Pattern Energy Group Inc.
Form 10-Q
August 05, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016.
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-36087

PATTERN ENERGY GROUP INC.
(Exact name of Registrant as specified in its charter)

Delaware	90-0893251
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Pier 1, Bay 3, San Francisco, CA 94111
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (415) 283-4000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer x Accelerated filer ¨
Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes ¨ No x
As of August 3, 2016, there were 76,170,183 shares of Class A common stock outstanding with par value of $0.01 per share.

PATTERN ENERGY GROUP INC.
REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016
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CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements and information in this Quarterly Report on Form 10-Q (Form 10-Q) may constitute “forward-looking statements.” You can identify these statements by forward-looking words such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "potential," "should," "will," "would," or similar words. You should read statements that contain these words carefully because they discuss our current plans, strategies, prospects, and expectations concerning our business, operating results, financial condition, and other similar matters. While we believe that these forward-looking statements are reasonable as and when made, there may be events in the future that we are not able to predict accurately or control, and there can be no assurance that future developments affecting our business will be those that we anticipate. Our forward-looking statements involve significant risks and uncertainties (some of which are beyond our control) and assumptions that could cause actual results to differ materially from our historical experience and our present expectations or projections. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to, those summarized below:

- our ability to complete the acquisition of power projects;
- our ability to complete construction of our construction projects and transition them into financially successful operating projects;
- fluctuations in supply, demand, prices and other conditions for electricity, other commodities and renewable energy credits (RECs);
- our electricity generation, our projections thereof and factors affecting production, including wind and other conditions, other weather conditions, availability and curtailment;
- changes in law, including applicable tax laws;
- public response to and changes in the local, state, provincial and federal regulatory framework affecting renewable energy projects, including the U.S. federal production tax credit (PTC), investment tax credit (ITC) and potential reductions in Renewable Portfolio Standards (RPS) requirements;
- the ability of our counterparties to satisfy their financial commitments or business obligations;
- the availability of financing, including tax equity financing, for our power projects;
- an increase in interest rates;
- our substantial short-term and long-term indebtedness, including additional debt in the future;
- competition from other power project developers;
- development constraints, including the availability of interconnection and transmission;
- potential environmental liabilities and the cost and conditions of compliance with applicable environmental laws and regulations;
- our ability to operate our business efficiently, manage capital expenditures and costs effectively and generate cash flow;
- our ability to retain and attract executive officers and key employees;
- our ability to keep pace with and take advantage of new technologies;
- the effects of litigation, including administrative and other proceedings or investigations, relating to our wind power projects under construction and those in operation;
- conditions in energy markets as well as financial markets generally, which will be affected by interest rates, foreign currency exchange rate fluctuations and general economic conditions;
- the effectiveness of our currency risk management program;
- the effective life and cost of maintenance of our wind turbines and other equipment;
- the increased costs of, and tariffs on, spare parts;
- scarcity of necessary equipment;
- negative public or community response to wind power projects;
- the value of collateral in the event of liquidation; and
- other factors discussed under “Risk Factors.”

For additional information regarding known material factors that could cause our actual results to differ from our projected results, please see Part II, "Item 1A. Risk Factors" in this Form 10-Q and Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2015.
Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date hereof. We undertake no obligation to publicly update or revise any forward-looking statements after the date they are made, whether as a result of new information, future events or otherwise.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Pattern Energy Group Inc.
Consolidated Balance Sheets
(In thousands of U.S. Dollars, except share data)
(Unaudited)

	June 30, 2016	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents (Note 5)	$87,641	$94,808
Restricted cash (Note 5)	12,228	14,609
Funds deposited by counterparty	49,480	—
Trade receivables (Note 5)	49,329	45,292
Related party receivable	689	734
Reimbursable interconnection costs	—	38
Derivative assets, current	18,381	24,338
Prepaid expenses (Note 5)	11,128	14,498
Other current assets (Note 5)	10,102	6,891
Deferred financing costs, current, net of accumulated amortization of $6,310 and $5,192 as of June 30, 2016 and December 31, 2015, respectively	2,158	2,121
Total current assets	241,136	203,329
Restricted cash (Note 5)	16,372	36,875
Property, plant and equipment, net of accumulated depreciation of $498,867 and $409,161 as of June 30, 2016 and December 31, 2015, respectively (Note 5)	3,225,658	3,294,620
Unconsolidated investments	92,792	116,473
Derivative assets	31,704	44,014
Deferred financing costs	3,572	4,572
Net deferred tax assets	10,888	6,804
Finite-lived intangible assets, net of accumulated amortization of $7,734 and $4,357 as of June 30, 2016 and December 31, 2015, respectively (Note 5)	94,256	97,722
Other assets (Note 5)	23,930	25,183
Total assets	$3,740,308	$3,829,592
Liabilities and equity		
Current liabilities:		
Accounts payable and other accrued liabilities (Note 5)	$29,923	$42,776
Accrued construction costs (Note 5)	4,494	23,565
Counterparty deposit liability	49,480	—
Related party payable	833	1,646
Accrued interest (Note 5)	8,916	9,035
Dividends payable	29,711	28,022
Derivative liabilities, current	15,711	14,343
Revolving credit facility	335,000	355,000
Current portion of long-term debt, net of financing costs of $3,638 and $3,671 as of June 30, 2016 and December 31, 2015, respectively	45,721	44,144
Other current liabilities (Note 5)	2,557	2,156
Total current liabilities	522,346	520,687
	1,163,229	1,174,380

Long-term debt, net of financing costs of $21,036 and $22,632 as of June 30, 2016 and December 31, 2015, respectively		
Convertible senior notes, net of financing costs of $4,449 and $5,014 as of June 30, 2016 and December 31, 2015, respectively	200,103	197,362
Derivative liabilities	69,842	28,659
Net deferred tax liabilities	22,860	22,183
Finite-lived intangible liability, net of accumulated amortization of $3,902 and $2,168 as of June 30, 2016 and December 31, 2015, respectively	56,398	58,132
Other long-term liabilities (Note 5)	60,004	52,427
Total liabilities	2,094,782	2,053,830
Commitments and contingencies (Note 15)		
Equity:		
Class A common stock, $0.01 par value per share: 500,000,000 shares authorized; 74,930,002 and 74,644,141 shares outstanding as of June 30, 2016 and December 31, 2015, respectively	750	747
Additional paid-in capital	927,812	982,814
Accumulated loss	(104,052)	(77,159)
Accumulated other comprehensive loss	(94,037)	(73,325)
Treasury stock, at cost; 67,344 and 65,301 shares of Class A common stock as of June 30, 2016 and December 31, 2015, respectively	(1,617)	(1,577)
Total equity before noncontrolling interest	728,856	831,500
Noncontrolling interest	916,670	944,262
Total equity	1,645,526	1,775,762
Total liabilities and equity	$3,740,308	$3,829,592

See accompanying notes to consolidated financial statements.

