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ATTORNEYS AT LAW

MEMORANDUM

June 25, 2009

TO: NATIONAL RENEWABLE ENERGY LABORATORY

FROM: STOEL RIVES LLP

RE: Securities Law Issues Relating to Community Solar Projects

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Introductory Note

This memorandum is intended to provide a general overview of federal and Washington State securities laws and regulations that may apply to community solar programs, their sponsors and their respective officers, directors, employees and affiliates. We hope that readers will use this memorandum to get acquainted with the general principles of federal and Washington State securities laws and to gain a sense of the kinds of securities law issues that should concern them when they are setting up a community solar program.

In writing the memorandum, we have tried to emphasize the more important practical considerations without getting bogged down in technical detail that may be critical in any given situation but is not helpful in achieving the kind of general understanding that we are trying to establish. We intend this summary to provide those who are responsible for establishing community solar programs with a basis for a general understanding of some of the basic elements of securities law.

We do not intend the information in this memorandum to constitute legal advice with respect to any specific matter or any specific transaction.

This memorandum speaks as of its date. Laws and regulations are constantly changing. In the wake of recent events, we expect to see substantial changes in securities regulation over the next few years. Such regulations could have a significant direct impact on the matters discussed in this memorandum. In addition, readers should be aware that the securities laws of Washington State may differ substantially from the securities laws of other states.

1. Introduction

A Community Solar Program ("CSP") is commonly sponsored by a municipal-owned utility (the "Sponsor") that develops or purchases power from a solar power system ("SPS") that is operated by the Sponsor or a third-party. The Sponsor enters into contracts or arrangements ("Consumer Contracts") with members of the general public ("Consumers") who wish to purchase electricity generated by the SPS.

The Consumer Contracts vary widely in their terms. If a Consumer Contract is deemed to be a "security" under federal or state law, a Sponsor must comply with such securities laws and will incur substantially more time and expense in offering and selling the Consumer Contract. Conversely, if the Consumer Contract does not constitute a security then the Sponsor does not need to comply with such securities laws. The Sponsor, its directors, officers, and employees involved in the offer and sale of Consumer Contracts are subject to liability for failure to comply with applicable securities laws if the Consumer Contracts are deemed to be securities.

Consequently, a Sponsor will typically seek to structure its relationships with Consumers to minimize the likelihood that a security exists. This Memorandum discusses what factors should be considered in structuring a Consumer Contract in Washington so that the Sponsor can minimize the likelihood of creating a "security" and being subject to securities regulation under federal and Washington law.

2. Executive Summary

Applicable law contains no bright line test to determine whether a contract is a security. Whether a Consumer Contract will constitute a security is highly fact dependent and must be determined on a case-by-case basis. Sponsors should follow two steps in order to avoid, as much as is possible, a Consumer Contract being deemed a security. First, a Sponsor should design a form of Consumer Contract that does not meet either of the two tests commonly applied by courts and regulators to determine whether a contract is a security, the Investment Contract Test and the Risk Capital Test. Section 5 of this Memorandum explains each element of each test and includes recommendations on how a Sponsor can avoid meeting each element.

Second, Sponsors should consult with counsel to consider whether a specific form of Consumer Contract can be further revised to reduce the likelihood that it will be deemed to be a security. Unfortunately, even if a Consumer Contract does not qualify as a security under each of the Investment Contract Test and the Risk Capital Test, a Consumer Contract could nevertheless constitute a security. In general, the fewer of the elements of each of the Investment Contract Test and the Risk Capital Test that a Consumer Contract satisfies, the less likely that a Consumer Contract will be deemed to be a security.

3. Consequences of Consumer Contracts Being Deemed Securities

A. Registration Requirements and the Exemption for Public Sponsors.

Federal and Washington securities laws have two principal components relating to securities offerings: (i) registration requirements and (ii) full disclosure (or "anti-fraud")

provisions. If a Consumer Contract is deemed to be a security under federal law, the Sponsor of the CSP in offering and selling Consumer Contracts would be engaged in the offer and sale of its securities. In that case, the Sponsor cannot legally offer Consumer Contracts without first filing a registration statement with the Securities and Exchange Commission ("SEC") or complying with a statutory exemption from federal registration, if an exemption is available. Similarly, the offer or sale of a security in the State of Washington is prohibited unless the securities offering has been registered with the Securities Division of the Department of Financial Institutions (the "Washington Securities Division") or an exemption from state registration is available.

