

CORONAVIRUS: KEY CONTRACTUAL CONSIDERATIONS IN SAUDI ARABIA

While the primary focus of any business will be on ensuring the health and wellbeing of its staff in light of the Coronavirus (COVID-19) pandemic, businesses are facing increasing uncertainty and challenges. In this briefing, we set out some of the legal risks and the practical considerations in relation to past and future transactions, as well as the Saudi Arabian legal perspective.

The economic and financial threat posed by Coronavirus passed largely under the radar in the first couple of months of the outbreak. That threat is now well and truly on the table. Countries across the world, including Saudi Arabia, are putting in place plans as to how they will respond in various scenarios, including implementing restrictions on travel and business operations. The latest developments in Saudi Arabia include the imposition of a nationwide curfew for certain hours during the day (depending on the city) for approximately 21 days which, however, exempts employees of certain sectors, including health, utilities, goods transportation, and media. At the time of writing, the Saudi Stock Exchange (Tadawul) has reduced its operating hours from 10am until 1pm (instead of 3pm).

Businesses operate at a micro-level and cannot expect governments to do their planning for them. Even prior to the introduction of government-imposed travel bans, curfews or other measures, many businesses had, quite properly during the early stages, laid down procedures designed to protect their staff. These included, for example, bans on business (or even personal) travel to affected areas and attendance at large events, and the introduction of self-quarantine procedures and remote working arrangements.

Measures of this sort are important, but they are probably not sufficient per se. Therefore, companies need to consider how the spread of the virus may affect the conduct of their underlying business and what they can do about it. This is not easy – there is huge uncertainty – but uncertainty does not obviate the need for business managers and owners to protect their companies as best they can.

Key considerations

- Parties should consider the effect the Coronavirus pandemic may have on past transactions by reference to existing contractual provisions, in particular (i) force majeure, (ii) change in law, (iii) material adverse change, (iv) limitation on liability, (v) termination
- In the absence of specific provisions which may relate to the Coronavirus pandemic, general legal doctrines may allow parties to terminate an existing agreement
- In transactions currently being negotiated, parties should be mindful of how the Coronavirus pandemic could potentially affect the parties' ability to perform their obligations
- Under Saudi law, absent contractual provisions that specifically address the effect of the Coronavirus pandemic, Saudi Courts will likely seek to apply the *Shari'ah* principles of *Ja'eha* and/or *Uthur* (as applicable) to excuse the parties from some or all of their obligations while observing the principles of reasonableness and fairness

PAST TRANSACTIONS

Talk to your counterparty. For transactions already agreed, the most obvious point is to discuss with your counterparty the potential impact of the virus. A discussion in advance as to what contingencies the parties might need to build in, even if the risk seems remote at the moment, is likely to be preferable to an unpleasant surprise later on. What comfort do you need, or can you get, that your counterparty will be able to perform its side of the bargain?

What does the contract say? The agreement covering the transaction is likely to be the starting point:

- **Force majeure.** Does the contract contain a force majeure clause? Whether and how a force majeure clause applies will depend upon its specific drafting. The spread of Coronavirus will be an event beyond the parties' control, but it may not have been outside the parties' contemplation if the contract was entered into in, say, February 2020. The clause may require (reasonable) steps to be taken to mitigate the consequences of the virus and, ultimately, it may allow suspension of performance or the termination of the contract. Force majeure clauses invariably require a link between the event and the inability to perform the contract – Coronavirus cannot be used as an excuse to walk away from an onerous contract. If a party does decide to rely on a force majeure clause, it would be wise to ensure that it retains the evidence upon which it acted (e.g. copies of governmental announcements).
- **Change in law.** Some contracts may also protect parties against changes in law and allow claims for additional time and unforeseen costs in such circumstances. Coronavirus controls imposed by the applicable legal instruments may fall within this type of clause.
- **Material adverse change.** Financial contracts and transaction agreements in Saudi Arabia often contain material adverse change (MAC) clauses that allow a party to call an event of default, terminate and/or refuse to perform if the other party or target company is subject to a material adverse change. In transaction agreements, a MAC clause is typically tied to a closing condition and/or a representation/warranty by the seller in relation to the target company to allocate risk between signing and closing. Until recently, transaction agreements did not typically constitute pandemics/epidemics as material adverse changes. As such, whether and how this applies will depend upon the specific drafting of the clause. That said, MAC clauses usually pose the following question: whether an event has had, or will have, a material adverse effect on either the ability of a party to perform its obligations under the contract or the condition of the target company/asset (in the case of an acquisition).
- **Notices.** Whether a contract contains force majeure, change in law, MAC or other relevant provisions, it may require that notice be given to the other party, perhaps within a certain timeframe of the occurrence of the relevant event. Notice provisions must be complied with strictly, especially in this climate.
- **Limitations on liability.** Even if the contract has nothing direct to say about Coronavirus, the contract may contain limitations on, or exclusions of, liability. Clauses of this sort might cap, or even exclude, a party's ability

to recover losses caused by Coronavirus complications from a counterparty.

