

COMMUNITY PARTICIPATION IN UTILITY-SCALE RENEWABLE PROJECTS: LESSONS LEARNED FROM THE LAST MILE ELECTRIC COOPERATIVE EXPERIENCE

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Purpose of White Paper

The purpose of this White Paper is to explore an alternative to stand-alone community renewable projects, that is, participation by community groups[†] in utility-scale renewable projects. For the purpose of this paper, we define utility-scale renewable projects as a project that is larger than 10 megawatts. The term community group is used in its broadest sense to include any group of individuals or organizations, whether or not physically located in the same place.

As a rule, larger renewable projects are considerably less expensive to build on a per megawatt basis. That is because they can take advantage of economies of scale such as feasibility studies, permitting, site development, turbine procurement, lower financing costs (per turbine installed), and the like. Thus, if a community group can participate in a utility-scale project, it may be able to do so at a lower cost per megawatt than if it were building a stand-alone project.

Background

The White Paper builds upon the experience of the Last Mile Electric Cooperative (Last Mile), one of the sponsors of the Northwest Community Energy Website. Last Mile is a cooperative whose members consist of utilities as well as nonprofit organizations. Its 200 megawatt White Creek Project, located in Klickitat County, Washington, is the largest publicly developed windpower project in the United States. As part of its mission is to facilitate broad and diverse participation in renewable resources, it is important to Last Mile to identify ways that smaller utilities and community groups can take advantage of economies of scale to participate in future Last Mile projects. Unlike typical models described elsewhere on this website, the objective here is to enable small participants to own shares in a large utility scale project.

Among the lessons learned by Last Mile members in the course of developing the White Creek Project and performing initial investigative work on the other sites, is that there are various financial, legal and project governance barriers to non-utility participation in large utility scale wind projects. Accordingly, Last Mile commissioned legal and institutional experts to identify ways that this could happen without jeopardizing the economics of the project or the ability of larger utilities to participate.

[†] The term community group is used in its broadest sense to include any group of individuals or organizations, whether or not physically located in the same place.

Small Participant Pools

After exploring a number of options, Last Mile has focused on the creation of risk pools of community groups and small utilities (separately or together) that can assume a share of the project commensurate with their financial strength[‡]. The pools would serve two functions.

First, they could aggregate the smaller shares together under an agreement that would entitle and obligate other members of the pool (Pool Participants) to pick up a share from a faltering participant without necessarily involving or endangering the larger shareowners (Project Participants), or jeopardizing overall Project financing. Second, they would make overall project decision-making more efficient by limiting pool representation in that decision-making to one voice representing the pool. **Appendix A provides further detail on the particular pooling structure being developed by Last Mile and is included as an example of how such a structure might function vis a vis the project as a whole.**

One drawback to this pooling is that it could add complexity to the project's governance. This might be mitigated by using the same basic structure within the pool that is used for overall project governance, in effect mirroring the larger structure and obligations among participants.

A second potential drawback is the challengeable assumption that among themselves, the Pool Participants would be financially strong enough to cover for one of their number who withdrew or failed to meet a cash call. But this is not much different from the same question at the larger project level. Participants at either Project or pool level who are fundamentally incapable of meeting a realistic schedule of cash calls and other Project development requirements at their selected level of participation should not be Participants.

A possible fix would be for the Pool Participants to, in effect, purchase financial backup services from one of the larger Project Participants (for cash payments, or a share of net returns). While this would reduce the ultimate financial value to the Pool Participants, it would more objectively align risk and reward. Of course it begs the question why the Project Participant would provide those services in lieu of simply taking a larger initial position in the project. In addition, the ability of governmental entities to provide such services is subject to limitations in their state constitutions and authorizing statutes, including, for example, the prohibitions that exist in Washington and Oregon on gifts of public property or lending of credit to non-governmental entities.

Financing and Purchase Power Agreements (PPA)

Utility scale wind projects are highly capital intensive endeavors. While the initial phases of

[‡] The authors explicitly acknowledge that they and their White Creek colleagues, as parties to the evolution of the White Creek Wind Project, have had limited experience in designing and applying the pooling structure proposed here. The ideas were developed largely from a “lessons learned” exercise undertaken by White Creek and Last Mile members to address issues that arose in the formation of White Creek LLC and the development and financing of White Creek Wind Project Phases I and II.

project investigation may be funded from the cash flow of participants, once a decision to develop is reached costs quickly escalate to the point where debt financing is required. It is essential that all participants be creditworthy and have the financial capacity to be able to debt finance their share of the project. There are numerous ways to demonstrate or achieve creditworthiness. For example, in the case of small utilities, a participant may demonstrate that it has sufficient equity in its utility plant, financial strength, including the ability to purchase and use the power to serve its own customers.

