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

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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

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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)

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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

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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

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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

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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

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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**

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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

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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

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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

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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

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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

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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

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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

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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**

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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

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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.

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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)

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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

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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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