IMPACTS OF COVID-19 PANDEMIC AND MEASURES AT CONTAINMENT ON LOAN REPAYMENT OBLIGATION

INTRODUCTION

Debt financing has become a significant aspect of capital raising for businesses globally. In 2019, the Central Bank of Nigeria issued a directive that increased Loan-to-Deposit Ratio (LDR) to 65%, which means that Deposit Money Banks (DMBs) were obligated to give 65% of their deposits as loan. Due to this directive, many DMBs gave out more loans, but no one could have predicted a global pandemic that would force businesses to close down with grim prospects on ability of borrowers to fulfil their obligations under a loan contract.

The ravaging Coronavirus (Covid-19) pandemic and measures to flatten the curve have thrown individuals and corporate bodies with outstanding loan obligations into a frenzy on how to redeem commitments to banks and other financial institutions. This is even as most businesses have been forced to shut down operations in compliance with directives issued by government in the wake of the pandemic. This, certainly, will affect their turnover, profitability and liquidity. Whereas the cloud of uncertainty continues to thicken, the banks' obligation to pay interest on deposits may be unaffected by the pandemic.

Many borrowers may be inclined to rely on the pandemic as force majeure or frustration to avoid or postpone liabilities under a loan contract. The lenders on the other hand may be disposed to interpret any default as such event that would entitle them to call in the facilities and make the principal sum and the accrued interest due and immediately payable. Would the doctrine of force majeure avail a borrower in the circumstance? Can the lender successfully invoke its powers under the facility on account that such failure constitutes event of default? Would the effect of the pandemic on businesses trigger provisions relating to material adverse change/material adverse effect? Can a borrower seek refuge in the pandemic to request for moratorium on repayment obligation?

In our maiden publication on the series, we carefully examined the implications of Covid-19 pandemic on contractual obligations generally; probable defences of force majeure and frustration; and the nuances of such defence where applicable[1]. This article interrogates effects of Covid-19 containment measures on

[1] https://www.topeadebayollp.org/featured/covid-19-pandemic-a-force-majeure-to-reckon-with-in-business-today/

loan contracts, prospects of repayment challenge on account of impaired financial health and nature of accommodation to incentivise the borrower.

Loan Facility and Repayment Obligation

A facility has been defined as "*formal financial assistance program offered by a lending institution to help a company that requires operating capital.*"[2] Also, Loan Facility has been described as "*an arrangement where a person or organisation can borrow money up to a particular amount if and when they need it*[3]." In this contractual arrangement, the lender advances certain amount of money to the borrower for a definite purpose and a determinable period, under certain terms and conditions. There are many types of facilities ranging from term loan, overdraft, deferred payment plan, line of credit, revolving credit, etc.

A loan agreement is a very complex document that contains many binding terms and conditions. The terms of each loan differ, depending on the type, purpose, amount, tenor, risk exposure and security support. Albeit, a common denominator in a loan agreement is obligation to repay the principal loan amount to the lender and, oftentimes, the interest element at a contracted rate[4]. Typically, structuring of repayments schedules may depend on the type of loan and the lending institution. In most loan contracts, the schedule is characterised in "equated monthly instalment (EMI)" which is a fixed payment amount made by a borrower to a lender at a specified date each calendar month[5].

Failure to comply with binding repayment schedule may trigger activation of various powers by the lender under the contract. But what about defaults on repayment induced by circumstances that implicate force majeure or frustration in the guise of Covid-19 pandemic?

Loan Contract and Covid-19 Measures as Force Majeure Event

Force majeure, a French word for "Superior Force" is usually inserted as a clause in contracts to remove liability for natural and unavoidable catastrophes that interrupt the expected course of events and prevent parties from fulfilling their contractual obligations as expected.

[2] https://www.investopedia.com/terms/f/facility.as

[3] https://dictionary.cambridge.org/dictionary/english/loan-facility

[4] In **Udofel Ltd & Anr. Vs. Skye Bank Plc (2014) LPELR – 22742**, the Court of Appeal held that there is both legal and moral duty or obligation, express or implied, to repay loans.

[5] https://www.investopedia.com/terms/e/equated_monthly_installment.asp

Where found in a contract, force majeure allows a party to suspend or terminate the performance of its obligations when certain circumstances beyond their control arise; making performance inadvisable, commercially impracticable, illegal or impossible. The provision may state that the contract is temporarily suspended or terminated if the force majeure continues for a prescribed period of time.

