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M&A in offshore wind: a global market

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M&A in offshore wind – some key themes

- Case study – the growth of a new asset class
- Bilateral sale or auction sale?
- Buyer and seller protections
- Warranty and indemnity insurance
- Purchase price adjustments

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Case study – Greencoat UK Wind plc

The growth of a new asset class

Pre-2012

- UK's first offshore wind farm – North Hoyle 60MW 2003
- By 2012 UK had 20 offshore wind farms – 3,566MW
- Initial owners were utilities (RWE, Orsted, Vattenfall, Centrica, E.ON, SSE) plus a few private equity investors
- Utilities wanted the green power and the asset management but not always the assets
- Investors liked the government revenue support, the inbuilt linkage to inflation and the exposure to power prices..,
- BUT…
  - Was offshore wind safe for financial investors?
  - What were the construction risks?
  - How secure was the government revenue support?
  - Should a pension fund or an insurance fund really buy offshore wind?

2012-13 Greencoat UK Wind plc IPO

- IPO cornerstoned by UK Government and SSE
- Invests jointly with UK government in Rhyl Flats offshore wind farm (90MW)
- Raises over $200million from private investors alongside UK Government and SSE
- Acquires interests in 6 wind farms including Rhyl Flats
- Unlocks the market in UK offshore wind
- 2018's owners include: Blackrock, PGGM, Maquarie, InfraRed, China Resources, J-Power
- 2018 Greencoat's market value is now $1.8 billion, owns over 30 wind farms
- 2018 – UK has 7.5GW, operational, another 10GW targeted by 2022

