Baker McKenzie Global Renewable Energy Conference

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Baker McKenzie's Global Renewable Energy Conference brought together over 25 industry experts from seven jurisdictions to discuss the global renewable energy market. As **Gregory Wetstone**, President and CEO, American Council on Renewable Energy, noted in his keynote address, the renewable energy sector is ripe for growth due to the global transition to renewable energy and corporate focus on approaching business in a sustainable way. This paper summarizes the main points made by each of the day's panels.

Current US Market Conditions

Eli Davis, Vice President - Structured Finance Americas, Intesa Sanpaolo
James P. O'Brien, Partner, Baker McKenzie Chicago
Clyde "Skip" Rankin, III, Partner, Baker McKenzie New York (Moderator)
Tremain Tanner, Program Leader - Renewable Power, Mott MacDonald
Swami Venkataraman, Senior Vice President, Moody's Investors Service
John Watson, Partner, Baker McKenzie Chicago

Status of PTC/ITC: The consensus among the panelists was that the current extensions of the PTC and ITC would remain in place, but the renewal of such tax benefits was not likely, in part because of the need to raise revenue in light of the proposed reduction in corporate tax rates. Also, the reduction in corporate tax rates could affect adversely the market for tax equity investment.

Import/Border Tax: The general feeling was that it was premature to talk about the details of a border tax. A border tax could impact the renewables sector because a significant number of renewables components are imported, particularly solar panels.

Jobs: It was noted that the renewables sector is a steady creator of jobs in America - both wind and solar - and that this statistic should be emphasized with the Trump Administration. In addition, there is significant political support for renewables in the Midwest due to farmers benefitting from wind farms.

Environmental Issues

- **Roll-back of Clean Power Plan**: Should not have a huge impact on renewables projects due to the involvement of state governments, which are likely to stay the course, although the long-term impact remains to be seen.
- **Endangered Species Act**: Possible weakening of the Act under the Trump Administration could decrease its impact on renewables projects.
- **Global standards and metrics**: Increasing in importance as a measure of what is expected in environmental performance.
- **Environmental due diligence:** Consider the impact on financing and the ability to de-risk potential litigation going forward.

FERC Status

- Chair of Commission (a political appointment) resigned, and currently there is no quorum, which prevents voting on certain matters.
- Authority has been delegated to staff, which is continuing business as usual pending the filling of three vacancies.
- Energy storage decisions, e.g., whether a storage asset can be a regulated transmission asset and also operate as a regulated interest market are very important decisions FERC will make.

DOE Status: Rick Perry's nomination for Secretary of Department of Energy could bring a balanced approach to energy. His influence is unclear but he has the economic experience and many feel that it would be beneficial if he could implement what Texas is doing in the renewables space.

New Technologies: The panelists discussed the success of the offshore wind project near Block Island, Rhode Island and the potential growth for offshore wind projects along the East Coast of the US. The technological advances in solar equipment were also noted.

Developing Renewable Energy Projects in Key Non-US Markets

Rick Angiuoni, Regional Director - Africa, The Export-Import Bank of the United States
Mona Dajani, Partner, Baker McKenzie Chicago (Moderator)
Naoaki "Nick" Eguchi, Partner, Baker McKenzie Tokyo
Tim Heitling, Partner, Baker McKenzie Berlin
Jose Roberto Martins, Partner, Baker McKenzie Sao Paulo
Michael Ratliff, Managing Director - Global Energy Group, Overseas Private Investment Corporation
Kieran Whyte, Partner, Baker McKenzie Johannesburg

Ways to Address Currency Risks

Currency issues are a big impediment to a USD lender where a PPA is denominated in a local currency. Some energy markets have addressed this risk by "dollarizing," e.g., in Chile payments and settlement are invariably now made in dollars and in Colombia all commodities are effectively dollarized. Other energy markets, such as those in Brazil and India, are not dollarized and have addressed currency risks through various means such as:

- Triggers for automatic adjustment in price if the exchange rate of the local currency moves by a certain percentage;
- Pass-through of costs;
- New or redesigned banking products such as swaps and hedging transactions to cover off the risks, e.g., OPIC provides a guarantee to a third party hedging provider to allow for lower costs of hedging and participation in a larger number of deals; and
- An index or link to USD, usually on a monthly basis (as the intra-month risk of currency movements is acceptable to lenders).

Multilateral Banks' Impact on Developing Renewable Projects

Multilateral banks are integral to mobilizing the capital required for renewables projects, especially in developing countries. Creditworthiness is very often a major impediment to achieving multilateral funding because utilities in developing countries frequently lack the financial resources. Instruments multilaterals use to mitigate such risk include:

- The partial risk guarantee, first used by the World Bank for the 1991 Azito Project (a gas power project), is a prime example of a multilateral lender facilitating long term financing necessary for renewable projects to succeed.
- Granting preferred creditor status to multilateral lenders.

