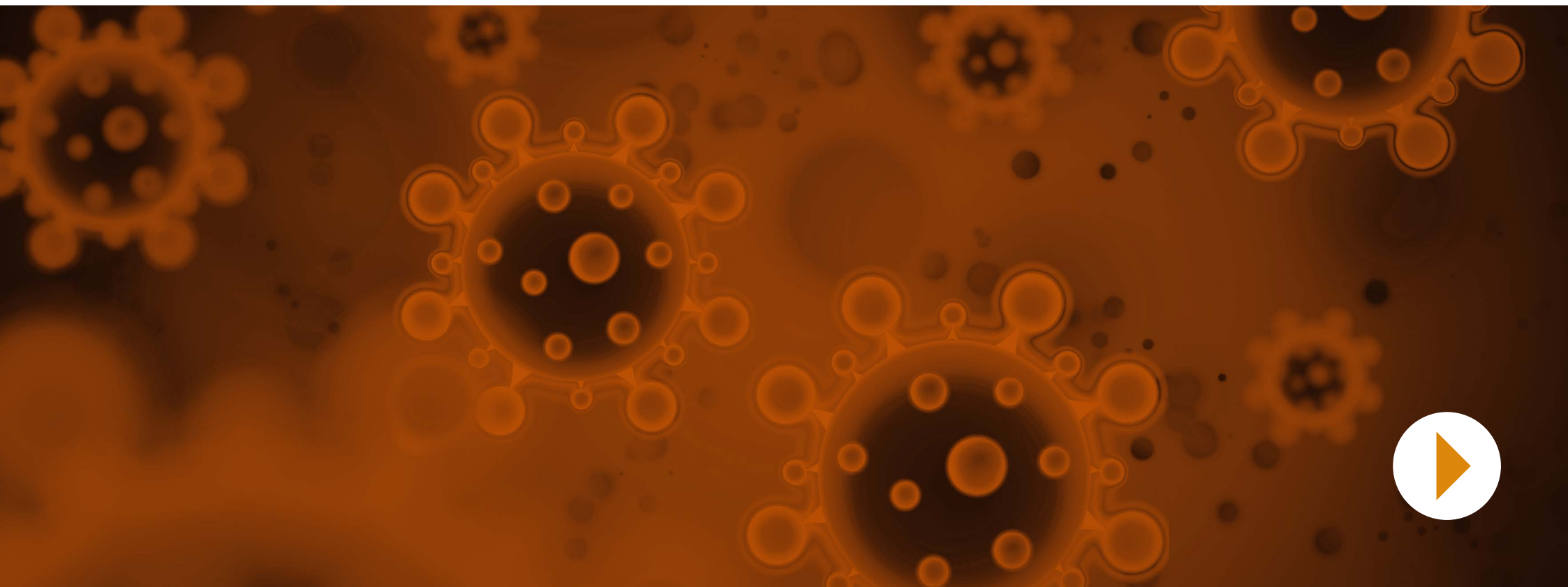
Bird & Bird

COVID-19 & Your Global Renewables Supply Chain

A Ten Step Guide - Spain



COVID-19 and the Renewables Sector

The renewables sector is feeling the impact as COVID-19 begins to cause disruptions to supply chains due to the spread of the virus. This sector is heavily reliant on global supply chains for raw materials and components, as well as an available workforce to build, operate and maintain the power plants.

Whilst Chinese factories are now at various stages of restarting and ramping back up capacity, production across the rest of the globe is currently being hindered and disrupted as a result of the pandemic. Examples of the practical impacts COVID-19 is having in the renewables sector supply chain are:

