

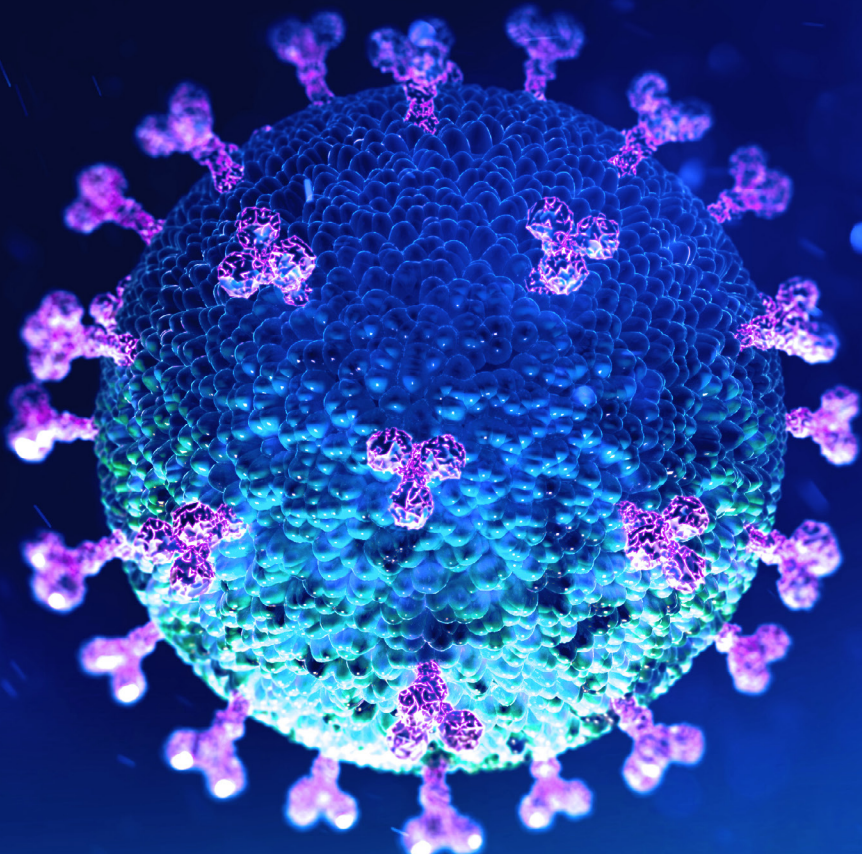
# COVID-19 AND PERFORMANCE OF CONTRACTS IN ZAMBIA

## Key Considerations

### Client Alert

March 2020





# Introduction

The wake of the severe acute respiratory syndrome coronavirus 2 (SARS-Cov-2), the virus responsible for the COVID-19 pandemic, has triggered widespread effects on many industries across the world.

The pandemic has the potential to affect business transactions including the ability to create restrictions and limitations that could enable a party to a **Zambian law contract** avoid their obligations by relying on a force majeure clause and/or the common law doctrine of frustration. However, both routes have a high bar to success and parties should consider the details of each case before pursuing either route.

## Disclaimer

The content of this article is general in nature and not intended as a substitute for specific professional legal advice on any matter and should not be relied upon for that purpose.

As a rule, contracts must be performed, in accordance with the terms, even where it becomes more difficult or even impossible. If not performed, the party who fails to perform becomes liable for damages. This is known as the rule of absolute contracts — there is no ifs, no buts when it comes to performance — unless, something out of the ordinary happens. Perhaps something like COVID-19?

## What are the legal possibilities?

Under **Zambian law**, two mechanisms are considered if a party is to escape liability under an existing contract, frustration and force majeure. The former is established by case law while the latter is normally set out in

the specific contract.

## What is frustration of a contract?

A contract may be cancelled on the ground of frustration<sup>1</sup>, and a frustrating event is one which is:

- (a). unexpected;
- (b). beyond the parties' control; and
- (c). makes performance impossible or radically different from that which the parties contemplated at the time of entering into the contract.



In other words, the frustrating event must “significantly change the nature of the outstanding contractual rights or obligations.” Take for example the SARS epidemic in 2003, the Courts of Hong Kong held that a 10-day period in which a property was vacant did not frustrate the tenancy agreement, which had a two-year term.<sup>2</sup> The Court held that a 10 day period was insignificant paralleled to the two-year duration of the lease. Further, whilst SARS was arguably an unforeseeable event, it did not “significantly change the nature of the outstanding contractual rights or obligations” of the parties in the case.

However, in instances where a party can prove frustration, both parties are discharged from further performance of the contract the event relates to.

### What is force majeure and its effect?

There is no generic definition of force majeure under case law. Therefore, every case relating to force majeure requires specific interpretation of the facts. And while it can be likened to frustration, a contract must contain a force majeure clause identifying specific events that constitute a “force majeure” that either suspends or terminates the rights and/or obligations. These events can encompass the

<sup>2</sup> Li Ching Wing v. Xuan Yi Xiong, [2004] 1 HKLRD 754.


COVID-19 outbreak. To rely on a force majeure clause, a defaulting party must prove:

- (a) an event captured in force majeure clause has occurred;
- (b) such an event prevented, hindered or delayed the performance under the contract.
- (c) non-performance of the obligations was due to circumstances outside the defaulting party’s control; and
- (d) there were no reasonable steps that it could have taken to avoid or mitigate against the event.

