

# Nontraditional Offtake Strategies for Renewable Energy: Avoiding Landmines in Contract Structuring and Financing

TUESDAY, JULY 16, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Stephen J. Humes, Partner, **Holland & Knight**, New York

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# OFFTAKE STRATEGIES FOR RENEWABLE ENERGY

*July 16, 2019*

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## Meredith Hiller

- Meredith is the General Counsel at the Massachusetts Clean Energy Center, a state economic development agency dedicated to accelerating the growth of the clean energy sector across the Commonwealth to spur job creation, deliver statewide environmental benefits and secure long-term economic growth. She is responsible for all of MassCEC's legal matters, including general corporate and public law matters and overseeing governmental affairs.
- Prior to joining MassCEC, Meredith was an Associate in the Boston office of Holland & Knight with a practice concentrated on energy regulatory, transactional and corporate matters, including advising clients on renewable energy project finance, public utility debt and equity financings, mergers and acquisitions and corporate restructurings.
- Meredith is based in MassCEC's Boston office.



## Steve Humes

- **Steve Humes** practices energy regulatory, transactional, energy project development and infrastructure law at Holland & Knight.
- Steve advises clients on renewable energy regulatory, project finance and development issues, including environmental issues and project contracts. He represents project developers, sponsors and financiers of large scale renewables, including solar PV, energy storage, offshore wind, geothermal, biomass, and cogeneration, among other technologies, and represents debt and equity investors from the Northeast to California and New York to Nicaragua, including energy projects in various Caribbean islands. He counsels clients on energy and environmental issues in corporate and M&A transactions, including acquisitions, development and divestitures of fossil and renewable power plants.
- Steve is based in Holland & Knight's New York City office and is a firmwide leader of the Energy & Natural Resources Industry Sector Group.

# Offtake Strategies for Renewable Energy Projects

- Risks and limitations of traditional PPAs
- Alternative offtake arrangements and options
- Structuring and financing nontraditional offtakes
- Best practices to minimize risks and ensure regulatory compliance



## PPAs Support Many Renewable Energy Resources

- Offshore Wind
- Solar
- Energy Storage
- Biomass
- Geothermal
- Hydro
- Waste to Energy
- Energy Efficiency
- Performance contracts



# Power Purchase Agreement

**Power Purchase Agreement (PPA)** – the offtake contract that guarantees Seller a long-term revenue stream to support investment in energy infrastructure and Buyer’s energy supply. Buyer can be utility, host customer, state intermediary or market.

- Conveys “Products” —can be energy, capacity, net metering credits, on-bill credits, RECs or energy services
- Defines commercial terms—when facility will commence operation, schedule for delivery of Products, penalties for under delivery, payment terms and liability conditions
- Identifies revenue and credit quality of Seller and Buyer—assures financing



# Risks and Limitations of Traditional PPAs



# Risk Identification

*It's all about risk ...*

## Construction

- Financing Risk
- Engineering Risk
- Completion Risk
- Force Majeure/Catastrophic Failure

## Operations

- Supply
- Operations
- Environmental
- Force Majeure
- Change of Law
- Financial

## Pricing Risk

- Long-term PPAs lock in pricing, but wind and solar pricing is on the decline, causing Buyers' remorse



# PPA Limitations

*It's all about risk ...*

## Legal Risk

- *Hughes v. Talen Energy*, 136 S.Ct. 1288 (2016)
  - No tethering of PPAs to wholesale markets
  - States cannot displace FERC-approved rates
- Federal Supremacy and Preemption
- But States can support new products
  - RECs are not subject to FERC

## Transaction Costs and Complexities

- Customized traditional PPAs take substantial time and add costs and complexities, especially when offtaker is inexperienced with PPAs or walks from the deal
- Multi-site Projects or multiple providers for one offtaker add complexities



## PPA Benefits for Buyer

- No direct commitment of capital
- Pay only for Products actually delivered/metered
- Ownership risks (e.g., equipment failure, damage and obsolescence) shift to third party developer
- Enables nonprofits to access investment tax credits and benefit from sale of RECs
- “Green” image from supporting renewable energy
- May deliver energy savings to Buyer compared to market price



