

New Jersey Law Provides Offshore Wind Incentives and Manufacturing Facility Tax Credits

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Last Thursday, New Jersey's Governor Chris Christie signed the Offshore Wind Economic Development Act, a law designed to provide project-tailored subsidies to 1,100 MW of offshore wind capacity and to support the establishment of offshore wind-related manufacturing in the state. The law eliminates several economic barriers to offshore wind development. At least four offshore wind developers are expected to be competing for the subsidies.

Incentives for Offshore Wind Projects

Until now, offshore wind projects have been slow to launch due to a combination of regulatory delays and project economics. Utilities hesitate to enter into long-term, fixed-price power purchase agreements (PPAs) with offshore wind developers, fearing that the high-cost contracts would become a stranded asset if their customers migrate to lower-priced energy suppliers. Valuing the long stream of renewable energy credits (RECs) from these projects also is a challenge since the REC market is small and fragmented, and state renewable portfolio standard program requirements may change over time. On the developer side, a long-term PPA is essential to financing an offshore wind project. Uncertainties in project capital costs, permitting timelines, renewable energy credit revenues, and incentives such as the investment and production tax credits add to the hurdles.

The New Jersey law addresses the difficulty developers have had entering long-term PPAs and securing a reliable REC revenue stream. The law establishes a program administered by the New Jersey Board of Public Utilities (NJBPU) that provides a fixed, long-term offshore wind production payment in the form of an offshore renewable energy certificate (OREC) that a qualified offshore wind project can earn for each megawatt-hour of offshore wind produced.

While regulations remain to be adopted by the NJBPU, the law provides that a qualified offshore wind project is a wind turbine electric generating facility located in the Atlantic Ocean that is connected to the electric transmission system in New Jersey, and that has been approved by the NJBPU. A developer of an offshore wind project may seek qualified status by submitting an application to the NJBPU. The application should describe the project in detail and include a complete financial analysis

showing cash flow projections for 20 years, expected state and federal tax benefits, and the project's internal rate of return. In addition, applications should include project financing details, operations and maintenance cost estimates, energy output estimates, and revenue estimates that show market price estimates over the anticipated life of the project, capacity sales revenues, OREC revenues, and revenues from any other tradable environmental attributes created by the project. The application also should describe the project's non-financial benefits such as its carbon emissions and other environmental impacts, and contain a cost-benefit analysis showing the project's impact on income, employment, wages, taxes and output in New Jersey.

Among the detailed application requirements, it is most notable that the applicant is required to provide a proposed OREC pricing method and schedule for the NJBPU to consider. Essentially, the developer's proposed OREC revenue is the "plug" in the financial model that gives the developer the desired rate of return. We expect the NJBPU to evaluate a developer's required OREC subsidy in light of the various benefits of the proposed project and competing offshore wind projects, if any, and determine whether a particular application merits an OREC subsidy and in what amount. The OREC could be compared to a tailor-made feed-in tariff; one that is set in part through competition and in part through regulatory judgment to provide the minimum (or reasonable) subsidy necessary to incentivize a viable offshore wind project.

This is the key innovation of the New Jersey law and sets it head and shoulders above conventional fixed-price feed-in tariff and REC programs. Given the newness of offshore wind energy in the United States and rapid changes in the cost of turbines, foundations, towers, cabling and other inputs to production, it is probably impossible to set a feed-in tariff price that is rich enough to encourage offshore wind development, yet not so generous that it provides excessive profits. The New Jersey OREC, however, is based on an open book inspection of the project and an analysis of its estimated revenues and required return. As the NJBPU acquires experience in evaluating these applications, and especially if it has the opportunity to evaluate competing applications side-by-side, the NJBPU should be able to narrow-in on the "efficient" subsidy level needed to incentivize offshore wind construction. Also, as noted above, difficulty in estimating the value of a REC revenue stream over the long-term makes RECs a poor subsidy mechanism. In contrast, an order by the NJBPU awarding ORECs would specify the value of the OREC and the term of the order. Moreover, the order cannot be modified by a subsequent NJBPU order, unless the modification is agreed to by the parties. Fixed OREC

prices will provide developers with revenue predictability that will be of great value in securing long-term project financing at reasonable terms.

