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Indian Country Deserves A Second Look

The economic stimulus package extended some key tax incentives for tribal nations, which could lead to increased project development.

BY ALICE BODNAR, JOHN MARCIANO, JEFF KEOHANE & PHIL GLYNN

Indian Country – the lands over which American Indian tribes exercise governmental authority – encompasses about 5% of the U.S. land base. But Indian Country's wind energy potential is 535,000 GWh per year – the equivalent of 13% of the U.S.' total electricity production.

Moreover, as sovereigns predating the U.S., Indian tribes have the ability to work with developers that state and local governments do not possess. Nonetheless, very few utility-scale wind power developments exist or are planned in Indian Country.

One possible explanation for the lack of such developments is the combination of a lack of tribal capital and the insistence of most tribes that they have proprietary control over any project. Nationally, the Indian poverty rate is 26%, or double the national average of 13%. In the wind-rich northern tier states, the Indian poverty rate reaches 42%. Tribes tend to insist on control over projects due to the credible perception that past projects in Indian Country have tended to primarily benefit non-Indians.

Even with access to capital, however, idiosyncrasies of wind power make it difficult for tribes to profit from developments, even in Indian Country. Up to two-thirds of the value of a wind project may derive from federal programs and tax subsidies, as the revenues from the sale of power may not be sufficient to pay for the project development and operating costs. These tax subsidies include combinations of accelerated depreciation, production tax credits (PTCs), investment tax credits (ITCs), federal cash grants and federal loan guarantees.

Because tribes do not pay tax, they cannot directly benefit from programs that offset tax obligations, and tribal involvement may make a project ineligible for other federal subsidies. In order to realize the benefit of the incentive programs, tribes must monetize or extract value from the subsidies in some other way.

Two ways that tribes can monetize federal subsidies include the Renewable Energy Production Incentive (REPI) and issuance of tax-exempt tribal bonds. REPI provides a cash payment of \$0.021/kWh to renewable energy owners, such as tribal governments, that are not eligible for PTCs. REPI as a grant program, however, is not a reliable source of financing and requires full tribal ownership of the project.

Tribal incentives extended

Tribes have several options for issuing bonds, and the American Recovery and Reinvestment Act of 2009 has recently expanded some of those options. Like states, tribes may issue bonds, which may pay a lower rate of return to the investor, because those returns are tax-exempt. Tax-exempt borrowing rates are currently so low that it may be possible for a tribe to raise enough funds on the bond market to own 100% of the wind project, and thus become eligible for the REPI payments.

Alternatively, a tribe may partner with a third-party developer and utilize bond funds to finance a pre-paid power purchase agreement (PPA). The tribe would serve as the project's power off-taker and enter into an agreement with the developer to purchase and pre-pay for the power, funding a portion of the developer's activities with proceeds from tax-exempt bonds.

The developer would use other financing means to fill out the rest of the project's capital structure. At that point, the tribe would not have an ownership share in the project, but the tribe and developer could negotiate an option for the tribe to purchase the project after the developer obtains its target return on investment – typically, after six to 10 years. In the meantime, the tribe would resell the pre-paid electricity as a source of revenue.

Use of federally subsidized sales proceeds generated by a pre-paid PPA should not disqualify a project's owner from use of other federal tax subsidies and programs, such as the

PTC or the ITC. Many tribes would be understandably reluctant to enter into a joint venture to develop a power project on tribal lands when the tribe owns no part of project, while the institutional investor captures all of the tax benefits.

Another typical arrangement, the "partnership flip" financing structure, would not work well for a tribal joint venture. Under this structure, an institutional investor receives up to 99% of a project's profits and losses until it has achieved a target return on investment. This usually allows the investor to capture most of the depreciation and tax credits from the project. When the investor reaches its return, the investor's interest in profits and losses "flips" down to 5%, and the developer's (the tribe's) flips up to 95%.

However, where a tribe has an ownership interest in a flip partnership, the tax credits are disallowed to the extent of the high-water mark of its ownership interest – in this case, 95%. In addition, the depreciation is decelerated. The results would be similar under a sale-leaseback structure, such as when a tribe develops a project and then sells the project to an investor and leases it back. As an alternative to project ownership, a tribe may decide to instead lease lands to developers and share in project revenues through rents or land royalties.

Because very little wind power development has occurred in Indian Country, many wind power investors may be unfamiliar with additional incentives to develop a wind projects on Indian reservations.

The New Markets Tax Credit (NMTC) is a federal tax credit given to investors in exchange for making equity investments in community development entities (CDEs). CDEs are private, for-profit, mission-driven lending and investing organizations that provide capital to economic development projects in low-income communities. The CDE can provide all or part of the debt capital required to fund a project.

Because the NMTC investor's return on investment expectation is realized in the form of tax credits and not cash, the CDE can offer the capital it received from the investor to the project company on highly favorable terms. These favorable terms often include interest rates of more than 50% below market, longer amortization periods, longer periods of interest-only payments and other features. Use of a CDE loan should not affect a project company's eligibility to utilize other renewable energy subsidies.

