THE LAW OF WIND
—Choice of Corporate Structure and Entity—

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The developer or owner of a wind power project typically holds a variety of real property rights, equipment, permits and regulatory approvals, and intellectual property. Creating the optimal corporate structure and entity to hold these assets is an important first step toward the project's success. Planning early helps avoid costly transitions later.

I. Use of Subsidiaries. There are many reasons to develop, own, or operate a wind power project through a subsidiary created specifically for that purpose:

A. Insulation from Risk. The use of a single-purpose subsidiary to own a wind power project allows the parent company to limit its potential liability to the value of the assets of the project. If a company holds several projects directly or owns other assets, a creditor with respect to one project can seek recovery against all of the company's assets.

B. Financing. Financing for wind power projects is typically provided on a stand-alone, limited recourse basis in which the lender looks primarily to the cash flow and assets of the project to satisfy debt service obligations. In this regard, the ownership of the project assets in a single-purpose subsidiary enables a project lender to protect its collateral package from other creditors. For more information about financing, see Chapter 3, "Siting and Permitting Wind Projects."

C. Exit Strategy. The use of a subsidiary also facilitates a transfer of all or portions of the project. It is easier to sell a wind project by transferring ownership interests in a subsidiary that owns the project than to identify and transfer commingled assets. Even if a company prefers to sell assets, the isolation of the assets in a subsidiary simplifies the transaction.

II. Choice of Entity. The choice of entity to own the project, whether a corporation, partnership, or limited liability company ("LLC"), is generally less significant than the choice to use a subsidiary. Subtle differences exist, however, among the entities based on various factors, such as taxation, liability, and transferability issues.

A. Taxation. Corporations are separate tax-paying entities. As a result, the income of a corporation is generally subject to two levels of tax: one at the corporate level and again at the shareholder level when distributions are made, stock is sold, or the corporation is liquidated. Partnerships and LLCs are "pass-through" entities that are generally not themselves subject to income tax; rather, the income, deductions, gains, and losses flow directly to the partners or members, who report these amounts on their individual returns.

1. Distributions. Corporate distributions must generally be made on a pro rata basis; however, partners and members have more flexibility in allocating profits, losses, and credits, including the production tax credit, and in making distributions on a non-pro rata basis. They can also generally allocate profits or credits in one way and losses in another. Moreover, subject to the tax laws regarding deductibility, partners and members may use partnership and membership losses against other taxable income.

2. Tax Credits. A corporation (rather than its shareholders) must use tax credits. If it cannot use the tax credits (for example, if it has insufficient net income), and if it cannot carry the credits forward or back to a tax year in which the credits can be used, the credits expire. Partnerships and LLCs, however, may pass credits through to their partners or members, who generally may use them to offset their separate tax liability, including their tax liability from other activities or operations. As discussed in Chapter 7, this may be an especially important consideration if a developer wishes to "monetize" tax credits. The ability of individual (as

opposed to corporate) partners or members to use tax credits may be limited by the "at risk" and "passive activity" limitations imposed by tax rules.

3. **Losses.** Corporate losses must also be used, if at all, at the corporate level. Losses of a partnership or an LLC, however, are passed through to its partners or members, who may be able to use them against their income, including income from other sources. The ability of individual (as opposed to corporate) partners and members to use losses may be limited by the "at risk" and "passive activity" limitations imposed by tax rules.

4. **Contributions.** Contributions of property (as opposed to services) to a corporation, either upon its initial organization or admission of additional owners, may trigger the recognition of gain with respect to the contributed property unless certain control requirements are satisfied. On the other hand, except in certain limited circumstances, contributions to partnerships or LLCs in exchange for an ownership interest are generally not taxable events.

5. **Reorganizations.** Corporations generally may engage in tax-free reorganizations, whereas a partnership or an LLC that is treated as a partnership for tax purposes generally may not.

6. **State Taxes.** Applicable state taxes may favor the selection of one legal structure over others.

B. **Liability.** Shareholders, limited partners, and members are generally not liable for the debts of the entity beyond their capital contributions, whereas the general partner is generally liable for the debts and obligations of the partnership. In certain circumstances, such as when the entity fails to comply with corporate formalities or when the subsidiary is undercapitalized, owners may be held liable for the debts of the entity. Because corporations generally must comply with more formalities than partnerships or LLCs, there may be less risk that limited partners or members of an LLC would be liable for the debts and obligations of the entity.

C. **Management and Operations.** Corporations must follow the formalities that are prescribed by law, such as holding annual shareholder meetings and annual board meetings and maintaining records of actions of the board of directors. Partners and members generally determine how the partnership or LLC is managed in the partnership or operating agreement and generally have more flexibility regarding management of the entity.

D. **Transferability.** Corporate stock is readily transferable, subject to restrictions under federal and state securities laws, whereas economic and management rights in a partnership or an LLC (represented by a partnership interest or membership interest) are severable and may not be transferable as a unit. In each case, there may be special transfer requirements in a shareholders' agreement, partnership agreement, or operating agreement. Owning the project through a subsidiary LLC may facilitate a sale of a partial interest in the project because the sale of a membership interest or issuance of a new membership interest is generally tax-efficient to the acquirer. Also, from an exit-strategy perspective, an LLC does not lock a potential buyer into the corporate form. This flexibility can be advantageous if investors are interested in owning and operating the project. Further, the sale of all interests in a multiple-member LLC to a single buyer may be treated as an asset purchase by the buyer, with the accompanying tax benefits.

E. Financing. As discussed more thoroughly in Chapter 5, although financing is best done through a subsidiary, the type of entity that owns the wind power project generally does not have an effect on financing.

III. Benefits of Early Choice of Structure and Entity. Many developers tend to begin work on a prospective wind project in the name of the parent corporation and create a project-specific subsidiary when the project is relatively far along. Although this process has a degree of logic to it, it is very important to understand that some property rights, permits, and contracts may have restrictions on transfer that would be triggered when the parent company attempts to transfer the rights and permits to the newly formed subsidiary. Transfer approval processes may be public (in the case of permits) or may reopen previously negotiated contract terms. For these reasons, choices of entity and structure should be settled as early as possible. In addition, transfers of assets that have become subject to the jurisdiction of the Federal Energy Regulatory Commission ("FERC") under the Federal Power Act may trigger a requirement to obtain the approval of FERC, under section 203 of the Act, for the transfer.