



RENEWABLE ENERGY

A GROWTH SECTOR FOR M&A

Gareth Baker and Samantha Hacking of Gowling WLG (UK) LLP discuss the due diligence and other issues that arise when investing in renewable energy projects.

Renewable energy is energy that is generated naturally and continuously in the environment. Its sources include: wind power, both offshore and onshore; solar power; wave and tidal power; hydroelectric power; biomass; and biofuels. Some commentators would include nuclear power within this definition as its normal operation does not give rise to emissions. This article does not address nuclear as that sector has some unique features.

As renewable energy can be generated with low or zero carbon dioxide emissions, it plays an important role in combating climate change.

The renewable energy market continues to attract more attention and more investment, particularly as the costs of building new energy-generating assets have fallen considerably. In the UK economy, energy projects have represented the most significant proportion of infrastructure spend in recent times.

This article examines:

- The current state of the renewable energy sector.
- The different stages of a renewable energy project and the kind of investment that might occur at each stage.
- The key issues on which due diligence should focus.
- Possible future developments.

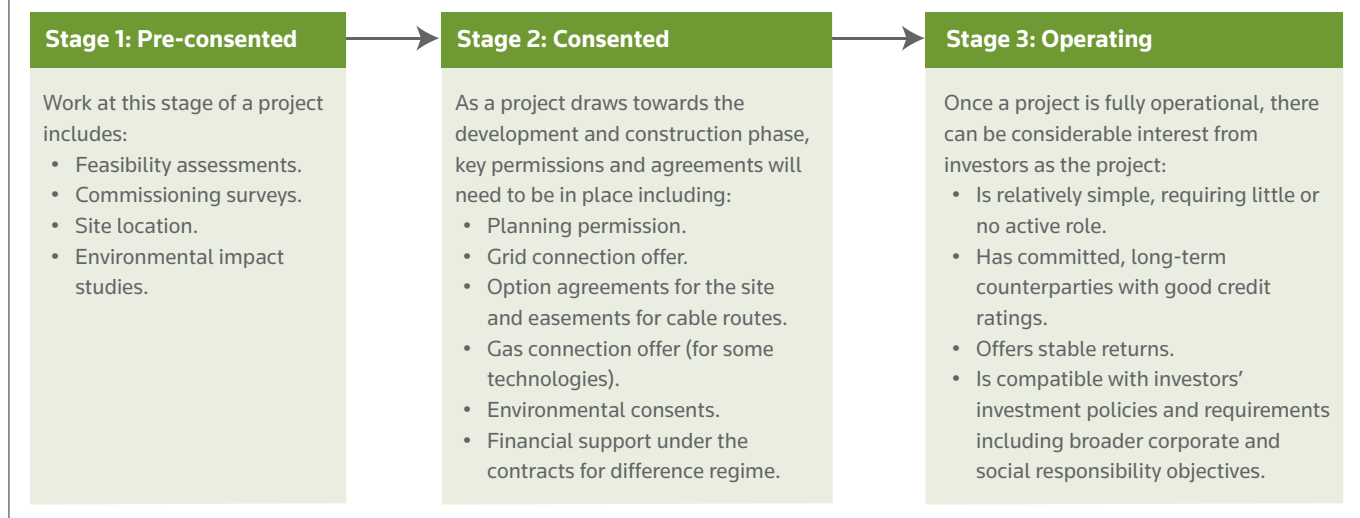
THE STATE OF THE INDUSTRY

Under the Renewable Energy Directive (2009/28/EC), the UK accepted a 2020 target of 15% renewable energy across electricity, heat and transport. The government published a renewable energy roadmap in 2011, setting out how it proposed to meet its target, with commentators suggesting that about half of that target would need to come

from renewable electricity generation (www.gov.uk/government/uploads/system/uploads/attachment_data/file/48128/2167-uk-renewable-energy-roadmap.pdf). In the latest version of the roadmap, published in 2013, the government reported that in the second quarter of 2013, renewables accounted for 15.5% of all electricity generated (www.gov.uk/government/uploads/system/uploads/attachment_data/file/255182/UK_Renewable_Energy_Roadmap_-_5_November_-_FINAL_DOCUMENT_FOR_PUBLICATION_.pdf).

The market has moved quickly. On 8th June 2017, it was reported that at one point during the day renewable energy provided more than 50% of UK electricity for the first time. These record-breaking figures were not maintained, but they indicate the significant progress that has been made. Government figures show that in the second quarter of 2017, renewables' share of electricity generation was a record 29.8%, up 4.4% from the previous corresponding period.

