TPE 2023 – Case Study Part 2

Schuyler

CASE STUDY

It is one week later. Your briefing paper to the directors was well received and you have been settling in at Schuyler. Jay Reynolds, another of the executive directors, has asked you to meet him in his office.

“Alex, come in,” says Jay. “Sorry I haven’t had a chance to say hello properly. Since the directors’ meeting last week, I’ve been working from home on an exciting new initiative. I want to impress my fellow board members, so I’d like you to prepare a report for the board so that I can convince them how great it is. I’ve worked with your firm a lot over the years and so I lobbied the other board members to bring in someone on secondment given our current shortages in the finance department. I’m looking forward to seeing what you can do with my new project.”

“That sounds intriguing,” you say. “What is this new plan?”

“One of my social media contacts has reached out, a former university friend of mine. We had some crazy nights out, back in the day. He now works for Laurens Petroleum Inc (‘Laurens’), the huge US-based global energy company. Laurens is currently working on a bid for the UK government’s Contract for Difference (‘CfD’) scheme in relation to an offshore wind farm. I’m not sure how much you know about the CfD scheme? It is the government’s main mechanism for supporting renewable energy generation by protecting renewable developers from volatile wholesale prices. It does this by guaranteeing a fixed price for the energy provided over the life of the development. The catch is that developers enter into an auction for each site and have to submit a ‘sealed’ bid to try to win the auction. It’s a stressful business!

“Anyway, my contact at Laurens has approached me and asked to form a joint venture with Schuyler as Laurens has no experience in renewables or windfarms. I’ll send you on the details I’ve received (Appendix 1) for you to use in the report. Please don’t mention my personal connection in the report, as I’d rather the other directors didn’t know.

“I’d like you to evaluate the financial and non-financial benefits of the joint venture. I suppose you’ll have to throw in some risks as well, for balance. If there are any other important matters that you think we should know about then add them as well.

“I feel that Schuyler has been stuck in a rut these past couple of years after the pandemic and I think this is just the opportunity we need to take the company to the next level. I need your report to convince the other directors, because I know that working with a company like Laurens would really raise the profile, and value, of Schuyler. I really had to persuade the other directors to bring you on board at such a high daily cost, so make sure you accentuate the positives.

“Following the briefing paper that you prepared last week we have considered both sites and have decided that we would like to proceed with the Martha site initially. Planning permission has been granted for the development and Schuyler is at an advanced stage of agreeing the power purchase agreement with a utility company. We haven’t ruled out also going ahead with the Philips site in the future at some point.

“We don’t have sufficient available cash to purchase and install the turbines, and so we will need to raise some funds. I’ve got some ideas how we might go about doing this which I’ve emailed to you (Appendix 2). I’d like you to include a section in the report evaluating my suggestions and providing practical advice where you can. We need to know what the best option is for Schuyler.

“I’ve got one final piece for the report. I’ve forwarded you an email from one of the non-executive directors asking about our non-financial KPIs (Appendix 3) such as health and safety and generation capacity. I’d like your thoughts on the matters raised, so include a section in the report on this as the non-executive director is going to want some answers from us. On that topic, health and safety is something I look after. Although we had quite a serious accident on the Theodosia site last year, I luckily managed to agree compensation with the workers affected so that I didn’t have to report the issue to the regulator, the Health and Safety Executive. We agreed to pay all of their private medical costs, for as long as it takes, and managed to get them to sign non-disclosure agreements.

“If you could pull the report together by the end of the day, that’ll give me a chance to check that you’ve made the Laurens deal look amazing and I can get it issued with the board papers in the morning.”

“Ok,” you say although you feel slightly overwhelmed. “I’ll get back to my desk and start working on that right away.”

When you get back to your desk, you check your email and see that you have all the information Jay referred to. You also do a quick browser search for Laurens Petroleum. Although you know the name, you don’t know much about Laurens other than it is a huge US-based oil and gas company. The top hit on the search results is a story about the poor sustainability standards of Laurens which it has attempted to greenwash. The article claims that Laurens has run several global marketing campaigns promoting its sustainable practices and low-carbon energies, despite the fact these only contribute 2% of total energy produced.

You shake your head, and decide you’d better start planning for the report right away.

Required

- Prepare the draft report for the board of Schuyler; and

- Prepare an email to the MJ ethics partner on any matters which you think are relevant.

APPENDIX 1

Details of the Laurens proposal

Laurens Petroleum Inc ('Laurens') and Schuyler Renewables plc ('Schuyler) will form a joint venture ('JV') to bid for, and operate an offshore windfarm situated off the south-east coast of England by applying for financial aid through the UK government Contract for Difference ('CfD') scheme. The JV will install 100 7MW turbines off the Kent coast.

