

COVID-19 AND IMPLICATIONS OF FORCE MAJEURE CLAIMS IN CONTRACTUAL ARRANGEMENTS

Background

The sudden and unexpected emergence of the coronavirus (COVID-19 or Virus) pandemic has greatly disrupted the global economy. Countries around the world have imposed travel bans, quarantined citizens and isolated the infected in attempts to stop the spread of the virus.

The local and cross-border movement restrictions have resulted in forced but temporary suspension of business activities and operations across different sectors of the economy. Therefore, the performance of contractual obligations has been delayed and, in some cases, completely abandoned. This has led to colossal financial losses in many businesses. Businesses are, therefore, assessing their contractual relationships to ascertain how they would be able to perform their contractual obligations. And if they are not able to, they want to determine what options are available to them in the circumstances. Due to the pandemic, there is an increasing number of force majeure claims being made globally with the largest number of the claims initially reported in China.

This article highlights specific issues, which have arisen or are likely to arise under construction, finance and employment contracts as a result of COVID-19. It also explores how the principle of force majeure can be deployed to limit or avoid liability or damages that would otherwise arise due to non-performance of contractual obligations.

The Principle of Force Majeure

The concept of force majeure is widely recognized in common law countries like Nigeria. A force majeure is either an event or effect that can neither be anticipated nor controlled, (www.lexology.com) or caused by a superior or irresistible force, according to Merriam-Webster dictionary. Nigerian courts have also defined force majeure as “something that is unexpected and unforeseen happening, making nonsense of the real situation



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envisaged by parties.” (Globe Spinning Mills (Nig) Plc v. Reliance Textile Industries Ltd (2017) LPELR-41433(ca) Per Ndukwe-Anyanwu, J.C.A. (P. 27, Para. E)) On this premise, the general consensus is that for an event to qualify as a force majeure, such event must not have been foreseen by the parties to a contract at the time of entering into the contract. And most importantly, the event must be one that cannot be controlled or prevented by either party to the contract.

The remedies available where a force majeure event has occurred range from the extension of time for performance, to the suspension or outright termination of the contract. However, it is important to note that the principle of force majeure can only be applied if the contract between the parties expressly provides for it.

Construction Agreements

Construction and infrastructure projects are heavily dependent on the seamless operation of a supply chain of labourers, goods, equipment and machinery. In many cases, there has been a break in this supply chain due to the lockdown and movement restrictions put in place to prevent the spread of the virus. Standard industry agreements such as the

FIDIC Engineering Procurement and Construction (EPC) Contracts contain force majeure provisions. However, in large construction projects with a number of contractors whose obligations are co-dependent and linked, it may be difficult to establish a causal link between the force majeure event and non-performance. In other words, which contractor's non-performance resulted in another's non-performance or delayed performance.

Problems also arise where there is a misalignment in force majeure provisions in contracts across the supply chain. For example, if force majeure is broadly defined to include a pandemic such as COVID-19 in a contract between a subcontractor and a supplier, the supplier may be excused from performance under the supply contract. However, if there are no corresponding force majeure provisions under the main contract, the subcontractor cannot make a force majeure claim and will, therefore, be in breach of the obligations to supply goods under the head contract to the main contractor.

In view of the above, the following actions may be taken:

- i. A record of all delays and the causes of such delays should be maintained in order to establish a causal link between the COVID-19 pandemic and non-performance or delayed completion of the contract.
- ii. For future contracts, the force majeure risk should be allocated on a back-to-back basis across the contracts in the supply chain and the scope of force majeure provisions should be identical across board.
- iii. Project managers should review all force majeure provisions in the contracts along the supply chain in order to identify any potential liabilities. Where force majeure risks have been identified, steps should be taken to mitigate financial loss and damages.
- iv. Timely communication with the project sponsor to procure an extension of the project timeline.
- v. A review of the insurance policies taken out for the project in order to assess if any losses suffered as a result of COVID-19 are covered.

A change in law provision may be invoked on the basis that non-performance under the contract is due to the movement restrictions imposed pursuant to the COVID-19 restrictions, which became effective in Lagos State, Ogun State and Federal Capital

Territory (FCT) on the 30th of March, 2020. This will be particularly relevant where construction has been delayed or suspended because of a shortage of labour arising from the movement restrictions and social distancing measures imposed by the government.

Commercial Lending and Financial Agreements

The decline in business activities and the financial crisis in the global economy will most likely result in the inability of many businesses to meet repayment obligations under loan agreements. Non-payment under a loan agreement is typically deemed to be an event of default under the relevant loan agreement, which may lead to termination of the agreement and enforcement of security by the lender, in the case of a secured financing.