Stages of a renewable energy project



In recent times, the government has promoted renewable energy in the UK through a combination of feed-in tariffs and the renewables obligation (RO). These replaced the non-fossil fuel obligation system, which was the government's principal mechanism for promoting renewable energy before the RO.

The RO is a certificate-based system that obliges electricity suppliers to source a proportion of the electricity that they supply from renewable sources. Electricity suppliers can choose to either buy certificates sufficient to meet their RO certificates target or pay a buy-out price. Since it came into effect in 2002, the RO has incentivised an increase in low-carbon electricity generation from around 2% to 42.9% in 2015. The RO has substantially closed to new projects, although it will continue to support existing accredited projects until 2037 under grandfathering arrangements.

The RO has been replaced by the contracts for difference (CFD) regime under the government's electricity market reform policy (www.practicallaw.com/2-584-9567; www.practicallaw.com/3-575-0645). A CFD is a long-term contract awarded pursuant to an auction in which renewables' generators bid for a fixed price for the electricity that they produce, known as a strike price. Where market prices for power are below the strike price, the generator receives a top-up payment. Where the market price is above the strike price, the generator pays the excess. The levels of support offered through the CFD currently appear far less than those offered under the RO.

In addition, in the last few years the government (formerly through the Department for Energy and Climate Change, now the Department for Business, Energy & Industrial Strategy) has announced subsidy cuts to the renewables market, and stated that it will limit support to technologies that have the potential to scale up and to compete in a global market without subsidy. Consistent with this thinking, the most established technologies, solar photovoltaic (PV) and onshore wind, were not permitted to participate in the latest CFD round, the outcome of which was announced on 11 September 2017, and which comprised offshore wind, advanced conversion technologies and biomass.

M&A IN RENEWABLES

The renewables sector offers long-term, stable returns for investors. Energy remains a fundamental need so it offers investors certainty, and even where the wholesale price of electricity varies, index-linked subsidies offered by the government are attractive. The wider landscape, despite the view of the current US administration, is a long-term global desire to tackle climate change which means that the renewables sector will keep growing and getting stronger.

Renewable energy projects often change hands many times and this has created a boom in M&A activity in recent years. According to a report produced by the Clean Energy Pipeline, there was a significant increase in UK renewables M&A activity during 2016 across all sectors other than solar (www.cleanenergypipeline.com/Resources/CE/ResearchReports/UK%20Renewable%20

[Energy%20Finance%202017.pdf](#)). The total value of deals was £6.6 billion, which is more than double the previous year. The number of deals reduced, however, indicating that the bigger deals are more interesting for investors and perhaps that the market is in an early phase of consolidation.

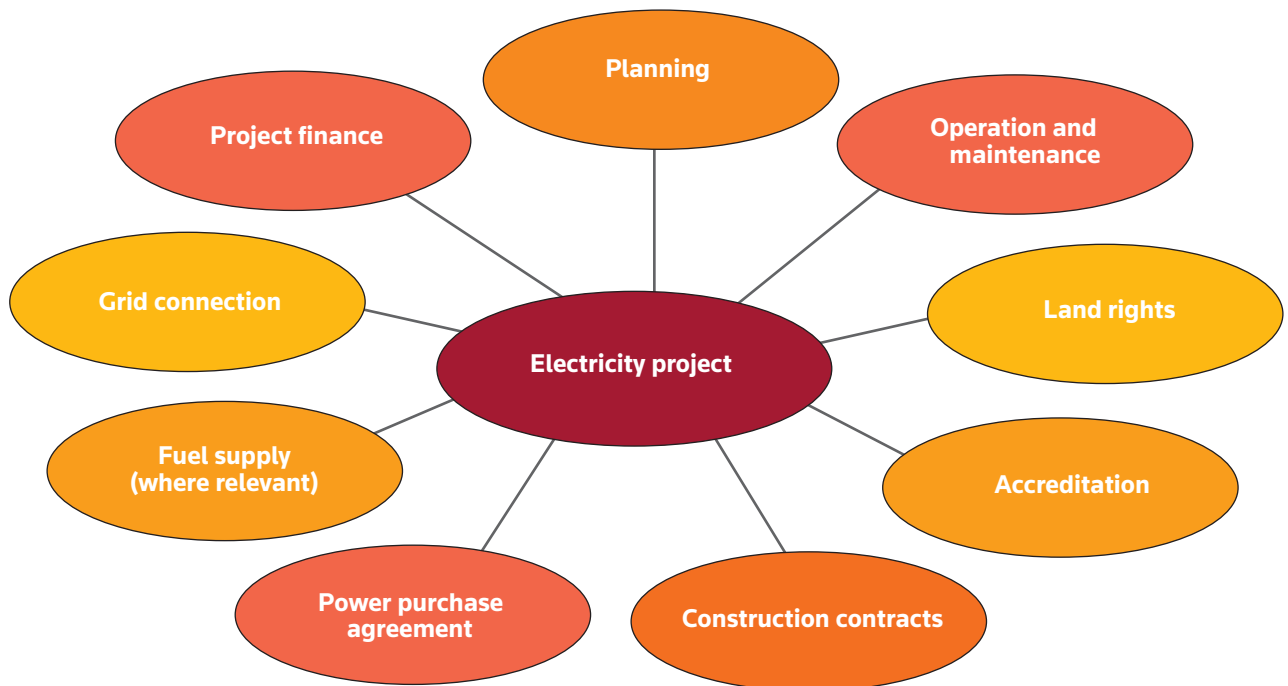
Different stages of a renewables project attract different types of capital and different investor attitudes to risk. Differing needs of investors make it likely that the sector will experience continued market consolidation, particularly of operating projects, resulting in larger deal sizes.

