

# *Tribal Energy Finance & Business Models*

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## *In the Context of Tribal Economic Sovereignty*

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***Tribal Energy Program***

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## **Objectives of Presentation**

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- **Clear the air on terminology**
  - **Economic Sovereignty: one goal of energy development and Trust Reform**
- **Understanding finance essentials**
- **Choices for Tribal Energy Business Structures**
  - **Ease of setting up**
  - **Flexibility in operation**
  - **Maximize access to funding and financial incentives**

## **Economic Sovereignty**

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- **“The power of [national] governments to make decisions independently of those made by other governments”**
  - » London South East Ltd.; [www.lse.co.uk](http://www.lse.co.uk)
- **“Economic Sovereignty invokes both the pride of the traditional era and the sophistication required *to compete* in today’s global economy. Economic sovereignty is about expanding the Tribes’ economic choices in a resource-constrained environment.”** (emphasis added)
  - » Economic Sovereignty, CTUIR Overall Economic Development Plan, 2010-2015 (hereinafter CTUIR)

## **In the Context of Tribal Sovereignty**

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- **“A country’s independent authority and the right to govern itself”**
  - » Merriam-Webster, Inc. 2014
- **“...sovereignty means a careful balancing of resources to counter threats, meet opportunities, and maximize the choices available to tribal families and to the community as a whole—all while protecting the gifts of clean water, clear air, and healthy land.”**
  - » CTUIR, *supra*.

## **In the Context of Trust Reform**

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- **United Southern and Eastern Tribes (USET):**
  - **The trust responsibility should not vary...on whether a Tribe is doing better or worse. It is not an economic indicator, but rather a fundamental obligation of the United States. However, the trust responsibility should support Tribal empowerment and self-sufficiency so that Tribes may achieve economic sustainability.**
  - **USET Resolution on Trust Reform, October 11, 2012**

## **Progress So Far In Leasing for Tribal Energy**

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- **Per S209, the TERA law continues to undergo fine tuning and amendment**
- **As of April 14, 2015, 14 tribes have had their surface leasing ordinance approved by the Interior Secretary – as required by the HEARTH Act --- and another seven have submitted tribal ordinances to the Department.\***

**\*Moorehead, Paul, *Get the Fed's Hands Off Our Lands*, Indian Country Today (April 15, 2015)**

## **The Result**

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- **Eliminate the lengthy and costly delays associated with the federal leasing approval process to help tribes attract outside investment and jobs for their members by increasing flexibility and competitiveness**
- **These structural reforms were proposed by Indian country leaders and enacted by a Congress motivated by a desire to increase tribal self-determination to facilitate investment, job creation and improved household incomes for Indian people**

## **More Info on Trust Reform & Tribal Energy**

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- **S383: Indian Trust Asset Reform Act**
- **HR 812: Indian Trust Asset Reform Act**
- **H.R. 329: Indian Employment, Training, and Related Services Consolidation Act of 2015**
- **NCAI: <http://www.ncai.org>**
- **USET: <http://www.usetinc.org>**
- **ATNI: <http://www.atnitribes.org/atni-energy-program>**



## **Before We Jump Into Project Finance**

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- **Resources for Funding, Technical Assistance and Renewable Energy Credits:**
  - [http://apps1.eere.energy.gov/tribalenergy/related\\_opportunities.cfm](http://apps1.eere.energy.gov/tribalenergy/related_opportunities.cfm)
- **Federal Financial Assistance Opportunities At The Department of Energy (March 2003)**
  - <http://energy.gov/sites/prod/files/maprod/documents/finassthowto5.pdf>

## **Economic Sovereignty and Project Finance**

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- **Economic diversification is key to financial self-sufficiency for tribal governments**
- **Financing established tribal enterprises can be challenging; capitalizing a new venture is even more difficult**
- **Tribes that are pursuing diversification efforts should expect that initial capital will either need to be in the form of equity, OR**
- **Will require substantial support in the form of guarantees from existing enterprise cash flow or general obligation of tribe**

## **Clean Energy Project Finance**

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- **Majority of clean energy projects have been financed with a tax equity model**
- **Tax equity model is a combination of:**
  - **Small amount of sponsor equity,**
  - **Bank debt, and**
  - **Tax equity (monetization of tax credits)**

