

COVID-19 vis-a-vis IMPACT ON PERFORMANCE OF CONTRACTS

I. COVID-19 AND ITS IMPACT

The unforeseen pandemic COVID-19¹ has brought an extensive disruptive effect on the businesses, the world over. The rapid momentum of proliferation of COVID-19 and its lethal consequences has forced the nations globally to take unprecedented steps towards containing the outbreak and to recover from the pandemic, including the complete cessation of not only the international air traffic but also the domestic traffic within.

In India, the government, on March 24, 2020, while taking preventive and mitigating measures towards containing COVID-19 pandemic, announced² a nationwide lockdown for a period of 21 days with effect from March 25, 2020. The lockdown, barring a few exceptions for essential supplies, has brought about a sudden halt in trade and commerce across the country. Similarly, many other countries have taken steps analogous to that of India, thereby, bringing the world economies at a standstill.

Such containment measures, though absolutely imperative, have made performance of contractual obligations by the parties to a contract either difficult or impossible. In context of the foregoing, it is expedient to evaluate the contracts for possible excuse to non-performance of contractual obligations without any liability or forcing compulsory performance.

II. FORCE MAJEURE

¹ The World Health Organization (WHO) has, on Feb 11th, 2020, officially named the novel coronavirus disease as 'COVID-19'

² Vide Order No. 40-3/2020-DM-I(A) dated March 24th, 2020 issued by Ministry of Home Affairs, Government of India

Force Majeure may be defined to mean "superior force"³ or "an event or effect that can be neither anticipated nor controlled"⁴. *Force Majeure* event may include events such as floods, war, terrorism, earthquakes, other natural calamities or other events that may neither be anticipated nor controlled.

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 language prescribed under the *force majeure* event in a contract.

An assessment shall further be made in a contract as to the consequences upon happening of a *force majeure* event such as suspension of contractual performance for a certain time span until the *force majeure* event is over or termination or renegotiation of contract.

The operation of Force Majeure clause may be explained through an illustration. Presume a party, ABC Limited, is contractually obligated to manufacture and deliver certain goods to the other party, say XYZ Limited. However, solely owing to lockdown, ABC Limited is not be able to manufacture and deliver the goods within the time prescribed, that is to say, ABC Limited is failing to perform its contractual obligations. In such case, ABC Limited may invoke the *Force Majeure* clause and, after complying with relevant procedure in this regard under the contract, if any, communicate its impossibility to perform contractual obligation. Subject to the express wording of *Force Majeure* clause, the parties may either renegotiate and suspend the performance till the time impossibility (owing to lockdown) subsists or terminate the contract (especially if time is of essence).

³ Black's Law Dictionary (9th edition)

⁴ Black's Law Dictionary (9th edition)

A word of caution here. The parties, while renegotiating the contract pursuant to invocation of *Force Majeure* clause, must contemplate expansive implication of events leading to impossibility of contractual performance (lockdown in instant case) and assess the inclusion for invocation of the *Force Majeure*, in the event of continuity of the lockdown as an unforeseeable event at the time of said renegotiation.

Government Perspective

A reference may be taken as to whether COVID-19 shall be classified as a *force majeure* event from the Office Memorandum⁵ dated February 19, 2020 issued by Ministry of Finance, wherein outbreak of COVID-19 has been classified as the natural calamity and thus a *force majeure* event and consequently, suspended the contractual performance till the time *force majeure* sustains.

Though the aforementioned Office Memorandum is aimed towards specified parties having contracted with the government and is not legally binding document on public at large, it may be advisable to acknowledge the Office Memorandum and conclude COVID-19 as a *force majeure* event.

III. FRUSTRATION OF CONTRACT (Section 56 of Indian Contract Act, 1872)

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 subsequent impossibility or illegality of a contractual obligation. Upon

such impossibility or illegality, the contract is frustrated and the doctrine of frustration comes into play, whereby, the contract automatically stands terminated and the contracting party liable to perform is absolved of its contractual obligation. Nonetheless, it is a pre-condition for frustration that the contracting parties while executing the contract could not have anticipated or foreseen the subsequent event rendering contractual performance impossible or illegal.

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 shall stand compulsorily terminated with contracting parties reserving no powers to suspend the performance or renegotiate the contractual terms. However, it shall always be within the right of the parties to novate or amend the contract, with such novation and amendment exhibited as a new arrangement.

