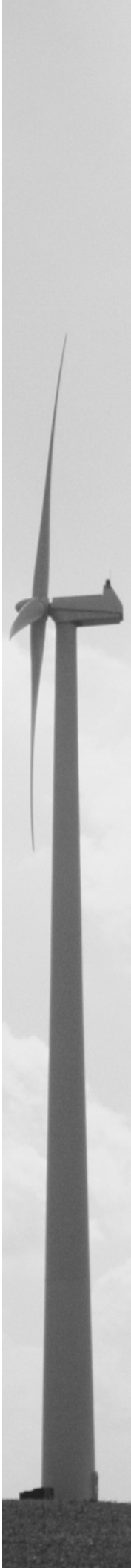

Chapter 10

Choosing a Business Structure for a Wind Project

As with any new business, getting a wind project up and running is a huge undertaking. The development of a wind project requires making careful decisions about how best to set up the legal structure of the business itself. These decisions will determine, among other things, who will hold title to project assets, what tax consequences will result, the degree of personal liability investors will have for the debts and obligations of the business, and the project's eligibility for various government wind energy incentive programs.

This chapter is written as a general overview of some of the business issues that will arise when creating and maintaining a wind development project. It is not a "how-to" guide to setting up a wind business. Indeed, this chapter does not discuss every legal issue that may arise in starting up a wind energy project. Instead, this chapter describes some common types of business entities, summarizes the business models of actual farmer-owned wind projects that have already succeeded, and touches on some practical and legal factors that should be weighed when deciding on a business structure. It is intended only as a starting place for a farmer to begin to explore these issues.

Structuring a business to build and operate a wind project is exceedingly complex and should not be completed without advice from a legal professional. Only an experienced attorney can assist with finding the best fit for an individual wind project's circumstances, now and into the future.

I. Choice of Business Entity

A. General Overview of Issues Affecting Entity Choice

The term "business entity" refers to the form of the organization used to invest in and operate a for-profit endeavor. There are several types of business entities that can be used for a wind development project, and each has its own legal and financial characteristics and requirements.

The legal requirements imposed on the different types of business entities may vary from state to state. In many situations, the standard legal characteristics and requirements of the various business entity types can be altered by an explicit agreement among the business's owners. Nonetheless, there are several overarching factors to consider and compare in choosing a business entity for a particular project.

For most investors and entrepreneurs, the major issues to consider when considering entity types are: (1) whether the entity will shield investors and owners from personal liability for business obligations and debts, and (2) how income and losses of the entity will be taxed.[1] In addition, project developers may consider the complexity of the legal requirements for establishing and maintaining various entity types, and whether the choice of entity also impacts a project's eligibility for various government wind development incentives or the applicability of various energy-related regulatory schemes. These factors will be discussed in more detail below.

1. Personal Liability of Owners

Entities that have a *liability shield* protect investors from personal responsibility for most business debts. In other words, creditors of the business can only collect from assets and income of the business entity itself. If a farmer creates a business entity that has a liability shield, and that entity holds title to the wind project and is responsible for operating it, creditors of the wind project cannot collect project debts from any personal income or assets of the farmer. Instead, the farmer is only at risk for the amount invested in the entity itself.

In general, a liability shield will cover not only the entity's traditional loans and credit obligations, but also any legally enforceable claim for money related to the entity's operation, including any money judgments that might result from a lawsuit against the project. In some circumstances and for some types of debts, however, owners may not be able to have an absolute

[1] For more information about these and other factors to consider when choosing a form of business entity, FLAG has produced a *Choice of Business Entity* booklet as part of its *Farm to Market: Legal Issues for Minnesota Farmers Starting a Processing or Marketing Business* series. Although these materials are not written with a wind project in mind, they contain general information that could be useful. To obtain a copy, contact FLAG or visit FLAG's Web site at www.flaginc.org.

shield from liability. It is therefore important to fully understand the extent of the liability shield created by a given business entity.

In addition, there may be circumstances where individual farmers or investors may find it advantageous to waive the liability shield and be personally liable for some business debts—for example, a wind project's lender may ask the farmer developer to sign a personal guarantee for the debt as a condition of making a loan.

If a farmer does not create a business entity for a wind project, or creates an entity that does not have the benefit of a liability shield, the farmer would be personally liable for all debts related to the project. In other words, any money owed by the wind project could be collected from the personal accounts, income, and property of the farmer and other project owners.

2. How Taxes Are Assessed

Different forms of business entities can be treated very differently for income tax purposes. Some entities are considered separate taxpayers from the individual owners and must file their own tax returns and pay taxes at the entity level before making any distributions to the owners. Thus, the profits of these separate tax-paying entities are subject to two levels of tax: The entity is taxed on its business income, and the investors are taxed on any subsequent income distributions from the entity.

Alternatively, some entities are *pass-through entities* that are not generally themselves subject to separate taxation. Such an entity's income is said to "pass through" the business directly to its owners. The entity does not itself pay taxes; instead, each owner pays tax on his or her share of the entity's income.

Still other types of business entities are able to choose whether they will be separately taxed or their income will pass directly through to the entity's owners.

Even with a general understanding of these tax rules, it is *essential to consult a tax professional* before forming a business. Small, newly formed businesses may face different income tax requirements than these general descriptions indicate, and only a tax professional can offer the specialized assistance required to ensure compliance with all tax laws and filing requirements.

3. Complexity of Formation and Operation Requirements

Some entities have much more formal requirements for formation and ongoing governance and control. Some entities may be formed simply by engaging in business activities with a particular intent, while other entity types require a detailed registration process. These more formally created entities also frequently have regular, and potentially cumbersome, reporting requirements.

In addition, different entity types vary in how they are governed or controlled by the owners. Some entities are entirely controlled by direct owner vote. Others may require a more complex scheme involving a board of directors, officers, and shareholders. Even within each type of governance scheme, there can be a range of permissible rules. Corporations, for example, may require annual shareholder meetings, board of director meetings, and some formal record of certain actions. Management of a partnership, on the other hand, has much more flexibility.

There can also be significant differences in the ways different entity types can be financed, how new owners can enter the business, and how investors can withdraw from the entity. An experienced attorney can help explore all of these issues in more detail.

