

Vinson & Elkins

January 2020

RENEWABLE M&A: WHAT MAKES IT DIFFERENT?

Energy Series

velaw.com



TODAY'S PANELISTS



DANIELLE MANGRUM PATTERSON
PARTNER, ENERGY TRANSACTIONS & PROJECTS

Houston

 +1.713.758.3637

 dpatterson@velaw.com



DEBRA J. DUNCAN
COUNSEL, TAX

Washington, D.C.

 +1.202.639.6635

 dduncan@velaw.com



MARY ALEXANDER
SENIOR ASSOCIATE, TAX

Washington, D.C.

 +1.202.639.6536

 malexander@velaw.com

WHAT'S INVOLVED IN A RENEWABLE “M&A” TRANSACTION

Renewable M&A deals often involve a wide range of transactions and agreements, not just the core M&A transaction / acquisition agreement

Example #1 – Development-Stage Investment

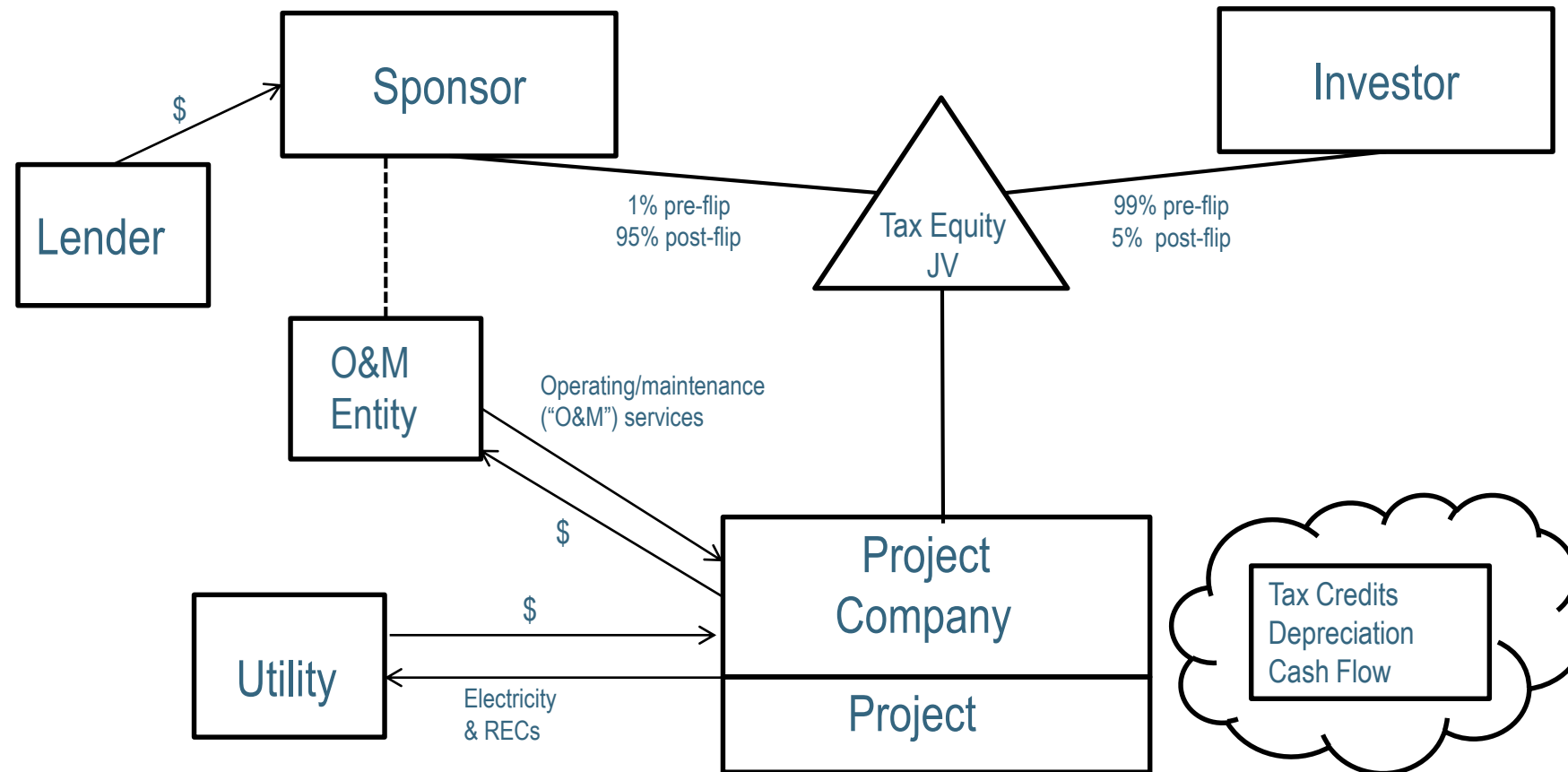
- Master Purchase and Sale Agreement with Rolling Acquisitions and/or Development Milestone Payments
- Development / Construction Management Agreement
- Asset Management Agreement
- O&M Agreement
- EPC Contract
- Newco LLC Agreement (or Other Upside Sharing Arrangement)

