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Renewables Update—Key Considerations for Renewables Transactions

Renewables M&A Series – Part 3

SUMMARY

The stage is set for substantial growth of the renewables sector in the years to come. Market and policy developments are creating opportunities for existing developers to increase their project pipelines and for new entrants such as oil and gas majors to quickly scale up their renewables portfolios. A number of utilities in the United States are increasing investment in renewables generation and investing in new battery and hydrogen technologies. Likewise, investment, pension and private equity funds and special-purpose acquisition companies (SPACs) and others not previously active in the renewables sector are looking to invest in the renewables sector, and their interest is driving an active M&A market.

The renewables sector is rapidly evolving, and dealmakers need to keep up with current developments in the relevant market and regulatory environments, the key diligence considerations unique to the renewables sector and how these factors affect transaction structuring. In [Part 1](#) of this series, we gave an overview of the global renewables market and key trends and regulatory developments in Europe. [Part 2](#) covered key trends and regulatory developments in the United States. This Part 3 covers key due diligence and deal structuring considerations for renewables transactions, including in respect of financing and JV governance.

INTRODUCTION

Today's renewables market spans many types of deals (single asset, portfolio of assets, development assets, platforms, cross-border, distressed/restructurings, warehouse/YieldCos, public M&A, SPAC, technology/IP-driven and others) and many types of buyers and sellers (local and regional developers, global sponsors, utilities, integrated energy companies, investment funds, pension funds, sovereign wealth funds, tax equity and others). Each deal is unique and requires both the seller and buyer to have a clear set of objectives and to ensure that their advisors (financial, technical, tax, commercial and legal) are aligned with those objectives.

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An acquisition of, or an investment in, a company in the renewable energy sector involves all the considerations and issues normally present in an M&A transaction and then some. As in any M&A transaction, the risk profile of the assets informs the financial model, the financing, JV arrangements and the deal structure and consideration.

Below, we discuss the unique renewables-specific deal considerations critical to a successful transaction in the renewables space.

KEY DUE DILIGENCE CONSIDERATIONS

Key due diligence issues that buyers should focus on and that sellers should proactively address in renewables deals include:

- **Technical:**
 - *Resource Risk:* For wind and solar projects, how robust is the historical data on wind or solar conditions? Consider impacts of climate change for long-term assets. Are there any performance guarantees in place covering resource risk (less common now)? Does the subsidy regime hedge weather conditions in any way (not common)?
 - *Technology Risk:* What is the track record for the technology utilized for the project, and what is the forecast remaining lifespan (and capex and opex requirements) for the plant? Are there any manufacturer warranties or performance/availability guarantees remaining?
 - *Repowering Potential:* What is the potential for repowering the site and what permitting would be needed? Could the subsidy regime, if any, be extended to the repowered site?
- **Contractual/Commercial:**
 - *Offtake Arrangements:* Is 100% of the power (and any renewable energy credits (RECs) or other environmental attributes) contracted via a long-term power purchase agreement (PPA), virtual power purchase agreement (VPPA) and/or hedged? Or are merchant sales part of the offtake strategy? Is there residual balancing or basis risk? Is there a capacity market available and, if so, what is the strategy for capacity sales? For emerging technologies, in particular [green hydrogen](#), how will anticipated developments in technology and possible applications affect the offtake strategy, and could offtakers be brought into a project via a JV structure?¹
 - *Subsidy Regime:* Is there a subsidy regime and what are the terms and remaining length: feed-in-tariff, feed-in-premium, contract for difference, long-term PPA, renewable energy certificates, tax credits, others?
 - *Transmission and Interconnection Arrangements:* Who is constructing or will construct, operate and maintain any required transmission and interconnection facilities, and on what terms? Are the facilities integrated or separate (and if so, is there multi-project risk)? What are the applicable force majeure/curtailment terms?
 - *Construction Arrangements:* Is it a single engineering, procurement and construction (EPC) contract (less common for many types of renewables projects) or multi-contract structure? What are the technology supply terms and warranties?
 - *O&M Arrangements:* Who will operate and maintain the project and on what basis (staffed entity, cost, cost-plus, third-party competitively bid)? What is the liability regime?
- **Permitting, Property and Regulatory Risk:** What is the status of the key permits and other regulatory requirements (environmental in particular) and property rights (leases, easements)?

