



# **ABA - Renewable Energy: What Kinds Of Incentives Are Needed & How Do The Current Available Incentives Work?**

**December 15, 2004**

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This presentation will review financing of renewable projects based on available incentives:

- Benefits and challenges.
- Equity and debt structures.
- Sponsor/Investor issues.
- Debt/equity issues.

# Financial Benefits

- Tax Benefits
  - Accelerated depreciation.
  - Production tax credits.
- Cash Flow
  - Power purchase agreement.
  - REC sale agreement.
  - Subsidy payments.

# Financial Challenges

- Significant Tax Component
  - 2/3 of value.
  - Technicalities of PTC.
  - Specialized market for investment.
- Limited Cash Flow
  - Power purchase agreement prices reflect tax benefits.
  - Bundling of green attributes with PPA may limit additional revenues.
  - Reliability of subsidy funding.

# Financing Structures

- Renewable energy projects have been financed using equity and debt.
- In the equity transactions, a principal challenge has been to monetize tax benefits efficiently.
- Sponsors of projects may or may not be able to use tax benefits.
- Other participants are financial investors which invest on the basis of a return including the tax benefits.

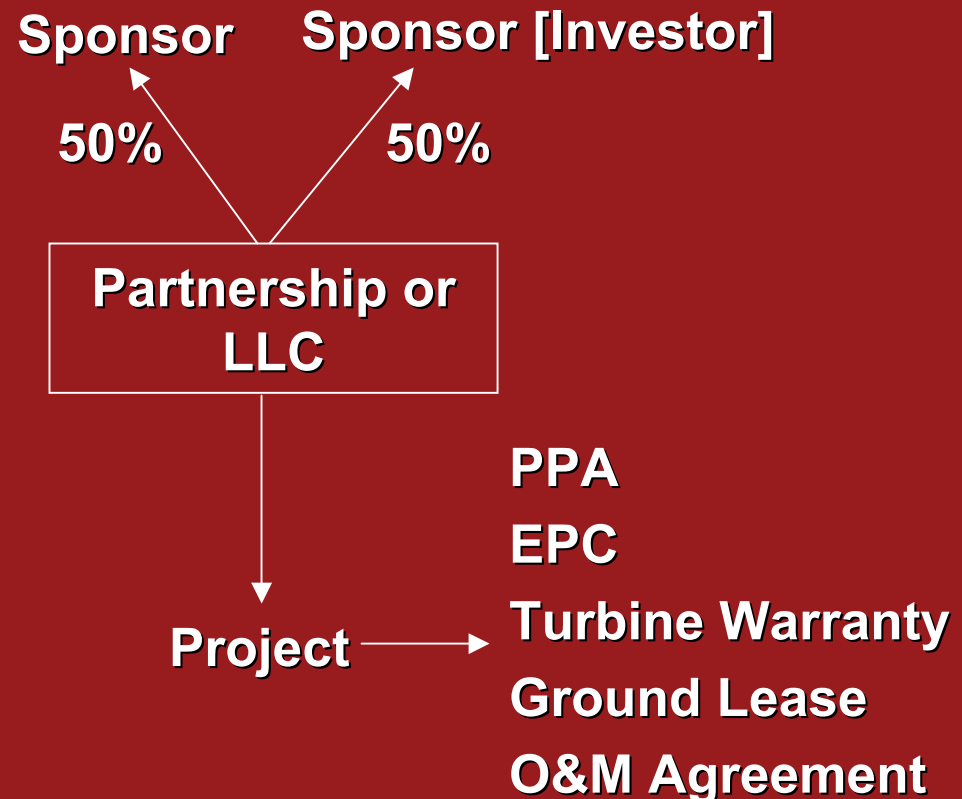
# Financing Structures

- Equity -- Equal Participant Structure
  - Tax allocation and cash distributions are pro rata.
  - Contributions are pro rata.
  - Voting and management typically by committee with pro rata voting.
  - Relatively simple structures because the interests of the participants are similar.

