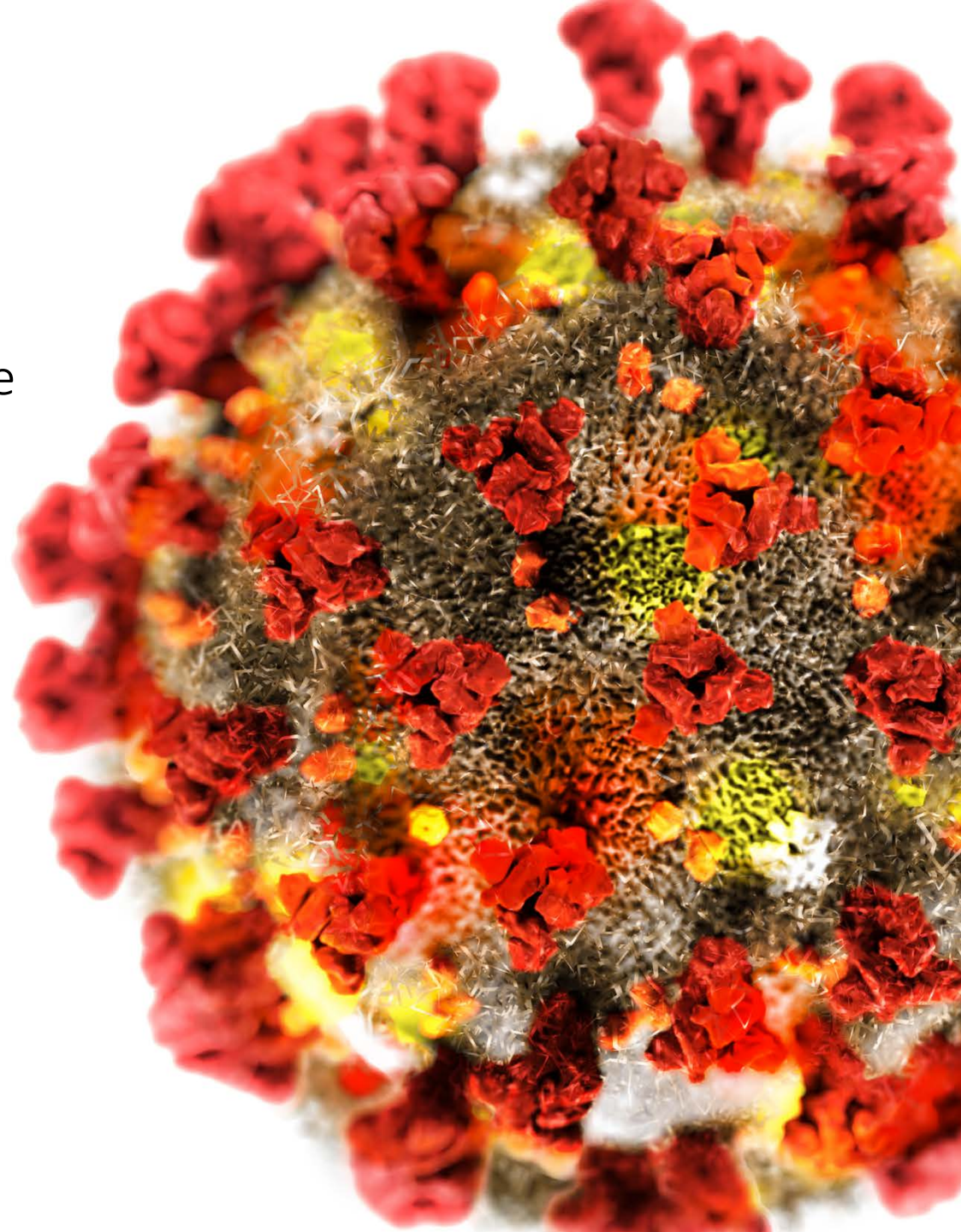


# Real Assets Roundup

Assessing Default and Enforcement Dynamics in the Real Estate, *Project* and Aviation Debt Markets

