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Renewable Energy Financing: An Update of Ontario's Feed-In Tariff Program

In the fall of 2009, the government of Ontario implemented a feed-in tariff program (the "FIT Program"). Administered by the Ontario Power Authority (the "OPA"), the FIT Program is North America's first comprehensive pricing structure for renewable energy generation. It offers renewable energy producers (e.g. wind, solar and biomass) above-market prices under stable, long-term term supply contracts ("FIT Contracts").

For lenders, the FIT Program has created considerable demand in the growing renewable energy generation market. The discussion below provides an overview of certain key issues related to financing projects under the FIT Program that have been identified in the early stages.

After just over one year of existence, the FIT Program has achieved some significant milestones. Under the FIT Program, the OPA has awarded FIT Contracts for the generation of more than 2,632 megawatts ("MW") of renewable energy.

As of January 21, 2011, solar projects accounted for 89% of all FIT Contracts. This figure includes contracts issued under the microFIT Program for renewable energy generation projects of 10 kilowatts ("kW") or less in size. These projects are often employed by homeowners, schools, churches and farmers across Ontario.

In contrast, wind projects provide 58% of total energy contracted under the FIT Program, derived primarily from large commercial developments. Small scale hydroelectric and bioenergy make up a smaller percentage of approved projects.¹

FINANCING FIT PROJECTS

Energy projects are traditionally financed through non-recourse, long-term project financing structures. Revenue payable to the project company is guaranteed under power purchase agreements such as the FIT Contract. These agreements provide lenders with a steady stream of income from a creditworthy counterparty. A lender's risk exposure is typically dependent on the quality of the developer or project owner, who manages the project company and its income-generating assets. Throughout 2010, lenders were hesitant to enter the Ontario renewable energy market due to the following three uncertainties:

1. The FIT Program is a relatively new initiative. As a result, some project developers are having difficulty demonstrating sufficient experience to satisfy lender concerns. In other words, lenders are finding it difficult to evaluate a developer's strength or ability to achieve commercial operation and comply with its obligations under the FIT Contract.

¹ The Ontario Power Authority, "Bi-weekly FIT and microFIT Report", dated January 5, 2011. Available at: http://fit.powerauthority.on.ca/Storage/102/11187_Bi-Weekly_FIT_and_microFIT_Report_January_21%2C_2011.pdf (Accessed January 9, 2011).



2. Enforcement and interpretation of the obligations arising under the FIT Contract are yet to be fully explored. As a result, lenders are unable to estimate their own risk or exposure with a sufficient degree of comfort.
3. It is unclear what rights a lender may have to 'step-in' and manage a project where the developer is in, or is at risk of, default. Unlike traditional project finance, lenders are not involved in the negotiations since the FIT Contract is a standardized contract. As a result, there is concern that the FIT Contract may not allow lenders an opportunity to address specific concerns in their customary manner.

For larger commercial projects, credit generally remained restricted to experienced developers in 2010. For smaller projects, such as rooftop solar installations, borrowers were able to cover upfront capital costs by leveraging existing operating loans. In 2011, analysts predict that Canada's clean technology sector is "poised for a banner year." As a result, demand for financing will continue to grow in this market.² Smaller developers and energy companies in particular are expected to benefit from more readily available capital, which some analysts suggest has already begun.³

RECENT NEWS & MARKET DEVELOPMENT

On January 6, 2011, Plutonic Power Corporation and GE Energy Financial Services announced that they had reached an agreement to acquire a 50 MW portfolio of three photovoltaic solar facilities to be built in Ontario from First Solar, Inc.⁴ Mark Tonner, Managing Director and Canada business leader at GE Financial Services, commented as follows:

"This transaction is GE Financial Services' first solar investment in Canada, broadening our USD \$6 billion renewable energy portfolio and supporting our strong partnership with Plutonic... We see significant growth potential for solar worldwide, which continues to improve our technology costs and efficiencies, and helps balance wind-generated power, which peaks at different times."⁵

From an economic policy perspective, a corollary of the FIT Program includes the agreement between the government of Ontario and a partnership of Samsung C&T and Korea Electric Power Company. Under this agreement, Samsung C&T has committed to building four manufacturing plants in Ontario and developing 2,500 MW of wind and solar projects.

² Richard Blackwell, "Clean tech poised for a breakthrough year," *The Globe & Mail*, December 31, 2010. Available at <http://www.theglobeandmail.com/globe-investor/investment-ideas/features/2011-market-outlook/clean-tech-poised-for-breakthrough-year/article1854716/> (Accessed January 18, 2011).

³ *Ibid.*

⁴ Plutonic Power Corporation Press Release, dated January 5, 2011 "Plutonic Power Agrees to Buy 50 MW Portfolio from First Solar in Partnership with GE Energy Financial Services; Plutonic Expands into Ontario Market." Available at <http://www.plutonic.ca/s/PressReleases.asp?ReportID=436216&Type=Press-Releases&Title=Plutonic-Power-Agrees-to-Buy-50-MW-Portfolio-from-First-Solar-in-Partnershi> (Accessed January 18, 2011).

