In brief

Recent macro risk events are placing high levels of pressure on the infrastructure sector in mainland China and Hong Kong, giving rise to a wide range of legal and commercial risks for governments, asset and project owners, builders, developers, investors and operators. Acting now by understanding your risk exposures, developing clear-cut mitigation plans and formulating robust business strategies for the eventual rebound will be the difference between thriving and surviving.

Key takeaways

• **Risk high on the infrastructure agenda**: Understanding and proactive management of risk has arguably never been more prominent for the Infrastructure Sector. If you have not yet done so, start engaging your teams to examine and re-examine whether the risk mitigation strategies in your contracts are as robust as originally planned.

• **Knowing your legal and commercial risk exposures**: Public bodies and private organisations need to be fully aware of the legal and commercial implications of current and pending market risks. Knowing your contracts, having clear-cut risk mitigation plans and understanding your legal avenues of recourse could make the difference between thriving and surviving.

• **Unpredictable events never far away**: Events such as the novel coronavirus outbreak, socio-political unrest and global trade tensions represent macro-risk dynamics that were challenging to foresee, complex to mitigate and have enormous commercial and legal ramifications such as reduced returns, stakeholder conflicts and mega construction project complications. Start identifying proactive measures to mitigate any potential losses and maximise returns and outcomes.

• **Infrastructure to play a key role in restoring confidence**: Now more than ever, public and private infrastructure has a vital role to play in safeguarding the stability of society and reinforcing continued economic development. This includes providing sufficient health and care services for citizens, ensuring the public can engage effectively with their workplaces and providing the foundation for continued local and cross-border trade in goods and services. Keep the faith and help foster market confidence.

• **Stakeholder engagement fundamental to success**: Proactive engagement with your partners and stakeholders will assist in collaboratively overcoming issues, resolving conflicts and achieving win-win outcomes.

• **Capturing the next round of growth**: As the market eventually stabilises, new growth-oriented government policies could be forthcoming, potentially including economic stimulus, new infrastructure project approvals and expansion opportunities for existing infrastructure. This means exciting business opportunities for groups that have successfully navigated the current environment and developed growth strategies for the eventual rebound. Start positioning your teams to hit the ground running when the next phase of growth arrives.
Key threats

“Road Works Ahead!”

Market turbulence is presenting a wide range of risks and challenges for existing infrastructure assets in operation and those under construction:

• **Project delays**: Reduced access to labour and construction materials, site access limitations due to labour and public safety concerns, plant and equipment failures due to idle usage and continuous rescheduling requirements are impacting the ability of contractors to meet their contractual obligations and leading to potential disputes.

• **Impediments to performance**: Physical and technical impediments to delivery and operations impact the ability to discharge contractual obligations such as completion or testing, commissioning milestones and KPI performance.

• **Cash flow impacts & cost blow-outs**: Construction milestone delays which cause payment delays to contractors and sub-contractors, cash flow volatility, increased working capital needs and reduced financial returns. Such delays can also lead to contractual conflicts, cost blow-outs and termination events if parties are not able to achieve win-win solutions.

• **Reduced financial returns**: Operational assets experiencing usage downturns will endure reduced revenues, decreased financial returns to shareholders and may be subject to cost cutting initiatives such as job losses and reduced capital investment.

• **Unforeseen regulatory responses**: Government intervention including the imposition of “new” regulatory requirements can have drastic impacts on existing and in-development infrastructure – including greater costs, reduced revenues, delays to construction and a range of undesirable knock-on legal consequences.

What you can be doing now

**Check your existing contracts**

“Is it as clear as mud?”

It is now more important than ever to review your contract terms, know your risk exposures and take measures to ensure your project or asset remains “on-track”:

• **Continue performing**: First and foremost, it is important to continue discharging your contractual obligations notwithstanding the current threat.

• **Reporting & notifications**: Check any initial reporting or notification obligations you may have to determine what conditions must be met before you are entitled to seek certain relief, waivers or entitlements.

• **High risk events**: Examine whether your contract contains any specific mechanisms that deal with various foreseeable and unforeseeable risks. Contracts may allow entitlements to time extensions and/or compensation, as well as avenues to seek mandatory variations to accelerate certain works or performance obligations for additional compensation and time relief.