Project stages

There are three separate stages, and many different components, of acquirable renewable energy projects (see boxes "Stages of a renewable energy project" and "Key components of an electricity project"). Each stage involves different emphasis and considerations, and also a very different level of risk, so from a funding perspective will attract a different type of investor (see box "Bankability"). However, the stages all lead towards the same goal, so there are common themes to each stage.

Pre-consented. The pre-consented stage will typically involve feasibility assessments, commissioning surveys, site location and environmental impact studies. It is the most speculative stage and many projects will be screened out. This stage does not therefore generally attract many conventional investors. Historically, many of the larger utility companies almost exclusively undertook these activities on their own balance sheet

Key components of an electricity project



but, as the market developed, specialist investors partnered with experienced developers and management teams became more interested. At the same time, businesses grew out of landowners wishing to maximise returns on their real estate.

Consented. At the consented stage, a project will usually have:

- Secured a planning permission.
- Received and accepted a grid connection offer from a distribution and network operator (DNO).
- Entered into binding option agreements for the main site or sites and secured the right to call down easements in respect of cable and access routes.
- Depending on the project, secured a gas connection offer, environmental licences or consents, or both, as required.
- Where available, secured support following a successful bid for a CFD.
- All other necessary consents in place.

Key agreements will have been signed, possibly in heads of terms format, and the project owners will start developing the site.

As the project moves forward to construction, significant capital commitments are required. At this stage, some developers will look to exit the project to monetise their initial investment, so the first in a series of significant M&A transactions may take place.

Historically, private equity and hedge funds have been willing buyers, as they are prepared to accept a level of project delivery risk to obtain a higher internal rate of return. However, as the sector has matured and debt funders have increasingly got comfortable with project risks, structured bank finance has become more available at the construction and pre-construction stages.

Operating. A project that has been constructed, commissioned, accredited (where relevant) and is supplying commercial volumes of power is fully operational. Infrastructure and other funds are attracted to buying projects at this stage as they are seeking projects that:

- Are relatively simple, with not too many complex elements, and require them to take little or no active role.
- Have committed, long-term counterparties with good credit ratings (often, but not exclusively, large utilities companies).

- Offer stable returns, with the downside risk of wholesale power price exposure often hedged by an offtaker to give some downside protection, while the RO certificates or CFD income streams offer a stable, index-linked yield.

- Are compatible with their investment policies and requirements.

DUE DILIGENCE

Acquisitions in different sectors require due diligence emphasis and negotiation to be concentrated in certain specific areas and the renewable energy sector is no different (see box "Comparing M&A in the energy sector with the service industry sector"). The following areas frequently take a prominent role in renewables transactions.

Regulation

The renewable energy sector operates within a heavily regulated framework, although it often has the benefit of relying on exemptions to operate (see box "Checklist of essential considerations"). There are numerous EU and UK laws, regulations, licensing and planning permissions, guidelines and codes to comply with. Ofgem is the key regulator for electricity and downstream gas markets in Great Britain. Understanding what is required and ensuring compliance is key. Different

energy projects will require different licences and permissions; for example, a generation licence will be required from Ofgem under section 6(1)(a) of the Electricity Act 1989 to generate electricity, unless an exemption applies. However, every project needs to be considered on its own facts.

Contracts

All renewable energy projects rely on the principal terms of the following key contracts, so detailed due diligence will be essential.

