Have you looked at your infrastructure financing and M&A transaction arrangements in light of COVID-19?

Key takeaways

- Review project and corporate financing documents carefully in conjunction with a review of major project and commercial agreements.
- Consider whether your financing representations, warranties, covenants and undertakings remain valid and whether project financial ratios have been adversely affected by COVID-19.
- Examine whether the outbreak may give rise to any potential default or termination of the facility arrangement and any consequent (earlier) demand for payment by the financiers.
- Ensure your corporate finance and project delivery teams jointly consider any remedial measures that need to be implemented.
- Have pragmatic discussions with counterparties on how you can work collaboratively through any challenges arising from changes to your financing and M&A arrangements.

In brief

As the COVID-19 pandemic continues to spread across the globe leaving in its wake an unprecedented level of disruption across industries and sectors, businesses and other relevant stakeholders in the infrastructure space are examining their deals and existing projects to ensure their commercial arrangements are not unintentionally compromised. This includes, among other things, engaging delivery teams to examine their delivery programs and/or supply chains to put in place methods to ensure upcoming obligations and deadlines are protected.

However, for projects which may be also funded by external third parties (for example, banks or through government support), parties will also need to pay attention to any further requirements that financiers have imposed within the related financing documents. It is important to be conscious of whether planned or unplanned breaches of underlying contractual arrangements (including suspension of work) may constitute a default event or a termination trigger under financing facility agreements and/or financier side deeds.

Time to dust off financing and M&A transaction documents

Parties who have executed finance documents to fund infrastructure projects now need to carefully consider how the COVID-19 outbreak may impact various financing related obligations and debt service commitments. We have identified some of the more typical financial covenants that businesses should be looking at, noting this is not an exhaustive list and businesses will need to consider their individual financing arrangements on a case by case basis.

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Representations, covenants and undertakings in your facility agreements

Generally, project financing agreements include a comprehensive set of representations and both positive and negative covenants or undertakings by the borrower that usually form the basis on which financiers provide funding. Breaches of the agreed representations or undertakings generally constitute a default event and some breaches may even arise without any (known) element of fault on the part of the borrower. Some undertakings will relate specifically to construction arrangements, such as an undertaking not to make variations to the works over a certain threshold.

It is now a good time to consider whether:

- The representations the business has made remain valid in the current environment and whether they will be able to be repeated at the specified times under the facility agreement?
- Your business is complying with the undertakings in the financing agreement?
- There are any grace periods and other thresholds that your reps and warranties, covenants and undertakings could benefit from?

Events of default and cross-default

Project financing agreements typically include a long shopping list of specific events of default that ensure there is a trigger that allows financiers to exercise their rights in unforeseen circumstances which have led, or are likely to lead, to a reduction in the borrower's creditworthiness. It is essential that borrowers be mindful of their obligations under the facility agreement and to ensure there are no unintended triggers of a default event.

For example, any delay in the completion of a project beyond a specified long-stop date or the lender's technical adviser certifying there is no reasonable prospect of the project being completed by that long-stop date will typically be included as an event of default under the facility agreement. Businesses, therefore, need to examine whether their delivery programs remain valid or whether they are entitled to claim extensions of time or time relief under the relevant design and construct (D&C) contract.

Many project finance agreements also include contractual undertakings that the business must ensure there aren't any defaults under the material project contracts. For example, with many major materials and equipment supply chains for projects having been disrupted and as the impact of the virus accelerates globally (in recent times, countries in Europe and the Asia Pacific region like China, France, Spain, Germany and Italy have become major contributors to global supply chains), it is possible that potential defaults of those supply contracts could simultaneously trigger an event of default under the financing agreements by way of a cross default. A careful joint examination of the relevant documents should also be carried out by your corporate finance and project delivery teams in this regard.