To reiterate, for a force majeure clause to be relied on, performance must become “physically or legally impossible, not merely more difficult or unprofitable.”<sup>3</sup> For example, a “crash” in Zambia’s economic conditions (even if caused by an event like COVID-19) will generally not constitute force majeure<sup>4</sup> unless such an event is captured under the clause.

<sup>3</sup> Thames Valley Power v. Total Gas & Power [2005] EWHC 2208 (Comm)

<sup>4</sup> Tandrin Aviation Holdings Ltd v. Aero Toy Store LLC [2010] EWHC 40 (Comm)



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## Could COVID-19 be a legally frustrating event or force majeure?

We are agreed, COVID-19 has the potential to affect numerous ways.

By way of example, if the Zambia government imposes a legal quarantine ban on movement out of an area, so that a supplier of materials cannot fulfil their supply obligation to a subcontractor, this may be a frustrating or force majeure event under the supply contract. But whether that is also the case under the subcontract with a main contractor is another story.

The above illustration raises another key question of whether the subcontractor assumed responsibility to the main contractor for carrying out the subcontract works and, consequently, took the risk of an inability to source the materials, when required. If they did (and this will be a matter of legal interpretation of the contract), then there will be no frustration and, depending on the contract wording, there may be no force majeure.

**Each case would have to be looked at individually in the circumstances in order to assess whether frustration or force majeure.**

Clearly, each case would have to be looked at individually in the circumstances in order to assess whether frustration or force majeure. Questions need to be asked, including:

- (a) how seriously did COVID-19 affect performance of the contract? Has COVID-19 made performance actually impossible/radically different or just less convenient and/or more expensive. For example, if the contract requires delivery of payment/goods on a specific date that is now made impossible due to a localised lockdown measures that may result in a frustrating event or a force majeure event;
- (b) did the performance of the contract become illegal or impossible or radically different and how, if at all, does the contract in question deal with this situation;
- (c) is a pandemic or similar wording such as COVID-19 or a general definition covering all events "outside the reasonable control of the parties" (e.g. International Swaps and Derivatives Association (ISDA) standard wording), for instance, defined by the contract as an event of force majeure?

If a claim of force majeure will not stand, the next consideration is whether any of the following grounds can be proved to make a successful claim of frustration:

- (a) Temporary unavailability – e.g., a person or object that is essential for performance of the contract is temporarily unavailable due to a quarantine;
- (b) Method of performance impossible – e.g., a contract for freight services by air where a travel ban is in place. However, a contract will not be frustrated where performance is possible by a different method, and the difference between the two methods of performance is not sufficiently fundamental;
- (c) Failure of a specific source – e.g., a contract to import goods from a country now subject to a travel ban; and
- (d) Illegality – e.g., a contract for airline services that are now subject to a flight ban. Consider also whether the illegality clause of the contract is invoked.

If successful, the effect of frustration is automatic termination of the contract and parties can recover amounts paid under the contract before it was frustrated (less the other party's expenses).

## COVID-19's Effect on Loans and Lease Agreements

### Loan Agreements

Finance teams and lawyers are coming up with new ways to mitigate the impact of the COVID-19 pandemic on loan documentation. A clause coined as the "corona clause" is recently being included in loan documentation giving borrowers more flexibility to absorb hits on businesses caused by COVID-19.

Numerous articles echo that corona clause allow the borrowers', actual or estimated, lost revenues to be added back to calculations of profits, thereby helping companies to avoid breaching limits on how much they can borrow. These corona clauses are also meant to address the borrowers increasing desire to secure flexibility to cope with shocks affecting normal course of business, COVID-19, in this case. This flexibility stems from extraordinary, unusual, infrequently occurring or nonrecurring loss, charge or expense, in order to keep debt levels within certain multiples of operating income.



However, corona clauses are being drafted in such a way that no reference of COVID-19 is mentioned but can be interpreted to include the pandemic. The clauses vary as are they negotiated per deal though they carry a similar goal — to mitigate any unforeseen events that may limit restrictions in borrowing by a company.

### Lease Obligations

COVID-19 raises numerous issues for landlords and tenants concerning leases, including:

- (a) whether a lease provides a force majeure clause, which excuses a party from performing under an agreement as a result of circumstances beyond its control such as COVID-19, which can be relied upon? If so, would the force majeure clause cover obligations such as payments; and
- (b) does the company maintain a policy of business interruption insurance coverage which does not exclude pandemics such as COVID-19?

In New York, there is currently a moratorium on commercial eviction actions and, as such, this may be the time to negotiate between a landlord and tenant.

### The legal versus commercial relating to COVID-19?

Other than relying on frustration or force majeure to terminate agreements, parties should also consider other options which take commercial considerations as precedence. For example, if suppliers, subcontractors and contractors want to continue working together in the future, in circumstances where no party is at fault, understanding on both sides will be required. If the shared objective

is the resumption of performance as soon as possible, collaboration (underpinned by a sound understanding of the contractual position), rather than confrontational legal battles, may be the way forward. This would greatly assist the economy in the hopeful event of COVID-19 being contained resulting in the normalization of business activity as force majeure and frustration are “nuclear” options to approach with caution. Particularly given the current forecasts of how long COVID-19 will disrupt normal business, and means that a business must temporarily halt production or miss a payment/delivery date, a moratorium could be requested from respective parties.

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