Pattern Energy Group Inc.
Consolidated Statements of Operations
(In thousands of U.S. Dollars, except share data)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Revenue:				
Electricity sales	$91,370	$ 82,871	$177,033	$146,996
Related party revenue	1,332	872	2,547	1,675
Other revenue	736	928	1,497	866
Total revenue	93,438	84,671	181,077	149,537
Cost of revenue:				
Project expense	33,359	27,981	65,605	53,227
Depreciation and accretion	43,678	34,342	87,089	63,398
Total cost of revenue	77,037	62,323	152,694	116,625
Gross profit	16,401	22,348	28,383	32,912
Operating expenses:				
General and administrative	10,362	8,870	19,931	15,091
Related party general and administrative	1,931	1,621	3,828	3,429
Total operating expenses	12,293	10,491	23,759	18,520
Operating income	4,108	11,857	4,624	14,392
Other income (expense):				
Interest expense	(21,275)	(18,943)	(42,336)	(36,861)
Gain (loss) on undesignated derivatives, net	(5,879)	4,178	(19,510)	778
Earnings in unconsolidated investments, net	7,240	13,801	11,070	10,719
Related party income	1,097	756	2,104	1,424
Net loss on transactions	(72)	(1,305)	(39)	(2,589)
Other income (expense), net	564	(1,084)	2,120	(1,408)
Total other expense	(18,325)	(2,597)	(46,591)	(27,937)
Net income (loss) before income tax	(14,217)	9,260	(41,967)	(13,545)
Tax provision	1,429	3,603	2,727	2,857
Net income (loss)	(15,646)	5,657	(44,694)	(16,402)
Net loss attributable to noncontrolling interest	(12,423)	(8,660)	(17,801)	(10,820)
Net income (loss) attributable to Pattern Energy	$(3,223)	$ 14,317	$(26,893)	$(5,582)
Weighted average number of shares:				
Class A common stock - Basic	74,443,901	68,943,707	74,440,950	67,426,286
Class A common stock - Diluted	74,443,901	69,147,260	74,440,950	67,426,286
Earnings (loss) per share				
Class A common stock:				
Basic earnings (loss) per share	$(0.04)	$ 0.21	$(0.36)	$(0.08)
Diluted earnings (loss) per share	$(0.04)	$ 0.21	$(0.36)	$(0.08)
Dividends declared per Class A common share	$0.39	$ 0.35	$0.77	$0.71

See accompanying notes to consolidated financial statements.

Pattern Energy Group Inc.
Consolidated Statements of Comprehensive Income (Loss)
(In thousands of U.S. Dollars)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Net income (loss)	$(15,646)	$5,657	$(44,694)	$(16,402)
Other comprehensive income (loss):				
Foreign currency translation, net of zero tax impact	780	(498)	11,642	(9,692)
Derivative activity:				
Effective portion of change in fair market value of derivatives, net of tax benefit (provision) of $1,379, ($628), $4,102, and $56, respectively	(9,964)	10,100	(30,661)	(657)
Reclassifications to net loss, net of tax impact of $281, $168, $583 and $341, respectively	2,721	3,465	5,623	6,956
Total change in effective portion of change in fair market value of derivatives	(7,243)	13,565	(25,038)	6,299
Proportionate share of equity investee’s derivative activity:				
Effective portion of change in fair market value of derivatives, net of tax benefit (provision) of $1,296, ($7), $3,969 and $859, respectively	(3,594)	20	(11,008)	(2,382)
Reclassifications to net loss, net of tax impact of $470, $206, $922 and $377, respectively	1,304	571	2,557	1,045
Total change in effective portion of change in fair market value of derivatives	(2,290)	591	(8,451)	(1,337)
Total other comprehensive income (loss), net of tax	(8,753)	13,658	(21,847)	(4,730)
Comprehensive income (loss)	(24,399)	19,315	(66,541)	(21,132)
Less comprehensive loss attributable to noncontrolling interest:				
Net loss attributable to noncontrolling interest	(12,423)	(8,660)	(17,801)	(10,820)
Derivative activity:				
Effective portion of change in fair market value of derivatives, net of tax benefit (provision) of $164, ($188), $507 and $17, respectively	(442)	955	(1,370)	(985)
Reclassifications to net loss, net of tax impact of $40, $50, $87 and $102, respectively	107	905	235	1,821
Total change in effective portion of change in fair market value of derivatives	(335)	1,860	(1,135)	836
Comprehensive loss attributable to noncontrolling interest	(12,758)	(6,800)	(18,936)	(9,984)
Comprehensive income (loss) attributable to Pattern Energy	$(11,641)	$26,115	$(47,605)	$(11,148)

See accompanying notes to consolidated financial statements.

Pattern Energy Group Inc.
Consolidated Statements of Stockholders' Equity
(In thousands of U.S. Dollars, except share data)
(Unaudited)

	Class A Common Stock		Treasury Stock							
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Accumulated Loss	Accumulated Other Comprehensive Loss	Total	Noncontrolling Interest	Total Equity
Balances at December 31, 2014	62,088,306	$621	(25,465)	$(717)	$723,938	$(44,626)	$(45,068)	$634,148	$530,586	$1,164,734
Issuance of Class A common stock related to the public offering, net of issuance costs	7,000,000	70	—	—	196,089	—	—	196,159	—	196,159
Issuance of Class A common stock under equity incentive award plan	186,136	2	—	—	(2)	—	—	—	—	—
Repurchase of shares for employee tax withholding	—	—	(11,058)	(310)	—	—	—	(310)	—	(310)
Stock-based compensation	—	—	—	—	1,989	—	—	1,989	—	1,989
Dividends declared	—	—	—	—	(48,003)	—	—	(48,003)	—	(48,003)
Distributions to noncontrolling interests	—	—	—	—	—	—	—	—	(1,511)	(1,511)
Acquisition of Post Rock	—	—	—	—	—	—	—	—	205,100	205,100
Other	—	—	—	—	4	—	—	4	—	4
Net loss	—	—	—	—	—	(5,582)	—	(5,582)	(10,820)	(16,402)
Other comprehensive income (loss), net of tax	—	—	—	—	—	—	(5,566)	(5,566)	836	(4,730)
Balances at June 30, 2015	69,274,442	$693	(36,523)	$(1,027)	$874,015	$(50,208)	$(50,634)	$772,839	$724,191	$1,497,030
	74,709,442	$747	(65,301)	$(1,577)	$982,814	$(77,159)	$(73,325)	$831,500	$944,262	$1,775,762

Balances at December 31, 2015										
Issuance of Class A common stock under equity incentive award plan	287,904	3	—	—	(3)	—	—	—	—	—
Repurchase of shares for employee tax withholding	—	—	(2,043)	(40)	—	—	—	(40)	—	(40)
Stock-based compensation	—	—	—	—	2,777	—	—	2,777	—	2,777
Dividends declared	—	—	—	—	(57,810)	—	—	(57,810)	—	(57,810)
Distributions to noncontrolling interests	—	—	—	—	—	—	—	—	(8,187)	(8,187)
Other	—	—	—	—	34	—	—	34	(469)	(435)
Net loss	—	—	—	—	—	(26,893)	—	(26,893)	(17,801)	(44,694)
Other comprehensive loss, net of tax	—	—	—	—	—	—	(20,712)	(20,712)	(1,135)	(21,847)
Balances at June 30, 2016	74,997,346	$750	(67,344)	$(1,617)	$927,812	$(104,052)	$(94,037)	$728,856	$916,670	$1,645,526

See accompanying notes to consolidated financial statements.

