

A year on from the IRA: A lawyer's view from past to future

Inflation Reduction Act | PV Tech Power Editor Andy Colthorpe speaks with John Leonti, head of the energy transactional practice at law firm Troutman Pepper, who reflects on the year since the Inflation Reduction Act (IRA) passed, and considers what we might see going forward.

John Leonti has represented sponsors and investors in the energy sector for over a decade, and says “probably 99%” of his time these days is spent working on solar, wind and battery storage deals. His and Troutman Pepper’s track record includes “helping some of the utilities craft their first power purchase agreements, tolling agreements in respect of standalone batteries”.

“We’ve really seen the space grow up, it’s been exciting to watch and learn, and see how these transactions are going to be transformative for the US power grid.

This Q&A can be read as an accompaniment to our contributed article from lawyers Adam Schurle and Morten Lund from Foley Lardner, also in this edition of ‘Storage & Smart Power’.

Leonti says Troutman Pepper is “very excited” about the IRA, especially the inclusion of the investment tax credit (ITC) for standalone energy storage. It’s “a game changer for the industry and how we’re going to be able to build out this technology in the space,” Leonti tells Andy Colthorpe.

What has the impact been of the IRA in the year since its passing?

The first thing that we really noticed was the influx of new entrants into the market. Most folks outside the US, a lot of European, whether private equity, infrastructure, or utilities, conglomerates really moved into the US pretty quickly after the passage of the IRA.

That was certainly true in the battery space, whether that’s being an independent power producer (IPP) for batteries, or wanting to build a manufacturing plant for batteries. It felt like



Credit: QCELLS

almost overnight, we saw lots of new entrants into the market.

For batteries, you went from a market where there was no investment tax credit (ITC) available for standalone storage. It had to be co-located with solar. Then you went to a market now where standalone batteries are eligible for the ITC. So the excitement level went through the roof.

On top of that, you now have this transferability market where potentially you didn’t have to do a traditional third party tax equity transaction to finance your project, you could just sell your credits.

Aerial view of the first grid-scale BESS acquired by international solar player QCELLS, a 190MW/380MWh project in Texas.

One of the really interesting things that battery folks got excited about is that on the energy storage side, lots of battery IPPs would like to run their projects, either 100% merchant or on a quasi-merchant basis, which doesn’t lend itself well to traditional tax equity, because tax equity is conservative. There’s more demand and supply of tax equity in the United States and therefore, it allows them to be more conservative on the types of projects they finance.

So the transferability market is there, allowing battery IPPs to really open up the market, run the battery and

optimise the battery how they see fit in their market, whether it be the CAISO or ERCOT or otherwise, and not have to worry about getting what they view as contracted revenue that can potentially impact their returns. So the transferability market is really a helpful tool for battery players to play in the market and keep their projects less contracted than they otherwise would have to be to get traditional tax equity.

Those are some really big changes. Of course, prior to its passing, for many years, the industry's biggest ask of government was for an ITC. But without transferability, it sounded at first as though financing might get complex and even a little expensive for some market participants.

I think that's right, but maybe not even so much that it gets expensive. It was just, I think, how they (IPPs) built their business models and how they were going to run their battery plants may have to have shifted. If you have to get a long-term contract when you were looking at more short-term contracts and some merchant optimisation, it's just a different business model.

I think we all saw that California raced into a leading position in the US grid-scale battery energy storage system (BESS) market with long-term contracts for resource adequacy (RA), but Texas is set to overtake, probably during 2023, based on merchant opportunities with few, if any, long-term contracts. Are the deals and transactions that come across your desk shifting more towards merchant revenue based projects, or are people still kind of looking where possible to limit their exposure to risk with long-term contracting where they can?

In California, we're certainly seeing long-term contracts continuing to be executed, and that is what we're seeing in the market for standalone storage. For some co-located batteries, we're seeing different types of strategies. But for standalone storage, we are seeing most of those deals being [locked] up with long-term contracts, and it's great that that's available in that market.

In ERCOT, we're seeing a mix where battery sponsors, energy storage sponsors, are really trying to balance running their projects on a merchant basis with what will optimise their financing opportunities.

Because if you do have some contracts, you could potentially raise more debt,

you can maybe get a traditional tax equity player in there and so your economics may look better than on a fully merchant basis. So we are seeing a mixture there, but certainly in the portfolio deals that we're seeing, there's a large merchant component to these deals.

The other thing in ERCOT is, there's not a vast ability to contract your storage project. There's limited offtake opportunities right now that seem to be economically viable for battery sponsors. That's one area where I think the market needs to find a solution; if folks want to move to more of an offtake structure in ERCOT, what are those battery offtake contracts going to look like?

In a recent report Troutman Pepper published, the firm offered up five trends for US energy storage investment post-IRA to watch out for. One of those was that despite the standalone storage ITC's introduction, solar-plus-storage will remain a popular asset class for development. Can you elaborate on that view?

I think co-location of batteries, in particular with solar, is something that we will continue to see, particularly here out west. It seems to make sense. There's an offtake market for the battery, there's an offtake market for the solar, so we will continue to see solar-plus-energy storage projects being built. At this point, based on the deals that we're helping finance this year, when we're financing a solar project, I would say the split right now is 50:50, meaning that 50% of the projects are being built with batteries and 50% of projects are being built without batteries, and a lot of them are being driven by the location where they're being built. We're certainly seeing solar-plus-storage in California, as well as in ERCOT.

Generally speaking, folks are really interested in trying to see how they firm up renewables, and obviously energy storage can help with that. With the battery storage eligible for its own ITC, it doesn't have to be co-located with solar to get the ITC which was somewhat of a driver of some of that [solar-plus-storage development]. Previously the battery always needed to be charged from the solar in order to get the ITC for the first five years, you can do some grid charging, but more or less, you have to charge it from the solar facility.

So now that batteries has its own standalone ITC, you don't have to worry about that connection. Now the co-location just has to do again, with

optimising the grid, plus your solar facility. I would take that one step further: now with the Inflation Reduction Act and Federal Energy Regulatory Commission (FERC) efforts to reform grid interconnection, broader than just co-locating with solar, you can think about co-locating with wind, with existing gas generation. These incremental steps that are supporting the energy transition, are really benefiting batteries in ways that prior to the IRA were on the table, but the economics were more challenging.

Another post-IRA investment trend Troutman Pepper identified is that the firm expects large institutional investors to back grid-scale BESS projects, with the inclusion of tax credit transferability having broadened the pool of companies that can benefit from tax credits. Attracting institutional investors has always been an aim of maturing clean energy markets. How do you see that playing out?

We always had our traditional tax equity investors, basically the large US banks, and on the wind [industry] side, several insurance companies, and then several OEMs. That was kind of the market for tax equity, generally speaking.

Over the last several years, we've had a few large corporates, mostly on the tech side, come into the market to do traditional tax equity. Although the IRA passed just over a year ago, the proposed regulations for transferability rules just came out early this summer and the amount of folks who are non-banks and not large corporates, but are in the market to buy tax credits -- we're just constantly seeing new entrants, companies that have US tax capacity as a US tax liability, looking to buy tax credits. It will be and it is a massive sea change in the market.

You are going to see more availability of ways to monetise the tax credits. Whether it is a better economic deal than doing traditional tax equity, I think remains to be seen, because you are just transferring the tax credit and you're not transferring the depreciation. So there is some potential economic hit if the depreciation is stranded, and there's some other [potential] economics that are being left on the table. But the transferability market is a fantastic strategy to allow for projects to be built. It's great for the industry, and it allows for another tool that can be utilised by sponsors to get their projects built and help accelerate the energy transition. ■