

ENERGY

Energy & utilities M&A in the Netherlands

BY CLAIRE SPENCER AND MARK WILLIAMS



The Netherlands energy market is in turmoil. Regulations seem to lack clarity and direction, and often work at cross purposes. Domestic players assess mergers with caution and hesitancy. Although the door is open to foreign acquirers, the country's restrictive and unpredictable regulatory climate, combined with the confusing tax and subsidy system, acts as a deterrent. Environmental and political issues – such as climate change, carbon emissions and corporate social responsibility – add further complications.

The regulatory effect on energy M&A

All this uncertainty has dampened Dutch energy M&A activity over the last 12-18 months. “This is due to the unrealistic expectations of different players in the energy field, which has expanded since liberalisation of the Dutch energy markets started about a decade ago,” says Louis Bouchez, a partner at Kennedy van der Laan. “The ever changing regulatory framework, inspired by a lack of political will and consensus, has led to an investment climate which lacks transparency.” The new government hopes that consolidation will raise industry efficiency, but changing regulations are hampering energy and utilities transactions.

Although deregulation and the unbundling of assets should encourage M&A and investment in theory, experts believe deals are occurring haphazardly. “Smaller deals between Dutch utilities were the result of economic concentration and a focus on less important, non-core

businesses,” asserts Ben van Gils, Global Utilities Leader at Ernst & Young. “Meanwhile, the main driver of activity at the top end of the market has been government policy.”

Perhaps the biggest regulatory development impacting M&A in recent years is the government's introduction of the Ownership Unbundling Act. It was approved in April 2006 and will come into force in July 2008. The Act aims to establish fully independent grid managers and discourages them from being part of groups that also include producers, suppliers and traders of power and gas. By 1 January 2011, currently integrated energy companies will need to split into two separate entities: one responsible for network activities and the other carrying out the supply, trade and production of gas and electricity. The Act comes into play when two conditions are met: first, when an EC Directive is implemented to prescribe such unbundling, and second, when the integrated energy companies impede the independent energy network management. According to a report by the International Energy Agency, the Dutch Cabinet hopes the Act will create a level playing field in the energy space, while boosting reliability and transparency.

Market observers believe the Unbundling Act could lead to a rise in transactions. “This unbundling may trigger events of default or change of control clauses under cross-border lease transactions entered into by all big Dutch energy companies in respect of both their production and network assets. This may

also lead to further forced sales of assets,” explains Mr Bouchez. One of the Act's clauses requires existing Dutch companies to sell their 110/150 kV transmission grids to the national transmission system operator TenneT, for example. In addition, the increasing need for capital expenditure on new production capacity and diversification of the fuel mix from gas to other fuels may have an impact on credit, which would affect the financing prospects of energy companies.

But at the same time, regulators appear to clamour against large-scale mergers. A consultation document published by the Netherlands Competition Authority (NMA) at the end of 2006 outlined its position on national and cross-border mergers of electricity companies. The NMA expressed its intentions to restrict the production capacity and client portfolio of large companies whose size hurts Dutch consumers.

Experts suggest the high-profile proposed merger of Essent and Nuon, two sizeable Dutch energy companies, was partly derailed by regulatory change. The end of the deal, which would have been valued at €24bn, came when Essent's initial 55/45 percent offer was rejected by Nuon, and a joint press release officially stated there was no longer a basis for continuing the merger process. Price may not have been the only stumbling block, however. Dutch advisers speculate that regulators would have taken a dim view of a combined Essent / Nuon and imposed harsh demands on its operations. The company would have also face compliance with the Unbundling Act, which reverses many of the synergies derived from a strategic merger. Both Essent and Nuon have questioned the need for the Act, and remain among its outspoken critics.

Encouraging overseas investment

Overseas companies and investors have shown interest in the region. Private equity firms have been drawn to the steady cash flows of energy companies and the opportunity to rationalise operations. These investors have been welcomed on the understanding that their involvement will have a positive knock-on effect, especially in terms of efficiency. Macquarie European Infrastructure Fund acquired a stake in the Southern Netherlands power grid, for example. Corporate deals ▶▶

have also taken place. Abu Dhabi National Energy recently bought BP's Netherlands-based upstream assets for a reported \$694m.

Particular areas of the energy market are attractive to foreign investors. Sustainable energy is high on the list, largely because of incentives offered by the Dutch government. "Over the last year, utilities and financial institutions have for various reasons started to launch and promote investment structures for sustainable energy in the Netherlands," observes Barend Post, a partner at AKD Prinsen Van Wijmen. "The investors include the public at large, qualified institutional buyers and customers of the utilities. Key drivers are, in view of the public debate regarding the environment, the creation of goodwill, tax breaks and governmental subsidies."