Pattern Energy Group Inc.
Consolidated Statements of Cash Flows
(In thousands of U.S. Dollars)
(Unaudited)

	Six months ended June 30,	
	2016	2015
Operating activities		
Net loss	$(44,694)	$(16,402)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and accretion	87,089	63,841
Amortization of financing costs	3,498	3,636
Amortization of debt discount/premium, net	2,074	—
Amortization of power purchase agreements, net	1,507	—
Loss on derivatives, net	32,209	333
Stock-based compensation	2,777	1,989
Deferred taxes	2,487	2,616
Earnings in unconsolidated investments	(11,070)	(10,719)
Distributions from unconsolidated investments	377	—
Other reconciling items	(965)	1,170
Changes in operating assets and liabilities:		
Funds deposited by counterparty	(49,480)	—
Trade receivables	(3,753)	(4,924)
Prepaid expenses	3,400	3,107
Other current assets	(2,998)	334
Other assets (non-current)	1,839	(99)
Accounts payable and other accrued liabilities	(9,631)	615
Counterparty deposit liability	49,480	—
Related party receivable/payable	(735)	(7)
Accrued interest	(178)	689
Other current liabilities	381	1,151
Long-term liabilities	6,363	1,270
Increase in restricted cash	(986)	—
Net cash provided by operating activities	68,991	48,600
Investing activities		
Cash paid for acquisitions, net of cash acquired	—	(404,377)
Decrease in restricted cash	20,561	25,277
Increase in restricted cash	(64)	(6,966)
Capital expenditures	(25,953)	(216,499)
Distributions from unconsolidated investments	31,774	13,847
Reimbursable interconnection receivable	38	1,246
Other assets (non-current)	—	(6,074)
Other investing activities	(163)	—
Net cash provided by (used in) investing activities	26,193	(593,546)

Pattern Energy Group Inc.
Consolidated Statements of Cash Flows
(In thousands of U.S. Dollars)
(Unaudited)

	Six months ended June 30,	
	2016	2015
Financing activities		
Proceeds from public offering, net of issuance costs	$—	$196,591
Repurchase of shares for employee tax withholding	(40)	(310)
Dividends paid	(56,097)	(39,170)
Payment for deferred equity issuance costs	(677)	(2,204)
Capital distributions - noncontrolling interest	(8,187)	(1,511)
Decrease in restricted cash	25,714	18,532
Increase in restricted cash	(22,342)	(21,718)
Refund of deposit for letters of credit	—	3,425
Payment for deferred financing costs	(134)	(5,614)
Proceeds from revolving credit facility	20,000	250,000
Repayment of revolving credit facility	(40,000)	(50,000)
Proceeds from construction loans	—	206,184
Repayment of long-term debt	(22,262)	(25,383)
Other financing activities	(343)	—
Net cash provided by (used in) financing activities	(104,368)	528,822
Effect of exchange rate changes on cash and cash equivalents	2,017	(2,596)
Net change in cash and cash equivalents	(7,167)	(18,720)
Cash and cash equivalents at beginning of period	94,808	101,656
Cash and cash equivalents at end of period	$87,641	$82,936
Supplemental disclosures		
Cash payments for income taxes	$155	$186
Cash payments for interest expense, net of capitalized interest	36,535	24,447
Acquired property, plant and equipment from acquisitions	—	579,712
Schedule of non-cash activities		
Change in property, plant and equipment	1,302	21,094

See accompanying notes to consolidated financial statements.

Pattern Energy Group Inc.
Notes to Consolidated Financial Statements
(Unaudited)

1. Organization

Pattern Energy Group Inc. (Pattern Energy or the Company) was organized in the state of Delaware on October 2, 2012. Pattern Energy is an independent energy generation company focused on constructing, owning and operating energy projects with long-term energy sales contracts located in the United States, Canada and Chile. Pattern Development owns a 23% interest in the Company. Pattern Development is a leading developer of renewable energy and transmission projects.

The Company consists of the consolidated operations of certain entities and assets contributed by, or purchased principally from, Pattern Development, except for purchases of Lost Creek, Post Rock and certain additional interests in El Arrayán (each as defined below, which were purchased from third-parties). Each of the Company's wind projects are consolidated into the Company's subsidiaries which are organized by geographic location as follows:

- Pattern US Operations Holdings LLC (which consists primarily of 100% ownership of Hatchet Ridge Wind, LLC (Hatchet Ridge), Spring Valley Wind LLC (Spring Valley), Pattern Santa Isabel LLC (Santa Isabel), Ocotillo Express LLC (Ocotillo), Pattern Gulf Wind LLC (Gulf Wind) and Lost Creek Wind, LLC (Lost Creek), as well as the following consolidated controlling interest in Pattern Panhandle Wind LLC (Panhandle 1), Pattern Panhandle Wind 2 LLC (Panhandle 2), Post Rock Wind Power Project, LLC (Post Rock), Logan's Gap Wind LLC (Logan's Gap) and Fowler Ridge IV Wind Farm LLC (Amazon Wind Farm Fowler Ridge));
- Pattern Canada Operations Holdings ULC (which consists primarily of 100% ownership of St. Joseph Windfarm Inc. (St. Joseph) and noncontrolling interests in South Kent Wind LP (South Kent), Grand Renewable Wind LP (Grand) and K2 Wind Ontario Limited Partnership (K2), which are accounted for as equity method investments); and
- Pattern Chile Holdings LLC (which includes a controlling interest in Parque Eólico El Arrayán SpA (El Arrayán)).

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The consolidated financial statements include the results of wholly-owned and partially-owned subsidiaries in which the Company has a controlling interest with all significant intercompany accounts and transactions eliminated in consolidation.

Unaudited Interim Financial Information

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) for interim financial information and Article 10 of Regulation S-X issued by the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, the interim financial information reflects all adjustments of a normal recurring nature, necessary for a fair presentation of the Company’s financial position at June 30, 2016, the results of operations and comprehensive income (loss) for the three and six months ended June 30, 2016 and 2015, respectively, and the cash flows for the six months ended June 30, 2016 and 2015, respectively. The consolidated balance sheet at December 31, 2015 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. This Form 10-Q should be read in conjunction with the consolidated financial statements and accompanying notes contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

Use of Estimates

The preparation of the financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates, and such differences may be material to the financial statements.