The World Health Organisation on March 11, 2020 declared the Covid-19 a pandemic and global health emergency. As part of measures to flatten the curve, many countries have issued different directives touching on social distancing, suspension of all non-essential businesses and mandating residents to stay at home. In Nigeria, President Muhammadu Buhari on 30 March 2020 declared COVID-19, a dangerous infectious disease and by virtue of sections 2, 3 and 4 of the Quarantine Act made regulations ranging from movement restrictions, suspension of all non-essential services and total lock down especially in Lagos and Ogun States and Federal Capital Territory, Abuja. This was for initial 14 days but subsequently extended for another 14 days. Many State governments issued directives on similar measures. The implication of compliance with the measures is a lull on economic activities with the attendant threat to capacity of borrowers to redeem their repayment obligations under a loan contract.

The pandemic and measures at containment were not foreseen and could not have been reasonably contemplated. Nonetheless, to take refuge in the global health crisis and measures at flattening the curve in avoiding repayment obligation, the pandemic must have been expressly recognized in the contract as constituting a force majeure event. Some loan contracts contain force majeure clauses either specific or general. This may be referred to as Money Market Condition Clause in some loan agreements[6]. Where the contract prescribes force majeure events, it presents no problem as the lender may relax strict terms on repayment schedules or fixed interest rates to subsidize recuperation from the unforeseen economic conditions or extraordinary circumstances. To this end, the repayment obligation may be suspended during the period the supervening event prevents performance rather than terminating them completely (as might be the

[6] https://www.ndtv.com/business/seven-clauses-in-a-loan-agreement-that-you-should-be-watchful-of-1204190

case in a commercial contract for the supply of goods or services).

However, most loan agreements do not have force majeure clause and a borrower whose business has been adversely affected by the Covid-19 lockdown may be left to his tethers on loan obligations. The focus of this article is on loan contracts without force majeure clause. Does the borrower have any remedy in law?

IMPAIRED FINANCIAL HEALTH AND REPAYMENT CHALLENGE; ANY DEFENCE?

As stated above, Covid-19 pandemic and several measures to contain the spread threatens turnover, profitability and liquidity of individuals and corporate bodies with undischarged loan obligations. As a commercial contract where parties reserve the freedom to agree on terms, in the absence of force majeure clause in a loan agreement, a borrower cannot rely on the pandemic as force majeure event to avoid repayment obligation thereof[7]. Given that force majeure is extrinsic to the agreement, can a borrower then take solace in common law implied term of frustration to accommodate extreme unforeseen intervening occurrence such as Covid-19 pandemic in a contract?

IS COVID-19 PANDEMIC AN EVENT OF FRUSTRATION?

Frustration is a common law doctrine which occurs when, subsequent to formation of contract, and without fault of either party, the contract is incapable of being performed due to unforeseen event(s), resulting in the obligation under the contract being radically different from those contemplated by the parties. Frustration need not be provided for in the contract terms but is often implied further to occurrence of a supervening event resulting in extinction of contractual obligations and rights.

It may appear that the pandemic and measures at containment constitutes unforeseen supervening event on performance of contract. It is arguable, however, whether it is capable of rendering performance of repayment obligation in a loan contract impossible or radically different from what the parties had contemplated under the contract. Frustration as a defence becomes a broken reed when the unforeseen event only imposes difficulties, hardships, inconveniences or other extreme results in performance of a contract[8]. Subject to

[7] In **Lewis v. UBA (2016) LPELR – 40661**, the Supreme Court held that where the parties have embodied the terms of their agreement or contract in a written document, extrinsic evidence is not admissible to add to, vary, subtract from or contradict the terms of the written instrument.

[8] In **Lewis v. UBA (Supra)**, the apex court held that mere hardship, inconvenience or other unexpected turn of events which have created difficulties though not

what a prolonged lockdown portends, the pandemic does not strictly render a loan contract impossible of performance neither does it make performance thereof radically different from what the parties contemplated. The nature of loan contract does not admit of complete extinction of repayment obligations, contractually or at common law, Covid-19 pandemic notwithstanding. What the pandemic does is to render repayment difficult and/or inconvenient, which is a risk that can be underwritten in an insurance policy.

