Renewable Energy Opportunities

01.09.2011
1.10.2011

On December 17, 2010, President Obama signed into law legislation that, among other things, includes a one-year extension of the American Recovery and Reinvestment Act's Section 1603 cash-grant program. This legislation extends through the end of 2011 the deadline to start construction of new renewable energy projects to qualify for a grant of 30% of the project cost. The legislation also includes other renewable energy benefits, including bonus depreciation of energy projects placed into commercial operation in 2011.

So, what does this recent development mean to retail companies? Potentially, it may be quite significant, as retail companies typically operate a network of stores, distribution centers and other operations throughout the United States and are large consumers of energy products, such as electricity, natural gas and steam/hot water.

In today's increasingly competitive environment, retail companies are looking to balance two important, but at times competing, goals:

• Reducing their carbon footprint and operating in an environmentally friendly fashion; and

• Reducing (or at least stabilizing) a significant ongoing expense item.

Over the past several years, there have been a number of retail companies that have announced solar and other renewable energy projects in an attempt to balance the desire to operate in an environmentally responsible fashion with the reality of operating in a cost-effective fashion. For instance, this past fall Macy's, Inc. began construction of a 3.5 megawatt solar power system on the roof of its online fulfillment center in Arizona, which will provide the equivalent of 70% of the electricity demand of the 600,000 square foot facility. Federal and state programs, such as the cash-grant program noted above, together with reductions in the component prices, have made the development and commissioning of renewable energy facilities economically feasible.

Those retail companies that have undertaken these renewable energy projects have typically followed one of the two business models set forth below (for simplicity and because solar electric generation has been the primary energy source, the models are described in terms of solar electricity generation):

The PPA Model

In this model, the retail company will enter into a set of contract documents (primarily a PowerPurchase Agreement, a lease and certain "net metering/interconnection" arrangements with the utility distribution company), pursuant to which a third party (the "Solar Developer") will design, build, own and operate a

solar generation facility that is located on the retail company's facility roof (or on nearby property, if ground-mounted). The Solar Developer will then sell all of the electricity produced from the generation facility to the retail company under a long-term (usually 10 to 20 years) contract. The generation facility is typically sized to satisfy all or some material portion of the typical energy needs of the retail company's facility.

Because the Solar Developer is the owner of the generation facility, the tax benefits and otherincentives will usually flow to it, which reduces the effective capital cost of the facility and allows the Solar Developer to sell electricity to the retail company at, or sometimes below, the current electricity supply price. The Solar Developer will often retain ownership of the "renewable energy credits" or "RECs" that are associated with the electricity produced by the generation facility (although ownership of the RECs is subject to negotiation in each case). These RECs typically have an independent value, which varies depending on the available markets for selling the RECs from the generation facility.

At the end of the Power Purchase Agreement term, the retail company typically has an option to purchase the generation facility for the then-current fair market value (which is necessary to preserve the desired tax ownership structure in this model). Otherwise, the Solar Developer is typically responsible for the removal of the generation facility from the retail company's site.

The benefits of this structure to the retail company are several: (a) no capital outlay for the construction of an electric generation facility; (b) a fixed price for at least a portion of its anticipated electricity needs for a long term; and (c) an option, but not an obligation, to purchase the generation facility at the end of the arrangement.

A caveat: Due to the different retail electricity regulatory structures among the various states, this PPA structure is not available everywhere. For instance, it has been the structure of choice in many northeastern and western states, which "deregulated" their retail electricity supply markets; on the other hand, states such as North Carolina and Florida do not appear to allow this type of structure.

The Self-Build Model

For those companies that prefer to own electric generation facilities or in those locations where the PPA Model is not feasible due to the state's regulatory structure, other retail companies are electing to own these facilities themselves and contract out the construction, operation and maintenance. These projects are more akin to other capital improvements at an existing facility.

Under this structure, the tax benefits (e.g., a 30% Investment Tax Credit or the cash grant in lieu of the credit) and other incentives would flow directly to the retail company. Also, the retail company would own and be able to sell the RECs that are associated with the electricity produced by the generation facility.

The benefits of this structure to the retail company include: (a) certain tax and other benefits associated with the ownership of the generation facility; (b) control over the development and operation of the facility; (c) not being subject to PPA-type regulatory restrictions; and (d) additional income potential from the sale of the RECs and other renewable credits that may apply over the course of the generation facility's operation.

Related People

- Robert F. Riley – 202.293.8121 – rriley@williamsmullen.com
- Paul G. Saunders, II – 804.420.6470 – psaunders@williamsmullen.com

Related Services

- Retail
- Infrastructure