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Green Revenue and Economic Development Opportunities for Public Sector Entities

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GREEN REVENUE AND ECONOMIC DEVELOPMENT OPPORTUNITIES FOR PUBLIC SECTOR ENTITIES

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On June 12, 2013, the Ministry of Energy issued a directive to the Ontario Power Authority (OPA) pursuant to the Electricity Act, 1998 to amend the Feed-in-Tariff (“FIT”) Program. The directive follows the May 30, 2013 speech by the Ontario Minister of Energy to an energy industry association announcing major changes to the procurement and planning processes for renewable energy in the Province. The directive clearly indicated a desire to encourage participation by public sector entities, and provide them with incentives under the FIT Program. While the exact form and type of incentives have not yet been specified, the directive indicates that they will be similar to those provided to communities. The incentives include Contract Capacity Set-Asides, revised prioritization points, price adders, reduced security payment requirements, and access to Funding.

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I. SMALL FIT

Under the directive, the OPA was tasked with revising the Feed-In Program (FIT) program for renewable projects between 10 and 500 kW (Small FIT) to give priority to projects partnered or led by municipalities and public sector entities, including publicly funded schools, colleges and universities, hospitals and publicly-owned, long-term care facilities, public transit and Metrolinx. These incentives include the provision of a “price adder” to the standard FIT pricing, the provision of priority points during the application process and the creation of capacity set-asides.

In addition, the OPA has been tasked with addressing two areas which have been particularly problematic from a public sector perspective. Firstly, the OPA will be required to ensure that site access requirements for municipalities and public sector entities are compatible with applicable public sector procurement legislation and directives. Secondly, the OPA will be required to provide municipalities and public sector entities with access to funding for costs associated with design and development of their Small FIT projects. This funding will be similar to the funding that is already available for community co-op and aboriginal sponsored projects.

These announcements and directives clearly signal Ontario’s strong commitment to small renewable energy projects by making a total of 900 MW of new capacity available between now and 2018 for the Small FIT and microFIT (10 kW and under) Programs. The OPA will open a new procurement window for Small FIT and microFIT starting in the fall of 2013. The fall 2013 procurement target will be 70 MW for Small FIT and 30 MW for microFIT, with annual procurement targets being set thereafter at 150 MW for Small FIT and 50 MW for microFIT. The OPA will also be launching a pilot program for rooftop solar projects on unconstructed buildings during the new procurement window for Small FIT.

II. LARGE FIT

Under the directive, the OPA was also tasked with developing a competitive procurement process for renewable energy projects over 500 kW, which will replace the existing large project stream of the FIT Program. Under the new competitive procurement process, the OPA will be required to engage with municipalities to help identify appropriate locations and siting requirements for future large renewable energy projects. The Government has also asked the Independent Electricity System Operator and the OPA to consult on the development of regional energy plans to ensure that it “gets siting decisions right the first time.” The OPA will be providing the Minister with interim recommendations by September 1, 2013, and will continue its consultation throughout the fall.

The Government has also indicated that it will work with municipalities to determine a property tax rate increase for wind turbine towers, as well as provide funding to help small and medium-sized municipalities develop municipal energy plans focusing on increasing conservation and helping to identify the best energy infrastructure options for their communities.

III. WHAT’S NOT CHANGING

Municipalities and public sector entities also need to understand the key aspects of the FIT process that will not likely be changing including:

- the requirement that an applicant must obtain written confirmation from a Professional Engineer that the existing building has sufficient usable surface area for a solar project and that it is suitable to support the project or would be suitable to support the project after implementation of improvements; and
- requirements around economic interests, what they consist of and how they must be maintained.

Municipalities need to understand how they should structure their activities to ensure that they can continue to maintain their tax-exempt status while participating in the development of the project in a tax-efficient manner. Some thoughts on these issues are discussed below.

Maintaining tax-exempt status

A municipal corporation formed by a municipality qualifies for tax-exempt status if it meets both a qualifying ownership test and a source of income test. The ownership test is satisfied by restricting ownership to one or more municipalities in Canada. The source of income test requires the municipal corporation to restrict its income-producing activities to activities carried on within the geographic boundaries of its municipal shareholders, subject to two exceptions. The first is a de minimis exception allowing up to 10 percent of the municipal corporation’s net income for a taxation year to come from activities carried on outside those municipal boundaries. The second exception applies to income from certain regulated activities, including the production or distribution of electricity, or income that arises from a contract with a Crown entity.

Determining whether the geographic source of income test is satisfied in a particular situation is a question of fact. The Canada Revenue Agency has in the past confirmed that it is the activities of the corporation itself and not of its subsidiaries that are relevant in determining where its income is earned for the purposes of the geographic source of income test. Also, the geographic source of income test is not concerned with the location of the municipal corporation’s income, but instead the location of the activities from which the municipal corporation’s income is generated.

Municipalities that participate in the development of a renewable energy project will need to ensure that their participation does not affect their ability to satisfy the geographic source of income test to maintain tax-exempt status. A normal first step in structuring municipal involvement in the development of a renewable energy project would be for the municipality to establish a separate subsidiary municipal corporation for that purpose.

