Legal Structures for Project Development

Tribal Energy Projects

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Overview of Presentation

• Goals and objectives of the tribe in developing a renewable energy project that influence legal structures
• Goals of the deal structure
• Elements of key deal agreements
Building Wealth in Indian Country

• Energy development a long-term strategy
• Successful energy projects, **no matter how large or small**, require 3 elements:
  – Efficient business structures
  – Standardized and fair regulatory processes administered by reliable, stable and transparent government authorities
  – Enforceable, fair and balanced contracts
• Once a level playing field is established, these three elements will generate a wide variety of economic opportunities for the tribe
A Team Approach

• Every energy project requires a team coordinated by the Tribe

• The team must have financial, legal, political and public relations experience

• Within each discipline, certain subject matter expertise is essential
  – Legal: e.g., tax, real estate/land, finance, contracts (PPA’s, joint venture, equity), Indian law, environmental law, government relations
  – Energy development experience key
Should the Tribe be a Passive or Active Player?

• Pros and cons of each approach
• Assess tribes resources and willingness to commit to the project regardless of choice
• Long-term partnership with non-Indian parties on Indian lands in both cases:
  – Tribal-owned/operated: PPA’s, investors
  – Not tribal owned/operated: long-term presence and partnership
• DOE Tribal Energy Program can help tribes evaluate this issue
From Grants to Long Term Resources

• Attracting private capital for renewable resource projects generally requires five essential elements:
  – 1. Renewable resource
  – 2. Site control
  – 3. Buyers for the energy
  – 4. Transmission to market
  – 5. Incentives (production tax credits, other tax incentives)
Have Energy Resources Been Assessed?

- Type and amount/magnitude of resource
- Economic feasibility of development
- Will resource(s) meet demand (both on and off the reservation)
- Ability to meet other tribal objectives
  - Tribe as sponsor of renewable energy projects
  - Tribes as utility owners/operators
  - Tribes as regulators
Land Control

• Site control and fair market valuation early in the development process

• Assumption by some private energy developers that obtaining third-party control of Indian lands may be simpler and cheaper than non-Indian private land

• Budget and schedule must factor:
  – Tribal land-withdrawal processes
  – Federal lease requirements
Buyers

- Fairly certain in states with RPS
- Price increase predictions driven by climate change issues changing the demand and supply outlook
- Tribal & non-tribal utilities
  - Firm capacity?
  - Infrastructure?
- Long-term offtake agreements (power purchase agreements or “PPA’s”) with credit-worthy third party buyers
Transmission

• Distance to transmission system
• Market factors for creative transmission contracts
• Load capacity to deliver to market
• Ballpark overview a fairly simple exercise for qualified energy consultants
• Regional transmission coordinating agencies manage regional transmission grid and maintain data, require reliability and capacity studies
• Other DOE agencies, private and public utilities with transmission info
Key Drivers for Energy Investment

- Tax benefits: Accelerated depreciation and Production Tax Credits
- Serve local energy demands and/or economic development with utility scale projects with revenues to tribe
- Cash flow to equity investors
- Affiliate contracts
- Economic Development and Other Policy
  - State/federal incentives
  - Environmental/social benefits
Understanding the Investors

• Strategic investors
  – Capacity to develop investment in the sector
  – Capacity to accept project risks because of knowledge and active management
Institutional Equity Investors

- Mainly passive investors, motivated by tax benefits and overall return
- Experienced in other energy tax credit regimes
- Will not accept significant development risk
- Requirements similar to lender requirements
Early Stage Development Equity

• Substantial development costs required to reach a financeable project
• Sponsor and developer may lack adequate capital, development expertise and ability to arrange additional financing
• Alternatively, sponsor finds developer with capital, expertise and financing ability
Late Stage/Construction Stage Equity

- Made through purchase or joint venture/limited liability company
- Required to support power purchase agreements (PPA) or interconnection agreement security, turbine purchase order and construction loans
The Formation of the Deal – One Model

• **Sponsor** (including the tribe and/or a tribal entity such as an enterprise, tribal corporation or Section 17 corporation)

• **Developer** (could be tribe or non-tribal entity)

• **Project company** formed to carry out:
  – Development
  – Construction
  – Operation
Joint Venture Process

• Usually begins with a non-binding Letter of Intent coupled with a Confidentiality and Nondisclosure Agreement
  – Sets the basic tone for discussions between the tribal sponsor and developer
  – Allows both parties to share information without fear of disclosure to competitors
• Most non-tribal third parties will accept dispute resolution at this stage pursuant to tribal law
Joint Venture/Joint Development Agreement

