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CORONAVIRUS: ISSUES FOR THE INFRASTRUCTURE SECTOR

Coronavirus (COVID-19) is having a significant impact on the infrastructure sector. Infrastructure projects are likely to be vulnerable to delays during the construction phase and/or disruption to services during the operational phase caused by:

- unavailability/shortage of staff due to public health measures and/or sickness;
- supply chain disruption; and
- Government action*, e.g.* lock-down of the project area, or restrictions on the use of essential facilities such as transport infrastructure.

In the absence of appropriate relief, disruption of this sort can lead to:

- liquidated damages or similar liability, or calls on bonding, for delays to construction completion/acceptance;
- (where projects rely on a contracted revenue stream) contracting authorities levying payment mechanism related deductions for deficiencies in performance/unavailability of the asset;
- (where the project has assumed some use/merchant risk, such as toll roads), shortfalls in revenue due to reduced demand and usage;
- termination rights incepting (e.g. as a result of deduction caps or time limits on relief being exceeded); and
- draw-stops or events of default under financing arrangements.

Consequences of disruption and managing claims for relief

Overarching considerations

Clearly, when addressing the impact of Coronavirus on infrastructure projects, the critical role public infrastructure plays must be the foremost consideration, not least at a time when societies are likely to be facing unprecedented pressures.

The situation requires all stakeholders to act collaboratively and flexibly to ensure the continued availability of critical infrastructure at a time of need. On a positive note, we have already seen a number of examples of co-operation and understanding between private and public sector participants. Adopting such an approach at the outset can both establish the communication channels necessary to respond to a rapidly developing situation and also help free up crucial resources to focus on the continued availability of such critical infrastructure.

The contractual requirements, therefore, reflects only one aspect of the relationship between the project's counterparties, and should be considered along with the implications of any wider-scale Government intervention, recourse to insurance, and commercial/relationship factors.

However, regardless of whether solutions are ultimately found within or outside of the contractual framework, project participants will be well-served by re-visiting the relevant underlying project or concession agreement (referred to here as the "Project Agreement") and the sub-contracting arrangements, finance and equity documentation associated with the particular project.

Ultimately, this documentation exists for the benefit and certainty of all participants, so to the extent the existing contractual framework needs to be re-visited in light of developing realities, project parties should be aiming to formally document their arrangements (even if on a temporary basis, such as by way of a "standstill agreement").

Identifying potential issues

A crisis as wide-ranging as the Covid-19 outbreak is liable to cause a number of disruptive events. It will be helpful to identify the aspects of the project that are most likely to be affected, and in turn the potential consequences under the Project Agreement.

Potential contractual issues for project sponsors and lenders are likely to include:

- termination rights, and if so, which party (or parties) controls exercise of that right;
- events of default and rights to levy deductions under payment mechanisms/ liquidated damages;
- reporting obligations;
- existing obligations affected by the outbreak, e.g. in respect of the health and safety of project personnel and the wider public;
- step-in rights and abilities to call on collateral, such as bonding; and
- grace periods and/or time limits.

Additionally, particularly where the project is subject to a civil law jurisdiction, mandatory provisions of law may need to be taken into account when looking at the contractual position.

Contractual relief mechanisms

Project Agreements will usually include some form of relief from obligations in specific circumstances, but the precise parameters of the criteria triggering relief, and the scope of that relief (for example, whether it extends to protecting the project company's revenue stream or simply suspends a termination right) vary greatly from project to project.

Not all of the contractual reliefs available will be expressly linked to public health emergencies or use the language of "epidemic", "pandemic" or similar. For example, relief may (depending on the facts) be available through provisions triggered by:

- "force majeure"events;
- disruption arising as a result of Government action (e.g. "supervening events" in respect of Government intervention or political risk);
- change in law; or
- third-party or contracting authority actions.

There are likely to be extensive limitations on the availability of relief; for example, under the relevant Project Agreement, relief may only be available to the extent the disruption event affects the project directly, rather thandisruption of a sub-contractor's broader business which consequentially affects that sub-contractor's performance of the relevant project. Careful analysis of the contractual language is required to determine the fact pattern(s) to which relief provisions will respond.