The growth of a new asset class

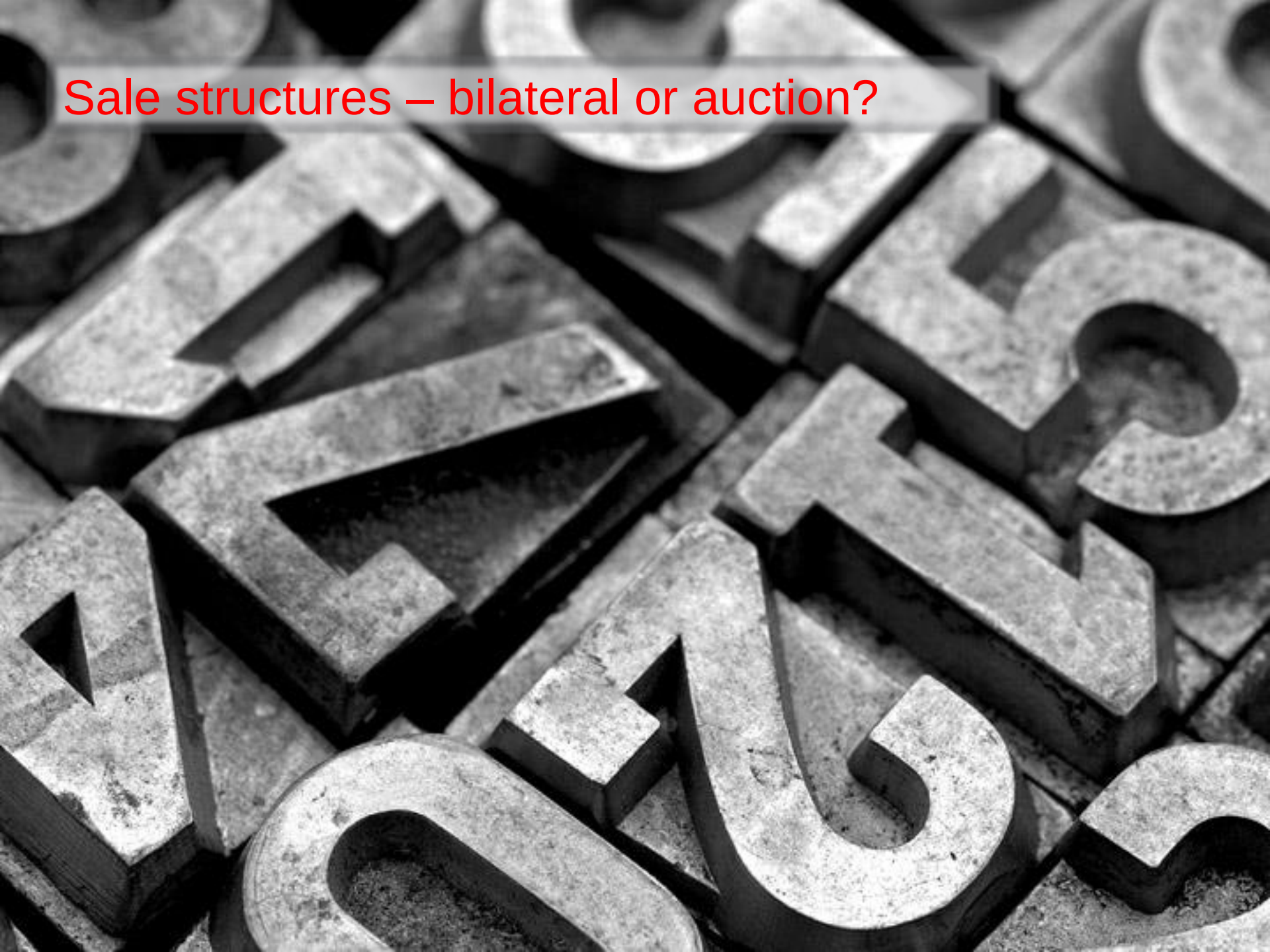
Europe

- France
  - 6x500 MW projects, operational 2021-2024
  - EDF, Enbridge, Engie, Iberdrola
- Germany
  - 4GW 20 projects operational, 6.5GW by 2020
  - Targeting 15GW by 2030
  - E.ON, Vattenfall, Innogy, Iberdrola, Orsted, Equanoretc
  - China Three Gorges, Danish Pension Funds, Itochu, Northland
- The Netherlands
  - 4 operational projects, 1.1GW, 4 more by 2020 1.5GW
- Belgium
  - 4 operational projects, 900MW, 4 more by 2020 1.4MW

North America and Asia

- USA
  - east coast: Massachusetts, NY, NJ, Maryland, Virginia, North Carolina
  - Potentially 15GW in 12 projects
  - Deepwater Wind, Orsted, Statoil, Copenhagen Infrastructure Partners
- Canada
  - east coast 4 projects under development

Sale structures – bilateral or auction?



Bilateral v auction sales

Bilateral

- Dominant form of M&A transaction in UK market; also common in US market but auctions very popular
- Involves negotiation between seller(s) and single buyer (or consortium)
- Particularly useful where:
  - limited pool of buyers/obvious buyer
  - lower value target means additional cost of auction process outweighs benefits

Auction

- Used in both UK and US markets
- Technique for packaging an asset for sale in a controlled process which reflects three key objectives for a seller:
  - achieving competitive tension
  - maximising value
  - reducing contractual protection offered by seller (i.e., buyer takes more risk)
- Particularly useful where:
  - higher value assets with expectation of investor appetite – ability to generate competitive tension and maximise value

Bilateral sales – pros and cons

Sell side – pros

- Lower costs and potentially shorter transaction timetable
- Less management time required
- Less disruptive to business
- Lower risk of leaks

Buy side – pros

- Stronger negotiating position - ability to negotiate lower price and more attractive contractual terms
- Greater control over the process
- More control over scope of DD/information flows

Sell side – cons

- Lack of competitive tension may result in lower price/less favourable terms
- Less control over timetable which may become extended

Buy side – cons

- Target less likely to be packaged for sale
- Timetable may become extended

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Auction sales – pros and cons

Sell side – pros

- More/broader range of potential buyers
- Competitive tension to maximise price
- Better contractual terms
- Control of process/timetable

Buy side – pros

- Access to the transaction
- Seller more likely to sell
- Quick deal closure
- Clear process

Sell side – cons

- Higher costs
- Disruption to target business
- Management time required
- Risk of "fishing" competitors
- Target business perceived as "damaged goods" if fail?

