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Solar Finance Breakfast Briefing

Steven M. Kaplan
Partner
202.263.3005
skaplan@mayerbrown.com

Nadav Klugman
Partner
312.701.8433
nklugman@mayerbrown.com

Anjali Garg
Associate
202.263.3419
agarg@mayerbrown.com

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Consumer Finance

MONTHLY BREAKFAST BRIEFING

Roadmap

- Background on the types of solar financing available to consumers and potential financing structures
- Overview of federal and state laws that may apply to residential solar products offered to consumers
- Key areas of potential legal risk associated with consumer financial protection laws
- Policy issues affecting the industry
- Examples of financing structures
- How to mitigate risk

INTRODUCTION

Types of Solar Financing

- Loans
  - Same as cash (deferred interest)
  - Fixed rate unsecured
  - Combination loans
- Leases
- Power purchase agreements (“PPAs”)
  - Purchasing power from a third-party owned solar system
- Property-assessed clean energy (“PACE”) programs
  - Financing secured with a lien on the underlying property
- Community solar
  - Solar subscription involving the purchase of solar credits

Financing Structures

- Partnership flip structures
- Sale-leaseback structures
- Pass-thru lease structures

POTENTIALLY APPLICABLE LAWS

Potentially Applicable Federal Consumer Financial Protection Laws

- Truth in Lending Act ("TILA") and Regulation Z
- Consumer Leasing Act (Regulation M – part of TILA)
- Prohibition on unfair, deceptive, or abusive acts or practices ("UDAAP" or "UDAP")
- Federal Trade Commission Holder Rule
- Electronic Funds Transfer Act and Regulation E
- Telephone Consumer Protection Act
- Servicemembers' Civil Relief Act
- Fair Credit Reporting Act and Regulation V
- Equal Credit Opportunity Act

Truth in Lending Act and Regulation Z

- 12 C.F.R. part 1026
- Regulation Z provides rules around disclosures that must be provided in connection with loan products.
- Penalties:
  – Actual damages and statutory damages (of not less than $200 and not more than $2,000).
  – Willingly and knowingly failing to comply with TILA requirements may also be subject to criminal liability, including up to a $5,000 fine and up to one year imprisonment.
  – TILA also provides for assignee liability for violations that are “apparent on the face” of the documents.

Consumer Leasing Act (Regulation M)

- 12 C.F.R. part 1013
- This regulation requires leases to include key contract terms such as payment schedules, security filings and warranties.
- Applies to leases not exceeding $54,600.
- Regulation M also contains restrictions around advertising leases.
- TILA penalties will apply.

UDAAP/UDAP

- Sections 1031 and 1036 of the Dodd-Frank Act
- Section 5 of the FTC Act
- "Advertisements" extends beyond the traditional print, television and radio mediums, and includes information contained on websites, sales practices at the point of sale and customer service scripts.
- Deception: an act or practice is deceptive if:
  - It misleads or is likely to mislead the consumer;
  - The consumer's interpretation of the act or practice is reasonable under the circumstances; and
  - The misleading act or practice is material.
- States also may have mini-UDAP statutes.

UDAAP/UDAP

- Consider the 4 P’s:
  - The **prominence** of the statement;
  - The manner in which the statement is **presented** to the consumer;
  - Whether the statement is **placed** in a location where a consumer can be reasonably expected to observe and understand it; and
  - In the case of a disclaimer, the **proximity** of the disclaimer to the statement qualified.

UDAAP/UDAP Reviews

- Disclosures for "triggering" terms, including the terms and conditions of credit product being offered
- Information regarding the impact of breaking the lease or loan term
- Disclosures regarding terms of the contract, including the length of the loan or lease, warranties, eligibility for tax credits, energy savings and environmental benefits
- Compliance with the FTC's Green Guides
- Compliance with the FTC's Endorsement Guide
- Use of the term "free"

UDAAP/UDAP Remedies

- CFPB:
  - Relief for consumers
  - Civil money penalties of up to $5,437 per day for a general violation, up to $27,186 per day for a reckless violation, and up to $1,087,450 million per day for a knowing violations
- FTC:
  - There is no private right of action under the FTC Act; however, many states have corollary statutes that may include private rights of action.
  - The FTC may impose penalties of up to $40,000 per violation on a violator.
  - The FTC can also require restitution, disgorgement, and/or reformation or rescission of contracts.

