

Eskom's COVID-19 *Force Majeure*

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Force majeure (*French*) or **vis major** (*Latin*) – meaning "superior force", also known as **cas fortuit** (*French*) or **casus fortuitus** (*Latin*) "chance occurrence, unavoidable accident" (*Force Majeure*, 2020).

In April 2020, three weeks into South Africa's strict COVID-19 lockdown emergency, the country's State-owned electricity utility, Eskom, sent legal notice which asserted "*force majeure*" on the already vexatious 25m tonnes per year coal contract with Exxaro Resources Limited. The implications for Exxaro's Grootegeluk mine in Limpopo, which supplied Eskom's Medupi (4 800MW) power station, were disastrous. In Exxaro's opinion, Eskom's move was not just illegal, but unethical, and "not in accordance with the spirit of the call by President Ramaphosa requesting businesses to continue paying contractors" (McKay, 2020).

Eskom – South Africa's pariah

Following SA's 1994 democratic election, Eskom, with generating capacity of 33 000MW, embarked on a massive electrification scheme in townships and rural areas, connecting more than 300 000 households each year and forcing down the price of electricity. In its 1995 annual report John Maree, chairperson of the board, noted that Eskom was "admired internationally" and a "pillar" of economic growth (Eskom Communications, 1995). In 2001 at the Global Energy awards ceremony in New York, Eskom was named the "Financial Times Power Company of the Year". It was described as "providing the world's lowest-cost electricity", using "superior technology", "increasing transmission reliably" and utilising "efficient and safe methods for combustion of low-grade coal" (Toit, 2019).

In the 25 years that followed, bad management and corruption had reduced the company to pariah status. Eskom, with capacity of over 45 000MW, could only generate 27 000MW and had, once again, reverted to "rolling blackouts". In 2019 Pravin Gordhan, Minister of Public Enterprises observed that Eskom was suffering from "systemic corruption, malfeasance, fraud and state capture" that had "compromised the credibility of the organisation and eroded investor confidence". Figure 1 summarises the most recent decade of mismanagement.

On 26th March 2020 President Ramaposa declared COVID-19 a national disaster and implemented stringent "lockdown" rules across South Africa. A month later Eskom reported that it was expecting to "bleed up to R2.5bn a month in revenue because of reduced electricity demand" (Khumalo, 2020). Shortly after this, Eskom sent precautionary *force majeure* notices to its coal suppliers (Cronje, 2020).

COVID-19

The COVID-19 strain of coronavirus, an infectious respiratory disease, was first identified in December 2019 in Wuhan, the capital city of China's Hubei province. By the end of April 2020, the virus had infected around 4m people worldwide, causing more than 200 000 deaths, and had been declared a global pandemic in March 2020 by the World Health Organisation (Coronavirus disease 2019, 2020).

The still unfolding economic impact of COVID-19 on the world's economy had been catastrophic as revealed by the following economic indicators. In the fastest selloff ever, the value of global equities had dropped by more than 30% towards the end of March as investors moved to less risky assets (Li, 2020). Investor portfolio flows from emerging markets amounted to \$100bn for the COVID-19 crisis, versus the \$25bn lost in the 2008 global financial crisis (Vogel, 2020). Government spending after COVID-19 as a percent of GDP (to date) was at 35%, the largest and fastest in peacetime for more than a century (Wigglesworth, 2020).

Force Majeure

Force majeure constitutes a usual and acceptable clause in most commercial contracts, protecting all parties from the consequences of unforeseen catastrophic events, including wars and natural disasters (Hargrave, 2020). Under French law (generally accepted as the origin of the concept) three criteria are necessary to claim *force majeure* – the event must be unforeseeable, external and irresistible^d.

Unforeseeable - *An unforeseeable event or situation is one that cannot be known about or guessed before it happens.* (Cambridge Dictionary, 2020)

Several questions arise from this definition. Are 100-year floods unforeseeable? Can glacier-melt and rising sea levels be known about? Could COVID-19 have been guessed?

Julian Cribb, in his 2017 book "Surviving the 21st Century", highlighted the ten greatest challenges facing the survival of humanity (Cribb, 2017). The list, in no particular order, includes the likelihood of "pandemics of new and untreatable diseases" (figure 2).

Bill Gates, quoting the example of Ebola in his 2015 TED talk (Gates, 2015), raised awareness to the fact that the world is not ready for the next epidemic.

Nassim Taleb, in his 2007 book "The Black Swan" (Taleb, 2008) states (p317):

*As we travel more on this planet, epidemics will be more acute
-- we will have a germ population dominated by a few*

numbers, and the successful killer will spread vastly more effectively.

[...]

I see risks of a very strange acute virus spreading throughout the planet.

Because of the vagueness of the definition of “unforeseeable”, many jurisdictions, including South Africa, required the *force majeure* clause to be detailed and to specifically list the events agreed by parties (such as a pandemic) (Kahle & Wilson, 2020).

External - of, on, for, or coming from the outside. (Cambridge Dictionary, 2020)

It was difficult to argue that COVID-19 was not external. Neither party had any incentive to manufacture a coronavirus!

Irresistible - impossible to refuse, oppose, or avoid because it is too pleasant, attractive, or strong. (Cambridge Dictionary, 2020)

In the case of COVID-19, it was necessary to show that the virus was impossible to arrest or avoid because it was too strong. But, what did that mean in practice?

It was certainly possible, even likely, that employees of Eskom would be affected by the virus, and some might even die. Did this mean that it was impossible for Eskom to continue operations at Medupi Power Station? The more likely scenario, because of the virus, was that Eskom was unable to sell power and therefore did not require coal. “Impossible” was a strong word.

