

Transferring Ownership From Developer To Utility

When structuring a wind energy project acquisition deal, be aware of the numerous possible closing complications.

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Utilities considering acquiring wind energy generation facilities should remember that all of the basic structures for acquiring all of a wind energy generation project involve some degree of joint ownership. Therefore, these arrangements offer greater potential for increased sharing – between an acquiring utility and the seller – of both the costs and risks of constructing, owning and operating a wind energy generation project.

There are two basic structures that may be used to acquire wind energy facilities: the build, own, operate and transfer (BOOT) structure; and the build, own and transfer (BOT, or build-transfer) structure.

For purposes of this article, it will be assumed that under either structure, the buyer acquires all of a wind energy project. The key difference between these two basic structures is the timing of the transfer of the wind energy project to the buyer in relation to the stage of the project's development and operation.

As its name suggests, the BOOT structure provides for the transfer to the buyer of ownership of a project only after the construction of the project has been completed and the project has been in commercial operation for some period of time.

This arrangement results in a key benefit to any prospective buyer. The

project being acquired will have an operational track record that the prospective buyer can evaluate before closing on its purchase of the project or before the buyer unconditionally commits to purchase the project.

This ability to evaluate an operational track record for the project should reduce the buyer's uncertainty about projected performance of the project.

Just how much the project's track record may reduce that uncertainty will depend upon what the record shows. Important information might include events or trends in the project's operating history, the quality and consistency of the operational data recorded, and the duration the record covers.

FERC approval

At least in part due to the benefits to a potential buyer of the ability to evaluate an operational track record, the BOOT structure is probably the most frequently used structure for acquiring just about any type of business or asset. This structure, however, has been used relatively infrequently for acquiring a wind energy generation project, except in the context of larger acquisitions of a developer that owns and operates a number of wind energy projects.

Several factors may account for this disparity. In many cases, all of

the output of an operational project has previously been committed to be sold to an off-taker for all or most of the remainder of the project's expected useful life pursuant to a long-term power purchase agreement (PPA).

In those cases, the project's owner has diminished incentives to sell, because the owner not only enjoys costs of operating and maintaining the project that are comparatively lower and more stable and predictable than the costs of construction, but also benefits from predictable revenues from the sale of the project's output.

Furthermore, utilities are not likely to have any interest in acquiring such a project, so long as its output is fully committed to a third party under a PPA.

Even if the owner of a project with an operational track record wants to sell that project to a utility that wants to buy it at a mutually agreeable price, the closing of the sale to a utility that is subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC) would likely be subject to the FERC's prior approval under Section 203 of the Federal Power Act (FPA).

Under Section 203, a public utility must obtain FERC approval before selling, leasing or otherwise disposing of the whole of its facilities that are subject to FERC's jurisdiction.

Facilities under FERC's jurisdiction include those used to make sales of electric energy at wholesale in interstate commerce, or facilities used to transmit electricity in interstate commerce, including generator step-up facilities, or any part of those facilities that has a value in excess of \$10 million. Approval is also required for merging or consolidating FERC-jurisdictional facilities with those of any other person.

In addition, prior FERC approval must be obtained for any purchase or other acquisition of an existing generation facility (with a value in excess of \$10 million) that is used for interstate wholesale sales of electricity, and over which FERC has jurisdiction for rate-making purposes.

FERC has adopted a rebuttable presumption that the acquisition of an existing generating facility connected to the interstate grid requires FERC approval, unless the acquirer demonstrates by substantial evidence that the generation facility is used exclusively for retail sales.

FERC has also clarified that an acquisition of an existing generation facility occurs if the generation facility being acquired is capable of producing power at or before the time the acquisition transaction closes.

This definition means that if the construction of a generation facility is complete, even if that generation facility was set aside before it was energized or produced any test energy, its sale would be considered the sale of an existing generation facility.

Buyer incentives

Unlike a single combustion turbine plant, where the point of operation is clearly defined, a wind energy generation facility is composed of many individual wind turbines. Therefore, determining the precise point of operation can be a difficult task.

Arguably, the first completed wind turbine would be considered capable of producing power and would no longer be in the development stage, even if the total wind capacity of the project were not yet developed.

Therefore, it is unclear exactly when a wind energy project moves from "development" to "operation." As a result, the sale of a wind energy generation project that closes after the construction of the first wind turbine in the project has been completed could be the sale of an existing generation facility.