Offshore wind

The turbines will be secured into a jacket foundation which is attached to the seabed. The electricity generated is transferred to a floating electricity substation via cables laid on the seabed. The floating substation is connected to the National Grid on the mainland by additional seabed cabling. Offshore wind turbines are much taller than onshore turbines and generate in excess of 5MW. The useful life of offshore wind turbines is expected to be 30 years. The load factor of an offshore wind turbine is an average of 41%.

The joint venture

Laurens and Schuyler will share control of the JV and each party will have the power of veto over both strategic and operational decisions. Management and day-to-day operation of the JV will be undertaken by staff from both companies, with each party seconding at least two staff members to the JV.

The bid process

It is proposed that Schuyler leads the bid process team, due to its renewables experience. The CfD bid must be submitted by September 2023, and the results of the auction will be announced in February 2024. The bid will require finance, legal and operational team members and the bid has several stages. An operational supply chain plan and a project plan including a cash flow forecast must be approved before the final sealed bid is submitted. Prior applicants have indicated that the bid process utilises around 9,000 staff hours due to the complexity and level of detail required.

Construction and operation of the windfarm

Laurens has identified a supplier for the floating substation, which it already uses for the production of small oil rigs. The supplier believes that the substation design can be easily adapted from another product they have. A wind turbine supplier is still to be chosen. Schuyler will be responsible for managing the construction process.

The day-to-day operation and maintenance of the windfarm will be managed by Schuyler. Laurens will provide back-office support.

Financial arrangement

Schuyler will be responsible for the bid process. Laurens will pay Schuyler £50,000 towards the costs of the bid. If the bid is successful, Laurens will put in £50 million towards the start-up costs of the joint venture. The construction timetable will be agreed between the parties, but any delays in construction might result in financial penalty for the party responsible. Debt funding will need to be obtained for the project, but Laurens has good relationships with several large lenders. Schuyler will bear the operational and maintenance costs of the business and any revenue generated will be shared equally.

APPENDIX 2

Email from Jay Reynolds

To: alex.accountant@schuyler.com
From: jay.reynolds@schuyler.com
Date: May 2023
Subject: Financing the Martha site

Alex,

We have a funding shortfall of £6 million in relation to the Martha site. We need about £7.5 million in total, and we have £1.2 million available. Our bank doesn't seem particularly keen on increasing our bank loans, which is a little annoying. I was at a conference last month where they talked a lot about project finance - that is setting up a new investment company for each new project.

The project finance investment company raises the finance for the project. The loan is obtained on the basis of the estimated future cashflows and all income and expenses of the project go through the investment company. Martha is predicted to generate good cashflows so it sounds like it would work well for Schuyler and it keeps our gearing ratio down. In the project finance presentation, they suggested average interest rates are 8%.

I've done some investigation, and project finance is used quite widely in the renewables sector. We've never thought to do it as we've always managed to use the existing cash in the business. We'd need to put some equity funding into the investment company ourselves, around 20% or so. The lender usually sets covenants for the investment company and requires regular financial updates. Repayments are usually made on an annual basis.

One of the speakers at the conference recently raised funds through a new share issue. I guess that is something Schuyler could think about, but I don't really know how we would go about doing it. I know that none of the existing shareholders are able to invest in more shares at this time, so we would be looking to issue new shares to another financial institution.

Best,

Jay

APPENDIX 3

Email from the non-executive board member

To: alex.accountant@schuyler.com
From: jay.reynolds@schuyler.com
Date: May 2023
Subject: Fwd: Key performance indicators for sustainability

The non-financial KPIs on our website he refers to below are:

KPI	Description	2022	2021
Reportable health and safety incidents	Incidents relating to Schuyler employees reportable to the Health & Safety Executive	0	1
Annual electricity generation - average UK homes equivalent	Total electricity generated represented as a number of homes	30,857	30,857
Installed capacity in MW	Total number of MW maximum capacity	44.85MW	44.85MW

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To: jay.reynolds@schuyler.com
From: thomas.washington@inlook.com
Date: May 2023
Subject Key performance indicators for sustainability

Jay,

I've been looking at the website, and in particular the non-financial key performance indicators.

I've had a look at the reports of a couple of our competitors and they both seem to be reporting the following, which they note are recommended disclosures from the Sustainability Accounting Standards Board for Wind Technology & Property Developers:

- Total recordable incident rate and fatality rate for direct employees and contract employees
- Aggregate capacity of wind turbines, by wind turbine class
- Average sound power level of wind turbines, by wind turbine class

I think we should discuss changing our existing KPIs to these to keep up with the competition. I'd also like your thoughts on how we might gain some independent verification over these KPIs?

Regards,

Thomas
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