Alternatively, when these utilities wish to acquire an interest in a project to provide for future load growth, or to acquire an asset from which they can remarket energy, they have much the same credit issues as organizations without loads. In either cases, whether individually or in aggregate (pooled), unless they have an extraordinary balance sheet, these parties will need to bring to the table a creditworthy, load-serving output buyer. It will be the revenues derived from the sale of power to the load serving buyer that the lender will look to as security for the financing.

The timing of obtaining a credit worthy load serving output buyer can be a significant problem for a small participant without significant financial capacity. It may be difficult to obtain a commitment from such an output buyer until a firm price can be offered and the project is sufficiently underway to appear real. By the same token, since lenders will be looking to the ability of the revenue stream from power sales to repay the debt, they will have to be convinced that the power sale price will cover the debt service. However, it is difficult to determine the cost structure of the project and offer a firm price to an off-taker in the early stages of development. This may lead to a “Catch 22” situation in which participants are required to self-fund substantial costs before they get to the point of being able to sell their share of project output and obtain project financing. Small participants must be extremely aware of this problem and plan for the financial obligations that they may incur if the availability of an off-taker contract and project financing is delayed.

Assuming that these Pool Participants are able to carry the development costs and risks, there is no intrinsic reason why such output purchasers could not be found. In marketing White Creek Windpower project, for example, we found some utilities preferred output contracts to equity positions. In some cases, these utilities had other uses for their limited store of credit. They may simply have had no appetite for the cost and risk of the early development work, i.e. before project feasibility has been verified, or of being a participant in a major construction project with the many accompanying costs and risks, including the requirement to self-finance prior to the availability of construction financing, preferring instead to enter the transaction at a later stage when most of the project risks are over and the resource is ready for commercial operation. In other cases, there could be political or other reasons for a utility to prefer a purchase to an equity position, to some extent independent of the immediate financial facts.

In the future, it could be that large industrial users of energy would commit to such off-taking for reasons of energy price stability and supply diversity, if delivery and shaping services accompanied the energy.

Whatever the circumstances, however, the Pool Participants will need to demonstrate creditworthy buyers to secure their pool shares. Again as a fallback, the Pool Participants

could do some risk shifting for payment with one of the larger Project Participants, assuming a willing seller could be found among the latter.

Organizational/Legal Structure of Pool

Pool Participants will need to form some kind of legal pooling entity or entities to define their relationships, hold assets, and act on behalf of the participants. The two most likely types of entities to be a pooling entity would be a cooperative or an LLC. The pooling entity would then become a member of the overall entity developing the project.[§]

Co-op—What is a co-op? A cooperative is a membership entity that operates according to a “cooperative plan.” Cooperatives are generally organized under not-for-profit corporation acts, but technically they could be organized as an LLC or under a conventional business corporation act. As long as they in fact operated as a cooperative, they would be eligible to be treated as a cooperative for relevant purposes such as the tax treatment under the Internal Revenue Code and/or eligibility for governmental grants available to cooperatives. Operating according to a “cooperative plan” means that the entity exists to furnish the members with an economic service under a plan that eliminates entrepreneur profit and that provides for substantial equality in ownership and control. There is no single or standard definition of a cooperative. For example cooperative or mutual corporations have been defined as follows:

- **State Law.** There is no state statute that sets forth an exclusive definition of a cooperative or provides an exclusive choice of law under which a cooperative must be established. For example, cooperatives may incorporate under the Washington Mutual and Miscellaneous Corporations Act, RCW 24.06, or under the Oregon Mutual Corporation provisions at, ORS 65.044 to 65.067. However, these are not the exclusive statutory authorities and a cooperative could incorporate under any other statute that does not preclude them from operating under a cooperative plan.
- **Black’s Law Dictionary.** A cooperative is a corporation or association organized for the purpose of rendering economic services, without gain to itself, to shareholders or members who own and control it. Black’s Law Dictionary 334 (6th ed. 1990).
- **Internal Revenue Code.** Perhaps most importantly, the Tax Court of the United States (“Tax Court”), and through its acquiescence the Internal Revenue Service (“IRS”), defines a cooperative as:

[§] For example, the White Creek Project LLC is a limited liability company formed under RCW 24.15, the Washington Limited Liability Company Act. The members of the White Creek Project LLC are two cooperatively owned utilities and another LLC whose members are the two Washington public utility district participants. The formation of a separate entity to participate in the larger project is not unlike the current participation of the two PUDs in White Creek through a separate PUD LLC except that the interests would be smaller.

