



Research Insight

2nd June 2020

“COVID 19 and its impact on the Extractive Industries, some contractual issues to consider”

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ABSTRACT

The present COVID-19 pandemic presents austere obstacles to the extractive industries. Besides the decrease in oil consumption and demand, there has also been a drastic fall in the prices of a range of many, but not all, metals and minerals across the mining industry due to the pandemic.

In addition to the fall in prices, the consequences of the COVID-19 outbreak for the extractive industries have been severe, with issues such as rig and mining site closures, disrupted supply chains, suspension of projects and low-level personnel as a result of workers self-isolating. It is almost certain that such issues will result in disputes, as companies in the extractive industries become unable to perform their existing contractual obligations.

It is against this backdrop that this Extractives Hub Research Insight examines these contractual issues that will likely give rise to disputes and how the parties involved can be excused from failing to fulfil their obligations paying particular attention to the legal concepts of *force majeure*, the doctrine of frustration and Material Adverse Change.

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1. Introduction

On the 11th of March 2020, the World Health Organization officially declared the spread of the infectious disease, the novel coronavirus (COVID-19) as a global pandemic.² This new coronavirus, first emerged in the Chinese city of Wuhan in December 2019 but had infected about three million people by May 2020.³

Several measures including the imposition of quarantine or isolation, travel restrictions limiting freedom of movement, social distancing, and complete nationwide lock down have been initiated in several countries to control the spread of this virus. COVID-19, has not only created an unprecedented health, social and economic crisis.

Given that the lockdown is still going on in many countries around the world, no one knows exactly when business will resume. This has presented some unique challenges in the extractive industries including disruption in supply chains, suspension of exploration and development projects, closure of oil rigs and mining sites, low demand for oil leading to a drop in the oil and gas prices, dramatic fall in prices of a range of many metals and minerals leading to low production and financial problems amongst companies in the extractive industries. Amongst these challenges, the challenge that this Research Insight focuses on is the probable inability, due to COVID 19 impacts, of many extractive industries companies to perform various contractual obligations.

Taking these challenges into consideration, it is advisable that companies in the extractive industries should now focus on planning for future disputes that will arise as a result of not fulfilling their contractual obligations and at the same time finding ways to be relieved from their contractual obligations by relying on legal concepts such as *force majeure*, frustration and Material Adverse Change (MAC). These concepts will be discussed in detail in Section 3 of this Research Insight.

The purpose of this Research Insight therefore, is to identify some of the current challenges faced by the extractives sector as a result of the pandemic and most importantly to examine how parties can use the doctrine of *force majeure*, frustration and MAC as an excuse from their inability to fulfil their contractual obligations. In light of the above, the main questions this Research Insight will address are as follows:

- Will COVID-19 be regarded as a *force majeure*/ material adverse change event?
- In what circumstances can a contract be frustrated?
- How can companies in the extractive industries mitigate the risk of potential contractual disputes that may arise for this outbreak or future outbreaks?

Beyond this introductory discussion the rest of the paper is structured as follows: Section 2 will identify some of the challenges the extractive industries is faced with during this pandemic. Section 3 will examine potential contractual legal issues to consider in the extractive industries looking at the legal concepts of *force majeure*, frustration and MAC and the paper will end with a conclusion in Section 4 of this Research Insight.

²'Coronavirus Confirmed as Pandemic' (BBC News, 2020) <<https://www.bbc.co.uk/news/world-51839944>>last accessed 29 April 2020.

³(Who.int)<https://www.who.int/docs/default-source/coronaviruse/situation-reports/20200428-sitrep-99-covid-19.pdf?sfvrsn=119fc381_> last accessed 13th May 2020.

2. Challenges in the extractive industries due to the COVID-19 Pandemic

It is no doubt that the extractive industries is one of the most important industries in the business sector as it is a significant catalyst for economic growth across the world. However, the COVID-19 pandemic has shattered the extractive industries leading to uncertainties in the sector. Amidst these uncertainties, the industry is currently faced with the following challenges, please see below discussion.