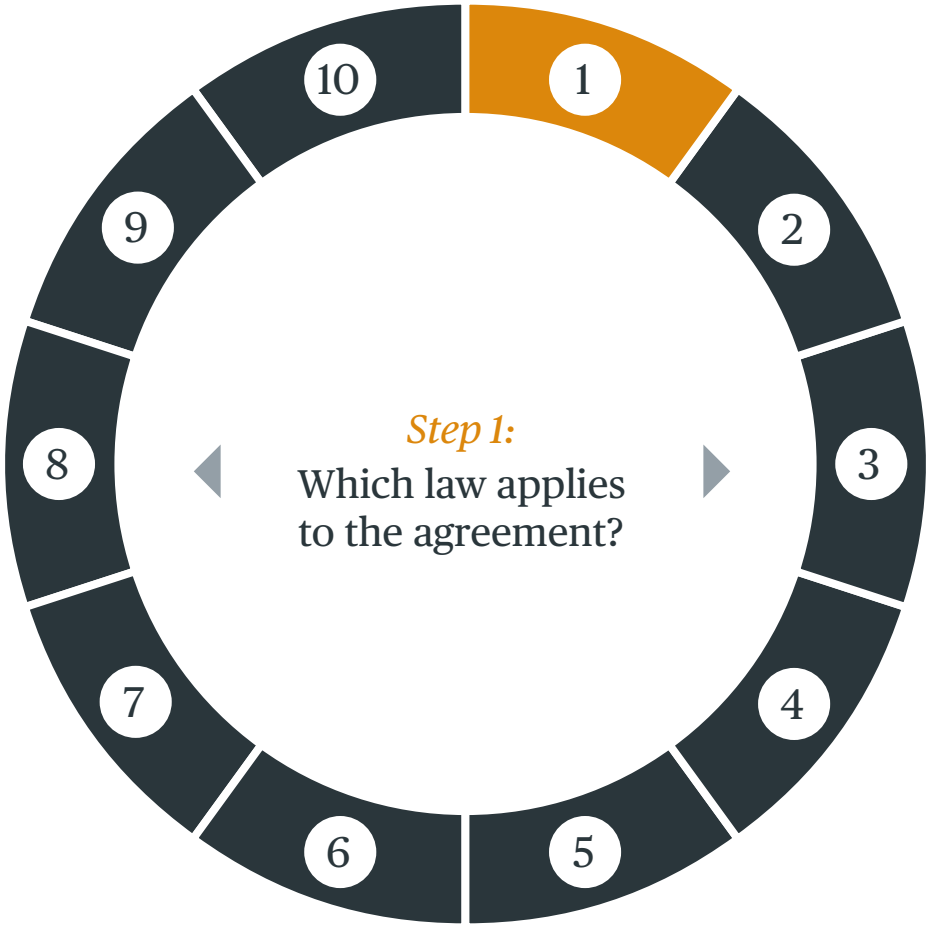
- *Imports/Exports stopped or slowed down:* several countries are enacting different measures concerning import of goods and services from COVID-19 high risk countries. The European Commission has allowed each Member State to adopt measures (proportionate and not prejudicial) aimed at safeguarding the health of its citizens and to prevent the spread of the virus COVID-19. Notwithstanding the foregoing, the specific scope of these measures varies according to each jurisdiction and the criterion of implementation adopted by its authorities. In the specific case of Spain, the publication of Royal Decree Law 10/2020 and the lack of definition of what is meant by "essential activity" and "non-essential activity" has caused uncertainty in the sector.
- *Factories and test facilities closing/reducing output:* many countries are adopting differing approaches as to whether or not production must halt, and this is changing almost daily. This is the case with Royal Decree Law 10/2020 and its precedent, Royal Decree 8/2020.
- *Reduced workforce:* employees not coming to work due to self-isolation, sickness or fear of risks.
- *Travel bans:* many countries have begun to close borders. Certain work in the sector (such as specialist installation or operation and maintenance) may require overseas-based specialists who are unable to get to the location of work due to travel restrictions.
- *Restrictions on foreign investment:* some countries have adopted restrictive measures for foreign investment in the energy sector under Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 on the control of foreign direct investment in the Union. This is the case in Spain with the amendment introduced in Law 19/2003 by Royal Decree-Law 8/2020, which includes a new article 7 bis, suspending the regime of liberalization of certain direct investments in Spain for the supply of essential inputs (where the energy sector is expressly included, understanding as such those that are regulated by Law 24/2013, of the Electric Sector and Law 34/1998, of the Hydrocarbon Sector) and if the foreign investor is directly or indirectly controlled by the government (including public bodies) of a third country or if the foreign investor has made investments or participated in activities in the sectors related to the aforementioned essential inputs (energy).

Renewables is also a sector packed with tight contractual deadlines with liquidated damages for delay. Many power producers are finding a mismatch between the relief they must grant to their EPC and O&M Contractors and the relief they are entitled to under the Power Purchase Agreement, so that it is generally not possible to relocate such offsets.

Specifically, of particular interest is whether liquidated damages remain payable by the supplier, and whether the supplier has any other options such as suspension, termination or entitlement to increased costs under the change in law clause, force majeure or by virtue of *"rebus sic stantibus"* clause.

This note looks at the implications of COVID-19 on agreements subject to Spanish law and highlights other contractual hints and tips that both owners of power generation facilities from renewable sources and suppliers of goods and services should be aware of.

Click to start ten step guide



In assessing whether or not a party is entitled to relief from its obligations as a result of the situation caused by COVID-19, it is important to check both:

1. the governing law of the applicable contract; and
2. the laws in the jurisdiction where the obligations are being performed (particularly with regards to any mandatory restrictions in place regarding imports/exports, production and travel bans).

For example, the agreement may be governed by Spanish law meaning the language of the contract will be interpreted under Spanish interpretation principles. However, the obligations under the agreement may be being physically performed in Italy (for example at a factory or testing site) meaning the Italian law governing whether or not production must be suspended will be relevant to test the impact of the force majeure event or a possible change of law or material adverse change clause (MAC) (see steps 4 & 5 below).