Engineering, procurement and construction contract.

The project company will typically enter into a contract with an engineering, procurement and construction (EPC) contractor that is experienced in the type of energy project being undertaken. It is customary in wind transactions for the EPC contract to be divided into, for example, a turbine supply agreement and a balance of plant contract (*see below*). The detail of the contract will depend on the nature of the project but the contractor takes frontline responsibilities for the build and for concluding the whole project. The contractor works with a supply chain but is responsible for delivering a fully completed project to the developer. The EPC contract will specify a detailed timetable, clear roles and responsibilities, price, guaranteed performance obligations, liquidated damages for delay and underperformance and large caps on liability. Typically, areas of due diligence focus include:

- Understanding what stage the project is at; that is, whether the project owner has granted the contractor a provisional acceptance certificate (PAC), an intermediate acceptance certificate (IAC), a final acceptance certificate (FAC) or all of these. In general industry terms, if more than two years have expired since the FAC, it is likely that the contractor's exposure under the EPC contract has either significantly reduced or extinguished.
- Where the EPC contract is more recent, it will be important to understand:
 - whether any issues arose on the build and, if so, how they were addressed. A buyer should obtain a good understanding of any existing or potential defects and make sure that they are insured and being dealt with. Suitable indemnities may need to be sought from the seller to protect against ongoing exposure

Bankability

Bankability, in the context of renewable energy, is the extent to which a project is structured so as to represent an acceptable overall risk to lenders, and is a fundamental component of each of the different stages of an energy project. A project must be bankable before it can reach financial close. Even if the development stage is financed by a developer's balance sheet, bankability will be relevant for any onward sale or refinancing. What will be bankable, and therefore represent an acceptable level of risk to the lender, will vary between the different projects and will differ according to whether a project is being considered on its own or as part of a broader portfolio.

Matters that will be considered, and that lenders will need to be comfortable with, include:

- Suitable site assessment.
- Completion risk.
- Changes in law risk.
- Technology risk.
- The terms of the key project documents, in particular, the land rights agreements, construction contracts, the power purchase agreement and, where relevant, the waste or feedstock supply terms.

Lenders will usually accept some level of risk but may require further protections, such as lender retentions, additional guarantees, more subcontracting or an increased level of equity investment to continue.

where the EPC contract does not provide adequate protection;

- whether any PAC, IAC or FAC issues have been identified, likely to be in a snagging list, and how they are to be addressed;
- whether any deferred payments are due under the EPC contracts;
- whether any amounts are due or recoverable from the EPC contractor and what is the likelihood of recovering amounts, for example, if they are protected by deferred payment mechanics, escrow accounts, bonding or other means;
- the credit status of the EPC contractor generally and whether protection is available if a problem arises during the warranty period;
- whether any practical problems need to be addressed, for example, if a sub-contractor has become insolvent;
- whether the EPC contract is compatible with the needs of a funder, for example, if

the contractor is committed to enter into a direct agreement in a form required by a funder; and

- what comfort is available to confirm that the contract was executed correctly. A general challenge of construction contracts is making sure that all the schedules were incorporated correctly, but often much of the supply chain is outside the UK, which can give rise to concerns over correct execution.

Interface agreement. In the wind industry, projects under construction are often segregated into separate subcontracts, usually a turbine supply agreement, balance of plant contract and a number of other, related subcontracts. This means that projects can run into difficulties if the different contractors fail to co-operate and co-ordinate sufficiently and disputes can arise, for example, as to liability for a default. This is sometimes addressed in an interface agreement, which regulates the relationship between the various subcontractors and sets out an allocation of risks and liabilities.

Operation and maintenance contract. Once the construction of the project is complete, the operational phase will begin. The operation and maintenance (O&M) contract is an agreement between the project company and an operator to manage, operate and maintain a project. During the early stages of the industry, it was typical for the O&M contractor to be the same as the EPC contractor or a member of its group. However, a vibrant secondary O&M market is now developing. The O&M contract will cover matters such as: the operator's services during both the pre-operational and the operational phases; the project's expected performance levels; the role of the project company; payment; changes to the project; unforeseeable events; and limitations on liability. Many of the topics mentioned in relation to EPC contracts will also be relevant here.

Power purchase agreement. The power purchase agreement (PPA) is the agreement under which the project company may sell electricity generated by the project to secure the revenue. It will contain obligations on the project company to deliver electricity to the delivery point. The buyer under the PPA is known as an offtaker and is frequently an electricity supplier or energy trading business. Under the RO regime, long-term PPAs which matched the debt term were common but any long-term price certainty that these PPAs provided came at a cost. Many investors are increasingly comfortable with a policy of short-term PPAs or at least long-term PPAs with the ability to periodically fix prices.

