

## Client Alert

### Managing the Impact of Coronavirus on a PFI/PPP Project

April 10, 2020

The London Energy & Infrastructure Team is seeing first-hand the impact COVID-19 pandemic is having on infrastructure and renewable energy projects both in the UK and more globally; from impact on cashflows to disruption in supply chains, from restrictions on travel for labor resources to Government action (including the partial or full closure of schools). In particular, we have seen how COVID-19 presents the very real risk of delays to completion and slowdown of projects due to absences among contractors, the potential for office and site closures and delays to the movement of materials and equipment.

Below, we look at some of the relevant contractual provisions which may be invoked in the wake of the crisis in a project agreement for typical PPP infrastructure project.

We also identify, in the absence of appropriate relief, the likely disruption that this could cause to a project.

#### Contractual Relief Mechanisms

##### 1) FORCE MAJEURE

###### PFI

In the PFI world, force majeure is being talked about a lot in terms of relief from performance of obligations due to COVID-19 related issues. Unhelpfully, however, PFI drafting for force majeure is typically quite restrictive and includes an exhaustive list of events which is typically as follows: war or other conflicts; nuclear, chemical or biological contamination; or pressure waves.

Our view is that “biological contamination” would not include a human virus in these circumstances so the force majeure provisions are unlikely to provide any protection to a contractor in these circumstances.

That said, even if force majeure were to apply, it offers only limited benefit to operational projects. It only prevents a party from bringing claims for breach, and availability deductions can still be applied.

If agreement cannot be reached and the force majeure event continues for a significant period (usually six months), the project agreement can be terminated.

#### Development projects

It is worth noting that the position in relation to force majeure is usually different on construction/development projects where standard form EPC contracts provide for a far more generous position for contractors.

In the 1999 editions of FIDIC (for example, the Silver Book), the definition of force majeure is wide. It has to be an "exceptional event" which "(i) is beyond a Party's control; (ii) the Party could not reasonably have provided against before entering into the Contract; (iii) having arisen, such Party could not reasonably have avoided or overcome; and (iv) is not substantially attributable to the other party". The list of events which follows is illustrative only and does not necessarily limit the general words of the definition. The drafting provides for:

- suspension of performance, on notice, in respect of any obligation prevented by force majeure;
- extensions of time and payment of costs; and
- the potential for termination.

Although pandemics are not included in the non-exhaustive list of potential "Exceptional Events", it could be argued by contractors that COVID-19 meets this broad definition.

The potential effect of the FIDIC force majeure clause is, undoubtedly, significant. However, where FIDIC is to be used in the context of a limited recourse financed project, it is very likely that the clause will be modified to reflect the PFI approach.

## **2) RELIEF EVENTS**

Relief events (which provide relief from termination) are generally events with an external cause which have a negative impact on the contractor's ability to perform its obligations under the project agreement and which are beyond the control of the contractor. Typically, this will include damage to the project site, shortage of power, blockage or embargo.

None (in our view) are likely to include COVID-19 related disruption.

## **3) EMERGENCIES**

An emergency is an event which causes death or injury, or serious disruption to the lives of a number of people and which is, on a scale beyond the capacity of the emergency services operating under normal circumstances and requiring the mobilization and organisation of the emergency services.

Where an "emergency" arises, a contractor may be required to perform additional or alternative services and if that is the case then the Authority is required to pay any costs incurred by a contractor, and/or cover any lost revenue.

Clearly this is different to relief from performance of obligations but may of course be helpful. More importantly the occurrence of an emergency does usually constitute an excusing event.

## **4) EXCUSING EVENTS**

Excusing events are usually set out in the Payment Mechanism and typically include:

- the implementation of a Authority change (potentially relevant if the Authority seeks to reduce services via the change mechanism);
- an emergency; and
- the contractor acting in accordance with a written instruction of the Authority

To the extent that any of the above impact upon availability and/or the performance of the services then the usual position is that neither unavailability deductions may be levied nor service failure points awarded, in each case for so long as any unavailability or performance shortfall is directly attributable to an excusing event.

As such, the excusing event provision can potentially offer a number of angles of protection for a contractor.

## **5) CHANGE IN LAW**

This may be relevant if new law or guidance is put in place which affects the performance of the services. Whilst new legislation might not necessarily be imminent, “guidance” is typically defined widely - “any applicable guidance or directions with which the contractor is bound to comply”. Service providers must also comply with any relevant standards such as any NHS requirements in respect of hospitals or primary care. On that basis it is possible that a General Change in Law may occur as a result of Government restrictions being put in place which affects a contractor.

That said, the General Change in Law provisions do not offer any protections unless a contractor is likely to incur capital expenditure (which may or may not be the case at this stage).

The Qualifying Change in Law mechanism would potentially be more helpful as it would (amongst other things) potentially allow relief from compliance with obligations including compliance with the Output Specification.

## **6) VARIATION ORDERS**

It is worth noting the possibility of agreeing upon a variation to the services through the Change Mechanism, either initiated by a contractor or the Authority. Possible variations could include a request that services are reduced or performed differently, or that additional services, such as cleansing, are required. The Change Mechanism would allow the contractor to request relief and compensation.