## PPA Risks for Buyer

- Loss of control from having a third party operating a facility – often on host premises
- Cost savings may be based on projections for future energy costs, which are uncertain
- Terms may be driven and/or changed by lender
- Seller may be unwilling to commit to specific output levels, yet buyer likely required to buy 100% output
- Requires monitoring of Seller's insurance and O&M performance
- Long-term degradation can reduce savings or Product delivery



## Traditional PPAs

- Grid-scale buyers/offtakers
- Distributed generation hosts
- Typical Structure:
  - Price—fixed price per MWh
  - Volume—all energy and environmental attributes
  - Delivery point—interconnection
  - Term—15 to 25 years
  - Credit Support—Seller performance assurance, not buyer (if utility)

# Alternative offtake arrangement options



## Modern PPAs: Many variants support clean energy projects

- Corporate (virtual) PPAs
- Community Solar PPAs
- REC Purchase Agreement
- Net Metering Credit PPA
- On-Bill Credit PPA
- Zero Emission Credit PPA
- ZEC Agreement (nuclear)
- OREC Agreement (wind)
- Energy Services Agreement
- Energy Savings Agreement

## Corporate (virtual) PPAs

- Buyer may have many sites or could be a buyer community
- Aim: CSR or “green energy”
- Typical Structure:
  - Project location—regional or beyond
  - Product—RECs and environmental attributes, not energy, capacity or tax credits
  - Price—fixed or variable price per MWh, may tie to market
  - Volume—fixed % of output
  - Delivery point—market hub
  - Term—10 to 15 years
  - Credit Support—Seller performance assurance, not buyer (if utility)

## “Environmental Attributes” definition:

*Includes . . .*

- Renewable Energy Certificates (RECs)
- Avoided emissions of pollutants
- Emission reduction credits
- Greenhouse gas emission reductions
- Green Tag Reporting Rights
- Green-e® products

*But not . . .*

- Environmental Incentives
- Tax Credits
- Capacity, energy or ancillary services



# Structuring and Financing Nontraditional Offtakes

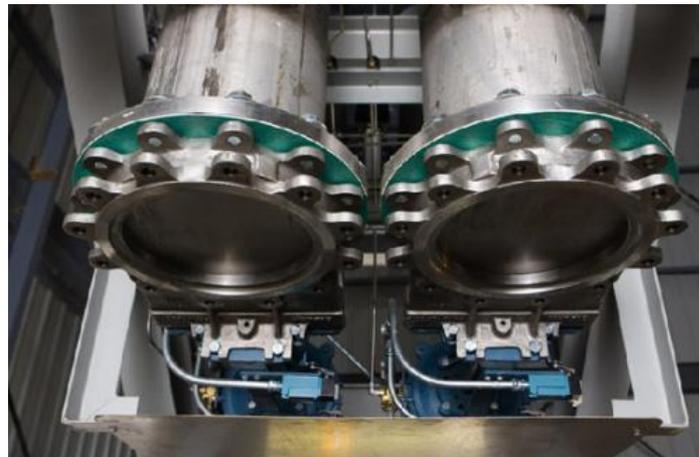


# Key Terms: Traditional Financing Agreements

- Financing Agreement
- Promissory Note
- Security Agreement
- Membership Interest Pledge Agreement
- Real Property Security Documents
- Intercreditor Agreement (if multiple lenders)
- Consents
- UCC-1 Financing Statement
- Guaranty Agreement (in favor of Lender)
- Forbearance and non-disturbance (SNDA) agreements

## Key Terms: Security

- Ensures payment
  - Rent
  - Royalty
  - Loan payment
- Ensures performance
  - Indemnification obligations
  - Insurance obligations
  - Completion



# Security Relationships

- Ensure obligations of:
  - Borrower to lender
  - Tenant to landlord
  - Licensee to licensor
  - Buyer to seller
  - Easement grantee to easement grantor

## Key Terms: Security Agreements

- **Security Agreement** is a contract that governs the relationship between parties to a secured transaction
- Personal property in which a secured interest is owned is the “collateral”
- Collateral can only be personal property, not real property
  - Stock, membership or partnership interest
  - Licenses, contracts
  - Equipment

## Security Agreements Cont.

- Governed by contract wording and UCC
- What further permitted sales or assignments are allowed?
  - What notices must be given by the parties if certain actions are taken?
- Must be perfected by filing UCC lien

## Key Terms: Traditional Guaranty

- **Guaranty** can be granted by any third party to encourage the entering into of a contract
  - Parent of single purpose entity
  - Shareholder of corporate entity
- What are limits of guaranty?
  - What if project is sold or expanded?
  - What if underlying agreements are changed?

