SolMarket Presents:
The Top 10 Tax Mistakes that Make your PPA Unfinanceable
with
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Agenda

Part 1: Sol Systems & SolMarket Overview

Part 2: Top 10 PPA Tax Mistakes

Part 3: Q&A
Sol Systems
& Sol Market Overview
Sol Systems Overview

Solar Finance Firm

• Founded in 2008 with a mission to make solar energy more affordable and accessible

• Oldest and largest SREC aggregator in the U.S.

• 2,300+ customers in 13 states

• 250+ partnerships with solar installers and developers, 170 of which are exclusive

• Manage 22 MW+ of solar capacity

• Facilitated over $100 million in project financing through SREC business
Five of the top ten states for solar development had SREC markets, a key policy driver for solar development in the United States. These markets have provided a significant window into the market.
For the Solar industry to scale we must...

- **Build an Ecosystem:** Provide an ecosystem in which multiple new developers and players can thrive and innovate. Competition is healthy.

- **Reduce overall transaction costs:** Bring down costs of developing, investing and architecting portfolios. Uniformity in the origination and vetting process, standardization in documentation.

- **Create a standardized asset class:** We must provide a level of standardization across the industry to create secondary markets, reducing initial investment risk and creating an opportunity for more advanced investment vehicles.
The SolMarket Focus

U.S. PV Installations, 2010-Q2 2011

- Q1 2010: 152.0
- Q2 2010: 186.5
- Q3 2010: 187.3
- Q4 2010: 360.8
- Q1 2011: 268.0
- Q2 2011: 314.3

Legend:
- Residential
- Non-Residential
- Utility
- Total
The vast majority of solar (in volume) is built in not utility and non-residential space. These developers must succeed if the solar industry is to continue to scale. Providing them with the appropriate resources and information will be critical to this success.
SolMarket Explained

Developers & Installers:
- Financing
- Installation Services
- Brand Recognition
- RFPs

Investors:
- Project Origination
- Underwriting
- Developer Review
- Servicing
- Portfolio Structuring
SolMarket Explained

Developers & Installers:
- Financing
- Installation Services
- Brand Recognition
- RFPs

Manufacturers
- Project Pipeline
- Marketing
- Transaction Efficiency

Investors:
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- Underwriting
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SolMarket Explained

Professional Services:
- Deal Volume
- Advertising
- Brand Recognition

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SolMarket Vision

• Transaction driven community for solar
• Project origination platform for investors
• Financing conduit for developers
• Transaction resources for solar development
• Collaborative development knowledge center
• Group purchase opportunities
• Development services
Top 10 Tax Mistakes that Make Your PPA Unfinanceable

with

Laura Ellen Jones, Hunton & Williams
Mistake #10
Purchase Option Inside Recapture Period

• Original intent of the parties regarding ownership?

• Recapture of Treasury Grant/ITC

Best practice: Purchase option not available until 6th anniversary of placed in service date
Mistake #9
Use of Commercial Operations Date

- PPAs generally define and use “commercial operation date” for various purposes.

- Placed-in-service date does not equal “commercial operation date” in all cases.
  - IRS follows 5-factor test for determining the placed-in-service date (POSTT).

Best practice - Define COD equal to PIS.

Caution: Provision in PPA which provide that the COD is deemed to be a certain number of days after notice/testing/etc.
Mistake #8
Multiple Facility Pitfall

- Placed-in-service date rules are applied on a facility-by-facility basis
  - In the context of wind projects, the IRS has ruled that each wind turbine on a wind farm is treated as a separate facility
  - It is assumed that the same rule would apply to solar energy property
  - Special rule for Treasury Grant (single unit of property election)

- Once solar energy property reaches the point of independent operations, there is a risk that the IRS would treat other similar property which is added later as separate facilities

- Significant issue under the special 3-month rule for sale-leasebacks

Best practice – Separate, identical PPAs for each facility
Mistake #7
Fixed Price Per Month for Electricity

• Tax Ownership/Service Contract Issue
• Good to have a steady stream of income from a business perspective, however:
• If payments for electricity are based on estimated amounts of electricity produced, there must be:
  – Tracking account to make sure the actual amount of electricity paid for is provided
  – True-up mechanism for deficits
• Power purchaser should not bear the risk of power production levels
Mistake #6
Power Price Above FMV

• Basis/Tax Ownership Issue
• Recent Treasury Grant Cost Basis Guidance provides:
  – “One example of related transactions would be in a case in which the benefits of a [PPA] are acquired at the same time the Section 1603 eligible property is acquired.”
  – “In cases where the income approach yields a value that exceeds the cost to build the property by a significant margin, this raises a question of whether a portion of the claimed value should, in fact, be allocated to other ineligible assets, rights, or contracts associated with the production of income from the eligible property, such as a power purchase agreement.”
• Risk is that part of the purchase price for the system will be allocated to above-market PPA
• Treasury/NREL generally request copy of PPA in connection with Treasury Grant application
Mistake #5
Term of PPA is Too Long

• Tax Ownership Issue
• Look to the leasing guidelines to make sure that the provider is the owner of the property (and not the customer)
  – At least a 20% residual useful life at the end of term
  – At least 20% residual economic value at the end of term
• Extensions should not be automatic
  – Extensions mutually agreed by the parties at FMV power price determined at that time
  – Prefer to have a limited extension period
• In lease deals, PPA term cannot exceed lease term
Mistake #4
Too Many Purchase Options

• Tax Ownership Issue
• Bad: Purchase options should not be open-ended, exercisable at any time by power purchaser
• Okay: Purchase options on certain anniversaries of the placed in service date/COD (the less the better)

Best practices - No purchase option until the 6th anniversary of the placed in service date/COD (the further out the better) & one-time purchase option at a set time for “fair market value”
Mistake #3
Acquisition of System on Customer Termination

- Related to #4 tax mistake
- Tax Ownership Issue
- Customer should not be able to purchase/acquire the system due to its own default or its termination for convenience
  - Results in open-ended purchase option for customer
- Example from FAR 52.249-3(a)
  - The Government may terminate performance of work under the contract, in whole or, from time to time, in part if the Contracting Officer determines that a termination is in the Government’s interest...Upon receipt of notice, if title to the property is vested in the Contractor under this contract, it shall vest in the Government regardless of any other clause of this contract...."
Mistake #2
Violating the Service Contract Rules

- PPAs must be respected as service contracts under section 7701(e) of the Code
  - Tax-exempt use property issue
    - ITC/Treasury Grant/Depreciation
- Special safe harbor for “alternative energy property”
  - Four “foot faults”: (1) operator foot fault; (2) significant financial burden foot fault; (3) significant financial benefit foot fault; and (4) purchase option foot fault
  - Related party rules: Beware of municipalities and operators that can trace roots to the state
  - “Higher of” purchase options: Higher of FMV or termination value may not satisfy purchase option foot fault
  - Force majeure events and events beyond service provider’s reasonable control
- Directly applicable if tax-exempt service recipients but also applicable to taxable service recipient- tax ownership proxy
Mistake #1
Bargain Purchase Option

• Tax Ownership/Service Contract Issue
• What is the likelihood that the purchase option will be exercised?
• Similar to issue raised by #5 (Term too long)
  – Worst: Bargain purchase option
  – Worst: Agreement to abandon system at end of term
  – Bad: Fixed price purchase option
    • Remember the service contract rules
  – Okay: Determined by agreement of the parties at the time of exercise

Best practice - Determined by independent third party at the time of exercise
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Q&A
Please send questions in using the chat function.

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