

Solar Power Purchase Agreements: What Every Municipality Should Know Before Signing

You have the power to make adjustments to the fine print before you sign on the dotted line so your town can reap the most benefits from its solar deal

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With its rapidly expanding solar industry, New York has experienced a 575 percent increase in the amount of solar power installed and in development from 2012 to 2015. With more than 500 solar companies employing more than 8,250 workers, New York's solar industry has quickly grown to be the fourth largest in the nation.

Solar industry growth is attributable to two significant government financial incentives. There's the federal 30 percent solar Investment Tax Credit (ITC) that, since 2005, has been available to companies that install, develop or finance the installation of solar panels. The other is the state's NY-Sun Initiative, in which New York State Energy Research & Development Authority (NYSERDA) incentivizes solar installations. In that program, the payments are divided between residential and small commercial users (typically 25 kW or less) and larger systems for industrial and large commercial users (typically 200 kW or less). Payments are made on a sliding scale in each category: the more installations in each category, the lower the NYSERDA incentive payments are in that category. The large commercial and industrial solar installations – the category under which most towns fall – have been lagging residential installations, so the money available for grants for large solar installations remains plentiful.

So, it's no surprise that solar companies seeking tax credits and NYSERDA incentive payments have been aggressively pursuing municipalities, looking to enter into agreements to lease town property in exchange for installing solar panels on the property. As part of the agreements, the towns purchase all of the solar-generated electricity credits that the solar company receives for the solar-generated electricity it sends into the grid. The cost for each kilowatt hour of solar-generated electricity is substantially lower than what the towns pay their local public utility for the same electricity, which makes this arrangement, on its face, attractive to towns. This article describes the basic business model used by the solar companies and demonstrates why towns need to proceed with caution before entering into long-term solar power purchase agreements.

How it works

A common misconception is that the solar company provides solar electricity directly to a town's metered power sources. The solar panels generate electricity that goes into the power grid, not to the town's buildings. It is the credits

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the solar company receives for this electricity that are important to the solar company's arrangement with the town.

In fact, after having solar panels installed on its property, a town remains connected to the local utility grid and may even continue to receive monthly bills from the local utility. Because the generation of power from solar panels relies on the sun, there may be interruptions in the solar panels' ability to generate electricity, and the panels may not be able to generate sufficient electricity to offset all of the town's electrical usage. By staying connected to the utility's grid, the town continues to receive a steady supply of electricity. Furthermore, the grid connection makes net metering possible.

Generally, net metering allows consumers with alternative energy systems, such as solar, to export unused energy back to the grid in exchange for credits on their utility bills. The solar electricity generated by the solar panels is sold back to the public utility for a dollar-for-dollar credit for each kilowatt hour of solar power generated. The town is the beneficiary of the credit against its electric bill. In concept, but not in reality, the credits stop the town's electrical meters from spinning. In any given month, the town may owe nothing to its local utility for its electricity usage even though it may still receive monthly statements from the utility. Once the solar panels are operating, the town will be billed monthly by the solar company for the kilowatt hour credits received for the solar electricity sent to the grid. In other words, the solar company charges the town for each kilowatt hour of electrical usage that the town now does not have to pay the public utility. However, the solar company's kilowatt hour charge is substantially lower than the public utility's charge for that same kilowatt hour of electricity. The solar company's kilowatt hour rate is not determined by a governmental agency. It is a market-driven charge that can vary from one solar company to another, and it can be negotiable. In theory, the more efficiently

the solar company operates, the lower the rate it can offer the town.

Where a municipality has more than one metered property, remote net metering may apply. (See generally, New York Public Service Law, Section 66-j). Remote net metering allows electricity generated from the solar panel array to be distributed across multiple utility accounts. Thus, a town could apply excess net metering credits to several of its electricity accounts. The metered sites receiving the excess credits are known as "satellite accounts," while the "host account" is the electric meter to which the solar power system is connected. For example, the town may have its host account at the town hall and transfer excess credits to power satellite accounts such as the town highway garage or police station. Certain restrictions apply, including those requirements that all accounts must be in the same name, from the same service utility and in the same load zone.

Solar Power Purchase Agreements

The solar power agreement a solar company proposes for a town is called a Power Purchase Agreement (or PPA). In essence, the agreement is simple. It allows the solar company to install its panels on town property. In return, the solar company promises that the solar electricity the panels generate will result in a credit to the town for at least 85 percent of the town's conventional electrical usage. The town never owns the solar panels.