Preparing, filing, and obtaining regulatory clearance of a registration statement at either the federal or state level are costly and time consuming. Absent an available exemption at the federal and state levels, if a Sponsor fails to file a registration statement when legally required, the SEC and the Washington Securities Division, as applicable, may bring enforcement actions against the Sponsor, and the Sponsor may be subject to civil law suits by Consumers who entered into Consumer Contracts.

Consumer Contracts made by Sponsors that are political subdivisions of states ("Public Sponsors") often will be exempt from registration under both federal law and Washington securities laws.[1] Consequently, Consumer Contracts made by Public Sponsors will not be subject to this first requirement of securities offerings, the requirement to register the offering at the federal and state level. However, if the Consumer Contracts are made by an entity other than the Public Sponsor (such as an entity created by the Sponsor for the CSP), this exemption from the registration requirements for Public Sponsors may not be available.

B. Anti-Fraud Requirements – Applicable to All Issuers of Securities.

All Sponsors, including Public Sponsors, that are deemed to offer or sell securities are subject to the second requirement, the anti-fraud provisions of federal law and Washington law (collectively, "Anti-Fraud Provisions"). The Anti-Fraud Provisions essentially require full and accurate disclosure of all material information about a securities offering. Specifically, the Anti-Fraud Provisions make it unlawful for any person in connection with the sale of any security to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.[2] Thus, in a typical municipal bond offering, even if the offering is exempt from registration under federal and state securities laws, the issuer prepares and distributes to prospective bond purchasers an offering memorandum disclosing all material facts about the issuer, the bonds, and the offering, in order to comply with the Anti-Fraud Provisions. In the CSP context with a Public Sponsor, compliance with the Anti-Fraud Provisions generally would involve, among other measures, the Public Sponsor preparing and providing Consumers with a current and detailed disclosure document (comparable to an offering memorandum or

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[1] Federal Securities Act of 1933 §3(2), and Rev. Code Wash. §21.20.310(1)

[2] Securities Exchange Act of 1934, §10(b) and Rule 10b-5 thereunder; Rev. Code Wash. §21.20.010

prospectus) with information that would include a description of the business conducted by the Sponsor and the securities being offered, audited financial statements of the Sponsor, and risk factors relating to the Sponsor and the securities being offered.

Under Washington law, if a seller sells a security without providing the disclosure required by the Anti-Fraud Provisions, the purchaser can sue the seller for rescission, if the purchaser still owns the security, and recover the consideration paid for the security, plus 8% annual interest and attorneys fees. If the purchaser no longer owns the security, the purchaser can sue for the difference between what the purchaser paid for the security and what the purchaser received when the security was sold, plus 8% annual interest and attorneys fees.[3] Under federal law, a purchaser also has a right to sue the seller for a violation of the Anti-Fraud Provisions, although different proof requirements and damage provisions may apply.

Under Washington law, if a seller (such as hypothetically, a Sponsor of a CSP) were found liable for violation of the Anti-Fraud Provisions, then specified individuals related to the seller would be personally liable as well, unless those individuals proved a due diligence defense. Specifically, in that event, (i) every person who controls the seller, (ii) every director and officer of the seller and every person occupying a similar status or performing a similar function of the seller, and (iii) every employee who materially aids in the transaction, is jointly and severally liable to the same extent as the seller, unless such person can prove that he or she did not know, and in the exercise of reasonable care, could not have known of the existence of the facts by which liability allegedly exists.[4]

In summary, if a Consumer Contract is deemed to be a "security" under applicable law, even if that security is exempt from registration, a Sponsor and its directors, officers, and relevant employees would incur substantially more time and expense, and would be subject to a higher risk and extent of liability, than if the Consumer Contract does not constitute a security. Therefore, the goal of a Sponsor typically should be to structure its relationships with Consumers to minimize the likelihood that a security exists.

4. What is a "Security"

The definitions under federal law and Washington law each includes a long list of financial instruments and agreements which, unless the context otherwise requires, are "securities." While the definitions are not identical, both lists include, for example, any note, stock, bond, evidence of indebtedness, certificate of interest or participation in any profit sharing agreement, or investment contract. (The relevant definitions are set forth on the attached Exhibit A.) However, the title given to an instrument or agreement is not necessarily dispositive of whether a security exists, and there are few bright line rules as to when a security exists. But

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[3] Rev. Code Wash. §21.20.430(1)

[4] Rev. Code Wash. §21.20.430(3)

some guiding principles have emerged from case law and the pronouncements of securities administrators that provide guidance in applying the definitions to a particular arrangement.

