

Joint Ventures in Renewable Energy Projects: Structure Options, Transferability, Allocation of Liability, Tax Equity and More

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Madeleine Tan has more than 20 years of experience in advising clients on acquisitions, structured investments and financing transactions in the energy, infrastructure and transportation sectors. She is a partner in the Energy & Infrastructure Group and also Co-Head of the Transportation & Social Infrastructure Team (US).

She has global experience, having worked on transactions in the US, Latin America, Europe and Asia. She counts among her clients US and foreign equity and debt funds, major financial institutions, multinational corporations and investment conglomerates. She has represented purchasers and sellers of both assets and operating companies and advised on investments and financings in the power generation sector (including alternative and renewable energy such as wind (both offshore and onshore) and solar), transportation sector (including aircraft and rail purchases, sales, financings and leasing) and infrastructure (including airports, light rail systems, high speed rail systems, intermodal operations, telecommunications systems and water treatment facilities). In addition to advising on the acquisition and sale of operating companies and assets, Madeleine's financing experience includes advising on mezzanine loans, leveraged leases, tax-equity and structured finance and securitization transactions.

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Marc has considerable experience representing lenders that provide credit to energy companies, including green banks and other entities that provide loans to renewable energy project developers, frequently negotiating joint venture formation documents. He also advises credit providers investing in competitive Energy Service Companies (ESCOs) secured by their purchase of receivables programs. He has also represented underwriters in connection with capital markets financings of electric power projects.

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Steve Humes practices environmental, energy, public utility and infrastructure law at Holland & Knight and advises clients on renewable energy regulatory, project finance and development issues, including environmental issues and project contracts. He represents project developers, sponsors and banks on wind, solar PV, biomass, geothermal, and energy storage projects, among other technologies, and represents green banks along with project owners and developers from New Jersey to California and New York to Nicaragua. He counsels clients on and negotiates clean energy joint ventures, EPC contracts, Power Purchase Agreements and other major renewable project contracts.

He also assists clients with state and federal environmental and energy regulatory compliance and enforcement matters and counsels clients on energy and environmental issues in corporate M&A transactions, including acquisitions and divestitures of fossil and renewable power plants.

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Joint Ventures in Renewable Energy Projects

- I. Market trends for joint ventures in renewable energy
- II. Choice of entity and deal structures
- III. Critical contract provisions; allocating liability and risk
- IV. Real estate, environmental and EPC considerations



I. MARKET TRENDS FOR JOINT VENTURES IN RENEWABLE ENERGY

1. Site Control/local ownership requirements

- Investors/developers need to secure site for project development or satisfy local content requirements.
- Ideal for landowners that would like to generate extra income or building owners that may want to have a behind-the-meter source of renewable power.

2. New market entrants - risk mitigation

- New market entrants trying to gain insight into a particular renewable energy technology or market “test the waters” with a smaller/minority investment in one or more before committing to a larger investment.



I. MARKET TRENDS FOR JOINT VENTURES IN RENEWABLE ENERGY (cont.)

3. Share expertise on larger projects

- Cash sponsors/investors provide project management (e.g. managing construction through COD) and typically has deeper local expertise.
- Developer benefits from sponsor's expertise as well as broad network of potential funding sources.

4. Horizontal combination

- Parties may be of comparable financial strength but provide solutions to the end-consumers at different ends of the spectrum.
- Benefits to combination to enable joint venture parties to provide a more comprehensive solution to end-users and enable the joint venture to capture, maintain or grow market share.



I. MARKET TRENDS FOR JOINT VENTURES IN RENEWABLE ENERGY (cont.)

- Recent examples: Renewable energy generators combining with transmission/grid providers to provide full service solution to consumers.

5. Secure feedstock/downstream market access

- Biofuels/biomass projects are highly dependent on a regular, reliable source of feedstock at price that is predictable. Long-term commodity hedges in this market are often costly.
- Project owners enter into joint ventures with feedstock suppliers to assume feedstock supply.



