

COVID-19: Remedies to mitigate the economic crisis in the absence of Force Majeure Clause

written by Rajdev Singh | June 3, 2020



How can you mitigate crisis without invoking Force Majeure?

It is projected that the current pandemic is the biggest threat to the global economy after the 2008 financial crisis.[1] This estimate is supported by the unprecedented actions taken by the governments across the globe in response to COVID-19 including severe containment measures accompanied by supply chain disruptions and decline in global trade.[2]

More specifically, it has affected business operations both, domestic and international, due to which parties find it difficult to fulfill their contractual obligations relating to supply chain contracts, construction contracts, lease agreements, etc. In light of these circumstances, the parties need to review and understand their rights and obligations. Various degrees of containment measures adopted by various countries, including India, have affected all corporate institutions.

Issues like premature termination or non-performance will raise a host of legal issues and concerns for businesses. It is advisable for companies to re-look their contracts and contractual obligations for the discharge of commercial arrangement particularly *force majeure* which squarely forms a defence against the grunt norm of '*pacta sunt servanda*'. [3]

Force Majeure Clause

Force majeure is a doctrine to excuse performance or delays in performance. The term "Force Majeure" has been defined in Black Law Dictionary as '*an event or effect that can be neither anticipated nor controlled*'. The term includes both acts of nature (e.g. floods and hurricanes) and acts of people (e.g. riots, strikes and wars). [4] Chapter III and more particularly section, Section 32 and 56 of the Indian Contract Act, 1872 ("the contract act") lay down provisions relating to *force majeure* dealing with contingent contracts. Potential Remedies other than *Force Majeure*

While a *force majeure* clause within the contract may act as a relief to the parties in an uncertain event leading to non-performance of obligations, the absence of which requires the parties to rely on other remedies. [5] Further, it is an established principle that "parties cannot seek *force majeure* if there exists an alternative mode of performing the contract." [6]

Force Majeure clause temporarily suspends the obligations of contracting parties upon the occurrence of a *force majeure* event. In the instance that

obligations remain suspended, till such time the event of force majeure continues which can have wide spread impact on the performance of commercial contracts. Hence, it may not be beneficial for parties in cash strapped business to include *force majeure* as a clause in contracts.

(i) Doctrine of Frustration of Contracts:

The theory of frustration applies when in the absence of any default of either party, it becomes impossible for the parties to perform their obligations.

In India, the concept of the frustration of contracts is envisaged under Section 56 of the Indian Contract Act, 1872. The statutory remedy discharged the parties of their respective contractual obligations in the event of "*impossibility or illegality of the act agreed to be done.*"[7] Also, with regard to COVID-19, in the case of *Standard Retail Pvt. Ltd. and Ors. v. M/s G.S. Global Corp & Ors.*[8], it was decided that "*the containment measures are temporary in nature and therefore, the parties cannot claim frustration of contract.*"

Similar provisions on the impossibility of performance applicable to international commercial contracts regarding the sale of goods operating in signatory states can be identified under Article 79 of the United Nations Convention on Contracts for the International Sale of Goods (UN CISG), 1980[9].

Section 56, however, cannot be applied for non-performance of obligations pertaining to lease agreements or in circumstances where there is a "*completed or concluded conveyance.*"[10] The exceptions to this case are the "*covenants under a lease agreement which can be declared void when the act becomes impossible or unlawful.*"[11] In lease agreements or rental agreements, in the absence of contractual clauses of *force majeure*, parties can rely on statutory remedy under Section 108(B)(e) of the Transfer of Property Act, 1882.[12]

(ii) Government's Economic Relief Measures:

To mitigate the economic crisis, certain measures have been taken by the Government of India for the revival of the economy. With regard to financial agreements, the Reserve Bank of India, through its COVID-19 regulatory package[13], announced a three-month moratorium on instalments pertaining to all term loans deferring the payments with interest on a later date when the containment measures are lifted. Further, the Ministry of Corporate Affairs raised the limit of default under Section 4 of the Insolvency and Bankruptcy Code, 2016, from INR 1 lakh to INR 1 crore.[14]

Further, various office memorandums have been issued by the Ministry of Finance[15], Ministry of New & Renewable Energy[16] and the Ministry of Shipping [17] stating that "*COVID-19 is a natural calamity and thus, is covered in the Force Majeure clause.*" The businesses should seek legal assistance to carefully analyse ensure compliance with the various notifications, orders, regulations and advisories being issued from time to time.