Project and financial ratios

Typical project finance agreements will include borrower obligations to demonstrate that it is maintaining certain agreed financial or physical ratios. These ratios typically measure the existing and future strength of projects and are usually objectively determined by the financial reporting borrowers need to regularly provide to the financiers.

Financial ratios that depend on earning inputs, such as debt-to-income and interest coverage ratios, are expected to be adversely impacted by the pandemic whilst others, such as the loan-to-value ratio, may take longer to be impacted as asset valuations for financial reporting purposes subsequently occur. Businesses should be examining their short-term strategies (such as delaying payment of dividends) to ensure that key financial ratios are not breached.

Material adverse change clauses

Financiers typically protect themselves through the inclusion of a heavily negotiated material adverse change (***MAC***) clause in project finance agreements. These clauses provide financiers with the ability to not fund at all if there has been a material adverse change to the circumstances of the project and the fundamentals for underlying funding arrangements.

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EJK 3,680 238,681,000
HPE 1,062 85,678,000
KEE 485 8,369,000
NAH 8,569 189,301,000
QOP 6,602 102,698,000
TIK 890 24,697,000
WIG 6,280 76,002,000
AHD 2,436 97,610,000

For project finance deals which may contain a broadly drafted MAC clause, the right to withhold funding could be triggered by circumstances relating to COVID-19. However, many project finance arrangements will include a heavily negotiated MAC clause which will only be triggered to the extent of an identifiable impact to the project. Businesses will need to carefully check the construct of their agreed MAC clause to ascertain whether it could be triggered by its lenders due to the COVID-19 pandemic.

To the extent that financial covenants or events of default are independently triggered, any expressed carve-outs and qualifications to the MAC clause will also need to be reviewed and considered.

Remember, MAC clauses are generally negotiated on a case by case basis for each and every project finance deal and, therefore, will need to be examined on the very same basis.

MAC clauses in the M&A context

The COVID-19 pandemic could have come at a time when businesses in the infrastructure space were in the process of negotiating or closing M&A transactions or are about to start. Like a financier, buyers in M&A deals might seek to protect themselves with a MAC clause under a share purchase agreement (SPA), which the parties can expect to be heavily negotiated.

A MAC clause usually allows the buyer to terminate the SPA and walk away from the deal if the target company's business, asset or profits suffer a material adverse effect during a specified period, for example between signing and completion of the SPA. If the buyer is relying on external finance, it should make sure that the MAC clause matches the finance terms. On the other hand, the seller may resist adding any MAC clause at all, failing which it may seek to carve out extraordinary events including those similar in nature to COVID-19. Especially for M&A transactions which have only just commenced, sellers may argue that there is in fact no MAC as COVID-19 risks are already well known to all the parties. The buyer may try to compromise by limiting the MAC clause's scope to situations which have a disproportionate impact on the target company or its key contracts.

As with finance documents, MAC clauses in SPA are likely to be contentious additions to a contract, especially in today's climate full of uncertainties. As there is no statutory concept of MAC, the extent to which a MAC clause can be invoked and any remedies available will be based on the precise wording of the SPA and the practical impact of COVID-19 on the target business. Even where a MAC clause is not included or may not be relevant to a particular case, given the potential impact of the pandemic on certain businesses, there may be other, more specific, contractual clauses which a buyer may seek to rely on, such as warranties or covenants related to the target company's financial health or the seller's obligations.

Here to assist

Whilst parties need to adopt a proactive approach to safeguarding project finance and other arrangements from the COVID-19 pandemic and ensuring business as usual, the team at SF Lawyers and KPMG stand ready to assist as required.

Please contact us to discuss how we can help you resolve any current issues facing your on-going business and transactions.

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Contact us

The team of commercial and legal advisors at KPMG and SF Lawyers are ready to assist you. Please contact us to discuss how we can help you resolve current issues facing your business and deliver future growth.

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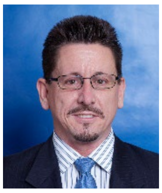

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