

COVID-19 – Project financing key considerations

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The impact of the coronavirus disease (COVID-19) cannot be underestimated. It is now time critical and project participants must be alive to the rapidly evolving COVID-19 outbreak and the consequential impact on their projects. Reports on slow production and supply of key equipment for power projects have begun to surface with major manufacturers and suppliers in China announcing delays in production and delivery. This will inevitably result in a chain reaction affecting project developers and contractors. Indeed, Bangladesh's infrastructure projects and Indonesia's power projects have been suspended, and Manila Electric Co. has also announced that its twin solar projects in the Philippines may be delayed.

The effects of the COVID-19 outbreak, initially thought to be confined to Asia, are wide-ranging and rippling throughout the world. With the World Health Organization's (WHO) recent announcement that the COVID-19 outbreak is now a pandemic, further knock-on effects on global supply chains remain to be seen.

This note provides a snapshot of key considerations for project development and financing in the context of the COVID-19 outbreak. Other legal and regulatory impacts of COVID-19 can be found [here](#).

Force majeure clauses generally

Force majeure clauses are naturally at the centre of any claim for time relief and cost recovery in a project context. Force majeure clauses typically operate to excuse the affected party from performing its contractual obligations during such period the performance is actually prevented, hindered or delayed. These clauses commonly require the affected party to show that the event or circumstance in question was not reasonably foreseeable at the time of entering the contract and is beyond the control of the affected party exercising reasonable care.

Most force majeure clauses in project documents set out a list of qualifying force majeure events which typically include acts of war and natural disaster. Epidemic and plague are also common qualifying force majeure events. Having an express reference to "epidemic" in a force majeure clause does not unequivocally mean that a party seeking to invoke the force majeure as a result of the COVID-19 outbreak will succeed. Care must be taken when examining force majeure clauses to consider whether a qualifying force majeure event entitles the affected party to claim for time and cost relief, and is a matter of contractual interpretation.

Force majeure in projects

In the context of project financing, construction contracts are a starting point. In an epidemic or pandemic scenario, notices of force majeure events would typically originate from contractors under construction contracts as they are at the 'frontline' of greenfield project development and will likely encounter supply chain issues almost immediately.

Invoking force majeure claims under the construction contract will trigger a domino effect on upstream project documents. The clock starts ticking when the project company receives the notice of force majeure under the construction contract. At this critical point, there are a number of key considerations to bear in mind:

- a) The project company has to assess whether the force majeure claims are valid under the terms of the construction contract and the assessment has to be made within the timelines for submission of force majeure claims under the upstream project documents so as to avoid its own claims being time barred.
- b) Most financing agreements will contain reporting obligations in relation to force majeure under project documents, the project company will need to be mindful of the reporting timelines under the financing agreements. It would be prudent to keep project lenders constantly updated to avoid technical breaches of the applicable reporting obligations. At the same time, the project company will have to carefully consider if there are any lenders' consent rights in relation to decisions relating to force majeure under project documents (i.e., reserved discretion consent rights) before responding to the contractor.

Assessing the force majeure claims

There is a spectrum of different drafting permutations of force majeure provisions. The stricter thresholds call for the contractor to show that its performance of contractual obligations is being 'prevented' by the qualifying force majeure event, and this will usually require evidence to show that it is impossible for the contractor to perform those contractual obligations. Certain force majeure clauses require the contractor to show that the performance of its contractual obligations have been 'materially and adversely' impacted by the qualifying force majeure event. Other force majeure provisions may require a less stringent threshold of the qualifying force majeure event 'hindering or delaying' the contractor's performance of contractual obligations.

Regardless, the contractor, and similarly the project company, will have to establish causality between the qualifying force majeure event and the impact to its performance of contractual obligations, and this is a fact-based determination. Documented evidence to show that office closures or mandatory quarantine measures are affecting the contractor's performance of contractual obligations (e.g., certain critical path tasks as evidenced in project timetables) as a result of governments' efforts to contain and mitigate the COVID-19 outbreak will be helpful. Technical consultants' input will be required to guide the collection and formulation of evidence for notices of force majeure.

