COVID-19 AND FORCE MAJEURE: A Contractual Perspective

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Abstract

The outbreak and spread of COVID-19 has impacted the world in all aspects and has inevitably hit the economy. How does one factor in a pandemic while drafting and negotiation contracts? What can the parties to contracts do in the event of a pandemic, to protect themselves from a legal perspective? How do you determine in COVID-19 is a force majeure event? What if your force majeure clause does not contemplate the happening of a pandemic? The Indian Contract Act, 1872, through Section 56 and Section 32 accounts for these scenarios. In this article, the author analyses Section 56 of the Indian Contract Act, 1872 in the background of the current COVID-19 outbreak. Author also refer to (i) a memorandum issued by the Ministry of Finance setting out the classification of the outbreak and spread of COVID-19 as natural calamity, thus constituting a force majeure event; and (ii) case laws which set out the current position of Section 56 of the Indian Contract Act, 1872. A part of our job as lawyer is to account for various of scenarios and ensure that we protect our clients. The outbreak and spread of COVID-19 is an example of how, while drafting force majeure clauses, we must cover all types of eventualities and situations, which may evolve and exist at that point in time.

Keywords: COVID-19, Section 56, Force majeure, Indian contract act, Impossibility

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Breaking down Section 56

Section 56 of the Indian Contract Act, 1872 ("**Act**") deals with the agreements between the parties to do an impossible act. Section 56 deals with the *doctrine of frustration* of a contract, which provides for discharge of a contract due to supervening impossibility or subsequent illegality of the act agreed to be done.

This section lays down a *rule of positive law* and does not leave the matter to be determined according to the intention of the parties. Section 56 encapsulates three different situations pertaining to impossibility of a party to do an act and how they impact the parties and the contract.

The first paragraph states that if the parties agree to do an act which is inherently impossible to do, or by its very nature is impossible to do, then such agreements are *void ab initio*.

The second paragraph of section 56 deals with the *doctrine of frustration* of the contract. The doctrine of frustration of the contract is applicable when it is found that the intrusion or occurrence of an unexpected event or change of circumstances frustrated the whole purpose or basis of a contract, which was beyond what was contemplated by the parties at the time when the agreement was executed.

The third paragraph imposes liability on the party that knew prior to entering into the contract or could have reasonably known that the promise made by him would be impossible or unlawful to perform. The third paragraph requires such party to compensate the other party for the loss suffered by the other party due to the non-performance of promise by the first party, i.e. the party that knew / would have reasonably known that his promise would be impossible or unlawful to perform. The payment of compensation can only be excused when there is a contract to the contrary which in simpler words, mean that section 56 must be read as an implied term in contracts.[1]

Does COVID-19 constitute force majeure?

World Health Organization has declared the spread of Covid-19 as a pandemic. Since force majeure ("FM") is a vital mechanism to excuse a party's non-performance or justify termination of a contract, the question that arises is, does COVID-19 constitute FM?

This question was answered on February 19, 2020, when the Ministry of Finance issued an office memorandum, addressed to secretaries of all Central Government Ministries and

[1] Pollock & Mulla, The Indian Contract Act and Specific Relief Acts, 15th Edition, 902.

Departments ("FM Memorandum"). The FM Memorandum was issued in the first place, to address the disruption in the supply chain due to the spread of COVID-19 in various sectors. Relevant portions of the FM Memorandum has been reproduced below:

"An FM clause in the contract frees both parties from contractual liability or obligation when prevented by such events from fulfilling their obligations under the contract. An FM clause does not excuse a party's non-performance entirely, but only suspends it for the duration of the FM. The firm has to give notice of FM as soon as it occurs, and it cannot be claimed ex-post facto."

"If the performance in whole or in part or any obligation under this contract is prevented or delayed by any reason of FM for a period exceeding 90 (Ninety) days, either party may at its option terminate the contract without any financial repercussion on either side."

The FM Memorandum further stated that the FM clause can be invoked wherever appropriate, subject to due procedure being followed. The FM clause does not excuse a party's non –performance entirely but only suspends it for the duration of the subsistence of the FM. During any such FM event, the entity must notify FM as soon as it occurs and the same cannot be claimed retrospectively. Finally, it was concluded that the spread of COVID-19 should be considered as a case of natural calamity and FM clause may be invoked.

