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Change of Law

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The change of law clause is a provision that may have a huge impact on the success of an infrastructure project and careful attention needs to be given to how the risk is shared.

Introduction

The operator should be obliged under the Contract to comply with all applicable legislation. The cost of complying with legislation which is current or foreseen at the time of the Contract should be built into the price, and so be the responsibility of the operator. Given the long-term nature of most PPP arrangements, the operator may not be capable of including in the price specific costs arising from changes in law which are not foreseeable at the time of entering into the Contract. In PPP arrangements involving third party financing, the lenders are also going to be concerned that the Contract provides for the possibility of a change in law. The Contract needs to address who should be responsible for the costs arising from changes in law and how such costs should be funded.

Click to download word and pdf versions of the Change of Law Checklist and Sample Wording

Operator's and Awarding Authority's Concerns

The Operator's concern is that change of law is a risk which it cannot control and which it regards as being more within the control of the public sector or Awarding Authority, although this will not necessarily be the case given that the Awarding Authority may be a local or other entity with little control over state-wide legislation that may have implications on the Contract. The Operator will be anxious to ensure that it is compensated and/or is able to exit from the Contract in the event that the rules upon which he relied when submitting his bid are changed and this change has an adverse impact on his ability to perform the contract or his financial return from the contract.

On the other hand, the Awarding Authority will be keen to ensure that the circumstances where a change of law can change the price of the Contract or any of the outputs of the project are kept to a minimum. In addition, where the project involves recovery of Operator's costs from charges to end users rather than through a fee charged to the Awarding Authority, then the implications of increases in such charges to end users resulting from changes in law will need to be considered.

Key Issues

The key issues that should be considered when drafting or reviewing a change of law clause are:

- The date from which changes are relevant – should this be the date of submission of the bids, the date that the contract was signed or some other date?
- Will draft laws need to have been anticipated by the contractor or only laws that were in force at the relevant date?
- Definition of "change of law" – should it cover legislation, regulations, interpretation of laws, court decisions, or even extend to practices of professional bodies or general engineering or other standards

that are not enshrined in law?

- Allocation of risk of change in law – Who should bear the risk of changes in law? Should there be a distinction between any change in the general law of the country (or wider region), or only a discriminatory change of law relating to the relevant contractor, specific contract or sector? In some projects it has been found possible to treat changes of law of any type as the Operator's risk – this has occurred in particular in projects in which such costs can be passed on to users such as toll bridges. In other sectors a risk sharing approach has developed where the risk cannot be quantified or fully passed on to third party end users. In such circumstances, a distinction is usually made between "Discriminatory Changes in Law", where the Awarding Authority bears the risk and a "General Change in Law" where the risk is shared between the parties. Again, where there is capital expenditure and third party financing involved, the lenders may require more risk to be borne by the Awarding Authority.
- If it is generally accepted that the Operator will be compensated for changes in law, how serious does the impact of the change need to be on the project before it may change the parameters of the project? Should a change result in a "material adverse effect" on the ability of the contractor to perform its obligations under the contract before an amendment will be made? Should there be a monetary value attributed to this materiality?
- What is to be the outcome if the impact of the change of law is such that the contractor can no longer perform the contract, even at a greater price – for example, where legislation is passed to prohibit a private sector entity from delivering the service? If the contract needs to be terminated, how will the contractor be compensated? Will compensation be merely for the expenses of the contractor or will the compensation cover loss of profit for part or the duration of the contract?
- The contractor should be under an obligation to mitigate the impact of the change of law.
- If a change of law results in a reduction in the cost of performing the contract, is this something that the awarding authority would wish to benefit from?
- Should a change in tax law or foreign investment law be treated differently? Again, this will partly depend on whether this is an extra cost that can be passed on to end users.
- Who will determine whether a change of law has occurred and any changes in contract price – will this go to an expert, adjudication?

Sample Wording

Set out below is some suggested sample wording:

Sample 1 (no distinction between general and discriminatory changes in law)

"Applicable law" means laws and any other instruments/ subordinate legislation having the force of law [or having been published[1] in [relevant country]. For the avoidance of doubt, Applicable Law shall include any applicable statute, ordinance, decree, regulation, or by-law or any rule, circular, directive or any licenses, consent, permit, authorization, concession or other approval issued by any authority which has appropriate jurisdiction.

"Change of Law" means the coming into effect after [the date of this Contract][bid submission date][other date] of:

Applicable Law; or any applicable judgment of a relevant court of law which changes the interpretation of the Applicable Law [and is a binding precedent] which [directly and adversely] affects the Contractor's performance under the Contract [in a material way].

If the Contractor suffers (or will suffer) delay and/ or incurs additional costs as a result of a Change of Law [and the net cost to the Contractor is in excess of [ ] as a result of a Change of Law, then the Contractor will be entitled to an adjustment to the [contract price/ tariffs] and /or an extension of time. The Contractor must

deliver a notice to the Authority [within [ ] weeks/ months of the occurrence of that Change of Law] identifying the Change of Law and the impact of that change of Law[, accompanied by full details of the claim]. The Authority will proceed in accordance with the Determination Procedure to agree or determine these matters.