Conversely, Covid-19 as a supervening occurrence may be interpreted by a lender as material adverse change which will entitle the lender to exercise some options under the loan contract. Standard loan agreements usually include the Material Adverse Change (MAC) clause to protect a lender from a material adverse effect on a borrower's operations, businesses, assets and financial conditions or ability to perform its obligations under the loan contract. Therefore, if a lender establishes that the Covid-19 pandemic has caused such a material adverse effect, it could crystallize an event of default. MAC permits the lender to suspend further drawdown or funding of the facilities, where applicable. In addition, it triggers acceleration which would make the outstanding loan sum due and immediately payable.

It is noteworthy, however, that the MAC clause should be activated with circumspection especially in circumstances of prevailing economic reality. Abuse of the clause portends great danger to the economy and may also injure reputation of the lender in this trying time. Aware of this, the Central Bank of Nigeria (CBN) has introduced certain measures aimed at providing buffers. These include reducing interest rates on all applicable CBN interventions from 9 to 5 percent and introducing a one-year moratorium on CBN intervention facilities[9]. Certainly, these measures do not affect private bank loan facilities the terms of which have been set out in loan agreements between lender and borrower. It is only hoped that the MDBs and other lending institutions will take a cue from the measures and bear with the mood of the moment.

Financial accommodation in view of Covid-19[10]

contemplated cannot constitute frustration to release from obligation.

[9] https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19 assessed on 25 April 2020

[10] https://www.mcglinchey.com/insights/top-11-tips-for-lenders-navigating-commercial-loan-modifications-in-response-to-the-covid-19-outbreak/ assessed on 25 April 2020

As stated above and subject to the loan contract, force majeure and frustration are not likely defences for failure to honour repayment obligations under a loan contract. But as Covid-19 pandemic continues to ravage the world economy, lenders may consider some accommodation and forbearance which offers (usually on request only and subject to normal underwriting and credit review) a 60–90day deferral of payments for principal or both principal and interest. This is necessary to give parties opportunity to assess how the COVID-19 outbreak evolves and what impact the government's response to the outbreak may or may not have on the borrower's business going forward. As shall be seen shortly, many Nigerian Banks and other lending institutions have issued circulars on nature of incentives available for borrowers.

Central Banks across the world are at the vanguard of this financial accommodation. Singapore's Central Bank offered loan relief for individuals and companies. In March 2020, Malaysia's Central Bank directed that banking customers be allowed to delay repayment of their existing loans for six months. In Thailand, banks have given companies a year moratorium to repay their loans. The story is the same in Britain, Italy and Canada. In United States, Fannie Mae and Freddie Mac has instructed lenders to grant reliefs to their customers by either lowering or halting home loan repayment for up to 12 months[11].

Back home, the Central Bank of Nigeria on March 16, 2020 issued policy directives in response to Covid-19 outbreak and spillovers[12]. The directives include;

a. Extension of moratorium on all CBN intervention facilities for all principal repayments effective from March 1, 2020 for a period of one year. By this, all participating financial institutions are directed to provide new amortization schedules for all beneficiaries.

b. Reduction in interest rate on all applicable CBN intervention facilities from 9% to 5% per annum, effective from March 1, 2020.

c. Creation of a ₦50 billion credit facility through the NIRSAL Microfinance Bank for households and SMEs that have been hit hard by Covid-19 pandemic. In a bid to implement this, On March 23 2020, the CBN issued a circular to DMBs and

[11] https://www.straitstimes.com/asia/se-asia/banks-around-the-world-are-suspending-loan-repayments-as-coronavirus-hits-borrowers

[12] https://www.cbn.gov.ng/

the general public on the guidelines for implementation of the ₦50 billion Targeted Credit Facility.

d. Credit support for healthcare industry by providing loans and facilities to hospitals, healthcare practitioners and pharmaceutical industry.

e. Regulatory forbearance: CBN granted leave to all DMBs to consider temporary and time limited restructuring of the tenor and loan terms for businesses and households most affected by the outbreak of Covid-19 pandemic. The CBN would work with DMBs to ensure that the use of the forbearance is targeted, transparent and temporary whilst maintaining individual DMB's financial strength and overall financial stability of the system.

f. Strengthening of the CBN's Loan-to-Deposit Ratio by measures which would include CBN's support to DMBs in order to direct credit to individuals, households and businesses and also consider additional incentives to encourage extension of longer tenured credit facilities.