4. Impact on Wind Incentives and Other Regulatory Restrictions

Farmers should be aware that eligibility for some government wind incentives may depend on how the business is organized, including who the co-owners are and what overall tax liability is available to take advantage of the various tax credits. This chapter should therefore be reviewed in conjunction with Chapters 12 (Incentives) and 13 (Tax Benefits and Obligations), and a tax expert should be consulted to assist with these difficult business structure issues.

Finally, the choice of entity type may be affected by whether a given choice creates an additional burden of compliance with various regulatory regimes. For example, state and federal securities regulations could be triggered if investors are solicited to purchase equity interests in the project, and state corporate farm laws may make some types of entities unavailable in certain circumstances to entity owners who do not have a family connection to the land. These issues are discussed in more detail in at the end of this chapter.

B. Types of Business Entities

1. Sole Proprietorship

A *sole proprietorship* is a business owned and operated by an *individual*. There is no entity involved in a sole proprietorship; the individual simply begins operation. Therefore, no specific documents are involved, and the business is not considered legally separate from the owner. All profits (and all losses) flow to the owner as an individual, and the owner pays income tax on these earnings. The owner is personally liable for all obligations arising out of the operation of the business.

For commercial-scale wind energy projects in particular, sole proprietorships are not recommended (nor likely feasible) as a business structure.

2. General Partnership

Generally, whenever two or more persons operate as co-owners of a business for profit, they have formed a *general partnership*. There are no formal requirements to form a partnership; however, partners may choose to establish clear guidelines in a written agreement to avoid the application *default rules* from the state's partnership law. Default rules are provisions of law that fill in the gaps in an agreement between private parties in case of a dispute. If a dispute arises and the parties' agreement does not address the disputed issue, the default rule will apply; if the agreement does address the issue, the agreement will control. If the parties have entered into a joint activity without making any formal agreement, the applicable default rules will govern all disputes that arise.

The default rules for partnerships vary somewhat by state but typically provide that partners have equal control over the business and equally share in the earnings or losses of the business. There are also usually default rules about how partnership interests can be sold or transferred, how new partners can join and existing partners exit, and how partnerships are dissolved when necessary.

Partnerships are generally not separate tax-paying entities. Earnings and losses pass directly through to individual partners, and partners include those earnings and losses on their individual tax returns.

Finally, like a sole proprietor, partners are not shielded from personal liability for the obligations of the partnership business. Many partnerships

will purchase insurance to provide the partners with some protection from liability. However, farmers should know that a partner's liability for a partnership debt is most often "joint and several," which means that any single partner could be personally liable for the entire business debt if not reimbursed by the other partners.

3. Limited Liability Partnership

A *limited liability partnership* (LLP) is similar to a general partnership, except the partners are shielded from personal liability for the obligations of the business. An LLP must be formally created by filing a registration form with the state, and the liability shield will not apply until the formation requirements are satisfied. Minnesota, for example, requires that a statement of qualification be filed with the Secretary of State and imposes ongoing reporting requirements.

The LLP business form is not available in every state.

4. Limited Partnership

A *limited partnership* is a type of entity that allows for different classes of owners. In a limited partnership, at least one partner must be a *general partner* and at least one partner must be a *limited partner*. General partners are personally responsible for the business's debts and obligations and typically have more decision-making authority, including authority over the day-to-day operations of the business.[2] Limited partners are typically investors who give up most of their authority over the business operations in exchange for a liability shield. However, limited partners usually do have some right to participate in extraordinary decisions affecting the business.

A limited partnership is typically not a separate entity for tax purposes. Instead, the business income and losses are distributed to the partners to be reflected in their individual tax returns.

A limited partnership must be formally created according to state requirements. Default limited partnership laws will apply unless altered by a written agreement among the partners.

---

[2] Some states have yet another type of partnership, a *limited liability limited partnership* (LLLP). These businesses are generally set up like a limited partnership, except the general partner then itself becomes an LLP. An LLLP therefore provides a personal liability shield to the general partners. *See, e.g.*, Minn. Stat. § 321.0404 (2006).

5. Limited Liability Company

A *limited liability company* (LLC) is a separate legal entity owned by *members* who obtain membership interests in the entity, sometimes called shares, in exchange for their investments or services.[3] LLC members are generally shielded from personal liability for the business's debts.

To form an LLC, articles of organization, which set out the form of the entity, must be filed with the state. The LLC's status must be renewed annually. Although they are not required to do so, LLCs typically use bylaws, also known as operating agreements, to manage and govern the entity and its members. In this way, LLCs can be flexibly organized to fit individual operating needs and goals.[4]

When bylaws are not adopted or are otherwise silent, state law will provide default rules for the LLC and its members. For example, most states provide that profits and losses for an LLC are divided proportionately among the members according to each member's investment; however, the members of any LLC may agree on an alternative division of profits and losses, and this will be controlling if the agreement is properly executed.

Under federal income tax rules, an LLC may choose whether to be treated like a corporation or a partnership for tax purposes. In most cases, the default rule is that an LLC is treated as a partnership, meaning that it is not taxed as a separate tax-paying entity, and business income and losses are passed on directly to the LLC's owners who claim that income or loss on their individual tax returns.

While the pass-through taxing scheme may seem superior to being taxed as a corporation, discussed below, there may be reasons why a particular LLC would choose to be taxed as a corporation. Thus, as with other business

---

[3] Some states define what is called a *closely held LLC*. In Minnesota, for example, this includes any LLC that has 35 or fewer members. Minn. Stat. § 322B.03, subd. 11 (2006). A closely held LLC is generally identical to an LLC with more members, but states can, and do, experiment with a range of variations. *See* Larry E. Ribstein, *Statutory Forms for Closely Held Firms: Theories and Evidence from LLCs* 73 Wash. U. L.Q. 369, 431 (1995).

[4] Carter G. Bishop and Daniel S. Kleinberger, *Limited Liability Companies: Tax and Business Law* § 1.02 (2006).

structure issues, an entity facing this decision should consult with a tax advisor before making any decisions regarding tax plans.

6. Corporation

A *corporation* is a separate legal entity from its owners, called *shareholders*. The amount of shares, or stock, a shareholder has in the corporation represents the shareholder's ownership interest and reflects the amount he or she has invested in the business.