The most relevant tests for analyzing whether the Consumer Contracts are securities are: (i) the Investment Contract Test under both federal and Washington law, and (ii) the Risk Capital test under Washington law. Under the Investment Contract Test, a security exists if there is a contract or arrangement whereby (i) a person invests money (ii) in a common enterprise (iii) with an expectation of profits (iv) solely or primarily from the efforts of others.[5] Under Washington law, the Risk Capital Test will find a security present when (i) money is invested (ii) in the risk capital of a venture with (iii) the expectation of some valuable benefit to the investor and (iv) the investor does not receive the right to exercise practical and actual control over the managerial decisions of the venture.[6]

5. Relevant Characteristics of CSPs

Consumers need not purchase interests that are called "stock" or "shares" in order for a Consumer Contract to be deemed a security under federal or Washington securities laws. Many contracts or other commercial arrangements that commonly might not be considered securities are in fact securities under federal or Washington law.

Whether or not a specific Consumer Contract is deemed a security will depend on the specific characteristics of a CSP, the terms of the Consumer Contract, and the expectations of the Consumer. A CSP commonly has the following characteristics that are relevant to this analysis: (i) the Consumers rely solely or primarily on the efforts of others to operate the SPS and administer the CSP; and (ii) the Consumers do not have the right to exercise practical control over managerial decisions of the CSP. Therefore, an element of each of the two common tests will most likely always be met due to the nature of a CSP. In order to determine the likelihood that a Consumer Contract will be deemed a security, it is necessary, therefore, to determine whether a particular CSP and form of Consumer Contract have other characteristics of a security under federal or Washington law.

CSPs may differ in the following ways relevant to the Investment Contract Test:

(i) whether Consumers are required to "invest money" in the CSP;

(ii) whether the CSP is a "common enterprise"; and

(iii) whether Consumers have an expectation of profits in entering into the Consumer Contracts.

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[5] *S.E.C. v. Howey Co.*, 328 US 293, 66 S Ct 1100, 90 L Ed 1244 (1946)

[6] Rev. Code Wash. §21.20.005(12)

Additionally, CSPs may differ in the following ways relevant to the Risk Capital Test:

(i) whether the Consumers expect to receive a valuable benefit in entering into Consumer Contracts (as described below, the statutes and case law do not determine whether social good is a valuable benefit); and

(ii) whether the amounts paid by Consumers under Consumer Contracts are part of the "risk capital" of the SPS.

A. Investment Contract Test

1. Investment of Money.

It is helpful to consider the distinction between a customary purchase of non-solar electricity and a Consumer Contract that requires the Consumer to make or agree to make any other payments in connection with a CSP. To the extent that a Consumer agrees to purchase solar power and to pay a specified, generally applicable rate for the solar power used and the Consumer is billed periodically based on recent past usage, just like the arrangements for purchasing other power, it is less likely that the Consumer would be viewed as making an investment of money in the CSP.

By contrast, to the extent that the Consumer is required to make payments in excess of the retail market rate for the solar power, it is more likely that the Consumer will be viewed as making an investment of money. Therefore, the rate charged for the solar power must be carefully considered so that it does not contain a component for the Consumer paying to acquire an interest in the SPS or the CSP. In addition, a payment is more likely to be an "investment" and is less like a customary consumer contract if the Consumer pays an amount up front in return for an undetermined amount of solar power over a period of time that may also be undetermined.

In order to reduce the likelihood that a Consumer Contract will be deemed to involve an investment of money, payments made under Consumer Contracts could be: (1) applicable to a specific, relatively short period of time (e.g. monthly, quarterly); (2) due after solar power is provided (or in a similar attribution manner by which non-solar electricity is billed); and (3) according to a specified, generally applicable market rate per unit that does not include a component that pays for the Consumer to acquire an interest in the SPS or the CSP. The Consumer Contract, pricing and billing arrangements and related materials, to the extent possible, could resemble a customary consumer purchase of non-solar electricity rather than an investment contract.

2. Common Enterprise.

A "common enterprise" is an enterprise in which the benefits to Consumers of entering into a Consumer Contact are interwoven and dependent upon the efforts and success of the Sponsor and/or the participation of other Consumers. A common enterprise can exist whether or not a Consumer Contract grants the Consumer ownership in an intangible interest (such as a percentage of the output of an SPS) or in a portion of a tangible object (such as a portion of a panel).

