EXPERT GUIDE

CorporateLiveWire

April 2016

Opportunities & Developments - East Coast USA 2016

Weil

FDS GLOBAL

FULBROOK Capital Management, LLC

Shearman & Sterling LLP

Robert Freedman
robert.freedman@shearman.com
+1 212 848 4340

Patricia Hammes
phammes@shearman.com
+1 212 848 8269

Donna J. Bobbish
donna.bobbish@shearman.com
+1 202 508 8089

Natural-Gas Fired Electric Generation in PJM, ISO-NE & NYISO Lead The Way For Project Finance in First Part Of 2016; Renewable Energy Projects Receive Encouragement

By Robert Freedman, Patricia Hammes & Donna J. Bobbish

SHEARMAN & STERLING LLP

In the wake of continuing low commodity prices, including in respect of oil and natural gas, it is reasonable to anticipate that energy project development could slow in the U.S. in 2016. Despite such anticipation, the project finance pipeline for new, large-scale natural gas-fired electricity generation projects appears robust in the northern east coast U.S.

It is anticipated that, during the first half of 2016, sponsors will seek financing for at least seven natural gas-fired electricity generating projects, with most of these projects located in the markets administered by PJM Interconnection, L.L.C. (PJM), the New York Independent System Operator, Inc. (NYISO) and ISO New England, Inc. (ISO-NE).

Record-level retirements of coal-fired electricity generation facilities in the region, along with revisions to the capacity market structures in NYISO and PJM are among the drivers of this new project development. The prospect of continuing low natural gas prices gives new, combined-cycle natural gas-fired electricity generating facilities a significant cost advantage over coal-fired electricity generating facilities. In addition, low natural gas prices are reducing wholesale electricity prices, decreasing the profit margins of existing coal-fired generating facilities.

In PJM, projects seeking financing include Panda Power Funds' 850 MW Mattawoman combined-cycled, natural-gas fired electricity generation project in Brandywine, Maryland, Clean Energy Future's 940 MW Lordstown combined cycle natural gas-fired electricity generation project in Lordstown, Ohio, and Invenergy's $900 million, 1.4 GW combined cycle, natural gas-fired electricity generation project in Lakawanna County, Pennsylvania. At the end of 2015, Panda completed the $710 million debt financing of its 1 GW combined-cycle, natural gas-fired Hummel electricity generating facility in Snyder County, Pennsylvania.

In January 2016, the United States Supreme Court issued a decision reviving the Federal Energy Regulatory Commission's Order No. 745, which requires market operators, such as PJM, NYISO and ISO-NE, to pay the same price to demand response providers for conserving energy as to generators for producing it, so long as a "net benefits test," is satisfied. In *FERC v. EPSA*, 577 U.S. ___ (2016), the Supreme Court held that, contrary to the lower court's ruling, the Federal Power Act provides FERC with the authority to regulate wholesale market operators' compensation for demand response bids, because demand response directly affects wholesale rates and, in Order No. 745, FERC has not regulated retail electricity sales. Moody's has designated the Supreme Court's ruling as credit-negative for unregulated generation in PJM. According to analysts, demand response in a power market is equivalent to adding more generation to that market, lowering electricity prices for generators.

Notwithstanding the potential impact of the Supreme Court's ruling on electricity prices, to date, project development in PJM appears not to have been harmed by the Supreme Court's decision.

In NYISO, Advanced Power is seeking financing for its $1.4 billion 1 GW Cricket Valley project in Dover, New York, and in ISO-NE, Competitive Power Ventures is seeking financing for its 785 MW natural gas-fired Towantic project in Oxford, Connecticut.

The financing of new build construction of natural gas-fired projects continues to be dominated by large commercial banks. The reasons for this are several fold; first, there is significant liquidity in the commercial bank market as new participants such as the Chinese, Indian and Korean banks have started to participate in these financings. Second, the term loan B market currently is closed for all but the best structured credits as that market struggles with the continued instability of the secondary trading market and fluctuations in pricing. Indeed, a panelist

at an industry conference held in January characterized the term loan B market, the market in which institutional investors primarily operate, as "dead" to borrowers. Finally, as a general rule, project sponsors prefer to deal with commercial banks during a construction process because, in most cases, the project sponsors have a close relationship with the core banks financing their projects allowing them to address issues that come up on a relationship basis (as opposed to paying a fee to the institutional investors). Also, the commercial banks that are active in the project finance power space generally have a better ability to understand and address issues that commonly arise in construction than the term loan B market lenders.

In light of climate and clean energy policies adopted at the end of 2015, another area of anticipated continued growth is the development of renewable energy projects in the eastern U.S.

The Paris Agreement (COP21), approved by 195 countries in December 2015, created procedures and non-binding emissions targets for participating nations, encouraging the development of clean energy projects. Also in December, the U.S. Congress granted significant extensions to the investment tax credit (ITC) for solar energy investments and to the production tax credit (PTC) for wind energy investments. The PTC was extended for five years, for wind, closed-loop biomass, open-loop biomass, geothermal, landfill gas, municipal solid waste, qualified hydroelectric, and marine hydrokinetic energy projects, with developers able to claim the full credit as long as they begin construction of their projects by the end of 2016.

The ITC for solar, which was set to drop to 10% for utility-scale projects and to expire completely for residential installations at the end of 2016, will be extended at the current 30% rate for projects that start construction by the end of 2019, 26% for projects that begin construction in 2020 and 22% for projects that begin construction in 2021, provided in each case that the projects complete construction by 2024. Solar projects that begin construction in 2022 and in later years will receive a 10% tax credit.

Analysts expect that the ITC and PTC extensions will result in increased clean energy project development, particularly since tax equity is the cheapest form of financing for project developers.

At the state level, in late January 2016, New York Governor Cuomo announced the New York Public Service Commission's approval of a 10-year, $5 billion Clean Energy Fund, to be administered by the New York State Energy Research and Development Authority, to accelerate the growth of New York's clean energy economy, address climate change, and attract and leverage more than $29 billion in private sector funding of clean energy projects.

In New England, also at the end of January, the Connecticut Department of Energy and Environmental Protection, the Massachusetts Department of Energy Resources, Eversource Energy, National Grid and Unitil received a total of 24 responses to the final New England Clean Energy Request for Proposals issued in November 2015 seeking projects that will advance the clean energy goals of Connecticut, Massachusetts and Rhode Island. The selection of bidders is scheduled to take place between 26 April and 26 July 2016.

Robert Freedman and Patricia Hammes are partners in the Project Development and Finance group at Shearman & Sterling. Each regularly represents borrowers and lenders in project finance transactions in power, renewables, oil and gas, transportation and other infrastructure sectors. Donna J. Bobbish is counsel in the Project Development and Finance group at Shearman & Sterling. She represents and advises clients with respect to energy regulatory developments, issues, requirements arising in project development, and finance and merger and acquisition transactions.