Reclassification
Certain prior period balances have been reclassified to conform to the current period presentation in the Company’s consolidated financial statements and the accompanying notes.
Funds Deposited by Counterparty
As a result of a counterparty's credit rating downgrade, the Company received cash collateral related to an energy derivative agreement, as discussed in Note 10, Derivative Instruments. The Company does not have the right to pledge, invest, or use the cash collateral for general corporate purposes. As of June 30, 2016, the Company has recorded a current asset of $49.5 million to funds deposited by counterparty and a current liability of $49.5 million to counterparty deposit liability representing the cash collateral received and corresponding obligation to return the cash collateral, respectively. The cash was deposited into a separate custodial account for which the Company is not entitled to the interest earned on the cash collateral.
Recently Issued Accounting Standards
In addition to recently issued accounting standards disclosed in Note 2, Summary of Significant Accounting Policies, in the Notes to Consolidated Financial Statements, contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015, the Company is evaluating or has adopted the following recently issued accounting standards.
In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, Financial Instruments —Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13), which requires the measurement of all expected credit losses for financial assets including trade receivables held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. ASU 2016-13 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently assessing the future impact of this update on its consolidated financial statements and related disclosures.
In May 2014, the FASB issued ASU 2014-09, which creates FASB Accounting Standards Codification (ASC) Topic 606, Revenue from Contracts with Customers and supersedes ASC Topic 605, Revenue Recognition (ASU 2014-09). The guidance replaces industry-specific guidance and establishes a single five-step model to identify and recognize revenue. The core principle of the guidance is that an entity should recognize revenue upon transfer of control of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. Additionally, the guidance requires the entity to disclose further quantitative and qualitative information regarding the nature and amount of revenues arising from contracts with customers, as well as other information about the significant judgments and estimates used in recognizing revenues from contracts with customers. The effective date of ASU 2014-09 was deferred by the issuance of ASU 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date, (Topic 606) by one year to make the guidance of ASU 2014-09 effective for annual reporting periods beginning after December 15, 2017, including interim periods therein. Early adoption is permitted, but not prior to the original effective date, which was for annual reporting periods beginning after December 15, 2016. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606) Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which clarifies how to apply the implementation guidance on principal versus agent considerations related to the sale of goods or services to a customer as updated by ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606) Identifying Performance Obligations and Licensing, which clarifies two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance, while retaining the related principles for those areas, as updated by ASU 2014-09. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients (ASU 2016-12), which makes narrow scope amendments to Topic 606 including implementation issues on collectability, non-cash consideration and completed contracts at transition. The Company is currently assessing the future impact of this guidance on its consolidated financial statements and related disclosures and expects to adopt these updates beginning January 1, 2018.
In March 2016, the FASB issued ASU 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09), which simplifies several aspects of the accounting for share-based payment award transactions, including the income tax consequences, classification of awards as either

equity or liabilities, and classification on the statement of cash flows. ASU 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. The Company is currently assessing the future impact of this update on its consolidated financial statements and related disclosures.

In March 2016, the FASB issued ASU 2016-05, Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (ASU 2016-05), which clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria remain intact. ASU 2016-05 is effective for annual periods beginning after December 15, 2017, including interim reporting periods therein, with early adoption permitted. The adoption of ASU 2016-05 on January 1, 2016 had no impact on the Company's consolidated financial statements and related disclosures.

In September 2015, the FASB issued ASU 2015-16, Business Combinations: Simplifying the Accounting for Measurement-Period Adjustments (ASU 2015-16), which requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments under ASU 2015-16 require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. ASU 2015-16 also requires an entity to present separately on the face of the income statement or disclose in the notes the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods, if the adjustment to the provisional amounts had been recognized as of the acquisition date. ASU 2015-16 is effective for annual reporting periods beginning after December 15, 2015 and interim periods within those fiscal years. The amendments in this update should be applied prospectively to adjustments to provisional amounts that occur after the effective date with earlier application permitted for financial statements that have not been issued. The adoption of ASU 2015-16 on January 1, 2016 did not have a material impact on the Company’s consolidated financial statements and related disclosures.

In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis (ASU 2015-02), which modifies the analysis that companies must perform in order to determine whether a legal entity should be consolidated. ASU 2015-02 simplifies current guidance by reducing the number of consolidation models; eliminating the risk that a reporting entity may have to consolidate based on a fee arrangement with another legal entity; placing more weight on the risk of loss in order to identify the party that has a controlling financial interest; reducing the number of instances that related party guidance needs to be applied when determining the party that has a controlling financial interest; and changing rules for companies in certain industries that ordinarily employ limited partnership or variable interest entity (VIE) structures. ASU 2015-02 is effective for public companies for fiscal years beginning after December 15, 2015 and interim periods within those fiscal periods. The adoption of ASU 2015-02 in the quarter ended March 31, 2016 resulted in certain entities formerly consolidated under the voting interest consolidation model to be consolidated in accordance with the variable interest model as further described in Note 5, Variable Interest Entities. The adoption of ASU 2015-02 did not result in the deconsolidation of any previously consolidated entities or the consolidation of any previously unconsolidated entities and had no impact on the Company's results of operations, and cash flows.

In June 2014, the FASB issued ASU 2014-12, Compensation – Stock Compensation (ASU 2014-12), which requires an entity to treat a performance target that affects vesting that could be achieved after an employee completes the requisite service period as a performance condition. The performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. ASU 2014-12 is effective for interim and annual periods beginning after December 15, 2015, with early adoption permitted either prospectively or retrospectively to all prior periods presented. The adoption of ASU 2014-12 on January 1, 2016 had no impact on the Company's consolidated financial statements and related disclosures.

3. Acquisitions

On May 15, 2015, pursuant to a Purchase and Sale Agreement, the Company acquired 100% of the membership interests in Lost Creek Wind Finco, LLC (Lost Creek Finco) from Wind Capital Group LLC, an unrelated third party, and 100% of the membership interests in Lincoln County Wind Project Holdco, LLC (Lincoln County Holdco) from Lincoln County Wind Project Finco, LLC, an unrelated third party. Lost Creek Finco owns 100% of the Class B membership interests in Lost Creek Wind Holdco, LLC (Lost Creek Wind Holdco), a company which owns a 100% interest in the Lost Creek wind project. Lincoln County Holdco owns 100% of the Class B membership interests in Post Rock Wind Power Project, LLC, a company which owns a 100% interest in the Post Rock wind project. The acquisition of 100% of the membership interests in Lost Creek Finco and Lincoln County Holdco was for an aggregate consideration of approximately $242.0 million, paid at closing. The Company also assumed certain project level indebtedness and ordinary course performance guarantees securing project obligations. Lost Creek is a 150 MW wind project in King City, Missouri, and Post Rock is a 201MW wind project in Ellsworth and Lincoln Counties, Kansas.

