KIRKLAND & ELLIS

Blog Post

COVID-19 Implications for Renewable Energy Tax Credit Deadlines

23 March 2020

COVID-19 has already been incredibly disruptive to a number of different industries, and coronavirus-related delays could prove particularly problematic for renewable energy sponsors and investors depending on how long the pandemic continues. Renewables sponsors were already under intense pressure to begin the construction of their development pipelines and place particular projects in service in time to meet looming IRS deadlines to qualify for tax credits. Recent coronavirus-related developments, including state business restriction orders issued over the last several days, are only compounding the difficulty of meeting these deadlines.

Background

The U.S. renewables market is particularly sensitive to supply chain and construction disruptions because of tax rules that cause the value of production tax credits ("PTCs") or investment tax credits ("ITCs") for which a project may qualify to fluctuate based on the year in which construction begins. Wind projects can technically benefit from both PTCs and ITCs. Onshore wind projects typically use PTCs, while offshore wind projects generally opt for ITCs. Solar projects can only utilize ITCs.

Once construction begins, for purposes of both the ITC and the PTC, a project either needs to be "placed in service" over the next four years or the sponsor has to prove that work was "continuous" based on facts and circumstances. Due to the difficulty of proving "continuity" through subjective facts, tax equity investors and lenders prefer (and it is easier to get financing for) projects that are placed in service within the four-year safe harbor window.

Wind

As of January 14, 2020, the U.S. Energy Information Administration projected that 18.5 GW of wind capacity would come online by the end of 2020. This is due in large part to sponsors who began construction on their development pipelines in 2016 to qualify for the maximum amount of PTCs — wind projects that began construction in 2016 qualify for PTCs at the full unreduced rate (currently 2.5 cents per kWh of electricity sold to third parties). The credit phases down by 20% for projects that commenced construction in each year thereafter through 2019, and was originally scheduled to expire for projects that commenced construction after 2019. Then, in a surprise December 2019 extension, the PTC was reinstated at 60% of the unreduced rate PTC (i.e., 1.5 cents per kWh) for projects that begin construction in 2020 only. Given the four-year placement in service deadline described above, wind projects that began construction in 2016 in order to qualify for PTCs at the full unreduced rate need to be placed in service by the end of 2020 to maintain a clear path to financing.

To address possible impacts from COVID-19, the American Wind Energy Association ("AWEA") is advocating for (i) an extension of the PTC/ITC safe harbor from four to six years for projects commencing construction in 2016 through 2020 and (ii) a direct pay (i.e., a cash grant or refund) provision equal to 100% of the PTC/ITC. As part of a broader economic stimulus, AWEA is also advocating for lifting import tariffs on equipment used for wind projects and extending the PTC/ITC. The paramount concern of the wind industry is obtaining an extension to the 2020 deadline for completing construction for projects that commenced construction in 2016, given these are late-stage projects that have large sunk costs. The request for a direct pay provision (i.e., a cash grant or refund) is intended to address a separate concern from both solar and wind sponsors that the economic fallout from COVID-19 and resultant loss of taxable income will lead to a material reduction in demand from tax equity investors. The proposals that AWEA is advocating represent the wind industry wish list, and until the final stimulus bill is signed it is not clear what elements (if any) will be included. There is also a strong likelihood that these proposals may be omitted from an initial stimulus bill but included in later COVID-19 economic relief packages.

Solar

Solar projects were required to start construction in 2019 to qualify for ITCs worth 30% of cost. The credit is reduced to 26% if construction begins in 2020, with further reductions in subsequent years. During the second half of 2019, many sponsors took steps to qualify their pipeline projects for 30% ITCs through the purchase of solar panels and other equipment — often financed through third-party loans. Many of these

solar sponsors relied on IRS guidance that permitted costs associated with an early 2020 delivery to count as incurred in 2019 if the sponsor made the payment in 2019 and reasonably expected the equipment to be delivered within three-and-a-half months of the payment date.

Some financiers have been requiring sponsors relying on the three-and-a-half month rule to represent that the equipment will actually be delivered within three-and-a-half months of the payment date. That may not be possible in some cases to the extent sponsors are relying on equipment or services from countries (or even U.S. states) affected by the coronavirus. This could result in the technical breach of a warranty or covenant under certain documents, even though the tax rules only require the "reasonable expectation" of timely delivery.