2.1 Low demand, Low prices and Low production

The pandemic has wrecked the oil markets in a way that has never been seen before. With travel restrictions, restrictions of movement and restrictions on other business activities across the world the extractives sector is currently faced with a low-level demand for oil. Global oil demand is expected to fall by a record 9.3 mb/d year-on-year in 2020.⁴ This low demand for oil has led to a drop in price as well as a drop in production. In April 2020, and in the volatile period close to the final trading day of a futures contract, the price of West Texas Intermediate crude oil turned negative for the first time in history, falling to minus \$37.63 a barrel.⁵ Spot prices also briefly fell below zero.⁶ Prices for Brent, the benchmark for crude from the North seas also crashed.⁷ The mining sector is also faced with the same challenges. Commodity prices across the industry have been plunging for many, but not all, metals. Notably these falls have been dramatic for aluminium and copper.⁸ Continuing a price trend occurring prior to the global onset of COVID-19 and its economic fallout, gold is a high-profile example of a commodity that has increased in price, its increase in traded value being additionally supported by a “flight to safety”.

2.2 Operational disruptions/ Supply Chain Disruptions

The lockdowns and other restrictive measures introduced by various governments around the world as a way of controlling the virus, have given rise to operational disruptions in the extractives sector. Operations in the oil and gas industry have been obstructed by the pandemic as employees are being diagnosed with COVID19.⁹ Due to workforce shortages, oil rigs have been closed. The industry is also facing challenges in terms of project execution. Most development projects, drilling obligations found in production sharing contracts and exploration licences operations have been arduous to fulfil during this pandemic. As such, most exploration operations and projects have been suspended. To name a few, pipeline operators in the United States of America (US) such as Pembina Pipeline Corp and Harvest Midstream Co are either stalling or delaying their projects due to the Covid-19 pandemic and economic

⁴ 'Impact of Covid-19 on the Global Energy Sector' (PV magazine International) <<https://www.pv-magazine.com/2020/04/24/impact-of-covid-19-on-the-global-energy-sector/>> accessed 29 April 2020.

⁵ 'The “Low-For-Longer” Story Of Global Oil' (Fortuneindia.com) < <https://www.fortuneindia.com/macro/the-low-for-longer-story-of-global-oil/104554>> last accessed 13 May 2020.

⁶ Ibid.

⁷ Ibid.

⁸ 'The Extractive Industries And Society | Journal | Sciencedirect.Com' (Sciencedirect.com, 2020) <<https://www.sciencedirect.com/journal/the-extractive-industries-and-society>> accessed 13 May 2020.

⁹ Matthew Farmer, Matthew Farmer and Matthew Farmer, 'How Coronavirus Has Spread through North Sea Platforms' (Offshore Technology | Oil and Gas News and Market Analysis) <<https://www.offshore-technology.com/features/coronavirus-north-sea-infections-evacuations/>> accessed 29 April 2020.

slowdown.¹⁰ Nigerian Gas Co Ltd has put its Obiafu-Obrikom-Oben pipeline project on hold as the contractor company is unable to ship equipment from port to the construction site due to the Covid-19 pandemic.¹¹ Restrictions imposed on mining companies has seen production shut down across multiple markets with a number of mining operations sites shutting down. For example in Mongolia, Rio Tinto was forced to suspend non-essential operations due to government regulations.¹² South Africa has also shut down a number of mining operation sites.¹³ The lockdown in Peru, the world's second-largest copper producer, has meant miners such as Anglo American, Pan American Silver and Newmont, have had to put a halt to operations, which includes the slowing of work on Anglo American's major copper project.¹⁴

COVID-19 has also disrupted the supply chain in the extractive industries in many ways. A lack of on-site personnel due to quarantine measures has led to delays and interruptions to supply and service delivery which has created a negative impact on profitability and productivity. COVID -19 has also caused huge disruption to international supply chains. The extractives sector relies densely on global supply chains for machinery, equipment and consumables. However, the flow of equipment, machinery and consumables has been interrupted as the suppliers/sub-suppliers of many companies in the extractive industries are based in affected regions such as China, south Korea, Italy and Spain.

2.3 Financial distress and bankruptcies

Low prices and production in both oil and minerals will continue to present major challenges for companies in the extractives, especially for those at risk of being incapable to refinance debt or meet existing debt agreements. In the oil and gas sector, about 30% of debt is identified as distressed, meaning companies are experiencing financial or operational problems severe enough to put them at risk of default or bankruptcy.¹⁵ The mining industry is also faced with immense financial distress as a contraction in demand would see earnings before interest, depreciation and amortisation for the big miners drop between 50 and 70 per cent and debt rise.¹⁶ However, some companies would be able to weather the storm but others won't and this will potentially spark a wave of bankruptcies.

