

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: HARDIN HILLTOP WIND, LLC	DOCKET NO. DRU-06-4
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ORDER DECLINING TO ISSUE DECLARATORY ORDER

(Issued September 21, 2006)

PROCEDURAL HISTORY

On July 27, 2006, Hardin Hilltop Wind, LLC (Hardin), filed with the Utilities Board (Board) a petition for a declaratory ruling on behalf of its seven individual members. The questions Hardin posed relate to the eligibility of certain limited liability companies for wind energy production tax credits pursuant to Iowa Code chapter 476C and 199 IAC 15.19 and whether eligible renewable energy facilities may utilize external equity financing as long as the qualifying local owner retains a majority of the governing rights at all times and at least 51 percent of the project's expected benefits over the life of the project. The Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed a petition for intervention that included some comments on the petition for declaratory ruling on August 10, 2006. Pursuant to 199 IAC 4.3(1), Consumer Advocate qualifies as an intervenor in this proceeding.

On August 25, 2006, the Board issued an order stating that it would issue, or decline to issue, a declaratory order within the 60-day time limit provided by Iowa

Code § 17A.9(8). The Board also said the parties could file additional comments on or before September 1, 2006. Hardin filed additional comments on that date.

HARDIN'S POSITION

In its petition for declaratory ruling, Hardin summarizes the relevant facts and arguments upon which the ruling is requested as follows: Hardin is a limited liability company organized to assist in the development of seven small wind generation projects in Greene County, Iowa. The seven individual projects are each owned by a separate Iowa limited liability company (collectively, the "Generating Companies"). The Generating Companies own Hardin. On June 23, 2005, each of the seven Generating Companies (and Jet Wind LLC) made application with the Board for certification of eligibility for renewable energy tax credits pursuant to Iowa Code chapter 476C. Each of the Generating Companies (and Jet Wind LLC) received a letter from the Board's Executive Secretary indicating that a preliminary determination of eligibility had been made for each 1.65 MW wind facility (total capacity 13.2 MW). Hardin states it will enter into an interconnection agreement with Interstate Power and Light Company (IPL) and the Midwest Independent Transmission System Operator, Inc., and will own and operate the interconnection facilities on behalf of the Generating Companies. Hardin subsequently determined that 1.65 MW turbines are unavailable but has located, through its equity investor, other turbines that are 2.1 MW each. The project was reconfigured and one limited liability company, Jet Wind, will no longer own an individual turbine.

Hardin states that each of the seven Generating Companies has executed a power purchase agreement with IPL. With respect to financing, Hardin explains that each of the Generating Companies has entered into an agreement with Edison Mission Energy (Equity Investor) whereby the Equity Investor assigns its right to purchase turbines to the Generating Companies and provides equity financing to the projects. In return, the Equity Investor will acquire 99 percent of the financial rights of each of the Generating Companies until a date when a certain financial return threshold is reached, at which time each of the local owners of the Generating Companies will automatically begin to receive the substantial majority of such financial benefits. Over a projected project life of 25 years, Hardin states the local owners will receive no less than 51 percent of the estimated total financial benefits for each project.

Hardin asks the Board to answer two questions in the affirmative. The questions are:

A. Whether a limited liability company that owns an otherwise eligible renewable energy facility complies with the ownership requirements of Sections 476C.1(6)(b) and 6(c) where (i) 51 percent of the voting rights of the company are owned by a qualifying owner or owners at all times and (ii) at least 51 percent of the expected financial benefits of the project are expected to be received by the qualifying owner or owners over the life of the project?

B. Whether the proposed financing structure for the Generating Companies complies with the ownership requirements of Chapter 476C as discussed in this Petition?

In asking the Board to answer the first question in the affirmative, Hardin argues that Iowa Code chapter 476C has one overarching objective: to promote the

development of small, locally-owned renewable energy projects. Hardin states that the 51 percent requirement makes it clear that the expectation is that majority ownership of a project eligible to receive credits should rest with local residents or businesses so that the project benefits remain in Iowa. However, Hardin states that while the state tax credits are of great value in financing projects, most local individual owners still cannot finance a project like these, requiring \$2 million to \$3 million in capital. Instead, Hardin states that a common financing tool is to use an equity investor to provide capital in return for a share of the project's financial benefits, including, in particular, the federal production tax credits and depreciation, which a local owner almost always cannot use.

Hardin has provided projections showing that, based on its assumptions, 51 percent of the financial benefits will accrue to the local owner over the 25-year life of the project. Hardin suggests the reasonableness of the assumptions could be tested by requiring an additional filing after the project is completed, but that any Board review of the assumptions should be limited to assuring itself that the 51 percent test is met using reasonable assumptions. Hardin states that Minnesota found a financing structure such as the one it is proposing to qualify under a similar statute. Hardin did not provide a copy of any written decision from Minnesota, however.

Hardin also asks that its second question be answered in the affirmative. Hardin provided benefit calculations showing that over the project's 25-year life the 51 percent threshold for a local owner is projected to be satisfied. Hardin includes any lease fees for turbines located on an owner's property in the benefit calculation,

but states that the 51 percent threshold is projected to be satisfied for local owners even without lease payments.

In its additional comments filed on September 1, 2006, Hardin notes that while project costs have risen to some extent since its original filing, the 51 percent threshold for benefits accruing to the eligible owner is still met. Hardin commits to making any adjustments necessary to assure compliance with the 51 percent standard.