Structuring municipal involvement

The structure of the investment entity will be affected by an analysis of whether the income from the generation activity will fit

within the source of income exceptions described above. If so, it would likely make sense for the municipal corporation to consider, where permissible, holding the investment through a limited partnership. This would provide some measure of limited liability, while not creating an intervening level of corporate tax.

If there is some ambiguity around the application of the source of income exceptions, another alternative is to organize a blocker entity to hold the partnership interest. If permitted by municipal law regulations, the municipality could capitalize the blocker corporation with a combination of debt and equity, sufficient to defer any corporate level tax for an indefinite period of time.

While the specific changes to the FIT Program, FIT Rules, and FIT Contracts have not yet been announced, the benefits potentially being provided under the directive to municipalities and public sector entities are substantial. Municipalities and public sector entities will need to understand these benefits in order to be in a position to take advantage of them. The changes will most certainly draw the attention of not only developers of renewable energy projects but equipment suppliers.

Municipalities and public sector entities that wish to take advantage of this potential opportunity and be ready for the new procurement window starting in the fall of 2013 will need to understand how the FIT process works, the impact that priority points and capacity set-asides will have on that process, and advantages that these changes bring to them.

IV. FEED-IN TARIFF (FIT) PROGRAM

The Feed-In Tariff (FIT) Program was enabled by the Green Energy and Green Economy Act, 2009. The Ontario Power Authority (OPA) is responsible for implementing the FIT Program. The FIT Program allows homeowners, business owners, and private developers to generate renewable energy and sell it to the OPA at a guaranteed price for a fixed contract term. Renewable energy has been defined to include wind, waterpower, biomass and biogas, solar photovoltaic (PV) power and landfill gas.

Until the recent announcement, the FIT Program was divided into two streams - FIT and microFIT, based upon the number of kilowatts of electricity generated. The FIT Program is for renewable energy projects that can generate more than 10 kilowatts (kW) of electricity. The microFIT program is for small projects, at a home or small business, that can generate 10 kW or less.

The FIT Program consists of standardized program rules, prices and contracts for anyone who is interested in developing a renewable energy project. Prices vary depending upon the type of renewable resource that is being utilized but have generally been designed to cover project costs and allow for a reasonable return on investment over the contract term (generally 20 years). The pricing schedule is generally reviewed by the OPA every year and is changed to reflect the changing costs associated with developing the particular renewable resource.

What is a Contract Capacity Set-Aside?

As the name suggests, a specified amount of MWs are set-aside/reserved for a particular group; in this case, public sector entities. For the next 2013 Small FIT application window, the OPA has been directed to provide a Contract Capacity Set Aside for projects involving greater than 50 percent equity participation from public sector entities of 24 MW.

If the Contract Capacity Set-Aside for other programs (Community/Aboriginal Set-Asides) are not fully allocated (i.e., the amount of MW applied for Community/Aboriginals is less than the amount set-aside) the OPA shall then apportion 1/3 of the

remaining capacity of these projects to public sector entities.

Based on the order of rank determined in Stage 3, Contract Capacity Set Aside Eligible Projects will be assessed to determine if they can be connected. If they can be connected, they will be added to the Offer List for a FIT Contract. The procedure is repeated until all of the MW under the Contract Capacity Set Aside are fully allocated.

After all Contract Capacity Set Asides are fully allocated, all remaining FIT Applications will be ranked by their Priority Points and by Time Stamp. So if for example, a public sector entity applied under the Small FIT Window but the Contract Capacity Set Aside was fully-allocated, the applications would then be ranked with all of the remaining projects.

The remaining applications then go through the same test as in Stage 4 to see if they can be connected.

How have the Prioritization Points been changed?

Prioritization Points are based upon a table that is contained in the FIT Rules. A revised Table was provided with the directive and provides that a project in which public sector entities have a minimum 15 percent equity interest will be awarded three points; only two priority Points were previously awarded.

What are the FIT Price Adders?

The directive suggests that municipalities or public sector entities will receive the same FIT Price Adders as are provided to Community Participation Projects. The price adder is 1 cent/kWh in addition to the contract price for a project in which there is greater than 50 percent equity participation and 1/2 a cent/kWh for a project that has more than 15 percent equity but less than 50 percent equity participation. However the FIT Price Adders do not apply to rooftop solar (at least currently).

What access to funding is going to be provided?

Under the directive, the OPA is required to provide public sector entities with access to funding for costs associated with the development and design of Small FIT projects similar to the funding available to Community/Aboriginal projects. In the interim (until that access is provided) the OPA is required to provide funding for the costs associated with the development of the Small FIT Applications. The OPA has not yet clarified when and how this funding might be made available.

What is the benefit to public sector entities?

If the public sector entities structure their projects so that they have an equity interest in the projects, it will mean that their applications will be considered ahead of developer/third party applications. It will also mean that the competition for FIT contracts will initially be between public sector entities and then subsequently as between those public sector entities and private/third party developers. In short this will provide public sector entities with a competitive advantage in securing FIT Contracts over developer/ third party applications.

Borden Ladner Gervais LLP has been working with municipalities, public sector entities and developers on renewable generation projects since 2004 and specifically in respect of the FIT program since its inception in 2009. If you are interested in hearing more about these developments or considering how these changes may provide your municipality or public sector entity with an opportunity, please feel free to contact any one of the following:

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