# Financing Structures

- Equal Participant Transaction

- By purchase or contribution, each party has equal investment
- Management by committee with equal representation
- Additional capital contributions are provided by each party



# Financing Structures

- Equity -- Cash/Tax Structure
  - Tax appetite of investors differs.
  - Cash and tax allocations in project company vary.
  - Cash may be further diluted through contracts with cash investor.
  - Management may be equal or use an active/passive model.

# Financing Structures

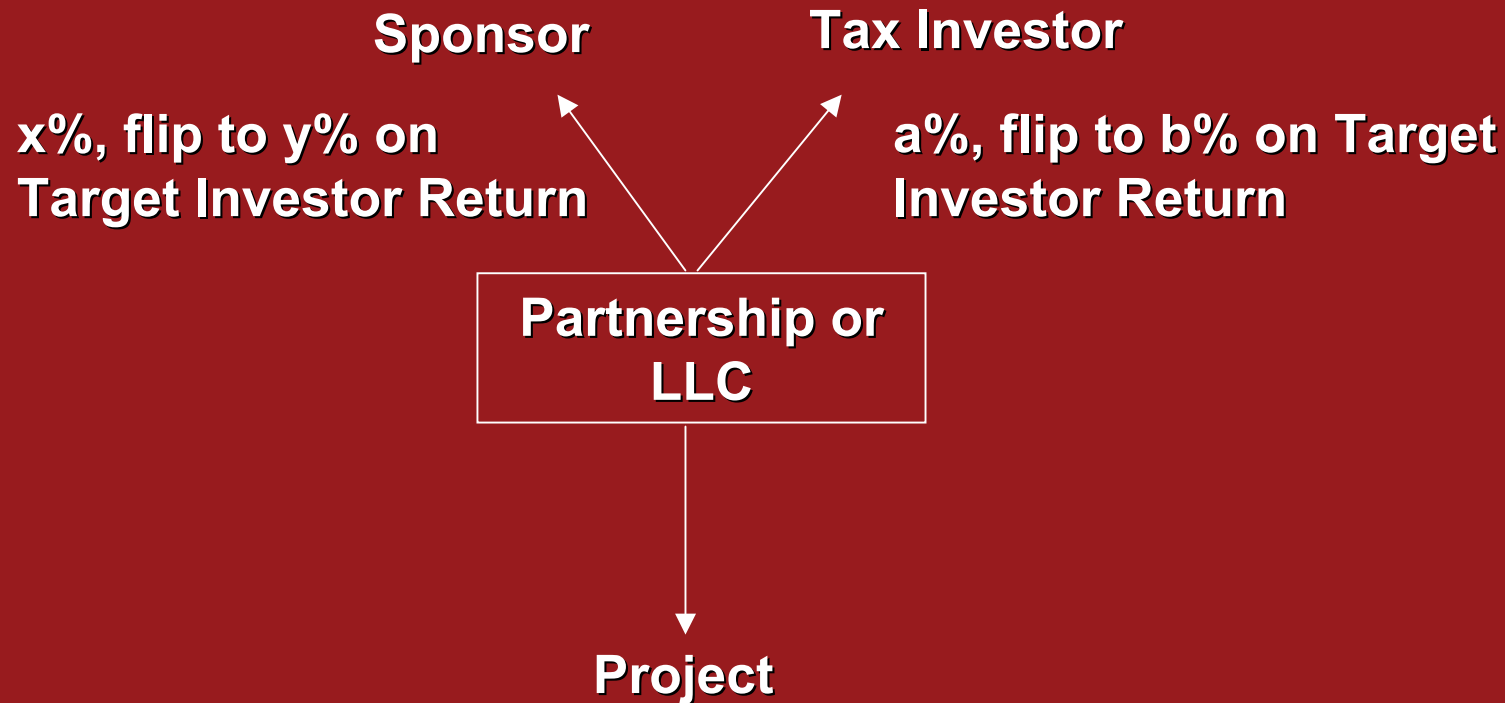
- Equity Flip
  - Allocations of income/loss and cash distributions are allocated in different percentages to the equity participants for the PTC period (10 years) or until Investor achieves IRR and then flip to leave the Sponsor with the majority of the residual.