A solar company invariably presents a town with a proposed agreement. The agreement looks like a form document, and the solar company may say it's their standard agreement. As a result, towns are likely to accept the document as is because a) the town officials believe they are incapable of critically reviewing the document, and b) they may be intimidated by representatives of a solar company who throw

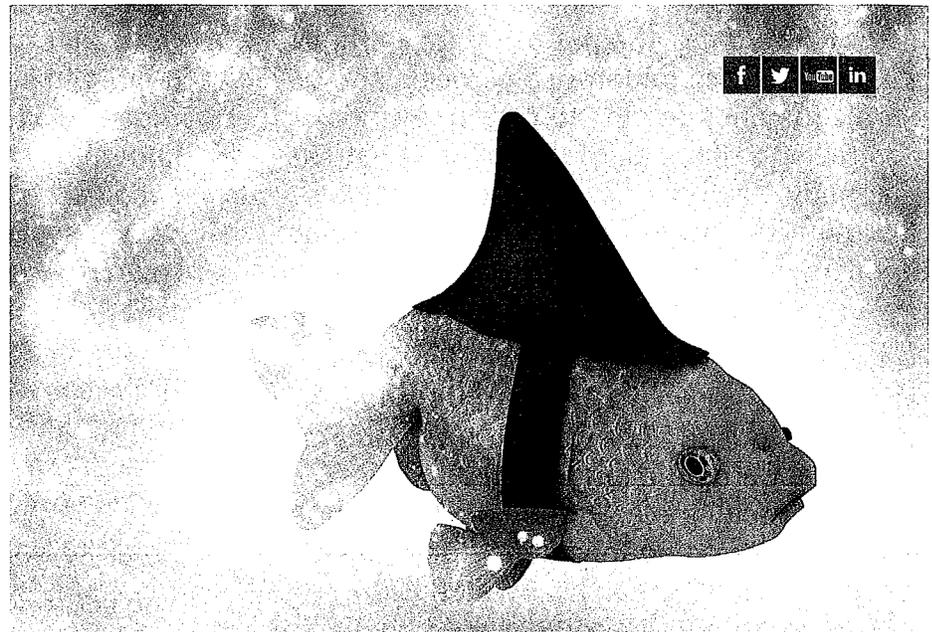
around language unfamiliar to the town officials while trying to negotiate. Nevertheless, there is nothing "standard" about these proposed agreements. The agreements are unregulated, their provisions are often unclear and inconsistent, and most of the time, the terms are negotiable and **should** be negotiated. For purposes of this article, we have limited the discussion to just a number of provisions of a PPA that are negotiable.

Duration. Most standard proposed agreements have an initial 20-year commitment. In other words, under the agreement, the town promises that for at least 20 years, it will purchase all the solar electricity generated by the solar panels. Some agreements will have two additional renewal periods of five years, which allow the town to extend the agreement for another 10 years. After the initial 20 years, the agreement gives the town the right to purchase the solar panels, but there is no purchase price in the agreement. Essentially, it is an agreement to agree on a price.

When was the last time your town agreed to purchase anything for 20 years with no ability to get out of the agreement? What is the justification for a town to saddle its taxpayers until 2036 with a solar panel array built with 2016 technology? Two decades from now, it stands to reason, solar power technology will be unrecognizable from its current form. The value of a 2016 solar panel in 2036 will likely be zero, or worse, it will have a negative value because of the disposal costs. There is no justification to burden future

town boards with a 20-year contract, and solar companies will sign agreements for far shorter periods.

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What solar companies really care about is that their agreement with the town last long enough (five years) for the full realization of the 30 percent solar Investment Tax Credit. As soon as they have installed the solar panel array, the solar companies frequently "sell" the solar panels to investors, who may then finance the

installation. The investors purchasing the panels then get the benefit of the solar Investment Tax Credit, which is tied to the net price of the installation of the solar array. The investors will lease the panels back to the solar company, which continues to have the responsibility of maintaining the system. The solar companies do not want to own the solar panels after they are installed because they can't use the tax credits.

Every proposed solar power purchase agreement will allow for the transfer of ownership of the solar panels to either a limited liability partnership or limited liability company. This provision is nonnegotiable because it is the heart of the solar industry business model. Although the solar company may continue to have the responsibility to maintain the panels, it will unload ownership of the panels as soon as they are built. We recommend that a town agree to a maximum of a 10-year agreement with two five-year renewal periods. This allows the town to re-evaluate the agreement after the initial term and decide whether the benefits are worth continuing. The solar company's offer to allow the town to purchase the solar panels at the end of the term is irrational. As time passes, solar panels degrade. In fact, the solar agreements build this decreasing efficiency into the electricity the solar companies guarantee they will generate as time passes. After 20 or 30 years, the panels will be virtually worthless.

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Commencement. This is a provision of which to be particularly mindful. Signing a solar power purchase agreement and receiving the benefits of the solar power are very different. A town could sign a long-term contract with a solar company but not see solar power for years, if ever. If the solar company intends to lease property from the town to install its panel array, we recommend the following provisions. First, the solar company should have a limited period in which to conduct its due diligence and determine the suitability of the site – three to six months should suffice. After that, the solar company should no longer be able to back out of the agreement except under a very narrow set of circumstances. Second, the contract should include a projected commencement date. The solar company should be able to give the town a commitment regarding its intention to begin generating electricity and selling it to the utility company. Third, and most importantly, the contract should have an outside commencement date. If the solar company has not begun generating electricity by that date, then it should begin paying the town liquidated damages for each day the system is not up and running. This could range from \$150 - \$250 daily, depending on the size of the system.