Holder Rule

- 16 C.F.R. § 433.2
- Sellers must include the following notice in certain consumer credit contracts (“Holder Notice”):
  – *Any holder of this consumer credit contract is subject to all claims and defenses which the debtor could assert against the seller of goods or services obtained pursuant hereto or with the proceeds hereof. Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder.*

Holder Rule

- The Holder Rule shifts the risk of a seller’s breach of contract or other misconduct to the assignee of that contract by enabling a consumer to raise defenses to defeat or diminish the right of a creditor to be paid under the contract, and arguably to assert affirmative claims against the holder.
- For example, if the solar contractor delivers defective panels to the consumer and then goes out of business, the consumer would then have recourse against the assignee of the associated credit contract.

Electronic Funds Transfer Act and Regulation E

- 12 C.F.R. part 1005
- Provides protections to consumers who effect electronic fund transfers, including preauthorized automatic payments from a consumer's accounts
  - Disclosures, notifications of changes in terms and procedures for error resolution
  - Extension of credit cannot be conditioned on payment via ACH

Electronic Funds Transfer Act and Regulation E

- Penalties:
  - No express assignee liability, but servicers must comply.
  - Statutory damages can range from $100 to $1,000 in an individual action and up to the lesser of $500,000 or 1% of the defendant's net worth in a class action.
  - Knowingly and willfully failing to comply with the EFTA may also result in criminal penalties, including a fine of not more than $5,000 and imprisonment for a term of up to a year per violation.

Telephone Consumer Protection Act ("TCPA")

- 47 U.S.C. § 227
- Provides restrictions on soliciting consumers via cell phones using auto-dialer technologies (including predictive dialers)
  - Prior express written consent is required for telemarketing calls.
- Penalties:
  - The TCPA provides consumers with a private right of action under which a plaintiff may recover actual monetary loss or $500 per violation.
  - For willful or knowing violations of the TCPA, a court may award treble damages, *i.e.*, up to $1,500 per violation.

Servicemembers Civil Relief Act

- 50 U.S.C. § 3901 *et seq.*
- SCRA generally protects members of the Armed Forces who are called to active duty, including, among other protections, the imposition of a 6% interest rate cap on obligations incurred prior to a call to active duty and protection from default judgments.
- SCRA applies directly to loan holders and their servicers.
- Penalties:
  - Civil action for monetary and equitable relief, attorneys' fees and costs and punitive damages.
  - Court also may award a civil penalty of up to $55,000 for a first violation, and up to $110,000 for any subsequent violation.
  - Knowing violations may subject a person to criminal penalties, including a fine, imprisonment for up to one year or both.

Fair Credit Reporting Act and Regulation V

- 12 C.F.R. part 1022
- Contains restrictions regarding the use of consumer reports for solicitations (i.e. prescreened offers) and in connection with credit decisions (i.e. using a consumer's FICO score in connection with offering a credit product).
- To the extent the provider uses consumer report information in making the credit decision, FCRA requires adverse action notices.
- In the context of servicing, if the servicer is reporting information about the consumer to credit reporting agencies, FCRA regulates that conduct (the "Furnisher Rule").

Fair Credit Reporting Act and Regulation V

- There is no express liability for a violation of FCRA for any party other than the violator.
- Penalties:
  - Consumer remediation
  - Civil money penalties
  - Negligent noncompliance with FCRA can result in actual damages, costs and reasonable attorneys' fees.
  - Willful noncompliance with FCRA can result in actual damages (of not less than $100 and not more than $1,000), punitive damages, costs, and reasonable attorneys' fees.

Equal Credit Opportunity Act and Regulation B

- 12 C.F.R. part 1002
- Prohibits creditors from discriminating on a prohibited basis in any aspect of a credit transaction, and requires that creditors provide certain notifications of action taken on an application for credit.
- Contains requirements to provide adverse action notices taken in connection with originating certain credit products.
- No express assignee liability, unless the assignee participates in the credit decision.
- Penalties:
  - Actual damages and punitive damages of up to $10,000 in an individual action and up to the lesser of $500,000 or 1% of the defendant’s net worth in a class action.
  - Costs and reasonable attorneys’ fees.

