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A New Model for Clean Energy: Community Solar Gardens

United States Renewable Energy Alert

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Introduction

Declining prices for solar equipment and generous government incentives have broadened the appeal of community solar gardens. Community solar gardens, which are arrangements in which multiple users invest in and benefit from a solar array, provide a simple and cost-effective means for power consumers to acquire clean energy without having to bear the entire cost of purchasing or leasing a solar array. According to GTM Research, the community solar market is forecasted to grow fivefold in 2015.¹

For a variety of reasons, most energy consumers cannot own or lease a solar array—for example, they may not control the rights to their roof or their roof may be physically unsuitable. Community solar gardens offer these consumers the opportunity to invest in an offsite, local solar array in exchange for reductions in their energy bills. This new model expands consumer access to solar energy while also conferring a host of ancillary benefits.

This alert outlines the foundation of community solar gardens and describes their main legal considerations. While this alert cannot describe all the legal issues of community solar gardens nationwide, it covers common federal and state law issues that individuals involved with community solar gardens should anticipate.

Background

Presently, there are at least 52 active community solar gardens and 29 under development in the United States. There are 24 states with at least one active solar garden and at least 20 states have or are in the process of enacting community solar garden legislation. Research indicates that over the next five years, the community solar market will grow at a compound annual growth rate of almost 60%.²

Key Parties

There are several key parties to a community solar garden:

- **Host:** A host provides the solar array a location, which may range from schools and public housing to privately owned land and buildings.

¹ Mike Munsell, *Community Solar Market to Grow Fivefold in 2015, Top 500MW in 2020*, Greentech Media (June 23, 2015), <http://www.greentechmedia.com/articles/read/us-community-solar-market-to-grow-fivefold-in-2015-top-500-mw-in-2020>.

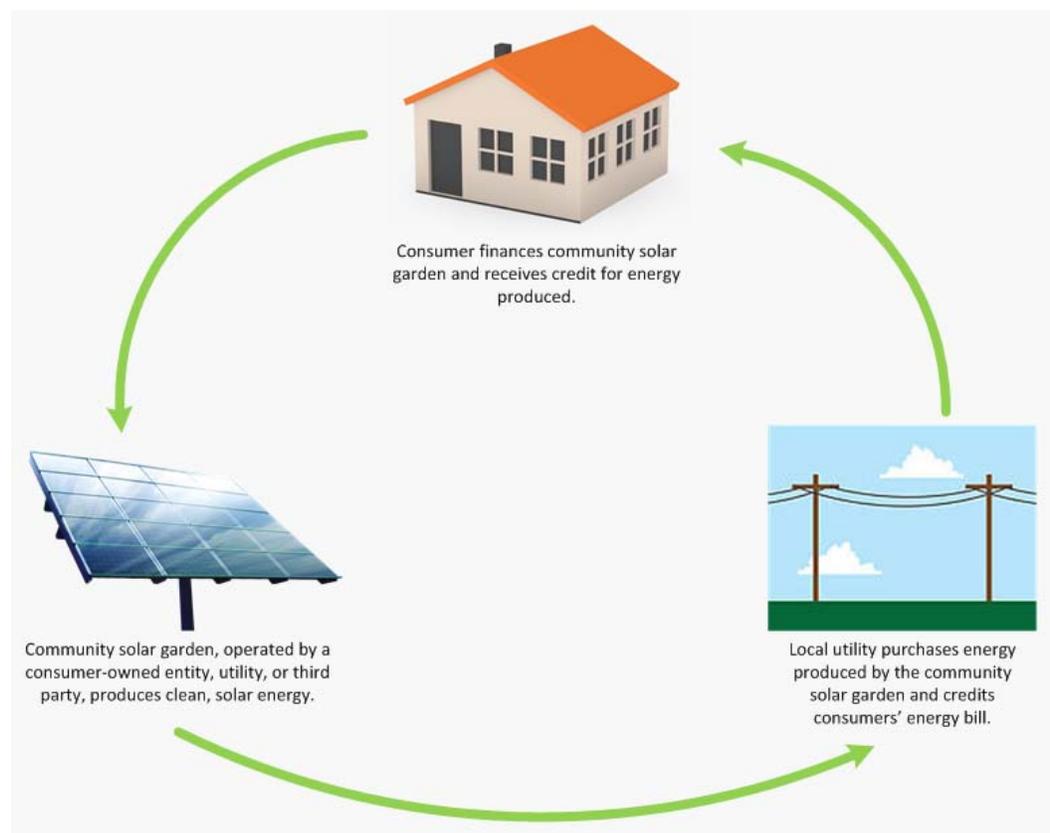
² *Id.*

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- **Developer:** A developer assembles anywhere from a dozen solar panels to over a hundred acres of panels on the space provided by the host.
- **Operator:** The host or a third party then operates the solar garden, providing the energy produced to a local utility under a power purchase agreement. Additionally, the operator contracts with consumers (members) who wish to participate in the solar garden.
- **Member:** An individual power consumer invests in the community solar garden to become a member and receives credit on their utility bill for energy produced by the solar garden.