¹⁰ Global Data Energy, Global data Energy and Global data Energy, 'Upcoming Oil and Gas Pipeline Projects Delayed by Covid-19' (*Offshore Technology | Oil and Gas News and Market Analysis*) < <https://www.offshore-technology.com/comment/oil-and-gas-pipeline-projects-delay/>> accessed 13 May 2020.

¹¹ Ibid.

¹²'The Impact of Covid-19 on the Global Mining Sector' (Miningreview.com) <<https://www.miningreview.com/investment/the-impact-of-covid-19-on-the-global-mining-sector/>> accessed 29 April 2020.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ David Hellier, 'Oil And Gas Producers 'In Distress' As Low Oil Price Pain Continues' (*the Guardian*) < <https://www.theguardian.com/business/2016/feb/20/oil-and-gas-producers-distress-low-prices-bankruptcy> > last accessed 13 May 2020.

¹⁶'Prospects of Global Recession and Demand Shock Hit Mining Stocks' (*Ft.com*) < <https://www.ft.com/content/a0b66e36-6a08-11ea-a3c9-1fe6fedcca75>> last accessed 13 May 2020.

3. The doctrine of *force majeure* and frustration and material adverse change

The continued lockdown, restrictions of movement and quarantines coupled with disruptions in supply chain, closure of oil rigs and mining sites, and low on-site staffing levels can negatively affect mining, energy and petroleum contracts. These challenges can give rise to impossibility of parties to perform their contracts or comply with their contractual obligations. In this respect, it is inevitable that future disputes will arise for parties failing to comply with existing contractual obligations and these parties will seek to find excuse for failure to fulfil their obligations by relying on legal concepts such as *force majeure* and frustration.

In addition to the restrictive measures, the unusual decline in demand and low price of oil and minerals have caused financial distress on companies in the extractives. Many companies in the extractives sector are currently facing constraints to meet heavy debt obligations they took out from banks and other financial institutions. For example, the US shale driller, Whiting Petroleum Corp. (Whiting) has already filed for bankruptcy, becoming the first sizable fracking company to succumb to the crash in oil prices.¹⁷ Whiting surely won't be the last as we expect to see more companies' filing for bankruptcy. This will result in an increase in insolvency and other financial related disputes and parties will therefore seek to rely on MAC clauses as loan agreements do not make provision for *force majeure*.

This Section therefore seeks to shed light on the legal concepts of *force majeure*, frustration and MAC looking at whether they can be used as an excuse by parties who find themselves unable to fulfil their existing contractual obligations during this COVID-19 pandemic.

3.1 Overview of the doctrine of *force majeure*

The term "*force majeure*" (meaning "superior force"), has its genesis in French Civil Law. *Force majeure* is a common clause in contracts that relieves a party from responsibility for non-performance when an extraordinary event or circumstance beyond the party's control prevents or prohibits that party from fulfilling its contractual obligation.

It is important to note that jurisdictions across the world have different approach towards the application of the concept of *force majeure*. In many civil law jurisdictions the *force majeure* is commonly enshrined in codified law and can be applied by an affected party regardless of any contractual provisions. For example, *force majeure* expressly stipulated in Article 1218 of the new French Civil Code and provides that: "in contractual matters, there is *force majeure* where an event beyond the control of the debtor, which could not reasonably have been foreseen at the time of the conclusion of the contract and whose effects could not be avoided by appropriate measures, prevents performance of his obligation by the debtor....."¹⁸

¹⁷ 'U.S. Shale Company Whiting Becomes First Major Bankruptcy of Oil-Price Crash' (U.S.) <: <https://www.reuters.com/article/us-whiting-petrol-bankruptcy/us-shale-company-whiting-becomes-first-major-bankruptcy-of-oil-price-crash-idUSKBN21J5KS> > accessed 13 May 2020.

¹⁸ Covid-19: Impact On Commercial Contracts – France | Publications | Insights | Linklaters' (Linklaters.com) < <https://www.linklaters.com/en/insights/publications/2020/march/novel-coronavirus-commercial-contracts/novel-coronavirus-impact-on-commercial-contracts/france> > accessed 13 May 2020.

In civil law however, to successfully claim for a defence of *force majeure*, the party must show that the consequences hindering performance needs to be unforeseeable, irresistible and external rendering the performance impossible and not merely more onerous.