Risk prevention

There were many levels at which the risks related to COVID-19 could have been prevented. At a global level the World Health Organisation has operational strategies to prevent and control epidemic-prone diseases (World Health Organisation, n.d.) and in addition, most countries have government departments doing the same. Furthermore, financial markets play a key role in risk prevention.

For example, airlines typically hedge fuel costs^a, either by locking into future price contracts (“forwards”) or by using (more expensive) options to limit their upside costs. The recent collapse of the oil price had impacted airlines differently, depending on their method and extent of hedging (Asquith,

^a Fuel costs represent about 25% of costs for airlines.

2020). Whilst airlines cannot fly, there is of course a natural fuel hedge – they are not buying fuel...

In the same way, Eskom (or Exxaro) could have hedged the coal-price risk in financial markets. However, Eskom's *force majeure* claim was an attempt to employ a natural coal-demand hedge. Eskom had reduced capacity at Medupi because it was unable to sell electricity, but for Exxaro, this had reduced revenues accordingly, but not costs, since these were largely fixed. A "take or pay" provision in the contract would have mitigated this risk for Exxaro, and forced Eskom to either take an agreed minimum supply of coal, or pay not to.

The issue

It was clear that *force majeure* favoured Eskom at Exxaro's expense. Exxaro's Grootegeluk mine had lost its source of revenue, but still needed to incur maintenance costs to protect the mine and pay wages or retrench staff. However, several questions were evident: Is Eskom using *force majeure* to mask their own mismanagement, re-focus on pressing maintenance issues, or cut costs? Since Eskom is still producing power, was the *force majeure* even valid? Should Exxaro extend the *force majeure* to their own suppliers? If taken to conclusion, how would such actions impact the entire economy?

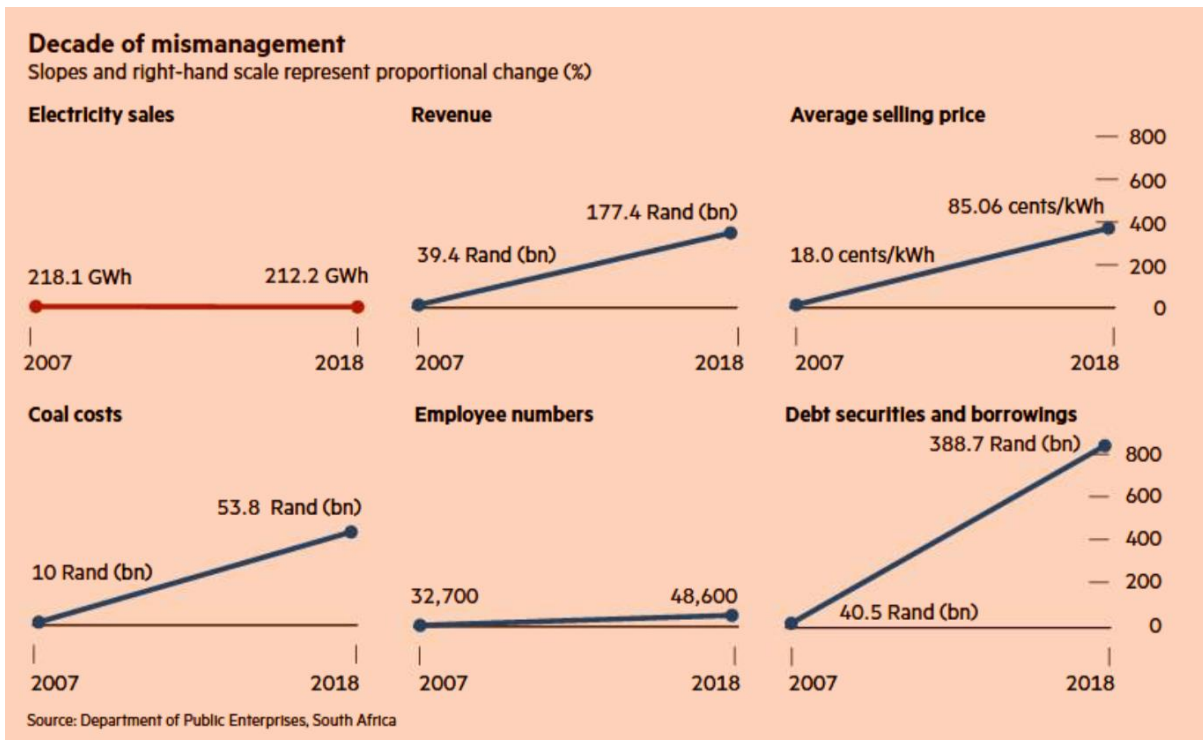


Figure 1: Eskom's decade of mismanagement - Financial Times 20th Feb 2019

- Decline of key natural resources and an emerging global resource crisis, especially in water
- Collapse of ecosystems that support life, and the mass extinction of species
- Human population growth and demand, beyond the Earth's carrying capacity
- Global warming, sea level rise and changes in the Earth's climate affecting all human activity
- Universal pollution of the Earth system and all life by chemicals
- Rising food insecurity and failing nutritional quality
- Nuclear arms and other weapons of mass
- Pandemics of new and untreatable disease
- Advent of powerful, uncontrolled new technologies
- National and global failure to understand and act preventively on these risks.

Figure 2: List of ten catastrophic risks (unranked), *Surviving and Thriving in the Twenty-first Century*, Cribb J. 2017, Springer.

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