Corporations are one of the most complex business structures. A corporation is created by filing articles of incorporation with the state. The articles of incorporation provide the initial rules that govern the corporation. Incorporators have some discretion in drafting the articles of incorporation, and statutory language may provide default rules. Shareholders may also vote to adopt bylaws that govern the management and affairs of the corporation. A board of directors, whose members are elected by the shareholders, establishes the policies of the corporation. Officers selected by the board of directors are responsible for the day-to-day operations of the business.

Shareholders generally are not personally liable for the obligations of the corporation.

A corporation typically distributes its income, beyond that needed for expenses and any reserves, to the shareholders according to their stake in the corporation, as measured by the number of shares owned. A corporation's income is typically taxed at the business level, and shareholders are taxed on any distributions made to them. Corporations using this traditional tax model are called *C Corporations*.[5] A different type of entity permitted in some cases, called an *S Corporation*, instead has pass-through tax status, with no income tax paid by the business itself and all income and losses passed to the shareholders.[6] To receive S Corporation status, a corporation must meet certain statutory requirements.

---

[5] 18 Am. Jur. 2d *Federal Taxation* § 4701 (2007).

[6] Carter G. Bishop and Daniel S. Kleinberger, *Limited Liability Companies: Tax and Business Law* § 1.01[2][b] (2006).

A *closely held corporation*, one having 35 or fewer shareholders, may have more restrictions, especially regarding the buying or selling of shares.[7] A closely held corporation is more likely to have overlap among shareholders, directors, and officers. Therefore, liability and business governance issues may function differently.[8]

7. Cooperative

A *cooperative* is a business entity that is owned by *members* who use its services or buy its products. Typically, a cooperative distributes income in excess of expenses and reserves to its members in proportion to each member's patronage, and not in proportion to a member's equity investment.

A cooperative is formed by filing articles of incorporation with the state. Members may also vote to adopt bylaws that govern the management and affairs of the cooperative. As with a corporation, a board of directors—elected by the members—establishes the policies of the cooperative, and officers selected by the board of directors are responsible for the day-to-day operations of the business.

To be recognized as a cooperative, the entity must meet the state requirements for cooperative status. For example, in Minnesota, a traditional patron-owned cooperative must be conducted "on a cooperative plan."[9] In practice, this means the cooperative must be governed based on a one-member, one-vote system; revenue distributions must be based on the members' patronage of the cooperative's goods or services; and dividends on capital stock or other units of equity must be limited to 8 percent annually.[10]

The governance of cooperatives incorporates a particular cooperative-minded value system. This means generally that the cooperative should manifest principles of "self-help, self-responsibility, democracy, equality,

---

[7] 18 Am. Jur. 2d *Corporations* § 38 (2007).

[8] 18 Am. Jur. 2d *Corporations* § 38 (2007).

[9] Minn. Stat. § 308A.005, subd. 5 (2006).

[10] Minn. Stat. § 308A.131, subd. 1 (2006).

equity and solidarity."[11] However, state and federal laws can vary on what exactly it means to operate on a cooperative basis and how it is measured. The most common distinguishing characteristic generally is a one-member, one-vote system of control.

Cooperative members are generally not personally liable for the debts of the cooperative.

Most cooperatives are a separate entity for tax purposes, similar to a C corporation, although some are tax-exempt. In practice, a cooperative may pay less tax than a C Corporation, because it may be able to deduct many of the distributions to its members from its tax obligations.[12]

Historically, cooperative structures have not been good vehicles for wind developments because they are not naturally designed for outside investment. Capital can be hard to raise when only patrons are eligible for membership, and the requirement that distributions be based on patronage makes it difficult for cooperatives to provide a significant return on investments.[13] However, some states, including Minnesota, have enacted laws authorizing alternative *investor cooperative* arrangements that permit both patron members and separate investor-only members.[14] These investor cooperatives allow individuals to invest in the cooperative without necessarily becoming members.[15]

In these arrangements, patron-members are generally still allocated distributions based on their patronage, while investor members are paid

---

[11] *See* International Co-operative Alliance, *Statement on the Co-operative Identity*, http://www.ica.coop/coop/principles.html (last visited June 8, 2007).

[12] For more detailed information, see FLAG's *Cooperatives* booklet, which is part of the series *Farm to Market: Legal Issues for Minnesota Farmers Starting a Processing or Marketing Business*, available from FLAG.

[13] *See* Mark Bolinger, *Community Wind Project Business Models*, Presentation at Community Wind Energy 2006, (Mar. 8, 2006).

[14] *See, e.g.*, Letter from Bill Oemichen and Maura Schwartz, Minnesota Association of Cooperatives, to Minnesota Cooperative Leaders, *New Minnesota Statutes Chapter 308B—Minnesota Cooperative Associations Act* (June 5, 2003), *available at* http://www.uwcc.wisc.edu/info/legal/mnsummary.pdf (last visited June 8, 2007).

[15] Minn. Stat. § 308B.005, subd.19 (2006) (defining non-patron membership interest).

based on their contributions to capital.[16] Although called cooperatives, there is some question whether investor cooperatives in fact qualify for the special legal treatment traditional cooperatives have received under antitrust, securities, tax, and federal farm credit laws.[17] In the context of wind energy development in particular, there may be limits on whether investor cooperatives are able to take advantage of the federal tax credits and other special federal provisions that give particular advantage to traditional cooperatives. This type of cooperative's ability to make a workable cash flow specifically for a wind project has not been proven.

II. Existing Business Models

This section provides examples of existing business structures that have worked for other farmers who have built wind projects. As has been emphasized throughout this guide, every project must be tailored to the individual circumstances of particular persons in particular places. Therefore, these models are merely examples of what some other farmers have chosen to try. They are not sure-fire mechanisms for developing a wind project in any case, and each one requires the assistance of an experienced attorney to be properly implemented.

A. "Flip" Models

Given the significant amount of investment capital required to build a wind project and the average individual's difficulty in accessing the federal tax incentives for wind development, many individual farmers struggle to put up a project entirely on their own. Therefore, farmers frequently partner with outside, tax-motivated equity investors. By setting up such a co-ownership arrangement, farmers can more quickly raise the needed capital. In addition, the fact that these outside equity investors are able to access the federal tax credits can significantly improve the project's financial prospects.

Generally, this *flip model* works by bringing in a tax-motivated equity investor who will own virtually the entire project in its first ten years. This equity partner

---

[16] Minn. Stat. §§ 308B.721, subd. 1, 308B.725, subd.3 (2006).