Potentially Applicable State Laws

- Licensing and notifications
  - Lending
  - Leasing
  - Servicing
  - Contractor-related licenses
- Home solicitation laws
  - 3-day right of rescission
  - Practice restrictions
- UCC-1 filings
- Do not call laws
- Mini-UDAP

POLICY ISSUES AFFECTING THE INDUSTRY

State Issues: Net Metering

- Net metering allows consumers to:
  - Provide unused energy generated from solar panels back to the energy grid.
  - Receive a credit for extra energy generated and returned to the grid.
- States take different approaches to net metering, including Nevada, which recently tried to phase-out net metering.
- Policy issues include whether the price assigned to this generated energy should be above or below the retail rate.
- Alternatives include compensating consumers for the value of the solar rate ("VOST") of the extra energy.

Tax Credits

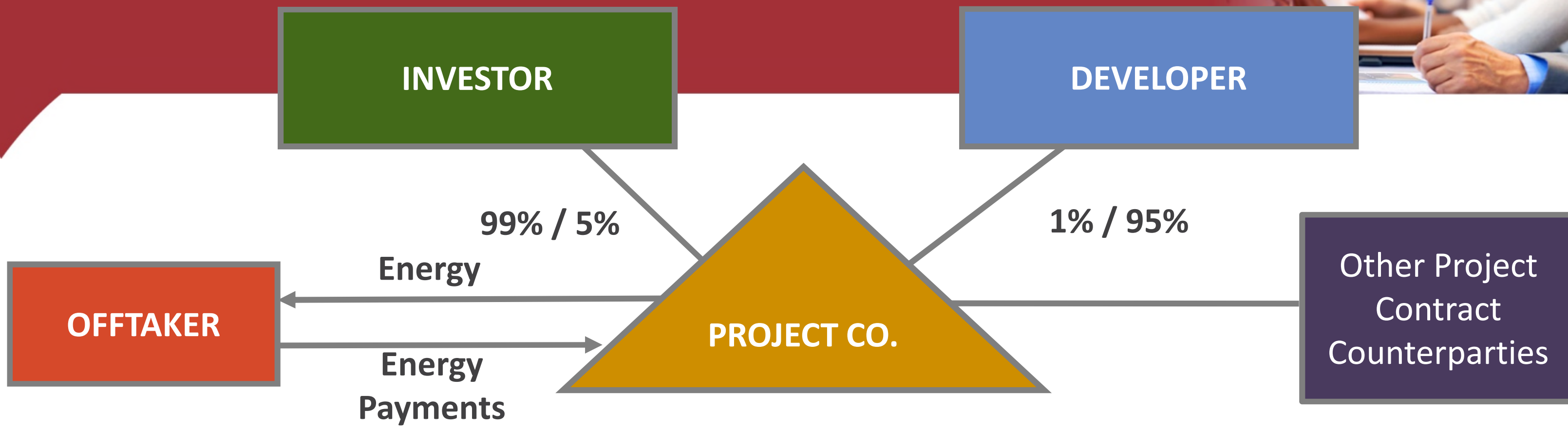
- Consumers may be eligible for energy-saving tax credits depending on the nature of the credit contract.
- Providers may sell the Solar Renewable Energy Credits ("SRECs") to the utility.
- States/localities may offer tax credits or rebates for solar usage.
- States/localities may impose monthly fees for solar usage that negate potential rebates or credits.
- States may use tax credits to make up for lower net metering benefits.

Scrutiny by State Regulators

- Even if the credit product is unsecured, solar providers may file a UCC-1.
- The UCC filing is a public notice indicating that the solar provider owns a piece of personal property attached to the real property.
- Regulators have expressed concern about whether those fixture filings represent a lien on the real property.
  – A lien could affect the consumer’s ability to obtain financing or sell the real property.
- Banks have successfully argued, in some foreclosure proceedings, that the panels are fixtures.

