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USA: Trends and Developments

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Trends and Developments

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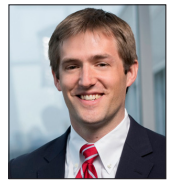

Chris Bowles is co-chair of Bradley Arant Boult Cummings LLP's renewable energy team and regularly advises solar developers, owners, operators and Engineering, Procurement and Construction (EPC) contractors regarding all stages of project finance and development, including debt financing and tax equity. Chris is active in real estate acquisitions, due diligence, permitting and zoning compliance for solar developers and advises clients on project documents, including power purchase agreements, interconnection agreements and EPC contracts, state and federal regulatory matters, and tax incentives. His work on utility and commercial-scale solar energy projects includes some of the largest developments in the eastern USA.

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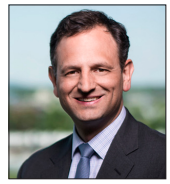

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Inflation Reduction Act

The most significant developments in the area of alternative energy continue to be related to the Inflation Reduction Act of 2022 (IRA), which offers approximately USD270 billion in tax incentives to help combat climate change. Its provisions are transforming the American manufacturing and clean energy landscape, expanding the economic appetite for emerging technologies, generating renewed development of domestic manufacturing, and providing renewable energy projects with a decade-long investment tax credit (ITC) for investment in qualified facilities. The IRA seeks to accomplish these goals through direct incentives to entities on both the supply and demand sides of the clean energy industry. Specifically, targeted tax credits were established for manufacturers in the clean energy supply chain and for those seeking to deploy clean energy projects, which – in turn – are creating additional demand for the products in that supply chain.

Since the IRA was enacted in 2022, many of its provisions continue to be interpreted by the US Department of the Treasury and the Internal Revenue Service in the rule-making process.

Prevailing wage and apprenticeship requirements

To obtain the highest level of facility-specific tax credits established by the IRA, taxpayers are required to ensure labourers or mechanics employed in the construction, alteration or repair of a qualified facility are paid federal prevailing wages and to make good faith efforts to ensure employment of apprentices (known as the "PWA requirements"). Following issuance of pre-regulatory guidance, issuance of a notice of proposed rule-making, and associated public comment periods, on 25 June 2024 the Department of the Treasury and the Internal Revenue Service published the final rule for compliance with the PWA requirements.

The final rule provides important clarification for taxpayers, developers and contractors in the renewable energy industry. It confirms that PWA requirements – although not equivalent to compliance requirements imposed by the Davis-Bacon Act (40 USC Section 3141 et seq) – will be interpreted in harmony with certain Davis-Bacon definitions, particularly with regard to:

- which workers constitute labourers or mechanics subject to PWA requirements; and
- what work constitutes construction, alteration or repair subject to PWA requirements.

The final rule clarified that the applicable prevailing wage determination will be the active determination at the time of execution of the construction contract – provided that additional substantial construction, alteration or repair not within the original scope of the contract or performed for additional time may require the parties to refresh the applicable prevailing wage determination. In addition, contracts with annual or annually renewed terms may be required to refresh the applicable prevailing wage determination.

As expected and consistent with the notice of proposed rule-making, the final rule for PWA requirements provided a process by which taxpayers, contractors and subcontractors may seek supplemental wage determinations from the Wage and Hour Division of the US Department of Labor, where existing prevailing wage determinations do not provide for all labour classifications needed based upon the project type. Supplemental wage determinations should be requested no earlier than 90 days prior to execution of the construction contract and will remain

effective for 180 calendar days after they are issued (or for the duration of the time the supplemental wage determination is incorporated into the contract).

With regard to apprenticeship requirements, the final rule confirms the previous proposed rule-making structure requiring taxpayers to confirm compliance with three separate elements: the labour hour requirement, the ratio requirement, and the participation requirement.

Taxpayers may satisfy the apprenticeship requirements by relying on the "Good Faith Effort Exception", which consists of diligent record-keeping of requests to registered apprenticeship programmes in an effort to employ qualified apprentices for construction, alteration or repair of the facility. The final rule provided significant additional detail on how a taxpayer may rely on this Good Faith Effort Exception, including with regard to a programme's partial denial of requests and how to manage unavailability of apprentices from employer-sponsored registered apprenticeship programmes.

In the event a taxpayer fails to comply with the PWA requirements, the taxpayer may elect to remit correction and penalty payments to the Secretary of the Treasury in order to cure the failures. However, correction and penalty payments double or triple if the taxpayer is found to have engaged in "intentional disregard" of such PWA requirements, which is a determination of wilful and knowing non-compliance based on the relevant facts and circumstances. Taxpayers are entitled to a rebuttable presumption of no intentional disregard if the taxpayer makes the appropriate correction and penalty payments prior to receiving notice of examination from the Internal Revenue Service. The final rule provides specific examples of mitigating factors against intentional disregard, including establishing compliance programmes, ensuring workers are notified of the applicable prevailing wages, and obtaining and maintaining relevant records.

