

1 Pre-Filed Rebuttal Testimony of Jim Kennerly and Tobin Armstrong –
2 Sustainable Energy Advantage, LLC
3

4 Jim Kennerly and Tobin Armstrong hereby testify under oath as follows:

5 **Mr. Kennerly, please state your name, employer, and title.**

6 My name is Jim Kennerly. I am employed by Sustainable Energy Advantage, LLC (“SEA”) as a
7 Director.

8 **Mr. Armstrong, please state your name, employer, and title.**

9 My name is Tobin Armstrong. I am employed by SEA as a Principal Analyst.

10 **Have you submitted other testimony in Docket 22-39-REG?**

11 Yes, we submitted joint Direct Testimony to accompany the 2023 recommended ceiling prices.

12 **What is the purpose of your Rebuttal Testimony?**

13 The purpose of our Rebuttal Testimony is to answer the Direct Testimony of the Division of
14 Public Utilities and Carriers’ Witness Michael Brennan (hereafter DPUC and “Mr. Brennan”,
15 respectively).

16 **In Direct Testimony, did the DPUC make assertions regarding their position over time with
17 regard to the incorporation of bonus depreciation assumptions into the ceiling price
18 calculations?**

19 Yes. In Mr. Brennan’s testimony, he accurately states that “the Division has long maintained that
20 this incentive should be included in the ceiling price calculations.”

21 However, we do wish to respectfully supplement Mr. Brennan’s statements with some further
22 context for the Commission – specifically, in prior years (including as explicitly stated in Mr.
23 Brennan’s Direct Testimony filed in Docket 5088), the DPUC has accepted SEA’s assumptions
24 for those prior program years that certain projects could not reasonably claim bonus depreciation
25 when claiming the full (or mostly full) value of the tax credits.

26 **Does SEA believe it is unreasonable in principle to incorporate bonus depreciation
27 assumptions into the ceiling price calculations?**

28 Not at all. In fact, SEA has incorporated partial bonus depreciation assumptions into the tax
29 credits for projects that lose their ITC, PTC or ITC in Lieu of PTC (ILoPTC) eligibility as a
30 result of a legislative sunset. Furthermore, as noted later in this testimony, SEA is open to
31 assuming bonus depreciation is monetized by REG project investors once more clarity becomes
32 available with regard to how project ownership is structured under the new tax credit
33 transferability regime established by the Inflation Reduction Act of 2022 (P.L. 117-169,
34 hereafter “the IRA”).

1 **For the Commission’s benefit, please describe and illustrate, in as simple terms as is**
2 **feasible for this testimony, a typical project equity ownership structure for a renewable**
3 **energy project that does not assume the transfer of a tax credit to an unrelated third party.**

4 Certainly. Under a structure in which the applicable tax credit is not transferred, the project
5 company (a limited liability corporation, or LLC) is typically owned by a partnership. That
6 partnership represents both a tax equity investor participant (usually, a large corporation with a
7 large tax appetite and an interest in investing in renewable energy projects) and a sponsor equity
8 investor participant. The sponsor equity participant is usually a corporate entity with an
9 ownership stake in the project LLC, but with an unknown degree of ability to monetize state and
10 federal tax benefits.

11 Once the project is operational, each participant in the partnership receives a specified allocation
12 of 1) net cash flow from the project’s operation and 2) federal (and where applicable, state) tax
13 benefits in exchange (in the REG case) for project attributes (energy, capacity and RECs). The
14 gains generated by the project are divided up according to a partnership agreement.

15 Typically, the partnership agreement comprises a “partnership flip”. Under such a structure, the
16 tax equity investor receives the vast majority of the tax benefits for 6 years, and the equity
17 investor receives the vast majority of the net cash from the project. After year six, the tax
18 investor functionally exits the project and the remaining benefits (both cash and tax) accrues to
19 the sponsor equity participant.

20 Therefore, SEA assumes, for its financing purposes, that the agreement is a partnership flip, or
21 any other structure in which the tax equity investor receives the majority of the tax benefits in the
22 early years. This structure is represented visually in **SEA Rebuttal Schedule 1**.

23 **Please summarize the changes to the Internal Revenue Code made by the IRA related to**
24 **the ability to transfer eligible tax credits.**

25 For all taxpayers, the IRA creates a regime (codified in 26 U.S.C. § 6418) under which all
26 relevant clean energy tax credits can be transferred once, in exchange for cash, from an eligible
27 taxpayer to an unrelated party (but not resold after that). Payments made in consideration of the
28 transfer of the credit are not considered gross income (and as a result, cannot be deducted
29 against).