Whilst most civil codes makes provision for *force majeure* events, under Common Law (e.g. English law), the doctrine of *force majeure* is ambiguous and has no explicit definition. It is neither defined in statute nor in case law. Donaldson J, in *Thomas Borthwick (Glasgow) Ltd. vs. Faure Fairclough Ltd*,¹⁹ remarked that “the precise meaning of this term, if has one, has eluded lawyers for years”.²⁰ However, McCardie J, indicated in *Lebeaupin vs. Richard Crispin & Co*,²¹ that words of *force majeure* should be construed in each case with a close attention to those words which precede or follow them, and with a due regard to the nature and general terms of the contract.²²

At this point it is important to know what is been regarded in a particular contract as a *force majeure* in Common Law. In the English case of *Lebeaupin vs. Richard Crispin & Co*, McCardie J. held that a promisor could not rely on his own act, or negligence, or omission or default as constituting *force majeure*.²³ Therefore, in English law and other common law jurisdictions, an event will be a *force majeure* event, if it constitutes a legal or physical restraint on the performance of the contract (whether or not occurring through human intervention, although it must not be caused by the act, negligence, omission or default of the constraining party, which is both unforeseen and irresistible.²⁴

Most importantly, unlike civil law, there is no implied application of the doctrine of *force majeure* in common law. A party’s success to claim for *force majeure*, will depend on the terms of the contract and an express *force majeure* clause in the relevant agreement, including a definition of what constitutes a *force majeure* event. The expression “*force majeure* clause” is normally used to describe a contractual term by which one (or both) of the parties is entitled to cancel the contract or is excused from performance of the contract, in whole or in part, or is entitled to suspend performance of the contract, in whole or in part, or to claim an extension of time performance, upon the happening of a specified event or events beyond his control.²⁵

Force majeure clauses however, may come in different shapes and sizes, ranging from simple clause providing for cancellation in the event that a performance is prevented by circumstances comprehended within the term of *force majeure*, to clauses of immense complexity containing inter alia, a list of excusing events, provisions for notices to be issued to the promise and entailing the consequences of the *force majeure* event.²⁶

Examples of *force majeure* clauses in different energy, petroleum and mining contracts will be examined in Section 3.3 of this Research Insight.

¹⁹ [1968] 1 Lloyd’s Rep. 16, 28.

²⁰ Ewan McKendrick, *Force Majeure and Frustration of Contract* (2nd edn, Informa Law 2013) 7.

²¹ [1920] 2 K.B. 714, 720. See also, Ewan McKendrick, *Force Majeure and Frustration of Contract* (2nd edn, Informa Law 2013) 7.

²² Ewan McKendrick, *Force Majeure and Frustration of Contract* (2nd edn, Informa Law 2013) 7.

²³ Ewan McKendrick, *Force Majeure and Frustration of Contract* (2nd edn, Informa Law 2013) 8.

²⁴ *Ibid.*

²⁵ Joseph Chitty, *Chitty on Contracts* (31st edn, Sweet & Maxwell 2012) 1087.

²⁶ Ewan McKendrick, *Force Majeure and Frustration of Contract* (2nd edn, Informa Law 2013) 9.

3.2 Will COVID-19 be regarded as a force majeure event?

There is no one specific answer for this question, as this will vary from contract to contract. Classifying COVID-19 as a *force majeure* event will depend on how the *force majeure* clause is drafted in the contract and the parties' reasons as to why they were unable to perform their contractual obligation. In instances where the *force majeure* clause explicitly lists pandemics as an event that will trigger a *force majeure* event, then the outcomes connected with COVID -19 will be fully covered. However, some contracts only include epidemics on their list of *force majeure* events and not pandemics.

Given that a pandemic is an epidemic of global ratio, the clause might still be triggered. On the other hand if the *force majeure* clause does not list epidemics/ pandemics as part of the events that give rise to a *force majeure*, other general words and clauses such as "any other event beyond the parties control", "an act of God" and "an act of Government or "national emergency" could potentially be banked on but will be subjected to the interpretation by the courts to decide whether COVID-19 falls within the scope of the clause and to what extent the outbreak impacted the contractual obligations.

