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Effect of the COVID-19 Outbreak and Restriction of Movement Order on Project Financing Agreements in Malaysia

The World Health Organisation declared the outbreak of the coronavirus ("**COVID-19**") as a public health emergency of international concern on 30 January 2020 and a pandemic on 11 March 2020. As a result of the global rapid escalation of COVID-19 and the recent spike in the COVID-19 cases in Malaysia, the Malaysian Prime Minister on 16 March 2020 announced the Restriction of Movement Order ("**Order**"), which will be effective nationwide for two weeks from 18 March 2020 to 31 March 2020 ("**Effective Period**"), to curb the outbreak.

The COVID-19 outbreak and the Order is likely to cause severe disruption to construction works for projects that are presently funded through external debts, either by direct lending from banks and financial institutions or through investors in the debt capital market ("**Financiers**"). This alert seeks to address the impact of COVID-19 and the Order on project financing agreements in Malaysia, specifically for projects which are still in the construction phase, and the steps available to Financiers.

Impact of COVID-19 and the Order on Project Financing Agreements in Malaysia

As a general note, it should be highlighted that the concept of force majeure is a contractual concept in Malaysia and therefore, unless a force majeure provision is included in the relevant agreement, parties will not automatically benefit from any protection or remedy arising from the concept of force majeure. Furthermore, the concept of force majeure is not one that is common in project financing or even general financing agreements. As such, even if a project company may be able to obtain force majeure relief under its project agreements as a result of COVID-19 and/or the Order, such relief is not usually available under project financing agreements.

Project financing agreements typically contain specific project undertakings to ensure that the borrowing entity, in its capacity as project company, constructs, completes, operates and maintains the project properly so that timely and sufficient returns can be generated to pay off the Financiers. There are also specific events of default relating to the project, the occurrence of which would entitle the Financiers to exit from the financing, take timely remedial actions to protect their interest and to recover the debt. Such undertakings and events of default include:

(i) undertaking to complete construction by a certain deadline or progress within a certain timeline;
(ii) event of default if the construction is materially delayed or abandoned or if the construction is suspended for a prolonged period; and.
(iii) event of default if there is occurrence of events that have a material adverse effect on the project.

Under the Order, only 'essential services' such as energy, transportation, banking and finance and healthcare are allowed to operate during the Effective Period. Construction works are not considered to be 'essential services' unless these are works which, if not continued, may bring danger to workers, the public or the environment, and therefore general construction works are not allowed to commence or continue until the end of the Effective Period.

It is also worth highlighting that even for construction works relating to the 'essential services' sector, the general rule under the Order is that such construction works are to be halted during the Effective Period. As such and unless an exemption is obtained, project companies are required to cease all construction works and this may have an adverse impact on their obligations under the project financing agreements.

Possible Steps to Consider

Financiers and project companies (i.e. borrowing entities) may consider taking the following actions:

(i) the borrowing entity may initiate conversation with the Financiers as to what impact COVID-19 and/or the Order has on the project and the financing transaction;

(ii) review the relevant project financing agreements carefully to identify any potential breach of any covenant or a potential occurrence of any event of default under the project financing agreements as a result of a delay or suspension in the construction of the relevant project during the Effective Period;

(iii) consider whether any potential breach may be addressed by any carve-outs, grace period or remedial action is permitted under the project financing agreements;

(iv) consider is there is a force majeure provision in the project financing agreements and if so, consider the applicability of the relief from such force majeure provision. More importantly, consider what are the financial ramifications depending on whether force majeure provisions exists;

(v) if right to claim force majeure exists, the financial impact may be mitigated and impact on the project financing may also be contained;

(vi) in the case of a clear default, the borrowing entity may consider seeking a waiver of such default. The Financiers, on the other hand, may consider, amongst others, the impact of the COVID-19 and/or the Order the project, the significance of such breach and the financial pressure on the borrowing entity if the loan is accelerated (particularly crucial if it may trigger the cross default or cross acceleration in its other financing transactions), before agreeing to grant such waiver or otherwise accelerate the financing facility. In the event a waiver is granted, the Financiers may impose tighter control or other conditions to protect their loan investments; and

(vii) assuming there is an amicable resolution between parties, it is also important to relook into the other terms of the project, the project financing and the project in its entirety as all dynamics would have changed as a result of COVID-19 and the Order.

Conclusion

There is no one-size-fit-all solution as every case has to be considered on its facts. Financiers will need to consider the impact of COVID-19 and/or the Order on the particular project, its dynamics and determine the best course of action. Restructuring of certain project financing could potentially be in the horizon.

We will be producing client alerts on possible rescue options in our next edition, so watch this space.

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