- Guides the parties through the pre-construction development process
- Sets the tone and the “template” for future agreements between the tribal sponsor and the developer
- Establishes the business relationship, and the allocation of project development risk between the tribe and non-tribal project entities
Major Issues in Joint Venture Structure

- Preconstruction development budget
- Project schedule and milestones
- Delineation of development activities and responsibilities between tribal sponsor and developer
- Rights of compensation before and after financial closing
- Allocation of development costs
- Property rights
Critical Issues for Tribal Parties in Joint Ventures

• Shareholder rights, especially minimum proposed minority shareholder protections (e.g., anti-dilution, rights to acquire interests in the project and project company, management issues)

• Tribal employment and contracting preference

• Compensation for use of tribal lands, taxation
Key Sticking Points

• Dispute resolution, governing law, choice of forum are not the roadblocks they used to be, but must be discussed early
  – Waiver of defense and right of sovereign immunity
  – Exhaustion of remedies in tribal courts
  – Arbitration vs. litigation

• Indemnification, limitation of liability, remedies on default and termination
Negotiating the Sticking Points

• Limited waiver of immunity to suit essential - limit to specific assets, protect tribal officials and individuals, tie to dispute resolution
• Binding arbitration to avoid state court jurisdiction
• Authority to compel arbitration, enforce awards, protect parties during arbitration in any court of competent jurisdiction
• Insist on clear terms preserving tribal jurisdiction (covenant not to contest tribal jurisdiction on tribal status as Indian nation)
Leasing Issues

- Critical early issue due to importance of site control in permitting, negotiations for PPA’s, transmission interconnection
- Joint venture or development agreement should guide sponsor and developer with general goals of project site lease to avoid surprises during the development process
Lease Basics

• Most likely vehicle for siting energy facilities on trust lands

• Federal law and regulation governing leases on trust lands (e.g., 25 USC §415; see also 25 CFR pt 162 and 25 USC §81).

• Allows tribe to collateralize trust land. The tribe may then assign the lease to a project company or third party lender
Suggestions to Improve the Leasing Process

- Evaluate tribal code provisions, if any, and consider adopting business site leasing regulations under BIA authority
- Consider creation of tribal energy authority (e.g., Dine Power Authority of the Navajo Nation) with leasing powers
- Talk with the local BIA officials early about the approval process, timelines, federal appraisal requirements, etc.
Select Features of Lease Structure

• Permitted uses
• Compensation, alternative tax structure
• Term (primary and renewal)
• Assignment and transfer
• Rights on termination, default
• Removal of improvements; reserve account
• Approved encumbrances
• Liability allocation
• Dispute resolution
Structures for the Tax Motivated Equity Investor

• Recap:
  – Joint venture or joint development agreement provides rights of equity investment for tribal sponsor and third party equity investors, including tax credit investors
  – Joint venture and lease provide for rights of third party investors as approved encumbrances
Significance of Structuring Tax Equity Investment

• Typically, 60 to 65% of the economic benefits in US wind projects (on or off tribal lands) are tax benefits; also applies to other energy projects

• Two primary benefits
  – Depreciation
  – Production Tax Credits

• Tribe not subject to federal income tax, not eligible for tax credits. Deal needs to structure tax credit investment opportunities
Institutional Tax Credit Investors

- Established market of institutional tax credit investors – e.g. insurance companies, investment funds, oil companies -- to invest in the equity side of renewable energy projects, particularly for the tax credits.
- These investors are primarily interested in the tax benefits, not long-term ownership.
- For up-front capital-intensive energy projects, a project’s cost of capital and financial structure has a significant impact on the financial performance of the project.
Why the Flip Structure Exists

• In order to claim the PTC, the taxpayer must own the facility and produce the electricity
• The party claiming the credit must receive the same proportion of gross revenues and PTCs from the project
• PTCs cannot be stripped and sold separately
• Other limitations (reduced by federal, state and local credits and grants related to construction of the facility, offsets limits to other taxes, subject to passive loss rules)
The Flip Structure Basics

• LLC agreement provides for percentage interests among investors, usually 90% or more to tax equity investor and remainder to sponsor equity/developer

• After 10 year period, or longer period for PTC investor to meet agreed-upon internal rate of return, percentage interests “flip” such that sponsor/developer holds 90+% and PTC investor holds 10%

• Usually combined with a purchase option for the PTC investor’s interest after the flip
Variety of Structures for Tax Equity

- Not all structures work or are appropriate in all transactions. Transaction specific tax advice is critical and must be obtained at an early stage.
- If flip is used, tribe should negotiate position to acquire PTC share after flip.
- Majority position usually negotiable after a number of years (typically, but not always the estimated life of initial project installation).
For More Information

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