30 **In theory, how, would the structure described in SEA Rebuttal Schedule 1 likely change if**
31 **the project owner(s) had the ability to transfer the tax credit to an unrelated third party?**

32 SEA’s interpretation of the change associated with tax credit transfer to the structure shown in
33 the initial rebuttal schedule is represented visually in **SEA Rebuttal Schedule 2**. Though
34 crucially, a number of specific details related to this approach cannot be concluded with certainty
35 until there are rules from the U.S. Department of the Treasury (Treasury) and the Internal
36 Revenue Service (IRS). The text of the statute specifically authorizes the project owner(s) to sell
37 its tax credit to an unrelated third party in exchange for “consideration” equivalent to a cash fee
38 for the credit. In exchange for this credit, the project owner(s) receive a cash payment (which

1 will be less than the full value of the tax credit, otherwise there would be no financial incentive
2 to complete the transaction).

3 **In its Direct Testimony, did the DPUC comment upon the types of financing structures**
4 **utilized for the development, construction and operation of renewable energy projects?**

5 Yes. Mr. Brennan states in his testimony that “The CREST model has long incorporated an
6 assumption that tax equity is brought in to support the full utilization of the ITC. If this is the
7 case, it stands to reason that the tax equity partners would also have the tax appetite to utilize all
8 tax attributes, including bonus depreciation. Tax equity structures are typically complex and if a
9 developer is going to utilize this complex structure, they would only do so if the full range of tax
10 benefits available are realized, including bonus depreciation.”

11 **Do you all agree with these statements?**

12 While we agree with the assertion that SEA has consistently assumed the full utilization of the
13 ITC, we respectfully disagree that it automatically “stands to reason” that, simply due to the
14 complexity of said structures in which no credit is transferred, that all investors participating in
15 structures in which credits are transferred have the ability to claim bonus depreciation.

16 **Did your joint Direct Testimony in this docket touch upon the issue of investor tax appetite**
17 **regarding bonus depreciation?**

18 Yes. On page 35, lines 1-4, the joint Direct Testimony states stated that “(a)lthough we
19 acknowledge the DPUC’s point that the new transferability could notionally allow some
20 investors to use bonus depreciation when they could not before, we believe it is too early to
21 assume this across the board, *and whether it is possible to do it is very specific to the investor in*
22 *question” (emphasis added).*

23 **Please explain why the ability to take bonus depreciation is “very specific to the investor in**
24 **question”?**

25 Though the specific reasons are varied and complex, they generally boil down to:

- 26 • The alignment of a given investor’s aggregate annual taxable income with the aggregate
27 quantity of net operating losses (driven by depreciation) generated across all of that
28 investor’s investments; and
29 • The interaction of bonus depreciation with other tax deductions against gross income that
30 corporate investors are eligible to claim.¹

31 **If an investor’s lack of sufficient tax appetite causes them to not claim bonus depreciation**
32 **associated with a “typical” project, what does that mean for the ceiling prices?**

¹ For a simple exploration of examples of considerations for corporations considering utilizing bonus depreciation, see Bennett, Eric and Miller, Linda. *Bonus Depreciation: To Take Or Not To Take, That is The Question*. 7 April 2022. Blue and Co. Blog Post. Available at: <https://www.blueandco.com/bonus-depreciation-to-take-or-not-to-take-that-is-the-question/>

1 In ceiling price (and CREST modeling) terms, we have concluded that this means that bonus
2 depreciation should not be assumed on a default basis. This is because in our (admittedly, pre-
3 IRA) experience, typical sponsor equity investors do not have sufficient income tax liability to
4 monetize the net operating losses from a renewable energy project *faster* than the standard 5- or
5 7-year MACRS schedule.

6 This means that an investor’s ability to monetize a larger amount of depreciation than the amount
7 available under a 5- or 7-year MACRS schedule (such as bonus depreciation) hinges upon
8 whether the totality of their investments – including those unrelated to the renewable energy
9 project – would generate sufficient gross income (and thus create sufficient tax appetite) to make
10 claiming bonus depreciation feasible. As a result, we are unable to conclude with confidence *at*
11 *this time* (and without further investigation) that such investors have other investments that yield
12 sufficient tax appetite.

13 **Given how specific to the investor these considerations are, does SEA believe it is prudent**
14 **to assume bonus depreciation is typical at this stage?**

15 No, we do not.

16 **Have Treasury and the IRS finalized their regulations implementing this provision?**

17 No, they have not. In fact, via [IRS Notice 2022-50](#), Treasury and the IRS sought stakeholder
18 comment on an extensive set of questions related to the transferability provisions.

