Tribal Energy Project Development

Deals in Indian Country

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Overview of Presentation

- Changing the historical paradigm
- Project finance basics and update on market trends in renewables
- Overview of the basic development process
- Goals and key elements of the joint venture for tribal energy projects
Historical Paradigm

• Energy facilities in Indian Country owned by non-tribal entities
• Typical business model
  – Lease/royalty arrangement
  – Some exceptions, but very few
• Tribal employment common, but management less common
• Federal control over development of tribal energy resources
Shifting the Paradigm

- Tribal owned, operated, regulated energy facilities to serve local and wholesale demand
- Significant tribal investment positions
- Tribal management and labor
- Greater tribal control over development of energy resources

= EQUITY, SUSTAINABILITY AND SHARING OF RISK
Fundamental Truths About Project Finance

• Tax incentives alone don’t drive the deal
• Ready market is vital
• Lenders loan to cash flow, and against assets
• The investment is secured against the assets
• Biggest risks occur BEFORE cash flows
Types of Risks Managed in the Deal

- Construction risk
- Operation risk
- Sales risk
- Contract extension risk
- Environmental/regulatory risk
What are Investors Looking For?

- Specific range for Return on Investment (ROI)
- Three essentials/questions:
  - 1. Project Size: scale and flexibility?
  - 2. Management Team: can it deliver?
  - 3. The Plan: will it work?
Renewable Energy Project Finance

- Majority of utility scale renewable projects have been financed with a tax equity model
- Tax equity model is a combination of:
  - Small amount of sponsor equity,
  - Bank debt, and
  - Tax equity (monetization of tax credits)
The Goal of Debt in the Deal

- Non-recourse debt, meaning the lenders do not have any other collateral except for the assets of the project
- Loan repayment is from the project cash flows net of operating and capital expenses
- Project cash flows will provide scheduled debt repayment
What is tax-exempt debt?

• Tax-exempt debt is a less expensive way for a Tribe to borrow money for a development project.
• Less expensive because the interest payments that the Tribe makes in repaying the debt is not treated as taxable income to the person who provides the money.
• Lender will therefore offer a lower interest rate = savings for Tribe.
Trends in Funding Energy Projects

• The landscape has changed;
  – Loss of tax equity investors and reduced supply of credit and debt
  – Shortage of bank finance in Q1 2009 compared to last year:
    • 44% drop from Q4 2008
    • 50% drop from Q1 2008
  – Less bank syndication; likely more “club” deals with a smaller number of lenders
  – Conservative approach re: financeable projects and transactions
Some Things Change, Some Things Don’t

• Dramatic reduction in large tax equity investors
• Banks prioritizing financing requests
• Terms have returned to conservative
  – Long term PPA/PSA’s
  – Creditworthy counterparties
  – Strong EPC contract/parties
  – Low technology risk
• Strong credit profile is essential
It Ain’t All Bad News

• Globally over $97 billion of clean energy projects were financed in 2008 as compared to $84.5 B in 2007
• US became the leader in new capacity investment with $24 billion invested (20% of global investment)
• US added more renewable capacity than conventional capacity for the first time
Balance Sheet vs. Project Finance

• On-balance sheet financing remained a dominant deal type at $48.6 billion, a 2.4% increase over 2007

• Project finance almost matched on-balance sheet finance at $48.5 billion, a 35.2% increase over 2007
Wind and Solar

- Wind project financing increased by 16% during 2008 from $41.3 billion to $47.9 billion
- Solar project financing increased by 84% during 2008 from $12.1 billion to $22.1 billion

Data provided by NERA Economic Consulting
New Energy Economy

• Climate change = pressure for fossil fuel alternatives
• Economic recovery efforts creating focus on green energy, energy efficiency and job creation
• Increased emphasis on collaboration between states, tribes, local communities and NGO’s
• Developing vision for the future: energy generated from renewable resources, transmission systems with “smart-grid” technology
The Point of the Stimulus:

• Double renewable generation by 2011 and reach a 10% renewable penetration goal by 2012
  – RES legislation may adopt different market penetration goals

• $134 Billion of new capital investment and renewable energy infrastructure required by 2011; $217 Billion by 2012

• Pace of investment in renewables and efficiency expected to increase dramatically over the prior years
Phases of Project Development

• Phase 1: Initial Assessment
• Phase 2: Feasibility and Scoping
• Phase 3: Studies and Initial Preconstruction Development
• Phase 4: Capital, Contracts and Permits
• Phase 5: Project Construction and Commissioning
• Phase 6: Project Operation and Maintenance
Phase One

- Tribal sponsor conducts preliminary assessment including:
  - demand for power
  - potential generating resources
  - availability of cost-effective interconnection with the power grid
  - control of potential project sites
Phase Two

• Tribal sponsor evaluates or “scopes” all aspects, including:
  – Proposals from outside project developers
  – Consideration of tribal resources
    • Financial resources
    • Capacity
    • Business and institutional resources

• This phase usually results in a formal decision or authorization to move forward
Phase Three

• Developer (which may be some combination of the tribe and a non-tribal party, or it may be either) invests in load and transmission studies and preliminary engineering designs, and begins to discuss electric load needs and terms with potential customers
Phase Four

- Completion of Pre-Construction Development
  - Permits
  - Transmission and power sales agreements
  - Financing
The Business Deal

• Depending on the tribe, this can start as early as Phase 1, but usually no later than the end of Phase 2.
• Details of the business deal this afternoon
• Importance of the tribe focusing on its goals and objectives before entering into the development process
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
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

• These are the people/entities that will likely approach the tribe first to explore the possibility of project development
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)
Basic Trend #1: Motive

• Tribal energy projects serve social, economic, environmental and political objectives
• A lot of good ideas searching for limited resources – separate your project from the pack
• Motives must be clear, up front, and packaged in a concise, well developed business plan
• Don’t let the investor define the tribe’s motives
• When the parties understand each other’s motives, they can see solutions, not just obstacles
Basic Trend #2: Scalable and Flexible

- **Scalability**: projects that can be designed in different sizes, capacities and configurations have a greater chance of capturing a wide range of tax credits and other incentives.

- **Flexibility**: projects that offer different and flexible approaches to investor revenues and risks are more bankable.
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
For More Information

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