Private wire PPA. The project company may also have entered into a private wire PPA, under which it agrees to supply a proportion of its output directly to a third party, through a private wire rather than the grid. Specific issues that should be looked at in relation to a private wire PPA include: whether any specific connection rights are required if the offtaker has an existing grid connection; whether there are obligations on the buyer to buy a minimum or maximum amount of electricity and to pay whether or not these amounts are taken; what the buyer's creditworthiness is; and whether separate supply licences are required. The termination provisions should also be considered carefully, as should the likelihood of a replacement private wire PPA being established to cover any lost revenue from early termination.

Connection agreement. The vast majority of energy generating plants will need to

Comparing M&A in the energy sector with the service industry sector

Due diligence area	Energy sector	Service industry sector
Real estate	Essential to have land rights, leases and planning permissions in place.	Depends on the specific business. Unlikely to be key.
Environmental	Essential to ensure that all required licences and consents are obtained.	Unlikely to be relevant.
Contracts	There will be a small number of key contracts.	Likely to be a large number of contracts, few of them key.
Employees	Likely to be few, if any, employees.	Employees and managers are of key importance.
IP/IT	Unless the project is operating in a developing area, unlikely to be relevant, and covered by the construction contracts where relevant.	May have significance, depending on the business.
Regulatory	Understanding applicable regulations is essential.	Industry-specific regulations will need to be understood.

be connected to the grid, usually to the electricity DNO, but for larger projects, the transmission grid. The project company will need to apply to the local DNO. The DNO has a statutory obligation to make a formal offer of connection setting out terms such as: the location; the estimated connection date; the cost; and a list of works that will need to be carried out, which are set out in the connection agreement. While the DNO must make an offer, the offer may not be on the terms that the developer was hoping for or expecting, frequently in relation to cost or timescale to connect and energise.

It will also be important to understand in due diligence whether any of the terms are onerous or unusual, whether at the outset or on an ongoing basis, so that a project could be impaired. Some areas of focus include:

- Export constraints; for example, whether there are any circumstances in which power may not be exported onto the network, such as congestion or outage.
- How the connection will be affected during planned maintenance.
- How the costs of local area grid reinforcement works will be split between network users, known as socialised cost.

The connection offers are usually split into contestable and non-contestable works. The non-contestable works are works that only the host DNO is permitted to carry out, for example, the physical point of connection. The majority of the works tend to be contestable, meaning that they can be carried out by the DNOs or by an accredited independent connection provider (ICP).

An ICP is a company that has been assessed and accredited nationally by the Lloyds register to carry out these works. There will usually be an agreement setting out the terms of the contestable works, which include the installation of the cables and other plant.

Real estate

Successful energy projects rely on having the correct leases, easements, planning permissions and landlords' consents in relation to the land on which the project site is established. It is essential to consider at an early stage whether the consent is required of any mortgagees with charges over the land on which the project is located in order to ensure that timing issues are managed proactively. Real estate matters can often make for the trickiest of issues in a due diligence exercise as every land transaction has its own features. This means that all possible threats, such as unhappy neighbours, environmental and wildlife protection concerns, deviations

from planning permissions and access rights should be identified early in the transaction, together with ensuring that the development has taken account of existing infrastructure which may affect a site.

Land rights

Project companies will have agreements with the landowners of the project site setting out negotiated land rights. The lease will cover: the location and the extent of the project site; access rights across neighbouring third-party land; any restrictions on the timings of operation; repair obligations; and any break clauses. Confirmation of compliance with these must be sought. The lease may be prefaced by a call option to be triggered once all the necessary planning and other applicable consents are in place, the terms of which must be checked if the project is in its early stages. Typical lease issues that arise during an operational project can include:

Decommissioning obligations. Often a lease will specify security arrangements that need to be put in place at identified points in the lease term. This is something which, once a site becomes operational, can be forgotten about between the landlord and the tenant.

Rental and royalty payments. Energy projects often have more involved payment mechanisms than a traditional land lease, so it is even more important to check that there is a complete audit trail that documents every rental increase having taken place at the correct intervals. Often, payment increases will also have triggered the liability to make stamp duty land tax returns to HM Revenue & Customs.