...an organization established by individuals to provide themselves with goods and services or to produce and dispose of the products of their labor. The means of production and distribution are those owned in common and the earnings revert to the members, not on the basis of their investment in the enterprise but in proportion to their patronage or personal participation in it...

Puget Sound Plywood, Inc. v. Commissioner, 44 T.C. 305, 306 (1965).

- **Broad Authorities.** Because a cooperative is a private corporation, not a governmental entity, it has broad legal authority. Unlike Public Utility Districts (PUDs), which must always consult their authorizing statute before engaging in any activity, coops can essentially engage in any lawful business activity.

Authority to Participate in Forming a Cooperative.

A definitive analysis of the authorities and limitations that apply to PUDs and municipal utilities is beyond the scope of this paper. Such entities should consult with their local counsel to determine the limitations on their ability to participate in the pooling entity or entities as suggested in this Paper.

There is no doubt, however, that the non-governmental non-profit/non-utility organizations and the electric cooperatives can be incorporators and members of a cooperative together. Moreover, the limitations on municipal entities generally proscribe specific activities, e.g. operating an unauthorized line of business, or prohibited practices such as “lending credit.” Governmental bodies, including Washington PUDs, are explicitly authorized to be members of a mutual corporation. For example, the Washington Mutual Corporation Act, RCW 24.06.020 states,

One or more individuals, partnerships, corporations or governmental bodies or agencies may incorporate the corporation by signing and delivering articles of incorporation in duplicate to the secretary of state.

In fact, PUDs are members in Last Mile and the questions about their legal authority have not involved membership itself, but what activities they undertake as members. A Washington PUD cannot use its membership in a mutual corporation to engage in business activities or practices that would be prohibited if engaged in directly by the PUD, such as lending its credit or making gifts to non-governmental parties. The same is generally true of People’s Utility Districts and municipal utilities in Oregon.

Advantages of a Cooperative. There are several advantages to using a cooperative as a pooling entity, particularly for the non-profit/non-utility pool.

- Eligibility for USDA programs. A detailed analysis of USDA rural development and environmental grant programs is beyond the scope of this White Paper; however, some of these programs are described on the website and as Appendix B to this paper. Cooperatives are eligible grantees for a number of these grant programs. Some of these programs

provide funding for capital costs. Others provide funding that could be used for technical assistance, including legal, accounting and other consultants. Acting through a cooperative, the non-profit/non-utility organizations may be able to avail themselves of grant money to help to meet their financial obligations

- For agriculture cooperatives (not electric cooperatives), the Energy Policy Act of 2005 amended the Internal Revenue Code to allow a portion of the Production Tax Credit to be passed through to patrons. If land owners engaged in agriculture elect to participate in a larger scale project via the non-profit/non-utility pool, it might be possible to pass some tax benefits through to them.
- Tax planning is beyond the scope of this paper and will have to be undertaken by each participant based on its own status and circumstances; however, there may be overall tax advantages to a cooperative pooling entity over an LLC. For example, an LLC is a pass through entity for tax purposes, while a cooperative is not. The non-profit/non-utility pooling cooperative would probably be classified as a subchapter T cooperative. It would not automatically pass income through to its members for tax purposes. The cooperative could also reduce or eliminate entity level taxation by allocating income to patronage capital and making the minimum 20% distribution of net margins to its members. Distributed net margins would be taxable to the member; however, tax could be deferred on the 80% that is not distributed. This would be less a factor assuming that each member sells its share of the project output individually, in which case the income would be directly attributable to the individual members, not the pooling entity.
- For electric co-ops, the use of a cooperative as a pooling entity would be a familiar format for doing business and would be acceptable to RUS, CFC, Co-bank and other electric co-op lenders.
- Finally, PUDs the limitations on the type of activities that municipal entities can engage in through entities to which they belong has been previously mentioned. In addition, state authorizing statutes for municipal entities should be reviewed to determine if there are other limitations. For example, Washington PUDs may not buy stock in a for-profit corporation. Similarly, to the extent that for-profit LLCs were used as the pooling entity, it might create an authority issue for the PUDs.

For further questions and answers regarding cooperative participation in a utility-scale renewable project, see Appendix C.

