

FAQs - COVID-19 vis-a-vis PERFORMANCE OF CONTRACTS

1. What is meant by the term '*force majeure*'?

Force Majeure is defined to mean “superior force” or “an event or effect that can be neither anticipated nor controlled”. *Force Majeure* events may include events such as floods, war, terrorism, earthquakes, other natural calamities or other events that may neither be anticipated nor controlled.

2. Can COVID-19 pandemic be classified as a '*force majeure*'?

What event amount to force majeure or not is determined by the contents of the force majeure clause. Generally, most force majeure clauses classify natural calamities and government actions as force majeure events. COVID-10 pandemic (being a natural calamity) and consequent actions such as unprecedented lockdown of 21 days announced by the Indian government (being government action) are the events that were unforeseeable and couldn't have been anticipated, hence, COVID-19 pandemic may qualify as a *force majeure* event.

Further, the Ministry of Finance has, vide Office Memorandum dated February 19, 2020, has classified COVID-19 pandemic as a natural calamity and thus a *force majeure* event and consequently, suspended the contractual performance till the time *force majeure* sustains. It may be noted that the aforementioned Office Memorandum is aimed towards specified parties having contracted with the government and is not legally binding document on public at large, however, an inference can always be taken.

3. What is the impact of *force majeure* events on business?

Force Majeure event such as COVID-19 pandemic and consequent actions such as lockdown has gravely affected the conduct of business operations and has brought the same to a standstill. The parties are finding themselves unable to performance their business obligations. Such inability to perform business obligations, without any fault of one's own, has resulted in breach of their contractual terms and has rendered them vulnerable.

4. Do contracts between parties provide for *force majeure* events?

Typically, a contract does provide for *force majeure* clause, however, the same is not mandatory and depends on the nature of contract and mutual understanding between the contracting parties. A *force majeure* clause determines the rights and obligations of the contracting parties upon happening of a *force majeure* event, and may detail the impact on the contract itself.

5. Does force majeure clause expressly enlist the events that may qualify to be *force majeure* events?

The *force majeure* clause in a contract may either form an exhaustive list of events that shall be classified as *force majeure* event, or may specify a wider scope which shall involve various types of unforeseeable events. Therefore, it is essential to assess the phrasing of *force majeure* clause in a contract.

6. What does a *force majeure* clause in contract typically provide for?

The *force majeure* clause sets forth rights and obligations of the contracting parties upon

occurrence of a *force majeure* event and the impact on the contract itself. A *force majeure* clause may provide either for the suspension of performance obligations till *force majeure* event subsists or for termination of contract (if time is of the essence) or an option to the parties to renegotiate the terms of the contract.

7. What if a contract does not envisage *force majeure* clause?

In the event where a contract does not explicitly contain *force majeure* clause, the impossibility to perform a contractual obligation shall be governed by section 56 of Indian Contract Act, 1872 ("ICA"), whereby, a contract after its execution becomes void when the contractual obligation becomes impossible or unlawful to perform, that is to say, upon supervening impossibility or illegality of a contractual obligation. Such supervening impossibility or illegality shall mean to have *frustrated* the contract.

It may be noted that section 56 of ICA, upon impossibility or illegality of performance, renders the contract 'void', that is to say, the contract can only be terminated with contracting parties reserving no powers to suspend the performance. Please note that a temporary impossibility of performance in a long term contract may not entitle a party to invoke section 56 of ICA.

8. What are the grounds for invoking *force majeure*?

A contracting party may invoke *force majeure* clause or doctrine of frustration under section 56 of ICA after proving to the other contracting party the following grounds:

- a) That the performance of contractual obligation has actually become impossible/unlawful to be performed, and the external unforeseeable events (such as COVID-19 and resulting lockdown) have

directly affected the performance of contractual obligation; and

- b) That all reasonable and possible measures have been taken to perform the contractual obligation, including through any viable alternate mechanism, but failed.

9. What if, owing to an event, the performance of contractual obligation has become difficult or not viable? Can the same be considered as the *force majeure*?

The performance of any contractual obligation that has become difficult or less profitable or onerous, but not impossible or unlawful, shall not absolve the contracting party from its liabilities. Accordingly, the *force majeure* clause in the contract or doctrine of frustration under section 56 of ICA can't be invoked.

10. How can *force majeure* be invoked?

A contracting party invoking *force majeure* clause shall comply with process and other relevant provisions in this regard envisaged under the contract. In order to invoke section 56 of ICA it is advisable to serve a formal notice to the other party immediately upon contractual performance becoming impossible or illegal.

11. What are the reliefs available upon invocation of *force majeure* consequence?

Relief to the contracting parties shall be guided by the principles laid down in the contract. In the absence of any express provisions, the parties may on mutual understanding devise and implement a compensation mechanism, where possible, or may take other mitigating measures.

Notwithstanding, the contracting parties may, at all time, on mutual understanding and express consent amend or waive any of the obligations envisaged under an agreement.

12. What is material adverse effect or material adverse change?

Material adverse effect or material adverse change ("MAE") often incorporates events or acts that may have a materially adverse effect on the business, financials, assets or liabilities of the targeted subject. The materiality is also explicitly defined in the contract. There may be a case where MAE provides for any default or act or omission specifically done by a contracting party that may have an adverse effect, or there may be MAE clauses which cover adverse effect, whether or not on account of default or act or omission by a contracting party.

Given the nature of COVID-19 and resulting lockdown, the same may have direct and sizeable adverse impact on the businesses and its financials. The invocation of MAE clause shall trigger the specific provisions in this regard under the contract. However, the provisions providing of the MAE may be assessed for any exclusion of the force majeure event.

13. What is effect of force majeure on leases and lease agreements?

Leases are specifically governed by the provisions of the Transfer of Property Act, 1882 read with the ICA and not vice-versa. Any relief with respect to the payment obligation shall be available, vis-à-vis, *force majeure*/ frustration, when provisions in this regard are expressly provided for in the lease agreements. The doctrine of frustration under section 156 of ICA is not available for invocation under lease agreements. The Hon'ble Supreme Court in ***T.T. Lakshmi Prasad v P Nithyanandy Reddy, (2003) 5 SCC 150 at page 160***, observed that "Doctrine of Frustration belongs to the realm of law of contracts, it does not apply to the transaction where not only a privity of contract but also privity of contract has been created, in as

much as the transfer of the interest in the immovable property as well the transfer of the right to enjoy such immovable property.

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(Refer to our Article on COVID-19 vis-à-vis Impact on Performance of Contracts (Force Majeure) at www.acumenjuris.com)

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