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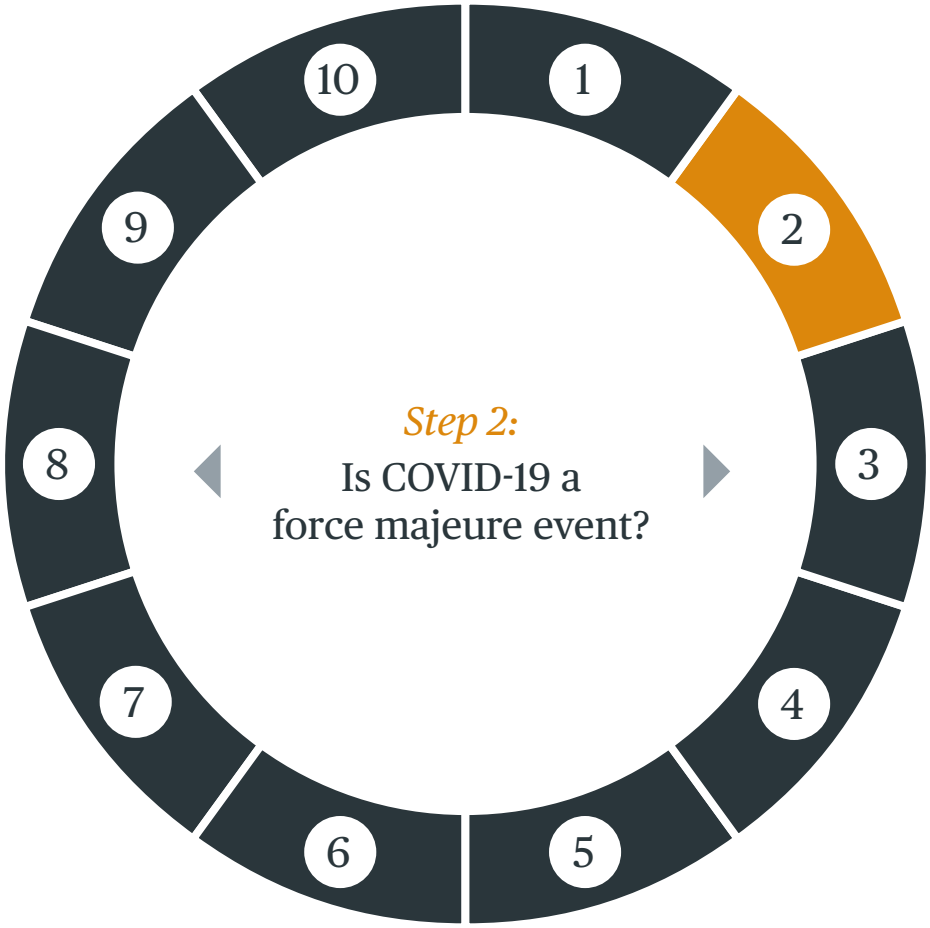

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Force majeure is defined under Spanish law as an event (i) which is unforeseeable or which, if foreseen, is unavoidable; (ii) which is independent of the will of the parties and therefore not attributable to them; and (iii) which results in some or all of the parties of the agreement being unable to fulfil what they have undertaken.

If we consider the above definition and the state of alarm declared by the Spanish Government, we could consider that the COVID-19 is an unforeseeable event, independent of the will of the parties. However, each specific case shall have to be analysed in order to consider the application of an assumption as force majeure.

In the event that the existence of a force majeure event is established, the consequence of the occurrence of such force majeure shall depend on whether or not this situation has been specifically regulated in the contract.

Firstly, according to the general principle of pacta sunt servanda, the will of the parties must prevail and therefore the specific regime agreed upon by the parties in the case of force majeure must be followed.