Regional Collaboration on Energy and Energy Security Policies

Regional collaboration, although generally a positive development, is not easily achieved due to cross jurisdiction issues. The panelists discussed the status of collaboration in the following regions:

- **Asia**: Regional collaboration is still limited with an increase planned in the long run.
- **Latin America**: Regional collaboration is growing, e.g., transmission lines running through Central America with the aim of eventually connecting to Colombia.
- **Africa**: There is an appetite to cooperate, especially in commodity rich countries, which require electricity for exporting, and DFIs can be catalysts for this. The 55 countries in Africa are currently divided into four power pools with South Africa dominating the southern pool. There is a spot market for trading. While regionalization may help to improve bankability and also allow resource-rich countries to provide energy to resource-poor countries, it is not without difficulty. For example, Mozambique has hydro resources but not the transmission capacity to export the energy out of the country.

FIT and Auction Processes

- **Japan**: FIT are best suited to attract global investment and therefore provide rapid growth as seen in Japan. However, this leads to higher costs and is sustained by a power surcharge on consumers that is not popular. Therefore, the Japanese government plans to introduce an auction system in an attempt to bring down prices by increasing competition and encouraging technological advancement (the first auction is planned for September 2017 for 500 MW capped at $190 per MW). Initial bids are expected to be close to the ceiling but competition will cause reduction in price in subsequent bidding rounds.
- **Germany:** It took longer in Germany than Japan to go from FIT to auction. FIT was first used in 1991 in Germany but it was niche at the time and the market was not mature (the legal framework was very short and the system easy to understand, so there was no need for a PPA - developers needed only to feed in electricity). While this proved a good start for the market, prices were very high and the market was fragmented with a large number of small developers. As a consequence of the high prices, the government reduced the FIT in the solar section and many solar producers went bankrupt. Germany is still lacking in solar production as a result.

  The move to auctions was gradual and involved testing various auction models. Auctions have become the standard method as of 2017, not least due to EU State Aid regulations essentially requiring a harmonized auction process across member states. The auction process is more time-consuming for government and can preclude a number of small developers and municipalities traditionally involved in FIT projects as it is harder for them to meet auction requirements (significant work and costs are required upfront in the bidding process before there is any guarantee of payment); consequently, there are some exemptions in place. A disadvantage of the increasingly competitive auction system is that it can lead to developers gambling by, for example, competing in the auction process without first securing the land on which to build the project.
- **Brazil**: The FIT approach was used for only two years, followed by a rise in auction processes. As a result, Brazil has risen to be the fifth largest wind power producer in around six years. Unique to Brazil, the same PPA is often concluded by a developer with multiple utilities buying

parts of the whole amount, which minimizes the payment risk taken on any one utility. Because solar lags behind wind, the government is planning a number of solar only auctions in the coming months.

Climate Change Risk Disclosures

Matt Arnold, Global Head of Sustainable Finance, JPMorgan Chase
Richard Saines, Partner, Baker McKenzie Chicago (Moderator)

Matt Arnold is the Global Head of Sustainable Finance, JPMorgan Chase, where he focuses on pursuing sustainable opportunities. He is also a member of the Task Force on Climate-Related Financial Disclosures (TCFD) set up by the G20's Financial Stability Board and chaired by former New York Mayor Michael Bloomberg. The idea behind the TCFD is to move climate change related risks into the main sphere of corporate reporting rather than treating it as a separate sustainability issue.

TCFD was formed at the time of COP 21, to be composed with 30 members, with the dual aims of (i) articulating the landscape to which the task force will be relevant; and (ii) developing voluntary guidance on climate related financial risks for both issuers and investors (in the parlance of the TCFD, for "preparers" and "users" of financial information).

TCFD seeks to become *the* standard on climate related disclosure by looking at financial risks and ensuring they are relevant to an investor. The basic intent is that all filers reporting take into consideration the guidance, but it is voluntary.

The focus of the guidelines is on both material and emerging risks. Although there are not yet metrics for assessing materiality, different institutions can develop different approaches. For example, a bank might assess its credit exposure to producers and users of fossil fuels and analyze the effect on the bank in a variety of hypothetical situations, including if the loans became non-performing.

The Task Force's report will not be final until the G20 conference in July 2017. It is hoped that the TCFD guidelines will be the standard in 5 years time, with debt providers initially using the guidelines and, assuming a critical mass of reporting among large financial institutions by 2018/2019, debt users using the guidelines thereafter.