April 15, 2020

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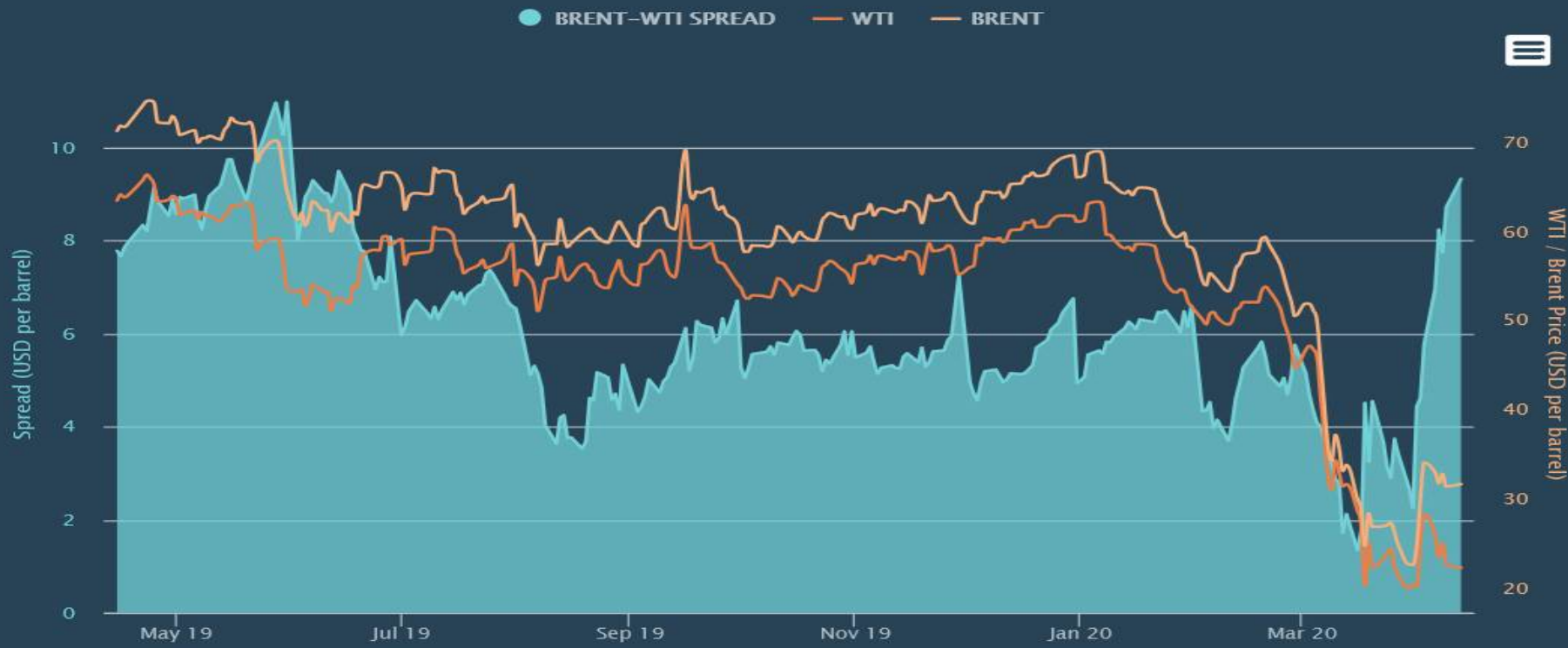
Mark Lessard  
Partner and Leader of  
Global Finance

# Agenda

- Introduction
- Current energy market dynamics, with a focus on U.S. power and oil & gas markets
- Typical project finance provisions
- These provisions in action: Restructurings & Workouts

# Current energy market dynamics

## Crude Oil Prices: WTI, Brent, Brent-WTI Spread



2019-04-14

2020-04-13

6 Months 1 Year 3 Years Max

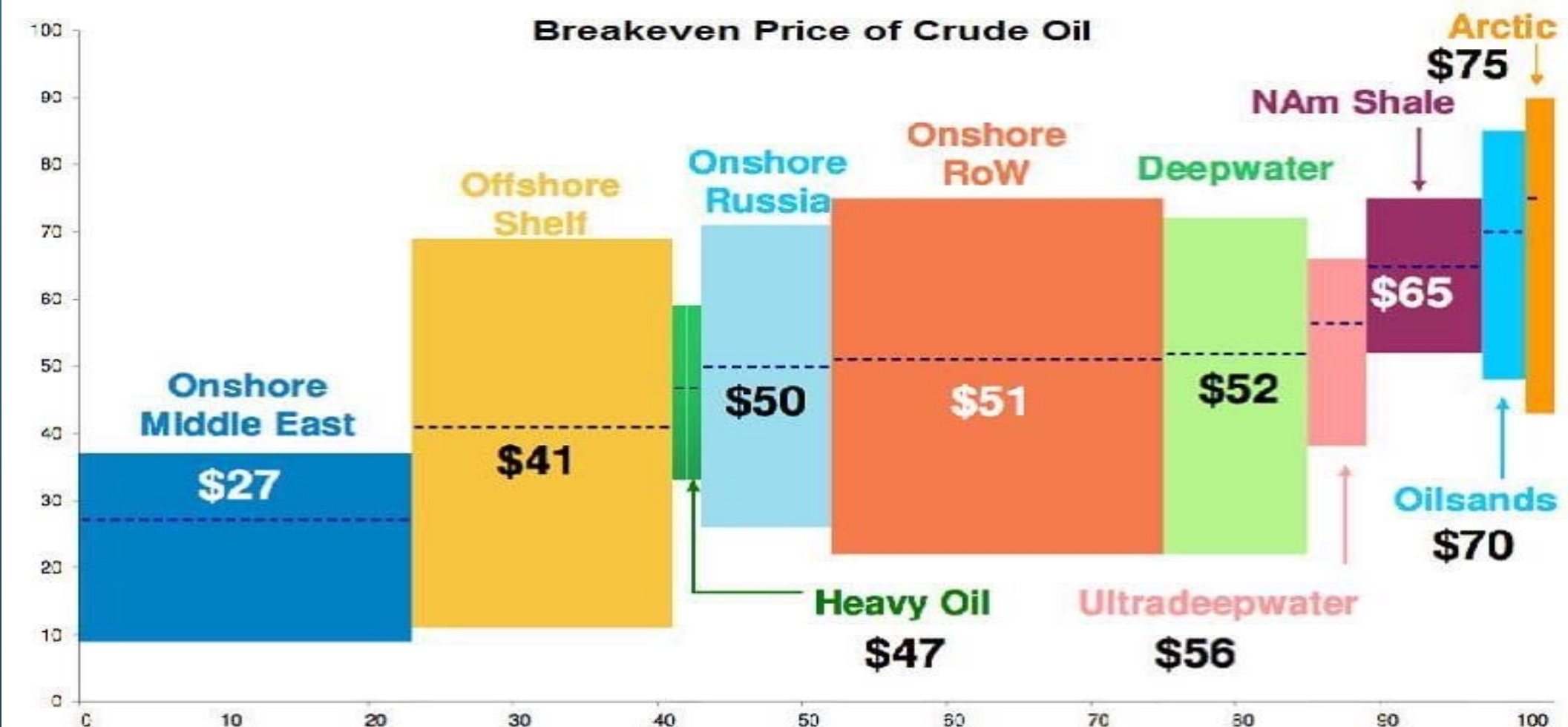
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# Apocalypse or Opportunity?