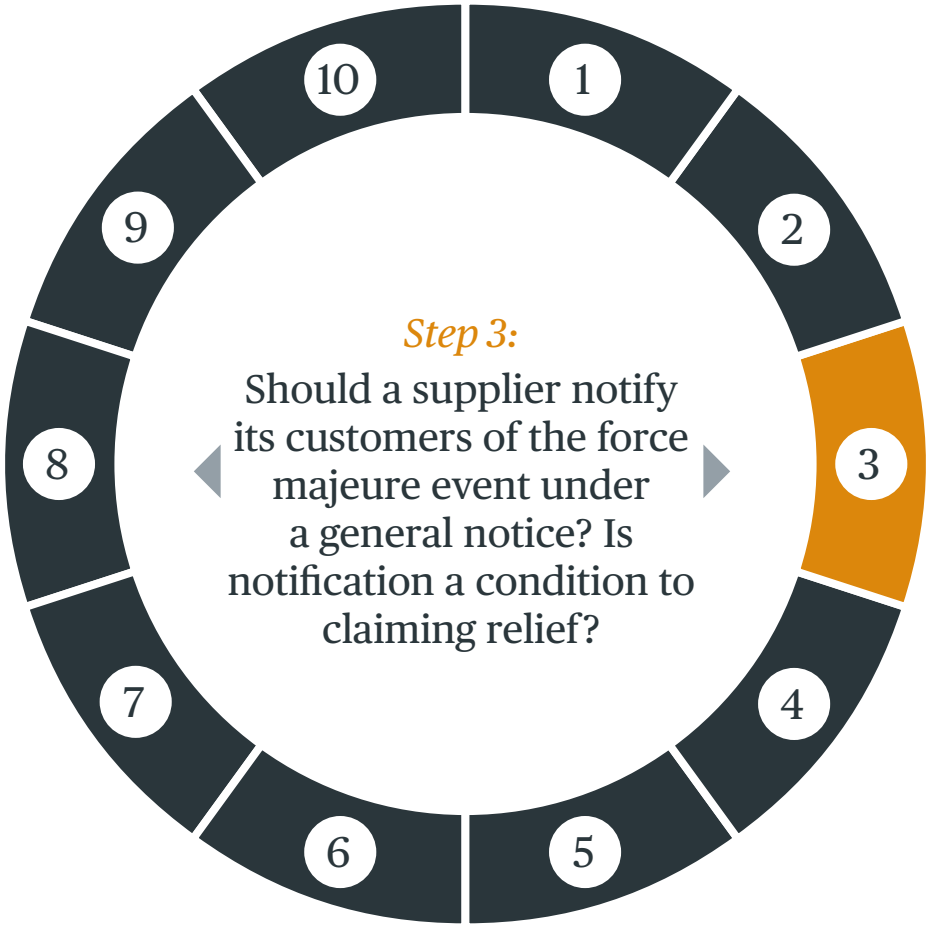
Force majeure clauses tend to follow two different formats:

- *Option 1 -* An exhaustive list of events; or
- *Option 2 -* A statement that a force majeure event is any event beyond the reasonable control of the affected party, followed with a non-exhaustive list of events which shall be considered to be force majeure.

If the contract follows option 1 - some exhaustive force majeure clauses will contain specific wording relating to disease or epidemic or pandemic. However, if pandemic is not expressly listed, other events that may be applicable to COVID-19 include:

- "shortage of supplies or raw materials" - where the downstream impact of the COVID-19 is limited availability of supplies/raw materials in the market as a whole, not just from a party's contractual or preferred supplier;
- "labour shortages" - where workers are unable to man factories because they are off work due to sickness or self-isolation; and
- "Act of Government" - where an order by the Government or a government agency in a country has caused the disruption.
- If the contract follows option 2 then, on the face if it COVID-19 is an event beyond the affected party's reasonable control. In either instance note:
- Even if COVID-19 is on the face of it a force majeure event under the contract, it does not automatically follow that the impact on business is beyond reasonable control and the affected party will still need to comply with the remaining steps below in order to claim relief; and
- Is the affected party claiming COVID-19 as the force majeure event, or another event that may have arisen as a result of COVID-19 (for example factory closure, lack of workforce)? This could be important for when notice obligations are triggered (see step 3 below) and how long the force majeure event is set to continue (COVID-19 may continue for months whereas shortage of supplies may be shorter term).

In the absence of a specific force majeure clause in the contract, the general regime provided by law for force majeure shall apply and there must therefore be an impossibility of performance in order for the non-performing party to be exempted from liability for non-performance. Furthermore, the party invoking force majeure must prove the connection between the pandemic and/or acts or measures deriving therefrom and the impossibility of performance of the obligation under the contract.



The affected party may feel there are benefits, from a relationship perspective, of flagging up the force majeure event and the delay it has caused or may cause. It may wish to serve a general alert or early warning notice to its clients that COVID-19 is causing it delay/disruption and that it is doing whatever it can to mitigate this. Parties affected by COVID-19 sending these notices should be wary that:

- A general notice may not satisfy the force majeure notification requirements in the contract since the contract clause normally requires further proof of the facts constituting force majeure; and
- A general notice can be understood as initiating the period of time that the affected party has to send a contractual notice of force majeure, so that this general notice must be followed by a specific formal notice fulfilling all the requirements established in the relevant contract.

The contract is likely to require that the affected party serves notice of the force majeure event within a specified period. This may be drafted as a contractual obligation to serve notice within a specified period, or that this period applies to the claim of relief. Look out for words/phrases such as “provided that” or “conditional upon” - these may indicate that if the affected party fails to serve notice within the required time period it loses its right to claim relief. The affected party must follow the requirements of the notice provision meticulously including who the notice should be addressed to, how it should be sent and information it needs to contain.

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Once a force majeure event has been established, the steps an affected party has to follow to claim relief will depend on what the contract says.

In the absence of specific contractual provisions, the party that wants to invoke force majeure must inform the affected party of the situation in writing and, where appropriate, inform about of the extension or suspension of the contractual deadlines or the alternative performance of the service if possible.