Interest in sustainable energy is still in its early stages, but there are reasons to believe the segment will take off. First, there is a growing realisation among policymakers, politicians and the public that the natural gas stock in the Netherlands will be exhausted within 30 years. Second, the new Minister of Environmental Affairs is a staunch supporter of sustainable energy. Third, the Dutch government is currently in the process of drafting a new environmental policy, which may bring the nation further into line with EU and Kyoto standards for carbon emissions. As traditional generation methods come under greater scrutiny from consumers and the media, advances in sustainable energy will yield higher financial rewards for their backers.

Venture capitalists are circling around the clean tech market. A trend is emerging as VCs fund start-ups which spin out of technology university incubators. In recent months, three funds dedicated to clean tech have been launched in the Netherlands. The larger is a €500m joint venture by Dutch pension funds ABP and PGGM. Another is a €60m private

equity fund named Rabo Ventures, launched by Rabo Private Equity. A third fund, the €50m Sustainable Energy Technology (SET) Fund, was recently set up by Essent and DELTA.

Popular methods of renewable energy production in the Netherlands include wind, biomass, and joint heat and power generation facilities. According to Mr Post, the retail market in renewables is flourishing, "Tax-driven institutional investors have invested in onshore and offshore projects. Institutional investors without tax capacity have expressed their interest and are exploring investment opportunities, but it will still take a while before they follow. The government should do pioneering work by taking part in investment structures so that big pension funds and insurance companies will join," he argues.

Yet there are enough negative market forces at work to speculate that overseas investor activity might be constrained. "The expectations surrounding private equity moving into the Netherlands continues to gain attention, but the Dutch government will have to remove any uncertainty over the future consequences of such transactions," says Mr van Gils. "Furthermore, the recent credit crunch has not helped. It is obvious that foreign utilities remain interested in moving to the Netherlands and building a more coordinated North West European energy market, but the government's position on such transactions delays action."

Restructuring is also made difficult by existing collective labour agreements. These contracts secure attractive long-term packages for the existing labour force. The cost and time spent renegotiating with workers can quickly destabilise a private equity owner's strategy for executing its own business plan and realising strong returns.

Another notable impediment which shrouds investment prospects in uncertainty is the tax

incentive system. MEP (*Milieukwaliteit van de Elektriciteitsproductie*) subsidies were introduced to pay domestic producers of electricity from renewable sources and CHP (Combined Heat and Power) who feed into the national grid. The State guaranteed the subsidy for a maximum of 10 years, though not for CHP. But the unexpectedly high cost of the scheme prompted the government to abolish it in the middle of 2006. Although the government is preparing to reintroduce a similar system, a track record of frequent change does little to inspire confidence in overseas investors, who need some stability on which to assess the risk of any opportunity. If the government continues to act in a way that undermines the objectives of private equity, these dealmakers will simply deploy their funds in other countries.

It does not help that many domestic energy companies harbour a fear of foreign ownership. "This has to do with existing shareholding structure of Dutch companies, where provinces and some big municipalities own most of the shares" explains Mr Bouchez. "Voting rights are consequently enforced by local and regional politicians. Decision making processes in these semi-state owned enterprises may not always be based on pure business considerations."

Yet there are ways the government can improve its profile and spur much-needed energy consolidation. Policymakers need to sharpen their focus on the main problems, argues Mr Bouchez. First, the Netherlands will benefit from a transparent regulatory framework and tax system. Second, it requires a lighter regulatory burden for sustainable methods of energy production. Third, higher levels of government investment in R&D will nurture start-ups. These steps should strengthen the industry and make M&A activity in the sector vibrant over the long term. ■



Louis Bouchez
Partner
T: +31 20 5506 692
E: louis.bouchez@kvdl.nl
www.kvdl.nl

Kennedy Van der Laan

Louis Bouchez joined Kennedy van der Laan in August 2006 as a partner in the corporate department. He specialises in corporate law, mergers and acquisitions, joint ventures, private equity and corporate governance, with a focus on the energy, telecom and food sectors.

Before that he worked for two years as a corporate governance specialist with the OECD in Paris, France, responsible for policy development in Asian countries. Louis started his career at Clifford Chance (1994 - 2002) in Amsterdam and Madrid (1996), working in the banking, leasing

and corporate practices, and also worked as a corporate lawyer at Norton Rose in Amsterdam (2002 - 2004). Louis publishes regularly on corporate law issues and energy related topics.