¹ See Sullivan & Cromwell LLP, "[Hydrogen – Fuel of the Future or Just Hot Air?](#)," September 23, 2020; Sullivan & Cromwell LLP, "[Hydrogen – Recent Developments in Hydrogen Projects](#)," September 28, 2020.

How many different regulators and levels of government need to be navigated?² Buyers will focus on anti-bribery and corruption diligence if there are material relationships with government (e.g., transparency of the lease and subsidy award processes), as well as the project's history of being able to obtain necessary permits. Consultations may also be required with Indigenous Peoples, for example if a project adversely impacts land or natural resources under their traditional ownership or use.

KEY FINANCING CONSIDERATIONS

Renewables financing structures and terms vary depending on a variety of factors. A single project may have non-recourse secured bank financing in place. A company owning a portfolio of projects may have corporate level bonds outstanding that finance its operations on a company-wide basis. Many large-scale developers, owners and operators of renewables projects employ an all-of-the-above financing strategy depending on whether individual projects are under construction or in operation, when individual projects were first completed and/or acquired and whether government subsidies were available (including tax equity financing in the U.S.).³ Consequently, buyers will want to understand and diligence a target's existing financing arrangements with care, as it may be advisable to leave some existing financing arrangements in place and/or arrange acquisition financing or refinancing. Other considerations include:

- **Sources of potential financing**, which will vary with the jurisdiction and technology:
 - Commercial bank markets are generally comfortable with photovoltaic (PV) and concentrating solar power (CSP), solar and onshore and offshore wind projects. Proven battery projects and other proven technologies can also generally be financed. In the U.S. market, given the availability of tax equity and deep capital markets, developers often use short-term construction or "mini perm" loans which are then refinanced.
 - The private placement market (from institutional investors) is generally an option for renewables projects/portfolios in OECD countries with long-term offtake arrangements.
 - The bond market is also an option for larger projects/portfolios and for refinancings.
 - Export credit agencies and multilateral lending agencies will finance greenfield projects to support exports (e.g., turbines) or in emerging markets or using emerging technologies.
 - Corporate/leveraged financing may be available for acquisitions of operating assets/companies. In this case, the financing arrangements could include elements of project finance (e.g., stricter covenants, debt service reserve accounts, reserve matters for financings of minority investments).
- **Environmental and social standards**: The recent implementation of the Equator Principles 4 has extended the potential scope of application of the IFC Performance Standards to projects in OECD high-income countries.⁴ Renewables also raise unique environmental and social

² See [Part 1](#) and [Part 2](#) of this series, which highlight certain permitting and regulatory issues in Europe and the U.S. In the U.S., for example, permitting and governmental engagement typically is required at the federal, state and local levels.

³ Tax equity financing has historically been integral to many United States wind and solar projects. Although the relevant U.S. tax credits are currently set to expire, it may be that the incoming Congress and Biden Administration will seek to extend or establish new subsidiaries for the renewables sector. Other jurisdictions may have their own unique subsidy regimes.

⁴ See S&C Critical Insights – An Overview of the Equator Principles 4 (November 17, 2020), available at <https://www.sullcrom.com/sandc-critical-insights--equator-principles-4>.

issues, such as the effect of wind turbines on birds, the effect of offshore wind on fisheries and viewshed concerns.

- **Green and sustainable finance:** Project or acquisition financings and refinancings in the renewables space can generally qualify as green bonds or loans.

GOVERNANCE ARRANGEMENTS IN A JOINT VENTURE

If a renewables project or portfolio of renewables projects are to be held in a joint venture, then JV governance will be a key focus. The buyer's approach will vary based on the type of JV partners involved (initial developer, operator, utility, financial investor, tax equity, etc.). Renewables-specific considerations include:

- **Scope of business:** We have seen many types of JVs in the space, some covering only the existing operating assets, others also assets under construction, assets in development and/or the sourcing of new projects. If the scope extends beyond completed assets, the parties must consider how projects are to be contributed and any non-compete obligations. These considerations take on greater importance if one of the JV partners is also a developer of renewable projects.
- **Key management matters:** Who is responsible for permitting/environmental matters, procurement, construction management, operations and maintenance (O&M), government/public relations, sales/offtake, insurance and budgeting? Notwithstanding they are considered "green", renewables businesses can pose unique environmental and social challenges and require competent management of these issues, in particular during development and construction.
- **Reserved voting matters:** As with most infrastructure assets, the focus is typically on budget, appointing management, disposals, material contracts (EPC, O&M, PPAs, Contracts for Difference, etc.), financing, dividends, tax and audit – but other areas may be important, depending on the asset. In the United States, regulatory considerations may inform the allocation of decision-making because greater voting rights may cause a JV partner to become subject to U.S. energy regulatory jurisdiction. As a result, financial investors in United States renewables projects may eschew board representation and certain voting rights.
- **Funding plan:** For any projects in development or yet to be sourced, what is the agreed approach towards financing structure (non-recourse or shareholder-funded, tax equity, etc.) and amount of leverage, provision of shareholder credit support/guarantees, cash calls and default mechanics? What is the approach to providing any required credit support in respect of project leases and commercial contracts?
- **Distribution policy:** Consider limitations in any existing project financing and the sharing of any tax assets or renewable energy credits.
- **Exit plan:** IPO (potentially via a YieldCo/SPAC) or a secondary buyout, any drag/tag, rights of first offer/refusal and any transfer restrictions. Consider regulatory approvals and key consents that would be required for any exit. For example, U.S. Bureau of Ocean Energy Management (BOEM) offshore wind leases require BOEM approval to assign.

STRUCTURING THE CONSIDERATION

Renewables transactions can be structured many different ways, depending on all the factors noted above. Specific considerations include:

- **Asset or share purchase?:** As with most infrastructure assets, it will typically be easier from a regulatory perspective to transfer a project company (or indirect holding company), as the holder of the project, rather than transfer the project assets themselves, in order to avoid the need to amend permits. Required consents from contract counterparties for existing project contracts should be diligenced (as noted above). While tax and accounting objectives also

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factor into transaction structuring, the risk inherent in re-permitting usually results in a share purchase transaction.

- **Purchase price/Earn-out:** It is common to see adjustments in the purchase price for non-operational renewable assets for differences in capital expenditures, working capital, equity funding and/or commercial operations date (COD) between those anticipated at signing and what is actually incurred through closing. Similarly, it is also common to see some form of earn-out for sales of renewable assets pre-FID or pre-COD. It is important for both parties to precisely define the base case assumptions and any consent rights of seller for any divergence by the buyer. Earn-out payments may also be linked to operations and maintenance costs, particularly when a deal involves a relatively new asset.
- **Representations and warranties:** Especially in single asset or small portfolio deals when risks are not distributed across a large number of projects, there should be a special focus on representations in respect of material contracts (PPA/offtake, guarantees/warranties, finance, IP, EPC, O&M), environmental matters, material permits, real property and regulatory matters. It is often possible to obtain R&W insurance for renewable portfolio sales.
- **Tax:** There are often unique tax considerations for renewables deals. For example, for non-U.S. buyers seeking to invest in the United States parties need to consider the applicability of FIRPTA (the Foreign Investment in Real Property Tax Act), as well as tax equity matters and any relevant state or local tax credits associated with the assets or obligations triggered by the transaction.

CONCLUSIONS

The ongoing transformational shift in energy markets from fossil fuels towards lower-emitting technologies (including [green hydrogen](#)),⁵ as well as the [increasing focus](#) on environmental, social and governance (ESG) factors in financial markets,⁶ will continue to attract new investors to the renewables sector.

The relatively strong influence of regulatory requirements and policy on renewables assets and businesses will require buyers and sellers to engage experienced legal counsel early in the transaction to ensure potentially material value points are flagged early and addressed in the commercial negotiations.

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⁵ See Sullivan & Cromwell LLP, "[Hydrogen – Fuel of the Future or Just Hot Air?](#)," September 23, 2020; Sullivan & Cromwell LLP, "[Hydrogen – Recent Developments in Hydrogen Projects](#)," September 28, 2020.

⁶ See Sullivan & Cromwell LLP, "[The Rise of Standardized ESG Disclosure Frameworks in the United States](#)," June 8, 2020; Sullivan & Cromwell LLP, "[Sustainable Finance Update](#)," April 30, 2020.

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