The following requirements must also be checked:

1. *Lack of fault on the part of the debtor.* It must be an event not attributable to the debtor, i.e. any event caused by the fault or negligence of one of the parties is excluded from force majeure.
2. *Impossibility of performance.* The event of force majeure must make impossible to perform obligations either absolutely or only partially, definitively or temporarily.
3. *Unpredictability/inevitability.* The event must be unforeseeable at the time the obligation is originated or, even if foreseeable, unavoidable.
4. *Causal connection.* The fortuitous or unavoidable event must be a cause and consequence of the non-fulfilment of the obligation.
5. *Burden of proof.* In addition, the debtor that wants to be exonerated from contractual liability on the grounds of force majeure must prove that the breach is due to the situation of pandemic generated by the COVID-19 and, therefore, outside its control.

The affected party must show it has taken all reasonable steps to avoid the operation of the force majeure clause or to mitigate its consequences. This is an implied duty which applies, in all apart from exceptional situations, even if the contract contains no express clause requiring the affected party to mitigate the impact of the force majeure event.

It will be a question of fact as to whether an affected party has taken steps to mitigate the impact, but relevant factors could be:

- Assuming the stop in production has not been mandated by law in the applicable jurisdiction, what could the affected party have done to keep producing during COVID-19 (e.g. protective measures, redeploying staff, recruiting additional staff)?
- Could the affected party have conceivably switched suppliers - e.g. used an alternative shipping company that was still running?

The fact that the above measures may be more expensive does not matter for the force majeure provisions to be invoked. A mere difficulty or additional expense is not a sufficient ground for force majeure to be invoked. Therefore, just because a contract has become more expensive as a result of COVID-19, or even uneconomic, to perform, that will not always constitute a force majeure event, notwithstanding the possibility to invoke the “rebus sic stantibus” clause to restore contractual balance in the event of a significant change in circumstances.

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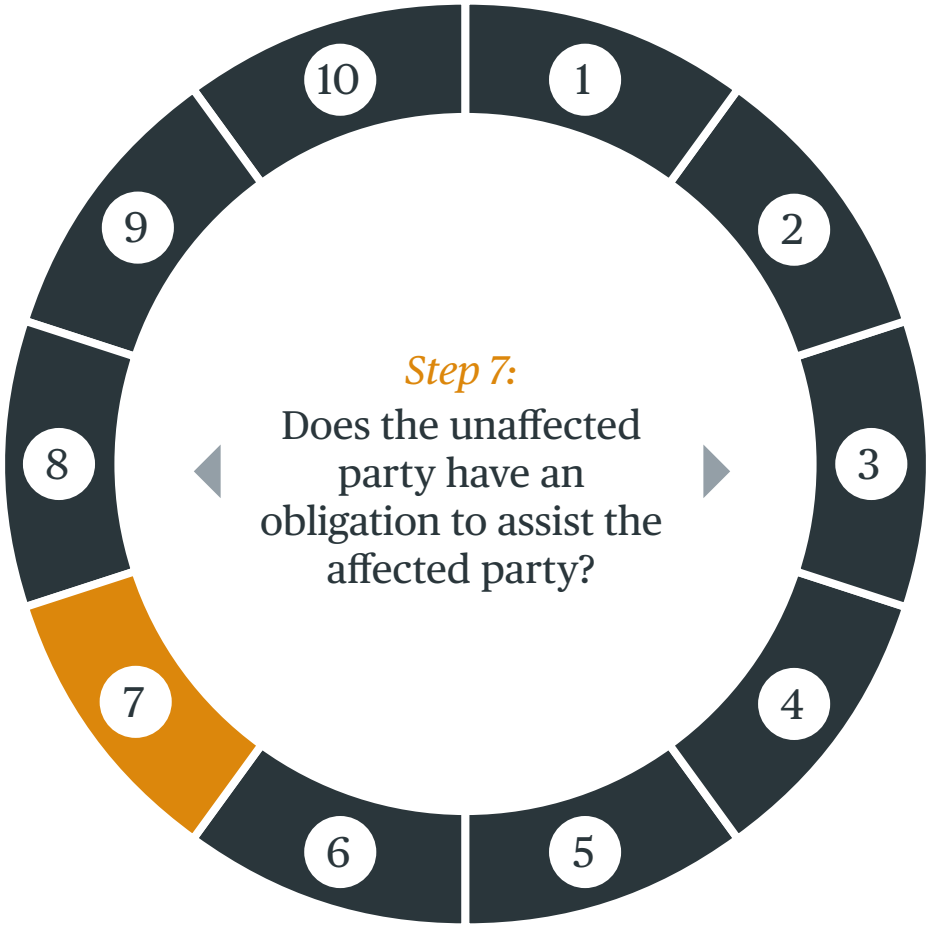
Where the contract or the applicable law does not provide for other specific effects, the consequence of force majeure will be that the party invoking this circumstance will not be liable for the breaches it may incur and will be exempt from the obligation to pay damages.