⁵ *Ibid.*



The agreement is worth approximately \$7 billion and is expected to generate roughly 16,000 green-collar jobs in Ontario. This development is consistent with the FIT Program's domestic content requirements, discussed below. Sung-ha Chi, President and CEO of Samsung C&T Corporation, commented as follows when the agreement was originally signed on January 21, 2010:

"With rapidly expanding expertise in the renewable energy sector, this project marks the forging of a win-win partnership where Samsung C&T will provide optimal solutions to assist the government of Ontario in reaching its goal to increase the amount of renewable energy produced in the province."

OTHER ISSUES

1. Domestic Content

Each FIT Contract for solar and wind projects generating more than 10 kW require that a minimum percentage of equipment, materials and services (including consulting and legal services) used for such projects are procured or sourced in Ontario. Notable requirements are:

- wind: minimum of 25% before January 1, 2012, and 50% thereafter; and
- solar: minimum of 50% before January 1, 2011, and 60% thereafter.

Developers must deliver a domestic content plan which outlines how they expect the project to meet domestic content requirements as a condition precedent to commencing construction. However, it is only once the project is declared for commercial operation that developers are required to submit a formal report for approval by the OPA outlining how such requirements have been met.

If approval is withheld, the project would no longer be entitled to the guaranteed, above-market rates stipulated in the FIT Contract. In response, developers are beginning to include covenants in their various sub-agreements which allocate provincial content requirement obligations to both contractors and suppliers. As a result, lenders are now having to get comfortable with subcontractors and supplier covenants in a way not previously required in traditional project financing.

2. Increase in Energy Prices

The FIT Program effectively provides a subsidy to the energy industry which will be funded over time by higher energy prices. Critics of the FIT Program are quick to point out that it guarantees a rate payable of C\$0.82 per kW hour for energy generated from small rooftop solar systems. It should be noted, however, that such rooftop projects contemplate only 3.4% of all energy generated under the FIT Program.⁶ Wind power, which is the largest source of energy under the FIT Program, is subsidized at a far lower rate of \$0.135 per kW hour.

⁶ Hamilton, Tyler, "Samsung deal keeps jobs from going south," the *Toronto Star*, January 25, 2010. Available at <http://www.thestar.com/business/cleanbreak/article/755239--hamilton-samsung-deal-keeps-jobs-from-going-south> (Accessed December 8, 2010).

⁷ Samsung Press Release, dated January 21, 2010 "Samsung C&T, Korea Electric Power Company to Build World's Largest Wind, Solar Panel Cluster in Ontario." Available at http://www.samsung.com/ca/news/newsRead.do?news_group=corporatenevs&news_type=others&news_ctgry=&news_seq=17081 (Accessed January 18, 2011).

⁸ Rooftop solar projects are a subset of all solar projects illustrated in the table above.



On November 18, 2010, the government of Ontario formally released estimates stating that retail electricity prices are expected to rise by 46% over the next five years. In conjunction with this release, the government also introduced the Ontario Clean Energy Benefit (“OECB”). The OECB will provide a ten percent rebate to help consumers manage rising electricity prices for the next five years. With an election scheduled for October, 2011, it remains to be seen whether voters will be willing to accept higher energy prices even in light of the OECB in order to support the renewable energy industry in Ontario.

3. Political Implications

On November 23, 2010, the government of Ontario released its long-term energy plan, committing a total of \$14 billion and \$9 billion over the next 20 years to wind and solar energy, respectively. Discussing the issue of rates payable and the impact on energy prices, Minister of Energy Brad Duguid commented as follows:

“I think that most of the industry would expect that the rates will likely go down, but we’re confident that we’ll do that in a way that maintains confidence in the investment climate in Ontario.”

Speaking at an event organized on January 7, 2011, Opposition leader Tim Hudak stated “I think all of us would support renewable energy, but it has to be affordable.” Needless to say, politics will likely play an important role in the future direction of this policy. Moving forward, policy-makers will ultimately need to balance (i) sustaining sufficient revenue streams to provide incentive for new investment in renewable energy projects and financing; and (ii) maintaining acceptable consumer energy prices.

CONCLUSION

The FIT Program continues to encourage investment in renewable energy in Ontario. To date, the greatest challenge for the industry has been access to financing. While the smaller companies remained underserved in 2010, this appears likely to change in 2011. Key benefits for lenders seeking to expand their presence in this market include guaranteed, above-market rates for 20 years. Nonetheless, there remain concerns for lenders as they become more accustomed to the provisions of the FIT Program. ■

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⁹ Government of Ontario, “Ontario’s Long-Term Energy Plan,” page 5. Released November 24, 2010. Available at http://www.mel.gov.on.ca/en/pdf/MEI_LTEP_en.pdf (Accessed December 8, 2010).

¹⁰ Susan Taylor, “Ontario expects rates to drop for green power,” *Thomson Reuters*, November 24, 2010. Available at: <http://ca.reuters.com/article/domesticNews/idCATRE6AM6D220101124> (Accessed December 8, 2010).