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The Renewable Energy Grid Initiative's **Antonella Battaglini** on social consensus

Tom Bruton on the economic benefits of bioenergy and its contribution to national policy

Issue 3

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A&L Goodbody

Recent trends in M&A activity in onshore wind

Kevin Feeney and Ross Moore consider some of the live issues for developers and the general state of the market.

Kevin Feeney

Ross Moore

There is evidence of an increasing interest in mergers and acquisition activity in onshore wind in Ireland and Northern Ireland. This is consistent with a European and global trend of heightened interest in the sector. In this regard, A&L Goodbody has been involved in a number of significant onshore wind acquisitions and investments on the island of Ireland in the last 12-18 months.

While our experience is that there is significant capital available for acquisitions particularly in Ireland, our experience is also that there remains a shortage of viable projects to meet the demand, or at least projects which meet both the scale of capital deployment targets and the investment criteria of many potential acquirers. Accordingly, a limited pool of industry investors are stepping in through acquisitions at an earlier development stage to ensure projects get built to meet their own demand.

Funds and investors

Following a relatively aggressive spending spree, utilities and semi-states are for the most part no longer on the acquisition trail (having become by and large 'own developers' and sellers rather than buyers of assets). The principal interest and available capital is coming from renewable energy and infrastructure funds, pension funds and other types of institutional investors.

For some time these investors had steered clear of the sector, viewing the assets as significantly overvalued driven principally by higher-priced M&A activity by larger utilities in the sector. However with utilities' activity increasingly constrained and unavailability of credit forcing developers without large balance sheets to either mothball or sell early stage projects, these investors have now seen a re-pricing of the assets. This has provided opportunities for acquisitions of lower priced assets with increased returns.

Sectoral and geographical approach

In addition to becoming increasingly sector focussed, it is true to say that many investors have also become more geographically focussed in sourcing investments. Ireland continues to be an investment location of choice for many renewable energy funds. This is due to a range of features, including Ireland's top class proven wind resource, availability of REFIT support, government policy commitments and relative regulatory stability (compared to some other continental European states who we understand have clawed back renewable subsidies), priority dispatch for wind, clear planning processes and Ireland's euro zone membership.

While issues such as firm access and network development, curtailment modelling, turbine availability for smaller projects and the potential impact of the single European Target Electricity Market continue to pose difficulties, many funds have, in conjunction with experienced local advisers, been establishing teams with specific knowledge and experience local to the Irish investments to more fundamentally understand and work through issues.

This increased sectoral and geographic knowledge, together with a need to 'rescue' capital constrained development projects which would otherwise be mothballed, has also both enabled and required certain investors to seek deeper involvement in development process, some with strategic development and construction partners.

It also appears that project financing banks are more attracted to private equity backed projects, not least because of their balance sheets, but also because they are likely to have greater project pipelines and wider interests which attract many commercial lenders' desire for relationship and repeat deals. Any bank concerns in respect of an institutional investor's construction and operation management expertise are relatively easily overcome, for example through robust outsourced management agreements.

Differing criteria and strategies

Institutional funds and private equity houses can have different investment criteria, capital deployment and project acquisition targets. Investment criteria can depend on a range of factors, including whether or not they have a development partner that will enable investment in an earlier stage project, IRR hurdles, requirements for short-term revenue for returns or to roll into development projects, strategies for exit events and monetisation events or mandates for long-term more stable cashflow.

Accordingly, some investors will be attracted only to operational projects and some will be interested in 'in-construction' projects or projects which have reached financial close. Others are happy to acquire consented or permitted only projects and some will invest in acquiring grid capacity to be used in wider project portfolio plans.

The investment criteria, fund structures and monetisation strategies drive the commercial and legal structure of many of these acquisitions, particularly in terms of payment structures and project management. In recent deals, we have seen a wide range of payment structures, from upfront payments, weighted payments upon achieving certain key development milestones (e.g. additional planning permission for higher turbines or export capacity for an extended project), bonus payments upon achieving financial close or achieving commercial operation, yield or output-based payments, developer earn-outs, construction cost savings payments and combinations of these.

For those investors without their own project management arms or developer partnership arrangements, 'lock-in' of the project developer through construction or the requirement for very robust outsourced construction and operation management arrangements can be conditions of acquisition.

Thorough due diligence

In our experience, the common feature of all these investors is robust investment criteria and stringent investor base accountability. This demands thorough (and often swift and resource intensive) due diligence and risk analysis of the project pre-acquisition and often robust warranties from the vendors in the acquisition documentation.

On the legal side, this requires advisers with significant experience not only of private equity transactions and M&A transactions generally, but also significant sectoral experience in renewables regulation, electricity markets, property, planning, environmental, windfarm construction and operation contracts, tax, competition law and project finance. A deep understanding of the investor's investment criteria, its monetisation strategies and internal fund management are also critical.

Some vendor considerations

From a vendor point of view in dealing with these transactions, it is important that the projects are well developed and the sales process well structured.

In this regard, we are aware of a number of potential acquisitions which have failed or become prolonged, difficult and value-destroying due to poor project development or projects coming to market too early with key components not in place or ultimate disposal objectives not clear. Similarly, to promote vendor credibility, maintain bidder interest and ensure no value leakage, it is important that formal sales processes are well structured and managed.

The need for efficient transactability also means that, before coming to market, vendors have thought through certain key transaction elements. For example, we have encountered difficulties where vendors have not considered at an early stage and structured the sale in a tax efficient way (for example to minimise vendor capital gains tax liabilities) leading to late stage changes in transaction structures.

Similarly, historic investments such as BES investments often have change of control tax clawbacks or gross-ups which can ultimately hinder the deal or cause investors to reduce value.

Many project finance credit agreements also have strict change of control restrictions and while it is unlikely that lenders will agree to removal of these, insufficiently close attention to these provisions and the process for effecting changes in ownership can lead to transaction inefficiency and increased transaction costs.

All of these elements are in the control of well advised developers and vendors. It is therefore key for project developers who are developing projects to bring to market for sale that the project is considered and structured with this in mind from the outset.

Conclusion

The interest of renewable energy funds and private equity capital in Irish onshore wind projects is undoubted. These institutions are also a key component in ensuring that equity and debt capital is made available to ensure projects get built and contribute to Ireland's renewables targets. It is hoped that the availability of suitable projects in the near term is such to maintain that interest and ensure competitiveness and growth in the sector.

A&L Goodbody's Energy and Natural Resources Group is a market-leading all-island transactional and regulatory energy practice. Ranked in the top tier by all major legal directories, A&L Goodbody has been at the forefront of the significant developments in this dynamic sector on the island of Ireland and has been involved in the most complex, demanding and innovative transactions.

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