This impossibility may be:

1. *Total and definitive impossibility,* releasing the debtor from the obligation. There are exceptions to this, such as generic obligations or pecuniary debts. In cases where the obligation consists of a monetary debt, case law considers that the impossibility of compliance cannot be alleged, admitting in certain cases temporary noncompliance or mere delay (Supreme Court Decisions of 19 May 2015 and 13 July 2017).
2. *Partial impossibility,* with the debtor being released only for the part it is unable to fulfil, but remaining bound by the part it can perform.
3. *Temporary impossibility,* when force majeure has suspensive effects on the obligation, so that the debtor is released for a specific period of time.



Step 7:

Does the unaffected party have an obligation to assist the affected party?

This issue will depend on what the parties have agreed in the relevant contract so that the unaffected party may have certain contractual obligations to assist the affected party in mitigating the impact of the force majeure event. In any case, the general obligation of good faith makes that parties are obliged to comply with the terms and conditions of the contracts and also with good faith, usage and the law (article 1258 of the Civil Code).

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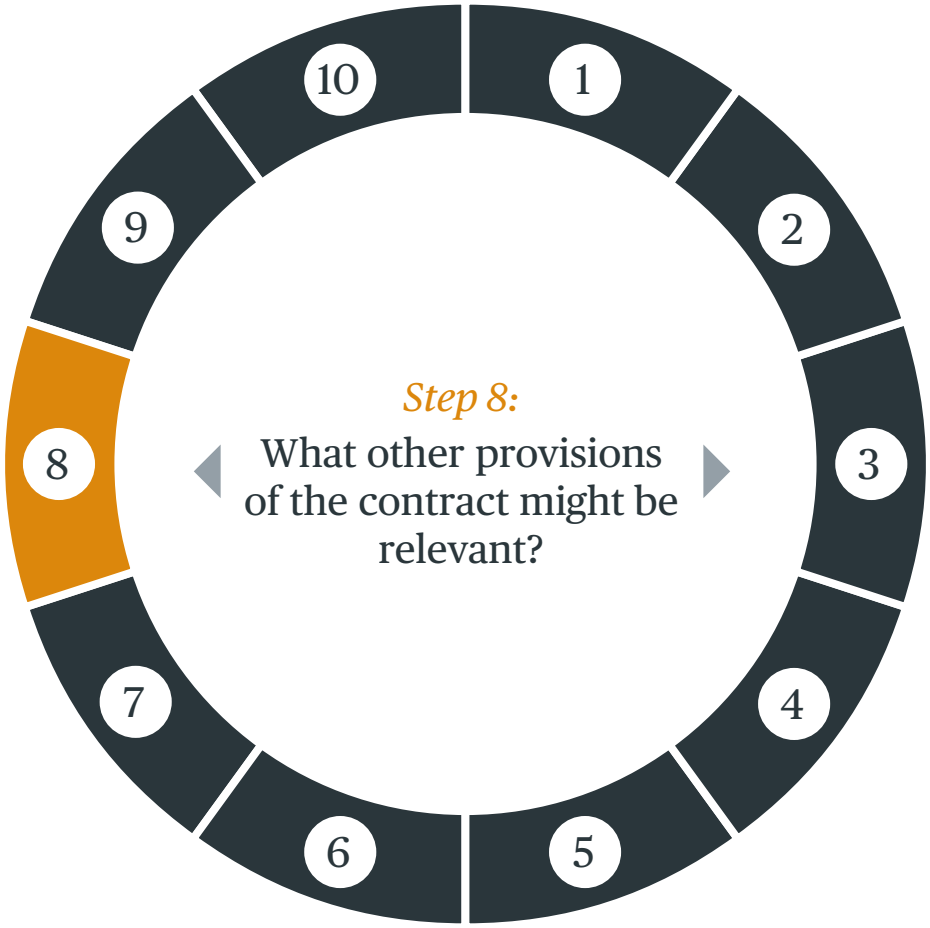

Step 8:

What other provisions of the contract might be relevant?

We suggest taking a holistic view of the entire contract. The following clauses may be particularly relevant:

- *Payment:* any rights for the customer to withhold payments if obligations are not performed (even if due to force majeure)?
- *Suspension:* any rights for the affected party to suspend its performance (for example due to economic change)?
- *Termination:* any compensation payable for termination for force majeure?
- *Changes in Law:* many countries are introducing new laws to deal with COVID-19 which could make performance of obligations more expensive. How is this risk dealt with? How is "applicable law" defined for the change in law clause and does this cover guidance and legislation? For example, if factory is in Italy and Italian law impacts costs of performance, does this still trigger a change in law price adjustment if the contract is governed by Spanish law?
- *Take or pay clauses:* some contracts specifically exempt the performance of take or pay obligations in the event of force majeure.
- *Material adverse effect:* are there any clauses entitling a party to terminate the contract if there is an event that has material adverse consequences or means that the contract would be loss making?
- *Health & safety:* can the supplier still comply with health & safety regulations and guidance that it may be contractually bound to comply with?
- *Key personnel:* are specified people earmarked for particular obligations?
- *Notice clause:* ensure compliance in order to ensure that notices are valid and can be relied upon.
- *Variations:* any amendments agreed due to COVID-19 will need to be made in accordance with any variations clause (which may require variations to be in writing).
- *Waiver:* a waiver clause does not necessarily protect a party from post-breach inaction. A non-breaching party should still reserve its rights and remedies and notify the party in breach by formal contractual notice.
- *Dispute resolution:* which may include an escalation clause which includes parties agreement to resolve any dispute on a staged basis?