- Russian/Saudi Conflict increased supply
- COVID-19 reduced demand
- BOTH could end in 18 months – or 4 years
- E&P companies hedge significant production to protect lenders, but hedges will start rolling off in mid-summer
- Horizontal drilling/fracking has sharp decline curve and high drilling and completion cost – production mostly within 24 months of completion
- Traditional stripper wells have lifting costs

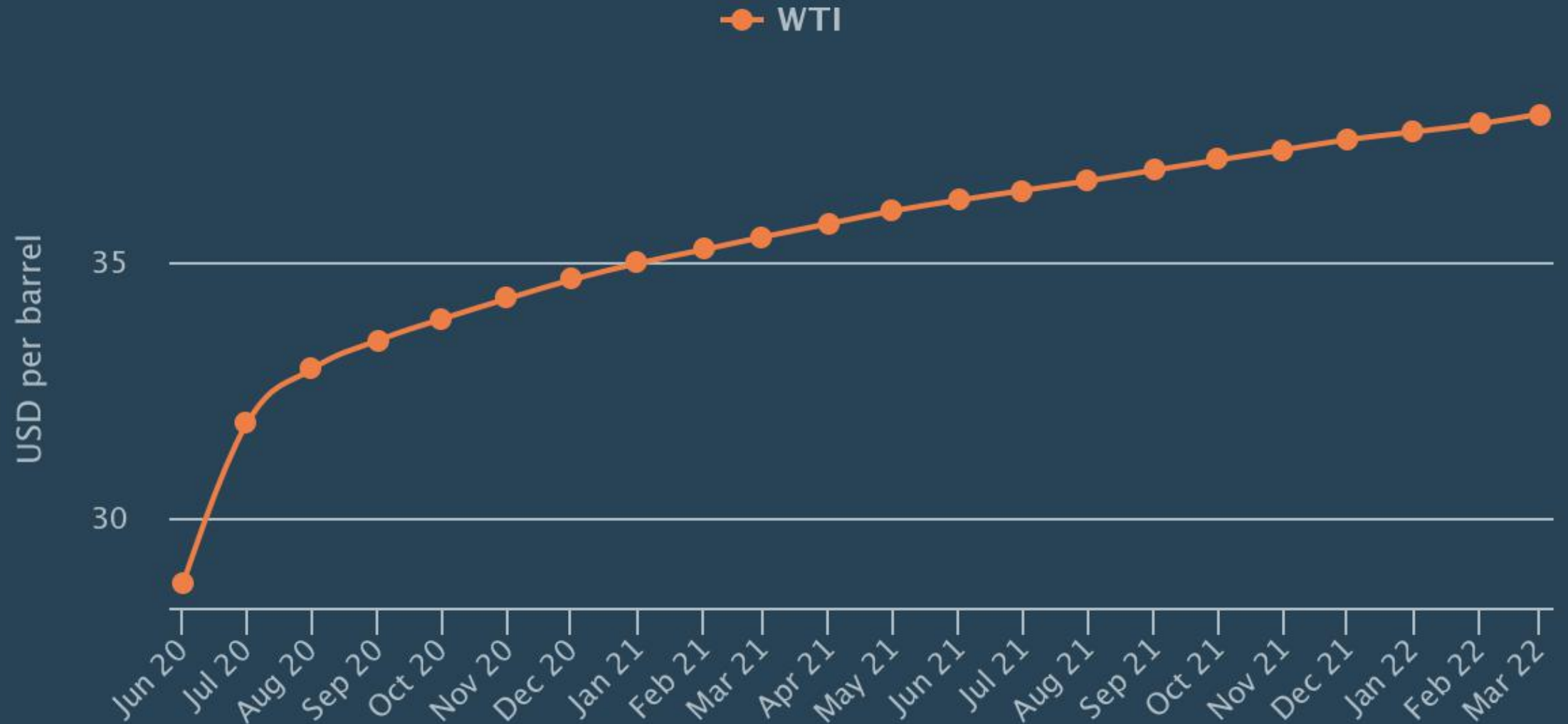
# Lifting Costs by Region



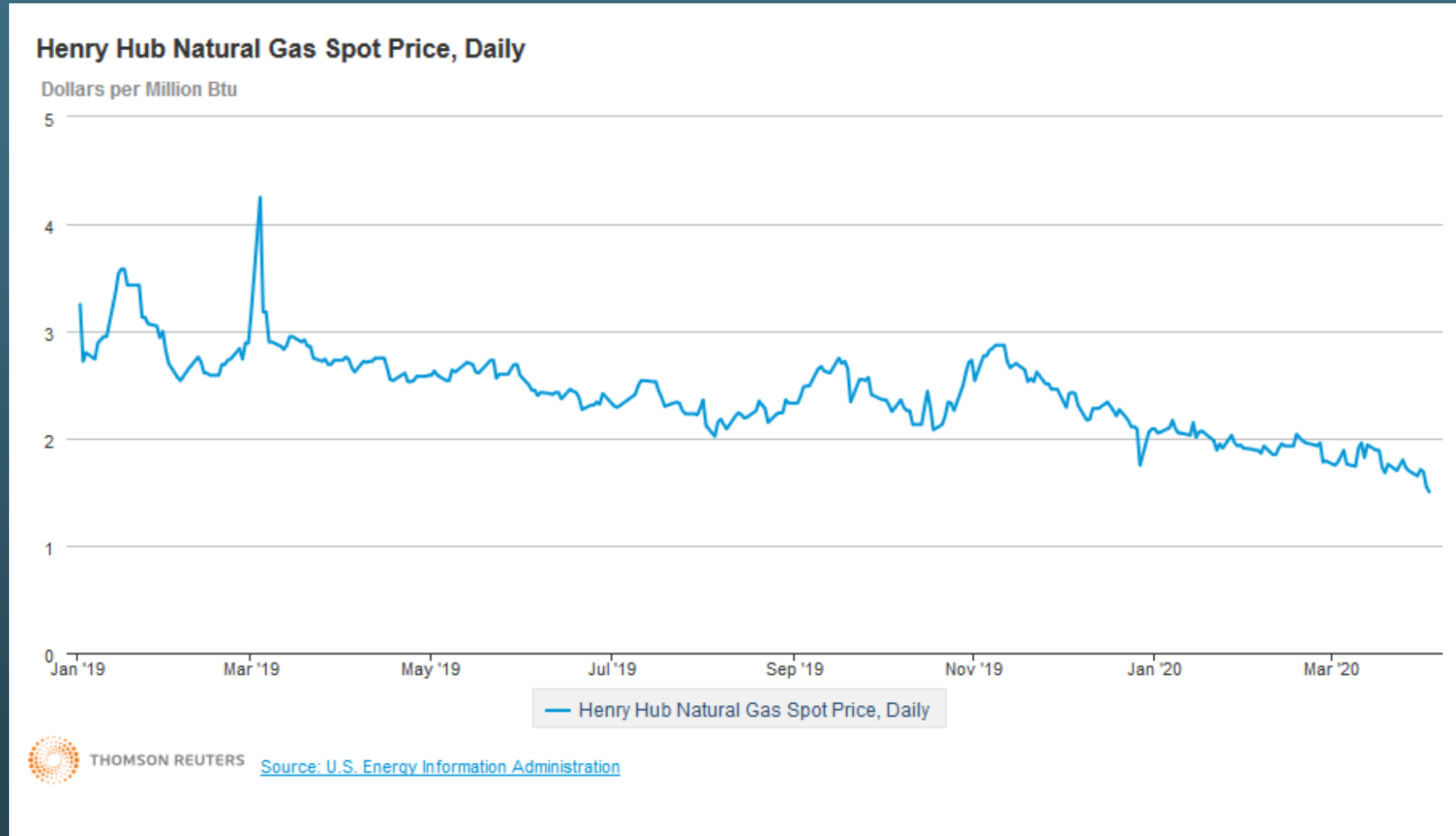
Market Realist

Source: Seadrill, Morgan Stanley Equit Research, International Energy Agency

# Strip Pricing of WTI Looks Thin



# Natural Gas Market





# Debt Markets – Oil & Gas

- Debt markets are effectively closed to upstream oil and gas, other than investment grade majors.
- Most long-term debt in the upstream oil and gas sector is not maturing this year and companies are drastically seeking to cut costs, which gives companies a longer runway.
- However lenders are considering options.
- Oilfield service companies and midstream operators will begin feeling the impacts of upstream driller distress which will impact their ability to obtain and refinance their own debt.

