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To: Lucas Snelling, Energize Vermont

From: Charles L. Merriman, Tarrant, Gillies, Merriman & Richardson



RE: Creation of a group net metering system in the Mad River Valley

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The Mad River Valley Energy Network (MRVEN) seeks to establish a solar farm in the Mad River Valley and Energize Vermont seeks to facilitate the process. The goal is to put ownership in the hands of local property owners (including businesses) in a manner that will allow the owners to enjoy the benefits of both the federal energy tax credit and reductions in electrical utility charges through Vermont's group net metering law. The parties anticipate there will be around 150 member owners, some of whom will be nonresidents. The solar farm will be located on leach fields owned by the Sugarbush Resort and will be subject to a multi-year lease.

You asked us to review the legal framework by which these goals can be achieved, recommend a course of action for achieving these goals, and provide some guidance in respect to securities and tax law which bear upon these plans.<sup>1</sup>

**Federal tax credit and legal structure.**

The Internal Revenue Code allows owners of qualifying energy property to take a 30% tax credit measured against the basis of the "energy property."<sup>2</sup> Because approximately 150 individuals wish to avail themselves of this tax credit as owners, the question becomes, what is the best entity structure to achieve this tax goal? The answer is the LLC.

An LLC can own the "energy property." An LLC, however, is a creation of state law. Consequently, the IRS does not recognize an LLC as a distinct, legal entity for federal tax purposes. Instead, the IRS requires LLCs to make an election—commonly referred to as "check

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<sup>1</sup> The enterprise will need to obtain a certificate of public good from the Public Service Board. That is a separate matter that is beyond the scope of this memo.

<sup>2</sup> Energy property includes the equipment used to generate electricity, not the land.

the box”—to be treated as a partnership or as a corporation. This works to your advantage, as it does many LLCs seeking pass-through tax credits or losses.

MRVEN should set up ownership of the “energy property” in an LLC and it should elect to have the LLC classified as a partnership. By so doing, the federal tax credit due to the LLC will pass through to the LLC members.

### **State taxes.**

A small, recent change in Vermont tax law suggests that the LLC will probably have to file composite returns and make composite payments at the middle marginal rate on behalf of its nonresident members. See 32 V.S.A. § 5920(b). This will add to the LLC’s administrative/accountant’s costs, but I don’t anticipate it being particularly burdensome. For nonresident members, the requirement will probably be welcomed as it will relieve the member from submitting the filing himself or herself. I don’t anticipate this being a problem for the LLC.

### **Securities issues.**

1. **SEC.** In general, any offer or sale of securities by an issuer must be registered with the SEC unless exempt. Provided membership sales in the LLC aggregate to less than \$1 million in a twelve month period, Ruled 504 of Regulation D of the Securities Act of 1933 exempts these transactions from registration with the SEC. Provided the issuer stays under the \$1 million threshold, the issuer can sell LLC memberships to an unlimited number of accredited or non-accredited investors in a Rule 504 offering.

2. **State regulation.** The issuer, however, will still need to register with the Securities Division of the Vermont Department of Banking, Insurance, Securities and Health Care Administration and with its sister-divisions in every state in which LLC members or potential purchasers reside. Thus, if a nonresident homeowner were to express an interest in becoming a member, the issuer would need to register in the home state of the nonresident prior to offering the membership to the nonresident.

3. **Registration.** Registration with the Securities Division is not onerous. It will require completion of a disclosure document, similar in scope to the copy I gave you of the one submitted by Magic Mountain to the Division, and the filing of financial statements.

Vermont securities law allows a party to request a “no action” letter from the commissioner. I have discussed in some detail your plans with the Securities Division and they encouraged us to submit a no action request along with the disclosure document and the financials. From our conversations, it is clear that the Division recognizes the worth of your endeavor and that your endeavor forwards policy goals of the legislature. I am relatively confident that the LLC will obtain a no action letter and support for the project from the commissioner.

### **Advertising and soliciting.**

Marketing the project is one area where we must proceed with caution. Securities regulation is vitally concerned with protecting “unsophisticated” investors from being led to invest, or be allowed to invest, in risky ventures that are beyond their means to sustain should there be a loss. By registering an offering with the SEC, the SEC is accorded the opportunity to scrutinize and approve or reject the sales prospectus of the offering.

For exempt offerings, the SEC partly attempts to protect the unsophisticated investor by putting heavy limitations on advertising and solicitations—and then leaves the actual task of regulation up to the individual states. In general, an issuer cannot advertise exempt offerings to more than 35 unsophisticated (in this case, non-accredited) investors. There is, however, an exception to the definition of solicitation, which is consistent with the goal of providing protection to unsophisticated investors.

In an SEC interpretation approving the website of an entity making an exempt offering, the SEC wrote “a general solicitation is not present when there is a pre-existing, substantive relationship between an issuer, or its broker-dealer, and offerees.” Later rulings from the SEC supported—albeit with reservation—the notion that a nonbroker-dealer could be the entity which establishes the pre-existing, substantive relationship with the offerees. In short the SEC is looking for an honest gatekeeper—someone who can provide objective scrutiny of the relative sophistication of the potential investor prior to the investment and will stop the investor if he/she cannot sustain the risk of the investment. However, as indicated above, the actual oversight of the exempt offering will reside with the state securities divisions, not the SEC.

I told the Vermont Securities Division that Energize Vermont would not be a member of the LLC. We then discussed whether Energize Vermont could fill the role of gatekeeper, thereby allowing Energize Vermont to reach out to potential investors on behalf of the LLC. The Securities Division was cautiously supportive of Energize Vermont filling that role. It could not commit fully to the idea, given that we have not yet set up the LLC or submitted a disclosure document and financials. Nevertheless, I am relatively confident the Division will accept you in that role.

It is imperative that we meet with the Division to discuss the plan and that we work closely with the Division to establish our structure. This is decidedly a situation in which the regulatory authority is on your side, willing to work with you to ensure your compliance and your success. To my satisfaction, all systems are go; we now need to work on the particulars.