## Key Terms: Letter of Credit

- Issued by a financial institution
- Typically irrevocable for a period of time, but may be automatically renewed
- Form of demand typically attached



## Structuring and Financing Nontraditional Offtakes

- ZEC Purchase Agreement—sells nuclear GHG reduction credits to buyers in NY power markets.
- OREC Agreement—NJ is awarding 1,100 MW offshore wind project to developer using this standard form of agreement to be funded by LSEs.
- Net Metering Credit Purchase Agreement or On-Bill Credit Purchase Agreement—allows ratepayers to enroll in program through utility to access renewables remotely.
- Community Solar—allows group of ratepayers to enroll in solar project using customer meters to support project financing

## Document Automation Trend: PPAs in a hurry

- PPAs contain hundreds, even thousands, of variables that need to be individually inputted manually. Document automation solutions enable fast and accurate document drafting by automating existing forms and precedents to generate first drafts of contracts and legal agreements.
- Saves more than 80% of drafting time by answering one questionnaire to create a full suite of PPA deal documents.

Notices to the Customer should be sent to:

The name of the person to put in the "Attention:" line of the address.

What is the Customer's telephone number?

Include hyphens (i.e., 123-456-7890)

What is the Customer's fax number?

Include hyphens (i.e., 123-456-7890)

Who is signing the Agreement on behalf of the Customer?

What is . . .'s title?

## **Standard System Specifications**

What is the System Size?

What is the System Type?

# Best Practices to Reduce Legal Risk and Ensure Regulatory Compliance



## *Hughes v. Talen Energy Marketing*, 136 S.Ct. 1288 (2016)

- » We mentioned *Hughes* as a case that raises legal risk for long-term PPAs. An issue arises when a state conducts a renewable energy procurement and seeks to lock in pricing while the project participates in wholesale power markets.
- » Both Maryland and New Jersey adopted programs to solicit wholesale power plant development and construction supported by long-term PPAs (called contracts for differences) at guaranteed prices (cost plus reasonable return), but the projects had to participate in wholesale power markets run by the PJM regional market.
- » The key issue was whether FERC's approval of PJM tariff rates preempted states from offering guaranteed contract prices to build new power plants in organized competitive wholesale power markets.
- » Both the Third and Fourth Circuits determined that similar procurement programs in two states were preempted by the Federal Power Act.

## *Hughes v. Talen Energy Marketing (continued)*

- » Supreme Court (8-0 decision by Justice Ginsburg, 4/19/16), affirmed state actions in MD and NJ were preempted by FERC by implied preemption.
- » “States may not seek to achieve ends, however legitimate, through regulatory means that intrude on FERC’s authority over interstate wholesale rates as Maryland and New Jersey has done here.”
- » States cannot regulate in a domain Congress assigned to FERC and then require FERC to accommodate the states’ intrusion.
- » Court concluded states were attempting to fiddle with the wholesale power markets by guaranteeing wholesale power generator compensation at rates that differed from what the plants could receive in the PJM power market.
- » FPA leaves no room either for direct state regulation of interstate wholesale power prices or for regulation that would indirectly achieve the same result.

## *Hughes v. Talen Energy Marketing (continued)*

- » States still have the right to take actions “untethered to a generator’s wholesale market participation.”
- » Court: *“Nothing in this opinion should be read to foreclose Maryland and other States from encouraging production of new or clean generation through measures ‘untethered to a generator’s wholesale market participation.’ ”*
- » Justice Sotomoyor concurred, writing to emphasize the collaborative federalism at stake:
  - Court’s decision recognizes importance of protecting states’ ability to contribute, within their regulatory domain, to the FPA’s goal of ensuring a sustainable supply of efficient and price-effective energy.
  - Collaborative federalism involves careful balance between federal and states’ rights over energy policy.

## *Hughes v. Talen Energy Marketing (continued)*

- » Justice Sotomayor concurred, writing to emphasize the collaborative federalism at stake:
  - The Court’s decision recognizes importance of protecting states’ ability to contribute, within their regulatory domain, to the FPA’s goal of ensuring a sustainable supply of efficient and price-effective energy.
  - Collaborative federalism involves careful balance between federal and states’ rights over energy policy.
- » Justice Thomas, concurring, would not have found implied preemption (the states’ actions violated the FPA outright):
  - “By fiddling with the effective price that [the generator] receives for its wholesale sales, Maryland has regulated wholesale sales no less than does direct rate-setting.”