What is an LLC? Limited liability companies are a relatively new form of business entity, having emerged in the past 20 to 25 years. Limited liability companies are authorized under most state laws including Washington, Oregon and California. An LLC is normally operated as a for-profit business; however, it is not required to be for-profit. A limited liability company combines the limited liability attributes of a conventional corporation with the tax attributes of a partnership. Members who own units in the LLC, like shareholders of a corporation, generally enjoy limited liability for acts of the LLC. For tax purposes, however, an LLC is treated like a partnership and 100% the income of the entity is passed through to the members.

Advantages of an LLC. Like a cooperative, an LLC has its own set of advantages.

- **Broad Authorities.** Like a cooperative, LLCs have broad legal authority to engage in any lawful business activity.
- **PUD Participation.** PUDs are generally authorized to participate in an LLC, with the same caveat as applies to their participation in a cooperative. PUDs cannot use an LLC to circumvent limits on their authority by engaging in activities that are otherwise proscribed under applicable law. E.g., a PUD LLC could not engage in an unauthorized line of business or lend its credit to non-governmental entities.
- **Flexibility.** One of the great advantages of an LLC is that the operating agreement can be structured to provide a great deal of flexibility, probably more than a cooperative, which is generally governed by the one member one vote principle and general corporate laws as well as its articles and bylaws. In that members of the LLC will have differential financial shares in both the pooling entity and indirectly in the project as a whole, it is possible to recognize these differences in voting rights and in other ways.
- **LLC as a Cooperative.** As there is no requirement that a cooperative be incorporated under any particular statute, it would be possible to establish an LLC and operate it as a cooperative. In order to qualify as a cooperative for purposes of IRS and USDA purposes, it would have to incorporate the required “cooperative principles” into its operating agreement.

It is premature to make a recommendation in this paper as to the choice of entity to serve as a pooling entity for smaller utility non-profit participants in a future project. That decision will turn on many variables, including the identity of the participants and their particular circumstances and authorities and the planned method of financing. A pooling entity that is made up entirely of electric cooperatives and non-profit entities might choose a different entity than a group that included primarily municipal entities that may be limited by their particular state laws. In addition, the financing plan will greatly influence the decision as to choice of entity. A plan that utilizes production tax credits might differ from a plan that involved conventional financing.

Other Formats for Community Participation in a Utility-scale Renewable Project

The format outlined in this White Paper for participation by small utility or non-utility participants in utility scale projects is not the traditional format for participation in smaller scale “community renewable” projects by community groups and small utilities. These are described in much more detail on the Northwest Community Energy website. The suggested pooling format has many advantages, as have been discussed; however, other formats are possible. The most popular other format, frequently referred to as “flip LLCs” or “Minnesota Flip” projects could be adapted to enable small utility and non-profit/non-utility members to participate in utility-scale projects. A brief outline of that format follows.

LLC/C-corporation Joint Ownership—“Minnesota Flip”. The “Minnesota Flip” model has been used successfully and involves joint ownership by local investors or community wind groups in an LLC and an outside corporate investor. This structure presumes use of federal Production Tax Credits (PTCs) and has been used for many of the small commercial wind power projects developed in the Midwest to date. This model would involve separating the interest held by the pooling entity and the interest held by the larger participants and it may be more appropriate if the participants in the pooling entity are all non-utilities. It is not clear under the tax code whether it would be necessary to segment ownership of certain turbines and sites between the project as a whole and a separate pooling entity made up of non-profit/non-utility participants, or whether the ownership interest of the pooling entity could be an undivided percentage interest in all of the project assets. In either case, it might be possible to adapt this model to large scale projects while retaining some of the economies of scale and other benefits of a utility scale project. If so, the pooling entity would enter into the arrangements described below with its own set of tax investors separate from the tax investors that would invest in the non-pooling entity portion of the project. An important issue that would have to be resolved is the willingness of tax investors in the non-pooling entity share to enter into this arrangement.

Project Structure. This kind of project could be structured in the following way:

- The community wind group would consist of an LLC or a cooperative composed of the small utility/non-utility members of the project, and perhaps others such as local landowners or an equity partner interested in developing wind.
- The community wind group would market its segment of the project to potential tax-motivated corporate investors, e.g. banks, insurance companies or any other entity with a tax appetite.
- The tax investors have taxable income to shelter and, because of the PTC and accelerated depreciation, might view wind power investments as attractive.
- The community wind group would provide funding for initial cash calls (perhaps with assistance from the investor).

