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CORONAVIRUS: ISSUES FOR THE RAIL SECTOR

Coronavirus is beginning to have a material impact on the supply chains of many businesses; and the rail industry is no exception. Rail equipment procurement is international, with extensive subcontract chains. In this briefing we look at some of the areas for consideration, including those where we have received requests for assistance and guidance.

Immediate impact

Industry focus to date has been on delays to supply by manufacturers of new rolling stock and other complex equipment (e.g. signalling systems). A number of major manufacturers in the sector rely on production facilities in affected regions (such as northern Italy) or supply chains for critical components extending into China. Wider impacts are likely to be seen in due course at the level of both train and infrastructure operators. This could occur as a result of their supply chains (including the supply of essential equipment and spares used for maintenance) being interrupted and/or staff becoming unavailable. While reductions in passenger and freight traffic have been notable to date in the aviation sector, economic contraction, government restrictions and public reluctance to travel could have a similar impact on rail operators.

Managing claims for relief

Parties under supply or operations contracts may seek relief where their failure to perform is, or is claimed to be, due to the Covid-19 outbreak. Such claims would typically engage force majeure provisions. Read more about force majeure [here](#).

Under a typical manufacture and supply contract, a force majeure claim by a rail equipment manufacturer would (if successful, and subject to mitigation), relieve the manufacturer of its liability for delay to delivery (including any liquidated damages). Similar relief would typically apply to train availability payments under a maintenance contract, or to an operator's obligation to deliver contracted services under a franchise or concession agreement.

Certain legal jurisdictions may have a codified or supervening principle for force majeure which needs to be taken into account. Claims may also be characterised as arising by reason of a change in law resulting from the responses of governmental authorities to Coronavirus (Covid-19), such as restrictions imposed on the movement of people and goods.

Regardless of the proposed nature of the claim, specific analysis of the contextual and contractual arrangements will be required. When undertaking this exercise, parties may wish to assess their relative positions throughout the contractual chain. Differing contractual terms may affect certain parties disproportionately, as definitions of force majeure across different industry contracts (e.g. supply agreements, equipment leases, concessions or franchise agreements) may not be aligned even within a single transaction.

Revenues and financing

Where procurement is privately financed (such as rolling stock supply), owners and lenders need to review their exposure to delays and force majeure claims. The owner's ability to service debt and project costs may be affected if counterparties are relieved of their obligations for any delay, and insurance claims are not possible. Reserves may be used for a finite period to service debt and costs, but the owner may then have difficulty topping these reserves back up as required by relevant finance documentation.

As well as monitoring the project itself, sponsors will need to review their obligations under loan documentation, including:

- actual or potential events of default (including, but not limited to, material adverse change);
- lender consent rights in relation to decision-making under the project documents;
- the borrower's ability to give repeating representations;
- adverse changes in financial covenant ratios;
- potential distribution blocks; and
- information obligations.

Risk of termination

A prolonged delay in construction or operation may trigger termination rights under industry contracts. This could arise from an express force majeure time limit or the invocation of a separate event of default. Parties should be alive to contractual interfaces and the potential impact of contracts higher up the supply chain.

A key issue will be the extent to which mitigation can be effected to avoid the need for a termination. In a manufacture and supply contract, such mitigation might include sourcing subcontractor-supplied parts from different subcontractors or geographies to avoid affected areas or shifting assembly to different plants to avoid affected areas. Such mitigation could conceivably entail entering into appropriate contract variations.

In principle, rights of termination may also arise in certain cases where project continuation becomes impossible (for example, by operation of a legal doctrine of frustration or its equivalent). However, the barrier for such rights to arise is typically high.

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