FERC Cuts Regulatory Burden on Tax Equity Investments in Renewable Generation

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Agency clarifies that Section 203 approval is not required for tax equity investments with specified, limited veto and consent rights.

The Federal Energy Regulatory Commission (FERC) issued a declaratory order[1] on October 4 that is expected to substantially simplify and expedite tax equity investments in eligible project companies that are subject to FERC regulation under the Federal Power Act (FPA).

Electric generating companies within the United States (except for portions of Texas) are generally subject to FERC regulation as "public utilities" under the FPA. Any direct or indirect equity or equivalent investment aggregating to 10% or more of the voting interests in a utility normally cannot be consummated without express, prior FERC approval under FPA Section 203. Certain investors regulated by FERC as "holding companies" must also secure pre-consummation FERC approval prior to making certain direct or indirect equity or equivalent investments in any public utility.

Tax equity investments are designed to monetize the value of investment tax credits, production tax credits, and/or the accelerated depreciation in the context of renewable (typically wind and solar) power production. The tax equity investor typically makes one or more investments in the generating company (or a special-purpose immediate parent company), often just before any production of electricity is commenced. These investments usually vest the tax equity investor with extensive veto and consent rights to protect the underlying investment but without any control over day-to-day decisions, affording the investor the ability to reject changes to tax or accounting treatment, incurring certain types of indebtedness, selling or transferring assets, making capital expenditures above a certain threshold, and changing the purpose of the companies in which the tax equity investment has been made. The tax equity investor may also remove (or cause the removal of) the managing member or manager of the company in the event of misconduct, bankruptcy, or a managing member's exit from the investment. However, the tax equity investor typically does not agree to take, and does not desire, the right to exercise day-to-day control over the project. This structure of veto and consent rights for these tax equity investments, intended to avoid triggering FERC jurisdiction, could involve pre-consummation approvals by FERC and, in some cases, state utility commissions.

Tax equity investments have been treated by FERC as “passive” and therefore lacking the “voting” characteristics that would be strictly subject to FERC’s FPA jurisdiction. Yet, FERC has received and acted on numerous Section 203 applications in which generating companies (and, in effect, the tax equity investors themselves) along with renewable generation developers, investors, managers, and others have sought comfort that tax equity investments would not violate FERC’s Section 203 regulations, from which substantial punitive exposure can result. Because the equity held by the tax equity investors confers certain rights, investors and generation companies have generally shied away from claiming that such equity investments by their nature are not subject to FERC jurisdiction.

Securing FERC approval prior to making tax equity investment has raised numerous timing risks in solar and wind generation transactions. Tax equity capitalization normally reaches a generating company only around the time of mechanical completion, and very shortly thereafter, the generating company must commence testing and power production, which itself almost always requires authorization from FERC, with a prior (not contemporaneous) FERC application filing as a non-waivable prerequisite. If a generating company has already filed with FERC an application for power sales authority, then the tax equity investment was sometimes interpreted—before the Declaratory Order—as requiring Section 203 authorization, in a FERC process that could easily consume weeks or even months. The Declaratory Order dispenses with that requirement.

The tax equity investor and the generating company need not seek the often time-consuming advance authorization for the investment as long as the investment in a generating company (or in the generating company’s special-purpose parent)

- confers on the tax equity investor only veto and consent rights consistent with those permitted in other recent FERC orders;
- does not permit the tax equity investor the right to direct or remove the managing member or other control-party, but for serious and specified cause; and
- does not otherwise place the tax equity investor in a position to direct or control the FERC-regulated generating company (or its FERC-regulated activities such as the sale and marketing of power).

The Declaratory Order does not, however, relieve any FERC-regulated generating company from other FERC power sales, change-in-control, financing, market-conduct, or other regulatory requirements. Tax equity investments will still require disclosure and explanation in, for example, “market-based rate” power sales applications filed routinely by generating companies. An exercise of control-related remedies by a tax equity investor can also trigger FERC approval requirements. Thus, although the Declaratory Order is a favorable development for generating companies and tax equity investors alike, its reach is limited to the tax equity investment itself under Section 203 of the FPA and does not extend to any other FERC subject matter, including rate regulation and power sales authorization.

[1] Ad Hoc Renewable Energy Financing Group, Order Granting Petition for Declaratory Order, Docket No. EL17-26-000, 161 FERC ¶ 61,010 (2017)(the Declaratory Order).

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