The legal pitfalls of PV acquisitions

Secondary market | Many mature solar markets are seeing strong investor interest in acquiring operating solar assets. But as the lessons from Italy show, transactions in the secondary PV market come with numerous legal risks attached, necessitating thorough due diligence, write Arturo Sferruzza and Ginevra Biadico of Norton Rose Fulbright

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Even after the retrospective cut in renewable energy incentives in Italy, the acquisition of operating solar photovoltaic (PV) plants in Italy under the right conditions may still provide strong financial returns to investors.

Nevertheless, irrespective of the financing structure or size of the project, there are risks associated with such transactions that a buyer will need to get comfortable with during the due diligence process.

A thorough legal due diligence exercise should cover a wide range of issues, including land rights, permits and environmental aspects, grid-connection rights, corporate aspects, any construction aspects that may be still relevant, O&M, as well as the existing financing agreements in place.

Property

Property due diligence would be initially required to establish whether the development of the PV plant on the site was allowed from a development planning perspective. If it emerges that, at the time of the construction works, the site had a "cadastral" classification that was in principle not suitable for the installation of the PV plant, or if the site fell within an area of special environmental value (like a special preservation zone or a site of European significance), then it is necessary to establish if the local authority amended the cadastral classification of the land or if specific environmental proceedings were carried out to evaluate the potential impact of the project on the environment.

To ensure that the permits were legitimately issued and the incentives are lawfully paid, it is necessary to investigate if the developer had in place at the start of the authorisation procedure the requisite land rights in respect of the site where the PV plant has been built, and if it has continued to hold such rights during the incentive period. The nature of the land rights (proprietary right versus land lease) giving the project developer use of the site may impact on the bankability of the project, as banks usually require security over the land itself.

Experiences from Italy's thriving secondary solar market underline the need for thorough legal due diligence on acquisitions

It is standard for a 20-25 year surface right to be granted, often with an option to renew for a further period of time if the project remains operational. A buyer should make sure that the duration of the land right is aligned with the duration of the incentive period, at no extra cost. In the case of rooftop PV installations, the owner of the building is required to grant the project special purpose vehicle (SPV) full access to the roof in accordance with health and safety regulations, and responsibility for maintenance works on the building, the roof and the PV plant needs to be adequately allocated.

In the context of property due diligence, both legal and technical advisors should review searches at the land registry to ensure that the site is not affected by prejudicial encum-

brances or third party rights (such as pledges, civic uses, or pre-emption rights) and that all titles affecting the site are reported on. However, excerpts from the land registry have limited legal value and the assurances that the SPV has acquired the land rights from the full owner of the land and that no prejudicial encumbrances affect the site may only be obtained through a 20-year notarial report *(relazione notarile ventennale)* prepared by a public notary. A 20-year notarial report may be a useful instrument to understand if the root of title over the land is good or not, allowing a purchaser to take adequate remedies in the sale and purchase agreement (SPA) in connection with the findings of the notary search.

If the 20-year notarial report shows that titles to the site have been transferred through donation or under wills, then there is a risk that legitimate heirs *(eredi legittimari)* may be entitled to start a legal claim, claiming that the donations made by the deceased or the provisions of the will have prejudiced the mandatory quota of the estate reserved to them at law and, therefore, asking for the restitution of the site or the payment of the value of the site. The buyer will expect a full indemnity against any losses or expenses arising from any claims that may be brought by any legitimate heirs, so as to pay them and avoid the restitution of the site.

It is advisable that the buyer's advisors review the findings of the 20-year notarial report well in advance of the signing date, in order to make sure that potential encumbrances (e.g. foreclosures, mortgages, etc.) or other issues (e.g. unregistered property rights, existence of donations or wills, etc.) are known in advance and that adequate protections are contemplated in the SPA.

A key part of the property due diligence is to check that the SPV has the rights to lay a cable to the point of connection to the grid. If the grid connection works have not been carried out by the grid operator, then full due diligence would be required, with the same level of detail as previously carried out for the project site itself. It is also crucial to identify where the electrical cables cross roads or other infrastructure (such as gas or water pipelines), so that it can be established whether the necessary consents were been obtained from the competent authority. Concessions for the use of public land may often trigger annual fees and taxes to be paid to local authorities.

Buyers will seek to confirm that all permits are valid and effective, that there is no risk of judicial review, that no additional permit is necessary and that the conditions set out in such permits (e.g. in terms of distances from buffer zones, and environmental mitigation measures) have been complied with.

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Avoiding challenges

In the secondary market, the risk that third parties may challenge the authorisations is quite remote due to the expiry of the statutory appeal periods. Notwithstanding this, an assessment of this risk may still be necessary in the event that new post-completion authorisations are granted to implement changes to the original authorised project or to rectify discrepancies between the as-built and the authorised project design. In this respect, it is crucial to understand if any changes are material. If they are material the authorisation procedure would be much more complicated and the entitlement to the incentives may be at risk.

Furthermore, any public authority is entitled to act in "self-defence" and annul an administrative act formerly approved when it becomes apparent that the relevant administrative act had been issued in breach of any provision of law and an actual and current public interest exists to support annulment of the act. According to recent changes in law, the power to annul in self-defence may be lawfully exercised only within 18 months, but this time limit is subject to some exceptions. A potential buyer would be interested in confirming that no circumstances exist that may lead the public authorities to start an action in self-defence.

The risk of third-party challenges and public authority actions in self-defence against the authorisations reduces with the lapse of time since commissioning of the PV plant. However, there is still a residual risk of forfeiture or revocation of incentives due to facts or circumstances existing prior to the award of the incentive. From a legal perspective, this risk assessment is the most important exercise to be carried out. The *Gestore dei Servizi Energetici* (GSE), Italy's state energy management agency, has a general power of inspection on PV plants. Depending on the seriousness of the violation, the GSE may order the suspension or the revocation of the incentives and seek to recover all of sums already paid.