Buy side – cons

- More competitive process
- Risk of overpaying
- Fewer contractual protections
- Risk of wasted costs
- Constrained/controlled DD/information flows

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Buyer and seller protections

Conditionality

Nature of conditionality

- US SPAs* typically contain a greater number of conditions than UK SPAs
  - reflects the US approach that risk passes at completion, not signing
- In UK SPAs, conditions more often limited to those required by law/regulation
- Common conditions in UK deals include:
  - shareholder approval
  - competition clearances
  - licences
  - change of control
- Common conditions in US deals include the above, plus:
  - requirement for seller's warranties to be "brought down"
  - absence of MAC
  - Financing
  - Pre-closing covenants satisfied ["in all material respects"]
  - Additional specific items (e.g., a certain contract has been amended)

"Bring down"/repetition of warranties

- US deals often include a condition that seller's warranties are "brought down" at completion
- "Bring down" standards vary, e.g. requirement could be that warranties are:
  - accurate in all material respects, or
  - accurate to extent required so as not to cause a MAC
- In UK deals, repetition of warranties beyond "fundamental warranties" is not common and rarely a condition to closing

Conditionality

MAC

- Use of MAC condition and associated termination right: common in US deals; less common in UK deals
- Allows buyer to walk away if economic position of target materially and adversely deteriorates between signing and completion
- Key issue = what constitutes a MAC? Rarely found to have occurred in US deals; Buyer should not rely on MAC clauses
  - common to exclude “market MAC”, i.e. matters affecting economy/industry in general
- Where MAC agreed in UK deals, sometimes try to tightly define in hope more likely to work in narrow circumstances specifically relating to target
- Alternative solutions:
  - insurance solutions – can business interruption insurance provide cover instead?
  - overlap with completion accounts/earn-outs – could these be used instead e.g. where event would result in an adjustment?

Pre-completion covenants

- Seller will want “business as usual” – underpinned by pre-closing undertakings confined to matters within seller’s direct control
- Buyer will want “business as usual” plus additional protections extending beyond what the seller can control plus information and access rights
- Covenants often less extensive in US deals given the higher degree of conditionality in US deals

Warranties

Scope of warranties

- Usual to agree set of warranties in US and UK transactions covering title, capacity and all aspects of target business
- Level of warranty protection usually heavily negotiated in both jurisdictions, but typically greater warranty coverage in US SPAs

Disclosure

- In UK deals:
  - warranties are usually qualified by matters disclosed in the disclosure letter which will include general disclosure of matters of public record and other specific disclosures
  - data rooms are typically generally disclosed against the warranties
  - parties typically agree “fair” disclosure standard
  - seller often has right to disclose against any (non-fundamental) warranty that is repeated at completion
- In US deals:
  - warranties are typically qualified by matters specifically disclosed against them in schedules to the acquisition agreement
  - general disclosures and disclosure of data rooms are rare
  - seller does not usually have right to disclose against warranties that are “brought down” at completion, or pre-closing disclosure may trigger a termination right for buyer

Warranties (cont.)

Warranties v. representations

- In UK deals, seller often gives assurances as warranties, but not also as representations. Seller's aims are to:
  - ensure buyer's only claim is a contractual claim for damages for breach of warranty; and
  - prevent buyer from bringing a tortious claim for misrepresentation seeking either damages calculated on a tortious basis or rescission of the SPA
- No distinction between warranties and representations in the US and terms often used interchangeably
  - remedy for breach driven by remedies expressly stated in SPA

Basis of damages

- In US deals:
  - seller usually gives warranties on an indemnity basis - $ for $ recovery for loss suffered
  - common to put proportion of sale proceeds in escrow to deal with warranty claims (see later slide)
- In UK deals:
  - contractual damages for breach of warranty generally assessed by reference to reduction in value of shares resulting from breach
  - indemnity basis of damages is still relatively rare and a hotly contested deal point
  - but common to negotiate specific indemnities to cover identified liabilities
  - escrow not commonly used
  - warranty disputes less common than in the US

Typical seller protection provisions[1,2]

Limitation	UK market practice	US market practice
Caps	• c 20-50% for general warranties • 100% for fundamental warranties • 100% for all claims under agreement	• c. 5-15% for general warranties • 100% for fundamental warranties • 100% for all claims under agreement
De minimis	c. 0.1%	Negotiated point; not included in all deals
Basket	c. 1%	c. 0.5% to 1%
Time periods	• General warranties – 1-2 financial cycles • Fundamental warranties – longer, may be unlimited • Tax – 4-7 years	• 12-24 months • Statute of limitations • Statute of limitations
Other key protection provisions	• Conduct of claims provisions • Exclusion of contingent/ unquantifiable liabilities • Exclusion of sums recovered from insurance/third parties • Exclusion of loss from changes in law/buyer's conduct	• Similar to UK practice but may have "materality scrape", which benefits buyer • Will include a materality scrape if RW & I is purchased

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Warranty & indemnity insurance

Warranty & indemnity insurance

What is it?