Many CDEs agree to an arrangement whereby a sponsor of the project, such as a tribe, can gain control of a significant portion of the loan funds it receives from the CDE after a period of at least seven years and convert that financing to direct equity in the project. Tribes and developers in Indian Country should seek out CDEs with allocations of NMTCs that have a focus on Indian Country.

Another incentive to invest in Indian Country wind power projects is the three-year modified accelerated cost-recovery system on property that would otherwise qualify as five-year depreciation property. This program was recently extended to Dec. 31, 2009.

A third incentive is the Indian Employment Tax Credit, which was also recently extended to Dec. 31, 2009, which provides up to a $4,000 tax credit per tribally enrolled employee working on a reservation-based project. Bills were introduced in January in both the House and Senate to permanently extend both of these programs (H.R.474 and S.288).

In addition to the financial incentives of working with tribes, locating a wind project in Indian Country has many attractive qualities from a land-use perspective, though not without significant challenges.

The federal government generally holds the fee title to Indian Country lands in trust for the benefit of the tribal or individual Indian owners of the land, and as trustee, the federal government has fiduciary obligations to the tribes and their members.

Many reservations include large contiguous tracts under the unified ownership of the tribe, making them conducive to location of turbines and associated transmission infrastructure. However, the federal government parceled out, or allotted, many reservations among tribal members in the 19th century, resulting in complicated land-ownership patterns on such reservations today.

Allotment left reservations as a mix of trust and fee lands owned by tribes, Indian individuals and corporations, and non-Indian individuals and corporations. Due to multiple generations of inheritance, trust allotments may now have hundreds of owners who inherited small, undivided interests in the land measured in thousandths. An allotted reservation also typically includes former allotments no longer in trust status. Such parcels remain in Indian country, and the tribe may have some authority over activities of non-Indians on such lands if they harm the health and welfare, economic security or political integrity of the tribe.

Federal law requires approval of the tribal or individual Indian owners of trust land before the Secretary of the Interior may grant a lease of or an easement across the trust land. Leases and easements on tribal trust land are relatively straightforward, because the tribal government can speak with one voice. Heavily fractionated trust allotments raise difficulties, because federal regulations require approval of owners of fractions of the parcel, adding up to more than 50% of the interest in the land to approve such agreements.

Land records are maintained by the Bureau of Indian Affairs (BIA) and are usually not readily available or fully up-to-date, and owners of fractional interests may be impossible to locate. Fortunately, the BIA may override the need for approval of owners holding more than 50% interest in the land if it finds that the approval is in the best interest of the owners.

Another possible advantage of working in Indian Country is that state and local laws do not generally apply; tribal and federal laws govern instead. Their autonomy allows tribal councils to make quick and final decisions – for example, to grant a final permit to a project – which means developers do not need to go through additional regulatory processes.

Further, tribal councils may tailor their regulatory regimes to address both the needs of a particular project and the needs of the tribe to maintain the reservation as a permanent homeland for future generations. In addition to tribal regulation, the general federal environmental statutes, such as the Endangered Species Act and National Environmental Policy Act (NEPA), apply in Indian Country.

If construction of the project would require a significant federal action, such as an approval or permit, then NEPA would require preparation of an Environmental Assessment or Environmental Impact Statement. As noted above, granting a lease over or rights of way across trust land requires approval by both the tribal or individual owner of the land and the Secretary of the Interior. Such approvals are also considered major federal actions triggering NEPA.

There are issues unique to business dealings with tribes that must be addressed in any contract with a tribal entity. These include tribal sovereign immunity, actual authority and venue selection. Indian tribes, like state and federal governments, are immune from suit, including arbitration, without their explicit consent or an Act of Congress.

The federal and state governments have waived their immunity for many purposes, but tribes typically only do so on a case-by-case basis in order to protect their much smaller treasuries. Such waivers are valid and commonplace in business transactions. The terms of the waiver of immunity control the process for obtaining adjudication of a claim against the tribe, such as in federal or state court or private adjudication.

The waiver will also control the tribal entity from which judgment may be obtained and any limits on that judgment. Because waivers of sovereign immunity are strictly construed, one must ensure that the body of the tribe purporting to waive sovereign immunity has the actual authority to do so. The authority by which a tribe waives immunity differs from tribe to tribe, depending upon the tribe's governing documents. NWP

Alice Bodnar is an attorney with New York-based law firm Chadbourne & Parke specializing in project development, project finance and mergers and acquisitions. She can be reached at (213) 892-1000. John Marciano is a tax law attorney with the firm. He can be reached at (202) 974-5678. Jeff Keohane is counsel to Forman & Associates, where he focuses on natural resources and energy matters. He can be contacted at (415) 491-2310. Phil Glynn is director of Travois New Markets, a community development entity. He can be reached at (816) 994-8970.