Grid connectivity. Rights that may have been taken in the name of a project company at the development stage of a project may have since been adopted by the DNO and may now form part of the DNO's network. Careful due diligence should be undertaken to ensure that robust rights remain in place so that the energy project continues to be able to operate on a standalone basis.

The project company tenant may need to be granted an easement to lay electricity cables along a defined route within the landlord's property. It is important to ensure that this route has been appropriately defined and is capable of exercise, and that all limitations and restrictions have been complied with.

Planning policies

In 2012, the government published the national planning policy framework (NPPF), which sets out the national planning policy for England (www.gov.uk/government/uploads/system/uploads/attachment_data/file/6077/2116950.pdf). This requires local authorities to have a strategy to promote energy from renewable sources, and also to consider identifying suitable areas for renewable and low-carbon energy sources and supporting infrastructure. The guidance produced to supplement the NPPF states that the need for renewable energy does not automatically override environmental protections and aims to give local communities a voice in respect of projects in their area (www.gov.uk/guidance/renewable-and-low-carbon-energy).

If the project has been identified as a nationally significant infrastructure project, it must comply with the renewable energy national policy statement as well (www.gov.uk/government/uploads/system/uploads/attachment_data/file/47856/1940-nps-renewable-energy-en3.pdf). This policy statement sets out further obligations and considerations, compliance with which must be investigated during the due diligence process.

Planning permissions

The project company will have had to consult with residents of the local area before seeking planning permission. As a condition to getting permission, the project company may need to put in place measures to mitigate the impact of the project in an agreement made under section 106 of the Town and Country Planning Act 1990 (a section 106 agreement). The consultation process and any consequent obligations under the section 106 agreement must be checked (*see also box "Planning policies"*).

Conditions, both before the start of a project and enduring throughout it, are often included in planning permissions and as any breach may have criminal consequences, prior confirmation that these have been complied with should be sought, backed up by appropriate warranties or indemnities, or both.

The section 106 agreements are linked to the land and can be enforced against the original covenantor and against anyone that acquires an interest in the land. It is therefore important for buyers of renewable energy projects to check the planning obligations carefully and ascertain the extent of liability of both the original and subsequent covenantors. It is good practice to request a table of all conditions with a column of commentary supporting conditions where they have been discharged, backed up by local planning authority acknowledgement wherever possible.

Any subsequent deviations from the original permission given must also be investigated to

ensure that the amendments were approved. Typically, the project company will need to have applied for and secured either a non-material amendment or a material amendment. This is not unusual, in particular where a change of site layout occurs when the EPC contractor terms have been finalised. Where the proposed change is radical, a new permission may be required.

Due diligence should also investigate the existence of, or an assessment of the likelihood of, a judicial review of any granted permissions on which a project relies. If there is a risk of a judicial review being pursued which remains outstanding when an M&A process reaches completion, judicial review insurance could be obtained.

Community benefit

The provision of community benefits has become a well-established and integral part of many renewable energy projects. It is seen as an important way of sharing the value that renewable energy can bring to the locality in which a project is based. Community benefits may comprise annual donations (often proportionate to the amount of energy produced by the project) to a community benefit society, which will administer the funds for the local community. They can also comprise benefits-in-kind such as direct funding of local projects and local energy discount schemes.

These benefits are voluntary and are separate to any conditions set out in section 106 agreements in relation to the community that may be attached to the planning

permissions obtained. The identification of appropriate benefits should be the subject of discussion between the community and the project developer at an early stage of the project. Depending on the stage of project being purchased, these community benefit discussions may be in progress or have completed. Either way, a buyer must ensure that it has a thorough understanding of what is being or has been offered, in particular where ongoing financial or equivalent commitments have been made.

Insurance

Often in M&A deals, the presence of insurance policies, although raised as a general enquiry, does not form a key concern for buyers. Having appropriate insurance arrangements in renewable energy projects should be considered a critical issue. The policies needed will depend on the stage of the project, and whether it is offshore or onshore, but should include contractors all risk and professional indemnity cover.

If the project is in the construction stage, it will need to cover the works, delay in start-up costs and possible loss of profits resulting from delay. The EPC contract ought to ensure that the contractor maintains appropriate insurances during the build. If the project is in the operation stage, the policies will need to cover machine and equipment breakdown and business interruption.

The policies may have been put in place by either the project owner or the contractor, both of which carry their own risks. If the project being acquired is large, there may be many different contractors all with separate insurance arrangements, creating a risk of some gaps that will need to be identified. An owner-acquired policy will carry more certainty but the buyer will not have any redress if the insurance policies are insufficient for the project needs.