CONSUMER ADVOCATE'S POSITION

Consumer Advocate notes that while Iowa Code chapter 476C does not direct the Board to review the financing structures utilized by chapter 476C applications, the Legislature's intent, as evidenced through the ownership limitations and requirements specified in the chapter, suggests that the Board should review these financing arrangements in making eligibility determinations, at least to the extent they may impact the applicants' ownership interest in eligible facilities. Consumer Advocate supports the Board's issuance of a declaratory ruling affirming the first matter requested by Hardin because Consumer Advocate's review of the proposed equity investment leads Consumer Advocate to conclude that the proposed financing arrangement does not adversely impact the Board's preliminary determination of eligibility for the renewable energy projects presented by Hardin.

APPLICABLE STATUTE

The issues raised by Hardin relate to ownership of and benefits flowing from facilities eligible for Iowa Code chapter 476C tax credits. The Legislature has

specifically defined an eligible renewable energy facility. Iowa Code § 476C.1(6)(b) provides that any eligible renewable energy facility must be at least 51 percent owned by one or more of any combination of the following:

1. A resident of this state;
2. Any of the following, as defined in section 9H.1:
 - a. An authorized farm corporation;
 - b. An authorized limited liability company;
 - c. An authorized trust;
 - d. A family farm corporation;
 - e. A family farm limited liability company;
 - f. A family trust;
 - g. A revocable trust; or
 - h. A testamentary trust.
3. A small business as defined in section 15.102;
4. An electric cooperative association organized pursuant to chapter 499;
5. An electric cooperative association that has members organized pursuant to chapter 499;
6. A cooperative corporation organized pursuant to chapter 497 or a limited liability corporation organized pursuant to chapter 490A and meeting other requirements; or
7. A school district.

DISCUSSION

In 2005 the Legislature enacted legislation establishing two types of energy tax credits, one for wind energy production tax credits (Iowa Code chapter 476B, often referred to as the large wind credits) and one for renewable energy tax credits (Iowa Code chapter 476C, often referred to as the small wind credits, although a portion of the credits are reserved for other renewable energy facilities). A history of the administrative rules adopted to implement the two pieces of legislation is set forth in the order adopting the tax credit rules and will not be repeated here; however, ownership issues were some of the primary issues in the rule making and the

Administrative Rules Review Committee encouraged the Board to adopt strict ownership limits for chapter 476B projects.

Chapter 476C differs from chapter 476B in that chapter 476C includes a specific list of eligible types of owners. Therefore, unlike the rules applying to chapter 476B projects, the Board found no statutory authorization to pierce the corporate veil and look through the listed entities when applying the ownership limits of section 476C.3(5), which provides that an owner meeting the eligibility requirements of the chapter shall not be the owner of more than two eligible renewable energy facilities; for chapter 476B projects, the Board considers the equity owners of the application, in addition to the applicant itself, when applying the ownership limit.

The issues raised by the petition for declaratory order are similar in many respects to those debated in the rule making because they involve statutory construction and a determination of legislative intent in establishing the ownership requirements and restrictions contained in chapter 476C. While the Board recognizes creative financing may be necessary for some wind projects to reach fruition, that creative financing must satisfy the ownership criteria of chapter 476C or the facility will not be eligible for the tax credits. The Board recently addressed issues similar to those raised by Hardin in another declaratory docket. In re: Paul Neppel, "Order Declining to Issue Declaratory Order," Docket No. DRU-06-3 (7/24/2006) (Neppel Order).

As was true in the Neppel Order, in this case ownership is being addressed as consisting of both financial rights and governance rights. Hardin has addressed one question that the Board considered in the Neppel Order with regard to governance

rights. Hardin has assured the Board that at all times during the project's projected life the governance element of the 51 percent ownership threshold will be satisfied. In other words, local governance will control. In the Neppel Order, the Board found that it appeared from the filed information that the eligible Iowa LLCs might not always retain a majority interest with respect to governance rights in the LLCs. However, the financing arrangement proposed by Hardin raises some of the same concerns the Board considered in the Neppel Order. For example, the equity investor (who is not an eligible owner as defined by chapter 476C) retains the majority of the project's financial benefits for a substantial period of time. The eligible owner only receives significant financial benefits in later years, assuming that the projections provided for the later years are met or exceeded; if the projections are wrong, the eligible owner could receive less than 51 percent of the financial benefits over the life of the project. The "equity flip" (a phrase used by Hardin) financing model proffered by Hardin relies on projections and assumptions for demonstrating that 51 percent of the financial benefits flow to the eligible owner.

In the final analysis, defining the word "owner" in this context may have substantial future tax consequences that are not within the Board's normal range of expertise. Moreover, it is not at all clear that a ruling by this agency concerning these questions would be persuasive to (or binding on) state or federal taxing authorities. Thus, even a favorable Board ruling might have no real value to the petitions. Under these conditions, the Board will decline to rule on the questions asked.

If wind projects such as the one proposed by Hardin cannot be financed by traditional means, and if advance regulatory approval of the financing method is

required for tax purposes, then project proponents may want to make their case for non-traditional financing (such as the equity flip model) to the tax authorities or to the legislature. As far as the Board is concerned, Hardin will not lose its place in the queue as a result of this declaratory ruling because financing arrangements are not explicitly part of the filing requirements. 199 IAC 15.19(1).

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The Utilities Board declines to issue a declaratory order pursuant to the request for declaratory order filed by Hardin Hilltop Wind, LLC, on July 27, 2006.
2. Any argument in the pleadings not specifically addressed in this order is rejected as not being of sufficient persuasiveness to warrant comments.

UTILITIES BOARD

/s/ John R. Norris

/s/ Diane Munns

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Curtis W. Stamp

Dated at Des Moines, Iowa, this 21st day of September, 2006.