Many sponsors with deliveries scheduled between now and the end of the three-and-a-half month deadline are already in discussions with their lenders and investors about ITC qualification. The coronavirus outbreak, and certainly the eventual scope of the outbreak, was not a known risk at the end of December 2019 that sponsors could have reasonably expected to cause delivery delays in 2020. Although sponsors that made 2019 payments should be able to rely on reasonable expectations to qualify for 2019 ITCs (assuming there are no other facts suggesting it would be unreasonable to expect delivery within three-and-a-half months), sponsors may have a more difficult time using the three-and-a-half month rule for 2021 deliveries to the extent COVID-19 begins to make timely delivery expectations unreasonable.

Like AWEA, the Solar Energy Industries Association ("SEIA") is advocating for an extension of the ITC and placed-in-service deadlines and an option for a direct cash payment in lieu of the ITC for solar projects. To address the three-and-a-half month issue, SEIA is also requesting that the safe harbor guidance be revised so that all qualifying equipment delivered by year-end in either 2020 and 2021 would qualify as safe harbor equipment as long as equipment was ordered in the previous year (e.g., equipment ordered in 2019 must be delivered by the end of 2020). As with the AWEA proposals, it is similarly unclear what (if any) of SEIA's proposals may eventually be included in a stimulus package.

Evolving Impact on Construction Schedule

The magnitude of COVID-19's effect on the renewable energy industry (and, consequently, the degree to which industry groups may seek ITC/PTC extensions or a cash grant option) is dependent in part on rapidly evolving facts. Initially, the primary

concern for renewable energy sponsors was managing supply chain issues from manufacturers in Asia. Beginning in February, many solar and wind sponsors received notices of force majeure from overseas suppliers, and while anecdotally many investors and sponsors have not experienced experienced significant delays *to date*, there is more uncertainty going forward. Just in the last few days, many U.S. states and cities have issued restrictions on permitted business activities that could lead to a much more dramatic and immediate impact on construction schedules.

Business Restriction Orders

As a general matter, jurisdictions have adopted one of two approaches to business restriction orders. The first, and broadest, restriction is referred to as a "shelter in place" restriction, which has been adopted in California, New York, Pennsylvania and Illinois. The approach to date in many other states has been to restrict mass gatherings and mandate closure of specified businesses (e.g., restaurants, bars and schools) — meaning a particular business activity is permitted unless restricted. "Shelter in place" restrictions essentially require all residents to stay home, except to perform essential business functions and take care of necessities — meaning a business activity must be expressly authorized as essential for that business to continue operating. While the electricity and power generation sectors are generally covered as essential industries, each state has specific and nuanced guidelines on the activities and workers within those industries that are essential. Regardless of whether a renewable energy project or company is an essential business, there are likely to be effects from suppliers that are restricted or are only able to operate at partial capacity. Additionally, permitting and interconnection processes are expected to experience more delays than usual as state agencies and transmission entities struggle with reduced staffing. These issues should be taken into account when forecasting construction timelines.

Kirkland is actively monitoring developments at the federal level and in all 50 states and the District of Columbia, and we would encourage clients to reach out for assistance in determining the applicability of these laws in a particular jurisdiction. SEIA is also maintaining a list of "shelter in place" or "stay at home" orders that have been issued to date and guidelines that it recommends solar companies follow.

Looking Ahead

It is difficult to confidently make any predictions about how COVID-19 will affect the renewable energy industry given the number of factors in play (e.g., scope of eventual

U.S. government incentive programs and losses realized by investors). In addition to the construction issues mentioned above, if the market continues to deteriorate sponsors may also be faced with challenges of increased counterparty risk, a tighter financing market and lower merchant prices (due to decreased demand for energy).

Strong sponsors that have long-established relationships with tax equity investors and lenders are keeping an eye on the situation, but for now are expressing optimism that the pandemic will not result in significant pricing shifts or execution risk. Small or cash-strapped sponsors may face more difficulty financing projects and could become targets for private equity or other deep-pocketed sponsors looking for a pipeline of projects. This is an issue that will continue to crystallize over the coming weeks and months. Stay tuned to this blog for further updates.

Read more insights from Kirkland's Energy & Infrastructure blog.

Author

Scott W. Cockerham

Partner / Washington, D.C.

Brian C. Greene, P.C.

Partner / Washington, D.C.

Related Services

Practices

- Transactional
- Tax
- Energy & Infrastructure

This publication is distributed with the understanding that the author, publisher and distributor of this publication and/or any linked publication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, portions of this publication may constitute Attorney Advertising.

This publication may cite to published materials from third parties that have already been placed on the public record. The citation to such previously published material, including by use of “hyperlinks,” is not, in any way, an endorsement or adoption of these third-party statements by Kirkland & Ellis LLP.