## **Project Finance Basics**

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- **Non-recourse debt, meaning the lenders do not have any other collateral except for the assets of the project**
- **Lenders loan to cash flows, and against assets (e.g., the panels, turbines, etc.)**
- **Loan repayment is from the project cash flows net of operating and capital expenses**
- **Project cash flows will provide scheduled debt repayment**

## **Common Debt Structures**

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- **General Obligation (GO) – promise to pay from all available moneys (backed by “full faith and credit”)**
- **Unsecured GO: no particular revenue stream or bundle of assets secures the debt**
- **Secured GO: some revenue stream or bundle of assets pledged to secure the borrowing**

## **Common Debt Structures, cont.**

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- **Revenue Obligation – revenues pledged to secure the borrowing, but the general credit of the tribe is not (lenders have recourse only against that stream of revenues pledged)**
- **Asset-Backed – borrowing is secured primarily or solely by one or more specific assets; if borrower defaults, the lender can seize the property and resell it.**

## **Some Bond Basics**

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- **Bonds – more commonly used for long-term financing of larger, more costly capital improvement projects**
- **Longer term (up to 20 years) lowers annual debt service, but greater all-in-cost of financing**
- **Tax-exempt investors typically comfortable with longer term, smaller size (but may be slight premium on smaller deals, e.g. \$10-15MM)**

## **Some Tax Exempt Debt Basics**

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- **Traditionally, tribal governments have been limited to issuing tax exempt debt only if proceeds of the financing would be used for an “essential governmental function”**
- **The IRS has interpreted “essential governmental function” very narrowly, excluding items that state and local governments can traditionally finance on a tax-exempt basis, such as hotels, golf courses, convention centers, event centers, parking garages, and related infrastructure**



## **Tax Exempt Debt, cont.**

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- **Private Letter Rulings for tribal energy treat debt as tax exempt**
- **The IRS has scrutinized several tribal tax-exempt financing transactions that state and local governments would traditionally have been able to finance on a tax-exempt basis**
- **As a result, tribes have traditionally been forced to either finance projects that would be tax-exempt for a municipality using taxable debt, obtain a PLR or leverage other funding sources**

## **The Lender's Perspective vs. Equity**

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- **Debt providers (banks and bond holders) provide more affordable capital but want little or no risk**
- **Lenders look for contracts that shift risk to someone with a deeper pocket and risk appetite (e.g., utility)**
- **Equity providers, by contrast, take the greatest risks but get compensated by getting all the cash available after paying project costs and debt**

## **Lender's Basic Requirements**

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- **Base case cash flow model showing debt will be repaid on schedule and the Debt Service Coverage Ratio (DSCR) requirements are satisfied**
- **A set of sensitivity (or reasonable downside) cases showing the impact on debt repayment and DSCR if things don't go according to the base plan**
- **Models must conform to the cash flow waterfall and DSCR covenants in the loan agreements**

## **The Language of Finance**

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- **Project team must be able to clearly forecast future cash generation performance, identifying key project and industry variables that drive those forecasts**
- **Finance is not simply accounting, which tends to focus on historical and current performance**

## **Working Knowledge of Key Industry Factors**

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- **Permitting and construction costs and timelines**
- **Technology costs and performance**
- **Operating costs**
- **Regulated utility allowable costs and revenues**
- **Merchant market price forecasting**
- **Sales and fuel contract review and interpretation**

## **Credit Market Trends**

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- **As the economy has improved, credit and capital markets have stabilized but in many areas credit is still very tight**
- **Strong tribal credits have access to less expensive bank debt**
- **Lenders providing loans to fund tribal enterprises are increasingly looking to tribal government as guarantor**

## **Planning is Key**

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- **Identifying the optimal financing structure to fund energy development should be based on a defined process and overall capital improvement or economic development plan**
- **Even if a tribe has sufficient funds to directly invest in a business opportunity, borrowing funds may allow the tribe to earn a higher rate of return on its money in investments elsewhere**