If the FPA Section 203 approval requirement applies to a proposed acquisition of wind energy generation facilities, FERC must grant or deny a completed application for the required approval within 180 days after its filing with FERC. The timeline is subject to extension of this 180-day review period by FERC for good cause by not more than another 180 days.

FERC often acts within three months on applications for approval under Section 203 of transactions

The ability to evaluate an operational track record should reduce uncertainty.

that do not involve a merger and are not opposed by an intervening third party within three months.

But the application of the FERC 203 approval requirement to a potential acquisition creates risks for both parties of a delay in closing, pending the grant by FERC of its approval – or of non-consummation, if FERC denies its approval.

In a properly structured BOT transaction, none of the factors described above (which may diminish the incentives of a wind energy project's owner to sell or a potential buyer's incentives to buy after the project has established an operational track record), nor the risks of delay and non-consummation posed by the FERC 203 approval requirement, will apply if the same project is sold before it has an operational track record.

In a utility's BOT acquisition of a wind energy project, the developer typically transfers the project's development assets to the buyer after development has been substantially completed, but before the construction of the project begins in earnest.

Upon such a transfer, the buyer will purchase and pay for the easements, leases or other rights to use the project site that the developer has acquired.

At this point, the buyer will also pay the fee ownership title to any portion of the project site (such as the portion of the project site on which the project substation will be located) of which the developer has obtained ownership, and all of the developer's rights under the permits it has obtained to allow the project to be built and operated in compliance with applicable laws.

Excess expenditures

The buyer will then typically pay for the wind turbine generators and the balance of the plant that will constitute the project upon the achievement of agreed milestones in the process of construction of the project.

At this point, the buyer will also acquire the title to the components of the wind turbine generators and other infrastructure when the buyer has paid for them and, in any case, before the construction of each wind turbine generator has been completed. The transaction will occur when the risk of loss remains with the developer and its contractors, pending substantial completion of construction.

The legal structure of the acquisition may be either an asset transfer or a stock – or equity – transfer, which is the transfer of the equity interests in the entity that owns the project.

Absent some uncertainty under the applicable law over whether a particular permit or other entitlement deemed critical to the project may be transferred in an asset transfer, a stock transfer seems extremely cumbersome for a build-transfer transaction. An asset transfer generally affords greater control over the extent of liabilities assumed by

the buyer, whether in a BOOT or build-transfer transaction.

The relevant tax and accounting considerations should also be considered in deciding whether to effect a particular acquisition by asset transfer or stock transfer.

What if the total projected capital expenditures required to complete development and construction of a hypothetical development-stage project, at its optimum size, exceed the budgets of the project's developer and a utility that is interested in acquiring the project, on an individual basis, but are within reach of the developer's and utility's budgets on a combined basis?

As an alternative to either sitting on the sidelines and waiting for capital markets and economic conditions to improve, or downsizing the project so that its costs do not exceed current budgetary limits, the developer and the utility could agree to divide between them the total project costs – at the project's optimum size – by owning the project jointly.

The joint ownership could be implemented pursuant to an agreement to jointly construct, own and operate the project, with the developer agreeing to contribute the project's development assets.

Both the developer and the utility would agree to fund a portion of the costs of completing development and construction of the project, as well as ongoing costs of project operation and maintenance, in exchange for acquiring their respective undivided ownership interests in the project.

This joint ownership structure would facilitate the utility's including its interest in the project in the utility's rate base. Historically, the structure has often been used to share among several utility co-owners the sizable costs and risks of constructing and operating nuclear-powered and large coal-fired electric generation facilities.

Alternatively, if the utility is amenable to not including its ownership interest in the project in the utility's rate base, instead having an unregulated affiliate acquire an interest in the project, the developer and the

utility affiliate may find it simpler or otherwise advantageous to implement the joint ownership a different way. They may form a new limited liability company to own the project and acquire equity interests in that new project company in exchange for their respective contributions.

Either way, these joint-ownership structures not only facilitate cost- and risk-sharing, but also provide the utility acquiring a stake in the project with some assurance that, at least within the project's boundaries, the developer's interests are heavily aligned with the utility's interests.

Joint-ownership complications

On the other hand, the prospective co-owners will need to work through and reach an agreement on how to address a number of typically

In a BOT acquisition, the developer transfers the project assets after development but before construction.

challenging issues that may arise because of the joint ownership.