Financing Renewables Projects

Trevor d'Olier-Lees, Senior Director, S&P Global Ratings
Jai Khanna, Partner, Baker McKenzie Chicago
Patricia McDonald, Partner, Baker McKenzie Chicago
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Marc Pangburn, Director, Hannon Armstrong
Ari Pribadi, Managing Director, Marathon Capital
Jacob Susman, Vice President Head of Origination, EDF Renewable Energy

Corporate Tax Reforms

Currently there are two broadly similar but competing plans: The Trump plan and a House Republicans plan. Both plans call for a reduction in corporate income tax (to 15% (Trump) or 20% (Republicans)). This reduction is to be paid for by a border adjustment tax, with no interest deductions unless interest expenses can be deducted against interest income (with the potential to carry forward interest losses). The consequence predicted by most economists is an appreciation of the dollar, hopefully to offset the negative effects of no cost recovery in the US for imported goods. The likelihood of tax reform becoming effective this year is quite low as repeal of the Affordable Care Act is the Administration's priority. This may lead to tax planning opportunities this year, ahead of the reforms taking effect.

Uncertainty around the reforms will create a tax risk on deals in the coming years. It remains to be seen how the tax risk will be allocated and at what stage of the project. With respect to tax equity bridge financing, bridge financiers may potentially price in the tax decrease and/or build in mechanisms to that effect in the financing documents.

There will likely be no change to ITC/PTC as a result of the reforms. There was a transitional period when the last revision of the Tax Code occurred in 1985/86, so the question now is whether a transitional period will be implemented with this reform to cover deals entered into before the reforms take effect.

Non-Tax Financing Matters

- If there is a shortfall among traditional capital providers, **developers might look to pension funds, sovereign wealth funds and insurance companies**, who appear more willing to enter into the project financing space.
- There is a move away from 20/25 year PPAs towards **shorter tenor PPAs for 10/12 years**. There is a trend towards more merchant exposure plus transacting at the hub, and consequently more basis risk.
- **Regulatory perspective**: If the Administration takes a more laissez faire and less proactively helpful approach, this will result in more project delays.
- **Tensions between back leverage and tax equity** as to who takes control of the project if the sponsor runs into difficulty. This tension can be managed with inter party agreements, as well as change of control, cash sweep, tax law changes and back leverage debt servicing, among other matters.
- Whether a sponsor uses IFRS or GAAP **accounting standards** is important as IFRS treats tax equity as debt; therefore, if a sponsor adds back leverage as well, then its overall leverage will be higher. Many entities do not use back leverage but rather asset rotation to avoid this risk.
- Because residential solar has a focus on ITC risk and fair market value, which leads to more structuring issues between tax equity and back leverage, **solar deals often remain more difficult than wind**.
- **Green bonds** might attract a premium compared to other bond issues, but this has not really been seen yet. Some investors want to buy because it is green, providing more access to capital for green bonds, but there are potential legal risks to green bonds if covenants are linked to green promises. A breach of a green promise is currently a reputational issue but could be a legal problem for issuers down the line.

Structuring Renewables Projects

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Grant Hanessian, Partner, Baker McKenzie New York
Tim Heitling, Partner, Baker McKenzie Berlin
Weero Koster, Partner, Baker McKenzie Amsterdam (Moderator)
Joel Link, Vice President Origination and Development, Tenaska
John Powers, Vice President - Strategic Renewables, Renewable Choice Energy

Guidelines for Corporate PPAs

- **Offsite PPAs**: First look at where is it legal to do an offsite PPA (deregulated state) and then where is it financially beneficial to do such a deal. Recognize that the US corporate PPA model

may not be appropriate in other countries; the ability of corporate PPAs to be taken up in emerging markets in particular will be determined by deregulation.

- **Investment treaties**: Can provide for international arbitration investors to bring cases against the state/government (in addition to an agreement with an entity). Many treaties are extremely easy to use or access, e.g., the Energy Charter Treaty.

- **Financial**: In the Australian market the challenge with corporate PPAs is making them bankable; due to the questionable creditworthiness of the offtaker, often more of the risk is pushed on the sponsor. Aggregation of offtakers adds complexity but definitely helps with creditworthiness. In Germany, banks are willing to take more risk and are lowering the threshold for doing financing; the banks are eager to finance these types of projects.

Corporate Leadership: The Future of Renewables and New Technologies

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Kevin Smith, CEO, SolarReserve

How Are Corporates Impacting the Renewables Industry?

- **Europe**: Due to Europe's heavy regulatory framework, there is less space for voluntary corporate commitments. In the area of energy efficiency, there is a detailed set of rules, including some for building rules/standards and products, that make for good corporate policy and incentivizes companies to be more energy efficient. Energy safety is a top issue for policymakers in countries like Germany.

- **US**: Europe generally has had federal government programs driving renewables whereas in the US it has been driven by the states, but now the corporates are moving in. For example, some are pushing the US federal level to promote policies that will encourage renewable energy use primarily by the corporates (e.g., removing trade barriers) and that will level the playing field between renewables and the fossil fuel industry.

New Technologies

- Our dependence on energy storage will increase, which will likely increase the price of renewables.

- It is difficult to obtain financing for energy projects that do not have a proven technology, so its better if a developer starts with a pilot project or a smaller project to prove that the technology is working.

- An advantage of government financing is support for that first risk of financing new technologies.