- The community wind group would arrange construction and permanent debt financing (perhaps with assistance from the investor) independent of but at the same time as the financing obtained by project members, with a commitment from the corporate investor to acquire an ownership interest in the project at commercial operation.
- The corporate investor makes its equity investment in the project when it is completed and begins to generate.
- Power generated from the community's turbines would be marketed by the project in conjunction with other power sales from the project. Cash flow from the sale of power goes to the corporate investor during the first 10 years of the project, but the investor may pay the community wind group an administrative fee.
- The corporate investor realizes its financial return objectives in the first ten years of the project, primarily through a combination of the PTCs and accelerated depreciation benefits. During this time frame, most of the project debt is also paid down.
- At the 10-year mark when the PTCs end, the ownership shares "flip" so that the community wind group is now the owner for the remaining life of the project. The federal tax laws require that the majority corporate investor maintain a "significant" ongoing interest in the project and cannot pre-arrange to sell its interest to the minority local investors or to another party at a pre-determined fixed price. However, the corporate investor can grant to the local investors the right to purchase its interest at fair market value.

Participation of small utilities and non-utility entities in a large utility scale wind project involves complex financial, legal and tax challenges. As became apparent during development of the White Creek Windpower Project, Treasury regulations applicable to PTCs are complicated. Legal fees for addressing these issues may be substantial in order to obtain an IRS private letter ruling or other assurance from the IRS, which would be essential for securing participation by the outside investor. Circumnavigating the limitations on the authorities of municipal entities is another complex problem and finding a way to make smaller entities that lack the financial strength to finance such large capital intensive projects without financial partners (e.g. load serving power purchasers, tax investors, or other) is a challenge. Still, there are economies of scale and potential financial benefits to the smaller entities in finding solutions to these problems. We believe that forming pooling entities to acquire small shares of projects that will allow small entities the ability to assume a share of future projects commensurate with their financial strength offers potential benefits that are worth attempting to realize.

Appendix A

Details on Proposed Pooling Structure for Nonprofit and Small Utility Participation in Last Mile Electric Cooperative Projects

NewCo. For purposes of this White Paper, a new Project Entity is referred to as “NewCo” that would finance and develop the project as a whole. As in the current White Creek Project, participants in the project could be members of NewCo in their own name (as the 2 electric coops are) or through a separate entity (as the 2 PUDs are). However, a new requirement would be established for all members of NewCo. Whether an individual member or an entity comprised of several members, any member of NewCo must own a minimum percentage interest of 5%. If a participant does not own at least 5%, it must “pool” its participation through an entity made up of participants that in the aggregate own greater than 5%. It is further suggested that there be at least 3 such entities, one for the small PUDs, one for the small electric Coops and one for the non-profit/non utility members.

Pooling Equity Shares of Less than 5%. Smaller participants that do not wish to own a greater than 5% interest will be required to join together with other small participants to “pool” their membership in NewCo in a pooling entity that in the aggregate owns a greater than 5% share. It would be possible for such an entity to own a significant share of NewCo. For example, as noted above, under the White Creek Participant’s Agreement that applies to Phase III, 5 small utilities own a 13% interest, but no one utility owned 5%.

Small PUD Pool. Although the PUDs that are members in White Creek each have large shares of White Creek, they elected to form a separate entity (White Creek Public LLC) through which to participate in the White Creek Project LLC. This was done largely to assure compliance with the PUD statutes and to preclude any violation of the state constitutional ban on municipal corporations “lending credit” to non governmental bodies. It is anticipated that the same state law considerations would cause small PUD participants to participate through an entity made up exclusively of PUDs or other municipal corporations.

Small Coop Pool. Electric distribution cooperatives are private corporations. They are not subject to the statutory and constitutional limitations that apply to the PUDs. However, it is anticipated that the differences between electric distribution cooperatives and the non-profit/non-participants will make it beneficial for the electric coops to form a pooling entity made up solely of other electric coops. Among the differences that could lead to conflicts if both types of organizations participated through the same entity is the fact that electric coops are load serving utilities with the ability to use power to serve their own members while non-profit/non-utility participants would have to sell their share of the project output to third parties. In addition, electric coops have established credit arrangements with RUS, CFC and to some extent Co-Bank, which do not loan money to

non-utilities, and the non-utilities may have very different credit capabilities and methods of financing their share of the project.

Non-Profit/Non-utility Pool. Non-profit/non-utility organizations, landowners, and any other non-utility participants that seek to own an interest of less than 5% in NewCo would be required to pool their interest with other non-profit/non-utility participants through an entity that would own greater than 5%.

Combining the Coop and Non-Utility Pool. In the event that total participation on the part of the non-profit/non-utility members (or for that matter the small electric coop members) was less than 5%, it would be legally possible for them to join together in the same pooling entity, however, for the reasons mentioned above, having separate entities for each group is probably preferable.