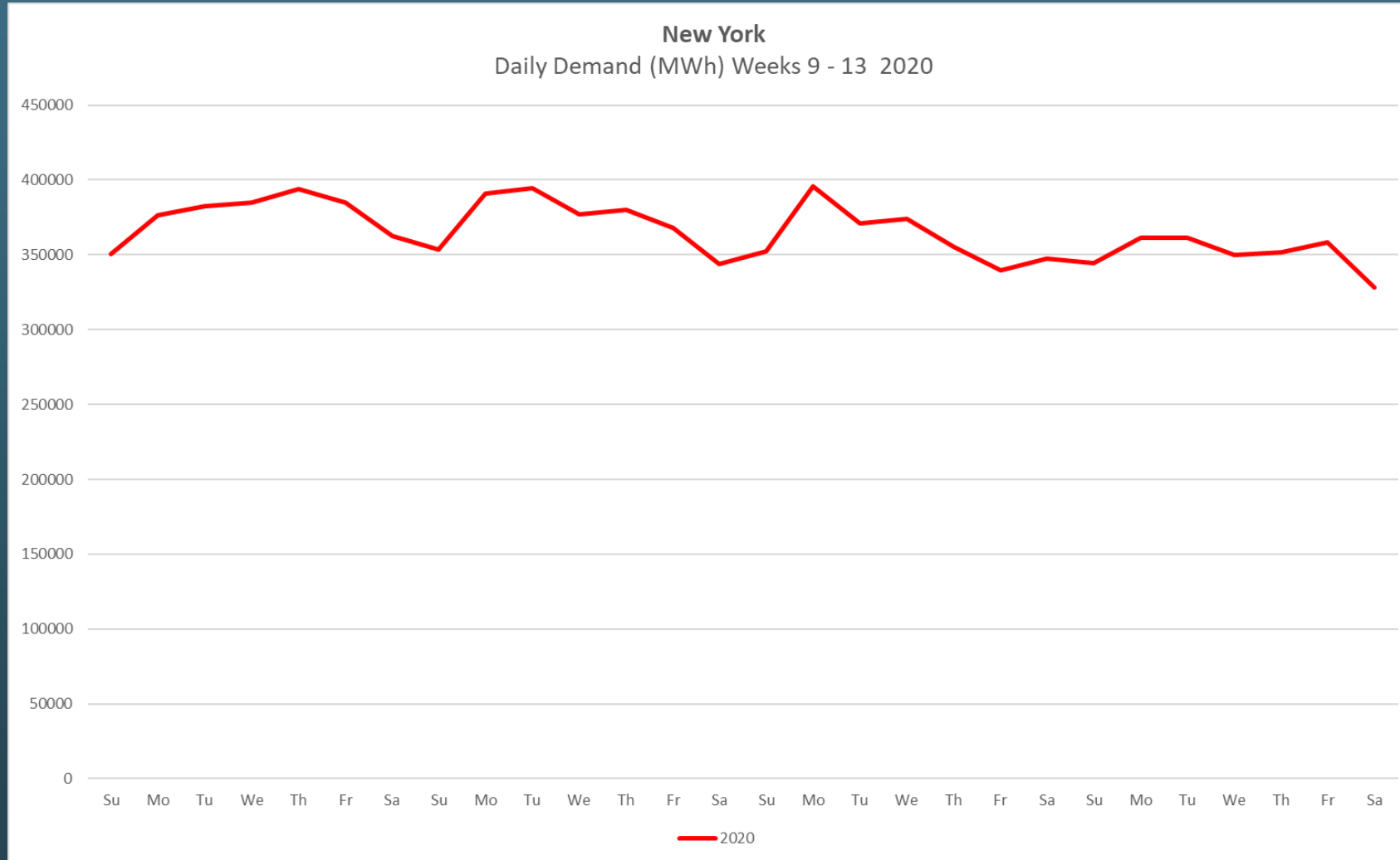
# 2020 Forecast

- Total U.S. electric generation declines by 3%
  - Commercial sales down by 4.7%
  - Industrial sales down by 4.2%
  - Residential sales down by 0.8%
- CO2 emissions drop by 7.5%

Source: U.S. Energy Information Administration, Short Term Energy Outlook, 4/7/2020.