Example #2 – Acquisition of Operating Portfolio by Two Investors

- Purchase and Sale Agreement between Seller and Buyer
- Buyer Newco LLC Agreement between Two Investors
- Credit Agreement for Back-Leverage Financing for Investor 1

Other Agreements – Parent Guarantees, Equity Commitment Letters, Legal Opinions

PARTNERSHIP FLIP STRUCTURE



(1) Project Company constructs project; (2) Investor funds its share (before project is placed in service if claiming ITCs or at placed-in-service date if claiming PTCs); (3) Partnership income, gain, loss, deductions and tax credits initially allocated 99% to Investor; (4) after flip point reached (and recapture period expires if claiming ITCs), Investor's allocable share reduced but not below 5%; (5) Sponsor may have right to buy out Investor at FMV after flip date.

DUE DILIGENCE CONSIDERATIONS

While a run-of-the-mill M&A transaction requires due diligence simply of the target, a renewable M&A transaction often involves multiple tiers of due diligence

Project Level Due Diligence

- Scope will differ depending on development-stage versus operating projects
- Key project documents:
 - PPA / Offtake Agreements, REC or other Revenue Contracts
 - Interconnection Agreement
 - Real Property Agreements
 - Shared Use Agreements
 - AMAs, OMAs and other Service Agreement
 - EPC Contracts, Warranty Agreements
- Environmental and Regulatory Permits
- Title Policies + Insurance
- Local Jurisdiction Considerations

DUE DILIGENCE CONSIDERATIONS (CONT'D)

Tax Equity JVs

- Waterfall, Allocations and other Economic Provisions
- Governance
- Transfer / COC Provisions
- Buy-Out Rights
- Capital Commitment Obligations, Deficit Restoration Obligations

Upper Tier JVs – all of the same considerations for tax equity JVs

Seller / Seller Affiliate Contracts – Anything from prior PSA, Third Party Guaranty in favor of Seller, Credit Support posted by Seller / Seller Affiliate, Services provided by Seller / Seller Affiliate

Debt Documents – may be construction debt, project level or back-levered

- Waterfall
- Transfer / COC Provisions
- Lender Consents
- Default Provisions

Buyer / Seller Creditworthiness – to support on-going transaction obligations

DUE DILIGENCE CONSIDERATIONS (CONT'D)

Tax Credit Eligibility

- Production Tax Credit (“PTC”)
 - Available for production and sale of electricity (on a per KWH basis) from wind, geothermal, biomass, municipal solid waste and certain other types of facilities for 10 years beginning on the date the facility is placed in service.
 - To be eligible for PTCs, a wind facility must begin construction before January 1, 2021.
 - Wind facilities that begin construction after December 31, 2016 will receive reduced credits. The reduction for wind facilities that began construction in 2019 is 60% and the reduction for wind facilities that begin construction in 2020 is 40%.
- Investment Tax Credit (“ITC”)
 - Credit equals 30% of qualified basis of solar energy property that began construction before January 1, 2020, 26% for property that begins construction in 2020 and 22% for property that begins construction in 2021.
 - Generally available only to persons that originally placed the project in service and is subject to recapture if property is disposed of or ceases to operate within 5 years of placed in service date.
 - Partner is deemed to dispose of property if its interest in partnership profits is reduced below 2/3 of its share of ITC.

