



# PLATFORM INVESTMENTS IN RENEWABLE ENERGY

STRUCTURAL SOLUTIONS AND  
CRITICAL ISSUES TO CONSIDER

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McDermott  
Will & Emery

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# PLATFORM INVESTMENTS IN RENEWABLE ENERGY PROJECTS

## WHICH IS RIGHT FOR YOU?

- Understand the benefits and potential pitfalls of platform investments
- Envision the full lifecycle of the investment so you can confidently select a best-fit option



**Convertible Debt:** Recent investments have increasingly included the use of convertible debt, which can be used to fund ongoing development expenses for a project (or portfolio of projects), and which converts to equity interests in the project company upon its sale or other negotiated liquidity events. This preferred debt can have pre-funded interest reserves or payment-in-kind (PIK) features.

- Pre-funded interest reserves can assist institutions that need cash-on-cash return where investors without immediate liquidity needs can opt for PIK features.
- The use of convertible debt gives rise to the question of whether such convertible debt is deemed to be “debt” or “equity” for tax purposes, so tax analysis will be critical to the structure.
- Tax-exempt investors will want to consider including a blocker entity in the structure of such investments.
- Convertible debt users should be aware of the heavy negotiations around convertibility terms, including anti-dilution provisions, mandatory conversion triggers and pre-money valuations.



**Preferred Equity:** A typical investment instrument on the equity side of platform investments is preferred equity, with a pre-negotiated target internal rate of return (IRR) or multiple on invested capital (MOIC) for the preferred equity investor.

- Determining which entity, or level in the investment structure, to install preferred equity is an important consideration as preferred equity investors should understand how cash flow will be managed through the structure and how upside gains can be captured.
- By its nature, preferred equity generally has limited upside based on the pre-agreed investment return targets, and unlimited downside given that it's on the equity side of the capital structure. This inherent characteristic should be considered and appreciated when crafting the terms of a particular preferred equity instrument.

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## While platform investments can be lucrative, there are key issues to assess and manage:

- Completion Milestones: For a Development Company - Operating Company (DevCo-OpCo) structure, the appropriate milestones for transferring a project into the operating joint venture need to be determined, which may depend on the structure and timing of financial closing and the level of development or construction risk tolerance of the operating joint venture.
- Governance and Partnering with a Sponsor: Regardless of the structure, rights related to approvals of development, construction, and operating decisions will need to be carefully negotiated, including off-ramps.
- Earn-Outs: Investors and sponsors will need to consider how earn-outs are structured, including the impact of off-ramped or failed projects on the cumulative return of the investors and sponsors.



# MARKET TREND IN RENEWABLE ENERGY PLATFORM INVESTMENTS



With renewable energy projects proliferating in the market, investors have seen decreased returns and increased risk when investing directly in renewable project acquisitions. However, a handful of investors are fully capturing their returns by funding development and management teams and creating a captive “platform” for future investment.

## THE BENEFITS OF ACTING STRATEGICALLY

Choosing an investment that is not appropriate for your portfolio or well-aligned with your risk tolerance is one of the most significant risks you may encounter. Understanding the risks and nuances inherent in these investment structures will help investors by:

- ✓ **Fully capturing the returns** of successful developments
- ✓ **Reducing or managing the costs** of failed projects
- ✓ **Increasing desirable exit or liquidity options** down the road

Thinking about platform investments? Here are 12 things you should consider:

Investors have expressed a significant appetite for clean energy investment. In 2021, global private investment skyrocketed to \$755 billion. The US set a record at \$105 billion.

*-Sustainable Energy in America Factbook*

1. Competence and development history of the management team or joint-development partner



2. Project pipeline and critical milestones for bringing development projects forward

3. Appropriate contracting mechanisms



4. Timing considerations

5. Governance and decision-making



6. Potential exit strategies (at both the project level and HoldCo level)

7. Tax structuring considerations (including the risk of investment tax credit (ITC) recapture for solar projects in particular)



8. Cash flow constraints

9. Use of debt (including convertible debt, revolving loan financings and warehouse financings)



10. Exclusivity (for a DevCo-OpCo structure)

11. Funding development expenses and timing



12. Accounting for dead or failed projects, including the effect on earn-outs



# HASTE NOT WASTE: FAST-MOVING ENERGY DEAL HELPS DRIVE CARBON-NEUTRAL ECONOMY

## THE SITUATION

On the spectrum of renewable energy projects, investments in solar and wind power are fairly common. But there's an unsung hero in the renewable space: Anaerobic digestion converts organic waste, such as animal manure and coffee grounds, into byproducts that can be used to produce electrical power.

The few anaerobic digestion operations that exist in the United States are primarily in the development stage, and they present a rare and unique investment opportunity. Unlike traditional energy plants, which require operators to pay for coal, natural gas or other fuel to create electricity—or wind and solar facilities, which get their fuel at no cost from the environment—anaerobic digestion operators are paid to remove waste products to their facility for fuel. Among energy producers, they are fairly unique in generating revenue from both input (the fuel they use to create electricity) and output (the electricity produced).

## THE CHALLENGE

Private equity firm Irradiant Partners sought an opportunity to invest in the innovative emerging market of anaerobic digestion by providing one of the few industry players in the US, Bioenergy Devco, with development capital. Irradiant tapped a cross-practice McDermott team, led by Chris Gladbach and Jim Salerno, to help structure and close the deal.

## OUR OBJECTIVE

To help Irradiant achieve its business goals and invest in a more sustainable future, McDermott needed to close the deal rapidly while protecting the client from unnecessary risk. The short timeframe, coupled with the complexity of the deal structure and diligence, required a deep bench of skilled lawyers with experience in the energy industry and in executing platform development deals

## THE OUTCOME

In close partnership with Irradiant, McDermott worked around the clock to successfully close the deal within an abbreviated period. During that time, the team handled diligence work, used their findings to calculate potential risks, developed a unique investment structure and successfully managed a number of complex legal and transaction issues.

Irradiant's \$100 million investment in Bioenergy Devco will support the development of multiple anaerobic digestion facilities, ultimately driving sustainable organic waste recycling and reducing greenhouse gas emissions in North America.

Because Bioenergy Devco's anaerobic digestion facilities are in development and not yet operational, Irradiant's investment demonstrated confidence in the company's vision and management story, providing development capital on the corporate finance level to help propel the projects forward. However, the deal also featured aspects of project finance, with diligence review examining the state of Bioenergy Devco's projects, stress testing their contracts and more. To accommodate the crossover between corporate and project finance, the McDermott team developed a unique investment structure for the transaction.

**Deals of this size and complexity typically require four to six months to close. In Irradiant's case, McDermott married principles of project finance and corporate finance—drawing on the experience and knowledge of a premier private equity practice.**



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