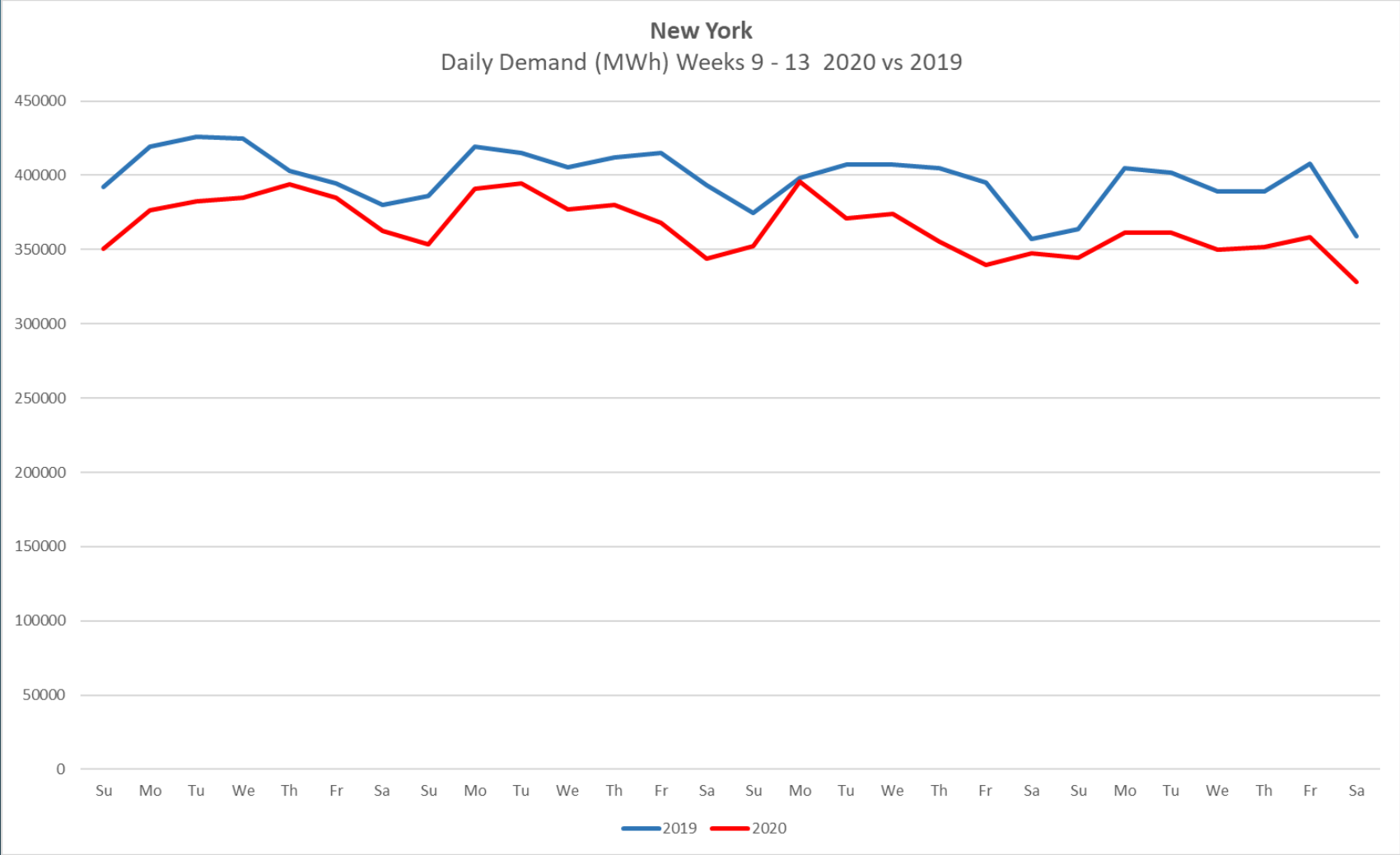
# Electricity Demand – New York



Data from the U.S. Energy Information Administration



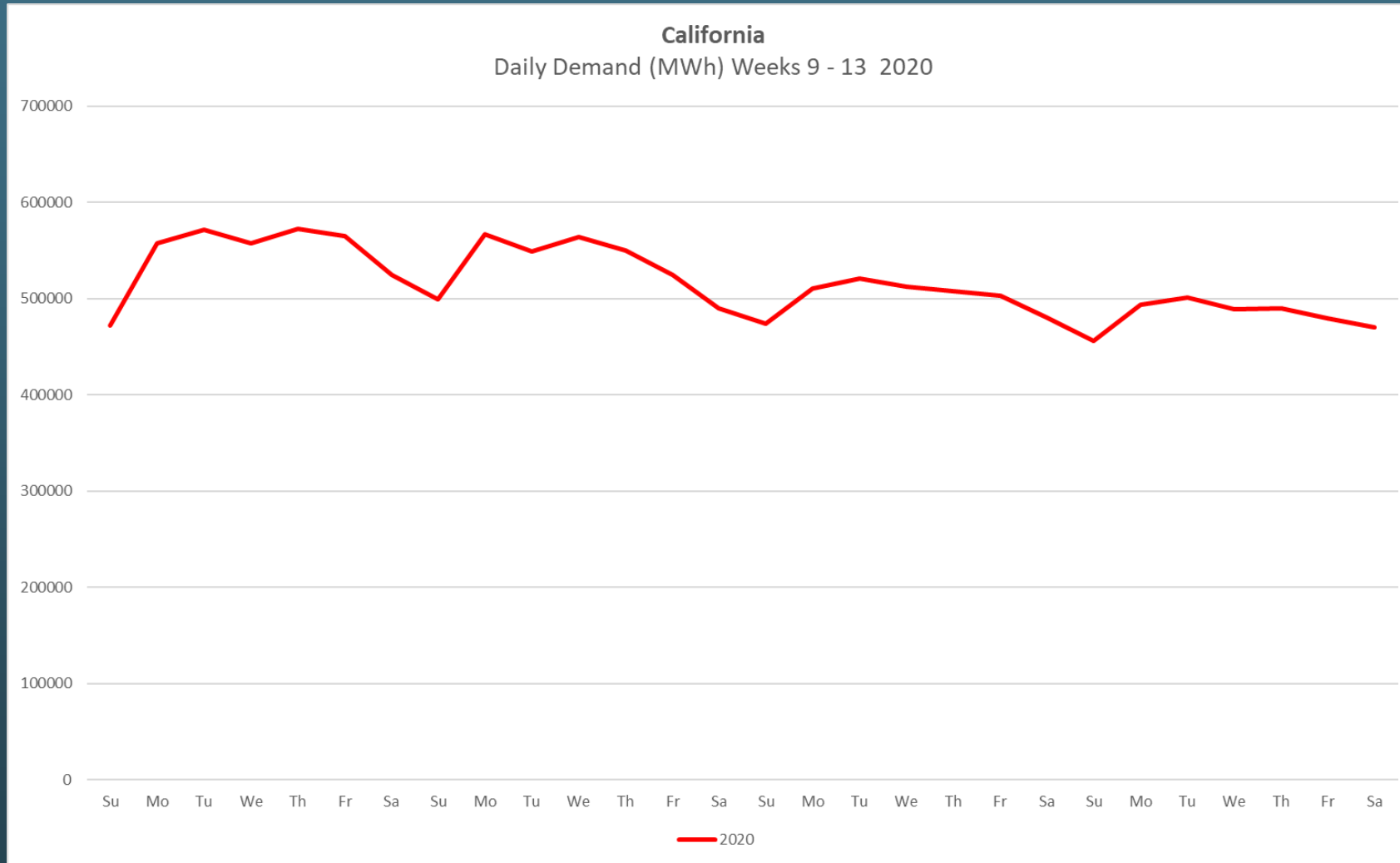
# Electricity Demand – New York



Data from the U.S. Energy Information Administration



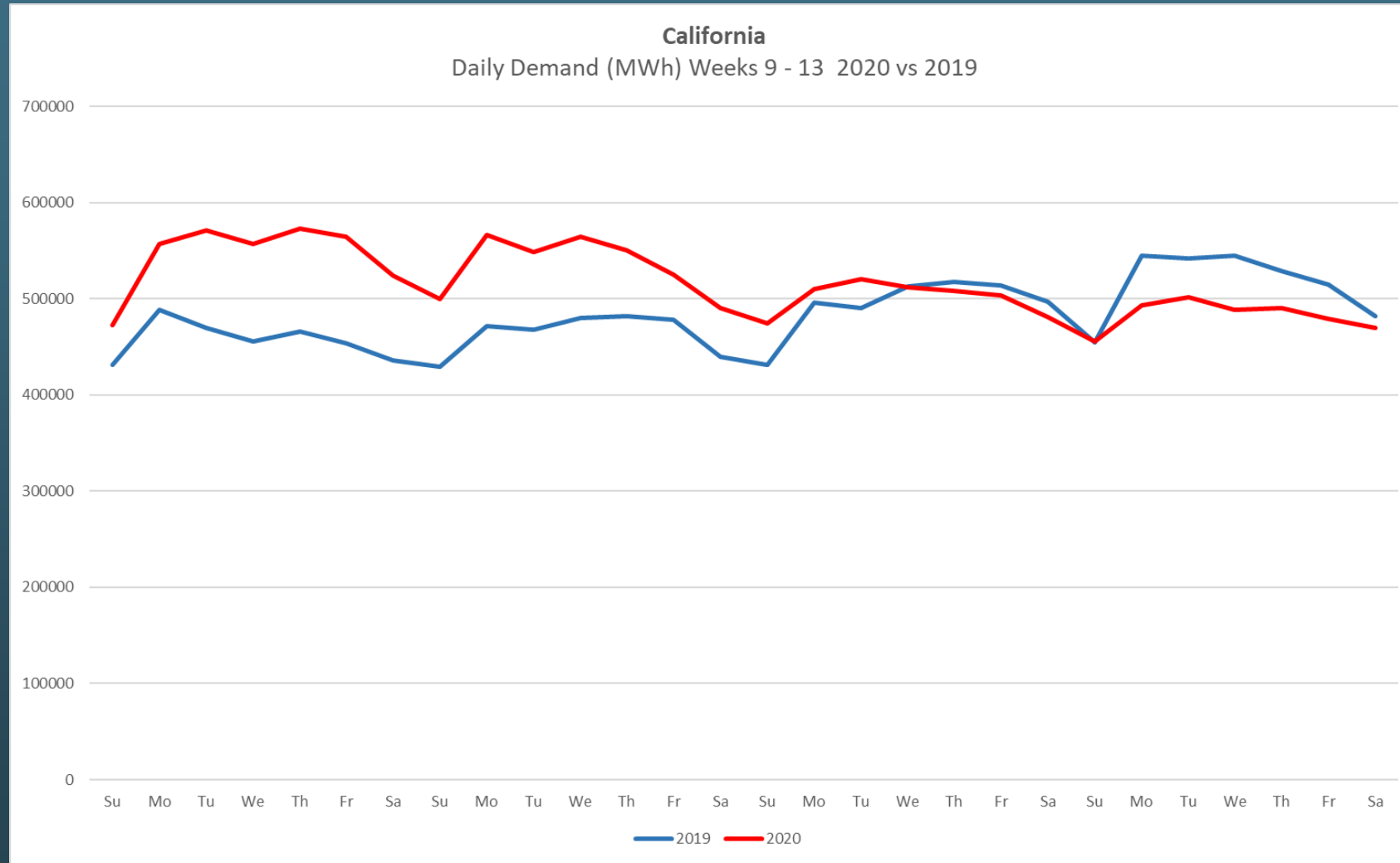
# Electricity Demand - California



Data from the U.S. Energy Information Administration



# Electricity Demand - California



Data from the U.S. Energy Information Administration



# Debt Markets – Power

- Balance Sheet Financing: Capital markets and bank loans are options for utilities, though with increased spreads and enhanced lender protections.
- Project Financing: Some power projects are reaching financial close; others are delayed.
- PJM auctions still delayed, which increases uncertainty in future years.

# Typical Project Finance Provisions

Borrower is a ring-fenced special purpose vehicle formed solely to own and operate a single defined asset (or group of assets)

Limited or non-recourse to the ultimate Sponsors/Owners

Covenants are typically more onerous than balance sheet financing and include prohibitions on the incurrence of additional debt or granting of liens

Collateral Package includes:

- Lien on all assets of Borrower, including all real and personal property comprising the Project.
- Pledge of all equity in Borrower.
- Lien on all cash revenues which are deposited into controlled accounts and subject to a cash waterfall that regulates cash flow.

