TURKISH HEALTH PPPS IN A PANDEMIC

THE EFFECTS OF THE COVID-19 PANDEMIC HAVE HAD A CONSIDERABLE IMPACT ON TURKISH HEALTH PUBLIC-PRIVATE PARTNERSHIP PROJECTS AND IT IS WORTH EXAMINING THE CHALLENGES THAT HAVE BEEN CREATED AS A RESULT. BY DEVRIM ERGUN, PARTNER, AND NIGAR ÖZBEK, SENIOR ASSOCIATE, ÇAKMAK AVUKATLIK ORTAKLIGI.

The public-private partnership (PPP) model began its implementation in the healthcare sector in the 2010s and there are currently 12 operational PPP hospitals. One of these projects was completed and became operational in May 2020, after the onset of the pandemic in Turkey.

All of the operational PPP hospitals in Turkey were designated as epidemic hospitals following the spread of Covid-19 to the country, and their contributions in combating Covid-19 have been positively received throughout Turkey.

Although Turkish healthcare workers have been the real heroes, helping each and every patient with their extraordinary efforts and dedication, the capacity of PPP hospitals, together with their state-of-the-art technology and equipment, also provided much needed assistance during Turkey's fight against the disease.

For example, the advanced facilities found in patient rooms, which enable them to be effortlessly transformed into intensive care units, ensured provision of first-rate healthcare to patients seeking treatment. Based on this experience, it would not be unexpected for increased healthcare investments in the PPP model to continue, perhaps contrary to other public investments, without awaiting an economic recovery, whether in Turkey or globally.

Covid-19 impacts on contracts

As in most sectors, the pandemic caused unprecedented challenges to the performance of contractual obligations in health PPP projects in the construction phase. Immediate challenges were the delays in construction and delivery of critical materials and equipment.

What seemed capable of recovery at the outset has started to manifest itself as a larger issue, which is likely to result in significant delays and cost overruns. Needless to say, this is not only a hurdle for borrowers, it may also turn out to be a major concern to be addressed together with finance parties and the government.

Despite the hospitals' designation as epidemic hospitals, no change has been made to the scope and remuneration of the services that the project companies provide under the project documents. Further, given the expectation of more global disruption in the coming months, the project agreements for the PPP hospitals may need to be modified to enable them to serve as epidemic hospitals as and when necessary.

As for projects at the construction stage, the government has not directly ordered construction sites to reduce activity or shut down. However, several manuals have been published regarding additional measures as well as health and safety precautions to be implemented on construction sites.

Although the required measures and precautions have not completely halted construction, project activities have decreased in a number of ways whereby the project companies will have to consider the impacts of the pandemic in terms of both time-scale and costs.

The new measures require (i) more diligent labour force management, (ii) compliance with newly introduced health and safety requirements, and (iii) alternative supply chain management and procurement methods.

Notwithstanding other causes of delays such as the already expected slowdown in the supply of materials and equipment, the measures themselves are likely to result in significant delays.

In particular, social distancing rules imposed by the manuals not only prevent intensive and accelerated construction activities that are necessary to recuperate the already incurred delays, they are likely to result in a considerable slowdown.

Some contractors have already minimised the number of employees on sites in order to ensure the safety of employees as required by the said manuals. Now, the challenge is to reconcile delays that have already occurred and to avoid further delays without undermining the safety requirements imposed, and more importantly, without demanding cost increase recovery, which the government seems to expect.

● *Is Covid-19 a force majeure for health PPP hospitals?* – Force majeure events, including pandemics, are customarily included in health PPP project agreements to excuse the performance of obligations of either party, ie project companies and the Ministry of Health, provided that such events are (i) unforeseeable and outside the reasonable control of the parties, and (ii) prevent either party from duly performing its obligations whether partially or in their entirety, despite taking all necessary measures and precautions to mitigate the negative impacts.

There is a consensus in Turkey that the Covid-19 pandemic constitutes a force majeure event, not only for PPP hospital projects, but for almost all project and construction activities. However, the applicability of force majeure relief to each project should be examined for each case based on the specifics of each project and the efforts of the relevant parties to mitigate the impacts.

In fact, Presidential Circular No 2020/5[1] regarding the impacts of the Covid-19 disease on public procurement contracts, explicitly states that the pandemic constitutes a force majeure, on the condition that contractual works have been suspended or interrupted due to the effects of the Covid-19 disease, despite efforts to prevent or minimise such effects.