This is an area to watch as we are aware that some Authorities are considering issuing a change to reduce the services on operational projects.

Whilst there are protections and limitations in place in the Change Mechanism which are helpful, clearly there are risks as well, for example an Authority change requiring a significant reduction of service provision could ultimately lead to a staffing reduction at sub-contractor level which is not desirable for a number of reasons.

That said, if a temporary arrangement around for example delaying certain services until later in the year or temporarily changing methods of working to deal with the current crisis, then it is of course possible to document this through a variation.

## 7) PRICE ESCALATION

Currency fluctuation provisions which allocate the risk of increased costs and/or currency movements to one of the parties (the introduction of these types of provisions on PPPs/development projects (as opposed to PFIs) became more common following the uncertainty caused by the Brexit vote in 2016). Although these provisions are unlikely to provide relief to contractors in the current circumstances.

## 8) INSURANCE POLICIES

Project insurance is unlikely to be helpful. Several large insurers have already confirmed that their business interruption policies will not pay out for COVID-19.

## 9) FRUSTRATION

Frustration is a common law doctrine which was developed by the courts to deal with situations which change fundamentally after the contract was entered into. The bar to establish frustration of a contract is therefore very high. Courts will not be quick to overturn the bargain made between the parties to a contract; hence it is rarely available as a remedy.

## 10) FURTHER GUIDANCE

Finally, it is worth mentioning the publication of the following helpful advice in recent days on PFI projects:

### **Cabinet Office Public Policy Note 02/20**

In late March 2020, the Government published [Cabinet Office Public Policy Note 02/20](#) which applies to all contracting authorities, local government, and central government bodies and provides welcome support for the private sector, focusing as it does on measures aimed at accelerating payment of invoices, even allowing for advance or interim payments and payment on order (rather than receipt).

It also allows Authorities to waive their own rights and remedies (e.g. to levy liquidated damages).

Public Policy Note 02/20 applies with immediate effect, until June 2020 when it will be reviewed.

### **UK's Infrastructure Project Authority Guidance Note (02 April 2020)**

The [UK's Infrastructure Project Authority's \(IPA\) guidance recent note](#) (which takes immediate effect, until 30 June 2020) on COVID-19 for PFI contractors reiterates the public sector's intention to ensure service provision continuity.

In summary:

- PFI contractors should consider themselves to be part of the public sector response to the COVID-19 emergency.

- Authorities should co-operate to ensure the continued delivery of public services.
- PFI contractors should ensure contingency plans are up to date and have been reviewed and discussed with contracting authorities to enable continuity of full services as far as possible to respond to the emergency and maintain vital public services, particularly across the NHS.
- Authorities should work closely with PFI contractors to use all available options to maintain public services during the emergency period.

This will include maintaining unitary charge payments, revising contract requirements/standards and moderating payment and performance mechanism regimes where appropriate.

The Government advice on Force Majeure on PFI projects, however, is resolute: it does not consider COVID-19 to be a force majeure event. Whilst this is likely to be the case (see our comments above), we would still recommend that sponsors and contractors, review the force majeure drafting in their contracts (and any other related relief, “excusing cause” or emergency drafting).

### **Potential Disruption**

In light of the recent Government guidance (referred to above), our view is that the public sector is expecting to provide relief to PFI contractors from performance deductions mechanisms at least in respect of issues arising from COVID-19 **provided** PFI contractors use their “best efforts” to continue to provide the services. That said, in the absence of appropriate relief, disruption could potentially lead to:

1. the levying of liquidated damages (and, a call on the Building Contractor’s Performance Bond).
2. the trigger of Events of Default and possible lock-up or draw stop under the senior lender’s financing arrangements.
3. inception of termination rights at the project agreement level (for example, if time limits on relief are exceeded or as a result of separate event of default) which may of course impact on a termination right under a sub-contract or the credit agreement.
4. payment of compensation on termination (although the calculation at the project agreement level will obviously differ depending on which right of termination is claimed, for example, Project Co event of default or force majeure).
5. where PFI projects rely on a contracted revenue stream (the “Unitary Charge” paid by the Authority once a project is operational), the Authority making deductions for performance or unavailability under the Payment Mechanism (although note that the IPA guidance recommends a temporary moratorium on COVID-19 related payment and performance mechanism deductions/points so that PFI contractors can continue to operate and pay their workforce and supply chain).
6. “step-in” rights being exercised by either the senior lender or the Authority.
7. the dispute resolution procedure being invoked. That said, given COVID-19 related disruption will likely mean that businesses will have less money and time available to spend on disputes, the situation will clearly require both public and private stakeholders to act collaboratively.

The situation and related Government advice is clearly changing frequently and rapidly. We will be continuing to monitor developments related to coronavirus and major projects and update our briefings as the situation evolves.

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For more detail and practical tips on managing the impacts of Coronavirus in the Infrastructure and Energy sectors, please see our updates in the [Crowell & Moring Coronavirus Alert Center](#).

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