## *Federalism Issues and Renewable Development*

- States retain jurisdiction over retail rates and energy markets involving local electric and natural gas utilities, even if they indirectly impact wholesale markets in exercising their jurisdiction.
- States have general powers, reserved under the FPA to the states, to regulate location and environmental permitting of renewable electric generating facilities.
- FERC has broad jurisdiction to regulate wholesale electric power markets, even if such regulation indirectly impacts states' jurisdiction.
- FERC's authority extends to all electric resources on the customer side of the meter, not just demand response. This includes solar panels on rooftops, energy efficiency programs, energy storage, and demand response. See *FERC v. Electric Power Supply Association*, 136 S.Ct. 760 (2016)

## *Issue: Who Owns RECs if PPA Silent?*

- » In *American Ref-Fuel Company* in 2003, FERC held that avoided cost PPAs between a qualifying facility (“QF”) and a utility buyer under the Public Utility Regulatory Policies Act of 1978 (“PURPA”), do not also convey RECs to a utility unless the contract expressly states otherwise. 105 FERC ¶ 61,004
- » But, see *Wheelabrator Lisbon v. CT DPUC*, 531 F.3d 183 (2nd Cir. 2008) (state law governs conveyance of RECs; “state may decide that a sale of power at wholesale automatically transfers ownership of the state-created RECs [but] that requirement must find its authority in state law, not PURPA.”).
- » Practical Advice: Make sure Power Purchase Agreement clearly identifies owner of any RECs created by project.

## *Best Practices to Reduce Legal Risk and Ensure Regulatory Compliance*

- States may encourage utilities to conduct procurements of electric power, renewable energy, or RECs to address state priorities – watch out for contracts or programs that promise specific compensation while requiring bidding into competitive wholesale markets.
- After *Hughes*, preemption is a risk, but not all state procurements are preempted. See *Allco v. Klee*, 861 F.3d 82 (2d Cir. 2017).
- **REC, ZEC or OREC PPAs are fair game for states.** See *Coalition for Competitive Electricity v. Zibelman*, 906 F.3d 41 (2d Cir 2018), cert. denied, 139 S.Ct. 1547 (2019) (NY’s nuclear ZEC program is not preempted; no impermissible “tether” under *Hughes*)

# Regulatory Considerations: Net Metering and Interconnection Issues

## State Regulatory Requirements Vary Significantly

- Distributed Generation: Project is “inside the fence” and interconnected electrically to host behind the utility meter.
- Net Metering: Revenue meter tracks electric usage both ways. When the host uses less electricity than solar PV system generates, surplus flows to local electric utility – the issue is who gets the credit for surplus power and for how much?
- DG Size Limits: Could be 2 MW or less, 6 MW or less, or less than the host’s annual consumption needs. States allow utility’s interconnection tariff to limit size of project.

# Regulatory Considerations: Renewable Energy Incentives

## Renewable Portfolio Standards (RPS)

- At least 29 states have an RPS; 8 states have renewables goals

## Renewable Energy Certificates (RECs)

- 1 for every 1,000 kWh produced; market value based on state mandates and alternative compliance penalties

## Tax Credits

- Investment tax credits
- Production tax credits

# Interconnection Agreement

- Construction
- Distribution
  - sending energy directly to utility
  - sending energy via utility's system to 3P off taker
- Term and renewals
- Point of interconnection/access
- Allocation of responsibility
  - PUC guidelines/tariff
  - Disconnection of unit
  - Ownership rights over wholesale power capacity
- Invoicing and payment
- Security
- Governing Law

## Strategies for Negotiation

- What is the market for Renewable Energy?
  - RPS and other Required Standards
  - Green Building/LEED Certification
  - Voluntarily Green
- Why does the lessor/seller/grantor want to contract with you?
  - Royalty
  - Recipient of Clean Energy, RECs
- Initial Stage of Development vs. Established Facility
- Who is the Offtaker? And will the Offtaker help you?
  - IOU
  - Local power company
  - Private User



# Holland & Knight

## Questions and Answers



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