

# Infrastructure – Risk Perspectives

Episode 7

## Infrastructure M&A: Navigating known risks part four

**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 the tax treatment of a sale of a wind farm and how contingencies arising from that were addressed through the use of specific risk insurance. Stefan, to start off with can you just share a bit of background as to this deal and the issues that arose?

**Stefan Farahani:** Yes, of course. So this was a circumstance where a fund had put time, effort, and money into developing a wind farm project and it was in the intermediate stage of being fairly advanced in development – so they'd got the licenses, they'd started construction, and got advanced in construction, but it wasn't yet fully operational. They were looking for an exit and they had found a buyer who was willing to purchase at a price that was attractive to them. But the key consideration that they had to ascertain was what are their disposal proceeds going to be and to know that, they had to have some degree of certainty as to what the tax treatment of the disposal would be. Now, they were selling the shares in their project company and typically when you sell shares in an operational business, certainly within the EU, you would expect to get some form of participation exemption or substantial shareholding exemption, which says that shares in an operational company are not subject to tax on the disposal but here there was a real tension to that analysis because the project company wasn't fully operational and one of the requirements is that it is a trading business and a trading company, and so you had this uncertainty in how to interpret the law. Is this sufficiently far advanced to be trading and therefore benefit from the tax exemption and the disposal or is it not trading, in which case the disposal proceeds would have been taxable on the gain and we are talking really big numbers on this transaction.

**Tom Burrell:** I think Stefan, as per our last session, a really interesting example of the type of risks that can come up during construction, something more of our funds are looking at. What did the solution look like here, and how many insurers were participating, and what did you need to get to the level of cover needed to help the deal go through?

**Stefan Farahani:** So starting with the final point – what did we need? Well we needed to work with the clients' tax adviser, understand the legal opinion they had put together, and understand the insurance that was needed and work with insurers. So in this particular situation, the gain was significant and so the tax exposure was significant so we needed a EUR200 million policy to cover the risk of tax arising,

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interest penalties, legal costs for having a dispute with the tax authorities etc. and because the numbers of significant we needed to get several insurers on board. Ultimately a tower of insurance was placed with five insurers, each taking part of the tax exposure and the policy cost was 3% of the policy limit so in the context of the counterfactuals being to withhold the money and keep it as escrow, it represented a significant saving on the cost of capital that would have resulted from a holdback.

**Martin Bennett:** Stefan, thank you for the detail of that – that’s super. The solution was put in place, you created that EUR200 million policy to address the risk. In terms of the strategic value that that gave to our client, to the seller, can you just say a bit more on effectively how the insurance actually created a bridge to a better outcome for them?

**Stefan Farahani:** Well the alternative to insurance would be to keep the cash on hand in case the tax liability was found to have arisen and given the statute of limitations is around seven years that would have been holding back about EUR200 million for a period of up to seven years. Now when you think about IRRs and cost of capital, that would have had a significant cost in the tens of millions of Euros and possibly even over one hundred million Euros, whereas having the insurance gave parties comfort that actually if the risk arose an insurer would be footing the bill, they could distribute that cash on the sales proceeds, distribute to investors and again, really allowing the IRR of the investment to be as high as possible because there were no holdbacks.

**Martin Bennett:** Okay, Stefan, Tom, thank you very much for your insights today. Really look forward to discussing a further case study again with you soon and sharing some thoughts and considerations as a result of that.