DEVELOPING WIND ENERGY PROJECTS IN LATIN AMERICA

I. Opportunities
As the U.S. wind power industry continues to mature, the field has become crowded with top-tier developers, PPAs have been harder to come by and project economics have been put under pressure. To the south, however, are whole new economies just beginning to develop their wind resources, offering U.S. developers the promise of better returns and more rapid growth of their businesses.

Many Latin American countries lack natural resources that make them overly reliant on hydro and imported oil and gas, or have insufficient or too few generating assets, all of which can push power prices well above $100 MWh. Among all of this promise, however, lurks new and dangerous pitfalls that, if not properly accounted for, can turn what appears to be a golden project with a dream IRR into a dramatic loss for a developer abroad.

II. Diligence
The first step for a U.S. developer going abroad, no matter how much success the developer has had in the U.S., is to do thorough and comprehensive due diligence of the project opportunity and the project country. Typically, the developer will want to hire able and experienced counsel and advisors both in the U.S. and in the project country to properly structure the investment and minimize the risks.

In the U.S., tax structuring, compliance with U.S. extra-territorial laws, such as Patriot Act and FCPA, and ensuring the project documents contain the protections necessary to shield the developer from emerging market risks and make the project financeable on an international basis, are all crucial. In the project country, local counsel will be essential to helping the developer comply with the written and unwritten foreign investment rules needed to realize the project.

III. Local Partner
In many instances, teaming up with a local development partner who can navigate the politics and inner-workings of a country may mean the difference between a successful or failed project. Selecting that local partner and clearly defining the roles and responsibilities of the partners, including funding obligations, sets the stage for a successful project.

IV. Threshold Questions
When considering an investment in a country, these are threshold questions for a developer:
- Does the foreign investment law allow the developer to own the wind project outright or does it require a percentage of local ownership (for example, Mexico prohibits foreign ownership on coasts and borders, unless properly structured)?
- What is the sovereign rated?
- Are there restrictions on repatriation of profits to the U.S.?
- Is there a bilateral tax treaty or investment treaty with the U.S.?

V. Investment Structure
Once a developer decides to establish operations in a country, the developer will need to carefully consider the business entities to be used to ensure proper U.S. and foreign tax treatment, as well as limitation of liability (typically, through an entity akin to the U.S.’ limited liability company). Poor structuring could cause the developer to create a “permanent establishment,” which would cause the developer’s world-wide income to be subject to taxation in the project country.

The developer will also want to be sure to properly structure the activities of employees working in that country. For example, unlike in the U.S., many Latin American countries have employment laws that provide substantial entitlements to employees, such as employee profit sharing and mandatory severance based on years of service (and which may count an expatiate’s tenure with a company prior to working in the country).

VI. Project
A. Project Costs
Both project costs and financing costs can be significantly higher in the developing world. On the project cost side, infrastructure, such as roads and ports, may need improvement, and operating in the country may be more difficult because of political or labor unrest, lack of regulatory transparency or a greater likelihood of arbitrary government action. Many of these same elements may also create uncertainty for the investment, which increases the country risk for lenders, who may charge more interest and fees to offset the risk.

B. Land Rights
Proper ownership of the land is fundamental to any project, but is of paramount importance for wind farms, which typically cover huge tracts of land. A foreign country may restrict foreign ownership of its lands or may altogether restrict the conveyance of certain lands, such as those owned by agrarian farmers or other protected classes.

C. Revenue Contracts
Although some Latin American countries have functioning and liquid spot markets for the sale of power, most projects will obtain a long-term power purchase agreement (PPA) for the sale of the project’s power. As with any PPA, the most crucial element is the creditworthiness of the offtaker. Often, that offtaker will be a government utility, and a proper and effective waiver of sovereign immunity is key. Also, the developer will want to obtain a change of law provision to guard against government action that may hurt the economics or viability of the contract over its term. A properly structured dispute resolution provision providing for offshore arbitration is also vital.

If the PPA does not include a sale of the project’s environmental attributes, the project will have them as another valuable revenue source. For developing countries, for example, there is a thriving market for carbon offsets under the clean development mechanism of the Kyoto Protocol.

D. EPC Contract
Unlike in the U.S., international wind projects often combine the turbine supply agreement and balance of plant (BOP) agreement into a turnkey contract or equipment procurement and construction (EPC) contract. Lenders prefer the EPC contract because it makes one general contractor responsible for the entire project and avoids, if a problem arises, having the turbine supplier and BOP contractor claiming the other was at fault.

As in the U.S., the key to the EPC is first selecting a reputable and reliable turbine technology, otherwise the project may not be financeable or easily saleable to a third party. Depending on the country, the EPC contract may need to be split into on-shore and off-shore components to minimize value-added tax.

E. Financing
In addition to commercial lenders, projects in the developing world may also benefit from other types of financing sources:
1. Development Banks and Multilaterals—Many government-sponsored development banks and multilateral institutions, such as the Inter-American Development Bank and the Work Bank’s International Finance Corporation, exist to reduce poverty or support sustainable development in emerging markets where financing may otherwise be limited or non-existent. A wind project, which adds jobs, diversifies the generation portfolio and reduces carbon emissions, may be among the most desirable projects for these institutions, which wield significant influence in many developing countries, can also act as a type of political insurance for a project, since a project with financing from them may be less likely to suffer nationalization or discriminatory government action.

2. Local Development Banks—Financing may also be available from the project country government itself as a way to promote renewable energy, such as that offered by Brazil’s development bank.

3. Export Credit Agencies—Depending on the type of turbine technology a project will employ, another source of financing may be from an export credit agency. These agencies, which exist to promote their home country’s products abroad, may provide financing to the project using turbines manufactured in the home country. The US Export Import Bank (US Exim), as an example, has provided financing to projects using General Electric wind turbines in Latin America.