- **Termination.** Does non-performance give the other party a right to terminate the contract, whether for breach or otherwise? For example, is “time of the essence”, such that any delay entitles the other party to terminate the contract immediately? If not, what kind of delay would be serious enough to have that effect? What should be done to avoid inadvertently waiving any right of termination?

Application of legal doctrines. If the contract does not deal with a matter specifically (and, perhaps, in any event), the application of general legal doctrines may come into play.

Under Saudi law, certain laws, regulations and court precedents deal with circumstances involving emergency events or force majeure events, however not in any level of detail. In the absence of any such specific statutory guidance, Saudi courts will likely be guided by *Shari’ah* principles.

The overarching *Shari’ah* principle governing contracts is that parties to a contract are legally bound by their terms unless otherwise excused by the other party(ies) or by a legitimate *Shari’ah* excuse which can include, among others:

- (i) *Ja’eha* (جائحة) or *Jawa’eh* (جوائح) which are general, external and unavoidable damage-causing circumstances over which contracting parties have no control. The benefit of this excuse falls away where the relevant party has negligently failed to perform its obligations under the contract (prior to the occurrence of the *Ja’eha*) or the contracting parties are not affected by the *Ja’eha*; and
- (ii) *Uthur* (عذر) which is the inability to perform the contract without incurring damages that are not otherwise contemplated under the contract.

While some *Shari’ah* scholars – particularly the *Hanafis* – take the view that the existence of an *Uthur* is sufficient to allow the damaged party to terminate the contract, particularly where the benefit of termination is deemed to outweigh the benefit of continuing the contract, the existence of a *Ja’eha* does not automatically give rise to a right to terminate. A case-by-case analysis should be undertaken to (a) examine the impact of the *Ja’eha* on the performance of the relevant contract, and (b) propose equitable solutions that would not prejudice one party over the other. As such, long-term contracts are likely to be ineligible for termination as a result of a *Ja’eha*, yet may benefit from a temporary suspension or recalculation of the underlying consideration (where, for example, performance remains feasible). In any event, the termination or recalculation of consideration will be subject to the views of the court.

As previously noted, to the extent the relevant contract contains provisions that address the pandemic (whether pursuant to a force majeure, change in law, material adverse change, limitation on liability, termination clause or otherwise), the same should be honoured so long as the relevant provision does not contravene with *Shari’ah* principles or principles of fairness.

Precedents in this respect are limited, however during the Gulf War of 1991, Saudi courts considered the war a state of emergency and examined contractual obligations accordingly. From among the judgments issued at the

time, Saudi courts dismissed late payment penalties and refused to enforce Government compensation clauses as a result of the war.

FUTURE TRANSACTIONS

In relation to transactions being currently negotiated, consider how Coronavirus might affect your company's ability to perform its obligations. For example, are you dependent on suppliers who might themselves be affected, or is the risk confined to the availability of staff? Is the risk one of timing (you will be able to perform, perhaps later than intended but not affecting the viability of the transaction as a whole), or is the risk more fundamental than that?

Once the risks have been identified, the next step is to consider what protections are required in the contract governing the transaction. For example, if the potential is for delay, at what point should delay have financial consequences and when should a party have the right to pull out altogether? We are currently seeing and expect to see more contracts in the future set out clear language agreeing the consequences resulting from a global pandemic.

Particularly from a Saudi law perspective, the terms of negotiated agreements should be very clear on the effect of pandemics with explicit reference to Coronavirus so as to avoid creating any ambiguity or gaps for interpretation.

If you are thinking about this, your counterparties will (or should be) doing so too. How will they be affected, and what protections will they want?

CONCLUSION

The impact of Coronavirus is not easy to predict. However, business managers and owners should continue to monitor the potential impact it may have on transactions and plan accordingly. The worst may not happen, but those who come out best after a catastrophe are inevitably those who have thought about it most in advance.

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