The solar garden's host, developer, and operator may be a single entity or may be three separate entities. These entities may vary from utilities, nonprofits, and cooperatives to private companies and individuals.

Community Solar Garden Models



There are a variety of structures of community solar garden models. The two primary models are as follows:

- **Utility-Sponsored Model:** A utility owns and operates a community solar garden that is open to voluntary participation for their customers.
- **Community-Owned Entity Model:** Community members join in a business enterprise to develop and manage a community solar garden.

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Each model comes with unique costs, benefits, responsibilities, risks, and legal concerns.

Utility-Sponsored Model

In the utility-sponsored model, an investor-owned or privately held utility controls operation and ownership of the community solar garden. The utility provides a subscription to power consumers after they contribute an upfront or ongoing fee. Depending on the subscription agreement, the subscriber will be entitled to a set amount of electricity at a fixed rate for a limited period. Some subscription agreements provide the subscriber a reduced rate for their utility bill based on their subscription fee and how much energy the solar garden produces.

In addition to producing electricity with a solar garden, a utility earns Tradable Renewable Certificates—also known as renewable energy credits or green tags—for producing clean energy in lieu of conventional gas or coal-fired power plants. The utility may keep the certificates and pass down the benefits to members and consumers, or sell the future rights to the certificates up front in order to keep development costs of the solar garden down. Note, however, that there can be Federal Trade Commission (FTC) restrictions on representing that power is “green” if the certificates or credits are sold separately from the power.³

Utilities normally have the legal, financial, and management infrastructure to handle organizing and managing a solar garden. Tax and financing incentives will vary based on the individual utility’s characteristics. For example, municipal utilities and public utility districts are generally exempt from federal income taxes.

Another issue that arises with community solar gardens is whether the sale of subscriptions to the solar garden is considered the sale of “securities” under federal and state securities law. The “Federal Concerns” section below elaborates on this issue.

Community-Owned Entity Model

In the community-owned entity model, individuals purchase shares in a business entity that will own and operate a community solar garden, transmitting power to the local utility. The entity then credits its members for the energy that the garden produces based proportionally on the member’s investment. The credit can be adjusted to reflect ongoing changes in costs, utility rates, technology, and capacity.

This model has members taking on the complexity of forming and managing a business. The first hurdle that members must overcome is raising enough capital to fund the entity. After formation, members need to operate the business, which entails a range of functions, including negotiating agreements, marketing, managing financials, and general maintenance of the solar garden.

Among the main challenges for community-owned solar gardens are qualifying for and fully utilizing available tax incentives. Specifically, solar garden investments must be correctly structured in order for investors to benefit from tax incentives. In addition, individuals and

³ See FTC Green Guides § 260.15 (“Example 5: A toy manufacturer places solar panels on the roof of its plant to generate power, and advertises that its plant is ‘100% solar-powered.’ The manufacturer, however, sells renewable energy certificates based on the renewable attributes of all the power it generates. Even if the manufacturer uses the electricity generated by the solar panels, it has, by selling renewable energy certificates, transferred the right to characterize that electricity as renewable. The manufacturer’s claim is therefore deceptive.”).

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certain business entities are subject to certain federal income tax restrictions that may limit the taxpayer's ability to utilize the tax incentives that are available.

Similar to utilities, community-owned entities need to be careful about complying with securities law.

Benefits

Community solar gardens offer substantial cost benefits over traditional residential solar panels. Members of solar gardens may qualify for certain federal and state tax benefits if the solar garden investment is correctly structured. Additionally, the size of a solar garden renders it better able to achieve economies of scale.

Solar gardens can provide the ratepayer with access to solar energy, regardless of property ownership or socioeconomic status. From the members' perspective, the experience is relatively hassle-free, as operators of solar gardens should handle most issues with installation, maintenance, management, and structuring the investment to obtain tax credits.

Solar gardens are also able to provide locations that are unavailable to most power consumers. Developers' flexibility in finding hosts allows them to overcome traditional residential hurdles such as building codes, zoning restrictions, homeowner association rules, and aesthetic concerns. In addition, developers factor in roof size, microclimates, and light exposure to ensure maximum energy output.

Solar gardens provide an opportunity to test new models of marketing, project financing, and service delivery. Additionally, solar gardens may stimulate the local economy through cost savings and job generation.

Legal Considerations

Development and operation of a community solar garden will require compliance with utility, business, land use, tax, and securities regulations.

Federal Concerns

The primary legal issue under federal law is compliance with securities regulations, although as noted above, other federal issues include tax and FTC considerations. Depending on the jurisdiction, solar gardens also may face similar restrictions under state securities law.

The structure of a solar garden has important ramifications for compliance with federal securities law. The U.S. Securities and Exchange Commission (SEC), the government agency responsible for enforcing federal securities law, strictly regulates the sale and purchase of securities. Depending on the structure of the solar garden and its agreements with consumers, the SEC could classify a subscription, benefit, or ownership interest in a community solar garden as a security.⁴

If the solar garden's agreements are deemed a security under federal law, any offering of the solar garden must be registered or exempted from registration with the SEC. Preparing, filing, and obtaining regulatory clearance of a registration statement is costly and time

⁴ See Federal Securities Act of 1933 § 3(2).

