WERKSMANS
ATTORNEYS

BANKING & FINANCE

A worldwide pandemic – is it time to consider the inclusion of force majeure provisions in loan agreements?

30 April 2020 *4 min read*

By Cara Gow, Associate; Reneilwe Maleka, Associate and Juliet Siwela, Candidate Attorney
Reviewed by Richard Roothman, Director and Head of the Banking & Finance practice

The previous global financial crisis occurred in 2008/2009 as a result of the subprime mortgage crisis that originated in the USA when house prices started to fall in 2006. The global financial crisis led to a worldwide global recession which in some instances led to payment defaults and breach of financial covenants by borrowers. Lenders typically exercised their rights under loan agreements by calling default and realise their collateral (if any). The Covid-19 pandemic is causing a much worse global economic crisis as a result of a worldwide economic standstill. The impact on borrowers and lenders is certainly much more severe than that experienced during the 2008/2009 global financial crisis. Today corporate and individual borrowers are prevented from fulfilling their repayment obligations as a result of circumstances completely outside their control namely, regulations and directives by Government prohibiting them to trade. One could say, a typical "force majeure" event. It goes without saying that lenders calling default and realising collateral provided in times like this is probably not the preferred route to take.

Force majeure events include war, riots, natural disasters, energy blackouts, lockouts and labour unrest. Loan agreements generally do not include a force majeure provision. In the event of non-payment by borrowers as a result of any of the abovementioned events, lenders would rely on the "material adverse event" clause or any other relevant event of default clause in order to enforce their rights under the loan agreement. The declaration of a lockdown period by Government and the prohibition on trade as a result of Covid-19 do not *per se* provide relief to borrowers in respect of their repayment obligations.

Is it not time for lenders and borrowers to consider the inclusion of a "force majeure" clause or similar provision in loan agreements to cater for worldwide pandemics such as Covid-19? Under South African law, force majeure provides relief to a party under a contract (the "affected party") upon the occurrence of an unforeseeable circumstance that prevents the affected party from fulfilling its obligations to the other party under the contract. The inclusion of a force majeure clause in a loan agreement should be carefully considered by a lender and tailored to the lender's specific requirements. There must be a link (whether directly or indirectly) between the occurrence of the force majeure event and the failure by the borrower to perform.

If included, such clause could specify, *inter alia* (i) the time period for which relief would be granted, (ii) that the relief period can be extended in the sole discretion of the lender, (iii) the specific provisions in the loan agreement and obligations of the borrower that will continue to apply, (iv) the obligations for which the borrower would get relief, and (v) the process/steps (if any) that must be followed once the relief period has lapsed.

The inclusion of such a provision will allow room for borrowers and lenders to find a way forward and to re-negotiate terms for a specific period of time. Borrowers would be able to obtain payment relief in the form of a payment moratorium or reduced payments for a specified period as well as relief from compliance with certain financial covenants for such relief period. Lenders could rely on a force majeure or similar provision in relation to funding obligations that they may have or to protect them in approving funding for certain projects.

As Covid-19 and the subsequent lockdown has affected and will continue to affect operations and/or revenues of most companies which may result in payment defaults and breach of financial covenants, lenders and borrowers should carefully review existing loan agreements

and revisit relevant provisions. With respect to new loan agreements to be concluded, lenders and borrowers may very well consider the inclusion of a force majeure clause or similar provision dealing with the elements referred to above.



Richard Roothman

Director

View Profile