Limitations on the scope of relief should also be reviewed. It may be, for instance, that the relief available is limited to suspension of the contracting authority's termination right for the duration of disruption event. However, this can lead to the project company remaining exposed to liquidated damages claims, calls on bonding, payment deductions or revenue impairment. In other cases, relief may extend to protection from payment deductions or revenue impairment, in which case it will be important to consider the extent and duration of that protection.

Equally, as the situation develops, avenues of relief initially unavailable may materialise; for example, changes in law or regulation driven by the COVID-19 outbreak may result in a widening of the scope of relief available, to the extent it can be shown that the issues affecting the project stem from such changes.

Termination rights

Termination rights under a Project Agreement may be triggered by reason of a prolonged delay itself, whether occurring as a result of a force majeure threshold or as a result of a separate event of default. Parties should be aware also of the contractual interfaces referred to in this note in respect of its financing and sub-contracting arrangements, and the potential impact that a termination right arising under the Project Agreement may have up and downstream.

In terms of the Project Agreement, of particular interest will be:

(i) whether each or a single party is entitled to exercise any option to terminate; and

(ii) the basis of the calculation of any termination sum, including whether any deductions or exclusions are applicable. This may well differ depending on the basis on which the termination right is claimed (e.g. "Project Co default"as opposed to "Force Majeure termination").

In principle, rights of termination may also arise in certain cases where project continuation becomes impossible (for example, by operation of a legal doctrine of frustration or its equivalent). However, the barrier for such rights to arise is typically high, and purporting to exercise such rights may carry risk.

Additional considerations

Apart from considering the issue of contractual risk allocation, project participants will also need to be alive to their wider legal and regulatory obligations, including, for example, with respect tothe health and safety of their workforce and the wider public, employees' rights, reporting obligations, directors' duties and insolvency considerations.

To the extent operational essential infrastructure is involved, the impact on the operational phase may reflect a balance between the need for Government to keep that essential infrastructure in operation, and safety-related duties and responsibilities to affected staff and host communities which may point towards shutting down operations.

Sub-contracts

Where the sub-contracts directly "pass down" the position under the Project Agreement, then the contractual rights, remedies and exposures of the sub-contractors would be expected to align with the agreement itself. However, the extent of any pass-down should be verified before decisions are taken in reliance on that expectation.

Additionally, given that infrastructure project sub-contractors will likely have extended supply chains, the risk of mis-match in terms of the relief available as a result of a COVID-19-induced failure to perform will need to be monitored and considered carefully along the full extent of the supply chain.

Implications on financing arrangements

The financing in place will likely affect the options available to the project sponsors in dealing with any disruption. A number of factors may be relevant or warrant consideration.

Funder discretions

To varying degrees, funders are likely to have controls over the exercise of key decision-making powers by the project company under the Project Agreement and key sub-contracts. Borrowers should therefore consider how to most effectively involve the funders in the decision-making process at an early stage.

Information undertakings

Borrowers will need to consider whether specific implications or consequences of COVID-19 need to be disclosed to funders pursuant to information undertakings under the finance documents. Funders may also have the right (and may, in the circumstances, be more likely to exercise the right) to seek information regarding the impacts of the pandemic on the project. Borrowers must ensure that they comply with such requirements within applicable time limits.

Capex/opex impacts

Borrowers may also need to consider whether the impacts of COVID-19 will increase capex or opex spending. Finance documents for infrastructure projects often permit budgeted expenditure, with funder approval required for unbudgeted expenditure (with carve-outs for essential "emergency" spending which may or may not be available to borrowers). Borrowers will need to ensure that they comply with any such budget restrictions, including by seeking approval for unbudgeted spending if required.

Draw-stop

If the project is in the construction phase and debt has not been fully drawn, Borrowers will need to consider whether any impacts of the pandemic would cause a draw-stop (whether as a result of an event of default, potential event of default, inability to make repeating representations, forecast funding shortfall or the inability to satisfy a "no material adverse change" or similar CP to funding). A draw-stop will clearly rapidly escalate the impacts of the pandemic, so Borrowers should be proactive in identifying upcoming draw requirements and testing their capacity to satisfy pre-draw conditions.