However, the final rule declines to provide industry-specific guidance, and indeed removes a solar industry-specific example used in the proposed rule-making. It emphasises that compliance with PWA requirements will be determined after review of specific facts and circumstances, and therefore leaves many of the detailed questions raised in comments to the notice of proposed rule-making unanswered – including many scope and task-specific questions of the applicability of PWA requirements.

Domestic content bonus

The IRA also established an additional 10% tax credit "bonus" (subject to compliance with PWA requirements) for facilities that procure and install domestically produced equipment. The rule-making process relating to this domestic content bonus remains ongoing and, to date, the Department of the Treasury and the Internal Revenue Service have only issued pre-regulatory guidance and supplemental guidance, the domestic content bonus (combined with a production tax credit available to manufacturers for domestic manufacturing) continues to spur significant investment in US manufacturing.

The pre-regulatory guidance for the domestic content bonus was released on 12 May 2023. It established two prongs to satisfy compliance for eligibility for the domestic content bonus:

- domestic procurement of all structural steel and iron; and
- procurement of an adjusted percentage of domestic manufactured equipment.

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The calculation of which manufactured equipment may be included in this adjusted percentage depends upon the location of manufacture of each first-level component of such manufactured equipment. The pre-regulatory guidance established a formula using the direct costs of each domestically produced first-level component of manufactured equipment and provided a table of non-exclusive examples of such equipment and components.

Many in the industry found compliance with the pre-regulatory guidance's calculation of the adjusted percentage impractical, as suppliers are reluctant to disclose direct costs of their supply chains.

On 16 May 2024, the Department of the Treasury and the Internal Revenue Service took the unusual step of publishing supplemental guidance to the pre-regulatory guidance, which offered taxpayers an alternative route to achieve the required adjusted percentage without disclosure of direct costs. The supplemental guidance's new elective safe harbour allows taxpayers seeking to qualify for the domestic content bonus for three types of facilities (solar photovoltaics, onshore wind, and battery energy storage systems) to calculate the adjusted percentage pursuant to a predetermined value for specified components of major manufactured products installed in the facilities. For facilities consisting of combined solar PV and battery energy storage system technologies, the new elective safe harbour establishes a "BESS multiplier" to allow equivalent calculations of each technology's adjusted percentage. If a taxpayer elects to proceed pursuant to the new elective safe harbour, the taxpayer must use only the specified equipment and components in the supplemental guidance, and cannot rely on the prior pre-regulatory guidance's direct cost formula.

Overall, the new elective safe harbour offers taxpayers the advantage of an objective, pre-formulated calculation of the adjusted percentage necessary for eligibility for the domestic content bonus. However, it appears to be less advantageous for combined solar PV and battery energy storage system facilities, because its predetermined values for components heavily favour batteries with domestically produced cells (not yet widely available in the market).

The recent supplemental guidance is not a notice of proposed rule-making. The industry continues to await issuance of the notice of proposed rule-making – and, eventually, final rule – for the domestic content bonus.

Transmission and Interconnection

In addition to the IRA, the recent Bipartisan Infrastructure Investment and Jobs Act of 2021 (the "Infrastructure and Jobs Act") provides for investment of up to USD7.5 billion in electric vehicle (EV) charging, USD10 billion in clean transportation, and USD7 billion in EV battery components, critical minerals, and materials.

Due in part to the incentives offered under the IRA and the Infrastructure and Jobs Act, renewable energy project development (eg, in wind and solar) has only accelerated in the USA in the past few years. As a result of that development, and other energy transition initiatives such as clean hydrogen, carbon capture and sequestration and advanced nuclear, grid congestion and long queue lines for interconnection have become major concerns for project developers. For the same reasons, grid reliability also is a major concern for transmission and distribution utilities. Indeed, according to one authoritative research institute (the Lawrence Berkeley National Laboratory) the US grid connection backlog grew by 30% in 2023, interconnection

queues increased nearly eight-fold, and – at 2.6 TW at the end of 2023 – the backlog is now more than twice the total installed capacity of the existing US power plant fleet. As dire as that sounds, the authors anticipate this issue will only worsen as data centres – increasingly in high demand with the emergence of AI technology – seek their share of limited grid space. For this reason, project developers of data centres are building their own microgrids while utilities play catch-up by building out more transmission and distribution capacity.

Regulatory reforms aimed at alleviating the grid interconnection backlog have been proposed and, in some instances, adopted. By way of example, the recently enacted Fiscal Responsibility Act of 2023 (FRA) included Section 321 of the BUILDER (Building United States Infrastructure through Limited Delays and Efficient Reviews) Act, which narrowed and refined the scope of environmental review required under the National Environmental Policy Act (NEPA) in an attempt to streamline the federal permitting process. NEPA reforms in the FRA include:

- narrowing the scope of review to only environmental impacts that are "reasonably foreseeable";
- limiting the scope of alternatives analysis to actions that are "technically and economically feasible, and meet the purpose and need of the proposal";
- imposing time limits on environmental impact statements (EISs) (ie, two years from the date an agency determines an EIS is required – although extensions are possible);
- imposing page limits on EISs and environmental assessments (EAs); and
- authorising project proponents to prepare EISs and EAs themselves (as opposed to the agency preparing).