In interpreting the application of a *force majeure* clause in light of COVID-19, the courts will consider the contract as a whole and whether the contractual obligation has been rendered impossible or whether it was obstructed as a result of been onerous or expensive to perform. The parties must therefore establish a connection between the trigger event and the party's contractual obligation. It will be vital for the parties to show a strong evidence that the COVID-19 pandemic is solely responsible for their non-performance and also prove that there were no reasonable alternative measures available to prevent the consequences of the trigger event.

It is therefore important for parties to carefully examine their circumstances before using a *force majeure* clause as an excuse for non-performance. Where a party relies on a *force majeure* clause, but is not contractually entitled to do so, he or she may be liable for a breach of contract and the other party may be entitled to claim damages. On the other hand, where a *force majeure* clause successfully gives rise to a *force majeure* event, the parties' obligations may either be suspended or may be excused from performing their obligations under the contract.

At this point, it is vital to note that not all energy, mining and petroleum contracts make provision for *force majeure* events. In an event where there is no *force majeure* clause included in a contract, the parties can still be excused from non-performance of their obligations by relying on the doctrine of frustration. The doctrine of frustration will be discussed in Section 3.4 of this Research Insight.

3.3 Examples of force majeure clauses found in energy and mining contracts and how they can be applied to COVID-19

3.3.1 The Petroleum Production Sharing Contract for Block LB -16 between The Republic of Liberia represented by the National Oil Company of Liberia, & Repsol Exploracion S.A.²⁷

This agreement made provision for *force majeure* in Article 32 and further defines a *force majeure* event in Article 32.2. as “any event unforeseeable and beyond the reasonable control of a party, such as earthquake, flood, accident, strike, lockout, riot, delay in obtaining the rights-of-way, insurrection, civil disturbances, sabotages, acts of war or conditions attributable to war, or any other cause beyond its control, similar to or different from those already mentioned.”²⁸

The *force majeure* clause in this agreement contains limited wordings and does not include a pandemic within such events. Taking into consideration the present situation, if any future dispute may arise, it is significant for the parties to carefully examine their clause. However, it does not necessarily follow that because the word ‘pandemic’ is not included in the relevant agreement, then a *force majeure* claim based on COVID-19 is going to fail. The clause however made mention of two important events which are, “any event unforeseeable and beyond the reasonable control of the party” and “and other cause beyond its control, similar or different from those already mentioned”. In this light, it is correct to say that a *force majeure* event may not only be limited to those events listed but may include events that are “unforeseeable” and “beyond the reasonable control of the party”. Therefore, if the event is beyond the parties’ reasonable control, then in principle an epidemic could well be seen as a *force majeure* event.

3.3.2 The Energy Charter Treaty²⁹

In this treaty, Article 15 makes provision for *force majeure*. The treaty defines *force majeure* as “Irresistible compulsion or coercion, unforeseeable course of events, excusing from fulfilment of contract”.³⁰

This agreement gave a rather general definition and excluded to name a list of events that will give rise to *force majeure*. In the absence of the express inclusion of relevant events such as “epidemics,” “acts of government”, it will be very difficult to claim for *force majeure* as an excuse for non-performance. However, in an event of a dispute, it will be left to the court to decide whether COVID-19 is an unforeseeable event. If not, it will be best to make use of other provisions, in the Energy Charter Treaty; for example a hardship clause. The use of such clause will depend on whether it is applicable and if

²⁷ This agreement was signed in 2005 with a contract duration for eight years. See 'Resourcecontracts.Org - Repsol Exploración S.A., National Oil Company Of Liberia, Block LB-16, PSA, 2015' (Resourcecontracts.org) < <https://resourcecontracts.org/contract/ocds-591adf-9922636059/view#/pdf> > last accessed 29 April 2020.

²⁸ 'Resourcecontracts.Org - Repsol Exploración S.A., National Oil Company Of Liberia, Block LB-16, PSA, 2015' (Resourcecontracts.org) < <https://resourcecontracts.org/contract/ocds-591adf-9922636059/view#/pdf> > last accessed 29 April 2020.

²⁹ (Energycharter.org) https://www.energycharter.org/fileadmin/DocumentsMedia/Legal/ECT-Positive_Annex_W.pdf >last accessed 3 May 2020.

³⁰ Ibid.

applicable, the party concerned can call for a renegotiation of the contract, in circumstances where the pandemic has hindered the continued performance of the said party's obligation.

