

DIGGING DOWN TO THE ECONOMIC DETAIL - KPMG

Posted on 28/06/2009



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Fernando Cuñado Garcia-Bernalt of KPMG Forensic sees an increase in financial analysis not only among those in dispute, but also now among parties entering into agreements

The economic squeeze is clearly prompting increased sensitivity over projects financial terms and conditions, but the lessons being learnt from current finance disputes can be applied positively to future deal analysis and evaluation, says Fernando Cuñado, a Director in KPMG's EMEA Forensic Dispute Advisory Service Group based in Madrid.

'The established loan market has pretty much collapsed. Mandated lead arrangers have given way to club deals and this inevitably presents a more complex finance scenario, with more players, more analysis of contractual terms and more conservative financial projections and valuations.'

Deal terms are inevitably tighter and the risk premiums much greater, while agreements are also now incorporating much stricter covenants and warranties, he notes.

'Financial institutions are lending less and being much stricter on the criteria on which they do lend, they are asking for much stronger contractual guarantees, and placing significantly more emphasis on financial projections. Nobody wants to rely on what may be 'out of date' financial information. If there is a single change in the economic or business model before the closing date, terms are being adapted.'

In new agreements there is also a move towards 'agreement vetting' with parties being extremely cautious over the inclusion of any specific economic clauses, says Cuñado Garcia-Bernalt.

'Different sectors present different risk and returns and so clauses or economic models used in one will likely not be appropriate in another. The current flood of litigation is prompting parties entering new agreements to reassess their liabilities from the outset and to be more pragmatic about economic commitments. There is no room for 'cut and paste' on the so called standard clauses of those contracts including on the financial side, especially on share purchase agreements (SPA) in a transactional context.'

Financial institutions also no longer want to be approached part-way through a project development, he says. 'They want to be involved from the outset of a project plan, and are asking for expert economic input in order to better understand or manage what risks there may be.'

For project deals already underway, the ability of parties to react, for example, to economic changes or delays, will clearly be determined by the contractual terms agreed. But conflicts are evidently on the increase along the project chain.

After taking legal advice, parties may find that there is no in built contractual flexibility, or as a result of the financials on which deals are now being analysed, says Cuñado Garcia-Bernalt. no willingness to be flexible on the part of the banks underwriting them.

'Previously, when liquidity was perhaps less of an issue, delays or minor financial variations could be absorbed; there was a willingness among parties to negotiate out of difficulty. Now we are seeing deals that no longer prove viable because of what may seem to be relatively minor financial changes or project delays.'

Deals turning bad are leading to immediate conflicts, he says. There is often no longer room for 'happy discussions' as events can lead to severe disequilibrium. Parties therefore want to understand the financial implications in order to establish a negotiating position or, should it be the case, a proper dispute to be put in place.

'The current situation is prompting a significant increase in complex disputes across the projects arena. There is an evident willingness, sometimes just driven by need when an agreement cannot be reached, to turn to litigation or arbitration even though it may not provide the best outcome for one of the parties involved,' says Cuñado.

'Parties clearly need a robust analysis of their contractual positions, but there is also a need for expert analysis to ascertain the relative financial impact of any deviation that has taken place, especially if unforeseen.'

Given the timescales of litigation and even arbitration, an eventual option in many cases may however be to engage in concerted, albeit complex, and independent-expert assisted negotiations or risk the failure of the entire project.

'If no remedy can be sought, companies may collapse and projects stall. A pragmatic position has to be adopted that weighs what is best for all the parties involved against the value or importance of

the end product.'