

# Coronavirus Disease (COVID-19) – Impact on commercial contracts and suggestions

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## Background

A respiratory disease caused by a novel (new) coronavirus that was first detected in China and which has now been detected in more than 110 countries, including in India. The virus has been named 'SARS-CoV-2' and the disease it causes has been named 'Coronavirus Disease 2019' ('COVID-19').

On 30 January 2020, the World Health Organization declared the outbreak a 'public health emergency of international concern'. On 11 March 2020, World Health Organization characterized COVID-19 as a pandemic. India's response was initiated on 8 January 2020, much before World Health Organization declared COVID-19 as a public health emergency. All Indian states were directed for health sector preparedness on 17 January 2020, on the same day, point of entry surveillance was also initiated. On the directions of Prime Minister Modi, on 3 February 2020 a high-level Group of Ministers was constituted to review, monitor and evaluate the preparedness regarding the management of Novel Coronavirus in the country. As on 13 March 2020, the Group of Ministers has met six times so far, guiding, reviewing and monitoring the situation.

### **Source and the outbreak**

Coronaviruses are a large family of viruses that are common in people and many different species of animals, including camels, cattle, cats, and bats. Rarely, animal coronaviruses can infect people and then spread between people such as with MERS-CoV, SARS-CoV, and now SARS-CoV-2. The SARS-CoV-2 is a new strain that was discovered not been previously identified in humans, it appeared in Wuhan, Hubei Province, China, at the beginning of December 2019.

So far, there have been more than 169,000 confirmed cases and 6,513 deaths. Over 77,000 people have recovered from the illness. The vast majority of the illnesses were initially in China, but the rate of new cases in China has slowed. There are now more cases outside of China than in the country. There are large outbreaks of the disease in multiple countries, including Spain, Italy, Iran, South Korea, France, Germany, Switzerland, etc. There are over 126 people with confirmed cases of COVID-19 and two deaths from the virus in India. The undiagnosed number may be much higher, on account of the limited testing availability in India.

### **Impact on trade and commerce**

Besides the effects on human life, the COVID-19 has the potential to significantly slow down not only the Chinese economy but also the global economy. The Indian Government, as well as many other countries across the globe have imposed quarantine and travel restrictions. At the local, state and district level-imposed lockdowns, restricting local movement, large gatherings, the shutdown of educational institutions, cinemas, commercial establishments, etc. The impact of all the above restrictions on business has only started to manifest but the long-term extent of the same is still uncertain. The impact of COVID-19 (and the consequent restrictions imposed

by governments) is impacting the ability of businesses in the performance of obligations agreed to in existing agreements.

In this document, we deliberate how the rules of force majeure in legal contracts and the Theory of Frustration can be exercised in the COVID-19 pandemic. We further recommend measures to be taken by the parties to safeguard their positions in the changing environment.

## Force majeure clauses in contracts

A force majeure event refers to the occurrence of an event which is outside the reasonable control of a party and which prevents that party from performing its obligations under a contract. The Indian Contract Act, 1872, ('Indian Contract Act') has no general concept of force majeure (save for the limited doctrine of contractual frustration). A party's ability to claim relief for a force majeure event, therefore, depends upon the terms of the contract, and the force majeure provision in the same. force majeure clauses are express terms and will not ordinarily be implied into contracts governed by the Indian Contract Act.

### Events capable of constituting force majeure

The test for force majeure usually requires the satisfaction of three distinct criteria:

- > The event must be beyond the reasonable control of the affected party.
- > The affected party's ability to perform its obligations under the contract must have been prevented, impeded or hindered by the event.
- > The affected party must have taken all reasonable steps to seek to avoid or mitigate the event or its consequences.

### The event

Many contractual clauses set out a specific list of force majeure events which are deemed to be events of force majeure beyond the control of the parties, such as pandemics, epidemics or diseases. A specific reference to a pandemic will make it easier to bring a force majeure claim but will still require the other tests to be satisfied. However, if the provision does not include language to that effect, then it will be necessary to consider whether COVID-19 or its impact on a business or a project, is captured by a different concept, such as an '*Act of God*', '*action by government*' or a catch-all provision. Most force majeure clauses contain all-encompassing language in respect of events which are '*outside the reasonable control of the party affected*'.

It is important to bear in mind however that the relevant force majeure event need not be COVID-19 itself. It is the consequences of COVID-19 and its impact upon the ability of the affected party to fulfil its contractual obligations that will be relevant.

The courts have generally construed 'force majeure' clauses narrowly. Accordingly, unless a particular event falls within the ambit and scope of a force majeure clause, courts may not accept such event as triggering consequences of force majeure. The primary focus, while interpreting such clauses, ought to be on whether the clause encompasses the type of event a contractual party claims is causing its non-performance.

The Government of India, vide office memorandum dated 19 February 2020, has clarified that the spread of COVID-19 falls within the definition of '*Act of God*' as a '*natural calamity*', for the purposes of considering disruption of the supply chains due to spread of COVID-19. Though

this only applies to Government Procurement of Goods, it does provide guidance towards other government contracts.

### **Performance**

The second factor would be determined by the degree of impairment in the capacity of the party involved to meet its contractual obligations owing to the case of force majeure. A force majeure provision typically relieves a party from what would otherwise be a breach of contract i.e. its failure to perform any obligation, payment of rent dues, etc. The party must establish the correlation between the event and its inability to perform.

A disruption that merely impacts the profitability of a contract may not be sufficient for a force majeure claim unless there is express contractual provision for such a situation. Nor would an economic downturn or other general adverse business conditions likely be considered sufficient, even if it could clearly be shown that a key trigger for the downturn was COVID-19.

