How COVID Has Changed Project Development And Finance

By **Nate Galer and Katy McNeil** (September 21, 2022)

When the COVID-19 pandemic first emerged, we wrote **an article** assessing short- and potential long-term impacts it might have on the project development and project finance markets.

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At the time, attention was focused primarily on existing and under-construction projects: Workforces were furloughed and supply chains were interrupted, leading to a cascading series of delays and additional costs for many projects.

As a result, analysis was targeted toward impact on existing documentation and interpretation of force majeure and related provisions to allocate risks associated with coronavirus-related delays and costs. As many of us quickly became aware, contractual language that was commonly in place was often vague and a poor fit for dealing with the novel fact patterns of COVID-19 pandemic.

As realization grew that the pandemic was not going to be short-lived, attention turned to future deals and how to manage and mitigate COVID-19-related risks. Existing contractual provisions were tailored for COVID-19 and a variety of new provisions were proposed and negotiated among counterparties.

Now, over two and a half years into the pandemic, this article revisits our original topic to identify some of the COVID-19-specific provisions that have emerged in the market and identify areas where negotiations are still ongoing.

In many respects, this is still a work in progress as COVID-19 has shown the ability to upset markets with new variants. For example, some approaches that worked well when there is a lull in case numbers have been rejected or revisited as new variants have spread.

We previously noted that COVID-19 disruptions may have created a "new normal"; however, as we discuss, what that normal is may still be under negotiation.

COVID-19 Impacts on Project Development Documents

Project development documents are the full suite of agreements signed between an owner of a project and its counterparties with respect to, inter alia, the design, procurement and equipment supply, construction and operation of a project.

Prior to the COVID-19 pandemic, many of these documents did not typically contain detailed provisions relating to pandemics, epidemics or other disease-related outbreaks. This is particularly true of equipment supply contracts, which were those that were initially hardest hit by COVID-19.

Equipment supply documents were among the first to be revised to introduce COVID-19-specific provisions, but COVID-19 provisions are now found in virtually every type of project development document.

The most relevant provisions in these documents are those that relate to force majeure, excusable events and similar cost or schedule adjustment provisions. These types of clauses generally allow the affected party relief to the extent a specified event occurs and hinders such performance.

There are several key considerations in how these clauses work, including (1) what constitutes an event permitting relief, (2) what impact such event must have on the affected party, (3) what steps the affected party must take to claim such event, (4) what types of relief are offered to the affected party, and (5) the extent to which a party may terminate a contract for an extended occurrence of such event.

Each of these has been revised in the market to address the impacts of COVID-19.

Definitions

Prior to 2020, many project documents did not expressly reference disease-related outbreaks, and those that did often used generic terms like "epidemic" or "quarantine," lacking specificity. COVID-19 is now regularly included by name throughout most types of project development documents, along with references to the underlying SARS-CoV-2 virus.

Our collective experience with COVID-19 variants, and in particular the delta strain in 2021 and the omicron strain in 2022, has also led to many definitions specifically referencing variants of the SARS-CoV-2 virus, whether currently known or that may arise in the future.

These provisions are likely to be included for the foreseeable future; indeed, some parties are already anticipating how their projects may be affected in the future by including more generic references to other coronaviruses and considering potential impacts of other disease events like monkeypox.

These definitional revisions led to a related threshold question: What type of disease event rises to the level of sufficient importance?

Here, the market is less settled. Some contractual approaches focus more on the potential impacts that the disease event has on the affected party, whereas others go a step farther and require that some sort of formal governmental action need to have been taken before contractual relief can be sought.

These actions range from formal declarations of a pandemic by the World Health Organization or similar national governmental authority, to declarations of mandatory quarantine by more local governmental bodies. A key gray area that is often subject to negotiation is whether workplace quarantines or guidelines should be included, as many of these may be prudent or policy-based, but not necessarily mandatory in a legal sense.

The result is that while there is consensus to include COVID-19-specific terms in project development documents, there is still a variety of approaches in the market about what constitutes a COVID-19 event that is worthy of special contractual treatment. Here, the question of impact comes into play.

Impact

Historically, negotiations on force majeure and excusable event provisions have focused on the concepts of materiality and direct versus incidental impact. This has not changed as a result of COVID-19.

Early on in the pandemic, as delays and additional costs began to mount in a variety of industries, it was common and commonly accepted to attribute such impacts to COVID-19. In short, there was a general understanding in many industries that we were facing a novel and significant threat to the way we typically do business.

However, as we are learning to live with the disease, a much more critical eye is being turned toward what types of impacts are worthy of special relief. It is becoming more recognized that parties to a contract should expect and assume some baseline level of impact and risk associated with COVID-19 recurrences. There remains disagreement, however, about where to draw that line.