[17] *See generally* Doug O'Brien, *Legal and Policy Considerations of Investor-Friendly Cooperatives*, (Nat'l Ctr. for Agric. Law Research and Info., U. of Ark. Sch. of Law 2005), *available at* http://www.nationalaglawcenter.org/assets/articles/obrien_cooperatives.pdf (last visited June 8, 2007).

then "flips" project ownership back to the local investors for the second half of the project.

This timing is largely tax-motivated. Although *power purchase agreements* typically last for twenty or more years, the major federal production tax credit (PTC) for wind generation is available for only the first ten years of the project. Therefore, the legal structure of these tax-motivated co-ownership arrangements is carefully designed so that equity investors can get in and get out, with sufficient return on their investment in the first ten years of the project when the PTC is available.

In what has come to be called the "Minnesota-flip model," a local landowner or a group of local investors organize and invest just enough to complete the initial phases of the wind project. Basically, the locals need to invest enough to ensure the feasibility of the project so that it is attractive to outside investors. This local group then finds a tax-motivated equity partner. This equity partner typically contributes a large amount of capital to fund the final phases of development, including construction and initial operation; however, there is usually also some debt financing, as discussed in the chapter on commercial-scale project financing (Chapter 8).

In exchange for this initial outlay of capital, the project entity—typically an LLC—is designed so that the equity investor has the right to virtually all of the project profits for the first 10 years of operation. During this time, the project's debts are paid down, and the equity investor pays all or the bulk of the project expenses. In return, the equity investor is able to realize a sizeable return on his or her investment, both by collecting almost all of the profits from selling the generated electricity and by fully utilizing the tax incentives associated with the project.

During these initial 10 years, the farmers and other local investors receive only a very small percentage of the project income. Some farmers participating in a flip-style wind project have sought to earn more earlier in the life of the project, by serving as manager of the project after construction or by providing some of the operations and maintenance services to the project. The fees associated with such services are typically built into the project budget and can provide some revenues to the farmer and local investors during the years when the equity investor is receiving the bulk of the project revenues and tax credits. However, these services, and the fees associated with them, must be negotiated with the equity investor, as the investor may want to hire other persons to provide such services to the project.

After 10 years, or once the equity investors have received the targeted return on their investments, ownership of the project flips to the farmers and other local owners, who collect the income for the remaining years of the power generation and purchase agreement. At the time of the flip, the farmers and local investors will generally have to buy out the equity investor's ownership interest, but at significantly depreciated rates.

In this model, the project's financial feasibility is improved by allowing the equity investor to take full advantage of the tax credits, thereby creating another revenue stream for the project. It also reduces the up-front investment required for the initial local investors.

There are some downsides to the Minnesota flip, however. For example, the local investors must wait 10 years before seeing any significant return on their investment. In addition, not all of the benefits of the project are kept local, as a large percentage of the profits flow to the outside equity investor. Furthermore, setting up this kind of flip structure is legally complex. Farmers should carefully consider the relative risk and return of any particular flip deal.

Most of these flip arrangements use the LLC entity structure, because LLCs can be so flexibly organized and have desirable tax and liability benefits.[18] For example, the ownership interests in the first 10 years are typically carefully structured so that the equity investors get 99 percent of the financial rights, but the locals get 51 percent of the ownership and control rights. This is often motivated by eligibility requirements for various other local incentives that the project also desires. Then, at the time of the flip, the equity investors need to be able to drop out entirely.[19]

Not surprisingly, properly creating this type of LLC—and drafting all of the arrangements for ownership, control, and ultimate transfer of ownership interests—requires sophisticated legal assistance. There are also complicated and very technical tax issues. For example, the Internal Revenue Service might not

---

[18] Mark Bolinger, *A Survey of State Support for Community Wind Development* 8 (Lawrence Berkeley Nat'l Lab. 2004), *available at* http://eetd.lbl.gov/EA/EMP/cases/Community_wind.pdf (last visited June 8, 2007).

[19] Mark Bolinger, *A Survey of State Support for Community Wind Development* 9 (Lawrence Berkeley Nat'l Lab. 2004), *available at* http://eetd.lbl.gov/EA/EMP/cases/Community_wind.pdf (last visited June 8, 2007).

permit the parties to negotiate a pre-arranged price for the local investors' "purchase" at the time of the flip.[20]

A variation of this Minnesota-flip model has been proposed by a Wisconsin group.[21] It has been characterized by some commentators as the *loan-to-own model*.[22] Basically, in this model, farmers and other locals form an LLC and provide credit, rather than equity, to the tax-motivated corporate investor, who owns 100 percent of the project. The corporate investor pays the local investors interest on the loan during the first 10 years of the project. After the tax incentives are fully tapped, the local investors forgive the loan in exchange for full transfer of the ownership interests in the project to them. However, this model is legally untested. No known examples exist, and some tax concerns have been raised.[23] Like other flip models, the loan-to-own model should be considered only in consultation with an experienced tax lawyer.

B. Pseudo-Cooperative Models

There are also farmer wind projects that are entirely driven and funded by local investors. This model requires the coordination of many more local investors who can collectively accumulate sufficient capital for the project—and possibly sufficient tax liability to take advantage of tax credits. The most noted, and perhaps only, successful example of this model is a farmer group in southwestern Minnesota called "Minwind Energy." Minwind Energy today is

---

[20] *See* Mark Daugherty and Damon Bresenham, *Implementation of Community Based Wind Power Businesses in Wisconsin* 3, App. B (Mar. 2005), *available at* http://www.focusonenergy.com/data/common/dmsFiles/W_RI_RPTE_CDS_B_M_Final_Rpt.doc; Mark Bolinger & Ryan Wiser, *A Comparative Analysis for Business Structures Suitable for Farmer-Owned Wind Power Projects in the United States* 10-11 (Lawrence Berkeley Nat'l Lab. Nov. 2004), *available at* http://eetd.lbl.gov/ea/ems/reports/56703.pdf (both sites last visited June 19, 2007).

[21] Cooperative Development Services, *Wisconsin Community Based Windpower Business Plan* (2003) (copies available from Michael Vickerman at RENEW Wisconsin (608) 255-4044 or mvickerman@renewwisconsin.org)).