3.3.3 The Mineral production sharing agreement between the Republic of the Philippines and Baldomero Nevada, Sr., Trinidad Nevada and Baldomero Nevada, Jr.³¹

In this agreement, Article 13.4 makes provision for a *force majeure* clause. This agreement defines *force majeure* as "acts or circumstances beyond the reasonable control of the Contractor including, but not limited to war, rebellion, insurrection, riots, civil disturbances, blockade, sabotage, embargo, strike, lockout, any dispute with surface owners and other labour disputes, epidemics, earthquake, storm, flood or other adverse weather conditions, explosion, fire, adverse action by the Government or by any of its instrumentality or subdivision thereof, act of God or any public enemy and any cause as herein described over which the affected party has no reasonable control."³²

One of the specific events listed in *force majeure* clause is an "epidemic." COVID-19 has been classified by the World Health Organisation as a pandemic. The confusion here will be whether the word pandemic can fall under epidemic. However, a pandemic, is an epidemic of global proportions. It is a more severe than an epidemic so if the *force majeure* clause mentions epidemic then in my view it includes extreme situations such as the pandemic. Notwithstanding, if any dispute arises as a result of a party's non-performance, the court will have to examine the existing circumstances to decide whether COVID-19 comes under the category epidemic. Another catching event made mention of in the definition is "adverse action by the government". It will therefore be the decision of the courts to decide whether other events such as "lockdown", "social distancing" and "quarantine" order issued by a government can fall under the category of "adverse action by the government".

3.4 Overview of the doctrine of frustration

The doctrine of frustration is a means of dealing with situations where events occur, after the contract has been concluded, which render the agreement illegal, or impossible to perform, or even commercially sterile.³³ The frustrating event must also not be the fault of either party or foreseeable.³⁴

Several years ago, the law was hesitant to excuse a party his or her performance of a contract even in the case where a supervening event rendered the performance difficult or impossible. The rationale of this rule was that a party could always express provision for unforeseen events and, if he or she did not do so, he or she should be bound by his or her contractual obligations. This is known as 'absolute contracts' rule which was clearly stated in the seventeenth –century case of *Paradine vs. Jane*.³⁵ Over the years this theory has been modified and courts now acknowledge that subsequent illegality of performance would frustrate the contract.³⁶ A land mark case that illustrated this modification and

³¹ This agreement was signed in 2009 and has a term of twenty five (25) years from Effective Date. See <https://resourcecontracts.org/contract/ocds-591adf-4621402481/view#/pdf> last accessed 29 April 2020.

³² See <https://resourcecontracts.org/contract/ocds-591adf-4621402481/view#/pdf> last accessed 29 April 2020.

³³ Elizabeth Macdonald, Ruth Atkins and Run Dawn, Koffman & Macdonald's Law of Contract (8th edn, Oxford University Press 2014) 469.

³⁴ Ibid.

³⁵ [1647] EWHC KB J5.

³⁶ See *Atkinson v Ritchie's* (1809) 10 East 530, 103 ER 877.

marked the recognition of the doctrine of frustration was the case of Taylor vs. Caldwell,³⁷ where the defendants were held to be absolved from the liability as performance of the contract was impossible; the contract was held to be frustrated.³⁸ The basis of this decision was that it would be unjust for the promisor to pay damages as external forces had rendered the performance impossible.³⁹

As the doctrine of frustration continued to evolve, a number of events have been held to potentially give rise to frustration including, “destruction or unavailability of the subject matter”; “death”, “illness or incapacity of a person” ; “frustration of purpose”; “supervening illegality or change in law”; “outbreak of war”; and “delay sufficiently long to frustrate the parties’ commercial adventure”⁴⁰

3.5 Frustration in the context of COVID-19

Where a contract does not make provision for *force majeure* the party or parties may rely on the doctrine of frustration for relief and the parties must prove that COVID-19 is either an “unforeseen” or “supervening event”, which has resulted in the termination of the contract and released both parties from their obligations. However, taking into consideration the circumstances surrounding COVID-19 and its rapid spread around the world, COVID-19 is undoubtedly an unforeseeable event.

There are instances where frustration cannot be claimed. For example, a contract will not give rise to frustration if the event in question was foreseen at the time that the parties entered into their contract or if the parties’ performance becomes more difficult or more expensive to perform.

