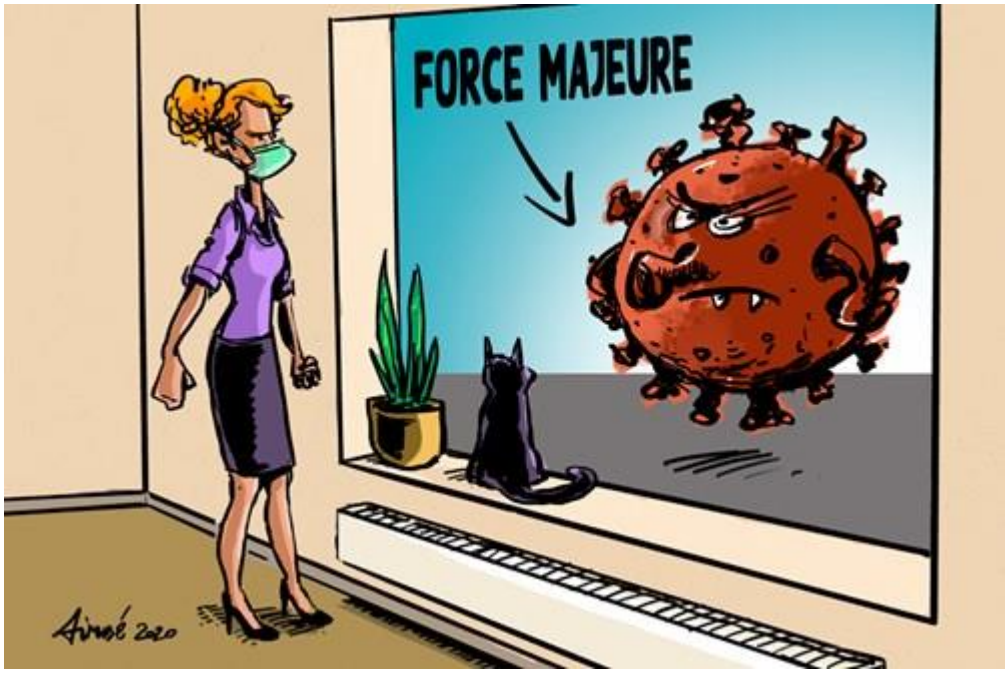
JMVD LEGAL UPDATES

ON *"COVID 19 PANDEMIC– WHETHER ERECTING A BULWARK KNOWN AS FORCE MAJEURE"*

APRIL 14, 2020



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We all are aware, that India and the world at large is grappling with the outbreak of COVID-19, which has been declared as a global pandemic by the World Health Organization on 11th March, 2020. The outbreak has been declared as an epidemic in India under the Epidemic Diseases Act, 1897 and a 'notified disaster' under the Disaster Management Act, 2005. The entire country has been placed under lockdown / curfew u/s Section 144 of The Code of Criminal Procedure, 1973, as applicable. Most of the institutions and commercial establishments have been shut down except essential goods & services. All domestic and international flights, trains and intrastate/interstate transport services have been suspended. Consequently, almost all Indian states have imposed complete lockdown in order to restrict the spread of the epidemic in the region. On account of the lockdown, all the transportation activities has come to standstill within the state as well, resulting in the complete collapse of majority of business enterprises for the time being.

The FICCI survey dated 20.03.2020 on "Impact of Coronavirus on Indian Businesses", provides the following statistics:

i. ***A significant 53 per cent of Indian businesses indicate the marked impact of the Coronavirus pandemic on business operations even at early stages.***

ii. ***Almost three-fourth of the businesses in their survey indicate big reductions in orders. Of these, almost 50 per cent indicate a 20 per cent and more decrease in the orders.***

iii. ***A significant 35 per cent respondents indicate an increase in inventory levels. Of these, another 50 per cent point that their inventory levels have risen by 15 per cent and more.***

iv. ***The pandemic has significantly impacted the cash flow at organizations with almost 80 percent reporting a decrease in cash flow. A fall of 20 per cent or more in cash flow was reported by more than 40 per cent recipients.***

v. ***The pandemic has had a major impact on the supply chains as more than 60 per cent respondents indicate that their supply chains were affected. The companies also highlighted that they are closely monitoring the situation and expect the impact of the pandemic on supply chain to worsen further.***

vi. ***Almost four-fifth of the respondents feel that the situation would come under control by six-months.***

In the abovementioned scenario, the issues relating to defense of Force Majeure in contracts, have a wide relevance. Hence, an attempt has been made in this research note to analyze these issues.

