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Project Finance

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Contributing editor**Aled Davies**

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Lexology Getting The Deal Through is delighted to publish the fifteenth edition of *Project Finance*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on India and Taiwan.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Aled Davies of Milbank LLP, for his continued assistance with this volume.



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Covid-19: force majeure provisions in project contracts

Aled Davies and Justen Fleming

Milbank LLP

It is in times of unprecedented uncertainty that parties to contracts and their legal advisers are often required to analyse more closely certain contractual provisions that were formerly regarded as relatively standard or 'boiler plate' and were in many cases afforded minimal attention. The current covid-19 contagion is an example of one such time of unprecedented uncertainty leading to a need to pay close attention to the force majeure clauses of project contracts. Covid-19 contagion has required parties to contracts to carefully manage the issue of making or receiving a force majeure claim under project contracts, particularly in the construction phase of project financings.

We consider whether the covid-19 outbreak and related governmental actions likely constitute force majeure events under project contracts typically forming the cornerstone of project finance transactions, such as construction contracts, natural resource sale and purchase agreements, and power purchase agreements. We further consider practical considerations of a potential force majeure claim in a project finance context.

This generic commentary is focused on the position under English law, but similar considerations apply in other common law jurisdictions, including under New York law. Project agreements are often governed by local laws and the analysis may be different. In particular, civil law jurisdictions frequently have a concept of force majeure that exists at law independently of the contract.

What is force majeure?

Generally, under common law the concept of force majeure must be expressly provided for under a contract. This is frequently achieved in commercial contracts through a specific 'force majeure provision' that seeks to protect parties to a contract from being held to performance obligations that, owing to events outside of their own control and expectation, they cannot fulfil. This is especially common in contracts contemplating performance over extended periods (such as project agreements – to construct, own or operate a project, or to supply or offtake from it), where there is a greater risk of an intervening event or circumstance arising that might hinder performance.

Is there such a thing as a standard force majeure provision?

Force majeure provisions take various forms and can be drafted to various degrees of sophistication. There is no 'standard' force majeure provision as such. However, a customary force majeure provision in a contract will provide contractual relief to a party affected by an event or circumstance that:

- is beyond the reasonable control of the affected party; and
- causes or results in that party not being able to perform its obligations (other than the obligation to pay money) under the contract.

The provision may then typically have an illustrative list of events or circumstances that would constitute a force majeure event (provided that the above general conditions are satisfied), such as acts of nature (sometimes referred to as acts of God, such as earthquakes, tsunamis and epidemics), acts of man (such as war, industrial action, piracy, riot and sabotage) and governmental action (such as change in law, regulations, government permits and expropriation).

Is covid-19 within the scope of force majeure?

Covid-19 may be primarily relevant as a force majeure event, as where, for example, key employees are sick: (as above) force majeure provisions commonly list 'disease' or 'epidemic' as one of the specific events or circumstances that may constitute force majeure. The covid-19 outbreak may be caught by a more general term such as 'act of God', or simply under the general 'catch-all' as an event or circumstance beyond the affected party's reasonable control.

Alternatively, the secondary effects of the covid-19 outbreak may be the more proximate (and so more clearly relevant) grounds for force majeure: most especially government recommendations or mandatory restrictions on employees attending the workplace, undertaking necessary travel or (for expatriate employees) entering the country; or perhaps governmental delays in processing applications for permits or clearing the import of equipment, etc.

As well as an event or circumstance that constitutes force majeure, what else would need to be demonstrated to make a successful claim?

A successful claim should precisely identify relevant elements of a force majeure claim by reference to the actual contract wording: the specific event or circumstance outside the affected party's control (ie, the primary or secondary effect of covid-19), the causal link between this and the specific contractual obligation that is prevented or impeded.

What is the requirement to 'mitigate' an event of force majeure?

A force majeure provision will typically contain express requirements to mitigate the impeded performance by exploring alternative means to perform: generally, we can expect that a force majeure claim is likely to succeed only where significant efforts have been made to exhaust alternative possibilities of performance, including through other supply sources, transportation routes, etc.

Mere increased costs of alternative performance (except perhaps in extreme cases) are unlikely to provide sufficient excuse for failing to take such steps. Similarly, lack of funds or a market to profitably onsell into are unlikely to provide grounds for force majeure relief (even if not expressly excluded, although such matters are customary

excluded). However, conceivably, insolvency of key suppliers or physical constraints on delivery to a market (eg, lack of ullage in a storage facility or pipeline or port capacity) could validly constitute force majeure.

What if the event of force majeure affects a party's suppliers or contractors rather than directly affecting the party to a contract?

As a force majeure event, the primary or secondary effects of the covid-19 outbreak could in turn affect a contract party directly, or only indirectly by affecting a contract party's suppliers and subcontractors in their performance along relevant contractual chains.

In the latter case of indirect effect, a typical force majeure clause will shift the analysis to the relevant point in the contractual chain to where performance has been effectively delegated: allowing force majeure relief only to the extent that the relevant supplier or subcontractor would have obtained force majeure relief applying the principles under the immediate contract (perhaps irrespective of the contract to which the supplier or subcontractor is party).