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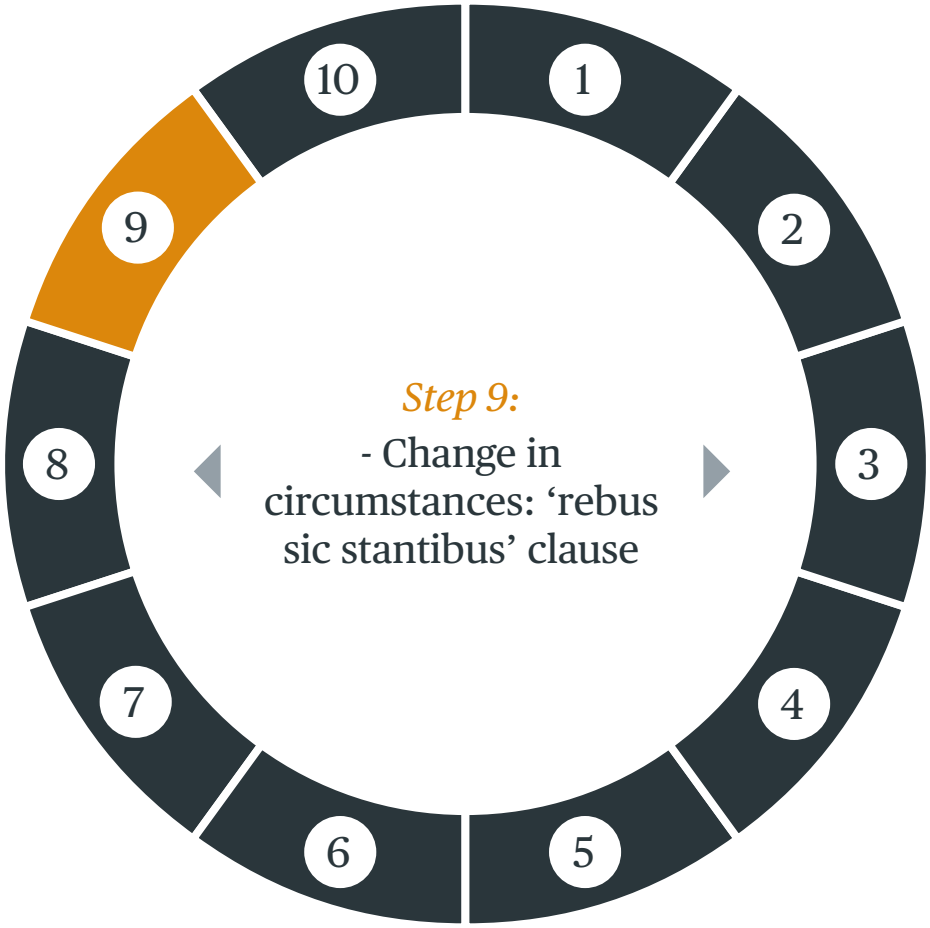

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Sometimes the crisis situation does not make fulfilment of the obligation impossible but it does produce an unbalance of the benefits and obligations of the contract. Therefore, when the coronavirus and the containment measures adopted to curb its impact do not constitute force majeure, the parties may still be able to invoke the 'rebus sic stantibus' doctrine.

In our legal system, the 'rebus sic stantibus' clause is a legal doctrine created by case law that modulates the formalistic rigidity of contractual performance when circumstances arise that may alter the economic basis of the contract.