I. MARKET TRENDS FOR JOINT VENTURES IN RENEWABLE ENERGY (cont.)

6. Share funding on larger projects

- Larger projects may have capital needs that are too high for any one investor to bear (in view of necessary diversification). Not uncommon for lead cash sponsor to “syndicate” or invite a co-investor.

7. Securing local expertise

- With certain technologies, for example offshore wind, companies with greater construction and development expertise are located outside of the US.
- Foreign companies may enter into joint ventures with domestic companies to take advantage of local knowledge and contacts for purposes of facilitating tasks such as permitting and subcontractor arrangements.



II. CHOICE OF ENTITY AND DEAL STRUCTURES

1. Proportionate Ownership Model

- Each partner's ownership percentage and control are proportionate to initial and future capital contributions.
- Simple and most easily understood.
- Not always feasible



II. CHOICE OF ENTITY AND DEAL STRUCTURES (cont.)

2. 50/50 Joint Venture

- Parties of apparently equal financial strength but 50/50 ownership is not always feasible because of differences in valuation of each party's contributions (tangible assets vs. Intangibles assets).
- What is the solution?
 - One party to pay a one-time additional cash contribution to “balance out” valuation of contributions - future contributions are split 50/50 to maintain 50/50 ownership.
 - Earn-out provisions - future payments by buyer to seller based on satisfaction of certain operating performance targets or net cash flow to the project. This gives seller the ability to realize a higher sales price post- closing once the project has achieved full ramp-up and generates sufficient revenue.



II. CHOICE OF ENTITY AND DEAL STRUCTURES (cont.)

3. Loan with Option to Buy (Development Loan)

- Sometimes referred to as a “Development Loan.”
- Buyer makes a loan (collateralized by the renewable energy project) to the seller, coupled with option to acquire the project in the future based on a fixed price or an agreed-upon procedure to determine the price of the project in the future.
- Seller typically pays interest on the loan but the loan does not amortize.
- Because initial proceeds to Seller is not in the nature of a purchase price, Seller is able to defer taxes on the initial sale of the project until the option to acquire is exercised.
- If this is structured properly, the seller will not pay taxes on the loan proceeds and will not recognize a gain on the sale of the option until the option is exercised or expires.



II. CHOICE OF ENTITY AND DEAL STRUCTURES (cont.)

6. 50/50 Joint venture but managed by a Manager or Operator

- Equal capital contribution (or equal valuation on assets/know-how contributed by the partners) but the party with the most experience operating a renewable energy project will take the lead in management, with the other partner not getting into the “weeds” in management.

7. Twin JVs with Ownership and Control

- The joint venture partners create separate joint ventures with each being owned in different percentages based on location of the businesses, market advantage, valuation, etc.
- Particularly useful for a portfolio of renewable energy projects spread across different regions or a portfolio of “mixed” assets.



II. CHOICE OF ENTITY AND DEAL STRUCTURES (cont.)

8. Registered Series Limited Liability Company

- Series LLCs are LLCs that permit the creation of separate “series” that are independent of each other. Each Series can have differing members and managers, file separate tax returns and have different assets.
- Developers have been reluctant to use series LLCs because of legal uncertainty as to the status of a series as a Debtor under the UCC as well as treatment of series in bankruptcy and for tax.
- Delaware has recently amended its LLC law in order to clear up confusion regarding UCC treatment. (Sec. 18-218).
- Challenges continue in certain areas, but series structures may be appropriate under certain circumstances.



III. CRITICAL CONTRACT PROVISIONS; ALLOCATING LIABILITY AND RISK

1. Considerations for Purchase and Sale Agreements.

- Purchase and Sale Agreement may be appropriate when joint venture partners enters a venture that has been partially developed. Examples include previously-contributed property, previously-contributed technology, previously-performed environmental due diligence and previously-obtained permits.
- Investor's may require certain representations and warranties or indemnities from a developer (IP, environmental, permitting, etc..) that the parties may not wish to include in the LLC operating agreement.



