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Clean Energy Strikes It Rich With House Dems' Tax Proposal

By **Keith Goldberg**

Law360 (September 14, 2021, 8:47 PM EDT) -- A far-reaching proposal by the U.S. House of Representatives' tax-writing committee would accelerate clean energy development at an unprecedented pace.

Democrats on the House Ways and Means Committee began marking up the clean energy portion of their $3.5 trillion budget reconciliation bill on Tuesday. The proposal, which lawmakers unveiled last Friday, checks off nearly all the boxes on the industry's wish list.

That includes a longer runway for project developers and investors to reap tax credits, eagerly awaited eligibility for energy storage, hydrogen and electric transmission, and a direct pay option for smaller developers in lieu of tax credits.

Combined with increased tax credits for energy efficiency and transportation decarbonization and electrification, the House package fills out much of the ambitious clean energy and climate change agenda laid out by the Biden administration, energy tax policy experts say.

"The scale and scope of what they're trying to accomplish here is really large," said Neeraj Arora, who co-leads the global energy industry team at Morgan Lewis & Bockius LLP. "It's not like they're not swinging for the fences here."

But swinging for the fences carries risks. Labor and domestic manufacturing requirements linked with the tax credits could make project financing trickier, while the House proposal must be reconciled with a Senate budget reconciliation proposal with a completely different vision of clean energy tax incentives.

And looming over everything is how much of what's being proposed can make it through Congress and onto President Joe Biden's desk.

"The question is: What gets left on the side of the road?" said Keith Martin, who co-heads Norton Rose Fulbright's U.S. projects practice and specializes in energy tax policy.

Here are five takeaways from the House clean energy tax credit proposal:

Long-Term Extensions Mean Long-Term Stability

At bottom, the House proposes a major expansion of the existing clean energy tax regime. That includes expanding to 10 years the full value of production tax credits, which are largely based on the electricity production of a completed project, and investment tax credits, which are largely tied to a project's construction.

That would mean project developers and investors can reap the full value of the PTC and ITC until 2031 before the values start phasing out. Experts say that's a dramatic shift from Congress' previous pattern of issuing one- or two-year tax credit extensions of the PTC and ITC. It would provide greater certainty for developers and investors in both well-established clean energy technologies, such as wind and solar, and those technologies that are more nascent and those that would be newly eligible for tax credits under the House proposal.

"It's one of those things where the amount of investment that will come out of this, as well as the revolutionary technology, will be shocking," said Tim Urban, who leads the tax policy practice at Bracewell LLP's policy resolution group.

And with the costs of certain clean energy resources dropping to levels approaching or even beating the costs of fossil fuel resources, a 10-year tax credit runway could significantly grease the decarbonization skids, experts say.

"If you're already at price parity and beyond by the middle of the decade, and now you've got tax credits for 30% of the [project] value, you could see a massive transition in our energy infrastructure occurring very quickly over the next decade," Arora of Morgan Lewis said.

More Technologies Get Seats at the Table

Not only does the House proposal greatly expand the tax credit eligibility window, it also greatly expands the number of eligible clean energy technologies. Topping the list is energy storage, which could finally collect the ITC on its own following a long-standing push by the clean energy industry because of its potential to address the intermittency shortcomings of renewable energy.

"I think there's a recognition that just pure-play, nondispatchable renewables are not going to be sufficient to realize the ambitious climate objectives set by this administration," said Arora, who does a lot of energy storage work. Nondispatchable electricity isn't under a grid operator's direct control and can't be used to meet demand in a short period of time.

"There's a recognition of the importance of energy storage," Arora said, "and part of that is that it cuts across different [energy] sectors."

The House proposal also expands the ITC to include transmission projects, a potentially significant carrot given the Biden administration's push to build out and upgrade the U.S. electricity grid to accommodate more renewables. The proposal expands the PTC to include nuclear power plants, and even more significantly, hydrogen, with so-called green hydrogen produced from renewable electricity sources reaping the biggest benefits.

The Biden administration has made a priority of developing and slashing the costs of green hydrogen to make it competitive with natural gas. Martin of Norton Rose Fulbright said the House proposal contains an added incentive for renewable project developers: a chance to collect both a PTC for their electricity and a hydrogen PTC if they use their electricity to create hydrogen.

"The tax credit is not large enough to close the gap currently, but it will speed the day," Martin said. "And it's making it easier for wind developers, principally, to use their own electricity and their own electrolyzers to make green hydrogen."