If the Contractor is prevented from performing its obligations under the Contract, but would be able to proceed if a variation were made to the Contract, then the Contractor should submit a notice for a Variation to the Authority in accordance with the Variation Procedure.

In the event that that the Contractor is prevented from performing its obligations under the Contract and this cannot be remedied by a Variation or the Authority has refused to grant a variation, then the Contractor may give notice of termination [in accordance with clause [ ]].

If a Change of Law occurs, the Contractor is obliged to take all reasonable steps to mitigate the adverse impact of such Change of Law upon the Contract."

Sample 2 (distinction between general and discriminatory changes in law)[2]

"Discriminatory Change in Law" means a Change in Law, the terms of which apply expressly to:

(a) the Project and not to similar projects;

(b) the Contractor and not to other persons; and/or

(c) Contractors involved in similar projects and not to other persons.

"Specific Change in Law" means any Change in Law which specifically refers to the provision of [services the same as or similar to the Service] or to the holding of shares in companies whose main business is providing [services the same as or similar to the Service].

"General Change in Law" means a Change in Law which is not a Discriminatory Change in Law or a Specific Change in Law.

"Qualifying Change in Law" means:

(a) a Discriminatory Change in Law;

(b) a Specific Change in Law; and/or

(c) [a General Change in Law which comes into effect during the Service Period and which involves Capital Expenditure,] which was not foreseeable at the date of this Contract.

Qualifying Change in Law

(a) If a Qualifying Change in Law occurs or is shortly to occur, then either party may write to the other to express an opinion on its likely effects, giving details of its opinion of:

(i) any necessary change in Service;

(ii) whether any changes are required to the terms of this Contract to deal with the Qualifying Change in Law;

(iii) whether relief from compliance with obligations is required, including the obligation of the Contractor to achieve the Planned Service Commencement Date and/or meet the [performance regime] during the

implementation of any relevant Qualifying Change in Law; (iv) any loss of revenue that will result from the relevant Qualifying Change in Law;

(iv) any Estimated Change in Project Costs that directly result from the Qualifying Change in Law; and

(v) any Capital Expenditure that is required or no longer required as a result of a Qualifying Change in Law taking effect during the Service Period,

(b) in each case giving in full detail the procedure for implementing the change in Service. Responsibility for the costs of implementation (and any resulting variation to the Unitary Charge) shall be dealt with in accordance with paragraphs (b) to (f) below.

(c) As soon as practicable after receipt of any notice from either party under paragraph (a) above, the parties shall discuss and agree the issues referred to in paragraph (a) above and any ways in which the Contractor can mitigate the effect of the Qualifying Change of Law, including:

(i) providing evidence that the Contractor has used reasonable endeavors (including (where practicable) the use of competitive quotes) to oblige its subcontractors;

(ii) to minimize any increase in costs and maximize any reduction in costs;

(iii) demonstrating how any Capital Expenditure to be incurred or avoided is being measured in a cost effective manner, including showing that when such expenditure is incurred or would have been incurred, foreseeable Changes in Law at that time have been taken into account by the Contractor;

(iv) giving evidence as to how the Qualifying Change in Law has affected prices charged by any similar businesses to the Project, including similar businesses in which the Shareholders or their Affiliates carry on business; and

(v) demonstrating that any expenditure that has been avoided, which was anticipated to be incurred to replace or maintain assets that have been affected by the Qualifying Change in Law concerned, has been taken into account in the amount which in its opinion has resulted or is required under paragraph (a) (v) and/or (vi) above.

(d) If the parties agree or it is determined under Clause 28 (Dispute Resolution) that the Contractor is required to incur additional Capital Expenditure due to a Qualifying Change in Law (excluding the Contractor's Share of any Capital Expenditure agreed or determined to be required as a result of a General Change in Law under this paragraph), then the Contractor shall use its reasonable endeavors to obtain funding for such Capital Expenditure on terms reasonably satisfactory to it and the Senior Lenders.

(e) The Contractor's Share shall be solely for the account of the Contractor.

(f) If the Contractor has used reasonable endeavors to obtain funding for Capital Expenditure referred to in paragraph (c), but has been unable to do so within [60] days of the date that the agreement or determination in paragraph (c) occurred, then the Authority shall pay to the Contractor an amount equal to that Capital Expenditure on or before the date falling 30 days after the Capital Expenditure has been incurred.

(g) Any compensation payable under this Clause by means of an adjustment to or reduction in the Unitary Charge shall be [see Section 5.2.3 (Calculation of Compensation) above].

Further reading

- UNCITRAL Model Legislative Provisions on Public-Private Partnerships 2019 and UNCITRAL Legislative Guide 2019

- Guidance on PPP Contractual Provisions (2019) - This document presents guidance on contractual provisions that can be found in virtually every PPP contract, taking into account feedback received during internal and external consultations with relevant public and private stakeholders.
- Guidelines of the UK Treasury on Public Private Partnerships - On 5 December 2012 the Government introduced PF2. These guidelines provided detailed drafting provisions. In 2018 it was announced the government will no longer use the PF2 model.
- For Change of Law issues in particular, see Standardization of PFI Contracts (2007). (PFI replaced by PF2 in 2012).

[1] If you want to exclude laws that are published but have not yet come into effect.

[2] Taken from Guidelines of the UK Treasury on Public Private Partnerships.

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