[22] Charles Kubert, *Community Wind Financing: A Handbook by the Environmental Law & Policy Center* 7 (2004), *available at* http://www.elpc.org/documents/WindHandbook2004.pdf (last visited June 8, 2007).

[23] *See* Mark Bolinger, *Community Wind Project Business Models*, Presentation at Community Wind Energy 2006, (March 8, 2006).

made up of nine separate wind projects, each owned and operated by its own 33-member LLC.[24]

The Minwind projects are all entirely local and have been built without any outside tax-motivated investor. Each project has been funded by selling "shares" in $5,000 increments to local investors. Additional funding came from local bank loans, and the later projects benefited from a U.S. Department of Agriculture grant. Some individual investors (many with passive income from ethanol investment) were able to personally take advantage of some of the federal tax credits. However, the Minwind projects are unique in that they have not relied as heavily on the federal tax credits to be profitable. The projects did, however, take advantage of a state 1.5 cents per kWh production incentive payment that is no longer available in Minnesota.

Minwind chose to operate in multiple LLCs for many legal, tax, and financial reasons. However, in the ownership structure and governing documents of those LLCs, the Minwind investors and developers intentionally decided to incorporate many cooperative-like principles. For example, in forming their LLC, the farmers decided that the projects had to be 85 percent owned by farmers, that no single shareholder could own more than 15 percent of the project, and that voting rights would be allocated on a one-shareholder, one-vote basis.[25] In addition, Minwind intentionally purchases as many local goods and services as possible, including construction and construction-related supplies.

Minwind's success shows that some farmers can collectively raise the capital needed for a commercial-scale wind investment. The capital for the first two Minwind projects was raised in just 12 days, and Minwind now has a long waiting list of potential investors. In addition, this project provides a more immediate return on investment for local farmers than the flip model, largely

---

[24] For a more detailed description of these particular projects, see Windustry, "Minwind I & II: Innovative Farmer-owned Wind Projects" from *The Windustry Newsletter* (Fall 2002), *available at* http://www.windustry.org/newsletter/2002FallNews.htm; Windustry, *Case Study: Minwind III-IX* (Oct. 2006), *available at* http://www.windustry.org/community/casestudyMinwind.htm (both sites last visited June 18, 2007).

[25] Charles Kubert, *Community Wind Financing: A Handbook by the Environmental Law & Policy Center* 4 (2004), *available at* http://www.elpc.org/documents/WindHandbook2004.pdf (last visited June 12, 2007).

because the local investors do not need to wait 10 years to take over project ownership.

However, as noted above, to make the project's finances work, Minwind took advantage of a cash incentive for wind production that is no longer available in Minnesota. Without that per kWh production incentive, it may be hard for other projects without a tax-motivated investor to make a similar arrangement work now.[26] In addition, some of Minwind's local investors were in a financial position to be able to take some individual advantage of the federal tax credits. This will not the be case for most farmer-owned wind projects.

Moreover, farmers should be aware that creating the Minwind structure was legally complex and took a significant community organizing effort. For example, Minwind hired a team of lawyers to make sure they complied with securities regulations and structured themselves in a tax-sensible way.[27] In addition, the farmers and rural community members who started the first Minwind projects also benefited from good relationships with local lenders due to prior experience with a farmer-owned ethanol facility.

C. On-Site Energy Use Models

In most community wind models, the local wind developers make their money by selling wind-generated electricity to utilities or some other power supplier or marketer. However, another source of revenue from a wind project can come from direct use of the generated energy itself, offsetting retail purchases of electricity from the utility while avoiding the need to sell generated electricity at wholesale rates.

In locations where there is an electricity consumer of a significant size combined with a good wind resource, it may be feasible to consider installing a commercial-scale turbine to supply power directly to that consumer. Several schools in Illinois, Iowa, and Minnesota have used this model and installed turbines on the customer side of their utility meters to offset their retail

---

[26] Charles Kubert, *Community Wind Financing: A Handbook by the Environmental Law & Policy Center* 5-6 (2004), *available at* http://www.elpc.org/documents/WindHandbook2004.pdf (last visited June 12, 2007).

[27] Mark Bolinger, *Community Wind Project Business Models*, Presentation at Community Wind Energy 2006, (March 8, 2006).

purchases.[28] Capturing retail value for the electricity generated by a wind turbine rather than wholesale value can give a project's economics a significant boost.

In many cases, though, these projects' likelihood of success depends on the scope and flexibility of the state's *net metering* rules. Because wind is an intermittent energy resource, the electricity consumer will likely need a back-up power supply. Net metering laws are discussed in much more detail in Chapter 7 (On-Farm Small Wind). However, generally, net metering laws permit customers with their own power generation sources to sell the excess power they generate back to the utility, and the existing interconnection allows electricity to flow to and from that customer through a single meter. Net metering measures the difference between the customer's use of electricity from the utility and the customer's generation of electricity for the utility—in effect, when the customer is producing more energy than it is using, the electric meter runs backward. This is equivalent to a credit on the customer's electric bill at the regular retail rate for every kWh produced that exceeds the amount of energy used from the grid.[29]

The Iowa school projects were built under Iowa's unique rule permitting net metering for projects of any size.[30] Therefore, large turbines in Iowa could be built and interconnected through an existing customer's meter. However, other states have limits on the size of turbines that can be net metered this way. For example, Minnesota only permits net metering for projects less than 40 kW in size.[31] A few state size limits are high enough to accommodate commercial-scale wind turbines—including Colorado, for example, which recently changed its net metering rules to allow projects up to 2 MW.[32] Iowa's unlimited net metering rule was challenged by customers of Iowa's largest investor-owned utility, and these legal challenges resulted in a settlement whereby the state's two major

---

[28] Charles Kubert, *Community Wind Financing: A Handbook by the Environmental Law & Policy Center* 3 (2004), *available at* http://www.elpc.org/documents/WindHandbook2004.pdf (last visited June 12, 2007).

[29] Government Accountability Office, *Renewable Energy: Wind Power's Contribution to Electrical Power Generation and Impact on Farms and Rural Communities*, GAO-04-756, at 26 (Sept. 2004), *available at* http://www.gao.gov/new.items/d04756.pdf (*abstract available at* http://www.gao.gov/docsearch/abstract.php?rptno=GAO-04-756) (both sites last visited June 12, 2007).

