

How To Avoid Pressure Points In Turbine Supply Agreements

Receiving wind turbines from the manufacturer may seem simplistic. However, pre-delivery negotiations can actually be quite complex.

BY EDWARD ZAEKE

In wind turbine supply negotiations, there are a few key areas of discussion that almost invariably get the most attention from the parties involved. The delivery obligation should be quite simple: The turbine buyer agrees to purchase a number of wind turbines for a specified price, and the turbine supplier agrees to deliver the turbines.

However, in order to be considered complete, the delivery provisions need to cover several subtopics, including the following:

- Where will the delivery occur?
- Who is responsible for the transportation?
- Who bears the risk of loss or damage to turbines during transport?
- Who pays any duties and taxes, including road bonds and road repair, for transport over local roads?
- When will the turbines be delivered?
- What is the order of component deliveries?
- What is the procedure for inspection and acceptance?
- What are the penalties if the turbines are late?

Let's start with the point of delivery. Turbine supply agreements typically provide that the turbines are to be delivered either "ex works" (i.e., at the factory) or to the project site or the individual pad sites by the tur-

bine vendor. The term "ex works" is one of several shorthand definitions describing how delivery is to occur. The definition of "ex works" and other terms, such as "free on board," are included in the list of "incoterms" used in shipping and delivery. These terms describe not only where the transfer of the goods is to take place, but also who handles shipping, who pays for import duties, who provides insurance and several other points.

Most wind turbine vendors favor "ex works" deliveries, even though they will arrange for transportation from their factory or from the factory of their blade manufacturers and tower suppliers, because it allows them to get paid for the component sooner and book the income. It also transfers the risk of loss or damage – and the delays that go with it – to the buyer.

Buyers often push hard to have delivery at the site because it shifts the risks of delays onto the turbine vendor. That way, if something were to happen to the turbines while they were in transit, the vendor would be motivated to move any replacement parts to the front of the production queue in order to minimize damages to the buyer.

If the risk of loss or damage is with the buyer, as in "ex works" delivery, the vendor does not have the same motivation in the event that a loss or

damage in transit occurs. Some turbine vendors have agreed that title will pass to the buyer "ex works," but that vendor would remain responsible for any loss or damage that occurs in transit. Such an approach is often a workable compromise.

Wind turbine taxes fall into three categories: import duties, state sales taxes, and road repairs and repair bonds. In most transactions, the vendor bears the cost of import duties, and the purchaser bears any sales taxes. The cost of road repairs is often divided. Because the vendor is either domestically located at its factory site or choosing which port to use when it imports its product from overseas and which domestic vendors to source for blades, towers and other components, the vendor often agrees to pay the cost of any road fees over the interstate highways.

The buyer, on the other hand, selects the location for its project. Thus, the buyer often takes responsibility for county and city road bonds and road repair. However, this is not always the case, and vendors will sometimes accept that responsibility as part of their delivery or transport obligation.

Once the parties decide where the turbines will be delivered, who pays for transportation, who bears the risk of loss and who pays the taxes and duties, they must determine when

the turbines will be delivered. This is never an easy question to answer, considering that turbine delivery consists of a series of component deliveries and often involves nacelles, blades, towers and other components coming from different locations in several pieces and usually from numerous sub-suppliers.

Most turbine supply contracts have a schedule by which “whole turbines” – or all of the required components comprising one whole turbine – must be delivered. Turbine vendors often ask for the right to deliver whole turbines or components 30 or 60 days before these deadlines.

This request often presents a serious problem for developers because they would have to start on-site roadwork and keep a delivery acceptance crew on-site 30 or 60 days before they had planned. Therefore, an early-delivery window is often heavily negotiated.

Turbine vendors usually want to require acceptance of damaged or non-conforming components that can be repaired or replaced prior to commercial operation, because rejection of parts often leads to the payment of late damages. In “ex works” deliveries, the buyer is often required to have an inspection and acceptance at the vendor’s factory. Even when delivery is not “ex works,” vendors will commonly ask for a pre-inspection by the buyer at the factory or the port in order to avoid delays and unnecessary transportation costs.

Oftentimes, the order in which the components are delivered is also important. Wind project developers

have learned that they can save on construction costs if the components arrive at the site in the exact order that they are needed. Although it may not always work perfectly in practice, this “just in time” delivery is often negotiated by the parties in an effort to minimize the double handling of these extremely large components and to speed up the construction process.

Furthermore, although turbine vendors may be willing to attempt a “just in time” delivery process, they are often reluctant to attach meaningful damages to the program that would be triggered if it does not perform as well as intended.

The last element of the delivery provision is the issue of late damages. Nearly every turbine supply agreement will have a provision for liquidated damages in the event that the turbines or components are late. This is one of those areas where both the buyer and the seller typically want a liquidated-damages provision. If the vendor is late in delivering turbines or components, the buyer may suffer damages resulting from the need to reschedule or pay its balance-of-plant contractor for “stand around” time.

If these setbacks result in delays in completion, the buyer will suffer lost revenues. If the delay is substantial enough, the buyer may have to pay penalties under – or suffer the loss of – its power sale agreement or lose tax benefits for the project, such as this year’s bonus depreciation.

In years past, buyers would also face the loss of the federal produc-

tion tax credit (PTC) if late delivery caused the project to be placed in service after the deadline. This year, that may be less of an issue, since the PTC is currently tied to commencement of construction and late deliveries of turbines will be unlikely to affect qualification for PTCs unless Congress places an outside completion date on PTC qualification.

However, even without the threatened loss of the PTC, the potential actual damages that a turbine supplier faces are significant.

Faced with these potentially huge actual damages, most turbine vendors often require a late-delivery liquidated-damages provision. Without such a provision or similar cap on damages, the turbine vendor could be responsible for catastrophic damages resulting from late delivery. The developer is also willing to accept a liquidated-damages provision because, although it may not fully compensate the developer for its additional costs and losses of the turbines if they are late, it does bring certainty to the amount of damages and provides that the damages will be paid without the need for the developer to prove its actual losses. **SP**

Edward Zaelke is co-chairman of the project finance practice at law firm Akin, Gump, Strauss, Hauer & Feld and an internationally recognized expert in the legal aspects of wind energy development and finance. He can be reached at ezaelke@akingump.com.