Dear All,

The outbreak of the pandemic, COVID-19 has brought to the forefront the importance and enforceability of "force majeure" clauses in contracts. In this regard, please find below the provisions pertaining to force majeure prevalent in India, the manner in which the same have been interpreted by the Supreme Court of India and whether the force majeure clause can be invoked in light of COVID-19.

It is pertinent to note that many contracts provide a mandatory notice period for invocation of the force majeure clause. If the notice is not served as per the said clause, you will be estopped from raising force majeure as a defence against a claim arising out of your failure to perform your contractual obligations.

We request you to review your contractual obligations and the impact the pandemic has been having on the same before deciding to issue the required notices.

Parinam is set up to work remotely and provide the necessary assistance / advice should you have any queries.

PARINAM
LAW ASSOCIATES

## COVID-19 - Force Majeure and Doctrine of Frustration

COVID-19 was declared as a "pandemic" by the World Health Organization on 11th March 2020. The world at large is amply aware about COVID-19 and its reeling effects on all global economies, politics, policies and businesses. In terms of the legal scenario, COVID-19 brought to the forefront the importance and enforceability of the "force majeure" clause in contracts. Through this article, we attempt to provide the reader with a brief overview of the provisions pertaining to force majeure prevalent in India, the manner in which the same have been interpreted by the Supreme Court of India and whether the force majeure clause could be invoked in light of COVID-19.

### Legal Provisions

Force Majeure translates into act of God. Essentially, for an event to be considered as Force Majeure, the same should be beyond the reasonable control of the parties to a contract, it should affect the ability to perform the contract and the parties ought to take reasonable steps to mitigate their losses.

The Indian Contract Act, 1872 ("**Act**") provides for and formalizes the law pertaining to force majeure and the Doctrine of Frustration, primarily in Section 32 (Enforcement of contracts contingent on an event happening) and Section 56 (Agreement to do impossible act).

For the sake of convenience, Sections 32 and 56 of the Indian Contract Act, 1872 are reproduced hereinbelow:

*32. Enforcement of contracts contingent on an event happening*

*Contingent contracts to do or not to do anything if an uncertain future event happens, cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.*

*56. Agreement to do impossible act.*
*Contract to do an act afterwards becoming impossible or unlawful.—A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.*
*Compensation for loss through non-performance of act known to be impossible or unlawful.—Where one person has promised to do something which he knew, or, with reasonable diligence, might have known, and which the promisee did not know, to be impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the non performance of the promise.*

The distinction between Section 32 and Section 56 of the said Act is to be borne in mind. This has been succinctly explained by the Supreme Court of India in the case of Ganga Saran v. Firm Ram Charan, AIR 1952 SC 9. The Court observed that "*Section 56 lays down a rule of positive law and does not leave the matter to be determined according to the intention of the parties. In cases, where the Court gathers as a matter of construction that the contract itself contained impliedly or expressly a term, according to which it would stand discharged on the happening of certain circumstances, the dissolution of the contract would take place under the "terms of the contract itself and such cases would be outside the purview of Section 56 altogether. They would be dealt with under Section 32*".

The Courts have observed that in a contingent contract, if the impossibility of the uncertain future event was within the contemplation of the parties at the time of entering into the contract, Section 32 of the Contract Act becomes applicable. However, when the impossibility is a supervening event that was never within the contemplation of the parties, Section 56 becomes applicable.

Simply put, where there is an express or implied clause in a contract which deals with contingencies, Chapter III dealing with the contingent contracts will apply, and more particularly, Section 32 thereof. However, in so far as a force majeure event occurs de hors the contract, it is dealt with by a rule of positive law under Section 56 of the Contract.

In cases where the Courts find that the contract itself either impliedly or expressly contains a term, according to which performance would stand discharged under certain circumstances, the dissolution of the contract would take place under the terms of the contract itself and such cases would be dealt with under Section 32 of the Act. If, however, frustration is to take place de hors the contract, it will be governed by Section 56. Further, impossibility if attributed to an act of a party cannot be grounds for invoking Section 56.

In both scenarios, the party aggrieved by the force majeure event/ impossibility of performance is expected to promptly notify the opposite party of the inability to perform along with cogent reasons for the same If the contract provides for a force majeure clause, the procedure for invoking the force majeure clause as stated in the contract must be followed.

