

# ***Legal Structures for Project Development***

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## ***Tribal Energy Projects***

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## **Overview of Presentation**

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- **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**

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- **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**

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- **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?**

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- **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**

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- **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?**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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

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- **Strategic investors**
  - **Capacity to develop investment in the sector**
  - **Capacity to accept project risks because of knowledge and active management**

## **Institutional Equity Investors**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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**

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- **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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