The Company acquired assets and operating contracts for Lost Creek and Post Rock, including assumed liabilities. The identifiable assets and liabilities assumed were recorded at their fair values, which corresponded to the sum of the cash purchase price and the fair value of the other investors' noncontrolling interests. The accounting for the Lost Creek and Post Rock acquisitions is final.

Supplemental pro forma data

The unaudited pro forma statement of operations data below gives effect to the Lost Creek and Post Rock acquisitions as if they had occurred on January 1, 2014. The pro forma net income (loss) for the three and six month periods ended June 30, 2015 was adjusted to exclude nonrecurring transaction related expenses of $1.5 million and $1.9 million, respectively. The unaudited pro forma data is presented for illustrative purposes only and is not intended to be indicative of actual results that would have been achieved had these acquisitions been consummated as of January 1, 2014. The unaudited pro forma data should not be considered representative of the Company's future financial condition or results of operations.

Unaudited pro forma data (in thousands)	Three months ended June 30, 2015	Six months ended June 30, 2015
Pro forma total revenue	$ 92,196	$ 170,800
Pro forma total expenses	86,865	188,725
Pro forma net income (loss)	5,331	(17,925)
Less: pro forma net loss attributable to noncontrolling interest	(10,233)	(17,612)
Pro forma net income (loss) attributable to Pattern Energy	$ 15,564	$ (313)

The following table presents the amounts included in the consolidated statements of operations for Lost Creek and Post Rock since their respective dates of acquisition:

Unaudited data (in thousands)	Three months ended June 30, 2015	Six months ended June 30, 2015
Total revenue	$ 5,172	$ 5,172
Total expenses	6,350	6,350
Net loss	(1,178)	(1,178)
Less: net loss attributable to noncontrolling interest	(800)	(800)
Net loss attributable to Pattern Energy	$ (378)	$ (378)

4. Property, Plant and Equipment

The table below presents the categories within property, plant and equipment as follows (in thousands):

	June 30, 2016	December 31, 2015
Operating wind farms	$3,718,625	$3,700,140
Furniture, fixtures and equipment	5,759	3,500
Land	141	141
Subtotal	3,724,525	3,703,781
Less: accumulated depreciation	(498,867)	(409,161)
Property, plant and equipment, net	$3,225,658	$3,294,620

The Company recorded depreciation expense related to property, plant and equipment of $43.0 million and $85.7 million for the three and six months ended June 30, 2016, respectively, and recorded $33.2 million and $62.5 million for the same periods in the prior year.

5. Variable Interest Entities

As of January 1, 2016, certain operating entities that were formerly consolidated under the voting interest consolidation model are now consolidated in accordance with the VIE consolidation model as a result of the adoption of ASU 2015-02 as further discussed in Note 2, Summary of Significant Accounting Policies.

The operating entities determined to be VIEs by the Company are Logan's Gap, Panhandle 1, Panhandle 2, Post Rock and Amazon Wind Farm Fowler Ridge primarily because the tax equity interests lack substantive kick-out and participating rights. The Company determined that as the managing member it is the primary beneficiary of each VIE by reference to the power and benefits criterion under ASC 810, Consolidation. The Company considered responsibilities within the contractual agreements, which grant it the power to direct the activities of the VIE that most significantly impact the VIE's economic performance. Such activities include management of the wind farms' operations and maintenance, budgeting, policies and procedures. In addition, the Company has the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIEs on the basis of the income allocations and cash distributions.

The following presents the carrying amounts of the consolidated VIEs' assets and liabilities included in the consolidated balance sheet (in thousands). Assets presented below are restricted for settlement of the consolidated VIEs' obligations and all liabilities presented below can only be settled using the VIE resources.

	June 30, 2016
Assets	
Current assets:	
Cash and cash equivalents	$10,473
Restricted cash	4,286
Trade receivables	8,032
Prepaid expenses	3,200
Other current assets	5,231
Total current assets	31,222
Restricted cash	5,922
Property, plant and equipment, net	1,459,110
Finite-lived intangible assets, net	2,156
Other assets	14,331
Total assets	$1,512,741
Liabilities	
Current liabilities:	
Accounts payable and other accrued liabilities	$8,211
Accrued construction costs	4,081
Accrued interest	76
Other current liabilities	1,524
Total current liabilities	13,892
Other long-term liabilities	17,640
Total liabilities	$31,532

6. Unconsolidated Investments

The following projects are accounted for under the equity method of accounting and are presented in the Company's consolidated balance sheets for the periods below (in thousands):

			Percentage of Ownership	
	June 30, 2016	December 31, 2015	June 30, 2016	December 31, 2015
South Kent [1]	$—	$6,185	50.0 %	50.0 %
Grand [1]	—	5,735	45.0 %	45.0 %
K2	92,792	104,553	33.3 %	33.3 %
Unconsolidated investments	$92,792	$116,473		

[1]As of June 30, 2016, the equity method investment balances in South Kent and Grand were $0. In accordance with ASC 323, Investments - Equity Method and Joint Ventures, the Company has suspended recognition of South Kent's and Grand's equity method earnings or losses and accumulated other comprehensive income (loss), if applicable, until such time as South Kent's and Grand's subsequent cumulative equity method earnings and other comprehensive income exceed cumulative distributions received, cumulative equity method losses and, where applicable, cumulative other comprehensive income (loss) during the suspension period. During the periods when South Kent's and Grand's equity method earnings or losses are suspended, the Company will record cash distributions received as gains in earnings (losses) in unconsolidated investments, net on the Company's consolidated statements of operations.

The following table summarizes the components of suspension during the period which are included in earnings in unconsolidated investments, net on the Company's consolidated statements of operations and components of suspension included in other comprehensive income (in thousands):

	Three months ended June 30, 2016	Six months ended June 30, 2016
Earnings in unconsolidated investments, net		
Gains on distributions from unconsolidated investments	$7,528	$9,240
Suspended equity losses	$1,894	$1,894
Suspended other comprehensive income	$(124)	$(124)

The following table summarizes the aggregated operating results of the unconsolidated investments for the three and six months ended June 30, 2016 and 2015, respectively (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Revenue	$54,147	$42,155	$126,563	$86,786
Cost of revenue	21,282	15,361	41,009	27,676
Operating expenses	2,914	2,908	6,059	5,314
Other expense (income)	30,177	(6,842)	68,267	28,449
Net income (loss)	$(226)	$30,728	$11,228	$25,347

Significant Equity Method Investees

The following table presents summarized statements of operations information for the three and six months ended June 30, 2016 and 2015, in thousands, as required for each of the Company's significant equity method investees, South Kent and Grand, pursuant to Regulation S-X Rule 10-01 (b)(1):