“Force Majeure”, being a French term means a superior force. Typically, force majeure events include an Act of God or natural disasters, war or war-like situations, labour unrest or strikes, epidemics, pandemics, etc. basically, it covers all those situations on which a person has no control over and its intention is to save the performing party from consequences of something over which it has no control.

The term Force Majeure had received wide connotation long back by Lord Mc Cardie J. in Lebeaupin v. Crispin, [(1920) 2 K.B. 714]. The same had been upheld and followed by the Apex Court in Dhanrajamal Gobindram vs Shamji Kalidas And Co. [AIR 1961 SC 1285], by stating that:

> *“…19. Mc Cardie J. in Lebeaupin v. Crispin ([1920] 2 K.B. 714), has given an account of what is meant by "force majeure" with reference to its history. The expression "force majeure" is not a mere French version of the Latin expression "vis major". It is undoubtedly a term of wider import. Difficulties have arisen in the past as to what could legitimately be included in "force majeure". Judges have agreed that strikes, breakdown of machinery, which, though normally not included in "vis major" are included in "force majeure". An analysis of rulings on the subject into which it is not necessary in this case to go, shows that where reference is made to "force majeure", the intention is to save the performing party from the consequences of anything over which he has no control. This is the widest meaning that can be given to "force majeure", and even if this be the meaning, it is obvious that the condition about "force majeure" in the agreement was not vague. The use of the word "usual" makes all the difference, and the meaning of the condition may be made certain by evidence about a force majeure clause, which was in contemplation of parties.”*

As per the Manual for Procurement of Goods 2017 (issued by Department of Expenditure, Ministry of Finance, Government of India), a Force Majeure (FM) means extraordinary events or circumstances beyond human control such as an event described as an act of God (like a natural calamity) or events such as a war, strikes, riots, crimes (but not including negligence or wrong-doing, predictable/seasonal rain and any other events specifically excluded in the clause).

Now, before we go into the enforceability or impact of force majeure on contracts, we should discuss, whether the instant outbreak of Covid-19 qualifies to be a force majeure?

The institution of Force Majeure in India, finds its basis in Section 32 & 56 of the Indian Contract Act, 1872 the same are reproduced as under:

> *"32. Enforcement of contracts contingent on an event happening.—Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened.*
>
> *If the event becomes impossible, such contracts become void.*
>
> *56. Agreement to do impossible act.— An agreement to do an act impossible in itself is void.*
>
> *Contract to do an act afterwards becoming impossible or unlawful.—A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.*
>
> *Compensation for loss through non-performance of act known to be impossible or unlawful.—Where one person has promised to do something which he knew, or, with reasonable diligence, might have known, and which the promisee did not know, to be*

impossible or unlawful, such promisor must make compensation to such promisee for any loss which such promisee sustains through the nonperformance of the promise."

In line with the above said provisions, the party who claims Covid-19 as a force majeure should ideally show:

i. The inability to perform the obligation was directly caused by the pandemic.
ii. Its non-performance was beyond its control.
iii. There were no reasonable steps it could have taken to avoid the non-performance and/or mitigate the damage.

It has been also seen that most generic term under most force majeure clauses is the 'Act of God', and the Covid- 19 can be clearly brought under the ambit of the same, by fulfilling the test mentioned above. But an alleviation to the effect of this clause can occur, through the 'duty to mitigate' and 'exercise of due diligence' clauses. An element of subjectivity is to be applied on the case to case basis in order to determine the same.

The primary focus involved in the interpretation of the above sections is upon the type of event a contractual party claims is causing non-performance of its contractual obligations. Herein the widespread recognition of the Covid-19's event as Force Majeure, by the Central & State Government and by various other authorities is of vital importance, i.e. on 19 February 2020, Ministry of Finance had clarified that the disruption in supply chains due to spread of coronavirus in China or any other country will be covered under the Force Majeure clause [Office Memorandum No. F/18/4/2020-PPD]. Ministry of New and Renewable Energy (MNRE) has further clarified that spread of coronavirus should be considered as a case of natural calamity and FM clause under the contractual agreements may be invoked, wherever considered appropriate, following the due procedure stipulated therein. On 20 March 2020, MNRE directed all RE projects implementing agencies to treat delay on account of disruption in the supply chains due to spread of coronavirus in China or any other country as a Force

Majeure event and accordingly, grant suitable time extensions for scheduled commissioning dates, based on evidence/documents [Office Memorandum No. 283/18/2020-Grid Solar]. On 28 March 2020, CERC issued an Order for implementation of direction of MoP, regarding reduction of LPSC, wherein it has provided the relaxation to the generating companies and inter-state transmission licensees whose tariff have been determined under Section 63 of the Electricity Act, 2003 by CERC, as they may now claim relief on the LPSC in terms of the Force Majeure provisions of the respective PPAs and Transmission Service Agreements read with the CERC Regulations [Central Electricity Regulatory Commission order dated 03/04/2020 in SMP No. 6/SM/2020].