III. CRITICAL CONTRACT PROVISIONS; ALLOCATING LIABILITY AND RISK (cont.)

2. Considerations for Joint Venture Agreements.

- Narrowly defined authority.
- Developer/Investor representations and warranties:
 - Corporate representations
 - Project-related representations
 - Tax-related representations
 - Environmental representations
 - IP representations
- Developer/Manager responsibilities:
 - Construction-related responsibilities (budgets, schedule)



III. CRITICAL CONTRACT PROVISIONS; ALLOCATING LIABILITY AND RISK (cont.)

2. Considerations for Joint Venture Agreements, cont.

- Project-related responsibilities (consider consumer protection laws for residential projects)
- Tax-related responsibilities
- Capital contributions (obligations to contribute capital).
 - Conditions precedent to capital contributions
- Transfers of interests.
- Limitation on authority of the manager
- Allocations and distributions of net income/loss.
 - Preferred returns



III. CRITICAL CONTRACT PROVISIONS; ALLOCATING LIABILITY AND RISK (cont.)

3. Considerations for Affiliated Service Providers.

- Often, vendors to a joint venture can be related parties. Related parties can include licensors, lessors, construction managers, and O&M services providers.
- Care should be taken to set contract terms that at least reflect arms length terms. Parties should also consider circumstances under which an affiliated service provider should be removed and replaced.



III. CRITICAL CONTRACT PROVISIONS; ALLOCATING LIABILITY AND RISK (cont.)

4. Risk Allocations - Debt Providers

- Debt providers will have various concerns depending on the timing of their investments. Debt providers during the construction phase have specific concerns that the construction be completed on time and on budget.
- Debt providers also are concerned that the completed project meets agreed performance requirements.
- Debt providers will look to compliance with the terms of the offtake agreements to gain comfort that their construction loans will be taken out by more permanent debt, such as a term facility.



III. CRITICAL CONTRACT PROVISIONS; ALLOCATING LIABILITY AND RISK (cont.)

5. Risk Allocations - Tax Equity

- Various tax credit regimes exist to promote the growth of renewable technologies as part of the national energy mix. Although certain programs are scheduled to be terminated or phased out in the near term, legislation is currently being proposed to extend them.
- Tax equity investors inject equity investments into projects in exchange for receiving cash distributions and allocations of the tax credits and accelerated depreciation benefits.



III. CRITICAL CONTRACT PROVISIONS; ALLOCATING LIABILITY AND RISK (cont.)

- Under tax law, tax credit investors must have a true partnership interest in the entity that owns the equipment that generates the tax credits. However, they typically do not take construction risk. For this reason, tax credit investors typically fund their investment after a project is mechanically complete.
- Tax equity investors generally will not accommodate debt that is secured by project assets:
 - debt distributions would be senior in priority to cash distributions to equity; and
 - potential debt foreclosures could jeopardize their ownership interest in the assets for purposes of the tax credits.



III. CRITICAL CONTRACT PROVISIONS; ALLOCATING LIABILITY AND RISK (cont.)

- For this reason, debt is often funded at the level of the parent of the company that operates the project. Referred to as “back leverage” or “holdco loans,” this debt is typically secured by the parent’s equity interest in the operating company.
- Back leverage debt also usually includes the negotiation of an intercreditor/forbearance agreement that outlines the circumstances under which debt providers may foreclose on collateral.



IV. REAL ESTATE/ENVIRONMENTAL/EPC CONSIDERATIONS

1. Project Permitting and Development Risk:

- Partner with permitting and regulatory advantage may mitigate execution risk (e.g.: regulated entity may have more experience with regulators than merchant IPP entrant)

2. Environmental Liability Risk:

- Legacy environmental issues pose project JV risk; contributing partner can retain environmental responsibility. Should contributing partner retain environmental responsibility?
- Level of due diligence or Environmental Impact Statement impacts project financing and execution.



IV. REAL ESTATE/ENVIRONMENTAL/EPC CONSIDERATIONS

3. EPC Considerations:

- Credit worthiness of EPC provider
- Provisions in EPC contracts that affect bankability:
 - Warranties
 - Liquidated damages
- Need for arm's length terms for EPCs with affiliates.



Thank You



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