It is important to bear in mind the notice requirements and timelines for submission of force majeure claims in the suite of project documents. Both the contractor and the project company need to adhere to these requirements to avoid having their claims time barred. Certain common law jurisdictions adopt a strict approach and the failure to adhere to notice requirements may render a claim invalid, particularly when a complete notice is a condition precedent to making force majeure claims. Whilst it may be challenging to provide notice with full particulars of the force majeure and the impact thereof at this stage given that the COVID-19 outbreak is constantly evolving, parties must nevertheless endeavor to submit a formal notice to avoid the strict operation of time bar clauses.

Force majeure clauses also typically require the affected party to mitigate the effects of force majeure and the duty to mitigate is an ongoing obligation. Affected parties need to consider if there are alternative means to perform contractual obligations and it would be prudent to formulate a response plan or remedial measures to address the impact of the pandemic.

Pass-through of force majeure risks

The project company and lenders must consider if there are gaps in force majeure relief contained in the upstream project documents. Ideally, any such gaps would have been addressed when the project documents were subject to bankability due diligence. Bankable project documents will typically contain similar force majeure provisions and the contractor's notice of force majeure will likely form part of the project company's notice in the upstream project documents. If there are discrepancies in the force majeure provisions in the suite of project documents, whether force majeure risks will be passed through will certainly be tested by the COVID-19 outbreak.

Other pass-through considerations include timelines for submission of force majeure claims. The timelines under the construction contract and upstream project documents may run consequentially given that the project company will only be put on notice when it receives the contractor's notice of force majeure. In practice, the contractor and the project company may be engaging in negotiations or discussions on the impact of force majeure and will therefore need to consider if the timelines are running in parallel. Bankable project documents should ideally contain staggered timelines so as to ensure that the project company has enough buffer time to provide its notice of force majeure under the upstream project documents.

Another important consideration is that project documents may have different governing laws. Construction contracts with offshore contractors may be governed by a neutral law (typically English law) but concession agreements or power purchase agreements may be required to be governed by local law. If the risks associated with different governing laws are not mitigated when the project documents were being developed, contractual interpretation of force majeure provisions can prove challenging.

There is also usually a distinction between natural and political force majeure events in project documents. The former deals with physical risks and the latter addresses political or governmental risks. This is effectively a risk allocation mechanism and the consequences and remedies of natural and political force majeure events differ. The COVID-19 outbreak will likely be a natural force majeure and the affected party will be entitled to extension of time or deemed commissioning relief, and may not be entitled to increased costs compensation (which is a more common remedy for political force majeure events).

Some project documents may contain an equivalent project relief mechanism, which is a powerful tool to ensure force majeure risks are fully passed through to the contractor. In such cases, the contractor shall only be entitled to receive relief if the project company receives a corresponding relief under the upstream project documents. The project company is usually required to duly pursue its claim for relief under the relevant upstream project document.

Considerations under the financing documents

Project lenders around the world are watching the situation very closely as they begin to receive notices of force majeure in relation to the COVID-19 outbreak. Whilst most of the force majeure considerations center around the project documents, lenders cannot wash their hands of the COVID-19 situation and will need to be mindful of the consequences in the financing documents which may be working in parallel to the terms of the project documents.

Upon receiving a notice of force majeure from the project company pursuant to notification obligations under the financing documents, lenders will have to consider carefully the impact on the project and the positions to take under the financing documents. Importantly, where the commitments are not fully utilised, force majeure events are commonly draw-stop events in which lenders are not obliged to fund.

The project company will typically be required to obtain the prior written consent of the lenders before exercising its discretion to agree to any relief as a result of a force majeure event under the project documents. In this regard, certain decisions may be expressed as time critical (this is especially so for force majeure events given that the project company needs to adhere to the strict timelines in the project documents) and lenders may have a shorter time to provide their responses.

Assuming the impact of the force majeure is material and may cause considerable delays to the project, lenders may have to consider whether the force majeure event is an event of default under the financing documents (commonly a material adverse change or a prolonged force majeure event of default). This will trigger acceleration and security enforcement rights. Notwithstanding, there may also be potential impact on the project company's repayment ability.

Hogan Lovells can help you respond to any challenges impacting across your business, anywhere in the world. Get in touch with us at COVID19@hoganlovells.com or speak to your usual Hogan Lovells contact.

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