Voting Rights. Individual participants that own greater than 5% equity (either directly or indirectly through an entity that is a member of NewCo), will be entitled to a seat on the NewCo Board and the right to vote their respective shares. Voting rights in NewCo will probably be based on percentage interest held. Members with less than a 5% interest that participate through one of the pooling entities would be represented on the NewCo Board by a single Board representative selected by the pooling entity to which they belong.

Member Financial Responsibilities & Alignment of Risk. As previously noted, the primary obligation of all participants in NewCo is to be ready, willing and able to meet financial obligations (cash calls, construction and permanent financing) in a timely fashion as they come due.

- ***Creditworthiness or Financial Capability.*** There may need to be some requirement for a demonstration or showing at some time prior to development that entities that wish to become members of NewCo, or a pooling entity that will, in turn, be a member of NewCo, have minimum creditworthiness and/or the ability to live up to the financial obligations of being a participant.
- ***Penalty for Default.*** In this regard, there should be some penalty for failure to perform to enforce these financial obligations. For example, a provision could be included in the NewCo governing documents making a default of the obligation to meet cash calls, to deliver financing commitments and/or to deliver a purchase power agreement (PPA) consistent with the project schedule is subject to a compulsory buyout of the defaulting Participant's interest by other Participants.
- ***Mandatory Buyout.*** A stronger variation of a compulsory buyout requirement might be to establish a price for the buyout at some percentage (e.g. 90%) of the equity investment of the defaulting Participant to the date of default, payable upon project finance closing. Such a provision would be designed to assure the larger and financially stronger members that their interest in the project will not be jeopardized by the inability of smaller financially weaker members to perform. Stepping up to this buyout would probably have to be obligatory on the part of the remaining Participants to ensure the project moves forward without pause; hence the "discounted" buyout price to compensate remaining Participants.

- ***Flexibility to Enter into Agreements with Third Parties.*** In order to meet their financial obligations, non-profit/non-utility participants should have the right to seek out and sell their interest to a third party satisfactory to the NewCo Board, and/or to enter into any contractual arrangements and to convey any economic interest to the third party, provided that nothing in the contractual arrangements purports to make the third party a “member” of NewCo, or a member of one of the pooling entities if they are not otherwise eligible to be a member and are duly approved as a member.
- ***Flexibility as to How Project Benefits are Allocated.*** It might be helpful, especially to the non-profit/non-utility members if the NewCo operating agreement provided some flexibility in the allocation of project benefits. For example, it might be possible for the non-profit/non-utility members to take an enhanced share of their benefits as green tags, which might be marketed by non-utilities more easily than power.

Appendix B

Summary of Some US Department of Agriculture Programs to Encourage Renewable Energy Development

Program	Eligibility	What Program Supports	Type of Support	2004 Funding Level
Renewable Energy and Energy Efficiency	Farms, Ranches, Rural Small Businesses, Cooperatives	Capital costs of renewable energy and energy efficiency equipment	Grants (loans and loan guarantees in future years)	\$22.8 Million
Value-Added Producer Grants	Farms, Ranches, Cooperatives, Producer Groups	Planning, marketing and feasibility studies; working capital	Grants	\$10.5 Million
Business/Industry Guaranteed Loan Program	Rural businesses	Guarantees for business loans made by rural lending institutions	Loan guarantees up to 80%	\$840.0 Million
Rural Economic Development Loan and Grant Program	Rural Electric and Telephone Cooperatives	Low-interest/no-interest loans	Loans to Rural Businesses, Public Agencies, others	\$18.9 Million
Rural Business Opportunity Grants	Local government, non-profit, tribes, cooperatives	Technical assistance and training supporting rural economic development	Direct grants to organizations	\$3.0 Million
Intermediate Relending Program	Local government, non-profit, tribes, cooperatives	Revolving Loan Fund	Subsidized loans to intermediaries	\$39.8 Million
Rural Business Enterprise Grants	Local government, non-profit, tribes, cooperatives	Loan funds or direct grants	Grants to intermediaries for use as seed grants or loans	\$43.8 Million

Source: USDA Rural Development

Appendix C

Additional Questions and Answers Regarding Community Participation in Utility-Scale Projects via Formation of a Cooperative

1. Can a co-op legally be formed consisting of nonprofit organizations who wish to participate in a renewable project? What constraints exist?

There is no legal restriction in the cooperative statute that would preclude a non-profit corporation from being a member of a cooperative. RCW 24.06 allows the following people to be incorporators and members.

