

Business, beware: do not simply invoke force majeure

Business Transformation & Forensic Litigation Consulting

The devastating effects of global pandemic Covid-19 have left many businesses unable to perform contractual obligations and with no option but to invoke force majeure clauses. Unfortunately, Covid-19 is also being used by certain businesses to escape contractual obligations without the business' inability to perform being directly related to events surrounding Covid-19. This trend, if unchecked, could have a detrimental effect on the South African economy. In his address to the nation on 9 April 2020, President Cyril Ramaphosa urged businesses not to simply resort to force majeure or to stop paying their suppliers and rental commitments, as this would further negatively impact supply chains and the wider South African economy.



In its simplest form, a force majeure event can be described as a reasonably unavoidable, unforeseeable and unforeseen event, which makes it objectively impossible for a party to perform their obligations under a contract.

The decision to invoke a stay of performance of contractual obligations cannot be taken lightly and must be justified in law and fact. It appears that the focus and discussion on such clauses since the outbreak of Covid-19 has mostly been limited to legal analyses, with less consideration of the financial and commercial implications that should underly the decision to invoke a force majeure clause. Consideration of these implications is vital in ensuring that it is legally sound and contractually justified to do so. Hasty notice of inability to perform without a proper commercial assessment could result in breach of contract and punitive damages claims that will add stress for a business long after the Covid-19 pandemic passed.

What constitutes a force majeure event will depend on the wording of a specific contract. If a contract does not contain a force majeure clause, then inability to perform is dealt with in terms of the common law doctrine of supervening impossibility of performance. In order to successfully raise supervening impossibility of performance, the performance must be objectively impossible, and the impossibility must be unavoidable by a reasonable person. It is not enough for the performance merely to have become difficult or expensive. Performance will be considered objectively impossible where it is factually possible but has become illegal. For example, inability to perform could be caused by the conditions of the lockdown imposed in terms of the Regulations published under the Disaster Management Act.

“Whether relying on a force majeure clause or supervening impossibility, contracting parties generally are obligated to use all commercially reasonable efforts to alleviate and mitigate the cause and effect of the force majeure event.”

This means that businesses should have certain risk management protocols and safeguards in place prior to the event occurring to ensure the sustainability of their business. Subsequent to the event occurring, business must take active measures to ensure they can meet their contractual obligations despite the effects of the event. In doing so, businesses must use all commercially reasonable efforts. If it is then established that performance is objectively impossible, then the terms of a force majeure clause may be followed, alternatively supervening impossibility may be raised.

Practically, what is required of a business will be determined on a case-by-case base, considering the specific circumstances impacting the ability to perform and whether it was justifiable to declare force majeure or claim supervening impossibility. This assessment would consider a variety of factors, including the nature of the business and the performance obligations, in establishing the nexus between the force event and the subsequent inability to perform. For example, a business cannot avoid contracted payment obligations due to financial difficulty which existed prior to the occurrence of the event. Generally, for businesses to justifiably and responsibly invoke force majeure or supervening impossibility of performance defences, they would at a minimum need to evidence:

- A causal link between the government imposed Covid-19 lockdown and the business' income generating activities;
- A quantification of the impact of the government imposed Covid-19 lockdown to the business' income generation, cost, and ultimately profit; and
- Proof of the business' inability to fulfill its contractual obligations from its pre-existing reserves or otherwise (e.g. extending credit lines etc.)

Instances where parties are unable to meet certain legislated payment obligations, such as payment of certain taxes to SARS, generally will not give rise to a justified reliance on force majeure as there is a difference between complying with the terms of a contract and with obligations to the revenue authorities. In these cases, the wording of the relevant legislation will need to be assessed, together with any obligations placed on parties claiming inability to perform.

How FTI Consulting can assist your organisation:

FTI Consulting does not take the importance of advising our clients through these extreme difficulties lightly, and we recognize that our experience managing through change and crises and mitigating risk is critical at times like this. Our team can provide independent advice and litigation support, in respect of force majeure clauses or supervening impossibility by:

- Assisting with the assessment of the circumstances of a party and their rights and obligation with reference to the agreement, including expressed and implied duties;
- Establishing a clear timeline for what government emergency declarations were in place and what impacts these had on the business;
- Documenting the procedures to describe the scope and nature of reasonable commercial measures that have been taken to evidence and support arguments relating to mitigation of the inability to perform contractual obligations;
- Supporting legal counsel in confirming that the force majeure event is covered/not covered by insurance and/or third party guarantees of performance; and
- Conducting a detailed analysis of all financial, ERP and accounting entries to support or evaluate the transactional flow of entries in relation to the force majeure event.

FTI Consulting can evaluate how the business and its cost going forward may be impacted by this unique force majeure event, including assessment of potential risk factors relating to:

- Identifying, separating and tracking costs resulting from the force majeure event;
- Quantification of the operational and financial impact of the force majeure event in anticipation of initiating or defending damages claims due to breach of contract;
- The impacts of the government emergency declarations and likelihood of additional constraints;

- The cost and time-impacts of new or heightened safety protocols and potential restricted resource mobility and other limitations due to the lockdown;
- Identifying and evaluating the impacts on or by supply chains and their possible disruption; and
- Providing force majeure specific standard operating procedures and key control measures.

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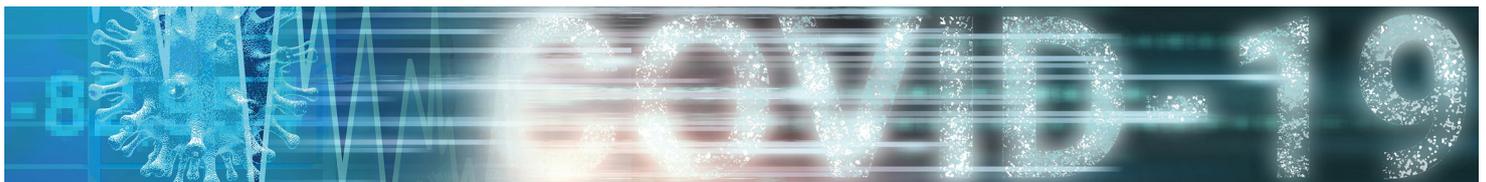
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