Considering the complexity of the concept of frustration it is important to pose the following question: In what circumstances can a contract be frustrated? This question can be answered by using the test formulated by the House of Lords in Davis Contractors Ltd v Fareham U.D.C.⁴¹

*“Frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do.....”*⁴²

This test may only be satisfied in circumstances where the commercial purpose of the contract cannot be attained. The main target will be on the parties’ specific contractual obligations and whether they have ‘radically changed’ as a result of the spread of COVID-19 to the extent that the affected party will have to do something significantly different from what was originally agreed upon to fulfil its contractual obligation. Simply put, the “supervening event” must not be the non-performing party’s fault. In this present situation, given the circumstances surrounding the pandemic, contracting parties cannot be blamed for the spread of COVID-19. Nevertheless, this may not stop the courts from putting the onus

³⁷ [1863] EWHC QB J1.

³⁸ Ibid.

³⁹ Ibid.

⁴⁰ Take note that this is not an exhaustive list.

⁴¹ 'The Doctrine of Frustration in English Law | Lexology' (Lexology.com)

<<https://www.lexology.com/library/detail.aspx?g=bd78a422-d7c3-4214-95f5-031b91438a21>> last accessed 29 April 2020.

⁴²Ibid.

on the non-performing party for failure to perform a contract. It will all depend on how the courts interpret an individual case.

A very important question that participants in the extractive industries should now have in mind is whether COVID-19 is an "intervening event" that may lead to a contract being frustrated. Finding the right answer to this question will need careful examination of the nature and terms of each individual contract, the particular circumstances around performance, and whether COVID-19 and its consequences give rise to a situation that will trigger a claim for frustration.

Finally, it is important for the parties to know that, where a claim for frustration is successful, the contract automatically comes to an end and all parties are relieved from all further performance of their future obligations.

3.6 Overview of Material Adverse Change

A material adverse change is a change in circumstances that protects the parties from an unforeseeable event which was not predictable in the risk assessment of the contract.

Material adverse clauses can be looked at in two contexts; in the context of mergers and acquisitions and in the context of lending. For the purposes of this Research Insight, we focus on the context of lending as a lot of companies in the extractive industries have huge debts. Therefore in the context of lending a MAC clause can be described as a clause which acts as a "catch all" provision and aims to allow the lender to call a default if there is an adverse change in the borrower's position or circumstances (for example, a large negative variation shown in successive financial statements of the borrower).⁴³ The form and content of MAC clauses vary depending on the nature of the transaction and the practice in any relevant jurisdiction.⁴⁴

There are very few reported cases on enforcement of MAC clauses in the lending context and no reported cases addressing MAC clauses in the light of pandemics/epidemics. However, the leading court case on this subject, Grupo Hotelero Urvasco vs. Carey Value Added SL and Another,⁴⁵ laid down the following principles:

"The ability to invoke MAC provisions will be dependent on the actual wording of the provision which will be construed in accordance with usual principles of contractual interpretation;

The adverse change must be material, the adverse change must substantially affect the ability to perform the transaction in question;

The change in question cannot be temporary or transitory;

⁴³ ([Uk.practicallaw.thomsonreuters.com](https://uk.practicallaw.thomsonreuters.com)) < [https://uk.practicallaw.thomsonreuters.com/0-107-6824?__lrTS=20180101214719001&transitionType=Default&contextData=\(sc.Default\)&firstPage=true&bhcp=1](https://uk.practicallaw.thomsonreuters.com/0-107-6824?__lrTS=20180101214719001&transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1) > accessed 13 May 2020.

⁴⁴ Ibid.

⁴⁵ [2013] EWHC 1039 (Comm).

The parties cannot rely on a MAC on the basis of circumstances of which it was aware at the time of the agreement, although it may do so where conditions worsen in a way that makes them materially different in nature.”⁴⁶

These principles can, however, be applied to pandemics/ epidemics.

3.7 Is COVID-19 a material adverse change?

The question as to whether the Covid-19 pandemic or its consequences can be classified as a MAC largely depends on how it is defined in your contract. Nevertheless, except the MAC clause specifically mentions a pandemic or a similar wording, the fact that we are currently in a pandemic crisis will not constitute a sufficient justification that a pandemic in itself will be used to establish a MAC. That said, when a generic MAC clause is relied upon, the counterparty relying on it must not be aware of the relevant situation when entering the agreement.

Taking into consideration the guidance the in *Grupo v Carey*, it is important to note that, the party seeking to rely on the MAC clause will have the onus to convince the court that there is ample evidence of occurrence of a MAC.