19 **Is there a specific due date for the regulations related to 26 U.S.C. § 6418?**

20 No. The Internal Revenue Code contains no specific due date by which regulations regarding
21 implementation of tax credit transferability regulations must be issued.

22 **In Direct Testimony, did the DPUC raise the issue of the statutory phase-out of bonus**
23 **depreciation?**

24 Yes. In his testimony, Mr. Brennan states that “projects placed in service in 2024 would only be
25 eligible for 60% bonus depreciation, declining to 40% for projects placed in service in 2025.
26 This step down in the amount of the project eligible for bonus depreciation makes it easier to
27 absorb this upfront benefit than in prior years.” In addition, Mr. Brennan states that “Given the
28 uncertainty that projects face in terms of project schedules, applying a conservative 40% bonus
29 depreciation assumption is both reasonable and appropriate.”

30 **Do you all agree with this statement?**

31

32 While Mr. Brennan is correct about the dates for the phase-out schedule of bonus depreciation,
33 we respectfully disagree with the implication he derives from it. More specifically:

- 34
- 35 • We are unconvinced that the amount of eligible depreciation to be utilized is relevant to
36 the question of whether the investor is able to use it; and
 - 37 • We are concerned that it may be unreasonable, given the increasingly long, costly and
challenging nature of the interconnection process in Rhode Island, to assume that all

1 projects procured in 2023 can be reasonably certain to reach commercial operation in
2 2025, the year in which the 40% bonus value is available. In other words, it is our
3 expectation that a substantial number of larger projects that may bid into the 2023
4 program year must still navigate as-yet-incomplete distribution system group studies, in
5 addition to transmission cluster studies, for which affected projects could face many
6 years of delay beyond 2025.

7 **Does SEA believe that any such assumptions related to tax credit transferability and its**
8 **implications need to be properly evaluated by OER, the DG Board, the DPUC and**
9 **stakeholders during the development of the 2024 ceiling prices?**

10 Yes, we do. As stated on page 36, lines 27-32 of our joint Direct Testimony, our view is that it is
11 more prudent to determine *via the 2024 ceiling price development process* “if transferability
12 becomes a common practice, the terms on which such transfers are made, and what impact it
13 should have on the financing assumptions associated with the ceiling prices...and... (w)hether the
14 enhanced transferability provisions encourage financiers to start utilizing bonus depreciation to
15 the benefit of REG-eligible projects (and thus, indirectly, to ratepayers).”

16 **Have there been other instances where issues raised during regulatory proceedings for one**
17 **REG Program Year are subsequently addressed in the following REG Program Year**
18 **ceiling price development processes?**

19 Yes. Over the years that SEA has supported OER and the DG Board in developing and
20 proposing ceiling prices, SEA has, on a number of occasions, formally proposed carrying over
21 certain issues to the next program year’s ceiling price development process. As part of the due
22 diligence required to develop ceiling prices that co-optimize healthy market development with
23 minimizing the cost to Rhode Island ratepayers, SEA has carried over issues from one year’s
24 ceiling price development process to another as a means to address certain issues that would
25 significantly benefit from additional research, dialogue, and stakeholder input beyond the
26 timeframe of existing regulatory proceedings and program year review. For example:

- 27 • At the end of the 2020 process, our team committed to consider (at the request of market
28 participants) variations in capacity factor inputs for Solar projects for the 2021 process,
29 and (at the request of Narragansett Electric) enlarging the size bin for Small Solar I
30 projects from 1-10 kW to 1-15 kW. Our team carried out both requests, and revisions to
31 these inputs and/or size bins were ultimately reviewed and approved by the Commission
32 for the 2021 REG program year.
- 33 • At the end of the 2021 process, our team committed (at the DPUC’s request) to review
34 project useful lives for Solar and Wind projects, as well as post-tariff compensation for
35 all projects. Both these issues were suggested by the DPUC for consideration during the
36 2022 process. After doing so, SEA found good cause to recommend the extension of the
37 assumed useful lives for most projects, with the exception of Medium and Commercial
38 Solar projects that are typically mounted on commercial rooftops. SEA also found it
39 reasonable to assume a 40% discounted post-tariff revenue stream associated with our

