# Managing contractual obligations post COVID-19

## Understanding *force majeure*, change in law, material adverse change clauses and the doctrine of frustration

Undoubtedly, the current pandemic has thrown up many uncertainties. Many governments, businesses, individuals and other legal persons are asking questions about their contractual rights and liabilities. Contracting parties are also asking what the best options are to protect themselves under their existing contracts. In this article, we discuss the differences in force majeure, change in law, material adverse change clauses and the doctrine of frustration. We also discuss how parties can rely on each.

### Force majeure

Force majeure ('superior force') is of French origin. It is a civil law concept with no real meaning under common law. The closest concept in common law, though narrower in scope, is the doctrine of frustration. In common law jurisdictions such as Nigeria, force majeure is a creation of contract – therefore, it can only be invoked as a protection where it is contained in a contract. The Court of Appeal[1] defined the term as

> *a common clause in contracts which provides that one or both parties can cancel a contract or be excused from either part or complete performance of the contract on the occurrence of a certain SPECIFIED EVENT OR EVENTS beyond the parties' control. Such event(s) may include; war, strike, riot, crime, or an event described by the legal term act of God (hurricane, flood, earthquake, volcanic eruption, etc.), prevents one or both parties from fulfilling their obligations under the contract. Force majeure is generally intended to include occurrences beyond the reasonable control of a party…*

**Key elements of force majeure are that the force majeure event:**

- is beyond the parties' control,
- must have been unforeseeable,
- is inevitable in its occurrence,
- insurmountable in its effects such that the consequences could not have been prevented and
- is the reason for failure to perform one's obligation under the contract.

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1. Globe Spinning Mills Nigeria Plc v. Reliance Textile Industries Limited

In the wake of COVID-19, non-performing parties may rely on force majeure clauses where it has become impossible to perform their obligation under a contract or, where not included in a contract, the more restrictive common law concept of frustration to avoid liability for non-performance of their contractual obligations. A standard force majeure clause would specify the force majeure events, consequences of the event (suspension or termination), mitigating steps that a party or parties may take to resolve the problem.

It is often thought that a force majeure clause, automatically terminates a contract. However, because it is a contractual term, parties can specify the consequences of a force majeure event. Parties can agree what would happen when the force majeure event ends or if it ends gradually, who determines whether the event has ended, what must be performed when the force majeure event ends etc.

## Frustration

In the absence of a force majeure clause, a party may rely on the default common law doctrine of frustration. The Nigerian Supreme Court[2] (SC) quoted with approval the definition of frustration applied by Viscount Simon LJ in *Cricklewood Property & Investment Trust Ltd. v. Leighton Investment Trust Ltd*:[3]

> *the premature determination of an agreement between parties, lawfully entered into and which is in the course of operation at the time of its premature determination, owing to the occurrence of an intervening event or change of circumstances so fundamental as to be regarded by law both as striking at the root of the agreement and entirely beyond what was contemplated by the parties when they entered into the agreement.*

**According to the SC, events that can result in frustration include:**

- subsequent legal changes,
- outbreak of war,
- destruction of the subject matter of contract,
- government requisition of the subject matter of the contract and
- cancellation of an expected event.

In the case before it, the SC found that the judgment of the International Court of Justice (ICJ) ceding the Bakassi Peninsula and the Cross River Estuary to Cameroon was a supervening event which frustrated an earlier agreement between Cross River and Akwa Ibom States. The agreement had attributed ownership of 76 offshore oil wells to Cross River States because, at the time, Cross River was a littoral state. According to the SC, because of the ICJ judgment, the agreement had become impossible to perform.

An important condition before a party can rely on frustration is that the supervening event makes performance of the contract radically different from what was intended by the parties. Such an event must be entirely beyond the contemplation of the parties at the time of contracting and must not be due to either party's fault.

However, it is more restrictive than force majeure. Where, in the light of COVID-19, a contract sets out what should happen in the event of a pandemic, a claim for frustration would likely fail. This is because it becomes difficult to prove that performance would be radically different if the situation was considered at the point of contracting. Also, the doctrine does not give room to save the contract.

2. Attorney General, Rivers State v Attorney General, Federation (2012) LPELR-9335(SC)
3. (1945) 1 All E.R 252

## Change in law

A law may be changed (amended, repealed, re-enacted) during the life of a contract. Such a change may affect the legality, costs of performing the contract or other fundamental term of a contract. When there is a change in law, parties can agree to vary the terms of the contract to bring it in line with the changes in the law. Unlike a force majeure event, a change in law is almost always as a result of a government action. However, a force majeure clause may include a government action or a change in law as a force majeure event. A recent example of a change in law event would be changes in UK law arising from Brexit. Another example would be the recent increase in the Value Added Tax (VAT) rate to 7.5%

In many instances, parties would include a change in law clause to mitigate the effect on price / cost of any changes in the law. The recent increase in VAT would affect the costs of performance under many contracts. In such cases, depending on the wording and circumstances, a change in law clause might be more appropriate than a force majeure clause. Except in instances where a change of law has made the contract illegal, a change in law clause allows parties vary the terms of the contract such that the contract can run under new or varied terms.

Many contracts may be affected by changes in law triggered by COVID-19. If this occurs, it is advisable for the parties to look at the change in law clauses to explore possibilities of varying the terms of the contract for the purpose of keeping the contract alive.