IV. OTHER ASPECTS

1. It shall be the duty of the contracting party invoking *force majeure* clause or section 56 of ICA to prove to the other party that:
 - a) the contractual obligation has actually become impossible/unlawful to be performed, and the external unforeseeable events have directly affected the performance of contractual obligation; or
 - b) all reasonable and possible measures have been taken to perform the contractual obligation, including through any viable alternate mechanism, but failed.
2. 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.

⁵ Office Memorandum No. F.18/4/2020-PPD

3. Notice - The contracting party invoking *force majeure* clause or section 56 of ICA shall comply with provisions in this regard as envisaged under the contract. In the absence of any specific provision, it is advisable to serve a formal notice to the other party immediately upon contractual performance becoming impossible or illegal.
4. Reliefs – 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. Where the parties fail to decide or agree upon the relief mechanism, the parties may approach the appropriate courts/ arbitration tribunal having the jurisdiction for any relief.
5. Novation – Subject to the specific provisions in this regard in the contract, the contracting party may be allowed the novation of contract by way performing an act, as may be agreed upon by other contracting party, in substitution of contractual obligation that has subsequently become impossible to perform or illegal.

V. LEASE OBLIGATIONS EFFECTED

It is a public news that many companies are invoking *force majeure* clause/ doctrine of frustration under their respective lease rental agreements with the purpose to absolve themselves from the liability of paying monthly lease rentals in view of COVID-19 outbreak. Leases are specifically governed by the provisions of the Transfer of Property Act, 1882. Any relief with respect to the payment obligation shall be available, vis-à-vis, *force majeure*/ frustration, when provisions in this regard is expressly provided for in the lease agreements. Further, the nature of

arrangement shall also be assessed as to whether the agreements in this regard pertain solely to lease or a leave or license arrangement or any other form of arrangement.

VI. MATERIAL ADVERSE EFFECT vis-à-vis Contracts

It is often noticed that the transaction documents such as investment agreements or acquisition agreements or the commercial agreements, often incorporate specific clause with respect to **material adverse effect** or **material adverse change** ("MAE"). Such clauses are highly fact specific, and the wording are based on the object and negotiating power of the contracting parties. However, to generalise, MAE often incorporates events or acts that may have a materially adverse effect the business, financials, assets or liabilities of the targeted subject. The materiality is also explicitly defined in the agreement. 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 covers adverse effect, whether or not on account of default or act or omission by a contracting party.

COVID-19 and resulting lockdown are events that has brought business operations to a standstill which may have direct and sizeable adverse impact on the businesses and its financials, so much so that the entire businesses may be required to be revalued and at that, reflecting a decayed position. Accordingly, such lockdown, subject to the phrasing of the MAE clause, may tantamount to be a material adverse event and therefore, leading to invocation of MAE clause.

The invocation of MAE clause may trigger other provisions specified in the contract, including relating to notice requirement and procedure thereof, compensation mechanism, renegotiation of terms of

contract, termination of contract, dispute resolution and others. The invocation of MAE clause, and consequences thereof, shall ultimately depend on the phrasing of contractual provisions and the underlying object.

VII. TO SUMMARIZE

Based on aforementioned analysis, we understand that the provisions explicitly contained in an agreement shall, at the foremost, govern the non-performance of any contractual obligation that has become impossible or illegal.

In the event, where there are no express provisions, the provisions under section 56 of ICA may be invoked, wherein the courts may govern the consequence of any such non-performance. The contracting party failing to perform shall be obligated to prove that it is solely owing to impossibility or illegality that contracting party has failed towards performance.

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.

Authors: I Abhishek Bansal, Partner (abhishek.bansal@corpacumen.com) I Pavish Singhla, Senior Associate (pavish.singhla@corpacumen.com) I **ACUMEN JURIS** I

Practice Areas: I Corporate & Commercial I Acquisitions & Investments I Arbitration & Dispute Resolution I

Refer to FAQs COVID-19 vis-à-vis Force Majeure @ www.acumenjuris.com

Disclaimer- This Article is for information purposes only, and the views stated herein are personal to the author, and shall not be rendered as any legal advice or opinion to any person, and accordingly, no legal opinion shall be

rendered by implication.

The Article does not intend to induce any person to omit, commit or act in any particular manner, and that you should seek legal advice before you act on any information or view expressed herein. We expressly disclaim any financial or other responsibility arising due to any action taken by any person on the basis of this Article.