[30] *See* Iowa Admin. Code r. 199-15.11(5) (2006).

[31] Minn. Stat. § 216B.164, subd. 3 (2006).

[32] 4 Colo. Code Regs. § 723-3-3664(a) (2005).

utilities, MidAmerican and Interstate Power and Light Company, have been granted "waivers" that now limit the size of net-metered generators to 500 kW or less.[33]

Many of the Iowa school projects also benefited from a state revolving loan program permitting the schools to borrow up to $800,000 to finance the project with interest rates of just 3 to 4 percent.[34]

If a wind project is built that is larger than the net metering limits in a given state, it may be possible to divide the project's electricity output for net metering purposes.[35] For example, if an Iowa MidAmerican customer has a 1,500 kW project, one-third of the output (that is, 500 kW) could be net metered, and two-thirds of the output could be sold to the utility under some other option—possibly under the utility's Public Utility Regulatory Policies Act (PURPA) avoided cost rate, as described in the previous chapter (Chapter 9, Selling Power).

Another limitation of the on-site energy use model is that larger energy consumers with large electricity demands typically face demand and standby charges that make the economic feasibility of net metering on a large scale more difficult.[36] *Standby charges*, for example, are meant to compensate utilities for the costs of maintaining generation capacity and transmission lines so that they are ready to serve the net metering customer when its wind turbine is not producing enough power to meet its needs. Some states limit or prohibit utilities from

---

[33] Iowa Utilities Board, *In re: MidAmerican Energy Company*, Docket Nos. TF-01-293, WRU-02-8-156, Order Granting Waiver and Approving, with Clarifications, Tariff (Mar. 8, 2002).

[34] Mark Bolinger, *A Survey of State Support for Community Wind Development* 12 (Lawrence Berkeley Nat'l Lab., 2004), *available at* http://eetd.lbl.gov/EA/EMP/cases/Community_wind.pdf (last visited June 8, 2007).

[35] *E.g.,* Iowa Utilities Board, *In re: MidAmerican Energy Company*, Docket Nos. TF-01-293, WRU-02-8-156, Order Granting Waiver and Approving, with Clarifications, Tariff, at 5 (Mar. 8, 2002).

[36] *See* Mark Bolinger, et al., *A Comparative Analysis of Community Wind Power Development Options in Oregon* 32-33 (Energy Trust of Oregon July 2004), *available at* http://www.energytrust.org/RR/wind/OR_Community_Wind_Report.pdf (last visited June 7, 2007) (discussing rate structure issues).

imposing these kinds of charges on net metering systems, as discussed in the chapter about on-farm small wind projects (Chapter 7).[37]

In addition, self-generation projects are probably not eligible for the existing federal tax credits. If the on-site electricity consumer is a tax-paying business, its energy savings as a result of this scheme may in effect be taxable because they would reduce the business's deductible business expenses.[38]

There has been some effort, especially in Ontario, Canada, and on the East Coast of the United States, to envision a farmer-owned, commercial-scale project in which multiple investors come together and create some kind of *aggregate net metering* or *group net metering* project. In this model, investors would jointly own off-site, utility-scale turbines, and the local utility would offset each investor's share of the off-site turbine's output against each investor's individual power consumption. This would enable consumer investors to reduce their retail–rate consumption costs, rather than having to cash flow a project with wholesale revenues, and it would give investors more flexibility in locating their turbines. To work, however, a group net metering project would require utility cooperation and possibly also some statutory and regulatory changes.[39]

The group net metering concept is similar to ideas being discussed about a traditional patronage cooperative for wind energy—where cooperative members finance and own the project and benefit by purchasing its electricity output at a reduced member rate.[40]

---

[37] *See, e.g.*, Cal Pub Util Code § 2827(b)(2), (g) (2006) (authorizing net metering for systems 1 MW or less and prohibiting utilities from charging any additional fees that would increase the net metering customer's costs beyond those of other customers in the same rate class).

[38] Mark Bolinger, et al., *A Comparative Analysis of Community Wind Power Development Options in Oregon* 65-66 (Energy Trust of Oregon July 2004), *available at* http://www.energytrust.org/RR/wind/OR_Community_Wind_Report.pdf (last visited June 7, 2007).

[39] Mark Bolinger, et al., *A Comparative Analysis of Community Wind Power Development Options in Oregon* 62-63 (Energy Trust of Oregon July 2004), *available at* http://www.energytrust.org/RR/wind/OR_Community_Wind_Report.pdf (last visited June 7, 2007).

[40] Mark Bolinger, *Community Wind Project Business Models*, Presentation at Community Wind Energy 2006 (Mar. 8, 2006).

D. Early Sale Model

A final example of successful farmer-developed wind projects has emerged where local landowners and investors complete most of the early development of the wind project and then sell a complete, ready-to-be-built wind package to an outside developer. In the *early sale model*, the locals do not retain any ownership in the project after the sale; however, they may receive a greater financial return than if they had simply leased their land and wind rights to that developer.

This model worked for a group of landowners in central Minnesota who responded to a request for proposals for wind power generation from Great River Energy, an electric generation and transmission cooperative. The landowners were awarded the contract by Great River Energy and then sold the development rights to their 100.5 MW Trimont Area Wind Farm to an outside wind developer. Instead of an outright sale price, these landowners negotiated to receive both a lease payment and a percentage of the developer's revenues from the project.[41]

III. Other Legal Issues Affecting Choice of Business Structure

There are several factors unique to wind project developments that require careful consideration before settling on a business structure. Eligibility for various government incentives and the tax consequences of the project development are major factors. Other issues that will need to be investigated are utility rate structures and whether there are any special tariffs in which the type of business entity used for the project may affect eligibility. These issues are touched on in other chapters of this guide and, in particular, in the discussion of government incentives for wind development in Chapter 12.

This section touches briefly on three other major legal issues that affect the choice of business structure for wind projects—securities regulations, energy regulations, and state corporate farming laws. As with other topics in this chapter, this information is only intended as an introduction to the issues. *Experienced legal counsel is essential before any actual decisions are made.* These are extremely complicated, and constantly changing, areas of the law.

---

[41] *See* Charles Kubert, *Community Wind Financing: A Handbook by the Environmental Law & Policy Center* 7-8 (2004), *available at* http://www.elpc.org/documents/WindHandbook2004.pdf (last visited June 12, 2007).