South Kent

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Revenue	$21,376	$20,210	$49,905	$52,746
Cost of revenue	7,650	6,733	14,775	15,122
Operating expenses	978	1,152	2,037	2,707
Other expense (income)	13,268	(9,208)	32,957	19,432
Net income (loss)	$(520)	$21,533	$136	$15,485

Grand

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Revenue	$11,051	$14,683	$25,088	$26,778
Cost of revenue	4,686	5,429	9,054	9,355
Operating expenses	819	1,182	1,563	2,033
Other expenses	9,207	562	20,431	7,213
Net income (loss)	$(3,661)	$7,510	$(5,960)	$8,177

7. Accounts Payable and Other Accrued Liabilities

The following table presents the components of accounts payable and other accrued liabilities (in thousands):

	June 30, 2016	December 31, 2015
Accounts payable	$517	$ 625
Other accrued liabilities	10,834	9,583
Operating wind farm upgrade liability	1,024	4,909
Turbine operations and maintenance payable	2,251	985
Purchase agreement obligations	1,725	5,749
Land lease rent payable	1,466	2,513
Spare-parts inventory payables	922	1,181
Payroll liabilities	4,382	5,345
Property tax payable	5,752	11,145
Sales tax payable	1,050	741
Accounts payable and other accrued liabilities	$29,923	$ 42,776

8. Revolving Credit Facility

As of June 30, 2016, $133.3 million was available for borrowing under the $500.0 million Revolving Credit Facility. The Revolving Credit Facility is secured by pledges of the capital stock and ownership interests in certain of the Company’s holding company subsidiaries. The Revolving Credit Facility contains a broad range of covenants that, subject to certain exceptions, restrict the Company’s holding company subsidiaries' ability to incur debt, grant liens, sell or lease assets, transfer equity interests, dissolve, pay distributions and change its business. As of June 30, 2016, the Company's holding company subsidiaries were in compliance with covenants contained in the Revolving Credit Facility.

As of June 30, 2016 and December 31, 2015, outstanding loan balances under the Revolving Credit Facility were $335.0 million and $355.0 million, respectively. In addition, as of June 30, 2016 and December 31, 2015, letters of credit of $31.7 million and $27.2 million, respectively, were issued under the Revolving Credit Facility.

9. Long-term Debt

The Company's long-term debt for the following periods is presented below (in thousands):

	June 30, 2016	December 31, 2015	As of June 30, 2016 Contractual Interest Rate	Effective Interest Rate		Maturity
Project-level						
Fixed interest rate						
El Arrayán EKF term loan	$105,262	$107,160	5.56%	5.56%		March 2029
Santa Isabel term loan	108,992	109,973	4.57%	4.57%		September 2033
Variable interest rate						
Ocotillo commercial term loan [1]	203,934	208,119	2.38%	3.77%	[2]	August 2020
Lost Creek term loan	107,324	110,846	2.57%	6.51%	[2]	September 2027
El Arrayán commercial term loan	95,692	97,418	3.21%	5.22%	[2]	March 2029
Spring Valley term loan	131,411	132,670	2.39%	4.89%	[2]	June 2030
Ocotillo development term loan	103,400	104,500	2.73%	4.37%	[2]	August 2033
St. Joseph term loan [1]	169,150	158,181	2.50%	3.84%	[2]	November 2033
Imputed interest rate						
Hatchet Ridge financing lease obligation	207,181	214,580	1.43%	1.43%		December 2032
	1,232,346	1,243,447				
Unamortized premium, net [3]	1,278	1,380				
Unamortized financing costs	(24,674)	(26,303)				
Current portion [4]	(45,721)	(44,144)				
Long-term debt, less current portion	$1,163,229	$1,174,380				

(1) The amortization for the Ocotillo commercial term loan and the St. Joseph term loan are through June 2030 and September 2036, respectively, which differs from the stated maturity date of such loans due to prepayment requirements.

(2) Includes impact of interest rate derivatives. Refer to Note 10, Derivative Instruments, for discussion of interest rate derivatives.

(3) Amount is related to the Lost Creek term loan.

(4) Amount is presented net of the current portion of unamortized financing costs of $3.6 million and $3.7 million as of June 30, 2016 and December 31, 2015, respectively.

Interest and commitment fees incurred and interest expense for long-term debt, the revolving credit facility, Convertible Senior Notes and other finance related interest expense consisted of the following (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Interest and commitment fees incurred	$18,352	$19,177	$36,502	$36,538
Capitalized interest, commitment fees, and letter of credit fees	—	(2,258)	—	(3,573)
Amortization of debt discount/premium, net	1,042	(32)	2,074	(32)
Amortization of financing costs	1,752	1,925	3,498	3,665
Other interest	$129	$131	$262	$263
Interest expense	$21,275	$18,943	$42,336	$36,861

Convertible Senior Notes due 2020

In July 2015, the Company issued $225.0 million aggregate principal amount of 4.00% convertible senior notes due 2020 (Convertible Senior Notes or 2020 Notes). The 2020 Notes bear interest at a rate of 4.00% per year, payable semiannually in arrears on January 15 and July 15 of each year, beginning on January 15, 2016. The 2020 Notes will mature on July 15, 2020. The 2020 Notes were sold in a private placement.

The following table presents a summary of the equity and liability components of the 2020 Notes (in thousands):

	June 30, 2016	December 31, 2015
Principal	$225,000	$ 225,000
Less:		
Unamortized debt discount	(20,448)	(22,624)
Unamortized financing costs	(4,449)	(5,014)
Carrying value of convertible senior notes	$200,103	$ 197,362
Carrying value of the equity component (1)	$23,743	$ 23,743

(1) Included in the consolidated balance sheets within additional paid-in capital, net of $0.7 million in equity issuance costs.

During the three and six months ended June 30, 2016, in relation to the 2020 Notes, the Company recorded contractual coupon interest of $2.3 million and $4.5 million, amortization of financing costs of $0.2 million and $0.5 million and amortization of debt discount of $1.1 million and $2.2 million, respectively, in interest expense in the consolidated statements of operations.

10. Derivative Instruments

The Company employs a variety of derivative instruments to manage its exposure to fluctuations in electricity prices, interest rates and foreign currency exchange rates. Energy prices are subject to wide swings as supply and demand are impacted by, among many other unpredictable items, weather, market liquidity, generating facility availability, customer usage, storage, and transmission and transportation constraints. Interest rate risk exists primarily on variable-rate debt for which the cash flows vary based upon movement in market prices. Additionally, the Company is exposed to foreign currency exchange rate risk primarily from its business operations in Canada and Chile. The Company’s objectives for holding these derivative instruments include reducing, eliminating and efficiently managing the economic impact of these exposures as effectively as possible. The Company does not hedge all of its electricity price risk, interest rate risks, and foreign currency exchange rate risks, thereby exposing the unhedged portions to changes in market prices.

As of June 30, 2016, the Company had other energy-related contracts that did not meet the definition of a derivative instrument or qualified for the normal purchase normal sale scope exception and were therefore exempt from fair value accounting treatment.