APPROVALS, CONSENTS & OTHER THIRD PARTY MATTERS

In all M&A transactions, must determine whether any regulatory approvals or third party consents required; in renewable M&A transactions, third parties will almost certainly be implicated

Transfer / Change of Control (“COC”) Restrictions

- Many project documents broadly drafted to pick up direct and indirect transfers well up the chain – project-level agreements, tax equity JVs and debt documents
- Not always clear how to apply COC provision in project-level document to a sale of interests in a tax equity JV
- Tax equity JVs often include “permitted transferee” concepts but can be difficult to technically satisfy and/or still require “reasonable consent” of other members
- Multiple forms of assignment agreements likely needed to satisfy requirements of each tax equity JV or any other agreement with specific assignment and assumption requirements
- Have to navigate diverging goals of lenders and tax equity JV members when consent from both is required

APPROVALS, CONSENTS & OTHER THIRD PARTY MATTERS (CONT'D)

Failure to Comply with Transfer / COC Restrictions

- Often draconian results expressly provided if transfer provisions not complied with – e.g., termination rights under project documents, events of default under credit agreement, or transfer of equity interest being “void ab initio”
- Even if consent is “not to be unreasonably withheld”, must weigh the potential negative impact of closing over a consent under a key project document
- Not clear in most jurisdictions what a voided transfer would mean with respect to a COC; however, Delaware courts, for example, have shown they will strictly enforce the provisions of an LLC Agreement

Who Bears the Risk to Identify

- In a typical M&A transaction, the transferor is most often responsible for identifying and complying with all consents; however, in renewable M&A transactions, whether or not a consent is required may very likely depend in part on the status / identity of the transferee

Governmental Approvals

- Must determine whether all of the “usual” approvals apply – e.g., HSR, CFIUS
- FERC Filings and Approvals
- Local Jurisdictions – e.g., Public Utility Commission or Local Permitting Matters

STRUCTURING CONSIDERATIONS

Key structuring consideration for renewable M&A deals isn't so much about structuring for the transaction at hand, but rather for future transactions

Asset versus Equity Deal – Almost always most advantageous to transact as an equity deal

Identify Acquirer

- Consider whether to aggregate or, more likely, keep separate from other assets and investments
- If providing services to the project, consider using a services entity separate from entity that owns (direct or indirect) interest in project
- Upper-tier structuring considerations

Focus on Flexibility for Future Transfers

- Cash equity investors, tax equity investors, debt financing – pre-bake these consents in as many transaction documents as possible
- Even if you don't need specific flexibility, think about what flexibility your investors / transferees may need
- Transfers to tax equity JVs and/or tax equity investors need to be directly defined and expressly permitted (e.g., traditional notions of COC or minority interest transfers don't always work)
- Always permit Affiliate transfers for maximum flexibility

KEY ACQUISITION AGREEMENT CONSIDERATIONS

FOCUS ON THE FINANCIAL MODEL

In a typical M&A deal, there would be no mention of the financial model in any transaction document; whereas in a renewable M&A deal, the model may be one of the key features of the transaction documents

Financial Model

- Financial model may be shared / jointly prepared by the parties or prepared solely by one party / its advisors
- Financial model may be used to determine milestone payments for development-stage projects
- Seller / developer may be required to give representations and warranties as to the accuracy of the financial model, that it was prepared in good faith, etc.

