5 years/29.8¢**

**That's only for projects in the "United States," defined as the 50 states and the District of Columbia and up to an uncertain distance offshore. Otherwise, the depreciation for most projects stretches out to 12 years, leading to loss of 6¢ in subsidy.**

**hydraulic — 50 years/7.6¢**

**The only marine projects that qualify currently for tax credits are “incremental hydropower” projects, meaning projects to add capacity at a facility that was in use before August 2005.**

**1¢**

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**Both the House and Senate have voted several times since December to add “marine and hydrokinetic renewable energy” to the list of eligible fuels for PTCs. It seems certain to happen; the only question is when.**

**gridlock**

**illusory Senate vote**

**Baucus bill**

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**PTCs run for 10 years. The project must be in the United States, defined as within 200 miles of the US or US possessions like Puerto Rico and the US Virgin Islands. The project must be new after enactment. The electricity must be sold to an unrelated person. The credit amount is only 1¢ per kWh, but it is a start.**

**150 kws**

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**One problem with tax subsidies is you can't use them until you are at the point of building a commercial scale project. Until then, developers need to rely on successive rounds of venture capital. The good news is looming carbon controls.**

**profound change  
horse track**

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**Other potential sources of early-stage capital are product vendors, federal grants, loans and loan guarantees, R&D limited partnerships and royalty trusts.**

**20% tax credit**

**The other problem with subsidizing renewable energy projects through the tax code is virtually no US developers are in a position to use the subsidies.**

**“monetization”**

**The most common structure monetizing tax subsidies in projects that qualify for production tax credits is a “partnership flip.” An institutional investor is brought in to own the project in a partnership with the developer and is allocated 99% of economic returns until it reaches a target return. After that, its interest flips down to 4.95% and the developer has an option to repurchase his interest.**

**cash**

**Returns in the tax equity market have been as low as 5.8% recently. A rule of thumb in the wind market had been that tax equity covers 65% of the capital cost. It covers 100% for photovoltaic projects. There may still be a gap in the capital structure for some projects.**

**debt**

**subprime mess**

**The other structure for monetizing tax benefits in PTC deals is a prepaid service contract. The offtaker for the electricity makes an advance payment for electricity that covers as much as half the capital cost of the project.**

**deferred income  
four “foot faults”**

**A few other financing tips: use a Delaware LLC for any projects in the United States. If the project is outside the US, consider owning it through an offshore holding company so that the earnings stay outside the US tax net as long as they are redeployed offshore.**

**Other financing options to consider might include export credit agency guarantees and double-dip leases. Renewable energy credits may be another source of revenue. Many coastal states treat ocean energy projects as eligible. They include California, Connecticut, Massachusetts, New York, Rhode Island and Texas.**

**REC ownership**

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