The following tables present the fair values of the Company's derivative instruments on a gross basis as reflected on the Company’s consolidated balance sheets (in thousands):

	June 30, 2016			
	Derivative Assets		Derivative Liabilities	
	Current	Long-Term	Current	Long-Term
Fair Value of Designated Derivatives:				
Interest rate swaps	$—	$ —	$10,224	$ 53,291
Fair Value of Undesignated Derivatives:				
Interest rate swaps	$—	$ —	$4,753	$ 16,226
Energy derivative	17,827	31,704	—	—
Foreign currency forward contracts	554	—	734	325
Total Fair Value	$18,381	$ 31,704	$15,711	$ 69,842

	December 31, 2015			
	Derivative Assets		Derivative Liabilities	
	Current	Long-Term	Current	Long-Term
Fair Value of Designated Derivatives:				

Interest rate swaps	$—	$ —	$10,034	$ 24,360
Fair Value of Undesignated Derivatives:				
Interest rate swaps	$—	$ 559	$4,309	$ 4,299
Energy derivative	20,856	42,827	—	—
Foreign currency forward contracts	3,482	628	—	—
Total Fair Value	$24,338	$ 44,014	$14,343	$ 28,659

The following table summarizes the notional amounts of the Company's outstanding derivative instruments (in thousands except for MWh):

	Unit of Measure	June 30, 2016	December 31, 2015
Designated Derivative Instruments			
Interest rate swaps	USD	$372,861	$379,808
Interest rate swaps	CAD	$196,650	$196,988
Undesignated Derivative Instruments			
Interest rate swaps	USD	$268,747	$275,424
Energy derivative	MWh	1,415,245	1,707,350
Foreign currency forward contracts	CAD	$60,200	$62,300

Derivatives Designated as Hedging Instruments

Cash Flow Hedges

The Company has interest rate swap agreements to hedge variable rate project-level debt. Under these interest rate swaps, the projects make fixed-rate interest payments and the counterparties to the agreements make variable-rate interest payments. For interest swaps that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (loss) and reclassified into earnings in the period or periods during which a cash settlement occurs. The designated interest rate swaps have remaining maturities ranging from approximately 11.3 years to 20.3 years.

The following table presents gains and losses on derivative contracts designated and qualifying as cash flow hedges recognized in accumulated other comprehensive income (loss), as well as amounts reclassified to earnings for the following periods (in thousands):

	Description	Three months ended June 30, 2016	2015	Six months ended June 30, 2016	2015
Gains (losses) recognized in accumulated OCI	Effective portion of change in fair value	$(9,964)	$10,100	$(30,661)	$(657)
Gains (losses) reclassified from accumulated OCI into:					
Interest expense, net of tax	Derivative settlements	$(2,721)	$(3,465)	$(5,623)	$(6,956)
Gains (losses) recognized in interest expense	Ineffective portion	$(423)	$—	$(512)	$—

The Company estimates that $10.2 million in accumulated other comprehensive income (loss) will be reclassified into earnings over the next twelve months.

Derivatives Not Designated as Hedging Instruments

The following table presents gains and losses on derivatives not designated as hedges (in thousands):

Derivative Type	Financial Statement Line Item	Description	Three months ended June 30, 2016	2015	Six months ended June 30, 2016	2015
Interest rate derivatives	Gain (loss) on undesignated derivatives, net	Change in fair value, net of settlements	$(3,937)	$5,378	$(12,818)	$2,306
Interest rate derivatives	Gain (loss) on undesignated derivatives, net	Derivative settlements	$(1,280)	$(960)	$(2,606)	$(1,919)
Energy derivative	Electricity sales	Change in fair value, net of settlements	$(9,327)	$(6,002)	$(14,152)	$(3,030)
Energy derivative	Electricity sales	Derivative settlements	$6,752	$5,928	$13,485	$12,097
Foreign currency forward contracts	Gain (loss) on undesignated derivatives, net	Change in fair value, net of settlements	$(654)	$(240)	$(4,615)	$391
Foreign currency forward contracts	Gain (loss) on undesignated derivatives, net	Derivative settlements	$(8)	$—	$529	$—

Interest Rate Swaps

The Company has interest rate swap agreements to hedge variable rate project-level debt. Under these interest rate swaps, the projects make fixed-rate interest payments and the counterparties to the agreements make variable-rate interest payments. For interest rate swaps that are not designated and do not qualify as cash flow hedges, the changes in fair value are recorded in gain (loss) on undesignated derivatives, net in the consolidated statements of operations as these hedges are not accounted for under hedge accounting. The undesignated interest rate swaps have remaining maturities ranging from approximately 4.8 years to 14.0 years.

Energy Derivative

In 2010, Gulf Wind acquired an energy derivative instrument to manage its exposure to variable electricity prices over the life of the arrangement. The energy price swap fixes the price for a predetermined volume of production (the notional volume) over the life of the swap contract, through April 2019, by locking in a fixed price per MWh. The notional volume agreed to by the parties is approximately 504,220 MWh per year. The energy derivative instrument does not meet the criteria required to adopt hedge

accounting. As a result, changes in fair value are recorded in electricity sales in the consolidated statements of operations.

As a result of the counterparty's credit rating downgrade, the Company received cash collateral related to the energy derivative agreement. The Company does not have the right to pledge, invest, or use the cash collateral for general corporate purposes. As of June 30, 2016, the Company has recorded a current asset of $49.5 million to funds deposited by counterparty and a current liability of $49.5 million to counterparty deposit liability representing the cash collateral received and corresponding obligation to return the cash collateral, respectively. The cash was deposited into a separate custodial account for which the Company is not entitled to the interest earned on the cash collateral.

Foreign Currency Forward Contracts

The Company has established a currency risk management program. The objective of the program is to mitigate the foreign exchange rate risk arising from transactions or cash flows that have a direct or underlying exposure in non-U.S. dollar denominated currencies in order to reduce volatility in the Company's cash flow, which may have an adverse impact to our short-term liquidity or financial condition. A majority of the Company's power sale agreements and operating expenditures are transacted in U.S. dollars, with a growing portion transacted in currencies other than the U.S. dollar, primarily the Canadian dollar. The Company enters into foreign currency forward contracts at various times to mitigate the currency exchange rate risk on Canadian dollar denominated cash flows. These instruments have remaining maturities ranging from one to eighteen months. The foreign currency forward contracts are considered non-designated derivative instruments and are not used for trading or speculative purposes. As a result, changes in fair value and settlements are recorded in loss on undesignated derivatives, net in the consolidated statements of operations.