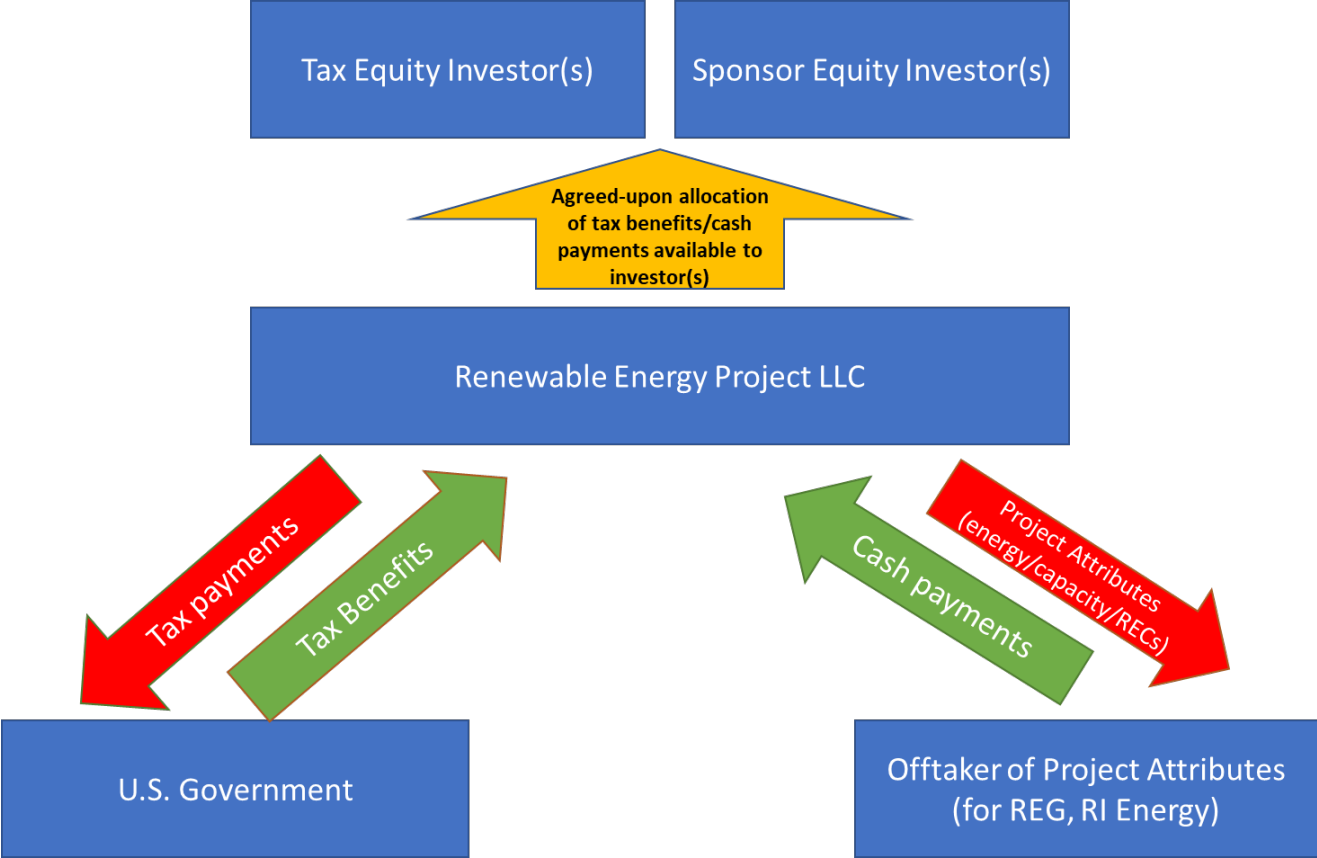
1 team's outlook for the R-16 and C-06 rate classes. Both approaches were approved by the
2 Commission for the 2022 REG program year.

- 3 • At the end of the 2022 process, our team committed for the 2023 process (at the DPUC
4 and, ultimately, this Commission's request) to revisit the effective tax rate for Small
5 Solar I projects and (at the request of market participants) revisit whether municipalities
6 are, in general, inflating the basis upon which property taxes are assessed against
7 renewable energy projects, and reconsider land/site lease payments in case further
8 primary source information was provided. SEA fulfilled all of these requests, and has
9 accounted for them in the proposed prices before the Commission in this docket.

10 **Does this conclude your rebuttal testimony?**

11 Yes, it does.

SEA Rebuttal Schedule 1 – Typical Renewable Energy Project Structure Without Assumption of Credit Transfer



SEA Rebuttal Schedule 2 – Assumed Renewable Energy Project Structure With Assumption of Credit Transfer