So far, there is no publicly available information on the opinion of the Ministry of Health concerning the force majeure nature of Covid-19 on health PPP projects, other than the observation that the Ministry of Health expects the project companies to show best efforts to mitigate the impacts.

Notwithstanding the foregoing, it seems clear and widely accepted that Covid-19 constitutes a force majeure and all delays incurred as a direct consequence of Covid-19 should enjoy the force majeure remedies (whether legal or by contract) that are available.

● *Is change in law protection applicable against Covid-19 related legislation?* – As mentioned, Covid-19 has led to the introduction of certain administrative measures, recommendations and restrictions. Initially, whether there could be a possibility for project companies to trigger change in law provisions under their contracts was discussed in the market.

This is a particularly important matter; while a change in law would provide compensation for additional costs, a force majeure would provide only a time extension in most cases.

In cases where the government introduced legislation that, for example, required complete suspension of construction activities, project companies could be entitled to enjoy change in law relief. However, no such law or order has been issued in Turkey to date.

Alternatively, some of the restrictions and measures, particularly those that relate to health and safety, may also be viewed as a change in law. Depending on the volume of delays and cost overruns to be incurred, this matter is likely to be debated further for healthcare PPP projects in Turkey.

● *Reaction of the government* – Whether countries may declare moratoriums, additional currency controls or nationalisation of projects is being discussed on a global scale. No such extraordinary steps are currently foreseen in Turkey. As far as we are aware, the Ministry of Health continues to fulfil its obligations under health PPP project agreements without delay.

Covid-19 impact on financings

To-date, the Turkish government has not implemented any legal or regulatory measures in response to the Covid-19 outbreak that specifically target or have a direct impact on the execution and repayment of health PPP project financings.

Furthermore, market standard loan agreements do not contain force majeure clauses that could be interpreted to provide relief from repayment and other financial obligations.

As with other sectors and businesses, health PPP projects are susceptible to the various adversities of changing economic and social conditions in the aftermath of the pandemic, including with respect to their ability to satisfy contractual obligations under their loan agreements.

The Turkish economy has been burdened with the effects of the currency crisis of 2018 with the Turkish lira prone to additional volatility following the onset of the pandemic, which saw many companies with borrowings in foreign currency attempting to meet the increasingly difficult obligation of fulfilling foreign currency debt service payments with revenues denominated in Turkish lira.

Although, as far as we are aware, these setbacks have not resulted in any repayment defaults under health PPP projects to-date - which, for the avoidance of doubt, typically have availability payment and services payment calculations indexed to foreign currency, providing a degree of protection for project company revenues against FX volatility – they have the potential to result in constraints and challenges of varying degrees, ranging from construction delays and cost overruns, to severe hindrances on day-to-day operations and revenue generation capabilities.

In light of these developments, although we are not aware of any such discussions to-date, it would not be altogether unexpected if one or more of the existing health PPP project financings saw new negotiations among obligors and banks, with a view to amending finance documents to provide for extensions to constructions periods, revisions to financial projections, easing of repayment plans, additional facility lines and other similar amendments.

In the meantime, Turkish banks are not without their own challenges.

Recent amendments to banking laws and regulations include restrictions on transactional fees and commissions banks can charge their commercial customers, resulting in a considerable impact on the ability of banks to generate income from their lending activities.

Following the outset of Covid-19, banks are now obligated to calculate a monthly active ratio that ensures that they maintain a minimum lending balance consistent with their asset size; this could potentially result in banks having to fund less creditworthy groups or projects than they may have preferred to in the past, hypothetically seeing an increase in their non-performing loan portfolio.

At the same time, as the finance sector becomes less liquid as a result of a downturn in global economic activity resulting from the pandemic, Turkish banks may find it is becoming increasingly difficult to fund themselves in the international markets. This could in turn make it more problematic for Turkish banks when allocating additional funds for health PPP projects in the event of project cost overruns.

As for governmental obligations concerning health PPP projects, as far as we are aware, the Ministry of Health has continued making its scheduled availability payments and services payments, and for projects with patient guarantees, payments in connection therewith. However, this does not rule out the risk that a sharp economic downturn and a corresponding decrease in the ability to generate tax revenues could jeopardise the ability to do so going forward. ■

Footnote

1 – Published in the Turkish Official Gazette on April 2 2020.