HUNTON& WILLIAMS

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Contents

Sustainability & Corporate Clean Power 1

IRS Issues Updated Guidance on Beginning of Construction Requirements Under Sections 45 and 48 of the Internal Revenue Code 2

IRS Wind Projects Win More Than $206 Million in Section 1603 Grant Litigation 3

Protections Against Mechanic's Liens 3

Sustainability & Corporate Clean Power

Hunton & Williams LLP recently announced the formation of a cross-disciplinary legal team to advise corporations and investors on sustainability issues as well as such clients' efforts to increase the utilization of renewable energy.

This move, which reflects increased client demand for the Firm's capabilities in these areas, brings together lawyers with extensive experience in transactional, finance (including "green bonds" and similar programs), corporate, securities, tax, environmental and real estate law to counsel clients on the complex legal issues arising out of participation in the market for renewable energy and related transactions. This initiative also centralizes the Firm's data center development and financing expertise.

"Retailers, manufacturers and technology companies are either entering the renewable energy arena for the first time or are significantly bolstering their current positions," said Eric R. Pogue, a partner in the firm's Washington office who heads the Firm's efforts in this space. "This multidisciplinary initiative will focus on the unique legal issues that companies face in meeting their sustainability and clean power procurement goals."

As part of the firm's renewable energy practice group, this new Sustainability and Corporate Clean Power team will counsel corporations and investors on matters related to:

- Clean power procurement
- Green bonds and similar clean power financing and investment transactions
- Development of sustainable facilities, including data centers
- Tax equity investments
- Joint ventures with renewable energy companies
- Renewable energy certificate (REC) trading
- Securities law compliance
- Project permitting and real estate
- Environmental law compliance

IRS Issues Updated Guidance on Beginning of Construction Requirements Under Sections 45 and 48 of the Internal Revenue Code

David Lowman, Laura Jones, Tim Jacobs and Hilary Lefko

The Internal Revenue Service has issued updated guidance on the “beginning of construction” requirement under Sections 45 and 48 of the Internal Revenue Code. On December 15, 2016, the Internal Revenue Service released Notice 2017-04, 2017-[ ] I.R.B. [ ] (“Notice 2017-04” or “the Notice”), which provides updated guidance on the beginning of construction requirement. The Notice extends and modifies the guidance previously provided in Notice 2013-29, 2013-1 C.B. 1085, Notice 2013-60, 2013-2 C.B. 431, Notice 2014-46, 2014-36 I.R.B. 520, Notice 2015-25, 2015-13 I.R.B. 814, and Notice 2016-31, 2016-23 I.R.B. 1022 (collectively, the “Prior IRS Notices”). Notice 2017-04 extends, modifies, and clarifies Notice 2016-31 with respect to the “Continuity Safe Harbor” and clarifies the application of the 5 percent safe harbor to retrofitted (or repowered) facilities. The Notice provides that the prior guidance continues to apply except as specifically changed.

The guidance in Notice 2017-04 is relevant for facilities claiming the production tax credit under Section 45, including wind facilities. Notice 2017-04 does not provide guidance for the ITC for solar energy facilities, but it confirms that such guidance is forthcoming.

Modifications and Additional Guidance on the Continuity Safe Harbor

The Prior IRS Notices provide that once construction has begun under either the physical work test or the 5 percent safe harbor, there must be continuous construction or continuous efforts (collectively, the “continuity requirement”). Notice 2016-31 discontinued the practice of fixing specified dates by which a facility must be placed in service to satisfy the continuity requirement and instead provides that a facility must be placed in service by the later of (1) a calendar year that is no more than four calendar years from the calendar year in which the facility began construction (the “four-year lookback”) and (2) December 31, 2016 (the “Continuity Safe Harbor”). Notice 2016-31 provides an example, stating that a facility on which construction begins on January 15, 2016, will be deemed to satisfy the Continuity Safe Harbor if that facility is placed in service by December 31, 2020.

Notice 2017-04 extends the December 31, 2016 deadline to December 31, 2018. This means that any facility that is placed in service by December 31, 2018, will satisfy the Continuity Safe Harbor and thus be deemed to satisfy the continuity requirement. Notice 2017-04 confirms the example in Notice 2016-31 and provides a new example: if construction begins on a facility on January 15, 2013, and the facility is placed in service by December 31, 2018, the facility will be considered to satisfy the Continuity Safe Harbor. Any facility placed in service after December 31, 2018, will be required to apply the four-year lookback.