## **The Project and the Plan**

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- **Evaluate your project within context of overall capital improvement or economic development plan**
- **Understand these key issues:**
  - **Will the project generate revenues?**
  - **Will the project generate enough money to cover debt service?**
  - **Are there other assets of the tribe that may be pledged to improve financing terms?**



## **The Goal of the Plan**

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- **For Tribal Council and Tribal Members: illustrate, explain and justify the costs and benefits of pursuing an investment in tribal energy and the rationale for the proposed financing structure**

## **Legal Issues in Financing**

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- **Appropriate authorization pursuant to tribal law required for any borrowing (and corresponding waiver of sovereign immunity) to be valid, must be done in accordance with applicable tribal law**
- **Lenders' counsel now scrutinizing tribal law more closely**
- **Lenders usually want to specify a familiar body of law, such as law of state in which tribe is located or laws of State of New York, as governing law for the transaction**

## **Supplementing Tribal Code**

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- **Lenders may request that the tribe adopt certain laws or tribal code(s) compatible with state law, such as an arbitration code or Uniform Commercial Code to govern security interests in personal property**

## **Who is the Borrower?**

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- **Tribe**
- **Tribal Instrumentality/Authority (e.g. Tribal Economic Development Authority, Tribal Housing Authority)**
- **A political subdivision and unincorporated instrumentality of the tribe – not a separate legal entity from tribe**
- **Tribal Corporation**
- **Tribally-chartered corporation or federally-chartered under Section 17 of IRA**
- **LLC or other separate entity**

## **Sovereignty and Business Structures**

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- **Tribes are free to choose the form of governmental or non-governmental organization through which they do business. *Mescalero Apache Tribe v. Jones*, 411 US 145, 157 n 13, 93 SCt 1267 (1973)**
- **As a general rule, state civil laws do not apply to Indians or their affairs within Indian country because either state laws are preempted by federal law, or state laws infringe on Indian self-rule. *White Mountain Apache Tribe v. Bracker* , 448 US 136, 100 SCt 2578, 65 LEd2d 665 (1980)**

## **Tribal Law Governs**

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- **The power of a subordinate agency, enterprise or corporation is a matter of tribal law. *Navajo Tribe v. Bank of New Mexico*, 700 F2d 1285, 1288 (10th Cir 1993)**
- **A non-Indian party's claim that it detrimentally relied on a subordinate tribal entity's apparent authority will not save an *ultra vires* contract**

## Part of the Tribe, or Not?

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- **The enterprise may or may not be a legal entity separate from the tribe. A tribal enterprise which is an integral part of a tribe enjoys all the privileges and immunities of the tribe itself for activities conducted on or off reservation. *Central Machinery Co. v. Arizona Tax Comm.*, 448 US 160, 164 n 3, 100 SCt 2599, 65 LEd2d 684 (1980)**

## **Distinction between Political Subdivisions**

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- **In some cases, a tribal authority may constitute a separate political subdivision of the tribe, meaning that the subdivision possesses one of the three commonly recognized attributes of a sovereign: police powers, taxing powers, or eminent domain powers**



# **Tribal Government Enterprises**

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- **The Tribe**
  - **Many successful ventures have been undertaken directly with the tribe.**
  - **Benefits include sovereign immunity, exemption from income tax, ability to issue tax exempt bonds, direct authority.**
  - **Downside includes exposing tribal assets to liability, delays in approvals due to political processes, lack of experience with business ventures**

## **Tribal Enterprises or Instrumentalities**

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- **Still a part of the tribe, but**
  - **Formed by tribal resolution, ordinance or code**
  - **Managed by separate Board of Directors and management staff**
  - **Certain financing options available to the tribe may or may not be available without full tribal approval**
  - **Can incur debt, enter into contracts, be sued without exposing tribe to liability**

## **Tribal Political Subdivisions**

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- **Full delegation of sovereign powers to a separate government entity**
- **BIA and IRS confirmation typically required**
- **Exempt from federal income tax, retains sovereign immunity, may issue tax exempt bonds**
- **May be less flexible than a tribal corporate entity, and less attractive to some business partners or investors**