# Financing Structures

- Equity Flip
  - In a basic structure, income/loss and tax benefits are allocated to the Sponsor and Investor in proportion to their ownership interests and distribute cash in the same proportion.
  - Special allocation of gross income (and thus credits and cash distributions) in percentages that do not reflect other sharing percentages possible, subject to capital account adjustments/make up obligation.

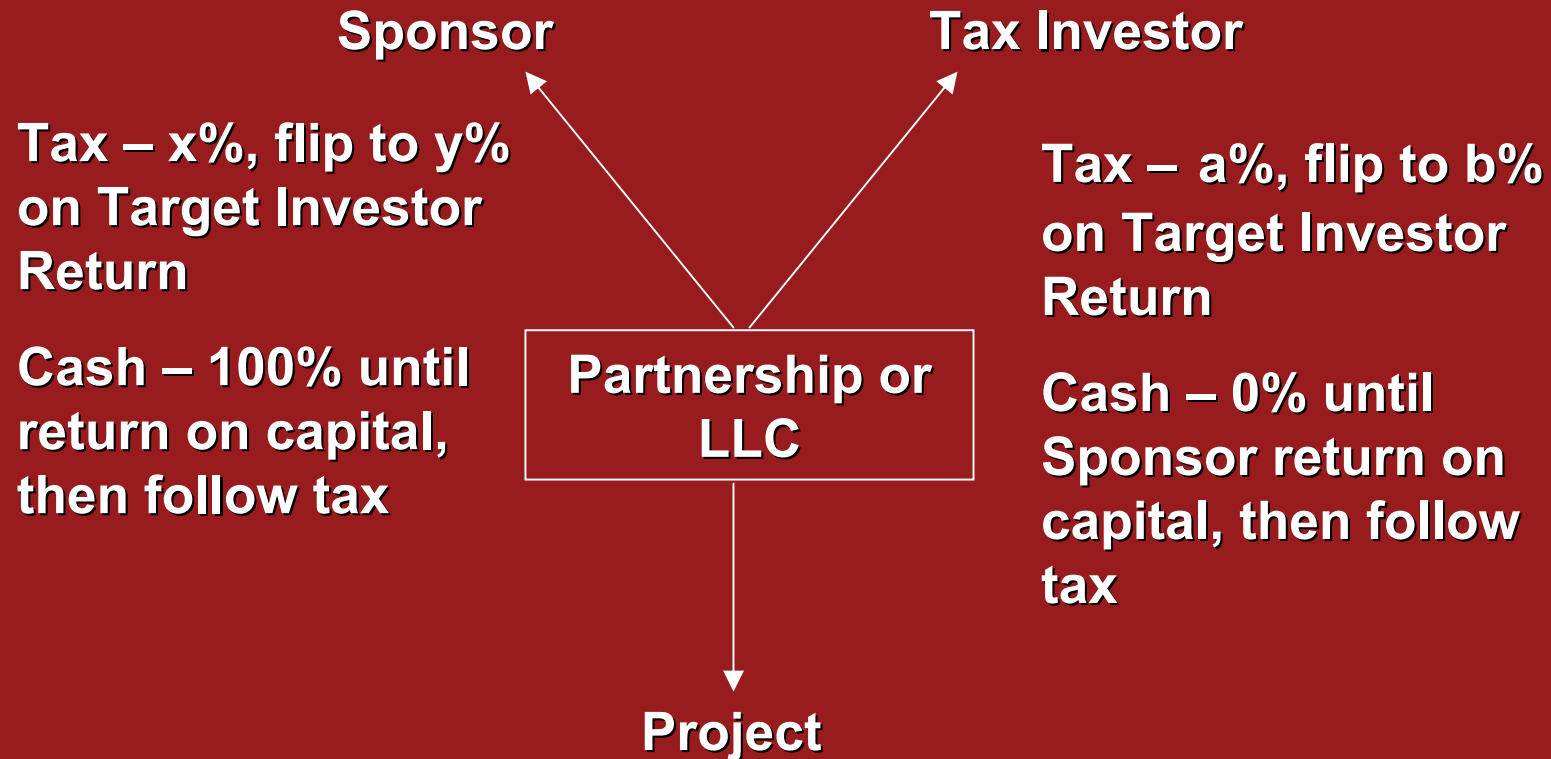
# Financing Structures

- Cash/Tax Structure -- Equity Flip



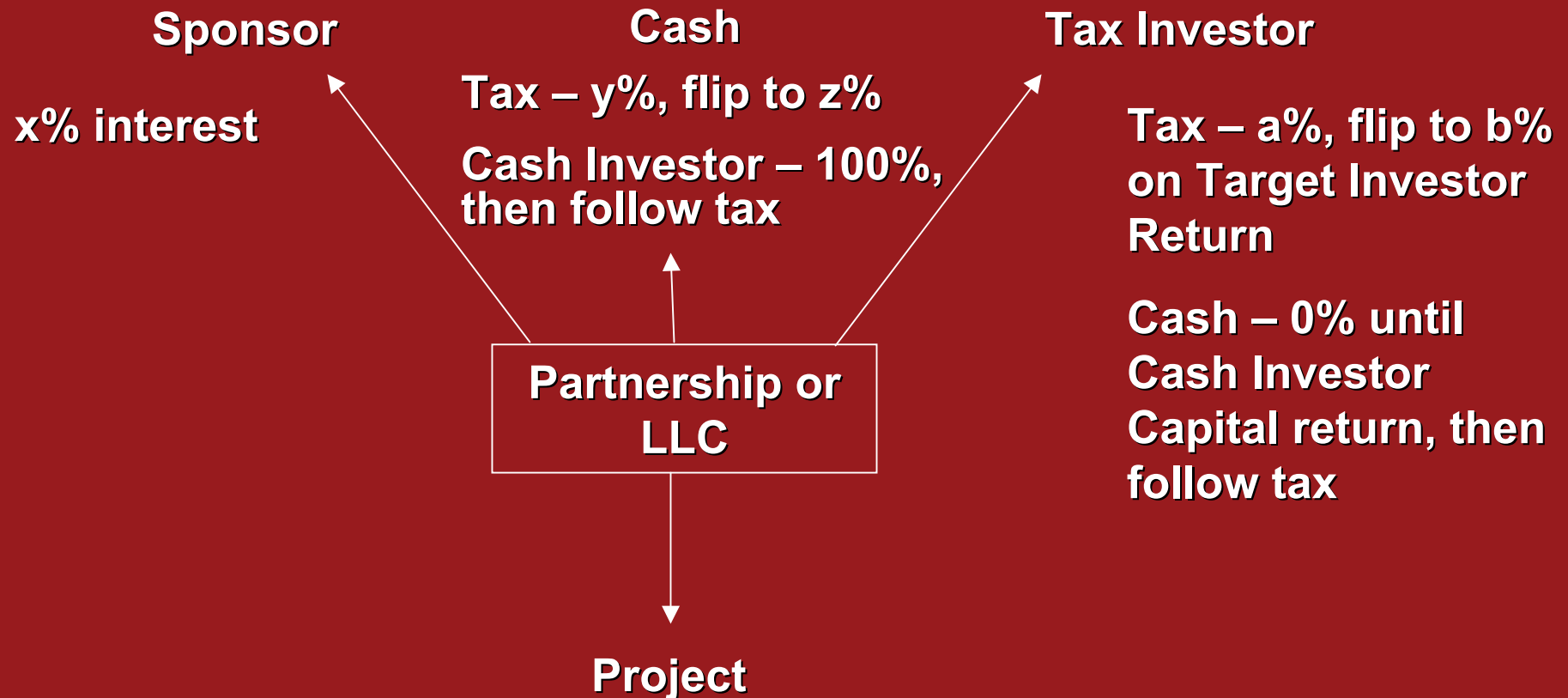
# Financing Structures

- Modified Flip v. 2.0



# Financing Structures

- Modified Flip v. 3.0