Notice 2016-31 imposes a rule that a taxpayer may not delay the begun construction date of a facility for purposes of the Continuity Safe Harbor by relying upon the Physical Work Test and the 5 percent safe harbor in alternating calendar years. The Notice states, for example, that if a taxpayer performs physical work in 2015 and then incurs 5 percent or more of the total cost of the facility in 2016, the Continuity Safe Harbor will be applied beginning in 2015, not 2016. In other words, you must determine application of the Continuity Safe Harbor based on the first year in which construction began. You cannot move that date forward by doing additional work or incurring additional costs in a subsequent year. Notice 2017-04 clarifies that the prohibition on alternating methods only applies to facilities for which construction commenced after June 6, 2016. This suggests that any facilities that commenced construction prior to June 6, 2016 may use the last year in which one of the two methods was satisfied as the start date for the four-year lookback.

Application of the 5 Percent Safe Harbor to Repowered Facilities

As stated in the Prior IRS Notices, a facility may qualify as originally placed in service, despite containing used property if such used property comprises no more than 20 percent of the total value of the facility. This rule is generally referred to as the 80/20 rule. The 80/20 rule applies separately to each facility, i.e., each

separate wind turbine. Notice 2017-04 confirms that, in circumstances where new property is used to retrofit or repower an existing facility, only costs relating to the new construction should be taken into account for purposes of satisfying the 5 percent safe harbor. The costs incurred for the new work are then compared to the total costs for all of the new work to determine whether the 5 percent safe harbor is satisfied. No part of the value of the old property is taken into account in applying the 5 percent safe harbor test. Notice 2017-04 clarifies that for purposes of the 80/20 rule, the cost of new property includes all costs properly included in the depreciable basis of the new property.

The new guidance provides needed comfort and clarity in evaluating which projects will satisfy the beginning of construction requirement.

Click the following link for a copy of Notice 2017-04. If you have any questions regarding the Notice, please contact us.

Wind Projects Win More Than $206 Million in Section 1603 Grant Litigation

Tim Jacobs, David Lowman, Laura Jones and Hilary Lefko

On October 24, 2016, in *Alta Wind I Owner-Lessor C et al. v. United States*, Nos. 13-402T et al., the US Court of Federal Claims ("the Court") ruled in favor of the owners of six wind farm facilities who had applied for grant funds under Section 1603 of the American Recovery and Reinvestment Act ("the 1603 Grant"). This case is an important development in the renewable energy area as the Court rejected all of the government's arguments for reducing the 1603 Grant. Treasury routinely made these same arguments to reduce the 1603 Grants claimed by numerous parties in renewable energy projects that qualified for the 1603 Grant program.

The wind farm owners had sought more than $206 million in the litigation, which they alleged the Treasury Department had underpaid, and the Court's decision awarded the entire underpaid amount to the plaintiffs. The *Alta Wind* case involved 20 plaintiffs and eight complaints, each of which involved the sale and leaseback of wind energy facilities. The developer was both the seller and the lessee in the sale-leaseback transactions.

The *Alta Wind* case is one of numerous cases in which Treasury reduced grant awards to applicants on the basis that the purchase price paid for renewable energy facilities involved "peculiar circumstances" and required allocation of cost basis to nonqualified intangible assets. As the Court summarized, "[t]he government maintains that basis really should be calculated from the value of each wind farm's grant- eligible constituent parts and their respective development and construction costs, citing a myriad of factors that allegedly made the purchase prices an unfair measure of each wind farm's value." The Government also argued in *Alta Wind* that "the residual method of accounting" under Internal Revenue Code (IRC) Section 1060 was applicable. The Court rejected those lines of attack by Treasury and upheld the cost basis reported by the wind farm owners as evidenced by the purchase price they paid.

A copy of the *Alta Wind* opinion is available here. The Court had previously granted the government's motion for full discovery and stayed the wind farm owners' summary judgment motions. For a full copy of a client alert, click here or for a prior alert, click here. The *Alta Wind* case is one of a number of Section 1603 Grant cases being litigated in the Court of Federal Claims.

