Financial Engineering's the Key: How a Long-Term Energy Sale Agreement and Bond Offering Transformed the McCommas Bluff LFG Project. Three Perspectives on One Project.

The "Legal" Perspective

15th Annual LMOP
Conference & Project Expo
Baltimore, MD
January 17-19, 2012

Douglas E. Lamb
McGuireWoods LLP
January 19, 1:15 pm

Overview

- Qualifying a non-governmental landfill gas project for tax-exempt financing
- New solid waste bond regulations - summarized
- Structural considerations for tax-exempt project financings
  – Market benefits
  – Federal tax and securities considerations
  – Special purpose vehicles & consolidation risk
- Project documentation
- Logistical concerns regarding timing of financing

Tax-exempt Financing a LFG Project

- A state or local governmental entity will issue the bonds for the benefit of the non-governmental borrower
  - The governmental issuer will have no obligation for repayment and generally will be fully indemnified for any liability
- The LFG project must qualify for tax-exempt financing under the new solid waste bond regulations
  - Generally, landfill gas assets qualify under the old or new solid waste regulations, except up until the point useful gas is created
  - Under the new regulations, is a landfill gas project an "energy conversion" process, OR as under the under old regulations, is a landfill gas project functionally related and subordinate to a "final disposal" process?
  - The answer may drive what costs of the project qualify

New Solid Waste Bond Regulations

- What is solid waste?
  - Garbage, refuse, and other solid material derived from any agricultural, commercial, consumer, governmental, or industrial (ACCGI) operation or activity if the material is:
    - Solid: means solid at ambient temperature and pressure, and *either*
      - Used: means used previously, and is a product of any ACCGI operation or activity, or a component of any such product or activity; it includes "animal waste," *or*
      - Residual: means residual byproduct or excess raw material resulting from or remaining after completion of an ACCGI process or activity or from the provision of any services; *and*
    - Introduced into a qualified solid waste disposal process within a reasonable period of time after its generation, purchase or acquisition

New Solid Waste Bond Regulations (continued)

- Qualified solid waste disposal process - QSWDP
  - Final disposal process: as to solid waste, it means landfilling, land applying, incinerating or containing indefinitely
  - Energy conversion process: thermal, chemical, or other process that is applied to solid waste to create and capture synthesis gas, heat, hot water, steam or other useful energy (GHWSE)
    - Starting point: first application of process
    - Ending point: "useful" energy is first created, captured, or incorporated into GHWSE and before its transfer or distribution regardless of whether it is a first useful product
  - Recycling process: reconstituting, transforming, or processing solid waste into a useful product

New Solid Waste Bond Regulations (continued)

- QSWDP (continued)
  - Preliminary function: collecting, separating, sorting, treating, processing, disassembling or handling solid waste that is preliminary to and directly related to a QSWDP
  - Functionally related and subordinate to any of the above
- First useful product: the first product produced from the processing of solid waste in a QSWDP that is useful for consumption in an ACCGI operation or activity and that could be sold for such use, whether or not actually sold
  - The determination may take into account operational constraints that affect the point in production when a useful product reasonably can be extracted or isolated and sold independently

New Solid Waste Bond Regulations (continued)

- First useful product (continued)
  - Costs of extracting, isolating and transporting the product to a market may only be taken into account as operational constraints if the product is not to be used as part of an integrated manufacturing or industrial process in the same location as that in which the product is produced
- Differences from prior regulations
  - Elimination of no value test
  - Introduction of QSWDP concept and “ambient” standard
  - Specific exclusions for virgin and hazardous material
  - Modification of 65% test and of the definition of first useful product

Structural Considerations – Project Financings

- Manner of financing, i.e. direct loan, private placement or underwriting, will affect the structure and loan covenants
- Tax and securities restrictions
  - Tax: straight-line depreciation of the costs financed, limitations on use of proceeds and funds and refinancing constraints
  - Securities: in an underwriting or placement there will generally be large bond denominations as a result of governmental issuer policies or underwriting criteria and significant on-going disclosure requirements
- Borrower constraints
  - Creating a special purpose vehicle to own the project assets and control the project revenues
  - What is consolidation?
  - Mitigating consolidation risk: limitations on business activities, scope of project, ownership, transfers and incurrence of future debt

Project Documentation

- Suitability for financing
  - Ensuring duration of underlying contracts (i.e., contracts generating revenue for the project, operation agreements, third party reports, leases, etc.)
  - Including proper third party assignment provisions
  - Addressing concerns of counterparty disclosure of information, including pricing, terms and technology
  - Coordinating consents, assignments and releases from counterparties

Logistical Concerns for Financing

- Securing a definitive term sheet
- Assembling the correct team and a budget for professional fees
- Scheduling: various governmental approvals, including volume cap, documenting the transaction, marketing the transaction and closing

Questions & Contact Information

Douglas E. Lamb
McGuireWoods LLP
dlamb@mcguirewoods.com
(804) 775-1107

Disclaimer: The statements in this presentation are informational and instructional only, do not constitute legal advice, do not create any attorney-client relationship between McGuireWoods LLP and the recipient of such statements and may not fully detail all applicable legal provisions. The recipient should contact its own legal adviser. Moreover, the following statement is provided pursuant to U.S. Treasury Department Regulations: This presentation is not intended or written to be used, and cannot be used, by a taxpayer for the purpose of avoiding penalties that the Internal Revenue Service may impose on the taxpayer.