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consuming. Absent an exemption, liability issues may arise should the project fail to comply with appropriate registration requirements.

To avoid any appearance of selling securities, the solar garden should carefully consider the following factors:

- What the member receives in exchange for their financial contribution;
- Whether the member's benefits are interwoven and dependent upon the efforts and success of the solar garden's operator and/or the participation of other members;
- Whether the member has an expectation of profits;
- Whether the member can transfer an ownership interest or subscription; and
- How the solar garden is marketed.

For example, Sacramento Municipal Utility District chose not to sell ownership interests, but instead credit members for an estimated monthly output of solar electricity that was specified in advance of a subscription fee to limit the appearance of selling securities.

If a solar garden cannot avoid the SEC's security classification, exemptions may be available based on the model and structure of the solar garden. Five potential exemptions from SEC registration include:

- Political Subdivisions of State under Section 3(2)⁵
- Private Placements under Regulation D/Rule 506⁶
- Offerings up to \$1 million under Regulation D/Rule 504⁷
- Intrastate Offerings under Section 3(a)(11)⁸
- Crowdfunding under the JOBS Act⁹

All solar gardens deemed to be issuing securities, regardless of any registration exemption, are subject to the anti-fraud provisions under federal law. These provisions require accurate disclosure of all material information about a securities offering.¹⁰ For example, a utility providing customers an offering memorandum with information that would include a distribution of business conducted by the utility, audited financial statements, and risk factors related to the security being offered needs to be in compliance with the anti-fraud provisions. If a material misstatement is made, the utility and its directors, officers, and relevant employees could be subject to liability.

In summary, if a solar garden structure is deemed to be providing a "security" under applicable law, even if that security is exempt from registration, the utility or consumer-owned entity and its directors, officers, and relevant employees would incur substantially more time

⁵ See Federal Securities Act of 1933 § 2(a)(1).

⁶ See Federal Securities Act of 1933 § 3(a)(2); 17 C.F.R. § 230.506(a).

⁷ See 17 C.F.R. § 230.50b(2) (2013).

⁸ See Federal Securities Act of 1933 § 3(a)(11); 15 U.S.C. § 77c(a)(11) (2012).

⁹ See JOBS Act, H.R. 3606, 112th Cong. § 302(a)(6)(A)–(B) (2012).

¹⁰ See Securities Exchange Act of 1934, § 10(b); Rule 10b-5.

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and expense, and would be subject to a higher risk and extent of liability, than if the solar garden's structure did not constitute provision of a security.

State Concerns

Twenty states have enacted, or are in the process of considering, solar garden-specific legislation.¹¹ Depending on the state's law, it may place limits on the entities involved in the solar garden.¹² Examples of common state restrictions include:

- Maximum kilowatt/megawatt output from a solar garden
- Minimum number of members
- Geographic restrictions on members
- Maximum amount of offset credit allowed per member

State laws covering land use, utilities, securities, and businesses can place additional restrictions on a solar garden's operation, location, and relationships. State laws and local ordinances also may provide or restrict tax and financial incentives based on the structure of a solar garden. For example, Washington State solar garden investors may apply for incentive payments based on production of electricity.¹³ In addition, certain types of solar equipment qualify for an exemption from the Washington State sales and use tax.¹⁴

The nuances of state statutes vary significantly, and prior to operating a solar garden, operators should carefully plan their structure and procedures accordingly.

Conclusion

Community solar gardens are a small but growing segment of the United States' broader solar market. Solar gardens are projected to continue increasing in efficiency and consumer demand in the future.

Hosts, developers, and operators should try to anticipate issues early in the formation process to fully address concerns that may result in legal issues, which can significantly impact a project. Familiarity with the types of models, structures of contracts, and analysis of active solar gardens can assist companies and counsel on how to structure transactions in a particular way to avoid complications and still meet economic objectives.

¹¹ See *USA Shared Energy Map*, Shared Renewables HQ (last visited July 15, 2015), <http://www.sharedrenewables.org/community-energy-projects/> (notes Colorado, California, Connecticut, Delaware, Hawaii, New Hampshire, Minnesota, Maine, Massachusetts, Maryland, Vermont, and Washington have enacted community energy legislation).

¹² See, e.g., C.R.S.A. § 40-2-127 (Colorado limits output at two-megawatts; requires ten subscribers minimum; requires members to have set address in same service territory as solar garden; and limits offset to 120%.); M.S.A. § 216B.1641 (Minnesota limits output at one-megawatt; requires no less than five subscribers; requires members in same county as the solar garden; and limits offset to 120%).

¹³ RCW 82.16.120; WAC 458-20-273; Seattle Municipal Code 21.49.087.

¹⁴ RCW 82.08.963, 82.12.963.

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