

Legal Aspects of Acquisitions and Disposals of Windfarm Projects

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Luke Gabb
Simon Hewes

These notes accompany a talk given by Luke Gabb and Simon Hewes, partners of Bond Pearce LLP, at the British Wind Energy Association annual conference held at Glasgow on 10-12 October 2006.

Bond Pearce LLP is a substantial UK law firm with a particular specialism in renewable energy.

Luke Gabb, who heads the Bond Pearce energy team, has been involved in property related energy matters for almost two decades. Simon Hewes is a corporate finance partner, who has advised on a wide range of energy related transactions in the past decade.

Bond Pearce LLP Energy SECTOR TEAM

- **Involved in renewable energy field since 1990**

Bond Pearce acted as legal adviser in relation to the Delabole wind farm, the UK's first operational wind farm. Since then it has broadened its practice beyond planning, consenting and property matters to include projects, electricity, construction and corporate finance. Bond Pearce acted on the sale of Windelectric Limited, the operator of the Delabole wind farm, 3 years ago.

- **Legal services tailored to sector:**

- Project development (including consenting)
- Procurement and construction
- Financing
- Investment and M&A

- **Full service offering: 110 corporate deals in 2005**

Bond Pearce has considerable corporate finance and finance capabilities, as well as specialist lawyers dealing exclusively with energy related transactions. Corporate finance transactions tend to require significant resource, as well as access to a range of non-sector specialists, such as tax, intellectual property, finance etc.

BOND PEARCE TRACK RECORD

- Rhyl Flats offshore wind farm project
- Kentish Flats offshore wind farm project
- Humber Wind Limited
- SCIRA Offshore Energy Limited
- Project Zephyr, phases 1 & 2
- Darracott Moor Wind Farm Limited
- Windelectric Limited
- Mynydd Clogau Wind Farm Limited
- Callagheen Windfarm Limited
- Glens of Foudland Windfarm Limited
- and many more

Bond Pearce has advised on a wide range of deals: sales and acquisitions of projects, as well as project companies. Transactions range from the sale of consented projects, or SPV's holding consented projects, sales of joint venture interests to the sale of fully operational windfarm companies. In some cases, the seller will retain an interest in consultancy or, indeed, construction or procurement contracts.

INTRODUCTION

- **The market for renewable energy projects**

A great deal of consolidation is occurring in the market, but there are still a number of independent developers. As in any other business sector, companies will have strategic reasons for wishing to sell or dispose of wind farm projects, particularly bearing in mind the high capital costs of construction.

- **Sellers**

Will be, principally, independent developers seeking to make a return on their investment in bringing together land rights, planning permission and related rights.

- **Buyers**

Principally energy companies, particularly bearing in mind the Renewables Obligation. Also, increasingly, financial institutions and investors.

PREPARATION FOR SALE

- **Consents, Contracts and Intellectual Property Rights**

This should comprise everything required to construct and operate the project. There are, of course, exceptions to this, ie. whether the buyer can source turbines and, indeed, construction.

It is essential that the consents and intellectual property rights are reviewed prior to sale to ensure that the actual project complies with the consents and intellectual property rights and that there is internal consistency. It is surprising how often changes are made and not reflected by a variation in the consents.

It is important to ensure that variations in specifications are reflected in the documents before a purchaser or its financier carries out its due diligence.

It is also important to ensure that intellectual property rights, and the benefit of reports, are held by the SPV (assuming that there is an SPV). All too often these are held by the shareholders, not the SPV. It can prove expensive and time consuming for reports to be novated to the SPV (some companies charge a standard fee for this).

Practical problems may be experienced in achieving assignments of the intellectual property rights to the correct company. It is good practice to insist upon standard wording allowing the holder of the report to assign it to a third party (and financiers) upon giving notice to the author. The author may require a release of obligations to the assignor.

It is sensible for a checklist to be compiled in relation to consents, contracts and intellectual property rights, to ensure that everything is covered. Larger projects may require more complex searchable databases (eg. Project Zephyr).

- **Title to the property**

It is important carefully to check title and registrations. Plans should be checked and in some cases it will be necessary to check any superior land owner's title. In addition, it is essential to check ancillary rights for access and grid connection.

