

Wrestling risk in green projects: take time to think before acting

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The increasing attention given to large-scale renewable energy projects over the last five years, has been driven primarily by larger companies. This has included specialist renewable energy organisations, such as Vestas or Orsted, alongside traditional oil and gas companies who are increasing their focus on renewable investment and generation.



Some smaller organisations, both upstream energy producers and members of the supply chain, are also getting involved for both corporate sustainability and commercial reasons. Many will be new to the field and will have limited internal resources to devote to opportunity evaluation.

Any energy-related project comes with its fair share of risk. The generally high potential margins in conventional energy projects are the reward for the inevitable failures or cost over-runs that are the nature of such a complex business.

The renewable energy sector is still in its

infancy and many of its subsectors have yet to demonstrate long-term investor returns, especially outside the confines of government revenue support. The best projects will probably succeed, but the euphoria of green development must be balanced by the need to make sound strategic and financial decisions regarding project investment, based upon thorough and timely due diligence (DD).

Main areas of risk in renewable energy projects:

Technology: much of the renewable energy industry is based upon either new

technology or technology which is being adapted from other sectors. For example, the use of marine gearboxes in wind turbines as a first stage towards creating lighter, more corrosion-resistant replacements. Sponsors must recognise how much of the development in their particular project is evolutionary and therefore carries lower risk, and how much represents a step change in technological development and hence represents a greater risk to investors.

Supply chain: in the well-developed and mature oil and gas business, even in periods of industry consolidation, there

are normally enough suppliers to generate competitive price pressures. This is certainly not yet the case in, for example, large scale wind or solar projects where the number of Tier 1 suppliers is limited. Supply bottlenecks are increasingly likely as demand for components and skilled labour expands; a difficulty which is compounded by Covid-related supply constraints and geopolitical supply risks. The dangers of having a sole-source for key elements of the project are significant and must be managed.

Planning permissions and the consent process: project managers need to cover the full consenting processes in their risk assessments and factor in both cost and time delays, should any of the steps result in additional consultations or even court hearings. They also need to estimate the likelihood and potential impact of local opposition, particularly for onshore projects and the onshore components of offshore projects. In the UK for example, large onshore infrastructure requires government level approval, which can be very time consuming and expensive to obtain. And as the offshore wind industry had found when looking for locations for their onshore substations, as more projects are consented there is risk in the interplay between them and in cumulative planning assessments.

Market development: these are the risks of the future direction and pace of development of the power market in a country or region. It is established that once crude oil is produced and treated to a saleable quality, the product can be traded globally; DD need not consider much beyond the price risk during the life of the project. Not so with renewable energy, which is both temporally and spatially restricted in its market. Looking downstream at the energy market is therefore vital.



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Will there be guaranteed demand for the renewable power or product in the time frame expected, and can any such prediction be underwritten, through subsidy or otherwise? How will renewable energy supply be rationed if there is insufficient demand at any moment?

Infrastructure: countries' national grids are typically based on a more predictable mix of fossil fuel, nuclear and hydro plants which can be called upon, and will normally deliver, at short notice.

Wind and solar energy are by their nature both intermittent and also uncertain, weather forecasts can change up to the last minute, and grid operators are already having to make investments in infrastructure to accommodate increasing shares of renewable energy. Their ability to do so, and the costs involved, are significant risks for the project developer and cannot be ignored simply because they lie outside the immediate boundaries of the project. Grid operators may find it easier to



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spill renewable energy than to turn down base load power plants, for example.

Political: the support for green energy developments may be attractive to politicians, but the costs and consequences of renewable power integration are often underplayed.

To what extent does the project rely on political goodwill, current regulation and/or subsidies? What effect might a change of government or policy have? Does the project become independent of subsidies, and how viable is this from a modelling and bankability perspective? If so, can the date of this independence be brought forwards by careful management and planning?

Based on UK experience with prior iterations of renewable subsidies, sponsors should be aware that government support can change or even be withdrawn at relatively short notice.

Project risk evaluation

Having identified the universe of risks, these must now be assessed in the traditional way by plotting likelihood versus potential impact on the project and the investment.

In our experience, this is best done as a team exercise and not left to one in-house risk expert.

At the level of the company board, the role of Non-Executive Directors is important to bring outside experience and challenge, particularly if the company's executive management has a strong bias towards project acceptance or rejection.

For green projects diligence requires not only normal financial accounting but also estimates of carbon production along the complete supply chain. The financial and carbon DD should encompass the entire lifecycle of the project, from sourcing raw materials through to decommissioning. It should cover the possible risks at each stage, particularly exit risks for the sponsors.





Bringing it all together

In their enthusiasm to pursue a new green project, management must be wary of being seduced by the ‘emperor’s new clothes’. Early movers in many areas of green technology and power supply may do well, but equally may be disappointed, especially as the number of quality assets utilising proven technology is finite, and the number of potential investors and counterparties growing. Larger corporates are more able to write off failures as part of the cost of market entry, but smaller investors don’t normally have that luxury. The DD process has to be optimised to reduce the chance of failure, particularly if renewables represent a new area for the organisation.

Not enough boards, in our experience, follow up risk identification with the creation of robust alternative plans for each of these main risks. In the current business climate, this certainly includes identifying supply chain bottlenecks, multi-sourcing of critical components and careful stock management.

All too often the corporate risk register gets stuck in a cupboard and only dusted down for the next board meeting. It is a living document, especially in an unfamiliar business area. Each main risk should have a single owner inside the organisation whose responsibility it is to raise concerns promptly and to keep colleagues informed of progress and problems. Participants should also be aware of current national and supranational

ESG reporting and regulatory burdens, and how these are likely to develop over time. ESG reporting and DD are increasingly becoming an annual requirement, rather than something to be considered as a one-off when an investment decision is made. A full and ongoing analysis of the supply chain is also critical.

Contractual implications

Desk work to evaluate project risks has to be translated into robust and practical contract terms. In the first instance, this involves identifying which of the parties, if any, has control over the risk. Ideally contractual risk exposure should be minimised, or at least borne by the party best placed to do so.

Directors or senior commercial staff who have an intimate knowledge of the business should work hand-in-glove with their lawyers when drafting agreements to ensure that contracts seek to reflect the risks being taken by each party. An integrated legal/commercial approach yields real benefits in this process.

And finally...

Investments in the fast-moving area of renewable and sustainable energy will break new ground for many organisations. Navigating the risks which such projects add to the corporate slate takes teamwork and strong, committed advisors.

Having gone through the rigorous process outlined above, an organisation is not only

better prepared for the demands of project management, but will also have a much more credible story to tell its stakeholders and the wider public.

Using senior expertise and minimising the number of professional interfaces is crucial to avoid missing risks and to increasing speed of operation.

The authors would be happy to discuss and expand upon any of the issues covered.

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About the authors

Matt Lewy is a partner at law firm Womble Bond Dickinson, specialising in energy and natural resources. WBD provides comprehensive legal services from seven cities across the UK and 19 offices in the US, including energy hotspot Houston. The firm has been immersed in the energy sector for decades, giving the team great depth of experience across the various different forms of energy and power.

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