©Getty Images

Restarting after COVID-19: A Q&A with Clifford Chance's David Metzger

Standby agreements for major capital projects can help preserve relationships as well as shore up suppliers' and contractors' solvency during construction standstills.

David Metzger

Head of Global Construction Group
and Coronavirus Advisory Group
Clifford Chance

Since the start of the year, major infrastructure project leaders have been grappling with COVID-19 issues that jeopardize many of their most basic strategic, operational, and financial project assumptions. Sponsors, contractors, lenders, and governments may be tempted to make short-term decisions—such as dismissing claims for extra time summarily and withholding payment for partial milestone completion—that could compound the issues in the long term rather than solve them.

In this interview, David Metzger, head of Clifford Chance's Global Construction Group and Coronavirus Advisory Group, discusses how negotiation and collaboration among stakeholders can help mitigate (or even preempt) disputes that otherwise could impair or prevent project recovery once the crisis eases.

McKinsey: What challenges has the COVID-19 crisis created for project stakeholders and eventual project restart?

David Metzger: Even the most sophisticated contracts are not designed to ensure the sort of stakeholder alignment that will be required when we emerge from the COVID-19 crisis. Conventional contract language and claims management are not well suited to the uncertainty we are seeing, since project owners and financiers can't accurately revise programs and models. When construction and the global supply chain come to a halt, it puts many contractors and suppliers at risk of not just missing milestones and delivery targets but going out of business entirely. Every stakeholder faces risks from revenue delays, time and cost overruns, reduced cash flow, and default and termination.

Precipitous action by any stakeholder could result in not just project defaults but long-term disputes and relationship issues. The more complicated the project, the more difficult it is to have open conversations with the full breadth of stakeholders to ensure that all parties are ready to restart the project smoothly when COVID-19 restrictions end. And in many cases, it is clear that the impact will stretch far beyond any formal site or facility shutdown because of supply bottlenecks for key equipment and plant, missed weather windows, and ongoing distancing and health restrictions—meaning few projects will pick up right where they left off without additional complications.

McKinsey: How can project stakeholders mitigate such risks?

David Metzger: Project stakeholders must recognize that it is in everyone's best interest to work together, with the primary goal of ensuring the project can continue with minimal additional delay as restrictions related to COVID-19 are progressively lifted. This may seem counterintuitive to those accustomed to defending their own interests first. However, the wider picture is that what often starts as a protective notice of possible force majeure can broaden into alternative concurrent claims for force majeure, variations, owner default (such as due to delays on other contracts), change in law, or project suspension.

Parties can redefine this narrative by creating standby arrangements designed to take the worst-case scenario—that is, contract terminations—out of the equation and enable a framework for speedy recovery. These arrangements will require everyone to recognize they have skin in the game and to be willing to put something in or, at the least, to minimize incentive to collapse a structure.

The heart of most standby arrangements is a fixed period during which a mutually agreed set of activities are understood to have been suspended and not subject to further claims. For example, the agreement may acknowledge a standstill of on-site construction but a continuation of design development, which can be performed remotely. Such agreements create the necessary certainty for structuring reliefs and remodeling the project while allowing for earlier restarts when possible. They can also avoid delay and suspension periods accruing to termination rights, enable collaborative planning for efficient remobilization, and shift some of the financial risk away from contractors and suppliers. One international project developer has implemented standby agreements across several renewable energy projects to avoid disputes affecting the second half of 2020.

McKinsey: Why might project owners and lenders consider taking on financial risks currently allocated to contractors and suppliers?

David Metzger: The pandemic is blind to whom it affects and, as mentioned, force majeure–type claims can quickly turn into broader disputes. Moreover, if a supplier or contractor becomes insolvent or a contact must be terminated, the added cost, delay, and risk to a project will likely be costlier than the concessions to extend time or to help them stay afloat and be ready for project restart. For example, parties can discuss partial payment of milestones while work is halted as well as who should bear which remobilization costs.

McKinsey: What are the obstacles to implementing a standby agreement?

David Metzger: The biggest obstacle is that a standby agreement requires all parties to sign on. This may be not just a question of lender approvals; it may also, for example, require recognition of relief from a power offtaker, concessional authority, or equivalent settlements with subcontractors. If the project is public or due to a public–private partnership (PPP), the complications are generally greater. The reliefs available in PPP structures—for example, changes in law—are usually much more limited than in private-sector contracts. And some public authorities may be too constrained to show the necessary flexibility for these agreements to happen (whether due to financial limitations, procurement law, or audit controls, for example).

We have seen some governments act as helpful promoters for such arrangements, showing flexibility and helping mitigate project risks. But we have also seen some governments unconsciously delaying resolutions, whether because resources are prioritized elsewhere or because of a desire to extract some benefit for the government or the taxpayer (especially in countries badly impacted by the fall in oil prices). Development finance institutions and export credit agencies may assist as interlocutors in such situations, though the political dynamics can vary; for example, multilaterals may feel obligated to assist not just the project but the country.

The dynamics of who should be managing standby agreement discussions for very highly leveraged projects can also be particularly challenging, as the consequences may be particularly severe for equity. This is where the "partnerships" component of PPPs should be at the fore, and a combined debt and equity approach is justified—but can again be lost by isolationist or defensive thinking.

David Metzger is the head of Clifford Chance's Global Construction Group and Coronavirus Advisory Group.