COVID-19 Effects on Large Project Transactions

Summary of Conference Call

March 25, 2020

The disruption caused by the COVID-19 outbreak is having a major impact on projects both in development and operation. What started the year as an epidemic threatening a loss of supply from China has broadened to a global pandemic impacting on our deals, employees and practices.

As dynamic as the impacts of the outbreak are, assessing how specific risks may affect your business is challenging. We have gathered market intelligence from the 250+ lawyers in Baker McKenzie's Projects Practice to share this insight in a high level summary with our clients during this difficult period.

Global Supply Chains

- The importance of China as a hub of global trade has increased substantially since the 2002-2003 SARS epidemic and the COVID-19 disruption to supply from China has been substantial. Most global companies have been blindsided by the full effects on their supply chains.
- While China has commenced its recovery, Europe, Middle East, Africa and the Americas are just starting to experience COVID-19. Impacts have shifted from supply shock to demand shock (the full scope of which we are yet to realize).
- For companies dealing with a supply shock there are three key questions: (1) who has supply chain risk, (2) what are the issues with alternative supply, and (3) who is most affected.
- Ultimately, we expect buyers will worry more about their supply chains (notwithstanding that sellers should bear supply chain risk) and will look deeper into the whole supply chain considering sub-supplier diversity as well as price.

Major Projects and Force Majeure

- We are seeing considerable attention on the issue of force majeure ("FM") for major projects both in development and under operation. FM rights fall into two general categories depending on whether the governing law of the contract is a civil law jurisdiction (i.e., China, Taiwan) or a common law jurisdiction (i.e., England, New York, Australia).
- There are 3 key questions: (1) is the COVID-19 impact a FM event, (2) is there an actual obligation that has been impacted, (3) does the FM regime require that the impact "prevent" performance or merely "hinder" or "delay" performance.
- The claiming party must normally take at least reasonable steps to mitigate the impact and this critical aspect of FM is often ignored.

M&A Transactions

- Global economies are experiencing extreme levels of volatility and the short-term viability of some infrastructure assets is extremely challenged. Some major transactions at early stages have been suspended. However, there remains liquidity in terms of private institutional capital and we see opportunities opening up.
- M&A "playbooks are being rewritten" and core assumptions underlying typical valuation models are no longer valid. Moving forward, there is likely to be a reassessment of valuations, a shift in how we conduct due diligence to address COVID-19 risks, further shifts to unlisted assets, less auctions and more bilateral deals being done on an exclusive basis.
- Public equity and debt markets have been affected and we expect to see emergency capital raisings and private placements to repair balance sheets through short bespoke processes.
- Notwithstanding government and central bank interventions, we expect to see pressure on credit. Some corporates will draw down existing lines, but others (particularly listed corporates) are avoiding increasing leverage.

Oil and Gas Market

- We are experiencing the perfect storm of COVID-19-related demand reductions and dramatic price collapse. If history is a guide, the price war between Saudi Arabia and Russia could be a long one. It is not yet clear how long the demand reductions will reverberate.
- Major products, including LNG, are at risk for financing and FM claims. Almost 20 proposed LNG terminals are vying for a shrinking pool of capital. With significant downward pressure on oil prices (and spot LNG), some of these projects may be shelved. On the customer side, we are already seeing FM claims from major Chinese buyers.
- CapEx fallout and layoffs have begun. Numerous oil and gas companies have announced significant reductions in capital spending as a result of COVID-19 and commodity price volatility. We have also started to see mass layoffs and employee furlough programs being put in place. These are likely to continue as liquidity concerns will be heightened as companies with secured debt face asset base redeterminations on April 1st

Debt Financing

- We have seen extensive discussion as to whether COVID-19 impacts will constitute a Material Adverse Effect ("MAE") under finance documents, although lenders have traditionally looked for more demonstrable matters of fact before taking steps to accelerate or enforce on a capital structure.
- For deals not yet signed, we expect new provisions directly addressing COVID-19 risk allocation although this is largely unchartered territory. Solutions that balance the risks of all parties are likely to be most productive in terms of getting the deal to financial close.
- For deals that have closed, it is important to identify notice requirements that may be triggered and potential default triggers. Communication between the parties is key.
- Looking forward, the market is rethinking how finance documents should deal with future outbreaks. New "standard" terms are likely to emerge.

Disputes and Force Majeure

- FM claims are an obvious area of dispute, but consider also alternative claims. Your bargaining power to try to resolve the dispute will be greater if you have supplementary claims available.
- Given the impact it is having on our lives, it is easy to fall into the trap of viewing COVID-19 as a clear FM event, without paying close enough attention to the multiple elements of the relevant clause/law which need to not only be met, but evidenced.
- Counterintuitively, if you are in the middle of supply chain, you may actually need to push your subcontractor to provide you with evidence of performance being affected to allow you to succeed in your claim up the chain.
- Notice requirements are boring, but important since non-compliance can be a total bar to relief if such requirements are drafted as a condition precedent. Remember, it is about form and content, as well as timeliness.

China Update

- Most parts of China are experiencing a slow, but steady return to normalcy, although, much depends on whether there is a second wave of infection. Practically, and due to local government policies, it is difficult for businesses to resume full operations.
- However, there is a clear and growing voice for life to return to normal as soon as possible to mitigate the impact of the pandemic on the Chinese economy.
- Many Chinese companies are dealing with supply chain issues and contractual claims arising from FM. There has been a shift to a more proactive management of risks, including via restructuring of debt and seeking alternative sources of financing. Companies are also alert to counterparty insolvency risks.
- Outbound investment activities are continuing, albeit at a slower pace. The current view is that key strategic deals, particularly "Belt and Road Initiative" (BRI) deals, will continue to be pushed forward.

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