Events of default / potential events of default

Depending on their terms and the impact of pandemic on the project, a number of events of default (or potential events of default) may be triggered, including:

- non-payment / financial covenant defaults: if impaired cashflows result in the Borrower being unable to service debt or satisfy financial covenants. Borrowers may be entitled to cure a financial covenant default by procuring an injection of equity or subordinated debt. The timing requirements and implications of curing (including, typically, a bar on using such cures in consecutive testing periods) will need careful consideration;
- project document defaults: delays or breach under the Project Agreement or sub-contract may trigger events of default relating to the project documents. If such events of default apply in respect of key sub-contractors (i.e. if these events of default apply to "major project parties"), an event of default may be triggered even if the issues affecting the sub-contractors have not directly affected the project;
- Material Adverse Effect (or “MAE”): finance documents for some infrastructure projects will contain stand-alone "material adverse change/effect" event of default. Similarly, other events of default are often expressed to be triggered if the issues subject of the trigger event are ascertainedto have a material adverse effect. In either case, borrowers will need to work through the specific terms of the provision and any underlying definitions. Typically, funders will be reluctant to rely on MAE-based defaults unless the impact on the project or the financial condition of the Borrower is significant and likely to be prolonged. Nevertheless, Borrowers will need to reach a degree of confidence in their analysis in order for authorised representatives to be able to sign-off on utilisation requests or compliance certificates.

Distribution block

Even if no event of default or potential event of default has occurred, distributions may be blocked if other distribution conditions (e.g. the applicable lock-up financial covenant thresholds, full funding of debt service and maintenance reserves) have not been satisfied.

Domestic Public Procurement Laws

In respect of Government procured infrastructure projects (PPPs, PFIs, public concessions or traditional works contracts) participants should consider any domestic public procurement laws. In certain jurisdictions, amending, terminating or even offering relief under public contracts may be unlawful and expose participants to risk.

Practical issues

The COVID-19 situation is fluid, fast-moving and will frequently require rapid responses from project sponsors and contracting authorities. Nonetheless, to minimise future disputes and uncertainty, best practice should be maintained in respect of:

- ensuring that variations, waivers, or claims for relief are properly documented, and appropriate legal advice taken;
- keeping up-to-to date on guidance, initiatives and policy announcements issued by governments and procuring authorities that may be relevant to the project;
- retaining evidence and records in respect of claims, mitigation of losses and disruption experienced;
- ensuring that all parties entitled to participate in project decision-making (such as lenders, insurers and shareholders)areinvolved and enabled to exercise any consent and/or decision-making rights they may have; and
- liaising with legal, insurance, technical and other professional advisors to ensure decision-makers have access to as complete a picture as possible of risks and potential mitigants to those risks.

Additional resources

See also our briefings on:

- additional financing considerations relevant to infrastructure investors and funders: https://www.cliffordchance.com/briefings/2020/03/coronavirus--infrastructure-finance---immediate-financing-consid.html
- force majeure provisions: https://www.cliffordchance.com/briefings/2020/02/coronavirus-and-force-majeure.html
- Insurance issues: https://www.cliffordchance.com/briefings/2020/03/coronavirus--covid-19---insurance-issues.html

CONTACTS

Michael Pearson
Partner
London
T: +44 20 7006 4753
E: michael.pearson
@cliffordchance.com

David Metzger
Partner
London
T: +44 20 7006 4240
E: david.metzger
@cliffordchance.com

Clare Burgess
Partner
London
T: +44 20 7006 1727
E: clare.burgess
@cliffordchance.com

Christof Häfner
Partner
Frankfurt
T: +49 69 7199 3160
E: christof.haefner
@cliffordchance.com

Dominic Watts
Senior Associate
London
T: +44 20 7006 2053
E: dominic.watts
@cliffordchance.com

Praveen Jagadish
Senior Associate
London
T: +44 20 7006 4330
E: praveen.jagadish
@cliffordchance.com

Andrew Dean
Director of Public Law
London
T: +44 20 7006 3274
E: andrew.dean
@cliffordchance.com

Alain Dodds
Lawyer
London
T: +44 20 7006 6183
E: alain.dodds
@cliffordchance.com

Laura Whiteway-Bell
Lawyer
London
T: +44 20 7006 1195
E: laura.whitewaybell
@cliffordchance.com

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