KEY ACQUISITION AGREEMENT CONSIDERATIONS (CONT'D)

PURCHASE PRICE / CONSIDERATION

A typical M&A transaction will provide for Purchase Price adjustments for NWC, Debt and Transaction Expenses, while renewable M&A transactions typically focus more on adjustments around the model / revenues streams

Development-Stage Investment

- Development milestone payments with a portion of the consideration paid at each milestone; may be an indemnity holdback
- Typically at each milestone the model is re-run to update assumptions that may have changed during development of the project
- Parties may negotiate which model assumptions are fixed versus variable (i.e., who bears the risk of the base case model assumptions ultimately being inaccurate)

Operating Project Investment

- Typically uses financial model to set expectations for monthly cash flows and sets an “effective time” for transaction
- Need to confirm whether effective time allocates economics on a cash versus accrual basis (usually cash)
- Seller will make a representation / provide a certificate to all distributions received from and after effective time
- Typically no NWC adjustment – but should always address if any inventory / spare parts are owned by Seller / developer / target that need to be acquired

Other Forms of Consideration

- Developer may roll a portion of consideration as equity into Buyer Newco
- If developer will continue to develop or provide other services to projects, it may receive additional consideration as services fees under development contract, AMA, OMA, etc.

KEY ACQUISITION AGREEMENT CONSIDERATIONS (CONT'D)

REPRESENTATIONS & WARRANTIES

Scope and breadth of representations and warranties (“R&Ws”) will vary greatly among deals; no “standard” suite of R&Ws

R&Ws Need to Correspond to Levels of Diligence

- R&Ws will need to follow the levels of diligence – a buyer will need project-level R&Ws, R&Ws around tax equity JVs, R&Ws around debt documents, etc., as each is applicable

Status of Project(s) and Role of Seller will Greatly Impact Scope and Breadth of R&Ws

- Developer should be able to provide robust R&Ws with minimal qualifiers
- Passive tax equity investor will highly knowledge qualify R&Ws
- Because the Buyer due diligence process, including its due diligence around the financial model, is often very involved, Sellers will push back on extensive R&Ws
- Key R&Ws for Buyer may simply be (1) a R&Ws that Seller has provided a material due diligence information and (2) no known inaccuracies in financial model

R&Ws regarding Consents and Governmental Approvals

- May be tricky / highly-negotiated for reasons discussed above; in fact, Buyer may be required to give R&Ws around its identity / status

KEY ACQUISITION AGREEMENT CONSIDERATIONS (CONT'D)

INDEMNIFICATION OBLIGATIONS – SURVIVAL PERIODS AND LIMITATIONS

“What’s market” in renewable M&A deals varies widely depending on a variety of factors and cannot (or at least probably shouldn’t) be reduced to relying on deals studies

Variety of Factors that Impact Right-Sizing Limitations on Seller’s Indemnification Obligations

- Status of Project (In-Development versus Operating Project)
- Identity of Seller (Developer, Managing Member or Passive Investor)
- Continued Role (if any) of Seller
- Return Margin for Buyer as compared to investments in Other Industries
- Leverage of Buyer versus Seller

R&W Insurance

- Like many industries, use is on the rise
- Has lead to more aggressive “no indemnity” regimes

KEY ACQUISITION AGREEMENT CONSIDERATIONS (CONT'D)

OTHER KEY PROVISIONS & FEATURES

Consents & Approvals – Covenants, Closing Conditions, Termination Rights

- What is each party's obligation with respect to seeking and obtaining consents?
- Which consents should be closing conditions?
- At what point does a party have the right to terminate PSA for failure to obtain consents?
- Consider rolling or delayed closings (but run risk that full sale never occurs)

Material Adverse Effect – The project-by-project versus portfolio dilemma

THANK YOU



1001 Fannin Street, Suite 2500
Houston, Texas 77002



+1.713.758.2222



velaw.com



plus.velaw.com

Austin
T +1.512.542.8400

Beijing
T +86.10.6414.5500

Dallas
T +1.214.220.7700

Dubai
T +971.4.330.1800

Hong Kong
T +852.3658.6400

Houston
T +1.713.758.2222

London
T +44.20.7065.6000

New York
T +1.212.237.0000

Richmond
T +1.804.327.6300

Riyadh
T +966.11.250.0800

San Francisco
T +1.415.979.6900

Tokyo
T +81.3.3282.0450

Washington
T +1.202.639.6500