# Financing Structures

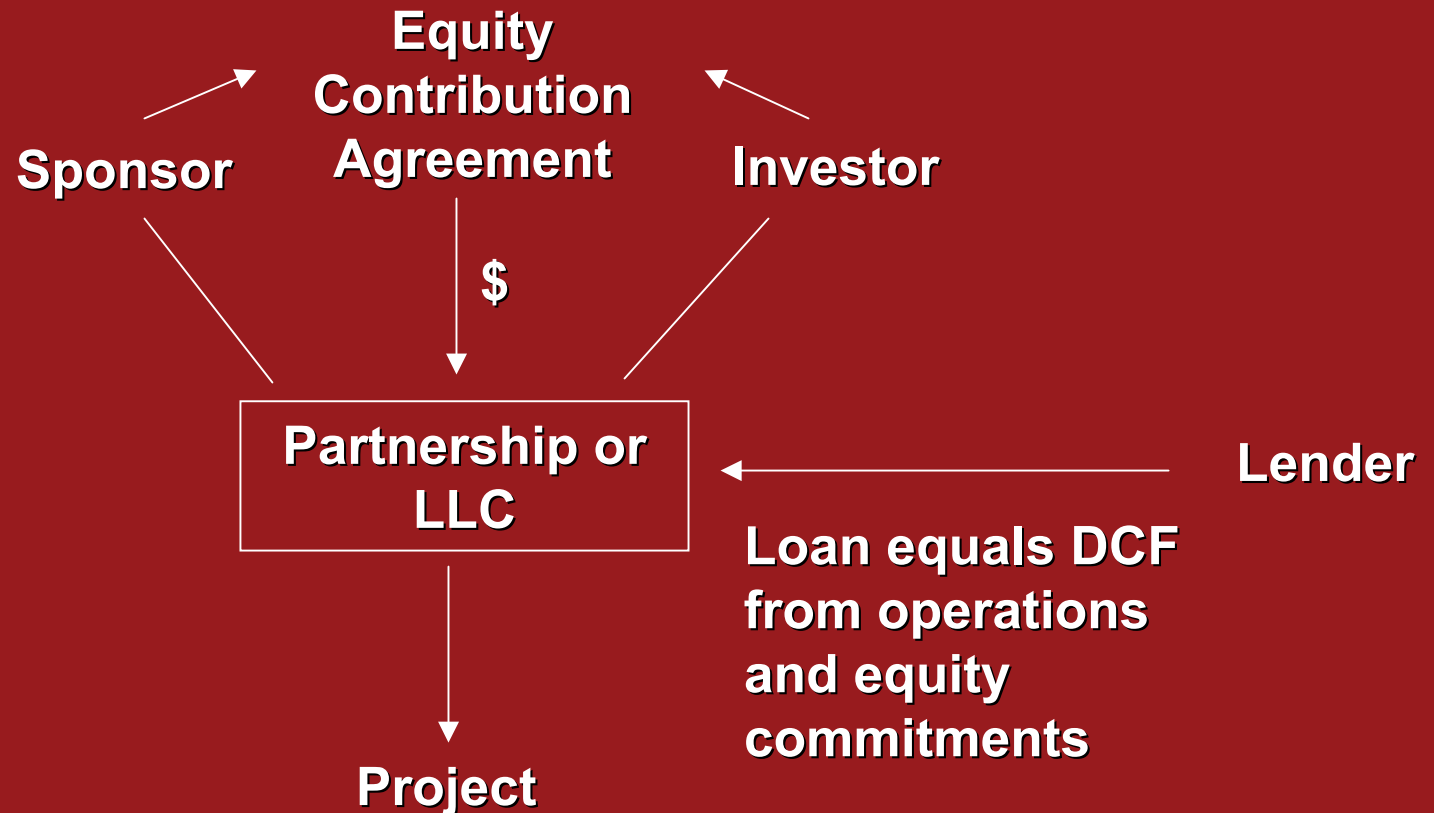
- Debt -- Project Cash and Equity Contributions
  - Third party project cash flow loans based on contracts, including subsidy payments.
  - Principal concerns are:
    - Term of contract.
    - Firmness of price and payment obligation.
    - Credit of payor.
    - Assignability of contract.
    - Cure rights.