The New Jersey law also succeeds in protecting utilities that had resisted any requirement that they enter into high-priced offshore wind PPAs. The law contemplates that offshore wind developers will sell the energy produced by offshore wind projects as a commodity product, on market terms. The NJBPU will establish a program that requires a percentage of electricity sold by the state's electric power suppliers to be from offshore wind energy "in order to support at least 1,100 megawatts of generation from qualified offshore wind projects." The percentage established by the NJBPU will reflect the projected OREC production of the qualified offshore wind projects approved by the NJBPU so that supply and demand for ORECs should match. An OREC subsidy order issued by the NJBPU to a wind developer for a 20-year term would match OREC purchase requirements imposed by the NJBPU on electricity suppliers for an equal term and amount of offshore wind production. Electric suppliers will satisfy their offshore wind purchase requirements by purchasing ORECs at a price and for the time period required by the NJBPU.

Although the actual movement of funds is not clear from the statutory text, it appears that the NJBPU acts as a broker between retail electricity suppliers and offshore wind projects. The NJBPU purchases the environmental attributes of offshore wind energy production from each wind project at a fixed price through a long-term OREC contract, then the NJBPU imposes an OREC purchase obligation on New Jersey retail suppliers to acquire ORECs (from the NJBPU) in an amount equal to the NJBPU's OREC inventory and at a price set by the NJBPU. We assume that the NJBPU would set the OREC price at the level necessary to fully recover the total cost of its portfolio of OREC subsidy orders. Importantly, under this system no individual retail electricity supplier is subjected to a long-term OREC purchase obligation that would put it at a competitive disadvantage vis-à-vis other retail suppliers in the state.

Incentives for Manufacturing Facilities Related to the Offshore Wind Industry

The New Jersey law provides financial incentives for offshore wind industry growth in addition to the OREC subsidy system. The New Jersey Economic Development Authority (EDA) is given broad discretion to provide grants and other forms of financial assistance from New Jersey's Global Warming Solutions Fund to "develop qualified offshore wind projects . . . and to provide financial assistance to manufacturers of equipment associated with qualified offshore wind projects."

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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Probably even more valuable are the tax credits that the EDA can provide. A business may apply to the EDA for a credit of 100% of its capital investment in “a qualified wind energy facility located within an eligible wind energy zone.” The EDA may approve under this provision tax credits up to \$100 million in the aggregate for all applicants, taken over a 10-year period. A qualified wind energy facility means buildings, including port improvements, and machinery and equipment used in the manufacturing, assembly, development or administration of component parts that support the development and operation of a qualified offshore wind project (or other wind energy project determined by the EDA), and that are located in a wind energy zone. The term “wind energy zone” refers to property located in the South Jersey Port District. In particular, a brownfield site in Paulsboro, New Jersey, once used as an oil terminal is being redeveloped as a deep water port on 190 acres along the Delaware River. It is hoped that this port will become the focus of offshore wind manufacturing in New Jersey and, perhaps, the Mid-Atlantic region.

New Jersey’s Offshore Wind Economic Development Act is a major step forward to unlocking the economic barriers that have slowed wind energy development in the United States. Up and down the Atlantic coast states have been searching for ways to promote offshore wind for regional clean energy supply and economic development. Many of these states have renewable energy requirements that will increase substantially over the next decade that cannot be met with local renewable resources unless offshore wind is developed. Clearly, Mid-Atlantic region politicians would prefer to see the subsidies that consumers pay for clean energy used to support local job creation, rather than used to purchase RECs from the Midwestern states or elsewhere. Given its various advantages, it would not be surprising if New Jersey’s OREC subsidy system were adopted by other coastal states.

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