A. General Securities Regulations

Although exact definitions vary by jurisdiction, a *security* is essentially a note or certificate, usually a stock or share, which represents a transferable financial interest in a for-profit business or activity.[42] If a wind project's business structure involves selling ownership interests in the business entity to outside investors—whether as shares in a corporation or cooperative, membership interests in an LLC, or some other form—certain securities laws will apply, and registration with the federal Securities and Exchange Commission (SEC) or a state equivalent, such as the Department of Commerce, may be required.[43]

Securities laws are designed to ensure that investment products meet minimum standards of fairness. They are intended to protect the public from fraud and misinformation. Generally, this objective is achieved by requiring securities or transactions involving the transfer of securities to be *registered* with the governing regulatory agency. There are also often detailed *disclosure* requirements, most commonly met in the form of a prospectus for potential investors that includes detailed information about the investment and the risks associated with the business.

The penalties for violating securities laws can be very severe. If the offer and sale of securities do not comply with the applicable securities laws, the entire investment may need to be returned to the investor, and the officers and directors of the issuing entity can be personally liable for any losses.

Evolving Securities Laws

Many states and the federal government are increasingly concerned about corporate responsibility and some securities laws have changed, and may continue to change, in response. Minnesota's securities laws will change effective August 1, 2007. Although the new law is not radically different from the old law, farmers and their attorneys should be careful they are using the correct version of the law for their own situation and stay up to date on any changes. Uniform Securities Act, 2006 Minn. Laws (Ch. 196, art. 1, § 52).

Complying with both state and federal securities laws can be financially and administratively burdensome for small businesses. In particular, if registration of the securities (or transaction) is required before offering the securities for sale,

---

[42] *See, e.g.,* 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (2006) (federal definitions of "security").

[43] *See generally* Thomas Lee Hazen, *The Law of Securities Regulation* (Thomson West, 5th ed. 2005).

legal fees can be quite high. In recognition of this, both federal and state governments have adopted several *exemptions*, which, if carefully complied with, can exclude certain types of securities and transactions from some or all of the registration requirements.[44] However, even if an exemption is permitted, a detailed disclosure may still be required, especially before offering securities to certain less sophisticated (also called *unaccredited*) investors. Moreover, seeking the exemption can itself be legally complicated and can require filing specific information and paying required filing fees to the regulatory agency.

In any sale of securities, a wind project will need to either register or qualify for an exemption under state law and an exemption under federal law. Even if an exemption is likely, an attorney will be required (1) to ensure the project's eligibility to claim the exemption, and (2) to properly file the required forms and/or fees to qualify for the exemption. In addition, an attorney will be needed to ensure that any remaining disclosure requirements are met.[45]

B. Energy Regulations

Historically, many energy-generating companies were subject to additional legal restrictions on their business transactions pursuant to the Public Utility Holding Company Act of 1935 (PUHCA). Under PUHCA, the Securities and Exchange Commission (SEC) had significant oversight authority over *who* could invest in electric-generating facilities, such as wind farms.[46]

---

[44] *See, e.g.,* 15 U.S.C. § 77d (2006).

[45] *See* Mark Bolinger, et al., *A Comparative Analysis of Community Wind Power Development Options in Oregon* 28-29 (Energy Trust of Oregon July 2004), *available at* http://www.energytrust.org/RR/wind/OR_Community_Wind_Report.pdf (last visited June 7, 2007).

[46] William D. DeGrandis, *Energy Bill Creates New Opportunities, New Challenges*, 83 Electric Light & Power 52 (Sept. 2005).

Congress repealed PUHCA effective February 8, 2006.[47] This repeal significantly reduces the amount of regulation imposed on investment in energy-generating facilities, among other things. The most significant consequence of this repeal, from a farmer's perspective, is that utilities can much more easily invest in their own wind energy projects now, whereas many of these investments may have been prohibited under the original PUHCA. This may affect utilities' willingness to enter into power purchase agreements with farmer-owned wind projects in the future, as utilities now may prefer to develop these resources on their own.

Farmers should be aware that, even after the repeal of PUHCA, there are still energy-specific regulations that could apply to their choice of business entity for a wind project. In what has been dubbed "PUHCA 2005," Congress granted both the Federal Energy Regulatory Commission (FERC) and, in some cases, state regulators access to the books and records of energy *holding companies*.[48] In addition, holding companies may be subject to certain requirements for records retention and special accounting systems.[49]

The term "holding company" is defined very broadly in PUHCA 2005, and could include many companies or other "organization[s] of persons" that hold an interest in a business that generates wind energy for sale.[50] Farmers should seek the advice of an experienced attorney to evaluate whether a given business structure will raise PUHCA 2005 issues.

If a wind project does trigger PUHCA 2005's requirements, it may qualify for some exemptions in the law. Farmers must work closely with an attorney to

---

[47] Energy Policy Act of 2005, 109 Pub. L. 58, Tit. XII, Subtitle F, 119 Stat. 594, 972 (Aug. 8, 2005); *see also* Markian M.W. Melnyk and William S. Lamb, *PUHCA's Gone: What Is Next for Holding Companies?*, 27 Energy L. J. 1 (2006); *see also* Federal Energy Regulatory Commission, *Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005*, 113 FERC ¶ 61, 248, Order No. 667 (Apr. 24, 2006), *available at* http://elibrary.ferc.gov/idmws/common/opennat.asp?fileID=10901242 (last visited June 21, 2007).

[48] Energy Policy Act of 2005, 109 Pub. L. 58, Tit. XII, Subtitle F, § 1264, 119 Stat. 594, 972 (Aug. 8, 2005) (codified at 42 U.S.C. § 16452).

[49] *See* 18 C.F.R. § 366.22-366.23 (2007); 18 C.F.R. pt. 367 (2007).

[50] *See* 18 C.F.R. § 366.1 (2007) (defining terms "holding company," "company," "public utility," "public utility company," and "electric utility").

decide the best course of action for them, including whether an exemption should be sought and, if so, which one.

One example of the exemptions available under PUHCA 2005 is that for holding companies that meet that definition only because they have ownership interests in a *Qualifying Facility* (QF) or an *Exempt Wholesale Generator* (EWG).[51] Wind project owners have to comply with particular FERC procedures to certify that their projects are properly designated as either a QF or EWG, if applicable.