# Financing Structures

- Debt
  - Monetization Loans.
    - Sponsor/Investor can commit to contribute equity based on earned tax credits (based on a contract formula).
    - Actual funding may not be required if DSCR is above minimum.
    - Loan is made against that payment commitment.
    - Risk of use of PTCs and change in law is not taken by Lender.

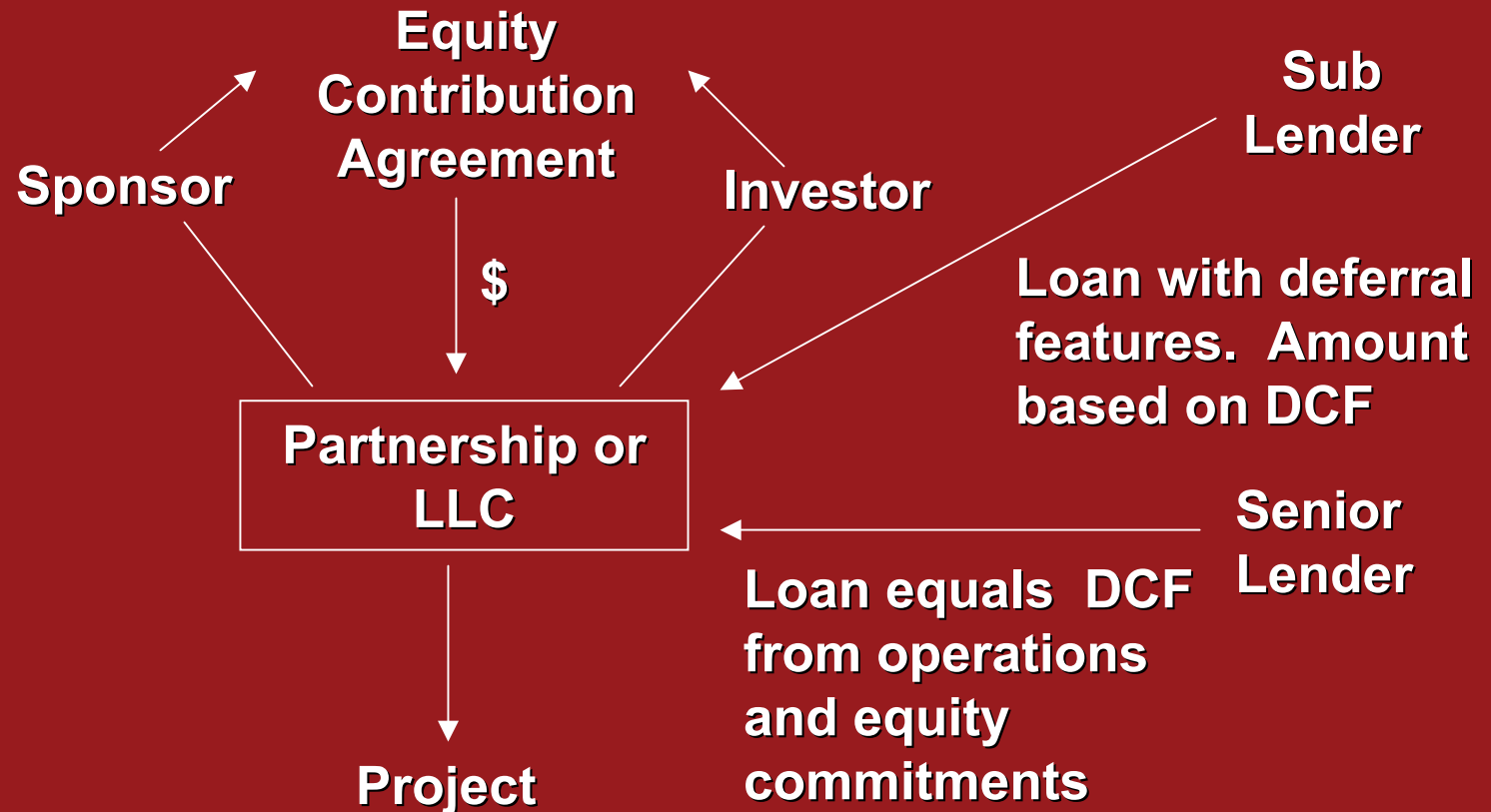
# Financing Structures

- Senior Loan Leveraged Transaction



# Financing Structures

- Senior/Subordinated Loan Transaction



# Sponsor/Investor Issues

- Risk allocation will depend on status of the parties as Sponsor or Investor.
- Typically, in a transaction between two sponsors (strategics), the risk allocation will be relatively equal (depending on which entity is buyer, seller).
- In a Sponsor/Investor relationship that is more active/passive, then there is much more project risk assumed by the Sponsor. Risk allocation is not unlike debt/equity.

# Sponsor/Investor Issues

- Project Risks
  - Project risk representations covered by Sponsor indemnity, with cap on dollars and limit on claims period.
  - Sponsor's distributions may be diverted to Investor until the Investor is made whole. Alternatively, Sponsor may be required to post security in favor of Investor or agree to holdbacks on the purchase price to support Sponsor's indemnity with respect to its representations.

# Sponsor/Investor Issues

- Tax Risks
  - Risk of change in law and ability to use credits usually rests with Investor.
  - After-tax indemnity by Sponsor to support representations - possibly without cap and subject only to statute of limitations. Such Indemnity is usually supported by Sponsor's security, holdbacks from the purchase price or mandatory diversion of Sponsor's distributions to Investor until Investor is made whole.

# Sponsor/Investor Issues

- Management -- Active/Passive
  - Institutional investor typically not involved in day-to-day management. Day-to-day management is conducted by designated representatives of Sponsor.
  - Investor will require consent rights on material events, and a prudent manager or similar standard of care from Sponsor.