These issues often include the following questions:

■ Which co-owner, or agent on behalf of the co-owners, will have responsibility and authority for managing the day-to-day construction of the project and, once it is operational, its operation and maintenance?

■ What limits will be imposed on the authority of the construction and operations manager to act unilaterally, without the prior approval of both co-owners?

■ What management decisions will require unanimous approval of both co-owners, in the event of a deadlock on a matter that requires unanimous approval of both co-owners?

■ Will either co-owner be en-

titled to trigger a termination of the joint-ownership arrangement by offering to buy out the other owner?

■ What remedies will each owner have in the event the other co-owner defaults on its obligation to pay its share of the project's costs?

■ What off-ramps will be available to the co-owners, and what restrictions will apply if a co-owner desires to transfer its ownership interest in the project?

Prospective co-owners may prefer to substantially reduce the zone of potential disagreement arising from joint ownership by adopting a hybrid structure. They may separately own individual wind turbine generators and jointly own – or agree to share the use of – only a specified subset of infrastructure facilities.

In such a hybrid structure, the original wind energy project site would be subdivided into two separate, side-by-side projects, and the developer and the utility would each individually own the rights to use one of these side-by-side project sites and all of the wind turbine generators constructed on it.

The owner of each side-by-side project would share with the other the use of certain infrastructure facilities that it makes economic sense to use in common, instead of replicating them for each project.

For example, such shared-use facilities may include roads, a collector system substation for stepping up the voltage of the output of both projects' wind turbine generators to a transmission voltage and a transmission line from that collector system substation to the point of electrical interconnection of both projects with the electrical transmission grid.

The sharing of such a subset of infrastructure facilities may be accomplished by an agreement providing either for their joint ownership or for the individual owner granting rights to use them. Except as restricted by the agreement, this type of hybrid structure permits the developer and the utility to be masters of their own destinies in managing the construction and operation of the wind turbine generators.

However, both parties' respective interests are no longer aligned to the degree they would have been if each owned an undivided interest in a single, jointly owned project. The utility, therefore, will need to act accordingly in conducting its due diligence and negotiating the terms of the agreements pursuant to which it will acquire one of the side-by-side projects.

As part of the sale of either a share in a jointly owned project or of one of a pair of side-by-side projects, a developer will often want the acquiring utility to also enter into a PPA. The agreement would provide for the purchase by the utility of the output of the ownership interest or side-by-side project retained by the developer.

PTC eligibility

The utility would then resell the energy purchased under such a PPA to its retail customers. Prior to the June 2008 release by the Internal Revenue Service (IRS) of IRS Notice 2008-60, there was a concern that, by virtue of their relationship under a joint or hybrid ownership structure as described above, the utility could be deemed by the IRS to be a related person of the developer.

This distinction is important for purposes of determining eligibility of the energy sold under the PPA for federal production tax credits

(PTCs). Under Section 45 of the Internal Revenue Code, electricity that is produced by a qualified renewable energy resource, such as wind energy generation facilities, may be eligible for PTCs only if the electricity is sold to unrelated persons.

Side-by-side ownership allows the sharing of infrastructure when it makes economic sense.

As a result of this concern, the parties to a proposed acquisition by a utility of an ownership interest in a jointly owned project – or of one of two side-by-side projects in a hybrid structure – often limited the size of the ownership interest or project acquired by the utility.

Their aim was to try to reduce the risk that the utility would be found to be a related person of the developer for purposes of Section 45 of the IRS code. Doing so would decrease the chances that the energy sold to the utility under the PPA would not qualify for PTCs, as well as lower the risk of other related adverse tax consequences.

The release by the IRS of IRS Notice 2008-60, however, eliminated the risk that the electricity sold under the PPA would not qualify for PTCs based on a finding that the utility is a related person of the seller. The IRS clarified in that notice that when applying the related person test under Section 45 of the code, it will look to the ultimate consumers of electricity. In this case, the ultimate consumers would be the retail customers of the utility.

There is no one-size-fits-all approach for deciding how best to structure an acquisition of wind energy generation. But perhaps joint or hybrid ownership structures may garner more extensive consideration in the coming months than has historically been the case.

This shift is based on both the elimination of any need to impose restrictions on acquisition size to reduce the PTC risk, which has now been addressed by IRS Notice 2008-60, and the potential these structures offer for enhanced cost sharing and cost efficiencies. **SNP**

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