## **Tribal Corporate Enterprises: Section 17**

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- **Section 17 of the Indian Reorganization Act (25 USC § 477)**
- **Requires tribal resolution, followed by approval of the corporate charter, and BIA ratification of the charter**
- **Must be wholly owned by the tribe, which precludes equity ownership by outside investors**

## **Tribal Corporate Enterprises: Section 17**

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- **Assets of the Section 17 corp. may be pledged as collateral**
- **Exempt from federal income tax**
- **May issue tax exempt bonds**
- **Unlike political subdivisions, assets and liabilities are wholly separate from assets and liabilities of the tribe**
- **Can be sued in its corporate form, with tribe retaining sovereign immunity**
- **25 year leasing authority; Section 81 approval of leases/contracts by BIA not required**

## **Tribally Chartered Corporations**

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- **Established under tribal law**
- **Separation of corporate assets and liabilities from tribal assets and liabilities**
- **Financing options broad (loans, taxable bond issuances, commercial debt)**
- **Tax status uncertain; may not be able to issue tax exempt debt**

## **State Chartered Corporations**

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- **Easy to form**
- **Full separation of assets and liabilities from tribe**
- **Same financing tools as tribal corporations**
- **Subject to federal income tax**
- **Cannot assert sovereign immunity**
- **Subject to state laws and state reporting requirements**

## **State Chartered Limited Liability Company**

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- **Easy to form**
- **Full separation of assets and liabilities from tribe**
- **Structure familiar to lenders and potential business partners**
- **LLC members achieve tax benefits of a pass through entity**
- **No sovereign immunity**
- **May not issue tax exempt debt**



## **Choosing an Entity for Joint Development**

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- **Most common types of entities for creating a joint venture between a tribe and a non-tribal business partner include:**
  - **Corporation**
  - **Limited Liability Company**
  - **Partnership**

## **Corporation as a Joint Venture Entity**

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- **Corporate owners enjoy complete protection from personal liability for the activities of the corporation**
- **Unless a wholly-owned Section 17 or wholly-owned tribal corporation, the corp. is subject to federal income tax, and even then, federal tax treatment is uncertain where taxable partners participate**
- **Non-tribal owners may also be required to pay income taxes on any income received from the corp in the form of dividends or distributions**

## **Partnership as a Joint Venture Entity**

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- **General and limited partnerships**
- **Both types enjoy the same tax status:**
  - **Partnership not directly subject to federal income tax**
  - **Each partner reports its share of the partnership's income or losses as part of its own annual income or losses (“flow-through” taxation)**
  - **IRS clear that tribal partners not subject to federal income tax**

## **LLC as a Joint Venture Entity**

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- **Most common between tribes and non-tribal businesses because it combines the limited personal liability of corporate status with the pass through tax feature of partnerships**
- **Does not have the attributes of the tribe (e.g., sovereign immunity) and cannot issue tax exempt debt**
- **Tribal participation may make certain types of federal tax credits and depreciation benefits difficult or prohibited**

## **Strong Communication Skills**

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- **The team must include experienced players who can explain complex technical and financial concepts in a straight forward and easy to understand manner**
- **The team must be able to persuade lenders of the feasibility of the project, and that all major risks affecting the project cash flows have been identified and adequately mitigated**

## **The Package**

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- **A concise and well developed business plan**
- **Management team that has demonstrated success in similar ventures**
- **Clear support and transparent connections between tribal enterprise/business entities and tribal government**
- **Solid project team of qualified professionals**
- **Defined contribution to the project**

## **The Business Plan**

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- **Executive Summary**
  - **Investors must be able to understand and appreciate the project without reading further**
- **Why Invest in Your Project?**
  - **Rewards and risks well defined**
  - **Simple, concise and understandable**

## **Business Plan Details**

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- **Describe the project**
  - **Not too much detail**
  - **Target market opportunities**
  - **Fully analyze risks and rewards:  
competition, prices, access to  
transmission, legislation, incentives and  
options**
  - **Reliable outside sources for projections**



## **Show Your Cards**

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- **Demonstrate your contributions**
  - **Funding**
  - **Management**
  - **Special access to incentives**
  - **Government support**
  - **Clear channels of decision-making**
  - **Plain vanilla dispute resolution, business structures**

## **For More Information**

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