In order to reduce the likelihood that a CSP will be deemed to be a common enterprise, Consumer Contracts could not be marketed to emphasize that the amount of solar power that Consumers will receive from a Consumer Contract will depend on the participation of other Consumers or the success of the Sponsor in obtaining Consumers or in operating the SPS.

3. Expectation of Profits.

The more that Consumers have an expectation of profits, the more likely the Consumer Contract will be deemed a security. "Profits" can be present in many ways: (i) if an ongoing or periodic return (comparable to dividends) is paid or otherwise provided to Consumers based on the financial success of the enterprise; (ii) if the Consumer can terminate participation in the CSP and the Sponsor has the right or obligation to purchase the interest of the Consumer at an appreciated price (comparable to a redemption payment); (iii) if Consumers have the right to sell their interest in the CSP either to the Sponsor or a third party for more than they paid for the interest (comparable to reselling stock); or (iv) if upon a liquidation of the SPS, Consumers are entitled to receive some or all of the liquidation proceeds in excess of their cost (comparable to a liquidation right of stock). Solar programs in which a credit given to Consumers varies and is based on the energy generated by the SPS raise the issue of whether "profit" from the enterprise is being returned to the Consumers by means of the credit. In terms of expectations, the promotion of the CSP should not characterize the program as an investment opportunity.

In order to reduce the likelihood that a Consumer Contract will be deemed to be a involve the expectation of profits (1) the Sponsor could structure the Consumer Contracts to minimize the extent to which Consumers can realize a profit based on the success of the CSP, whether through an ongoing or a periodic return, a redemption, a resale, or a liquidation; (2) in particular, any credits to Consumers should not be based upon the Consumer's relative share of the profits of CSP or SFS, the success of the venture, or any other return on investment; (3) any description of such credits on statements or invoices should avoid any of those characterizations; (4) Consumer Contracts and any interests in a CSP or SFS should not be marketed or promoted by the Sponsor as an investment or an opportunity for Consumer to make money or to buy power for less than the normal market rate for solar power; and (5) if the price of solar power purchased by Consumers under the Consumer Contract is higher than the price of non-solar electricity, that could be included in the information about the CSP provided to prospective Consumers.

4. Transferability.

The more readily a Consumer can sell or otherwise transfer a Consumer Contract, an interest in a CSP or an ownership interest in part or all of SFS, in exchange for an appreciated value of that contract or interest, the more likely the Consumer Contract will be deemed involve an expectation of profits. One of the classic hallmarks of a security is the ability to transfer the interest for its present value, and as noted above, a sale is one method of realizing a profit from a security. Under Washington law, the Sponsor would have to put provisions in the Consumer Contracts to restrict the transferability of these contracts and interests and to limit the price at which they are permitted to be transferred.

A CSP could either prohibit the transferability of interests in a CSP or allow only limited transfers (such as upon the sale of a house that has a Consumer Contract for solar power) and only for a price that does not permit the Consumer to realize any appreciation of value of the Consumer Contract.

5. Description of CSP.

The terms used to describe the participation of Consumers in the CSP can be relevant to the securities law issues as well. For example, it is inadvisable to refer to Consumers acquiring "shares" or "stock" in the CSP, since those terms are the classic ones used to describe securities issued by a corporation. Use of those terms because of their securities connotations can create in Consumers an expectation of profits and other rights customarily associated with stock or shares are being offered in Consumers in the CSP. All marketing and promotional materials used for the CSP should refrain from making any statements suggesting that an investment or other opportunity to make money is being offered to Consumers who participate in the CSP.

B. The Risk Capital Test

1. Valuable Benefit.

The risk capital definition of a "security" requires only that a "valuable benefit" be acquired, rather than an expectation of profits. The test was first articulated by the California Supreme Court in *Silver Hills Country Club v. Sobieski.*[7] In that case, the promoters of a country club bought a ranch for a small down payment. They intended to develop the ranch into a country club and run it for a profit. The promoters made some improvements and then sold memberships to finance the purchase of the property and to make additional improvements, including building a golf course. The members were not entitled to share in the income or assets of the club, but they had the right to use club facilities while monthly dues were paid. The court held the memberships were securities and noted that "Only because the purchaser risks his capital along with other purchasers can there be any chance that the benefits of club membership will materialize."[8]

While "profit" emphasizes the monetary return that a Consumer may obtain from a Consumer Contract, the term "valuable benefit" is broader than profit. Some courts require that to be a "valuable benefit," the benefit received must be worth more than the amount paid for the benefit. However, other courts do not impose this requirement. A Consumer may be viewed as creating a valuable benefit by purchasing solar power, although many benefits, such as the beneficial effects on the environment, are not received by the Consumer, but by society as a whole. We did not find any case where a social good, such as the use of solar power instead of other electricity, was treated a benefit under the risk capital test. However, this is an area of the

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[7] 55 Cal2d 811, 13 Cal Rptr 186, 361 P2d 906 (1961)

[8] 55 Cal2d at 815

law where there have not yet been enough cases decided to establish what the boundaries of the law are under the risk capital test.