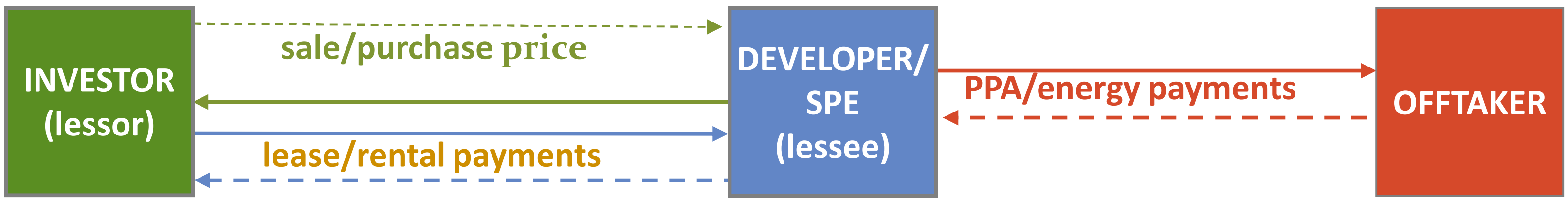
FINANCING STRUCTURES

Partnership Flip Structure



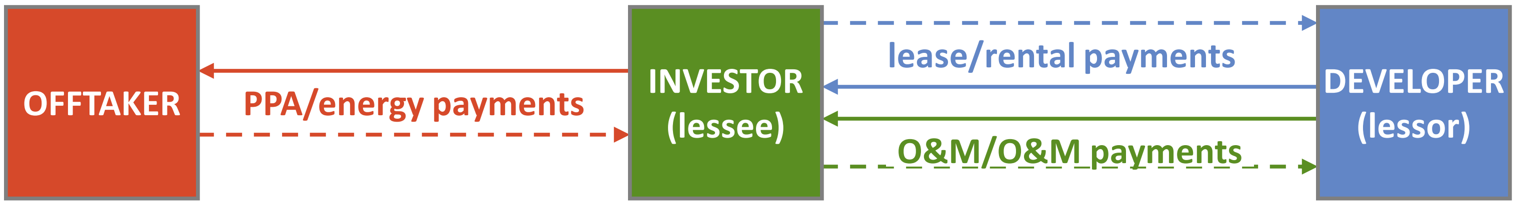
- A portfolio of consumer contracts (typically, either leases and PPAs, or loans, but not both) is financed with some combination of Developer equity, tax equity and debt.
  - Tax equity investor acquires an interest in the project company for cash
  - Tax equity investor typically purchases "tranches" of projects that have achieved a level of development, but have not been placed-in-service for tax purposes
  - The Developer typically takes out "back-leverage" debt, secured by the Developer's interest in Project Co., though in some cases tax equity investors have begun to permit debt at the Project Co. level, subject to forbearance rights
- Investor is initially allocated as much as 99% of tax items (ITC and depreciation) and subsequently "flips" down to 5% after achieving a specified after-tax IRR.
- Cash may be distributed in the same manner that tax items are allocated, or Developer may have a cash preference for some period.
- Developer generally has purchase option, either at a fixed time or after the later of the flip point and a fixed time after the 5-year ITC recapture period has expired.

Sale-Leaseback Structure



- Project is sold by Developer to Investor and then immediately leased back to Developer or more typically, an SPE-owned by Developer.
  - Developer delivers power to offtaker via PPA.
- Investor as owner/lessor claims:
  - ITC
  - Tax depreciation
- Developer as lessee retains option to purchase the project at the end of the lease term (and sometimes at one or more specified times prior to the end of the term) at fair market value.

Pass-Thru Lease Structure



- Project is leased by Developer to Investor and Developer makes election to allow lessee to claim the investment tax credit.
  - Lease may be prepaid or monetized by financing lease stream.
  - Developer operates the project on behalf of Investor pursuant to an operation & maintenance agreement (“O&M”).
  - Investor delivers power to offtaker via PPA.
- Developer as owner/lessor claims tax depreciation.
- Investor as lessee claims tax deductions for rental payments in lieu of tax depreciation.
- Project automatically reverts to Developer at the end of the lease term.

MITIGATING RISKS

Mitigating Risks

- Due diligence:
  - Licensing
  - Compliance with applicable laws
  - Compliance management system (board and management oversight, consumer complaints, training, policies and procedures, vendor management)
  - Consumer-facing documents
  - Provider due diligence of program sponsors/contractors selling the financing products
- Consumer satisfaction certificates/surveys
- Enforceable arbitration agreements
- Indemnities

QUESTIONS?

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