One approach has been to focus on what specific impacts are noteworthy. For example, mandatory governmental quarantines clearly have an impact on any type of labor that cannot be done remotely. As noted above, the line becomes more blurred when considering company-specific shutdowns or nonmandatory guidance, and some parties have included specific provisions in their contracts to clarify whether stoppages from such events are covered or excluded relief events.

A related impact — and one that has been at the forefront of negotiations for a long time now — relates to material disruptions in the supply or transportation chain as a result of COVID-19.

While initially arising as a labor issue, its consequences can quickly morph; for instance, it is clear from anyone who has done even a little bit of grocery shopping in the past few years that there have often been sudden and unpredictable shortages in specific materials.

These shortages are often far removed, both in time and space, from the original quarantine or other labor disruption that gave rise to it. It may be many months, for example, before a transatlantic shipping route returns to normal after a temporary quarantine in an Asian port.

These types of knock-on risks are very difficult to fully assess.

Parties supplying goods and services understandably do not want to take the risk of predicting when and where they may be affected by such events. Their counterparts also understandably believe some amount of risk and delay should be priced into commercial terms in the post-pandemic era.

The area in the middle is vast and is still negotiated on a case-by-case basis. In some cases, supply chains are being chosen that may not be the most economically advantageous but are seen — whether for regulatory, geographic or other reasons — as more reliable. In others, parties may agree on a commitment to plan B supply chains for certain goods.

Procedures

One early question raised by the COVID-19 outbreak was how to handle related claims. In particular, how should claims be treated and what supporting documentation should be required?

This has been a particularly interesting case study insofar as COVID-19 was widely experienced but, at the same time, direct impacts were difficult to evidence. Many project participants were inundated with generic notices from counterparties claiming delay or cost relief due to COVID-19. Contracts provided little guidance as to how to evaluate these

claims.

Procedural requirements are still an area for development, are frequently negotiated, and are tied to the above-discussed question of impact.

Some contracts now require evidence of the underlying actions by governmental authorities that have led to the impact. Others require evidence reasonably satisfactory to the counterparty of material impact.

Still others have expanded provisions requiring the duty to mitigate the impacts of COVID-19, for example, by seeking alternate supply chains, replacement labor or transportation providers.

In our experience, the focus on this issue is likely to depend on the development timeline for the project in question: A domestic renewable energy project that can be constructed in several months is likely to have a different procedural risk profile than a large international industrial project that may take several years.

Relief

The question of relief relates to which party bears cost and schedule relief for force majeure and other excusable events. The market in many industries takes a straightforward view of this question by allocating cost and schedule risk entirely to one party or the other.

For example, one traditional approach for force majeure has been binary: Owners bear schedule risk stemming from such events, and contractors bear the associated costs of delay.

For other specified events not excusable by force majeure, owners often bear both schedule and cost risk. However, this traditional approach has long been eroding, and the issue is frequently a common battleground in negotiations. COVID-19 has further complicated these discussions.

Even after two and a half years, there remain significant disagreements about what type of relief parties should receive as a result of COVID-19 impacts. At one end of the spectrum, there are parties who view COVID-19 as endemic and an annual, or semiannual, or even more frequent, occurrence. Put bluntly, these parties believe it should be considered a cost of doing business, and potential impacts should be fully baked into any bid for goods or services.

At the other end of the spectrum, many providers of those goods and services find it a no-win situation to try and account for such potential impacts: They either act conservatively and risk losing bids with overly high pricing or long schedules, or they risk exposure to potentially significant additional sourcing costs and/or liquidated damages for delay.

While we regularly see approaches from both ends of this spectrum, the plurality that seems to be emerging in many markets is somewhere in the middle.

For example, it is fairly common now to see a time-based limitation of relief.

If the COVID-19 impact, such as a quarantine or delay, was in effect upon signing of the contract, or was reasonably foreseeable in light of the facts at the time, such as an expiring quarantine order that might be extended or renewed, such event typically is excluded from

being a relief event. If it is something new that arises — for example, because of the emergence of a new variant — then relief may be sought.

What type of relief?

Parties generally agree that schedule relief is warranted, although in many cases the amount of this relief is capped, either expressly or through the inclusion of termination rights.

Cost relief is a much more mixed bag. Many parties who traditionally do not provide cost relief for force majeure events have maintained that philosophy for COVID-19 events. Others are more sympathetic to cost-related impacts and/or prefer to ensure that the bids they receive are unburdened by additional cost and schedule buffer.

One middle-ground approach that has been seen more widely in the marketplace is to provide schedule-only relief for COVID-19 events but include provisions requiring counterparties to propose accelerated or catch-up schedules to overcome or mitigate associated delays.

The costs associated with these catch-up measures are then paid by counterparties if they accept such proposals. This approach provides parties with some ability to recoup costs associated with the effects of COVID-19, while allowing their counterparties to have a stronger voice on mitigation efforts.

We have also seen some parties begin borrow from other industries and take a more nuanced approach to relief. This can be done many ways, such as through sharing of schedule and cost risk rather than a binary allocation.