Cash Grants a Potential Boon for Small Developers

The House proposal includes a direct pay option for the PTC and ITC that will essentially allow developers or investors to receive their tax credits in a lump-sum rebate. Experts say a revival of a post-2008 financial crisis program, where renewable project investors could collect cash grants instead of federal tax credits, could help widen the pool of potential investors and make smaller-scale projects more attractive since smaller developers generally have a tougher time attracting, or affording, tax equity investment.

"Even where you can raise tax equity, you're not getting 100 cents on the dollar," Martin of Norton Rose said. "This is the way of getting the full subsidy."

Urban of Bracewell said that could be crucial for startup companies that are trying to make huge investments in emerging clean energy technologies but won't have major tax liabilities for years.

"There are all sorts of hazards out there to being a nascent energy technology company," Urban said. "Anything you can do to start taking away some of these impediments for them … increases the chance that they become commercial."

But direct pay isn't a complete panacea, experts say. Taking cash grants doesn't allow companies to claim accelerated depreciation on their taxes, for starters. And since it's the federal government cutting a check, direct pay recipients will draw more scrutiny from both the federal government and Congress.

"It takes months, and it's like signing up for a very intense audit," said David Burton, energy tax partner at Norton Rose Fulbright. "I think you're going to have to be relatively short on choices to go for direct pay as a [project] sponsor, and it's going to be awhile until you get your money."

Labor and Manufacturing Requirements Pose Financing Challenges

True to Biden's stated goals of creating well-paying clean energy jobs and booting U.S. clean energy manufacturing, the House proposal contains labor and domestic manufacturing requirements. Project developers must ensure they and their contractors meet those requirements to reap the full value of the tax credits, with significant haircuts if they don't.

That could throw a wrench into developers' ability to secure financing for their projects, experts say. Tax equity investors may be reluctant to sink money into projects without some significant indemnification from developers in the event they can't meet those requirements.

"If you're a big [project] sponsor, you can provide the tax equity investor indemnity, and then they say, 'Sure, I can trust you,'" Burton of Norton Rose Fulbright said. "What if you're not a huge sponsor, and you don't have the means to get the tax equity investor comfortable with an indemnity?"

Under the House proposal, developers can receive increased tax credits if their projects use at least 55% U.S. steel, iron or manufactured products in their projects, but they could lose some or all of any potential cash payments if they don't use enough U.S.-based materials. But Martin of Norton Rose Fulbright said the bigger concern for industry is the requirement that developers and any contractors pay prevailing wages for workers and dedicate up to 15% of all labor hours to qualified apprentices, or have the value of their tax credit cut by 80%.

While the House proposal offers ways for developers to cure any wage shortfalls, the potential haircut is so great that putting up sufficient indemnification could be a tall order for both developers and their contractors, Martin said.

"The developers don't want to wear this indemnity risk, it's a large contingent liability," Martin said. "They can ask for indemnities from the contractors, but the indemnities could exceed the caps on indemnities in these types of arrangements. I suspect some sort of tax insurance market will develop around this."

Getting the House and Senate Aligned and United

The Ways and Means Committee is expected to complete its budget reconciliation process on Wednesday. And while the House proposal envisions a broad expansion of existing clean energy tax provisions, it sharply contrasts with an earlier proposal from Senate tax writers that envisions a wholesale rewrite of the federal tax code.

The Clean Energy for America Act advanced by the Senate Finance Committee in May shrinks dozens of tax credit categories into a basic trio of tax credit categories for any technologies that decarbonize electricity generation and transportation, and increase energy efficiency in buildings and homes.

"The House approach is more granular, very technology-specific," Burton of Norton Rose Fulbright said. "The Senate side … gets Congress out of the business of trying to write definitions that then become obsolete as technology changes."

The Senate bill also wipes out several tax incentives for oil and gas companies, something the House proposal doesn't do.

While both the House and Senate approaches to tax credits share the goal of accelerating clean energy development and decarbonization, and both approaches have their benefits, reconciling them in an overall budget reconciliation bill will be challenging, experts say.

"I think there is a baby-splitting way to go about this, but it's not easy," Urban of Bracewell said. "They have to get to the point, frankly, where their success in that endeavor will put a bill on the president's desk."

And that's on top of potential resistance from more conservative Senate Democrats to big-ticket items such as the direct pay option, experts say. The sweeping nature of the House proposal has the clean energy industry both excited about its potential and anxious that it could be scaled back significantly in its trip through Congress, Urban said.

"They're almost like Charlie Brown: They're worried someone is going to pull the football out from under them," Urban said.

--Editing by Robert Rudinger.