Generally, loan agreements do not contain force majeure provisions. Therefore, it is unlikely that a borrower will have the benefit of making a force majeure claim in order to excuse non-payment. However, a borrower in default for non-payment may bring a claim that the agreement has been frustrated due to the COVID-19 pandemic. On that basis, repayment of the loan has become impossible. The drawbacks to relying on the principle of frustration are (i) it is strictly construed and as such a mere decline in revenue will not suffice; (ii) it terminates the contract (*Malik v. Kadura Furniture & Carpets Co. Ltd* (2016) LPELR-41308(CA)) and the lender will proceed to enforce the security under the agreement in order to recover the funds provided.

A lender may invoke the Material Adverse Change clause to accelerate the repayment of funds advanced under the loan agreement. Depending on exact provisions of the agreement, a material adverse change clause may have the effect of suspending the obligations of parties or terminating the agreement. Equity financing agreements will usually tie the occurrence of a material adverse change to fall in the company's earnings before interest, taxes, depreciation and amortization (EBITDA) or revenue of the target company. In such a case, an investor or financier may have to prove that due to the COVID-19 pandemic, the target company has experienced a decline in revenues or there has been a fall in company's EBITDA below the threshold provided for in the financing agreement, which has affected the borrower's ability to repay the loan.

Generally, the effect of a claim for frustration or

material adverse change will result in the termination of the agreement. Where both parties do not wish to terminate the agreement, the following alternative measures may be explored:

- i. The parties may renegotiate the terms of the loan. A borrower can make a request for a reduction in the interest rate, the grant of a moratorium on principal repayments or an extension of the tenor and repayment timelines of the loan. The Central Bank of Nigeria (CBN) is leading the way in this initiative through its policy measures in response to the COVID-19 outbreak released on the 16th of March, 2020. The CBN extended the moratorium on principal repayments under all CBN intervention facilities for an additional one (1) year. Furthermore, the CBN has authorized all Deposit Money Banks to consider temporary restructuring of terms and tenors of loans for businesses and households that have been most affected by the COVID-19 outbreak, particularly businesses in the oil and gas, agriculture and manufacturing industries.
- ii. The loan may be restructured, and lenders may request for additional security in the form of guarantees or charges over unencumbered assets as an incentive for the restructuring.

Employment Agreements

A major impact of the COVID-19 pandemic is the increase in the unemployment rate as many businesses look to reduce employee numbers in a bid to manage financial resources. (iclg.com). As with any other agreement, an employer may only suspend or terminate an employment contract on the basis of force majeure only where the contract expressly contains such provision. While employment agreements for employees in large corporate organisations may contain robust force majeure provisions, majority of employment agreements for small and medium-sized companies are silent on force majeure events. Where an employment agreement does not contain force majeure provisions, the following steps may be taken:

- i. Both parties may renegotiate the terms of the contract and amend the contract to reflect, for example, a reduction in remuneration and working hours.
- ii. Where the contract expressly allows the employment to be suspended, the employer may



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temporarily suspend the contract of employment until the business commences operations and the employee can be remunerated.

- iii. Where it is completely impossible to make concessions, the employer may claim frustration of the agreement due to the inability to keep up salary payments during the lockdown.
- iv. Termination and suspension of employment should be done in accordance with the notice or procedural requirements provided under the contract or the Labour Act as applicable.
- v. Given that the National Industrial Court in Nigeria is employee-friendly, termination and suspension of employees, even where allowed under the employment agreement, should be carried out in accordance with International Labour Organisation best practices.

It is important to note that the relationship between an employer and an employee is contractual. Therefore, save for limited instances such as frustration, all measures taken out by employers should be done in compliance with the terms of the employment contract in order to avoid wrongful termination claims. (U.T.C. Nigeria Ltd. v. Peters (2009) LPELR-8426(CA)).

General Recommendations

In addition to the specific recommendations provided above, the following general recommendations are applicable across all types of contracts:

- i. A review of the contract in order to assess the scope of the force majeure provisions is required. The review will also identify if any other remedies are available under the contract that may excuse non-performance and limit contractual damages.

- ii. Active steps should be taken to mitigate any losses that may be suffered as a result of the COVID-19 pandemic by actively seeking alternative means of performing contractual obligations where possible. This may involve making arrangements for alternative means of satisfying contractual obligations such as arranging for third parties to meet the supply obligations under a supply contract. Mitigation measures will be required even if such steps result in increased costs.
- iii. Communication between parties and strict compliance with any procedural and notification requirements under the force majeure provisions in the contract should be carried out.

Conclusion

A successful force majeure claim will serve as a bailout from contractual liability. In most cases, it will end all contractual obligations under the contract. It is also important to note that the threshold for making a claim of force majeure is high as it is factual. Therefore, the events resulting from the COVID-19 pandemic must be such that they make the performance of an obligation under a contract impossible. In order to preserve the contractual relationships, other non-terminal measures discussed above should be explored.

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