All too often the property rights are not sufficiently buttoned down, making it necessary to re-open negotiations with the land owner in order to deliver an acceptable package to the purchaser. This can prove very expensive, because at this stage, after consents have been awarded, the land owner is in a much stronger negotiating position. We can understand that developers may not wish to dot the i's and cross the t's, while the project remains speculative but, as subsequent negotiations carried out with the land owner may be difficult and time critical, the marginal additional expense of entering into fully legally binding options and lease agreements and doing full due diligence on title and enquiries at an early stage is fully justified.

As with consents, contracts and IPR's, it is necessary to review the title and in particular consider issues such as turning points (to enable large vehicles to enter the premises during construction) and blade extensions (in a worse case scenario the blades may pass over a neighbour's land, requiring the neighbour's consent).

Easements should be checked. There is a danger that the network operator may not consent to the route.

The golden rule is that all the relevant rights should be put in place by the time of sale. If they are not, then the purchaser can, quite justifiably, insist on holding back a significant part of the price, pending satisfactory resolution of the outstanding issues. In such circumstances, it is impossible to predict what changes may occur and this could significantly prejudice the seller, in terms of when, or even if, it will receive the balance of the price.

- **Status of power purchase contracts**

Much will depend upon whether or not an acquirer is likely to be an energy company. Accordingly, the sellers need to do their homework. An energy company will be relaxed about not having a power purchase agreement. Indeed, it may prefer not to have one so that it can acquire the energy itself. However, a project which is to be financed will require a power purchase agreement. Indeed, a financier may require to "sign off" the power purchase agreement.

- **Grid Connection**

The costs in relation to this can be astronomic. Often, the obligation to meet the first instalment gives rise to the need to sell the project, the developer may simply not have the resources to meet these costs.

- **Corporate Status of SPV**

A Special Purpose Vehicle (SPV) is an efficient way of structuring a project as all the rights and liabilities are held in a single company. On a sale the bundle of rights can be transferred to a buyer by virtue of the sale of the shares in the SPV. Whilst planning permission relates to the land, the other contracts and rights will vest in the owner of such rights, and will need to be individually transferred unless the company owning the rights is sold. Check for any change of control provisions, where the consent of a third party is required.

SPVs should be clean and clear. Do not go for the cheapest company available from incorporation agents. Often, the initial formalities are simply not dealt with correctly. Ensure that the formalities are properly dealt with and that the statutory books of the company are correctly completed and that all filings are made at Companies House.

SPV's should not be re-used. Otherwise, a purchaser will be understandably concerned about other liabilities which may exist within the SPV. If assets need to be transferred into an SPV, then upon that SPV leaving the group within 2 years of the transfer, a de-grouping charge can arise. This is another reason why it is appropriate for all assets to be held by the SPV.

An SPV ringfences the assets and liabilities relating to a wind farm project.

- **Tax**

Check the tax rules which apply in relation to the deductibility of losses. Clearly, developers must accept that not all projects will succeed and it is therefore important that if they have to write off costs in relation to a project, they can at least take those costs into account to reduce their tax liability.

Some projects are structured as separate holdings of assets, in which case each participant will, presumably, hold the rights, bear the costs and claim tax losses as appropriate (although even in those scenarios sometimes rights are held in an SPV owned by the participants). Provided the shareholding in the SPV is large enough, the shareholder should be able to take the benefit of tax losses, regardless of whether the expenditure was incurred by the SPV or the shareholder.

Clearly, individual shareholders will prefer to structure the transaction as a sale of shares, hopefully enabling them to claim full taper relief. This is not so important for corporate shareholders.

THE SALE PROCESS

- **Auction process**

The first question to ask, if you are wishing to sell a wind farm project or SPV, is whether it justifies an auction process. Generally, auctions are time consuming and best left to the professionals, who are geared up to handle them. The advisors to the sellers will prepare a longlist of possible buyers and, subject to confidentiality undertakings being obtained, allow access to the interested parties. On the basis of initial bids, a shortlist will be produced. Those bidders will be allowed access to detailed due diligence information and also given a standard form share purchase agreement and asked to make their bids on the basis of the information provided, indicating what changes they would propose to make to the SPA. The advantage of this process is that it forces a purchaser to "sharpen its pencil" in relation to the legal as well as the financial terms. Accordingly, the seller should be able to obtain concessions from the interested parties at this stage, rather than granting exclusivity to the preferred bidder, which is then able to take a hard line in relation to the terms of the SPA.