### **Duty to mitigate**

Finally, a party seeking to rely upon a force majeure provision will usually have to show that it has taken reasonable steps to avoid or mitigate the event and its consequence and that there are no alternative means for the performance of the contract. What constitutes a reasonable mitigation measure is fact-specific and depends upon the nature and subject matter of the contract in question.

### **Notice requirements**

Typically, the affected party's right to relief for force majeure under the contract will be conditional upon the issuance of a notice by it to the other party, supported by the required evidence. The contract may additionally require the notice to state the anticipated consequences and duration of the force majeure event. Some contracts include a clause that requires notice to be provided within a specified period from when the affected party first became aware of the force majeure event, failure of which will result in a loss of entitlement to claim force majeure.

### **Consequences of force majeure claims**

The consequences for the parties where a valid force majeure event have occurred will depend on the nature of the affected party's obligations under the contract, as well as the consequences and remedies expressly contemplated by the force majeure clause(s).

Contractual remedies for force majeure typically include an extension of time to perform those obligations or suspension of contractual performance for the duration of the force majeure event. If the force majeure event extends over a longer period, some clauses may entitle the parties to terminate the contract.

## Doctrine of frustration

In the absence of an express force majeure clause within a contract, parties may be able to rely upon the doctrine of frustration, which has been envisaged under Section 56 of the Indian Contract Act. The doctrine of frustration is not available if the contract contains an express force majeure provision since the provision will be regarded as the agreed allocation of risk between the parties.

The doctrine of frustration will apply if:

- > The underlying event is not the fault of any party to the contract.
- > The event or circumstance occurs after the formation of the contract and was not foreseen by the parties.
- > It becomes impossible to fulfil the contract.

The doctrine of frustration results in the contract automatically coming to an end. The parties to the contract will no longer be bound to perform their future obligations. The threshold for proving frustration is much higher than that for most force majeure clauses since it must be shown that the obligations impacted by the event or circumstance are fundamental to the contract. The Supreme Court in the case of *Satyabrata Ghose vs. Mugneeram Bangurn & Co (1954 AIR 44, 1954 SCR 310)*, considered the principle of Impossibility and held that 'impossible' has not been used in Section 56 of the Act in the sense of physical or literal impossibility. The performance of an act may not be impossible but it may be impracticable and useless, and if an untoward event or change of circumstances upsets the very foundation upon which the parties rested their bargain, it can very well be said that the promisor finds it impossible to do the act which he promised to do. Therefore, if the object of the contract is lost, the contract is frustrated. Furthermore, if and when there is frustration the dissolution of the contract occurs automatically. It does not depend, as does rescission of a contract on the ground of repudiation or breach, or on the choice or election of either party. It depends on the effect of what has actually happened on the possibility of performing the contract. What happens generally in such cases is that one party claims that the contract has been frustrated while the other party denies it. The issue has got to be decided by the court 'ex post facto', on the actual circumstances of the case.

It should, however, be noted it is well settled that there is no frustration where the performance remains physically and legally possible though commercially unprofitable. The courts have time and again held that mere commercial impossibility will not excuse a party from performing a contract.

## Suggestions for business

To be prepared for different scenarios as the situation continues to unfold, we recommend that all businesses consider taking the following proactive steps.

1. Review your contract(s) to determine whether the contract(s) include a force majeure provision and, if so:
  - Review the definition of force majeure in the contract to determine whether there is any express inclusion of events such as COVID-19 and, if not, whether the general language is sufficient to include COVID-19 and its consequences. If in doubt, seek legal advice early in the process.
  - Consider the aspects of the contract that you may not be able to perform and satisfy yourself that the inability to perform is due to the consequences (direct or indirect) of COVID-19 and not a different reason.
  - Review what steps you are taking as a business to avoid or at least reduce as far as possible the effects of COVID-19 and your ability to continue to perform contracts.
  - Consider whether there are any notice requirements to trigger a claim of relief, including what type of supporting documents must be provided and whether there is any time limit for that notice to be issued.
  - Consider what the consequences of a successful claim for force majeure are.
  
2. If there is no force majeure clause in the contract, is there frustration of contract:
  - Consider the aspects of the contract that you may not be able to perform and satisfy yourself that the Impossibility to perform is due to the consequences (direct or indirect) of COVID-19 and not a different reason.
  - Though as per the law being there is no notice required to be given to claim frustration, However, it would be prudent to notify the opposite party about the situation and the impossibility to perform.
  - Parties may mutually agree to extend or waive performance of obligations if not the issues of frustration will be decided by the court.
  
3. **Parties receiving notices of force majeure**

A party receiving notice of force majeure should carefully examine the claim to determine:

  - If it is consistent with the scope of protection conferred by the force majeure provision.
  - If the process for giving notice has been complied with.
  - Whether the relevant supporting documentation or information has been provided.
  - A party involved in back-to-back contracts or interrelated contracts will need to take a strategic approach, considering the overall impact of the claim for force majeure on its obligations under the related contracts.
  - A party embedded within a chain of contracts is involved must also consider whether to issue notices of force majeure under the linked contracts as a preventive measure.

- Where different laws govern back-to-back contracts, the differing interpretations of force majeure under those laws requires careful consideration.
4. Parties making claims
- A party affected by the COVID-19 outbreak should take steps to record and document the steps it is taking to prevent or mitigate the impact of the COVID-19 outbreak on its ability to perform its obligations under the contract.
  - A party looking to make a force majeure / Frustration claim should consider carefully how the force majeure event is framed, and the consequences from that event.
  - A party should only make a force majeure claim with care, because a wrongful claim could have serious consequences, including amounting to a breach of contract or a repudiation of the contract. In such circumstances, the other party may be entitled to claim damages or to terminate the contract.

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