Protections Against Mechanic's Liens

Michael Klaus

The following article highlights a few of the ways for lenders, investors and sponsors to protect against the risk of losses due to a mechanic's lien.

Overview of Mechanics Liens

Each state has a statute under which a contractor, subcontractor or supplier has an automatic right to a lien on a project for the value of the contractor's work until the contractor is paid. To enforce a lien, a contractor generally must record notice of the lien in the county where the project is located within a certain period of time.

Unlike a UCC Article 9 lien or a deed of trust, a mechanic's lien does not require a security agreement or pledge by the project company, or even an agreement between the project company and the party asserting a lien. While priority of UCC liens and mortgages is generally determined by the "first to file"

rule, a mechanic's lien has priority over a lender's mortgage if work began before the lender's filing (i.e., lien priority relates back to the first day of work).

Lien laws vary by state and are subject to change. Such differences could significantly affect the scope of liens and the losses that may result from unpaid subcontractors. Some states cut off the lien rights of lower-tier subcontractors; for example, in Arizona lien rights apply only to persons who have an agreement with the owner or with a contractor that has an agreement with the owner. In addition, some states, such as New York and Texas, limit the value of a subcontractor's lien to the remaining amount that has not been paid to the general contractor.

Key Protections Against Mechanic's Liens

- **File notices or other instruments prior to the start of work in order to (1) protect against the risk of a mechanic's lien from an unknown subcontractor and/or (2) limit liability for subcontractor's liens**. In several states, including North Carolina and Ohio, the owner of a project records a notice or designates a lien agent prior to commencement of the work; to be protected by lien laws, any subcontractor must notify the owner and lender (or agent) that it is working on the project at the outset of work. Once subcontractors are identified, the owner/lender can protect itself by obtaining lien waivers from those subcontractors. In Colorado, if a memorandum of the prime contract is filed in the county, subcontractors' liens are limited to the unpaid amount under the prime contract; if the prime contract is not filed in the county, the value of the subcontractor's lien may exceed the amount that remains owed to the general contractor.
- **File deed of trust prior to start of construction (for purposes of establishing priority of lien).** As noted above, given that the priority of a mechanic's lien relates back to when work began, lenders should ensure that a deed of trust is filed prior to start of construction. Where construction has already commenced, lenders may require a contractor to enter subordination agreements, subordinating the contractor's lien rights to those of the lender. However, Nevada courts have ruled that such subordination agreements are not enforceable.
- **Require payment bonds as security for subcontractor liens.** In many states, including Texas, an owner may require a contractor to post a "statutory" bond, which is recorded in the county; subcontractors then must look to the bond as security for the contractor's failure to pay the subcontractor. Given the expense of such bonds, most creditworthy, reputable contractors resist providing bonds.
- **Require liens waiver as a condition to funding.** Each invoice from the contractor should attach: (a) a conditional lien waiver, waiving liens through the invoice date upon receipt of payment, and (b) an unconditional lien waiver, waiving liens through the date of the previous invoice for which payments have been received. In several states, a lien waiver must comply with a form prescribed by the applicable state.
- **Lenders' Title Insurance**. Extended mechanic's lien coverage under a lenders' title policy is available in many states, subject to the title company receiving an affidavit from the owner and lien waivers. Without extended coverage, a title policy has an exception for unfiled mechanic's liens.
- **Representations and indemnities from the sponsor.** Transaction agreements include representations from the sponsor regarding the absence of liens, other than mechanic's liens of contractors for amounts that are not then due and payable.

Mechanic's liens are a state-specific area of law, requiring close coordination with title companies and, if applicable, local counsel. In financing transactions, negotiated protections against mechanic's liens depend on, among other factors, the reputation of the contractor, availability of title insurance coverage in the state, and the unique features of the applicable state's lien statute.

Hunton & Williams' Renewable Energy Newsletter is prepared quarterly to provide general information about selected clean power developments and issues for attorneys at Hunton & Williams LLP, and is provided to clients and friends of Hunton & Williams LLP. It is not intended to provide legal advice or legal opinions and must not be relied on as such.

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