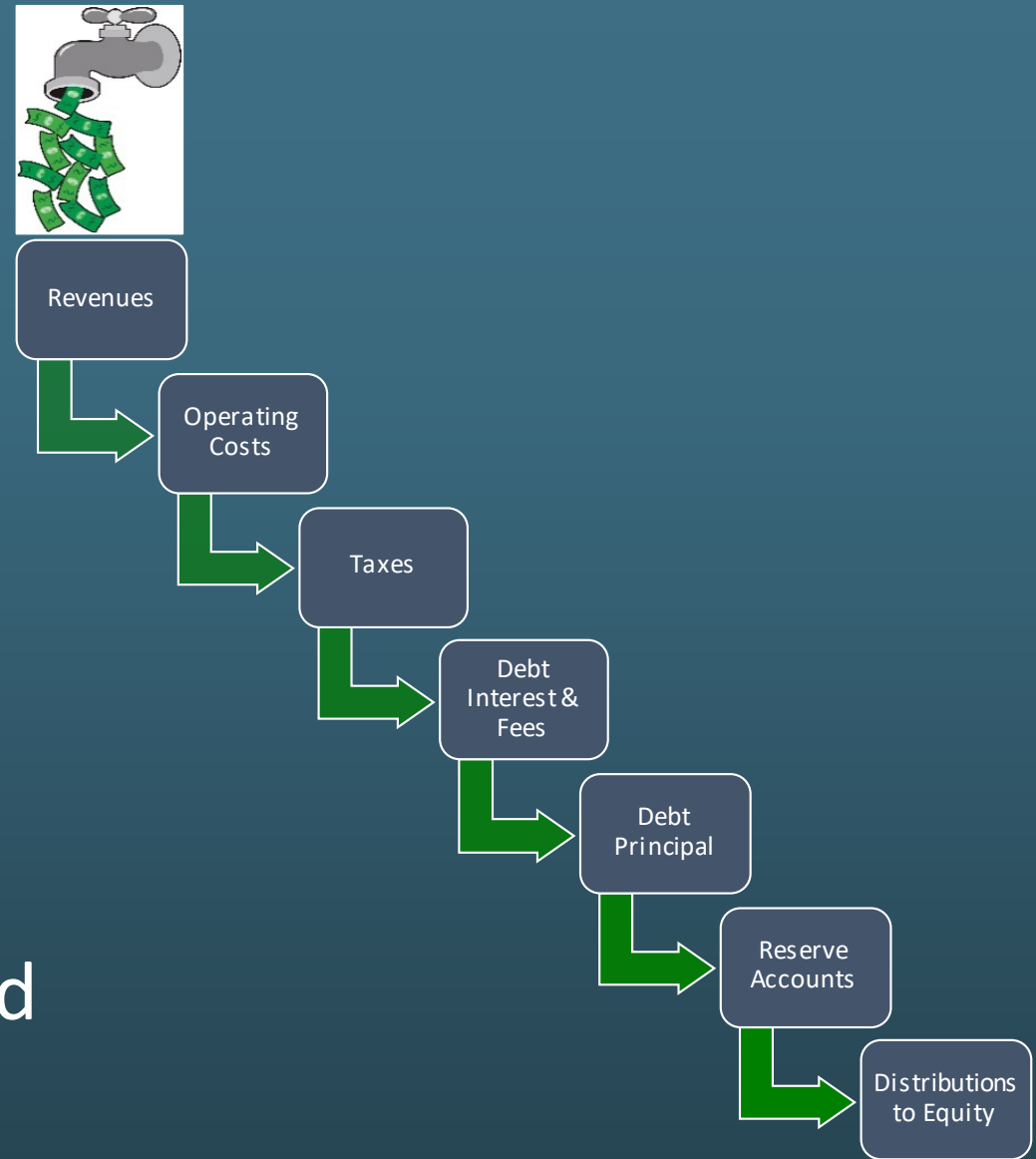
Direct Agreements with Counterparties to Key Project Documents (e.g. EPC or PPA)

- Provide Lender's with step-in rights during default.
- Obligates counterparty to enter into replacement agreement if original agreement is rejected in Borrower's bankruptcy.



# Cash Waterfall

- All cash generated by asset operations is isolated and controlled.
- Runs through periodic waterfall.
- Costs necessary to operate project and taxes paid first, then debt service, then to fund reserves and last to make distributions to equity.



# COVID-19: Impacts depend on Stage

- Pre-Development – currently little impact for projects on 2021-2022 (or later) timeline.
- Development – parties seeking to allocate COVID-19 risks in project documents but credit markets tightening up.
- Construction – may impact ability to obtain financing (including for renewable projects, tax equity) and supply chain disruptions may cause projects not to achieve key construction milestones.
- Operation – will depend on whether they have a long term PPA, Offtake, Sale Terminal Use Agreement or other agreement that provides long term stable revenue streams.
- Closure/Decommissioning – assess unexpected closure costs and options to minimize costs.

# Oil & Gas Projects/Reorganization

- Unlikely to have demand for new LNG or Refinery projects
- Midstream transmission and compression should be flat
- E&P options
  - “Throw the keys at the bank”
  - Extend and Pretend, then De-Lever
  - De-lever now and capture upside
  - Merge to reduce operational costs
- Long term results of cheap oil?

# How to Decide the Course of Action (E&P)

- Debtors
  - Gain realistic view of costs and options to weather the storm
  - Negotiate with lenders to provide for upside
- Lenders
  - Determine the fulcrum lender, which depends on the strip predictions
  - Determine the options for capturing an upside based on expected future prices
- Equity
  - Do not hold your breath expecting a return

# Options for Power/Renewable Energy EPC

- Evaluate immediate risks and long-term costs
  - Conduct professional analysis of contractual and other risks based on stage of the project
    - In service deadlines
      - Lenders
      - Offtakers/Owners
    - Additional financing
      - Interplay of Performance or Payment Bonds
    - Increasing risks of default
    - Governmental rescue
    - Mothballing
    - Waivers or Forbearance
    - Walking away
- Restructuring Options
  - Balance Sheet (maybe out of court or a prepack if only limited creditors are impacted)
  - Operational (most likely requires a more traditional chapter 11)
  - Both?

# Power/Renewable Operating Project

- Unique considerations
  - Long term supply/purchase agreements
    - Exclusive purchasers
    - Up to purchaser's requirements
  - Government-regulated contracts
    - Rate setting (non-bankruptcy)
    - Modification/Assumption/Rejection of contracts (FERC v. Bankruptcy Court)
    - Other Public Policy Considerations
- Restructuring Options
  - Balance Sheet (maybe out of court or a prepack if only limited creditors are impacted)
  - Operational (most likely requires a bankruptcy)
  - Both?

# Questions



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