- Provides cover for loss re. breach of warranty/claim under tax deed
- Bridges competing interests between buyer and seller as to warranty protection (scope, value and duration), covenant strength, clean exit v retention etc
- Can be seller or buyer policy:
  - in UK, 90+% are buy-side policies, although some “flip” from seller to buyer as part of auction process
  - in US, substantial majority are buy-side policies

The sell side objectives

- Clean exit – seller driven buyer policies
- Immediate distribution of sale proceeds (reluctance to retain proceeds in escrow)
- PE owned assets - but increasing use by corporate sellers
- Reduce impact of contingent liabilities (e.g. future financial plans by seller?)
- Avoid/reduce claims against individual sellers personally
- Provide additional comfort where a buyer may be perceived to be highly litigious

The buy-side objectives

- Concern about strength of seller’s financial covenant (in particular, individual sellers)
- Enhanced position in highly competitive auctions (e.g. low liability caps, warranty durations, blanket awareness etc.)
- Best practice risk management/corporate governance
- Maintain business relationships (e.g. seller(s) are future management team or key supplier)
- Concerns over unknown risks
- New/unfamiliar jurisdiction or industry

Warranty & indemnity insurance (cont.)

Use of W&I insurance

- Very common in UK and growing in US markets
- Increasing popularity due to:
  - becoming more flexible and less expensive
  - increased ability to claim (as result of favourable terms)
  - differentiation on terms offered by different insurers

Pricing

- Previously expensive and inflexible, the UK market is now more developed and the product adaptable to deal requirements and timelines
- Premiums dependent on terms, but generally c. 0.9 - 1.5% in UK
- US more expensive (2.5 - 4%) – premium is percentage of total insurance coverage requested but for right type of deal (i.e., perceived as low risk) can be lower

Warranty & indemnity insurance (cont.)

Limits of cover in UK

- Market standard exclusions, e.g.:
  - known issues – actual knowledge of the buyer deal team
  - forward looking warranties – coverage is intended to catch historical, not speculative, liabilities
  - criminal/regulatory fines and penalties which are uninsurable at law
  - punitive, exemplary and other non-compensatory damages
  - product liability/construction defects – these should be covered by specific insurances
  - availability of tax assets, secondary tax and transfer pricing
  - pension scheme underfunding liabilities
  - liabilities for pollution, asbestos or other contamination
  - post-close consideration adjustments
- De minimis and basket thresholds typically market
- General disclosures (including data room)
- All diligence materials qualify the policy cover

Limits of cover in US

- Fewer standard policy exclusions
- No de minimis and lower excess
- No general disclosures
- Scope of due diligence does not generally qualify policy cover

Purchase price adjustments

Pricing mechanisms

Completion accounts v. locked box

- Completion accounts remains most common approach in US deals
- Completion accounts and locked box mechanisms both used in UK deals
  - locked box more common in auctions/competitive situations

Completion accounts

- Price
  - estimated price payable at completion based on estimated net debt and working capital
  - final price based on actual net debt and working capital per completion accounts
  - post-completion true-up for any difference between final price and estimated price
- Accounts
  - completion accounts should be specifically drawn up for the purpose
  - audited annual accounts or management accounts are drawn up for a different purpose and therefore not suitable e.g. materiality threshold will not be appropriate

Locked box

- Price
  - net price for the shares agreed before completion
  - no post-completion true-up
  - generally seller friendly
- Accounts
  - agree price on basis of accounts already in existence
  - risk of decrease (and benefit of increase) in value of business passes to buyer from date of “agreed accounts”, but control does not pass till completion so pre-completion covenants of increased importance
  - deal must prevent seller from extracting value from “agreed accounts” date, save as previously agreed – seller gives indemnity against “leakage” (other than “permitted leakage”)