11. Accumulated Other Comprehensive Loss

The following tables summarize the changes in the accumulated other comprehensive loss balance, net of tax, by component as follows (in thousands):

	Foreign Currency	Effective Portion of Change in Fair Value of Derivatives	Proportionate Share of Equity Investee's OCI	Total
Balances at December 31, 2014	$(19,338)	$(26,672)	$(7,903)	$(53,913)
Other comprehensive loss before reclassifications	(9,692)	(657)	(2,382)	(12,731)
Amounts reclassified from accumulated other comprehensive loss	—	6,956	1,045	8,001
Net current period other comprehensive loss	(9,692)	6,299	(1,337)	(4,730)
Balances at June 30, 2015	$(29,030)	$(20,373)	$(9,240)	$(58,643)
Less: accumulated other comprehensive loss attributable to noncontrolling interest, June 30, 2015	—	(8,009)	—	(8,009)
Accumulated other comprehensive loss attributable to Pattern Energy, June 30, 2015	$(29,030)	$(12,364)	$(9,240)	$(50,634)

	Foreign Currency	Effective Portion of Change in Fair Value of Derivatives	Proportionate Share of Equity Investee's OCI	Total
Balances at December 31, 2015	$(48,285)	$(13,462)	$(12,131)	$(73,878)
Other comprehensive income (loss) before reclassifications	11,642	(30,661)	(11,008)	(30,027)
Amounts reclassified from accumulated other comprehensive loss	—	5,623	2,557	8,180
Net current period other comprehensive income (loss)	11,642	(25,038)	(8,451)	(21,847)
Balances at June 30, 2016	$(36,643)	$(38,500)	$(20,582)	$(95,725)
	—	(1,688)	—	(1,688)

Less: accumulated other comprehensive loss attributable to noncontrolling interest, June 30, 2016				
Accumulated other comprehensive loss attributable to Pattern Energy, June 30, 2016	$(36,643)	$(36,812)	$ (20,582)	$(94,037)

Amounts reclassified from accumulated other comprehensive loss into net loss for the effective portion of change in fair value of derivatives is recorded to interest expense in the consolidated statements of operations. Amounts reclassified from accumulated other comprehensive loss into net loss for the Company's proportionate share of equity investee's other comprehensive loss is recorded to earnings in unconsolidated investments, net in the consolidated statements of operations.

12. Fair Value Measurements

The Company's fair value measurements incorporate various factors, including the credit standing and performance risk of the counterparties, the applicable exit market, and specific risks inherent in the instrument. Nonperformance and credit risk adjustments on risk management instruments are based on current market inputs when available, such as credit default hedge spreads. When such information is not available, internal models may be used.

Assets and liabilities recorded at fair value in the consolidated financial statements are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels directly related to the amount of subjectivity associated with the inputs to valuation of these assets or liabilities are set forth below. Transfers between levels are recognized at the end of each quarter. The Company did not recognize any transfers between levels during the periods presented.

Level 1—Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2—Inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities and which reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuations technique and the risk inherent in the inputs to the model.

Financial Instruments

The carrying value of financial instruments classified as current assets and current liabilities approximates their fair value, based on the nature and short maturity of these instruments, and they are presented in the Company's financial statements at carrying cost. The fair values of cash and cash equivalents and restricted cash are classified as Level 1 in the fair value hierarchy. Certain other assets and liabilities were measured at fair value upon initial recognition and unless conditions give rise to an impairment, are not remeasured.

Financial Instruments Measured at Fair Value on a Recurring Basis

The Company's financial assets and liabilities which require fair value measurement on a recurring basis are classified within the fair value hierarchy as follows (in thousands):

	June 30, 2016			
	Level 1	Level 2	Level 3	Total
Assets				
Energy derivative	$—	$—	$49,531	$49,531
Foreign currency forward contracts	—	554	—	554
	$—	$554	$49,531	$50,085
Liabilities				
Interest rate swaps	$—	$84,494	$—	$84,494
Foreign currency forward contracts	—	1,059	—	1,059
	$—	$85,553	$—	$85,553

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
Assets				
Interest rate swaps	$—	$559	$—	$559
Energy derivative	—	—	63,683	63,683
Foreign currency forward contracts	—	4,110	—	4,110
	$—	$4,669	$63,683	$68,352
Liabilities				
Interest rate swaps	$—	$43,002	$—	$43,002
	$—	$43,002	$—	$43,002

Level 2 Inputs

Derivative instruments subject to re-measurement are presented in the financial statements at fair value. The Company's interest rate swaps were valued by discounting the net cash flows using the forward LIBOR curve with the valuations adjusted by the Company’s credit default hedge rate. The Company’s foreign currency forward contracts were valued using the income approach based on the present value of the forward rates less the contract rates, multiplied by the notional amounts.

Level 3 Inputs

The fair value of the energy derivative instrument is determined based on a third-party valuation model. The methodology and inputs are evaluated by management for consistency and reasonableness by comparing inputs used by the third-party valuation provider to another third-party pricing service for identical or similar instruments and also agreeing inputs used in the third-party valuation model to the derivative contract for accuracy. Any significant changes are further evaluated for reasonableness by obtaining additional documentation from the third-party valuation provider.

The energy derivative instrument is valued by discounting the projected net cash flows over the remaining life of the derivative instrument using forward electricity prices which are derived from observable prices, such as forward gas curves, adjusted by a non-observable heat rate for when the contract term extends beyond a period for which market data is available. The significant unobservable input in calculating the fair value of the energy derivative instrument is forward electricity prices. Significant increases or decreases in this unobservable input would result in a significantly lower or higher fair value measurement.

The valuation techniques and significant unobservable inputs used in recurring Level 3 fair value measurements were as follows (in thousands, for fair value):

June 30, 2016	Fair Value	Valuation Technique	Significant Unobservable Inputs	Range
Energy derivative	$49,531	Discounted cash flow	Forward electricity prices	$15.25 - $74.81 (1)
			Discount rate	0.65% - 0.79%

December 31, 2015	Fair Value	Valuation Technique	Significant Unobservable Inputs	Range
Energy derivative	$63,683	Discounted cash flow	Forward electricity prices	$12.48 - $74.94 (1)
			Discount rate	0.61% - 1.46%

(1) Represents price per MWh

The following table presents a reconciliation of the energy derivative contract measured at fair value on a recurring basis using significant unobservable inputs (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
Balances, beginning of period	$58,858	$67,447	$63,683	$64,475
Total gains (losses) included in electricity sales	(2,575)	(74)	(667)	9,067
Settlements	(6,752)	(5,928)	(13,485)	(12,097)
Balances, end of period	$49,531	$61,445	$49,531	$61,445

During the three and six months ended June 30, 2016, the Company recognized unrealized losses on the energy derivative of $9.3 million and $14.2 million, respectively, and $6.0 million and $3.0 million, respectively, for the same periods in the prior year, which were all recorded to electricity sales on the consolidated statements of operations.

Financial Instruments not Measured at Fair Value

The following table presents the carrying amount and fair value and the fair value hierarchy of the Company’s financial liabilities that are not measured at fair value in the consolidated balance sheets, but for which fair value is disclosed (in thousands):