Where a contract contains a FM clause, the yardstick is whether COVID-19 would fall within the scope of the clause. If the contract does not include a FM clause or if the COVID-19 outbreak falls outside the scope of that clause, the parties have to ascertain whether Section 56 is applicable to discharge them from their contractual obligations.

Till date, the landmark judgment in relation to section 56 is *Satyabrata Ghose v. Mugneeram Bangur and Comapny and Ors.*[2], has held its ground, and the ratio of the judgment has been reiterated and followed hitherto. The current position in relation to the validity of a *force majeure* clause has not quite changed, as evidenced from the stance of the judiciary.

In *Satyabrata case*[3], the defendant company started a scheme for the development of a tract of land into a housing colony. The plaintiff was granted a plot on payment of earnest money. The company undertook to construct the roads and drains necessary for making the lands suitable for building and residential purposes and as soon as they were completed, the purchaser was to be called upon to complete the conveyance by payment of the balance of the purchase money. But before anything could be done, a considerable portion of the land was

[2] *Satyabrata Ghose v. Mugneeram Bangur and Comapny and Ors., AIR 1954 SC 44.*

[3] *Ibid.*

requisitioned by the State during World War II for military purposes. The Supreme Court held that that the contract was not frustrated as the requisition orders "*were temporary and such a change of circumstance was not of such a character that it would totally upset the basis of the bargain and commercial objects which the parties had in view.*"

Further, it was held that where the Court finds 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[4] of the Act. If, however, frustration is to take place *de hors* the contract (that is the impossible events have not been mentioned in the contract), it will be governed by section 56 of the Act.

In 2017[5], the Supreme Court had to decide on the issue that whether an increase in coal prices (due to a change in Indonesian law) could be cited as an *FM* event by certain power-generating companies that were sourcing coal from Indonesia. The Supreme Court, relying on *Satyabrata case*[6], held that if the fundamental basis of the contract remains unchanged and no frustrating event occurs, except for a rise in coal prices, it could not be held that a mere increase in prices constituted an FM event. The Court further observed:

"…*force majeure is governed by the Indian Contract Act, 1872. In so far as it is relatable to an express or implied Clause in a contract, such as the PPAs before us, it is governed by Chapter III dealing with the contingent contracts, and more particularly, Section 32 thereof. 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.*"

Similarly, a contract is not frustrated merely because the circumstances in which it was made are altered. 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[7]. It has also been held that applying the doctrine of frustration must always be within narrow limits. In an instructive English judgment, namely, *Tsakiroglou & Co. Ltd. v. Noblee Thorl GmbH*[8], the House of

[4] Section 32 deals with contingent contracts and the event when such contingent event becomes impossible the contract is void.

[5] *Energy Watchdog and Ors. v. Central Electricity Regulatory Commission and Ors.*, (2017) 14 SCC 80. Also see *Uttar Pradesh Power Corporation Limited v. Lanco Anpara Power Limited & Others*, decided on on 7 September, 2018 (Appellate Tribunal For Electricity)

[6] *Supra note* 4, AIR 1954 SC 44. Also, see *Andhra Pradesh Power Coordination Committee & Others v. NSL Sugars Ltd & Anr.* decided on 30 January, 2020 (Appellate Tribunal For Electricity); and *Adani Power Maharashtra Ltd. v. Maharashtra Electricity Regulatory Commission & Others*, decided on 31 May, 2019 (Appellate Tribunal For Electricity)

[7] *Naihati Jute Mills Ltd. v. Khyaliram Jagannath*, (1968) 1 SCR 821

[8] (1961) 2 WLR 633

Lords held that even though the contract had become more onerous to perform, it was not fundamentally altered. Where performance is otherwise possible, it is clear that a mere rise in freight price would not allow one of the parties to say that the contract was discharged by impossibility of performance.

Conclusion

In light of the current scenario, it is evident that COVID-19 was never going to be contained. While the lockdowns have slowed down the outbreak, the COVID-19 disruption is slated to continue, and have a continued effect of the world economy. Most contracts will be inevitably impacted by closures / delays / lockdowns, and it is important that companies follow due process while invoking a FM / Section 56 clause. Going forward, it is important that while drafting FM clauses, we cover all types of eventualities and situations.

In the context of the Act, in the event when a change in circumstance has occurred and the change is of such a nature that strikes at the fundamental / root of the contract or makes the obligations of parties impossible to be performed, and such an event was not provided for within the contract then the contract would be held void under Section 56.