Nevertheless, these regulatory reforms clearly are still trailing alternative energy development and in any event are no safeguard against costly and protracted litigation. By way of example, in Tohono O'odham Nation et al v US Dept of Interior et al, a case that was recently filed in US federal district court in Arizona in January 2024, the plaintiffs allege that the Bureau of Land Management (BLM) violated the National Historic Preservation Act (NHPA) and the Administrative Procedure Act (APA) in issuing permits to the SunZia Southwest Transmission Project for construction of a 520-mile transmission line across the San Pedro Valley for purposes of delivering primarily renewable energy from New Mexico to markets in Arizona and California. Plaintiffs seek to vacate the permits and halt construction based on alleged harm to historic and culturally significant properties, flora and fauna, and water sources sacred to Native American tribes. This case remains pending in its early stages but is typical of the tension that has arisen in recent years between renewable energy development and private landowners.

In short, the transmission and interconnection system in the USA is starting to catch up to the demands alternative energy is placing on the system. However, progress is slower than developers or utilities would like.

Developments in Administrative Law: Future of the Chevron Doctrine and Waters of the USA

Energy and power projects are subject to federal and state statutes and regulatory regimes administered by agencies at all levels of government. These can include federal permits and assessments under the Clean Water Act (CWA), the Rivers and Harbors Act, NEPA, the Endangered Species Act (ESA), the NHPA, the Migratory Bird Treaty Act, and the Bald and Golden Eagle Pro-

tection Act. Projects implicating federal land and other federal interests can be subject to additional reviews under several statutory regimes. State and local requirements vary, but these can include significant additional environmental reviews, public utility commission proceedings, and local land use and zoning approvals.

Several significant developments and trends at the federal level are altering the governmental review and permitting landscape. These include reforms to the NEPA review process in the FRA discussed earlier with regard to developments in transmission and grid interconnection. These changes should alleviate many challenges associated with NEPA compliance – although project opponents likely will test these new legal standards in federal court and seek expansive judicial interpretations of agencies' obligations to assess environmental impacts.

Additionally, recent case law developments involving federal jurisdiction over waters and federal administrative law should be closely followed by practitioners.

The US Supreme Court's opinion in Sackett v Environmental Protection Agency (EPA), 598 US 651 (2023) is significantly impacting project development, generally reducing the need to obtain permits under Section 404 of the CWA and to conduct ancillary federal reviews triggered by virtue of being under federal jurisdiction – eg, Section 7 review under the ESA and Section 106 review under the NHPA. The Sackett opinion narrowed the US Supreme Court's interpretation of the definition of "waters of the United States" (WOTUS) set forth in the CWA, thereby limiting federal agencies' (US Army Corps of Engineers' and the EPA's) authority to regulate streams, wetlands, and other water bodies. On 29 August 2023, the EPA promulgated a final rule defining WOTUS consistent with Sackett. This rule is subject to multiple ongoing federal lawsuits across the country, including an action in which Texas is leading a group of states arguing that the EPA failed to fully implement the US Supreme Court's directives in Sackett – see generally State of Texas et al v EPA, Docket No 3:23-cv-17 (SD Tex). While disputes over WOTUS continue, the overall impact of Sackett has been to reduce the scope of waters under federal jurisdiction and thereby the role of federal involvement in project permitting.

Finally, federal courts have recently called into question the "Chevron doctrine", which has generally required federal courts to defer to agency actions and decisions as long as an agency's interpretation of ambiguous authority is reasonable. The seminal case articulating this balance between the courts and federal agencies is Chevron USA v Natural Resources Defense Council, 468 US 837 (1984). The US Supreme Court, however, has narrowed the doctrine over time to give less deference to agency actions and interpretations that do not carry the force of law (eg, agency manuals and policy statements) (known as "Skidmore deference").

The major questions doctrine has also chipped away at the Chevron doctrine by limiting an agency where a claim of authority is of vast economic and political significance and Congress has not clearly empowered an agency with regard to the issue. See Util Air Regul Grp v EPA, 573 US 302 (2014); see also West Virginia v EPA, 597 US 697 (2022). Further, Sackett articulated a principle that may curtail agency deference when interpreting ambiguous text, specifically requiring statutory language to be "exceedingly clear" where it "significantly alter[s] the balance between federal and state power and the power of the government over private property". Most

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recently, on 28 January 2024, the US Supreme Court in Loper Bright Enterprises v Raimondo overruled Chevron USA v Natural Resources Defense Council, 468 US 837 (1984). The Court held that federal courts must exercise their independent judgment in deciding when an agency acts within its statutory authority and may not defer to an agency interpretation of the law simply because a statute is ambiguous. Taken together, the trend towards courts giving federal agencies less deference should generally limit their authority, particularly when regulating in areas of controversy or economic significance.

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