• **Claim time limits**: Failing to comply with time limits for making and assessing claims can have a dramatic impact on recovering your losses. For example, in the case of a health epidemic, the clock could have started when the epidemic was first announced, even if it may not yet have impacted the project.

• **Record keeping & data analytics**: Proper record keeping systems to ensure all evidence is available will be necessary to substantiate your claims. Incorporating data tracking into project delivery and operating assets, supported by robust analysis systems will assist in identifying performance failures and supporting your claims for recovery.

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Good friends during times of crisis can make all the difference. The same is true for infrastructure. Engaging with your stakeholders, understanding their motivations and proactively pursuing mutually beneficial outcomes can be what it takes to prevent legal disputes and commercial risks being realised. Key stakeholders and factors to consider in the current environment include:

- **JV & consortium partners:** Is your partner being negatively impacted by current market dynamics? Will your organisation be exposed to greater risk if your partners fail? Proactive engagement will help address disputes before they arise.

- **Subcontractor & supplier performance:** Are your suppliers facing resource constraints that will impact your performance? Will you be able to recover your losses — whether financial, reputational or otherwise? Can these risks be addressed through supplier diversification, operational innovation, purchaser financing or other means such as time extensions and insurance? Understanding these risks and how you can help can make the difference.

- **Insurance & risk management:** Understanding the full details of your insurance coverage framework will mitigate potential losses. More importantly, it will help identify gaps in your risk management model and the necessary actions to take.

- **Knowing your future financial performance:** Is your financial performance going to impact your ability to meet lender financial covenants? Will a downturn lead to reduced shareholder dividends — resulting in reduced financial commitment and investment for the future? Being able to forecast financial performance is the first step towards delivering sustainable and robust financial performance.

- **Public sector stakeholders:** Governments inevitably have an interest in the performance of infrastructure. Regular engagement with affected bureaus, departments and public interest groups can ensure maximum support is available when the going gets tough.

- **Professional advisers:** Last but not least, seeking support and guidance from your professional advisers will provide you with more clarity on how best to address the issue at hand.

In addition to the above, proactive stakeholder engagement can also provide the foundation for future growth. Relationships forged during tough times will ensure you are better positioned to capture the upside on new business opportunities when market dynamics turn positive.

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"When shall we three meet again…?" 

1 Shakespeare, Macbeth, Act 1, Scene 1
Ways to avoid the inevitable

“It’s a recession when your neighbour loses his job; it’s a depression when you lose yours.”2

Whilst disputes and risk are common dynamics associated with construction projects and infrastructure assets, these events do not have to be inevitable. Parties that are willing to take a proactive approach based on “partnering and collaboration” stand a much greater chance of achieving collective success. Key aspects of this include:

- **Early identification**: Identify issues early and communicate with the relevant parties to resolve them quickly and achieve win-win outcomes.

- **Commercial mitigation**: Risk mitigation does not always have to be about insurance. Approaches that involve contract extensions and allow greater flexibility to capture more income streams can lead to reduced risk and greater returns to all parties.

- **Transparency**: Be transparent with your partners in challenging times. Whilst it is important to maintain your commercial and legal position, there may be scenarios where you should consider claims on a “without prejudice basis” and explore interim settlements tranche by tranche.

- **Partner motivations**: Understand the commercial pinch points of your partners and explore solutions that would address these challenges. Positive cash flow, hitting KPIs, sustaining performance, and seeking growth opportunities are motivations that are common to most project stakeholders.

- **Smart solutions**: Rather than adopting traditional, time consuming and expensive dispute resolution processes to resolve claims, explore interim resolution processes such as executive negotiations or conciliation and mediation.

Dry land ahead, Captain!

Whilst the future direction of the market is never certain, history has repeatedly shown that during challenging economic times government-led policy stimulus is a common measure to restore economic growth. Such a stimulus can benefit the infrastructure sector through expedited project approvals, industry funding programmes and incentives for existing assets.

Potential programmes in mainland China and Hong Kong could include expanded rail projects and associated transit-oriented real estate development; wide ranging investment in social infrastructure including health, education, sports, tourism and the arts; a renewed focus on construction innovation, research and development as well as continued prioritisation of policies for the Belt and Road Initiative and Greater Bay Area.

Groups that have successfully navigated the current environment and developed effective growth plans for the eventual rebound, will be well positioned to capture these and other growth opportunities when they arise.

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2 Harry S. Truman, The Observer, 13 April 1958
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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