What are the basic consequences under a contract of successfully invoking force majeure?

The basic consequence of a valid claim under a force majeure clause is that a non-performing party will not be held to be in breach of contract for its non-performance owing to the force majeure, and so will be excused of any potential liability in damages for such non-performance.

Do contracts provide for additional consequences of a successful force majeure claim?

Project agreements often elaborate on the consequences of force majeure. Project agreements or construction contracts will detail a day-for-day deferment to required completion dates and other milestones (at least to the extent of delay affecting critical path). Less commonly, construction contracts may also provide cost compensation for an affected contractor. Some supply contracts (such as a liquefied natural gas sale-and-purchase agreement or a gas sales agreement) may provide more details on exactly when a delayed delivery becomes effectively a cancelled delivery rather than merely a deferred delivery, and what obligations there may be to reschedule or to deliver and take substitute quantities in the future. Often, longer-term contracts will provide for a right of one or both of the parties to terminate the contract if performance cannot be sufficiently resumed within a given period.

What particular force majeure provisions might we find in an infrastructure concession or power purchase agreement?

Power purchase agreements (PPAs) and other concession-based agreements with a state-controlled entity often contain other arrangements to allocate the risks of various categories of force majeure between the parties – including 'natural force majeure' and 'government force majeure'.

Under a PPA, the classic position (although there is considerable variation in approach and certain allowances are negotiated from time to time) is that the availability charge would typically not be affected by force majeure events that do not affect the independent power project itself (eg, downstream of the interconnection) though the availability charge may be reduced if an IPP itself is not available owing to force majeure.

One consideration might be whether any regime of government force majeure under a PPA (which may be included in a PPA) would extend to cover acts of government authorities or changes in law that implemented a quarantine, lockdown or closure of transportation infrastructure or borders. In this case, there may be (during the construction period) cost compensation available (often by way of a tariff adjustment, thus leaving the project with the working capital

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burden of funding such additional costs) as well as deferral of start dates (or deemed availability regime) and (during the operational period possibly) possibly a 'deemed availability' regime and increased cost compensation.

What practical steps should we take if there is a potential force majeure claim?

If there is any potential for making or receiving a force majeure claim under a contract, in addition to very specific consideration of the exact wording of the force majeure provisions to ascertain with legal counsel its applicability to the particular factual circumstances, the following should be diligently attended to.

- Importance of paper trails – the burden of proof is on the person claiming force majeure relief. It is that party that will need to 'prove' (or demonstrate on a balance of probabilities) that its performance was prevented by force majeure, in each case to the extent required and within the scope of the provisions, as well as that it satisfied the requirements to take steps to pre-emptively avoid, and subsequently mitigate, the impact of such force majeure. An affected party will therefore wish to carefully preserve evidence (including paper trails) relating to both the extent to which its performance was prevented and the measures that it took to avoid or mitigate its effects (both internally, such as provision for remote working; and externally, such as seeking alternative supply sources or means of transport).
- Timely notice – strict adherence to the notice requirements in a force majeure provision may be a condition of being able to make a successful force majeure claim. However, inadvertently making a premature force majeure claim may also be a risk: pursuant to the contract terms this may relieve the counterparty of its corresponding obligations or permit the counterparty to source an alternative supply or market. With something as amorphous as covid-19, precise timing of the event may be ambiguous (ie, is it

the outbreak in Wuhan, the World Health Organization declaration or a lockdown) – though if the relevant trigger for notice is the actual prevention of performance rather than merely its potential, this may be clearer.

- Notice to other parties – especially in the case of a project company, receiving notice of force majeure under one contract may trigger obligations to make corresponding notices under related project contracts in a contractual chain, under finance documents or under insurance policies. There are particular challenges to balance in being simultaneously a recipient of a force majeure claim under one contract and the maker of a claim under a related contract – balancing the need to make a valid force majeure claim up the chain without conceding that a valid claim has been made elsewhere along the chain (noting that claims under one contract may be vulnerable to disclosure requests in a dispute under another contract).
- Responding to a force majeure claim – in responding to a claim from a counterparty, it is important not to concede (prematurely) that a claim is valid. This may involve a careful balance between duly acknowledging receipt of a claim, engaging in cooperative dialogue and coordinating activities as a practical matter so as to assist in overcoming the impediment, while at the same time, among other things, not inadvertently assuming responsibility for any mitigation; not acknowledging the validity of a claim or sufficiency of mitigation; not waiving a time-bar on a claim; and not unwittingly educating the claimant in how to sharpen an insufficient claim.

It goes without saying that force majeure claims will be fact-specific and dependent on particular contractual provisions. Common law jurisdictions may be reluctant to allow force majeure claims without sufficient demonstration of performance standards and evidential burdens being met – though some local jurisdictions may also be relevant to project agreements and may be broader in their approach. Being seen to act reasonably may be an important consideration where there are potential disputes. Ultimately, practical considerations of reputation and the need to get the project done may outweigh strict legal analysis.

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