## Material Adverse Change / Material Adverse Effect

MAC clauses are usually found in financing agreements. They protect a lender against unforeseen changes to the borrower's finances, changes in ownership, drastic market fluctuations and generally any material changes in the position of the borrower during the tenure of a facility. Depending on how the clause is drafted, if a MAC event occurs, a lender can ask for more security / assurances, suspend drawdowns, declare an event of default and / or accelerate early repayment. Generally, while borrowers would try to limit the scope of the clause, lenders would prefer broader terms. Though a shield, lenders may also be exposed to damages where a MAC clause is wrongly or prematurely invoked.

Though there is a dearth of caselaw on the topic, these clauses may become more relevant considering the likelihood of borrowers experiencing material adverse changes in their finances as a result of COVID-19.[4] Fortunately, the UK High Courts have provided some guidance on the operations of MAC clauses. In *Grupo Hotelero Urvasco SA v. Carey Value Added SL*[5], the lender, a Spanish fund, suspended funding to the borrower – part of the Urvasco Group, alleging that a MAC had occurred because of concerns about economic downturn in the Spanish property market and Urvasco Group's deteriorating financial position. As a result, construction stopped and receivers sold the project. The borrowers sued for damages for breach of contract. Even though the court rejected the lender's arguments that a MAC had occurred in respect of two of the group companies, it found that a MAC had occurred in respect of the guarantor and other defaults had occurred which warranted suspension of funding. In its decision, the court outlined a few principles to guide:
(2013) EWHC 1039

***Burden of proof lies on lender:***
the lender has the burden of proving that a MAC had occurred and must satisfy the court that the MAC posed a real threat that the borrower would not be able to fulfil its obligations under the agreement.

***Strict interpretation of MAC clauses*:**
where, as in this case, the MAC clause referred to changes in the company's 'financial condition', determining whether a MAC had occurred should be restricted to financial information gotten from usual financials such as interim accounts and management accounts etc. However, where there are other compelling evidence of a MAC, the courts would consider these.

***General economic downturn would not always result in a MAC:***
the existence of a downturn would not be conclusive that a MAC had occurred especially considering the strict interpretation of the MAC clause which, in this case, referred to "financial condition'

Also, in 2018, infrastructure funding also increased in Africa by 24% to over a US$100 billion. See https://www.icafrica.org/fileadmin/documents/IFT_2018/ICA_Infrastructure_Financing_Trends_in_Africa_-_2018_Final_En.pdf. Last accessed 11 May 2020
5. (2013) EWHC 1039

***A MAC must be material*:**
the MAC must be such that the borrower's ability to repay is significantly affected. In addition, where a lender is aware of a pre-existing condition or the likelihood of one at the inception of the relationship, it cannot rely on such as a MAC.

***MAC must not be temporary:***
MACs must not be temporal. The courts would look to see if the change was merely temporal and the borrower was not capable of bouncing back before agreeing that a MAC had occurred.

## A comparison of the clauses

Let us assume that under a loan agreement, a toll operator's (borrower) obligation to repay is directly linked to the projected number of vehicles that use the toll. As a result of the pandemic, the government passes a law that imposes a 3-month restriction in movement such that no vehicles would go through the toll. During the 3 months, the borrower cannot make any repayment of either principal or interest. As a palliative to road users, the government imposes a reduced toll fee to take effect after the 3 months. This may affect the finances of the borrower.

**In the scenario, assuming the loan agreement contained all three (3) clauses:**

| | Force majeure (FM) | Change in law | MAC | Frustration |
|---|---|---|---|---|
| Trigger events | Government action of imposing a lockdown (assuming the loan agreement has a standard FM clause which includes government action as a trigger event and the period of the event exceeds the period contained in the contract.) | Change in law | Possible adverse effect on borrower's financial position | Act of God (pandemic), government action, change in law that makes performance radically different than previously contemplated |
| Effect | Delay in performance or non-performance | Borrower can no longer make payments as a result of the change in law. | Lender can ask for early repayment, suspend further drawdowns (if any) etc if borrower's financial position is adversely affected permanently. | Both parties are discharged from performing the contract |
| Relief for breach | Non-performing party is excused for non-performance or delay in performance. | Parties can vary the contract in line with the change in law.<br><br>Repayment terms may be recalculated based on reduced toll fees. | If effect on borrower is material & permanent, lender can ask for early repayment.<br><br>If not material & permanent, borrower can access further funding. | Non-performing party is discharged and excused for non-performance of contract |
| Status of contract | Saved if toll is operational after 3 months.<br><br>Or terminated if lockdown is prolonged beyond 3 months or indefinitely (depending on contractual terms) | Contract is varied and saved | Contract may be terminated if lender rightly calls for early repayment | Frustrated for lack of performance due to Act of God |

## Conclusion

Contracting parties need to take a close look at their contracts to see what clauses would be most appropriate considering the circumstances caused by the pandemic. The operations of each clause would of course depend on the drafting, facts and circumstances of each case.

For innocent parties, it helps that the courts would generally respect contractual terms and are not keen that contracts are perfunctorily terminated for non-performance triggered by external events. On the other hand, it is only fair that a contract is terminated if a party cannot genuinely perform under a contract because of external factors. In such cases, the non-performing party should be excused from performance without incurring any liability. It is also interesting to note that some of these clauses (force majeure and change in law) are not mutually exclusive and can be invoked simultaneously. Parties are advised to speak to a professional before deciding what the best option is for their circumstance.

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