Sponsors who may be treated as raising the risk capital (discussed in section B.2 below) for a CSP from Consumers should be very careful not to promise or provide Consumers with any valuable benefit, beyond solar power at a market rate under customary consumer arrangements. The potential reach of the term "valuable benefit" combined with the lack of cases in Washington or other states establishing a clear meaning for this term makes it difficult to determine whether the valuable benefit element of the risk capital test is present in any situation.

Additionally, the more readily a Consumer can sell or otherwise transfer a Consumer Contract, an interest in a CSP or an ownership interest in part or all of SFS, in exchange for an appreciated value of that contract or interest, the more likely the Consumer Contract will be deemed involve the return of a valuable benefit for an investment in risk capital. Under Washington law, the Sponsor would have to put provisions in the Consumer Contracts to restrict the transferability of these contracts and interests and to limit the price at which they are permitted to be transferred. Use of those terms because of their securities connotations can create in Consumers an expectation of a valuable benefit resulting from an investment in risk capital.

2. Source of Funds for the "Risk Capital" of the CSP.

Under the risk capital test, the more that receipts from Consumer Contracts are subjected to the risks of the enterprise of a CSP, the more likely that the Consumer Contracts will be deemed to constitute the "risk capital" of the venture. Receipts from Consumer Contracts would be treated as risk capital when they are used to fund the construction of a SPS. But risk capital is not limited to capital used for the initial construction of an SPS. Receipts from Consumer Contracts might also be deemed risk capital if they are used to expand an SPS or for other capital improvements, particularly where the capital improvements may increase the amount of benefit to the Consumer. Even Consumer receipts used for working capital may be deemed risk capital where the Consumer may receive a valuable benefit from successful use of the working capital, such as if the CSP used the increased working capital to hire more employees to staff the SPS and make the operations of the SPS more efficient or to make the cost of the solar power to Consumers less expensive.

In order to reduce the likelihood that the receipts from Consumer Contracts will be deemed to be "risk capital," the construction, improvement and other major aspects of the CSP should be financed from other funds available to the Sponsor. The Consumer Contracts should not be marketed as a way for the CSP to obtain funds for specific capital improvements, operational programs, or other specific financing needs, particularly where the successful use of those funds is expected to increase the benefits to Consumers, whether by increased capacity, efficiency, economy of scale, reduced cost of solar power or other benefits.

6. Conclusion

The securities laws are intended to protect persons who invest money with an expectation that they will receive profits from the efforts of others, or under the Risk Capital test, who invest

money in the risk capital of a venture with the expectation of receipt of a valuable benefit when the investor does not have control over the managerial decisions of the venture. Over the years, some promoters have been very creative in their efforts to avoid the application of the definition of a security. However, the courts have been correspondingly diligent in focusing on the economic substance and the specifics of any particular arrangement to determine if the investors need the protections of the securities acts. This memorandum is intended to set forth some of the key factors that the courts tend to use and our general recommendations on structuring those factors in an effort to minimize the likelihood that a security exists. Ultimately, each situation will have to be judged on its specific facts using the factors and principles described above.

End of Memorandum

EXHIBIT A

1. Federal Definition of a Security. The definition of a "security" under federal law relevant to this discussion is in Section 2(a)(1) of the Securities Act of 1933, which provides, unless the context otherwise requires, that:

> The term "security" means any note, stock, treasury stock, security future, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

2. Washington Definition of a Security. The definition of a "security" under Washington law relevant to this discussion is in RCW 21.20.005(12)(a), which provides, unless the context otherwise requires, that:

> "Security" means any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; investment contract; investment of money or other consideration in the risk capital of a venture with the expectation of some valuable benefit to the investor where the investor does not receive the right to exercise practical and actual control over the managerial decisions of the venture; voting-trust certificate; certificate of deposit for a security; fractional undivided interest in an oil, gas, or mineral lease or in payments out of production under a lease, right, or royalty; charitable gift annuity; any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof; or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any security under this subsection. This subsection applies whether or not the security is evidenced by a written document.