Energy and infrastructure: the resilient opportunities for investment in post-pandemic Latin America

Contributed by Maria-Leticia Ossa Daza, Jorge Kamine and Matthew Vitorla, Willkie Farr & Gallagher

GC Latin America Survey 2020 | Energy and Infrastructure

WILLKIE
WILLKIE FARR & GALLAGHER LLP

THE PROMISED ENERGY AND INFRASTRUCTURE INVESTMENT OPPORTUNITIES

In the early months of this year before COVID-19 became a global pandemic, all indications were that 2020 would be another record-setting year for investment in energy and infrastructure throughout Latin America. Significant institutional capital was being raised by debt and equity funds with an increasing appetite for and interest in Latin America. More and more global companies and strategic investors were lining up to pursue the development of renewable energy and infrastructure projects throughout the region. Renewable generation was increasingly cost-competitive with other generation without government subsidies, distributed generation was expanding rapidly, and commercial and industrial (C&I) businesses in Latin America were increasingly interested in direct contracting for renewable power. Governments were proposing new policies and reforms: advancing the evolution and diversification of Latin American energy markets, addressing climate change concerns through various investments, tackling urban congestion and pollution with public-private partnerships (P3s) to increase the electrification of public transportation, and structuring a pipeline of P3s to address other infrastructure gaps. Investment returns were better and opportunities more plentiful in Latin America than in most advanced economies. A growing roster of commercial banks and other lenders offering financing for those projects followed, also drawn, in part, by the better returns.

THE AFTERMATH OF THE PANDEMIC

Then, the global pandemic spread to the Americas and led to a rapidly cascading shutdown of economic and human activity across the region resulting in an unprecedented deceleration of ongoing construction and an indefinite pause in new projects and investment. Quarantines resulted in a dramatic drop in electricity demand and substantially disrupted logistics for the construction and operation of projects. Government orders mandating uninterrupted supply of essential services coupled with suspensions of payment to private operators and the overall emergency have led to disruptions across value chains, including widespread force majeure claims, all of which have raised questions about the financial health of companies in these sectors despite mitigating efforts by countries like Brazil, Chile and Colombia. In short, the pandemic has set the region back economically, brought about a number of challenges for private and public sector plans for energy and infrastructure projects, and created uncertainty about the post-pandemic future.

It remains to be seen how these various dislocations will be resolved. Force majeure claims, in particular, have been asserted by parties across value chains and may raise a number of questions given the legal intricacies of the provisions that need to be interpreted, the economic consequences of contract milestones, term extensions, performance metrics and related payments, and the impact of these disputes on future contracts. The litigation generally arising from the pandemic, including claims for increased costs due to the pandemic and for the suspension of private operators' rights to charge tolls or exercise remedies for nonpayment, will take time to be resolved and may produce outcomes that are inconsistent from project to project. Most importantly, investors will be watching the outcomes of these disputes, particularly those associated with government actions requiring private owners and operators to continue to provide services without compensation, in order to reassess political risks and the strength of investor rights under contracts in the different countries in the region.

THE OPPORTUNITIES REMAIN WITH CHALLENGES

As the Inter-American Development Bank stressed in this year's Development in the Americas report, Latin America and the Caribbean should 'invest more and better'. Countries there/in the region have historically invested much less in energy and infrastructure than other developing regions and closing that gap will require greater and more effective public and private investment to produce better quality public services. The pandemic may shift aspects of how we live our lives and conduct business – and by extension whether we invest more in technology, media, and telecoms (TMT) and digitalization of services – but the need for investment in energy and infrastructure in Latin America has never been greater. Per IRENA's Global Renewables Outlook, recovery measures that employ technologies consistent with long-term climate sustainability, like renewable generation, flexible power grids, efficiency solutions, electric vehicles, energy storage, and 'green' hydrogen, can help drive socio-economic development and create new private sector investment opportunities while addressing climate change goals.

Certain Latin American governments have already adopted policies designed to attract foreign investment in energy and infrastructure and make it a centerpiece of economic recovery efforts. Chile has introduced major initiatives on renewables, green hydrogen and electrification of public buses. Brazil has even reversed decades of prohibitions on the dollarization of contracts to increase the bankability of projects. Additionally, the United States has expressly made it a foreign policy goal to promote investment in energy and infrastructure in Latin America and the Caribbean in order to encourage a geographic shift in key suppliers to the United States from China and Asia to the Americas.

Further, the fundamental factors that promised opportunities prior to the pandemic – availability of capital, appetite for greater returns and need for investment – remain. There has been a reassessment of risk among investors and lenders and recent reports estimate that only a small percentage of newly raised capital is earmarked for Latin American investments. The International Energy Agency has cautioned that sponsors and investors will find that governments have focused their attention and resources on addressing the immediate impacts of the pandemic. As a result, government sponsorship of projects will be limited and public sector processes, including tenders, permitting and regulatory procedures, will be subject to delays. Moody's predicted in July that future financing of energy and infrastructure will come from multilaterals and institutional investors given governments' fiscal constraints and commercial banks' focus on strengthening their balance sheets. Consequently, financing projects will be more difficult, particularly projects viewed as being riskier.

Nevertheless, from the perspective of Latin American companies, investments to ensure more reliable and affordable supply of electricity and infrastructure are essential to competitiveness and profitability and by extension economic growth. The pandemic has also underscored, if not accelerated, the public's focus on climate change, ESG and sustainability concerns, including environmental and social costs, the importance of a diversified, reliable supply of energy, and the broad impacts of choices made with respect to infrastructure. As IRENA and OLADE stated in announcing their expanded collaboration this past July, 'accelerating the development of sustainable energy' as part of the economic recovery following the pandemic 'could provide the Latin American region with a long-term strategy to address social inequality, energy access and energy security'. Companies seeking to encourage investment can support broad adoption of renewable generation or contract directly with developers and project owners seeking creditworthy buyers for their electricity. They can also partner with those developers as has happened in the United States to provide capital while mitigating political risks in this uncertain time. Consequently, we remain optimistic that there will be good investment opportunities in Latin America and that Latin American companies with access to industry expertise and seasoned counsel experienced in structuring and negotiating successful investments can play an active role in ensuring these positive changes continue.

Maria-Leticia Ossa Daza is a partner in the Corporate & Financial Services Department and head of the Latin America Practice at Willkie Farr & Gallagher LLP. Jorge Kamine is a partner and Matt Vitorla is an associate in the Corporate & Financial Services Department of Willkie Farr & Gallagher and both are members of the Latin America Practice focusing on the energy and infrastructure sector.