When it comes to the granting of permits and administrative matters, the key issues known in the market that may adversely impact the incentives are generally related to the legality and completeness of the authorisation relating to the type of plant, its size, location and the date of title release. This is due to the fact that Italian legislation, over the years, has proven to be complex and inconsistent. Because responsibility for energy matters has been vested, since the 2001 constitutional reform, both in the state and in the regions, the regulatory framework relating to the permits necessary to construct a PV plant is different in every region. This situation has ultimately resulted in a series of regulatory mismatches rendering the applicable authorisation procedure uncertain, due to the cumbersome nature of the multilevel regulatory system, the tangle of administrative competences and the increase of the litigation between state and regions.

Major issues for market relate to PV plants authorised by means of a simplified deemed-consent procedure *(dichiarazione di inizio attività)* and which have been built on adjoining plots of land. Since 2008 some regions have introduced guidelines to detect instances where applicants were seeking separate authorisations for ajoining projects to ultimately build larger PV plants that should have been

authorised through more complex procedures. The regulation relating to the subsidy for solar PV generation has been amended since 2011 to take account of these issues. The so-called "Fourth Conto Energia" introduced certain criteria which must be applied when calculating the capacity of PV plants for the purpose of determining the applicable level of incentive. This is to prevent operators from splitting a single PV plant into multiple sites to benefit from an incentive that is higher than that applicable to the plant considered as a whole. Finally, pursuant to Ministerial Decree dated 23 June 2016, the GSE can consider many items as an indicator of "malicious fractioning", including the fact that plants share the same grid connection infrastructure or the same electrical line.

Portfolios comprising PV plants subsidised according to the Second Conto Energia that have applied for the benefits under the Salva Alcoa Law have to be analysed with particular attention. Some of the most serious issues generally relate to problems in the drafting of the certificate of completion of the works, the absence of any notice of completion submitted to the grid operator and the authority, or the lack of documentation demonstrating the actual completion of the plant by 31 December 2010 (e.g. pictures showing the installation of modules, inverters and transformers, parts labelling and shipping documents).

The legal and technical due diligence exercise will also investigate whether a grid connection agreement is in place between the SPV and the competent grid operator, whether the export/import capacity is sufficient for the project's planned generation output, whether all the connection costs have been paid, the grid connection works have been completed with no outstanding liabilities, that the grid connection granted by the grid operator is not limited in time and that the date of entry into operation of the plant is compatible with the project's accreditation under the incentive regime granted by the GSE.

Environmental risk

There may also be environmental risks. Various laws may require a current or previous owner, occupier or operator of property to investigate and/or clean-up hazardous or toxic substances or releases at or from a property. These owners, occupiers or operators may also be obliged to pay for property damage and for investigation and clean-up costs incurred by others in connection with any such substances.

The standard set of representations and warranties to be given by the seller in an SPA is expected to cover most of the above issues. Generally, there will be no liability on the seller's side if the relevant issue has been "fairly" disclosed. On the other hand, if the seller has not been able to provide access to a comprehensive suite of documentation, then from the buyer's perspective it would be prudent for the due diligence exercise not to limit the representations and warranties of the seller in the SPA and for the buyer to negotiate appropriate pro-sandbagging language in the SPA.

Depending on the findings of the due diligence, buyers may also seek a purchase price reduction or special indemnity protections in the SPA alongside representations and warranties. In general, it is important to make sure that monetary caps on the seller's liabilities allow sufficient compensation and that any time limit on the buyer's ability to claim under the indemnities allows sufficient time for completion of surveys plus a few additional months to prepare the claim.

In this context, there is a trend towards requiring warranty and indemnity (W&I) insurance, providing cover for breaches of warranties, covenants and indemnities given by the seller under an SPA. This insurance product seeks to bridge the gap between the buyer's wish for deal protection and the seller's desire for a clean exit. Advantages for buyers may include the duration of the coverage, and the reduction of the risks of an insolvent seller. W&I insurance is designed to cover unexpected issues that arise after a deal has completed; however, this assumes that the buyer has performed thorough due diligence on the target rather than relying on the policy (and that the seller has carried out a thorough disclosure exercise). Insurers will expect a balanced negotiated SPA and that the due diligence exercise has been robust and complete. Indications that the due diligence process has been skipped or rushed could lead to a high premium, lowering the scope of the coverage or denial of a policy entirely. Environmental issues, defects in the construction works, bribery and corruption are generally excluded from the scope of W&I coverage.

Finally, it is not uncommon for sellers to seek earn-out provisions, for instance, in the event that, after the closing date, the competent authorities approve a repowering or grant a special subsidy in addition to the Conto Energia incentives (such as the Tremonti Ambientale). While the approval of a repowering may be a win-win situation for both the seller and the buyer, the feasibility and the conditions for the simultaneous application of Conto Energia incentives and other types of public subsidies should be prudently verified depending on the applicable Conto Energia.

Notwithstanding these issues identified, there is a strong secondary market for Italian PV projects which demonstrates that risks are manageable provided that buyers undertake the appropriate level of due diligence and achieve adequate mitigation measures within the SPA. ■

PV market consolidation

As subsidies for PV dwindle in many of the European solar markets that initially thrived on mechanisms such as feed-in tariffs, the importance of the secondary market is coming to the fore.

Italy has seen significant activity in this space, earning it the unofficial badge of Europe's leading secondary solar market. The UK, meanwhile, has also emerged as a leading secondary market player, as the initial investors in PV projects sell up to secondary investors looking to amass large portfolios of operating assets. Some analysts have predicted UK solar to have the most concentrated ownership among mature market by the end of 2017.

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