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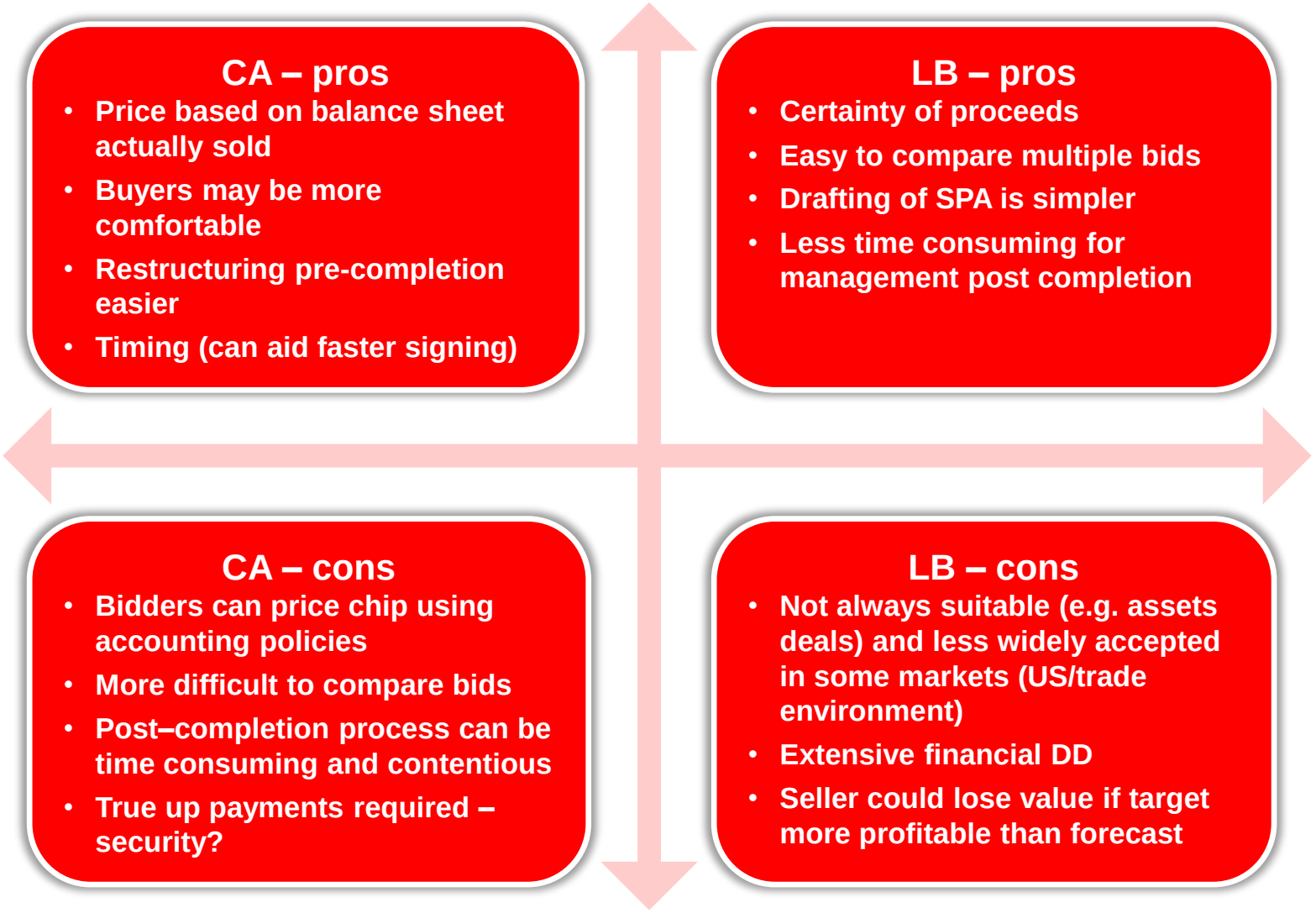
Pros and cons – completions accounts v locked box



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Other price considerations

Use of retention/escrow

- Often a contentious issue on UK deals
  - driven by underlying concern that the warranties/indemnities are only as good as seller giving them
  - where used, rare for escrow to be buyer's exclusive source of recovery
- More common on US deals
  - often covers closing adjustments as well as claims under warranties/indemnities
  - US standard = approx. 10%
  - escrow is often buyer's sole recourse other than for fundamental representations and covenants

Deferred consideration/earn out

- Seen in UK:
  - where there is uncertainty as to future earnings due either to broader economic conditions or where performance is dependent on key management sellers
  - in the service sector, i.e. where the assets being acquired may be worth only a small fraction of the purchase price and future performance can often be the key to justifying the consideration
  - on development projects, i.e. where the value of the business will only be realised once a series of milestones have been reached, so staged payments are made as the project develops
  - to bridge price gap
  - where the target has a short track record but significant growth potential
- In US, often discussed, but not a common feature
- Concern is control over business during earn-out period and adjustments to accounts (e.g., salary increases or marketing expenses)

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