There are some important points to bear in mind in relation to an auction process:

- *It only really works where the project rights are in good shape. If there are any areas of concern then bidders are likely to reserve their position, and the preferred bidder will be able to re-open negotiations on the pretext of seeking to resolve the open issues.*
- *The auction process may put off some bidders, who simply will not wish to incur substantial legal costs in carrying out the due diligence and considering and marking up the SPA. This is a very real risk and we are not sure whether an auction process is appropriate for smaller projects.*
- *If there is effectively only one bidder then whilst valiant efforts may be made to pretend that more than one person is in the race, it is generally pretty obvious to a bidder and the position can become somewhat farcical.*

- **Data Room and Due Diligence**

The data room is the name given to the documents to be disclosed to bidders in relation to the project. Very often it is not a room at all and it can be a virtual room.

It is essential that the contents of the data room are checked against the project in its current state and against other documents relating to the project. There should be internal consistency and a seller should work hard to ensure that all gaps are covered. It is really important that the process is rigorous. If there are any issues or problems, you don't want to find out about them when three sets of lawyers are on the case.

The purchaser will carry out its due diligence in relation to the contents of the data room. Often a seller will prepare a questionnaire and purport to answer the questions and provide the documents in answer to those questions.

A prospective purchaser should have a clear view of its requirements in relation to the project and should produce a commercial and legal checklist, so that it can compare the contents of the data room against its checklist, so enabling any gaps or inconsistencies to be identified. The purchaser should ask supplementary enquiries in relation to any areas of concern.

- **Share Purchase Agreement**

In relation to an auction process, the SPA is a critically important document, setting out the seller's position and inviting prospective purchasers to challenge this. It is important that the seller resists the urge to put forward too one sided an agreement, as this is likely to lack credibility. Rather, the agreement should be near to what one could expect in relation to a finely negotiated deal, although this will, of course, vary depending on the negotiating strength of the parties.

Even if there is no auction process, it may well be appropriate for a seller to submit its draft SPA to the prospective purchasers, stating that it will assume the purchaser will enter into an agreement broadly in these terms. This enables a seller to flush out whether or not a purchaser is likely to take an aggressive stance.

The usual protocol in relation to share purchase agreements is that the purchaser or its lawyer drafts the agreement. However, wind farm project companies are sufficiently different from the norm to justify a tailored approach to warranties (which generally comprise the bulk of a share purchase agreement). If the project is consented, but not constructed or operational, then the purchaser should not require full warranty coverage. However, conversely from the purchaser's perspective, it is important that it identifies the key issues and ensures that these are subject to appropriate warranties.

- **Warranties and indemnities (and seller limitations)**

As mentioned above, a share purchase agreement relating to a consented, but not built project, or the transfer of a joint venture party's shareholding to the other party, would be very different from a standard share purchase agreement.

The general rule, subject to the Financial Services and Markets Act provisions, is that of caveat emptor (or buyer beware). Accordingly, virtually no terms are implied in relation to a transfer of shares (or indeed assets) and it is therefore necessary for a purchaser to ensure that it has adequate warranty coverage.

The purchaser should think carefully, along with its legal advisers, as to what warranties it needs in relation to the project. Conversely, the seller will not want to accept risk in relation to the warranties, but will want to ensure that it only gives warranties which it knows are correct. Sector knowledge is essential in relation to transactions of this type, both for purchaser and seller.

In relation to critical risk areas, a purchaser may legitimately require indemnities, particularly if the seller has not dealt with things properly.

We mentioned above the need for full verification and checking to be carried out by the seller and its advisers before the sale process begins. If it does not do this, there is a risk that considerable expense will be incurred in relation to resolving the issues and also the likelihood that the purchaser will require indemnities in relation to any aspects which it considers unsatisfactory.

It is usual for the sellers to be protected by limitations including time limits for claims under the warranties as well as thresholds and de minimis concerning liabilities. Clearly, if there is a fair degree of competition for the company or project, the seller is in a better position to insist on a high level of threshold or de minimis before claims can be made.