However, although status as a QF or EWG can relieve project owners of some of the burdens of PUHCA 2005, this does not necessarily exempt the projects from other, related FERC regulations. FERC has made clear, for example, that owners of some EWGs may still be subject to federal regulations requiring access to records and books, along with other rate-related regulations.[52] Under the Energy Policy Act of 2005, owners of QFs may also be subject to additional regulatory burdens from FERC, especially if the QF is over a certain size.[53]

---

[51] 18 C.F.R. § 366.3 (2007). QFs are given the same definition they have under PURPA, as discussed in Chapter 9 (Selling Power). *See* 18 C.F.R. § 366.3(a)(1) (2007). EWGs must be engaged exclusively in the business of owning or operating facilities for selling electric energy at wholesale. 18 C.F.R. § 366.1 (2007). In some cases, certain authorizations by state PUCs may be required to receive EWG status. *See* 18 C.F.R. § 366.1 (2007) (citing 15 U.S.C. §§ 79z-5a(a)(2)-(4), 79z-5a(b)-(d) (2006)).

[52] 16 U.S.C. §§ 824(e), 824d, 824e (2006); *see also*, Federal Energy Regulatory Commission, *Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005*, 115 FERC ¶ 61,096, Order No. 667-A, at 7 (Apr. 24, 2006), *available at* http://www.ferc.gov/legal/maj-ord-reg/fed-sta/ene-pol-act/final-orders.asp#skipnavsub; Stephen C. Hall and Marcus Wood, "Regulatory and Transmission-Related Issues," 10-1 to 10-2 from *The Law of Wind* (Stoel Rives, LLP, 3d ed. 2006), *available at* http://www.stoel.com/webfiles/LawOfWind_WEB_02_07.pdf (both sites last visited June 18, 2007).

[53] 18 C.F.R. § 292.601 (2007) (under 30MW exempt from power plant licensing requirements and 20MW or less exempt from rate regulations); *see also Stephen* C. Hall and Marcus Wood, "Regulatory and Transmission-Related Issues," 10-2 from *The Law of Wind* (Stoel Rives, LLP, 3d ed. 2006), *available at* http://www.stoel.com/webfiles/LawOfWind_WEB_02_07.pdf (last visited June 18, 2007).

In addition to its inherent complexity, this is a constantly changing area of the law—especially as the Energy Policy Act of 2005 continues to be implemented and reinterpreted. Thus, while these and other energy-specific regulations should inform a farmer's decision about how best to structure the wind business, only an experienced, qualified attorney can help navigate a farmer-owned project through this highly specialized area of the law.

Finally, farmers should be aware that some states are also considering adopting their own regulations to oversee energy-specific investments. Any developments in this area should be closely monitored.

C. Corporate Farm Laws

Several states have laws restricting the ability of some liability-shielded business entities to farm or own agricultural lands.[54] Typically, these laws provide that corporations, LLCs, and limited partnerships may only engage in farming or own farmland if they qualify for a specific exemption and comply with reporting and other requirements.

These laws are generally designed to promote family-owned and -operated farming. Therefore, qualifying family-centered entities are typically permitted. However, non-family-owned, liability-shielded businesses seeking to own farmland on which to develop a wind project will likely need to qualify for a different exemption.

Minnesota's law, for example, prohibits corporations, LLCs, certain trusts, and limited partnerships from farming or owning, acquiring, or otherwise obtaining a direct or indirect interest in agricultural land, unless the interest comes through a *bona fide* encumbrance. The statute, however, has 20 exemptions, some of which may be available for entities seeking to own agricultural land for a wind project.[55] For example, utility corporations, electric cooperatives, and non-profit corporations are exempted.[56]

---

[54] *See, e.g.*, Iowa Code §§ 9H.1 to 9H.15 (2006); Kan. Stat. §§ 17.5902 to 17.5904 (2006); Minn. Stat. § 500.24 (2006); Mo. Stat. § 350.015 (2006); N.D. Cent. Code §§ 10-06.1-01 to 10-06.1-27 (2005); Okla. Const. art. XXII, § 2; S.D. Codified Laws §§ 47-9A-1 to 47-9A-23 (2006) and S.D. Const. art. XVII, §§ 21-24; and Wis. Stat. § 182.001 (2006).

[55] Minn. Stat. § 500.24, subd. 3(a) (2006).

[56] Minn. Stat. § 500.24, subd. 2(t) (2006).

In addition, the Minnesota corporate farm law permits an otherwise restricted business entity to own an interest in agricultural land if the land is zoned nonagricultural, is located within an incorporated area, or within six years of purchasing the land, the entity will use the land for a "specific non-farming purpose."[57] During the development of the land for nonfarm purposes, it may only be used for farming by a qualifying farmer or family farm business entity.

Minnesota also provides a *de minimis* lands exemption, whereby an otherwise restricted business entity may own and use agricultural land if the land is 40 acres or less and receives less than $150 per acre annually in gross revenue in rental or agricultural production.[58]

Finally, for those entities that fall under the prohibition and do not qualify for an exemption, Minnesota's corporate farm law allows the state Commissioner of Agriculture to grant a special exemption.[59] An exemption may be issued if "the exemption would not contradict the purpose" of the statute, and if "the petitioning entity would not have a significant impact upon the agriculture industry and the economy." This exemption is a discretionary one, and the commissioner is not required to grant the exemption even when the two conditions are met. Moreover, every year the commissioner re-evaluates any specially exempted entity to ensure that it still complies with the two requirements. If the entity no longer complies, the commissioner will withdraw the exemption and enforcement proceedings may follow.

Regardless of how a restricted business entity receives an exemption, it is likely subject to reporting requirements. These requirements ensure that the business is not circumventing or directly violating the law. In Minnesota, the report must include the names and addresses of officers, directors, and owners of the entity, a description of the land owned, and a list of the products produced on the land. [60]

Other states may have similar restrictions, and these state laws should be carefully consulted.

---

[57] Minn. Stat. § 500.24, subd. 2(u) (2006).

[58] Minn. Stat. § 500.24, subd. 2(bb) (2006).

[59] Minn. Stat. § 500.24, subd. 3(b) (2006).

[60] Minn. Stat. § 500.24, subd. 4 (2006).