General Checklist for businesses in the absence of *FM* Clause"

In general, in commercial agreements that do not have a *force majeure clause*, the enterprises may consider taking the following steps:

1. Listing the statutory remedies available (within the governing law of the contract) and examining if the contract has been frustrated.
2. The contract should be analyzed to assess the rights and obligations,

termination, governing law and dispute resolution.

3. In the case of supply contracts, parties should look for alternative modes of performance (ensuring supply of goods) even if it costs relatively high than defending a breach of contract claim before the court of law.
4. Contractual parties should consider renegotiating the terms of agreements mutually in light of the present situation.
5. The company should keep a record of correspondences and other communications to establish that all reasonable possible steps have been taken by the company to mitigate the losses.
6. Parties may invoke other contractual clauses like price adjustment clauses, limitation or exclusion clauses, MAC("Material Adverse Clause")/MAE("Material Adverse Effect") clauses, sharing risks, limitation of liabilities clause, recovery from an unforeseen disaster clause, to limit the liability for non-performance.
7. The businesses should keep a record of and check on various notifications and orders by government and administrative bodies issued to mitigate the economic crisis to be used as evidence during the litigation stage.
8. Lastly, businesses should seek legal remedy and immediately consider the inclusion of a *force majeure* within the existing agreements with careful assessment while drafting the clause as to listing the events and conditions for invoking.

Conclusion

Due to the unprecedented actions by the governments all across the globe, a variety of contracts from commercial agreements to supply agreements and from construction contracts to manufacturing, are likely to be the strict lockdown measures. Further, suppliers and professional service lenders may take this crisis as a ground to avoid immediate performance and parties may cite this pandemic as a ground to seek renegotiation of price and terms of the contract. It is essential for the business to review their rights, obligations, governing law, dispute resolution clauses within the contracts and consider invoking appropriate remedy for non-performance to avoid litigation for breach.

In the absence of a *force majeure*, the businesses must consider the checklist provided above. The threshold to establish the defence of the doctrine of frustration is very high and not a straitjacket formula. It is quite likely that normalcy in operations will not be restored in the near future, and the dispute pertaining to the plea of *force majeure* and frustration of contract are going to mount eventually, however, it would be an interesting development in the Contract law in India regarding pandemics like COVID-19.

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 - [2] UNCTAD Stat, Committee for the Coordination of Statistical Activities, *How COVID-19 is changing the world: a statistical perspective*, p. 22, 13 May 2020, available on: <https://unstats.un.org/unsd/ccsa/documents/covid19-report-ccsa.pdf>
 - [3] Latin for "agreements must be kept"
 - [4] Black's Law Dictionary Eighth Edition, First South Asian Edition 2015
 - [5] M.P. Ram Mohan et al., *The doctrine of frustration under section 56 of the Indian Contract Act*, Indian Law Review, 4:1, p. 91, (2020) DOI: 10.1080/24730580.2019.1709774
 - [6] *Energy Watchdog v. Central Electricity Regulatory Commission & Ors.*,

(2017) 14 SCC 80

- [7] *Boothalinga Agencies v. VTC Pariaswami Nadar*, AIR 1969 SC 110
- [8] *Order No. 404 of 2020 dated April 8, 2020 passed by the Bombay High Court in Commercial Arbitration Petition (Lodging)*
- [9] United Nations Convention on Contracts for the International Sale of Goods (CISG) 1489 U.N.T.S. 3 (1980)
- [10] *Raja Dhruv Dev Chand v. Raja Harmohinder Singh & Anr.*, AIR 1968 SC 1024
- [11] *Ibid.*
- [12] *Ramanand & Ors. v. Dr. Girish Soni & Anr.* Before the Delhi HC, RC.REV. 447/2017 decided on 21 May, 2020.
- [13] Reserve Bank of India, COVID-19 – Regulatory Package, RBI 2019-20/186, March 27, 2020, available on:
<https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/NOTI186B27003E9DB3D4FB49BDDF955F4289D68.PDF>
- [14] Ministry of Corporate Affairs, General Circular No. 11/2020, available on: http://www.mca.gov.in/Ministry/pdf/Circular_25032020.pdf
- [15] <https://doe.gov.in/sites/default/files/Force%20Majeure%20Clause%20-FMC.pdf>
- [16] <https://mnre.gov.in/public-information/current-notice>
- [17] order no. PD-13/33/2020-PPP/e-339106 dated 20.03.2020 and letter dated 24.03.2020

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