The CBN in its directive issued on March 16, 2020 further encouraged DMB's to continue to build capital buffers in order to improve resilience of the sector. The CBN also assures of its readiness to provide liquidity backstops as and when required and to continue to monitor developments and issue updates as may be appropriate.

Admittedly, the directives are quite proactive. However, its application appears to be limited to the remit of CBN intervention facilities. A borrower cannot rely on it to postpone, forbear or diminish its obligations in a loan contract. Although not under any compulsion to grant repayment holiday or restructure existing facilities, some DMBs and other lending institutions have commendably granted some concessions to borrowers. For example, on April 11, 2020 GTBank Plc announced suspension of loan repayment plan for SMEs[13]. Also, the Lagos State Employment Trust Fund (LSETF) suspended repayment of loan obtained by SMEs in the State[14].

It must be stressed that the CBN directives should be implemented in a manner that will not hurt the banks and other financial institutions. In order to avoid establishing a course of dealing, lenders should be clear in

[13] https://nairametrics.com/2020/04/11/covid-19-gtbank-suspends-loan-repayment-plan-for-smes/

[14] https://nairametrics.com/2020/04/07/lsetf-suspends-loan-repayment-for-smes-startups-amidst-lockdown/

communicating that any accommodation is a one-off event and that future accommodations may not be granted. Lenders should also consider[15]:

a. Developing standard/formal communication to borrowers which explains the context in which and the reason accommodation is being granted; and

b. Implementing policies to prevent loan officers from over-promising to borrowers via informal communications such as phone calls, social media, emails, and texts. It is natural to empathize with a borrower's challenges, but individuals dealing directly with customers should avoid over-committing to another round of accommodations if the outbreak lasts longer than anticipated.

Deferred Payments and Interest Accrual[16]

Lenders should consider how interest will be treated during any period of deferral. Will interest continue to accrue during the deferral period? If so, when will that interest be due for payment and how? How will deferred payments be repaid? At maturity? Will the maturity date itself be extended as part of the accommodation? If interest will be accruing during the deferment, representations that the number of payments being deferred will be added to the maturity date should be avoided, unless the amortization in the loan supports the ability to make such promises.

Regardless of how the lender decides to manage deferred payments and interest accrual, the lender should take the time to clearly explain the same to the borrower to avoid any confusion down the line. Additionally, once payment accommodations have been made and clearly documented, lenders should ensure that their internal accounting/payment systems are set up to properly track the terms of any modifications granted to a borrower.

Lenders also have to manage covenant and reporting requirements, going forward. For instance, if a borrower agrees to payment deferrals for its customers, what impact will those deferrals have on the borrower's borrowing base? What about inventory or accounts that become aged and are not replenished due to a longer than expected shutdown? Most borrowers will have a difficult time complying with their financial covenants

[15] https://www.mcglinchey.com/insights/top-11-tips-for -lenders-navigating-commercial-loan-modifications-in-response-to-the-covid-19-outbreak/ assessed on 25 April 2020.

[16] https://www.jdsupra.com/legalnews/top-11-tips-for-lenders-navigating-99547/ assessed on 8 May 2020

as well due to the economic impacts of the pandemic. Lenders will need to re-think how to measure a borrower's financial health during this crisis. In anticipation of these issues, modifications done in the immediate term should contain standard reservation of rights clause.

CONCLUSION

In these challenging times, borrowers will need to review the terms of the loan agreement to analyze if they can claim any genuine concession from the lender and request for moratorium on payments.

On the other hand, lenders should expect borrowers to look for financial support, whether in the form of additional lending or a payment holiday on existing facilities. Lenders will no doubt face requests for additional financing and/or a relaxation of covenants, and will need to consider whether waivers of breaches or short-term forbearance of repayments may be appropriate. Early communication is recommended so that the parties can aim to mitigate the effects of the crisis on financing arrangements.

HARRISON OGALAGU
PARTNER
h.ogalagu@topeadebayollp.org
+234 (0) 8090797782

ANTHONIA UDEH
ASSOCIATE
a.udeh@topeadebayollp.org
+234 803 711 4309

OLUWASEUN OJO
NYSC ASSOCIATE
o.ojo@topeadebayollp.org
+234 (0) 8161787312