1. *What are the requirements for its application?*

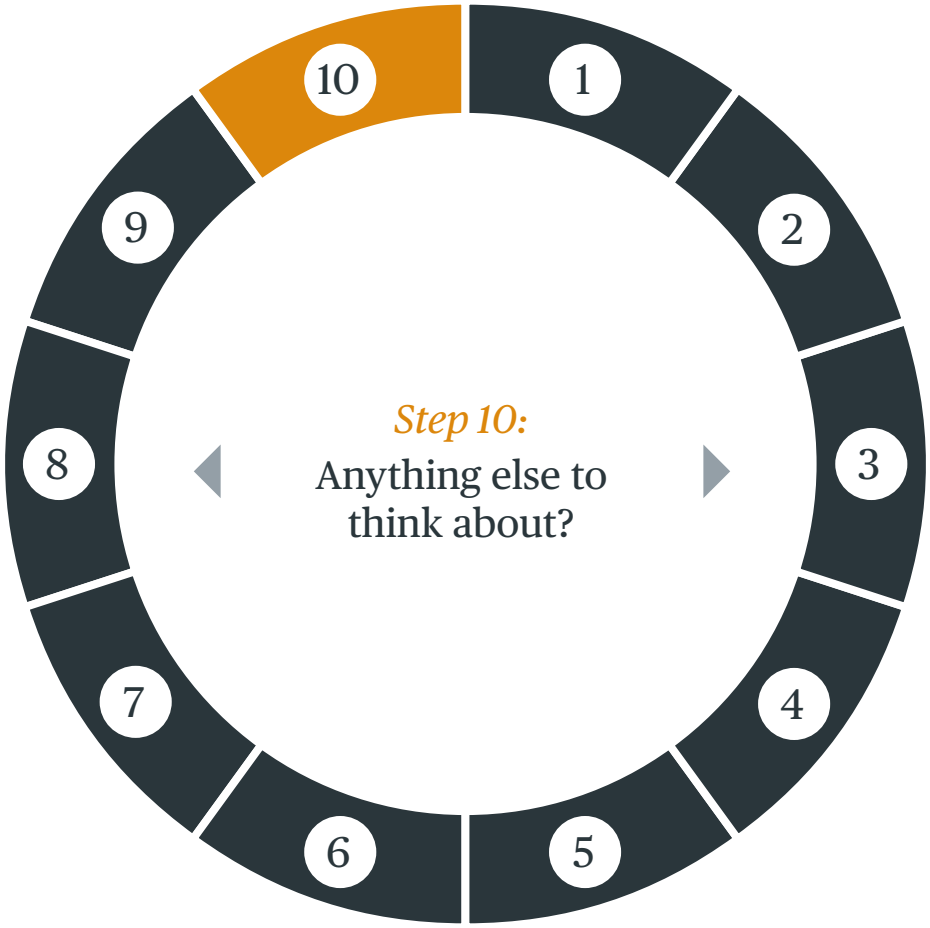
   This doctrine allows the modification of a contract due to the unexpected alteration of circumstances, as long as two assumptions for its application concur:

   - unpredictability: these new circumstances are required to be unpredictable when entering into the contract; and
   - breach of contractual balancing: unforeseeable circumstances should make performance excessively burdensome for one of the parties. For example, because they result in continuous losses or the complete disappearance of any profit margin.

2. *What are the effects of the 'rebus sic stantibus' clause?*

   Traditionally, both the doctrine and the jurisprudence have recognized that this figure does not have termination or extinctive effects, but only modifying effects of the contracts, especially when it refers to long term contracts.

   Consequently the temporary modification of the contract has generally been the preferential solution applied by case law, aimed exclusively at seeking and attempting to compensate for the imbalance in services between the contracting parties due to unforeseeable circumstances. However, the courts have sometimes ruled in favour of terminating the contract considering that it is absolutely impossible to restore the balance between the parties.



1. Follow the contractual process for notification meticulously.
2. Take a holistic view of the contract analysis - consider what clauses may help/hinder and don't forget to look at the boilerplate.
3. Retain documented evidence of steps you are taking, the reasons surrounding those steps and steps taken to mitigate (and also steps counterparties may be taking if they are the ones invoking force majeure). This could include credible records - including trustworthy public domain information where available -which set out the factual context for the decision in question. It is important to document the alternative options available at the time of performance (or lack of them!).
4. Consider whether you wish to adopt a collaborative/non-adversarial approach to resolve the issue. Early engagement with contract counterparties and a collaborative resolution of issues may be preferable to an adversarial approach.
5. Re-source supply wholly or partially - risks can be reduced or removed if you have a viable alternative which can be implemented quickly. Consideration should be given to the lead times for re-supply and how these fit with existing inventory. Be careful as re-sourcing may be in breach of existing supply contracts.
6. Recover assets - you may have supplied tools or certain assets may be used under licence. Equally, there may be stock or other materials on site which belong to you. The terms of any applicable contract will strongly influence your ability to recover these items.
7. Ensure you make all required third party notifications in timely fashion (including insurance, industry regulators, etc.).

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Hermenegildo Altozano

Head and Partner of the Energy and Infrastructure department

hermenegildo.altozano@twobirds.com
+34 91 790 3202

Matt Bonass

Co-Director Partner of the International Energy and Infrastructure Group

matt.bonass@twobirds.com
+44 (0)20 7415 6731

Elizabeth Reid

Co-Director Partner of the International Renewable Energy Group

elizabeth.reid@twobirds.com
+44 (0)20 7905 6226

Emilio Martínez

Senior Associate of the Energy and Infrastructure department

emilio.martinez@twobirds.com
+34 91 790 3216

twobirds.com

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