RCW 24.06.020. Incorporators. One or more individuals, partnerships, corporations or governmental bodies or agencies may incorporate a corporation by signing and delivering articles of incorporation in duplicate to the secretary of state.

Nor is there any prohibition in the non-profit corporation statute (RCW 24.03) that would preclude a non-profit corporation from being a member of a cooperative that participates in a renewable project. Among other things, the general purposes of a non-profit corporation include engaging in “any lawful purpose or purposes” (RCW 24.03.015) and the powers of such corporations include the following:

RCW 24.03.035 * * * (17) To be a promoter, partner, member, associate or manager of any partnership, joint venture, trust or other enterprise.
[and] (20) To have and exercise all powers necessary or convenient to effect any or all of the purposes for which the corporation is organized.

However, there are two internal issues that a non-profit should consider before becoming involved in such a project. First, the non-profit should examine its articles to see if the purposes of the corporation as defined in the articles are broad enough to authorize participation in a renewable project. Sometimes articles intentionally contain limitations on authority. The non-profit should make sure there is nothing in the articles that would preclude such activities. Second, if the corporation obtained tax exempt status under § 501(c)(3) or some other section of the Internal Revenue Code, it should determine whether engaging in the renewable project is consistent with maintaining that tax exempt status. It should examine its letter from the IRS granting exempt status and other IRC materials concerning the requirements of the exemption that it received.

2. Could the Co-op have mixed membership: nonprofits, utilities, individuals (e.g., landowners)? Or should a separate co-op be formed for each type of participant?

As a matter of co-op law, there is no reason why the members could not consist of a mixture of non-profits, utilities, and individuals. Nor is there any legal reason why cooperative utilities and individuals could not be members.

The question is probably a bit closer when it comes to the Public Utility Districts (PUDs) and they will want to consult their own attorneys on this point. For example, although RCW 54.16.090 gives PUDs broad authority to enter into contracts with any kind of organization as long as it is in furtherance of a legitimate municipal purpose, the PUD participants in White Creek elected to form a separate LLC made up only of PUDs to be the member of the White Creek LLC. The purpose of this was to avoid circumstances that might involve an unlawful lending of credit.

Forming separate cooperatives for each type of member would be feasible, but it would increase the administrative cost and hassle as there would be 3 or 4 different co-ops that would each be members and each would have to have its separate board of directors (with E&O insurance, meetings, annual corporate fees, attorneys and auditors fees, etc., etc.).

3. What are tax implications? If the Co-op makes a profit, does that affect the taxable status of the members?

Unlike most electric cooperatives, the Co-op would probably be a Subchapter T cooperative. Subchapter T cooperatives are not tax exempt. Subchapter T cooperatives may deduct their net margins (profits) from their taxable income, if they are allocated to patrons and at least 20% is paid out as a patronage dividend to patrons in the year following the year in which earned. Patronage dividends are taxable to the member unless they are in respect of purchases of consumer goods.

Each of the member entities in the Co-op would have a different tax status and the receipt of taxable patronage dividends would affect each differently:

- Electric distribution co-ops that are tax exempt under IRC 501(c)(12) would remain tax exempt if at least 85% of their income is from their members. Since the Co-op would not be a “member” of an electric distribution co-op, any patronage income received from the Co-op would be non-member income. However, the amount of income is likely to be less than 15% of a distribution co-op’s total member income from electricity sales to its member/customers. The electric co-ops in White Creek will have to deal with this issue.
- A non-profit may generally be tax exempt, but only for income related to its exempt purpose. To the extent a tax exempt non-profit has “unrelated business income” that would be taxable. If income from the sale of a renewable resource is unrelated business income for the non-profit in question, it would be taxable. The receipt of unrelated business income could affect the tax exempt status of a non-profit organization if it became a major part of the organization’s income. The lengths to which a non-profit might wish to go to avoid this problem (e.g. setting up

an affiliate to be the member of the Co-op) would largely depend on the amount of income the Co-op was spinning off.

- Individual landowners who are members of the Co-op would be treated like members of any taxable subchapter T cooperative. Income from patronage dividends would be taxable.
- Small PUDs might use their share of output in their own system rather than sell it; thus largely avoiding the issue of profits from their share. If they did not use the power in their own systems, they would have patronage income from the subchapter T cooperative. Relatively small amounts of income may not be a problem; however, PUDs are by statute required to be non-profit organizations.