A few landmark decisions of the Supreme Court of India and the guiding principles relating to force majeure situations have been mentioned below.

**Landmark decisions of the Supreme Court of India**

For the sake of brevity, we have stated only the necessary and crucial observations of the Supreme Court of India in the following matters:

i. **Satyabrata Ghose v. Mugneeram Bangur & Co. (AIR 1954 SC 44) -** The Supreme Court stated that "The Courts have no general power to absolve a party from the performance of its part of the contract merely because its performance has become onerous on account of an unforeseen turn of events." *The Court also placed reliance on this observation in the matter of Naihati Jute Mills Ltd. v. Hyaliram Jagannath* **(AIR 1968 SC 522)**-.

The Court further held that the effect of what has actually happened on the possibility of performing the contract is a vital consideration. Further, "*if there was a definite time limit agreed to by the parties within which the construction work was to be finished, it could be said with perfect propriety that delay for an indefinite period would make the performance of the contract impossible within the specified time and this would seriously affect the object and purpose of the venture. But when there is no time limit whatsoever in the contract, nor even an understanding between the parties on that point and when during the war the parties could naturally anticipate restrictions of various kinds which would make the carrying on of these operations more tardy and difficult than in times of peace, we do not think that the order of requisition affected the fundamental basis upon which the agreement rested or struck at the roots of the adventure*".

In this case another interesting observation was made with reference to the meaning of the term 'impossible' used in section 56 of the said Act. The Court observed that "*This much is clear that the word "impossible" has not been used here in the sense of physical or literal impossibility. The performance of an act may not be literally impossible but it may be impracticable and useless from the point of view of the object and purpose which the parties had in view and if an untoward event or change of circumstances totally upset the very foundation upon which the parties rested their bargain, it can very well be said that the promisor found it impossible to do the act which he promised to do*".

ii. **M/s Alopi Parshad & Sons Ltd. v. Union of India (AIR 1960 SC 588)-** The Supreme Court stated that "Parties to an executable contract are often faced, in the course of carrying it out, with a turn of events which they did not at all anticipate, for example, a wholly abnormal rise or fall in prices which is an unexpected obstacle to execution. This does not in itself get rid of the bargain they have made." Unless there is a fundamental change in the events and not merely circumstantial changes, there can be no frustration of contract. From a practical stand point, the Court further observed that "*It is only when a consideration of the terms of the contract, in the light of the circumstances existing when it was made, showed that they never agreed to be bound in a fundamentally different situation which had unexpectedly emerged, that the contract ceases to bind*".

iii. **M/s. Dhanrajamal Gobindram vs M/s. Shamji Kalidas And Co. (AIR 1961 SC 1285) -** This case bears significance as an argument pertaining to the force majeure clause being vague was put forth. The argument was that there was no consensus ad idem, and that the parties had not specified which force majeure clause they had in mind and in view thereof the contract was incapable of being performed. The Supreme Court observed that where a reference to "force majeure" is made, the intention is to save the performing party from the consequences of anything over which he has no control. This is the widest meaning that can be given to "force majeure" and the Court went on to hold that the agreement was not vague. It was further

observed that commercial agreements are to be construed widely and the efforts of the Courts should be to give effect to them, if possible.

iv. **Energy Watchdog vs Central Electricity Regulatory - *(2017 14 SCC 80)* -** This coupled with Satyabrata Ghose (supra) are considered to be landmark judgments in the sphere of interpretation of the force majeure clauses in India. In the Energy Watchdog case the Court held that "*We are, therefore, of the view that neither was the fundamental basis of the contract dislodged nor was any frustrating event, except for a rise in the price of coal, excluded by clause 12.4, pointed out. Alternative modes of performance were available, albeit at a higher price. This does not lead to the contract, as a whole, being frustrated*".

The Courts have been cautious whilst invoking the doctrine of frustration and have relied on the test of "radically different" it has been observed that the mere incidence of expense or delay or onerousness is not sufficient; and that there has to be as it were a break in identity between the contract as provided for and contemplated and its performance in the new circumstances.

The Court in this case eventually proceeded to hold, "*We are, therefore, of the view that neither was the fundamental basis of the contract dislodged nor was any frustrating event, except for a rise in the price of coal, excluded by clause 12.4, pointed out. Alternative modes of performance were available, albeit at a higher price. This does not lead to the contract, as a whole, being frustrated*."