Further, we move upon to look upon the law of contracts on Force Majeure. As already mentioned the Sections 32 & 56 are of wide relevance here.

The landmark judgment of Satyabrata Ghose v. Mugneeram Bangur & Co [AIR 1954 SC 44] is to be seen in this respect, wherein a suit was filed against wrongfully repudiating the contract of developing the lands which were sold to the plaintiff and also for specific performance of the same. The defendant took the defence of frustration as the lands, which needed to be developed were temporarily requisitioned by the Govt. under the defence rules such that for unspecified period of time, any development work if executed on the land would be illegal. The contract was made at a time when war conditions were prevailing and any such requisition was imputed to be in contemplation of the parties while forming contract. Further, no time was specified in the contract. The Apex Court held that, *"Impossibility u/s 56 doesn't mean literal impossibility to perform (like strikes, commercial hardships, etc.) but refers to those cases where a supervening event beyond the contemplation and control of the parties (like the change of circumstances) destroys the very foundation upon which the contract rests, thereby rendering the contract 'impracticable' to perform, and substantially 'useless' in view of object and purpose which the parties intended to achieve through the contract."*

Much of jurisprudence on Force Majeure had been well summarized by Justice R.F. Nariman of the Supreme Court in the case of Energy Watchdog v. CERC [(2017) 14 SCC 80]. Wherein the major consideration was on the issue that How far the ambit of frustration of contract can be stretched? The Apex Court went through all the prevailing land mark judgments and held that doctrine of frustration is inapplicable to the present case as the fundamental basis of the Power Purchase Agreement remains unaltered. It also held that Force majeure clauses are to be narrowly construed and on construction of the force majeure clause "Hindrance" could mean an event wholly or partly preventing performance, but mere rise in prices is not hindrance whole or part. An excerpt from the aforesaid judgement is hereunder:

> *"34. The law in India has been laid down in the seminal decision of Satyabrata Ghose v. Mugneeram Bangur & Co., 1954 SCR 310. The second paragraph of Section 56 has been adverted to, and it was stated that this is exhaustive of the law as it stands in India. What was held was that the word "impossible" has not been used in the Section in the sense of physical or literal impossibility. The performance of an act may not be literally impossible but it may be impracticable and useless from the point of view of the object and purpose of the parties. If an untoward event or change of circumstance totally upsets the very foundation upon which the parties entered their agreement, it can be said that the promisor finds it impossible to do the act which he had promised to do. It was further 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 of the Act. If, however, frustration is to take place de hors the contract, it will be governed by Section 56.*

…40. It is clear from the above that the doctrine of frustration cannot apply to these cases as the fundamental basis of the PPAs remains unaltered. Nowhere do the PPAs state that coal is to be procured only from Indonesia at a particular price."

A force majeure clause cannot be enforced by implication under the Indian law, it must be expressly provided for under the contract and protection afforded will depend on the language of the clause. In the event of a dispute as to the scope of the clause, the courts are likely to apply the usual principles of contractual interpretation. But this doesn't means that absence of such clause will not allow the defense of Force Majeure be taken, even in such situations the shelter u/s 56 of the Indian Contract Act can be taken but the availability of relief, magnitude and enforceability would completely depend upon the mutual consensus among the parties and on case specific basis. It is also to be noted that, a party can be excused from a contract on account of Covid-19 being declared a pandemic is a case-specific determination that will depend on the nature of the party's obligations and the specific terms of the contract. Also, the party claiming force majeure is usually under a duty to show that it has taken all reasonable endeavors to avoid or mitigate the event and its effects, but in the scenario of Covid-19 outbreak this duty would be restricted to the mitigation of losses caused by the lockdown and not to the whole event.

The remedies/relief available due to the lockdown would purely depend upon the mutual consensus between the parties, whether contained in a Force Majeure clause or in a mutual consensus made thereupon after the lockdown. However, there exist certain contracts that contain clauses empowering the other party to terminate the contract when the defense of Force Majeure is taken for a period longer than specified, these will also be effectuated in line with the mutual consensus thereon and to be determined on case to case basis. Some contracts may provide that the contract will be put on hold until the force majeure event is resolved and some contracts may provide for limitations in time after which either party may terminate the

agreement with written notice to the other (i.e. if non-performance caused by the event is prolonged or permanent). Some of them may require the contract to remain in effect until the force majeure event is resolved, while some contracts will only allow for certain obligations to be suspended.

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