A buyer will need to ensure that the policies in place at the time of acquisition are appropriate for the project and should consider seeking a specialist insurance review before completion.

Fuel supply

Renewable energy projects that generate electricity from waste or anaerobic digestion will need to put in place a fuel supply agreement, also known as a feedstock supply agreement. These projects are often considered to be more difficult to structure as:

Checklist of essential considerations

There are a number of key issues which a buyer should consider when carrying out due diligence. These include:

- ✓ Which, if any, of the government subsidy programmes apply to the project.
- ✓ Which EU and UK regulations apply to the particular development.
- ✓ The provisions of the government's Electricity Market Reform.
- ✓ Licences that are required, for example under the Electricity Act 1989 or the Gas Act 1986.
- ✓ The industry codes and agreements under which the energy companies operate.
- ✓ The role of the applicable regulator (Ofgem for the electricity sector).
- ✓ The role of the distribution network operators and how it is changing in response to the rise of renewable energy.
- ✓ Government planning policies to support renewables.
- ✓ Whether bankability issues have been addressed.
- ✓ Whether covenant and credit support issues have been addressed on key contracts.

- There is an additional project risk to consider and manage; in particular, the technology risk of commissioning the assets and the ongoing management to maximise plant performance.

- The UK market for reliable commercial volumes of the correct types of fuel supply is highly regionalised, and bankable terms, in particular the desired credit support elements, are difficult to find.

Asset condition and maintenance

The terms of the EPC or the O&M contract, depending on the stage of the project, should give comfort about asset condition and maintenance. However, if there are any concerns, it would be worth obtaining a confirmation about the state and value of any projects assets from an independent expert, and carrying out a review of the contracts managing the maintenance (see "Contracts" above).

It is common for the different assets to be held under different contracts with the developer or within different corporate entities, so a pre-sale restructuring may be needed to bring all the required assets together; for example, the grid connection offer may need to be novated to the project company.

Other areas to note

While the following areas do not usually form a key part of the due diligence on energy projects, there may be occasions when they are worth bearing in mind.

Employees and pensions. Renewable energy projects typically do not rely on an experienced employed workforce or on the identity of specified individuals in the way that, for example, service industries do. The project company is unlikely to have many employees, if any. At the development stage, the employees will be employed by the EPC contractor and, at the commissioned stage, the O&M contractor will be the employer.

IP and IT. Where a project uses established technology, the ownership and protection of intellectual property (IP) rights is unlikely to be a significant issue as it would usually have been addressed under the EPC contract or the O&M contract, or both. A warranty should be sought to confirm that the project company does not use or own any IP.

There will, however, be projects where new technology is being advanced, for example, in the energy storage market, so IP issues should not be dismissed, and due diligence enquiries should still be raised.

WARRANTIES AND INDEMNITIES

The warranties should focus on known sector issues and those matters identified as being significant issues (see “Due diligence” above). Regardless of the project development stage, they should cover all property-related planning permissions, land rights and leases, and seek confirmation of compliance. Environmental warranties should also be sought to ensure that all environmental laws have been complied with and that there are no outstanding environmental proceedings or risks of land contamination.

However, it is important to pause and consider the stage of the project, the renewable technology under discussion and the extent of the project company’s obligations under leases and easements. For example, acquiring a solar development project is very different to acquiring and operating an energy from waste facility.

As each project in this sector generally relies on a small number of key contracts, it should be possible for all the main contracts to be listed in a schedule to the sale and purchase agreement. Confirmation of compliance with all terms should be obtained, with additional warranty protection that there are no other contracts or agreements in place in relation to the project.

Specific indemnities should be sought in relation to any known breaches of the main contracts and any outstanding property issues, and in relation to known defects, litigation, complaints or claims. Certain land issues may require insurance and the extent of the insurance is often negotiated.

In recent times, many sellers in the UK market have been developers or private equity or hedge funds. Sellers such as these have been unwilling or unable to either stand behind full commercial warranties or to open themselves up to potentially high-value claims for any extensive period after the deal completion. This is because fund rules may require that proceeds are distributed to fund members as soon as possible or developers want to invest proceeds in their next project.

An absence of post-deal protection has been a feature of the sector and due diligence has therefore been given greater prominence. Parties reluctant to engage in difficult deferred consideration discussions have pushed risks onto advisers through increased

use of seller due diligence, and warranty and indemnity insurance has been used to plug any perceived risk gaps (see *feature article “Warranty and indemnity insurance: a global reach”*, www.practicallaw.com/7-534-6007). The market for insurance in this sector has evolved in recent times and, as with corporate real estate transactions, pricing and terms have improved for policyholders. A clear understanding of the policy, and in particular any exclusions, is needed, as they will often exclude, for example, construction defects.