Secondly, it will be best for those for those relying on MAC clause to prove that the event is material. This means that the party must show the consequences for the particular business will last for a significant period of time rather than temporary and or recoverable. If it is temporary, it will not be adequate to constitute a MAC. Parties may struggle to illustrate with the coronavirus outbreak that the change is either long-term or temporary due to the fact that the duration of the pandemic remains undetermined.

It is also vital to know whether the drop in oil prices and commodities can constitute a MAC. However, since each clause is interpreted on its own language, if the clause does not include the terms market or external conditions, a party will be unable to successfully rely on these if it is seeking to invoke the MAC clause.

Last but not the least, parties should be scrupulous before enforcing MAC provisions in connection to COVID-19 as its consequences are erratic and change daily. Any party who wrongfully claims for a MAC will face reputational damage and the risk of paying compensation for consequential loss to wrongly defaulted counterparties.

4. Conclusion

The current pandemic has unarguably caused severe havoc on the extractive industries. It has led to diminished demand for oil, steep-slide in oil prices, disruptions in supply chain, closure of oil rigs as well as mining sites, suspension of exploration and mining projects and financial distress. It will therefore be prudent for participants in the extractive industries to look beyond the present situation and think about

⁴⁶COVID-19: The Key Legal Principles Surrounding The Material Adverse Change (MAC) Clause | Lexology' (*Lexology.com*) < <https://www.lexology.com/library/detail.aspx?g=a57c48ba-1a40-43ef-b12a-36e86f6642ed> > accessed 13 May 2020.

the aftermath of the pandemic and be prepared for any disputes that may arise as companies are expected to default in fulfilling their obligations during this trying time.

In light of the above, participants need to gauge their capacity to make a claim of *force majeure* or frustration or MAC and at the same time assess their risk of being liable in regards to COVID-19 related events and manage the risk accordingly. In doing this, parties need to take certain measures now.

Firstly, parties should review their existing contracts, paying particular attention to the *force majeure* clauses in the contract. Most importantly the wordings of these clauses need to be reassessed paying particular attention to the list of *force majeure* events often included in these clauses. The corona virus should be an indication to contract drafters that unforeseeable and unavoidable events like “pandemics”, “epidemics” crisis, outbreak or governmental actions should now be added as part of the events that trigger a *force majeure* when drafting a *force majeure* clauses for a new contract.

Secondly, it is significant to examine the notice provisions of any *force majeure* clause to know whether a notice is needed, when it is needed, and what information it must encompass where and to whom it should be sent and by what means. This is very vital when contemplating to claim for *force majeure* as failure to provide the precise notice within the time stipulated in the contract will be disadvantageous to the party attempting to rely upon the clause.

In addition to *force majeure* and notice clauses it is also significant to check dispute resolution clauses, termination procedures and other procedural issues within the contract and contemplate whether there is a need for re-negotiation or modification of some kind.

Parties in the extractive industries need to consider how the risks associated with this outbreak, or a future outbreak of similar effect can be mitigated both now and in future contracts. Companies in the extractive industries should use this experience to give utmost importance to drafting *force majeure* clauses. Such clauses should be drafted properly using a clear language when defining events and no longer be considered absolutely boilerplate.

Last but not the least, in terms of MAC clauses, parties will need to revisit the MAC provisions in their financing agreements carefully and seek advice from their lawyers to determine how COVID-19 may affect their lending transaction. Apart from their lawyers it will also be best to have early discussions with the counter-parties to have a clear understanding of any concerns with regards to the operation of the agreement. Nevertheless, a party desiring to use a MAC clause need to be mindful of the many challenges which need to be overcome. While some of these challenges can be alleviated by careful drafting, one of the major challenges is for a party to prove that the trigger event will last for a significant period of time. Taking into consideration the remarkable uncertainties created by the pandemic, the impact of COVID-19 on MAC clauses, not only in the context of seeking to exit existing agreements but also drafting new ones, may be far more significant than has been seen in previous financial crises.

Please, cite this work as: Mara, MM (2nd June 2020) Covid-19 and its Impact on the Extractive industries: Some Contractual Issues to Consider. Extractives Hub Research Insight, 2nd June 2020. Extractives Hub, Centre for Energy, Petroleum and Mineral Law and Policy- CEPMLP, University of Dundee.