Infrastructure – Risk Perspectives

Episode 6

Infrastructure M&A: Navigating known risks part three

Martin Bennett: Hello again, I'm Martin Bennett and I lead Marsh's engagement with infrastructure and energy sector investment funds. I'm joined again today by Stefan Farahani, Marsh's Head of Specific Risk insurances, and Tom Burrell from our infrastructure and energy team.

Today we are going to be discussing an example of an onshore wind farm acquisition and the potential impact to the owner from a judicial review. Stefan, could you perhaps just start off by giving us a little bit of a background to this situation and just contextualise the issues for us, please.

Stefan Farahani: Yes, of course. So on this particular transaction our client was looking to acquire a company that was in the construction phase of a wind farm, so construction was part way through, and an environmental agency had brought a judicial review against the licenses and permissions of the project to kind of operate in the expected manner going forward. Intuitively, you would expect an environmental agency to be supportive of wind farms, but this particular one was focused on birds and its concern was that the turbines would chop up the birds or disrupt their migratory patterns. And that was causing a real block to the transaction because with that litigation, if it had had a negative outcome they'd have been paying tens of millions of pounds for a field, where as if the litigation failed, as everyone anticipated, then they had a profitable project.

Tom Burrell: Thanks, and hugely relevant seeing the uptake in construction phase risk that many of our funds and clients are looking at. What ultimately was the solution in this circumstance?

Stefan Farahani: So for this issue you had live litigation running through the courts, and the solution was to work with a couple of insurers to place a EUR30 million policy to cover the risk that the project either had to be dismantled or amended, resulting in either costs of dismantling or lost investment, or in the event of an amendment lower than expected cash flows on a going forward basis with the insurer making a payment to the present value for that loss in value. For this particular fact pattern, the cost of the insurance was 9.25% of the policy limit. We've worked on other litigation risks on wind farms, and photovoltaic plants, where the cost has been slightly lower so usually I would say it's between 3 – 10% of the policy limit.

Martin Bennett: Stefan, obviously great that that solution was able to be put in place. Thinking about the onshore wind, the solar photovoltaic projects that we work on for our clients, securing debt finance is obviously a key element of making these projects successful – how receptive were the clients' lenders to this insurance solution and how much of a help was it to them?

Stefan Farahani: So, you're right to mention debt financing because that was absolutely the motivating factor for seeking insurance. Frankly, our clients were pretty relaxed that the litigation was facetious and had no chance of winning but the lender simply wasn't willing to allow the drawdown of debt when the value of the collateral could be significantly diminished if the litigation was successful. At the very initial stages the lender was frankly cynical that we would be able to find a solution to cover what it needed to cover but by working with them, by showing them the policy wording, by showing them the fact that these policies really have almost no exclusions, I mean for fraud and misrep but not really anything else. To bring them along on the journey and get them comfortable with the fact that the insurance would give them protection in the event the litigation was successful.

Tom Burrell: Excellent and I suppose as a final question Stefan, where did the enquiry come from – where is the start, is it a fundraising, is it a lawyer, what is the source of it exactly and what is your advice in terms of if you spot something like this in a scenario what you should do?

Stefan Farahani: So for this particular dispute, you know it was in the due diligence report, it was in the legal DD. There is no way that the seller wouldn't have been able to disclose this so it was a fact of life that this project was in litigation. Who though, hypothetically, can you speak to obviously – well it's whoever has got the information. So it might be the lawyers, it might be the technical advisers, it might be the investor itself but the key thing is early engagement. As soon as the risk has been identified, that's when you should start the discussion as to whether or not the risk is insurable because it is so fact specific, because you need to get into the detail, there is no point waiting until two days before signing and actually you've been unable to agree a risk allocation and trying to get it done in two days. Early engagement and an open and collegial process is really fundamental.

Martin Bennett: Stefan, Tom, many thanks for sharing today's insights. Really look forward to another conversation, another discussion about a further case study soon with you and being able to share that via a further podcast so thank you very much.