FUTURE TRENDS

There are a number of areas where change in renewable energy M&A could be seen in the years ahead.

Energy storage

Utility scale electricity storage uses a variety of technologies to store electricity generated by renewables for later transmission or distribution. Significant advances are currently being made in the development of these technologies, in particular, battery storage. This is likely to have a significant impact on the renewables industry as it has the potential to change technologies that generate intermittently (known as a low-load factor) to generators of baseload power, such as nuclear. As the storage market continues to grow, it will attract more investment, leading to a shift in focus for some of the investors currently looking at the renewable energy projects. Equally, as the market for renewable energy projects continues to consolidate, leading to larger deal sizes, investors will be pushed into different directions, leading to a wider scope of the M&A activity around energy storage.

Existing operating renewables projects may look to install storage facilities to take advantage of this new innovation and enhance project returns. The benefits appear clear but many issues need to be addressed when looking at the co-location of storage and energy generation. These include whether:

- The current land rights permit installing a storage facility.
- New planning or landowner permissions are required.
- The existing grid connections enable storage or need to be revised.
- The PPA permits generated electricity to be exported to a storage facility.

- Lender consent is required.

In addition, if the existing project is accredited under the RO, whether ROCs can continue to be claimed is usually fundamental to the viability of the project. In this respect, Ofgem announced in September 2017 that, in relation to several existing commercial solar sites co-located with energy storage sites, ROCs can be claimed on all the renewable electricity generated, including any that is used to charge the storage facilities (www.ofgem.gov.uk/news-blog/our-blog/electricity-storage-under-renewables-obligation). Ofgem said that it had reviewed the sites on a case-by-case basis but would be issuing bespoke guidance on storage considerations later in 2017.

Behind the meter

Behind the meter, also known as private wire, arrangements refer to energy generation or storage on the customer’s site, connected by a private wire. This system is adopted by large commercial customers and on industrial sites, and can help reduce energy costs as the generator is able to avoid certain distribution costs and charges, and typically shares a proportion of the savings with the energy customer. This part of the industry is starting to grow, creating economies of scale that are attracting new investors, resulting in further investment and M&A activity.

Policy changes

There have been significant changes to renewable energy policy within the UK recently which will affect development of the sector and usage levels. Existing projects, however, can usually benefit from grandfathering, so that subsequent changes in tariffs or eligibility do not affect them. There are exceptions to this, as the use of levy exemption certificates, under which an exemption could be claimed from the climate change levy in respect of supplies of electricity from a renewable source, were withdrawn for existing projects from April 2015.

As discussed above, the RO is closed to new projects, having been replaced by the CFD, appearing to reduce the level of support offered (see “The state of the industry” above). There are further uncertainties about how many CFD auction rounds there will be and how wide the net of participation will be. In the latest auction round, launched in March 2017, with the results announced in September 2017, solar energy was not included in the scheme.

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The government consulted in 2016 on changes to the Renewable Heat Incentive, which is a scheme that makes regular payments to individuals and organisations that install eligible heating systems (www.gov.uk/government/uploads/system/

www.gov.uk/government/uploads/system/uploads/attachment_data/file/505972/The_Renewable_Heat_Incentive_-_A_reformed_and_refocused_scheme.pdf). Further stages of reform will follow in 2018 (www.gov.uk/government/uploads/system/uploads/attachment_data/file/577024/RHI_Reform_Government_response_FINAL.pdf).

Although the impact of Brexit is as yet unknown, it is unlikely to have a great effect on the UK's climate change policies, most of which are determined at a domestic level (see "Brexit sector briefing: energy", www.practicallaw.com/3-633-7909). However, the UK may be released from its target under the Renewable Energy Directive (2009/28/EC), which could mean a change of direction and a change to the support mechanisms currently in place.

Subsidy-free market

Energy projects will need to develop to be able to operate in a subsidy-free market. New solar and onshore wind projects, in particular, continue to not be eligible to participate in the new subsidy regimes but are now part of a well-established market. It is expected that supply chain costs will continue to fall so that continued project development without subsidy will make economic sense and mean that new greenfield projects will continue to attract investment. Some large subsidy-free solar and onshore wind projects are already entering the planning stages.

Of course, a whole new industry exists, so even if no further projects were constructed, there would be a vibrant secondary M&A market. Consolidation within this new market has started and will continue for the foreseeable future.

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