This, in our view, would have a material bearing whilst analysing the contractual obligations in light of COVID-19. The Courts will analyse the facts of each case and contractual provisions vis-à-vis impossibility and impracticability in performance of the contracts. Strictly interpreted, financially unfeasibility doesn't imply that the contract ought to be frustrated. However, whether performance would lead to a fundamental disequilibrium keeping in mind the changing market conditions and economic downturn is a parameter that the Courts would keep in mind.

**Government Notification for categorizing Force Majeure Events**

It is pertinent to note that the Department of Expenditure, Procurement Policy Division, Ministry of Finance has issued an office memorandum dated 19th February 2020 ("**Office Memorandum**") wherein a clarification has been provided with regards the disruption of supply chains due to spread of Corona Virus in China being construed as force majeure event as defined in paragraph 9.7.7. of the "Manual of Procurement of Good, 2017". The same has been issued with regard to contracts for public procurement of goods entered into by Government owned/funded organisations and does not apply to contracts entered into between private parties . The Office Memorandum clarified that the spread of Corona virus is to be considered as a natural calamity. Therefore, the force majeure clauses contained in Public Procurement Contracts can be invoked whenever considered appropriate by following the procedure as contained in paragraph 9.7.7 of the "Manual of Procurement of Goods, 2017"

**Conclusion**

i. A perusal of the above would demonstrate that the Courts have interpreted the force majeure clause strictly and have enforced it when appropriate. The Courts are mindful of the fact that there is an underlying assumption that when parties are entering into contracts wherein, an in-depth and thorough risk analysis is undertaken prior to execution of the same. Further, it is also assumed that the contract captures all the contingencies which had occurred to the parties whilst negotiating the terms of the same. Given the facts of each case, the Courts have attempted to

strike a balance between equity and commercial propriety to ensure that even widely worded clauses are not open to misuse by parties.

ii. Although, prima facie it could be argued that COVID 19 comfortably satisfies the test of unforeseeability and a fundamental change affecting the foundation of the contracts, from the above it can be concluded that reliance on the force majeure clause in light of COVID-19 may not be permitted in a blanket manner for every contract. Much would depend on the nature of the contract, the obligations of the parties involved, the time period when the contract was entered into, the performance of their obligations prior to it being declared a pandemic and the steps taken to mitigate the loss. It would have to be proved that the foundation and purpose stood frustrated due the party's inability to perform and in view thereof, the parties stood discharged from performing their obligations under the contract. The Courts will also be mindful of whether or not time was of the essence in a contract keeping in view of the judgment of the Supreme Court of India in the case Satyabrata Ghose (supra).

iii. Parties must therefore proceed cautiously and give due consideration to the provisions discussed hereinabove and the law laid down by the Supreme Court of India before suspending/ terminating their contracts. Parties must also ensure that due procedure is followed in order prevent the termination/ suspension from being declared wrongful and/or invalid.

iv. Going *forward*, legal professionals and parties will certainly be more conscious of the following whilst negotiating agreements:
   a. consequences and eventualities related to force majeure events;
   b. the impact on the contract and the performance of the obligations by the parties;
   c. provisions pertaining to compensation/termination/liquidated damages;
   d. the events and circumstances included in the definition of force majeure;
   e. the provisions pertaining to force majeure made by various institutional arbitral tribunals;
   f. the manner in which the courts in different countries interpret and enforce the force majeure clause. The same would need to be examined in the context of the governing law and dispute resolution mechanism being agreed upon by the parties; and
   g. owing to the travel restrictions imposed, the concept of paperless execution of contracts and enforceability of the same will also assume significance.

v. It is evident that in today's day and age where businesses are global and vulnerable to prevailing instabilities around the world, *COVID*-19 has certainly brought to the forefront the importance of a well-drafted force majeure clause which, prior to the outbreak of this pandemic was fairly boiler plate.

**DISCLAIMER**

*This alert has been written for general information of our clients and should not be treated as a substitute for legal advice. We recommend that you seek proper legal advice prior to taking any action pursuant to this alert. We disclaim all liability for any errors or omissions. For further clarifications you may write to Pooja Tidke (pooja.tidke@parinamlaw.com), Krushi N. Barfiwala (krushi.barfiwala@parinamlaw.com), Rima Desai (rima.desai@parinamlaw.com) and Ryan Sherif (ryan.sherif@parinamlaw.com).*

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