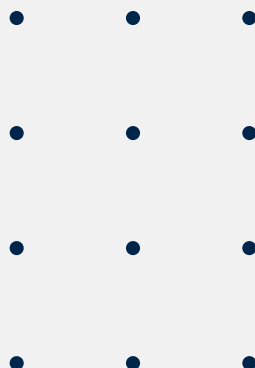


Disputes and Case Studies

AUTHORS




Peter Bird
Managing Director

Calvin Qiu
Associate Director



A guide to the fundamentals of infrastructure projects covering project economics, risk, structure and financing and the main sources of disputes.







Infrastructure projects can be complex and involve multiple parties in multiyear contracts, which can give rise to disputes.

In part three of our series, we give a brief overview of factors that are more likely to lead to disputes, common causes of disputes and how project finance can affect the dynamics of disputes. We conclude with three case studies.

Factors affecting prevalence of disputes

In general terms, projects with the following features are more likely to give rise to disputes:

- 
- (I) **Incomplete or unclear allocation of risks:** infrastructure-related agreements typically contain terms specifying how risk is allocated between different parties. If risk allocation is poorly defined or incomplete, disputes can arise over the party that is responsible for taking on risks.
 - (II) **Contract terms that are open to interpretation:** contracts may contain poorly defined terms that are open to interpretation. Parties involved may have different expectations on their obligations and/or rights based on their interpretation, e.g. over the valuation method that should be used to determine the level of compensation.
 - (III) **Projects with poor underlying economics** can give rise to disputes. Where project companies find their involvement unsustainable, the project company may ask the host government to provide compensation or additional support or may engage in behaviour that adversely impacts operational quality. Equally, projects that are excessively burdensome on the offtaker may lead to disputes where the offtaker seeks to evade its obligations.
- 



Causes of disputes

Global Infrastructure Hub, a nonprofit organisation created by the G20 to support infrastructure investment, conducted a study of 165 public–private partnership (PPP) projects where disputes arose.¹ For projects with identifiable causes, the study found that:

- (I) Where the dispute notice was issued by the private entity, the most common reason was an increase in costs for which the private party was seeking compensation. The cost increases had a variety of reasons, such as unexpected ground conditions or changes in project scope.
- (II) Where the dispute notice was issued by the governmental entity, the most common reason was a private partner's ongoing failure to meet certain operational requirements.
- (III) Disputes also were caused by the actions of a third party, e.g. decisions by an environmental regulator or ongoing protests by local populations.

1 Global Infrastructure Hub, *Managing PPP Contracts After Financial Close* (2018), pp. 109–110.





Project finance and disputes

The use of project financing can affect the dynamics between the parties in a dispute. Two examples are discussed below: (i) emphasis on the maintenance of cash flows and (ii) dominance of lenders' interests in disputes.

Emphasis on maintaining regular cash flows

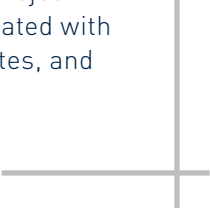

The sponsors and lenders to a project-financed company are concerned about maintaining its regular payment schedule, the project could be at risk of default without a regular stream of cash flows.

The project company's conduct is heavily influenced by the above consideration. In a dispute, it may lead to greater emphasis on maintaining cash flow, at the possible expense of longer-term value considerations.

Interests of lenders in disputes

Project financing agreements customarily require sponsors and the project company to notify lenders about pending or actual disputes. The interests of the sponsors and lenders may be broadly aligned in the early stages of a dispute. However, if the dispute worsens and/or begins to impact covenants, the interests of lenders will become dominant over those of the sponsors.

There also may be direct agreements between lenders and offtakers that contain step-in rights, which give lenders the ability to step in and take over the project. While lenders in practice are reluctant to do so (due to the liability associated with taking on a project), this places pressure on how offtakers react to disputes, and outcomes in a dispute tend to be geared more towards the lenders.