For example, parties may be able to get relief for only a specified percentage of certain cost and/or schedule claims. Alternatively, the concept of deductibles may become more widely used, whereby owners would bear X days or Y dollars' worth of documented delay above a certain threshold minimum, with contractors bearing the remainder, or vice versa. These could be used in conjunction with the caps mentioned above.

Termination

Finally, one common approach to COVID-19 in project documents is to now regularly include voluntary or automatic termination in case of extended COVID-19 impacts. While the terms of such provisions can vary greatly, the most common approach is that if COVID-19 impacts have occurred for more than a threshold period of time, either party can terminate the agreement.

Pre-COVID-19, a similar right existed in some project documents for force majeure events lasting longer than 180 days. However, it is now not uncommon to see much shorter thresholds in respect of COVID-19.

Many parties view this termination right as a protective backstop to ensure that if, for example, a significant supply chain disruption occurs as a result of COVID-19 and cannot be mitigated by the counterparty, there is an earlier exit right, so an alternative supplier can be found.

These types of provisions were typically an afterthought or boilerplate in project documents before COVID-19; now, they receive much more scrutiny and are often considered carefully

in light of the project's sourcing strategy and construction schedule.

COVID-19 and Project Finance Documentation

Project finance documentation has traditionally been silent on the issue of disease-related outbreaks. Lenders and investors are typically reliant on overall deal structure to capture any residual or unknown risks to the project being financed. However, there are a few key areas in these documents that have received some increased scrutiny as a result of COVID-19.

Schedule Analysis

A major risk element for any project is the time it takes to achieve completion. As such, schedule risk is a key area of focus of lenders, investors and their advisers, particularly in the financial, legal, tax, technical and insurance areas.

While a certain amount of float is always built into project schedules, analyses now account for the potential of lingering and recurring COVID-19 impacts and similar outbreaks.

Alternate sourcing strategies and plan B discussions are a much more common discussion now, particularly in the middle of a variant wave. This is mostly done on the technical and commercial side, but has become a focus of project diligence as well.

For example, lenders and investors have been focused not only on the project document developments noted above, but also on the reporting requirements relating to outbreaks.

This is done to ensure that there are relatively firm and prompt reporting and update requirements to the project — and in turn, to the lenders and investors — whenever a COVID-19 impact arises. In short, lenders and investors want to know about these impacts early on and receive regular updates.

Project Covenants and Direct Agreements

By the very nature of project financings, lenders and investors are deeply involved in the details of the project documents underlying a project. Finance documents often contain customized, detailed covenants to account for project document risk areas identified during the diligence phase.

These risk areas can be addressed with the project counterparties directly in lender-required documents such as consents to collateral assignment or estoppels. These risk-allocating measures have increased the complexity and length of negotiations between financing parties and the project counterparties.

For example, while terms may vary from deal to deal, there is often a condition to funding that there by no event of force majeure or excusable event under any project document.

This approach also often extends directly to project document counterparties, as lender consents and estoppels typically contain representations that there are no COVID-19 related delays as of the date of signing such estoppel. These terms are often tailored to ensure that they capture however COVID-19 is treated under key project documents.

The rationale behind these approaches is not necessarily to stop funding whenever there is a COVID-19 issue anywhere at the project, but to ensure that lenders and investors are

kept apprised of potential issues early on and have a seat at the decision-making table.

The Bottom Line

The net effect of all these considerations is that, depending on the specifics of the project in question, lenders and investors may price deals with more risk or for longer construction schedules than would have existed but for the COVID-19 outbreak.

Such approach may have flow-through impacts on base case financial models and the required capital raise for some owners. In some cases, it may determine whether certain tightly scheduled projects, particularly with sourcing or labor areas affected by COVID-19 recurrences, are even viable in the marketplace.

Renewables and U.S. Tax Incentives

Our prior article focused on implications to both project development and finance as well as the tax incentive market stemming from the COVID-19 pandemic. Recently, tax incentives have been the subject of major legislative overhaul.[1]

Conclusion

The global rise of COVID-19 has caused repercussions throughout the project development and finance market. Some of these were immediate and temporary, but others are lasting and even evolving as time goes on.

Two and a half years after the widespread emergence of COVID-19, it would be unusual to see documents that do not address the disease and its impact in some way. While some drafting approaches in the market have reached a convergence, there remain stark differences in others. Some of these are likely to remain project-specific, but in many cases they remain key points to be negotiated among the parties.

One commonality is that all these developments have focused very closely on COVID-19 rather than revisiting more generally the impact of endemic diseases on projects. This may prove to be shortsighted as new diseases linger on the horizon. However, the key drafting touchpoints noted above may serve useful in a broader discussion of how to handle disease events more generally and proactively.

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[1] https://www.mayerbrown.com/en/perspectives-events/publications/2022/08/the-green-energy-tax-incentives-of-the-inflation-reduction-act-of-2022.