Damages in the Event of a Breach. No one enters a contract expecting that they will end up in a dispute that will ultimately cause the contract to fall apart. However, it happens, and the solar PPA should provide for meaningful monetary damages for both sides. Most solar PPAs have at least one paragraph that provides what the town will have to pay if a court or arbitrator ultimately determines that the town improperly cancelled the contract. The problem is these complex provisions do not translate into dollars and cents. Under most of these provisions, a town has liability exposure for millions of dollars in damages to the solar company. Isn't it better to know from the beginning what this potential liability could be? One solution to correct this uncertainty is

to have capped liquidated damage amounts, diminishing for each year of the contract, for which the town may be liable.

The flip side is what damages should be owed to the town if the solar company stops generating electricity and the town is again required to purchase all of its electrical usage from the utility company without any credit. A general principle of contract law is that a non-breaching party to a contract should get the benefit of the bargain it would have had if the other party had not breached the contract. Abiding by this principle, any agreement with a solar company should provide that if the solar company stops producing the electricity that gives the town its credit, then the company will owe the town the difference in cost between what the town has to pay the public utility and what it was paying the solar company.

Arbitration Clauses. Most solar power purchase agreements will include an arbitration clause where, in the event of a claim or dispute between the parties, the parties agree to binding arbitration in a particular venue, which is likely the location of the solar company's corporate headquarters. Can you imagine your town having to arbitrate a dispute in San Francisco? To avoid this, we recommend removal of the arbitration clause and replacement with a term that provides for litigation in a venue in which the town is located.

Purchase Options. While this is another standard provision of the solar company's agreement, there is no benefit for a municipality to own solar equipment because it is already a tax-exempt entity that doesn't receive a tax benefit. Moreover, as previously mentioned, due to updates in technology, the purchase options are not fiscally advisable to a municipality.

Removal. Removal of the solar equipment at the end of the term should be solely borne

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by the solar company at its expense. This provision of the agreement should specify (i) the timeframe in which the solar company has to remove the equipment (usually not to exceed 120 days after the expiration of the term) and (ii) if the solar company fails to remove (or make substantial efforts to remove) the equipment by the mutually agreed upon date, the municipality's right to remove the equipment at the solar company's cost. This provision should also include that the solar company will return the premises to its original condition, including the removal of the system mounting pads and other support structures and that the company shall leave the premises in clean and neat order.

Other Procedural and Legal Issues

State Environmental Quality Review Act (SEQRA). Generally, the siting and installation of solar panels is required to comply with SEQRA and is ideally done as soon as possible after the town considers entering into a PPA with a solar company, and certainly must be complete before approving and executing a PPA. Notwithstanding, the New York State Department of Environmental Conservation (NYSDEC) has proposed to revise its Part 617 regulations to include certain solar projects as Type II exempt actions. The proposed rulemaking is expected to be released for public comment in spring 2016, for which there will be at least a 90-day public comment period.

Permissive Referendum. A resolution to approve and authorize the execution of a solar power purchase agreement/land lease is subject to permissive referendum in accordance with Article 7 of the New York State Town Law section because it entails the leasing of municipal property.

Prevailing Wage. It is unclear whether installations of solar arrays are subject to prevailing wage under the New York State Labor Law. In 2012, an Assembly bill (A9149-A) was introduced that provided prevailing wages be paid for the installation of qualified solar

generating systems of 250 kW or greater. The bill died in the Ways and Means Committee, and when it was reintroduced in 2013, the prevailing wage language was removed. The Court of Appeals has recently established a three-prong test for determining whether a project is a "public works" project subject to prevailing wage. *See De La Cruz v. Caddell Dry Dock & Repair Co.*, 21 N.Y.3d 530 (2013). Among the factors to be considered, the contract must concern a project that primarily involves construction-like labor and is paid for by public funds. Notwithstanding, the New York State Department of Labor has not taken a formal position regarding the applicability of prevailing wage to solar installations. This is an important issue because if prevailing wage is applicable, it will result in towns paying more for installation costs that will be passed through to the municipality by an increased rate from the solar company.

Conclusion

In conclusion, solar energy can provide cost-savings benefits for towns; however, there are important considerations, as discussed above, that towns should carefully examine before entering into a solar power purchase agreement. The solar energy industry is growing, but for the long term, the landscape is unknown. The economics of solar power are driven by government incentives, so if those government incentives are taken away, solar power may no longer be economical. A town should be proactive about negotiating the terms of solar power purchase agreements to protect it from unforeseen liabilities and future costs. □

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