4. **We know that at a minimum, financiers will probably want a purchase power agreement (PPA) in place before they will lend money to a non-utility. What else would be required? Would a PPA with one of the utility members suffice?**

Based on the White Creek experience lenders will not loan, even to a utility, unless the borrower is “creditworthy.” In this context creditworthy means that the utility has the capacity to use the power in its own system and to increase its rates sufficiently to pay for the power, which is the source for repayment of the debt. For example, if a lender believed that using the power in the utility’s own system would cause a utility to have to impose a disproportionately large rate increase, the lender might find the utility to not be “creditworthy.”

Nor is being a utility a prerequisite to being “creditworthy.” There are many independent power producers (IPPs) that are not utilities and have no internal use for power. If such a company had the financial resources to guarantee payment, it could be creditworthy regardless of not being a utility. Alternatively, an IPP without the financial resources to guarantee payment, could have a power purchase agreement (PPA) in place with a creditworthy utility or large power user that would make a project creditworthy even if the IPP did not have sufficient financial resources alone.

Most of the White Creek output will be sold in the early years to third parties. While the fact that the White Creek members are utilities and could take the power into their own systems if that became necessary is important, the lenders will be looking through the creditworthiness of the members to the creditworthiness of the third party off-takers to whom it will be sold by the members.

Since the Co-op is likely to have only a small share of the output (probably 5 to 10 MW of capacity) it would be extremely difficult for the Co-op to market its share independently. The Co-op share to be marketed would become even smaller if some utility members of the Co-op used their share of the power in their own systems. The Co-op would almost certainly have to enter into an arrangement with the larger owners to market its output as part of a larger sale.

The White Creek experience has been that it was not possible to engage potential buyers of power in a discussion about a PPA until there was some certainty that the project was real and some idea of the cost of power. Thus, it would be extremely difficult to obtain any

lender financing during the investigative phase before a project is shown to be feasible. The investigative costs for White Creek were \$1.5 to \$2.0 million. At a minimum, the Co-op members need to expect that they will have to finance their proportionate share of this expense.

In addition, White Creek members have had to finance a significant portion of the total project cost beyond the initial investigative phase. This is a huge impediment to participation by non-profits and individuals that do not have access to revenue or credit to allow them to finance their share of these costs. A key to making it feasible for small members to participate in the Co-op is to eliminate the need for internal financing (at least by the non-profits) beyond the initial investigative stage.

If larger utility members agreed to be back up purchasers of the Co-op share that would go a long way toward eliminating the financial risk faced by the small less financially capable members, but if the intent of the larger members is to sell the output, a PPA with an off-taker is still needed. However, if the larger utility members are going to assume this risk there would have to be some economic rationale to do so.

5. Would the co-op have to be registered with the Federal Energy Regulatory Commission (FERC) or some other regulatory body?

If the Co-op turned its share of the output over to the project entity or a group of larger members to market, it would probably not be considered an IPP. If it marketed the power itself, it might have to meet the minimal registration requirements for an IPP.

6. Could the co-op be considered an “agricultural co-op” in order to take advantage of the Production Tax Credit (PTC) and pass the PTC on to its taxpaying members (if any)? Or could a separate agricultural co-op be formed consisting of folks who are able to take advantage of the pass-along?

Section 1302 of the Energy Policy Act of 2005 amended section 45 of the Internal Revenue Code to allow “eligible cooperatives” to elect to pass on any portion of the renewable electricity production credit to their patrons. An eligible cooperative is defined as a cooperative organization that is more than 50 percent “owned” by agricultural producers or entities owned by agricultural producers. This provision is effective as of August 8, 2005, although with respect to cooperatives and their patrons, the provision applies to tax years ending after August 8, 2005.

Thus, if 50% of the “ownership” of the Co-Op was “agricultural producers” or “entities owned by agricultural producers,” it would be an eligible co-op and could pass on a proportionate share of PTCs to these members. If the landowners were engaged in agricultural production and they “owned” more than 50% of the Co-op, presumably the Co-op could pass a proportionate share of the PTCs through to these members.

There is not much explanatory material about Section 1302. For example, it is unclear what it means to “own” a co-op. If it means 50% of the membership, it might be possible to find 5 or 6 landowners to be members along with 4 or 5 non-profits. If it means subscribing to 50% of the Co-op’s ownership share of the project, that could be a \$4 to \$7 million total investment if the Co-op had a 5% to 10% share. If this was too large, this

might be a reason for the landowners to form their own co-op to be a member of the Co-op in order to assure compliance with the 50% requirement.

There is a need to clarify how the IRS will interpret and apply this new provision.