Legal Alert

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Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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Impossibility of performance, *force majeure* and section 129(7) notices

In brief

COVID-19 has, to varying degrees, adversely affected the ability of contracting parties to perform in terms of contracts. Parties may seek to avoid performing under contracts on grounds of the common law doctrine of supervening impossibility of performance or the *force majeure* provisions (if any) contained in contracts. COVID-19 has had an adverse impact on many businesses. A company that is financially distressed and has not commenced business rescue proceedings may be required to notify certain affected persons of its decision not to commence business rescue proceedings.

This Alert explores certain legal aspects of force majeure and section 129(7) of the Companies Act in the context of the global COVID-19 pandemic.

In detail

What is *force majeure*?

Force majeure, *vis major* and *casus fortuitus* are synonymous terms used to describe events or circumstances beyond the reasonable control of a party to a contract, that render performance under that contract by that party impossible. Such events or circumstances usually include wars, states of emergency, riots, strikes, criminal acts and natural events such as earthquakes, fires, plagues and floods (typically referred to as 'acts of God').

Supervening impossibility of performance

In terms of the common law doctrine of supervening impossibility of performance, the rights and obligations of parties to a contract under that contract will be extinguished if performance by a party of its obligations under the contract becomes objectively impossible as a result of unforeseeable and unavoidable events or circumstances that are not the fault of any party to that agreement.

What is objectively impossible to perform is not a simple question to answer. It is not sufficient that performance has merely become more costly or difficult. At the same time, absolute factual impossibility is not required. The standard of conduct generally acceptable in business dealings in the particular community will determine whether performance is objectively impossible, and performance might, in law, be regarded as impossible while still factually possible. Conversely, if a party has guaranteed performance, then the fact that performance subsequently becomes factually impossible does not absolve that party of liability.

Our courts have held that considerations such as the nature of the contract, the relationship of the parties and the particular circumstances of the case will determine whether the doctrine may be successfully invoked.

Force majeure clauses

Contracts may include a *force majeure* clause in terms of which the contracting parties agree on the circumstances under which performance of their obligations will be suspended, and the consequences thereof. For example, some force majeure clauses allow one or more of the contracting parties to terminate the contract should an event or circumstance of *force majeure* endure for more than a prescribed period of time. The nature and effect of *force majeure* clauses vary widely, so it is important to consider the precise language of the clauses concerned.

Importantly, our common law requires contracting parties to take commercially reasonable steps to mitigate against the adverse effects of a *force majeure* event or circumstance.

Section 129(7) notices

In terms of section 129(7) of the Companies Act, 2008 (Act No. 71 of 2008), if the board of a company has reasonable grounds for believing that the company is financially distressed but the board has not passed a resolution to commence business rescue proceedings, then the board must deliver a written notice to each of the company's shareholders, creditors, employees and trade unions setting out the test for financial distress to the extent to which it applies to the company, and the reasons for not adopting a resolution to commence business rescue proceedings.

Financial distress, in relation to a company, means that it appears to be reasonably unlikely that the company:

- will be able to pay all of its debts as they become due and payable within the immediately ensuing six months (referred to as commercial insolvency); or
- will become insolvent within the immediately ensuing six months (referred to as factual insolvency).

Accordingly, if a company is in financial distress and has not commenced business rescue proceedings, then its board is required to give a notice in accordance with section 129(7).

Failure by the board to discharge its duty under section 129(7) of the Act may, amongst other things, result in personal liability for the debts of the company for the directors.

A notice in terms of section 129(7) may have adverse unintended consequences. It has the effect of "advertising to the world at large the precarious financial position of the company. In such circumstances, for example, creditors of the company may seek to place the company in liquidation, and suppliers may only be prepared to supply on condition that payment is made in advance.

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Please contact us for more information on this Legal Alert and how we may be able to assist during the lockdown.