Case studies

Each case study below illustrates different types of risks in infrastructure and how these can lead to disputes between project participants.²

CASE STUDY 1: geopolitical dispute in relation to a power plant project

The owner entered into a contract for a power project, but with the contract conditional on the owner's ability to raise finance. The owner subsequently terminated the project, claiming its inability to raise finance.

The owner and contractor entered into a dispute. The owner maintained that the project could not be financed. The contractor claimed that financing was available and sought damages for termination.

The experts involved had to testify whether financing was genuinely available. It was alleged that political factors had influenced the parties' decisions.

This case study illustrates how important political considerations can be in infrastructure projects.

CASE STUDY 2: solar power tax credit dispute

A government allowed the owners of solar power systems to claim a percentage of the fair market value of the systems as investment tax credit. A large solar power system installer applied to receive a substantial investment tax credit, while the government estimated the tax credit to be significantly less.

The parties differed in their assessment due to different valuation methods used. The government valued the project using a cost-based approach by estimating the cost of the system plus a small markup as profit margin to the installer. The installer used a discounted cash flow (DCF) approach, as it had an installation contract for the solar power system, under which it would receive predictable cash flows over a long period of time. The experts in this matter debated whether a cost- or DCF-based valuation approach was more appropriate.

Subsidy regimes are common in infrastructure projects; however, these place pressure on treasuries, which want to find ways to minimise costs. Such regimes can lead to disputes, where governments would end up disputing the amounts of subsidies.

² The case studies are provided for illustrative purposes only.






CASE STUDY 3: project termination payment dispute

An offtaker terminated a 25-year power purchase agreement (PPA) for a gas-fired power project after 16 years because the power was no longer economically competitive. Under the PPA, a termination payment was due based on the project's expected future cash flow in present value terms.

The PPA tariff incorporated a fixed element to cover capital costs and fixed operations and maintenance (O&M) costs. It also included a variable element to cover fuel costs and variable O&M costs, linked to indicators of fuel and labour costs.

The project company put forward a claim for the termination payment, based on forecasts of labour cost indicators, exchange rates, fuel prices and despatch of the plant. The forecasts were derived from different sources. The offtakers disputed the calculations on the basis that the fuel price forecasts were inconsistent with the despatch assumptions.

Projects may have to be terminated when they are no longer economically feasible. Disputes may arise between parties over how to allocate the costs/residual economic benefits of a project. When formulating scenarios based on inputs from different sources, it is important to ensure overall internal consistency.





A guide to the fundamentals of infrastructure projects covering project economics, risk, structure and financing and the main sources of disputes.

Contacts:

PETER BIRD

Managing Director
Singapore & London
pbird@thinkbrg.com

MUSTAFA HADI

Head of Asia-Pacific
Hong Kong & Singapore
mhadi@thinkbrg.com

CALVIN QIU

Associate Director
Hong Kong
cqiu@thinkbrg.com



About BRG

Berkeley Research Group, LLC (BRG) is a global consulting firm that helps leading organisations advance in three key areas: disputes and investigations, corporate finance, and performance improvement and advisory. Headquartered in California with offices around the world, we are an integrated group of experts, industry leaders, academics, data scientists and professionals working beyond borders and disciplines. We harness our collective expertise to deliver the inspired insights and practical strategies our clients need to stay ahead of what's next.

THINKBRG.COM

Copyright ©2022 by Berkeley Research Group, LLC. Except as may be expressly provided elsewhere in this publication, permission is hereby granted to produce and distribute copies of individual works from this publication for nonprofit educational purposes, provided that the author, source, and copyright notice are included on each copy. This permission is in addition to rights of reproduction granted under Sections 107, 108, and other provisions of the US Copyright Act and its amendments.

Disclaimer: The opinions expressed in this publication are those of the individual author and do not represent the opinions of BRG or its other employees and affiliates.

The information provided in the publication is not intended to and does not render legal, accounting, tax, or other professional advice or services, and no client relationship is established with BRG by making any information available in this publication, or from you transmitting an email or other message to us. None of the information contained herein should be used as a substitute for consultation with competent advisors..