  - Investor is typically indemnified by Sponsor for material breaches of Sponsor's management obligations causing demonstrable loss to Investor. Such indemnity is often supported by Sponsor's security or mandatory diversion of Sponsor's distributions to Investor until Investor is made whole.

# Sponsor/Investor Issues

- Management -- Active/Passive
  - Events of default are similar to loan defaults, but applicable to Sponsor/Manager (e.g., misrep., breach of covenant, bankruptcy, change of control, etc.).
  - Consequences of event of default:
    - Termination as manager.
    - Liquidation of investment.
    - Subordination of Sponsor claims or diversion of Sponsor's distributions to Investor.
    - Indemnity of Sponsor for Investor loss.

# Sponsor/Investor Issues

- Management -- Active/Passive
  - Note voting rights may change after flip date.
    - Percentage interest changes.
    - Certain substantive rights (e.g., replacement of manager) may be terminated.

# Sponsor/Investor Issues

- Transfer Restrictions
  - Certain “hygienic” conditions.
  - ROFO, ROFR.
    - May become inapplicable after flip.
- Regulatory Events Requiring Transfers
  - Investor right to put to Sponsor if PUHCA event.
- Purchase Option/Put
  - By Sponsor to purchase Investor interest, put by Investor to Sponsor, after target return. Price at FMV.

# Sponsor/Investor Issues

- Dissolution
  - By agreement, Event of Default, Event of Loss or deadlock election.
  - Priority of distribution.
  - Deficit capital accounts.
- Dispute Resolution
  - Senior management.
  - Arbitration for contract disputes.
  - Financial arbitrator for flip calculation.
  - Shot gun or push-pull for non arbitrable disputes.

# Debt/Equity Issues

- Debt/Equity Issues
  - Use of leverage may increase the risk of a deficit capital account for the Sponsor.
  - Financial investors may seek cure or step in rights, standstill on senior debt remedies, and purchase options to manage senior debt default risk.
  - Financial investors may seek certain rights and remedies free of the senior debt.
  - No market practice as yet developed in this sector.

# Questions?



Thank you!

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