It is important to "close off" liability in relation to self authored reports. Whilst the seller can limit liability in relation to warranties and indemnities, there is always a risk that when the seller has provided services to the SPV the purchaser could seek to claim through the SPV against the seller in relation to services provided. It is therefore important that as between the seller and the SPV appropriate protections are put in place for the seller in relation to self authored reports and data provided by the seller. This might be relevant in relation to wind data, for example. Likewise, the seller might want to give itself access to generic information, by way of licence (which is not site specific).

- **Disclosure**

The convention is that a seller will not be liable in relation to warranties to the extent that it makes fair and accurate disclosure of the facts which are contrary to the warranties. Such disclosures are made in a disclosure letter, with the relevant documents being set out in the disclosure bundle. The courts have in the last couple of years made it clear that a reasonably high burden is placed on sellers to point out the

precise nature of the disclosure so that they cannot get away with simply passing the risk to the buyer by providing the relevant documents to the buyer. It is important, therefore, that the seller takes the process seriously and makes proper disclosure, otherwise it risks claims under the warranties. Deliberate non-disclosure can be construed as fraudulent. No seller should deliberately withhold information and take the risk that a warranty claim will be the worst that can occur. Under Section 397 of the Financial Services and Markets Act 2000, it is an offence for a person to make a statement, promise or forecast which he knows to be misleading, false or deceptive in any material particular, dishonestly to conceal any material facts whether in connection with a statement, promise or forecast made by him or otherwise or recklessly make (dishonestly or otherwise) a statement, promise or forecast which is misleading, false or deceptive in a material respect. This underlines the importance of making full disclosure.

- **Retention of part of sale price**

If a seller does not have a strong balance sheet and/or there are any open issues in relation to a project (eg easements have not been completed between the onshore plant and the connection to the grid) the purchaser might insist on money being held back, and only released after a period of time has elapsed, or the relevant condition has been satisfied.

An auction process can help flush out prospective purchasers' positions on security. Although probably stating the obvious, a seller should aim to have no open issues at the point of sale. Otherwise, it risks a purchaser insisting that part of the purchase price be retained.

FINANCE

- **Requirements of financiers**

Financiers are risk adverse. In relation to early projects, financiers were extremely nervous in relation to all conceivable risks. Nonetheless whilst they are perhaps less nervous now that wind farm projects have a better track record they are very rigorous in relation to their due diligence. A financier, and its advisers, are likely to scrutinise all the arrangements and documents very carefully and are unlikely to take a "commercial view".

This underlines the importance of ensuring all aspects of the project dovetail because the likelihood is that if the seller does not discover any inconsistencies, the financier or its advisers will. This will affect the credibility of the seller as well as adding considerably to the costs, particularly as the financier's costs, as well as the costs of its legal adviser, will be borne by the purchaser. Then there is the cost of the seller's legal advisers dealing with the financiers legal advisors...we flag the need to get things ship shape before the process is initiated.

There is a natural tenancy on the part of developers to do the minimum necessary to get them to the next stage.

- **Assignment of Rights**

Debt financiers may well require the right to have the benefit of all relevant rights assigned to it, in the event of the enforcement of its security. This may include rights in relation to the major contracts, such as procurement, construction and power purchase agreements.

CONCLUSION

- **Guidance for Sellers**

Spend adequate time reviewing the project and the contracts, consents and intellectual property rights relating to it. Consider also the property rights. It is important that a thorough pre-sale audit is carried out, so that the seller is satisfied that any irregularities or inconsistencies have been resolved. If they cannot be resolved then, providing they are not deal breakers, the disclosure of these weaknesses needs to be managed.

It might be appropriate for an independent person to review the project.

- **Guidance for Buyers**

Carry out an independent appraisal as to objectives and requirements and test the data room contents and contractual documents against this. It is essential to have a benchmark. Equally, it is important to predict a financiers' requirements. These should be factored into the purchaser's requirements. It damages a purchaser's credibility if it needs to make additional demands, as a result of its financiers' requirements.

Please contact Simon Hewes or Luke Gabb in relation to any queries in relation to the acquisition or disposal of wind farm projects and companies or in relation to the contents of this talk.

Simon Hewes
Partner
Corporate Finance
Bond Pearce LLP

simon.hewes@bondpearce.com

DDI: 0845 415 6950
Mobile: 07767 352 137

Luke Gabb
Partner
Property
Bond Pearce LLP

luke.gabb@bondpearce.com

DDI: 0845 415 7701
Mobile: 07774 973 900