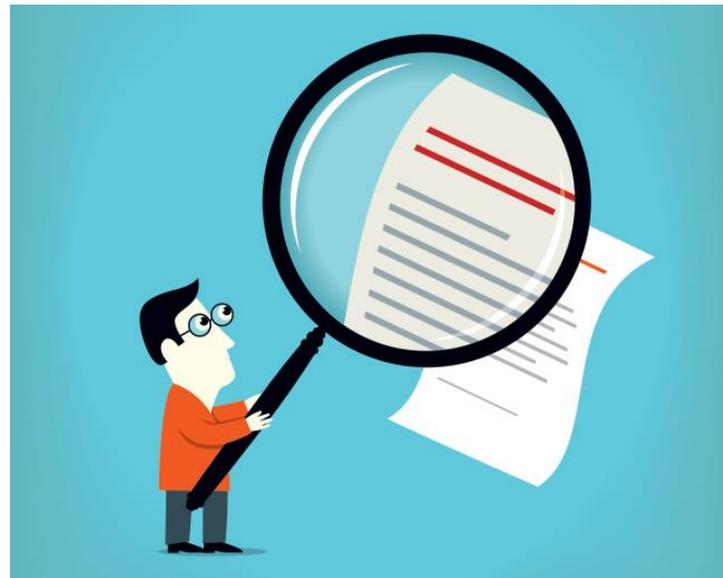


De Jure

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**Force Majeure & Frustration of Contract in
Light of COVID-19**



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Apart from the devastating impact that COVID-19 continues to unleash on human beings and countries worldwide, its outreach has also reached commerce and business. COVID-19 has resulted in lockdowns or restricted movements in countries. Consequently, businesses have been impacted and so have operations and consequently contracts and obligations under contracts are being revisited to assess these impacts. The term that has assumed relevance in contractual context today for businesses today and heard most often is "force majeure" and how will this term be construed in a contract in the background of COVID-19. We have, through this De Jure endeavoured to demystify the concept of "force majeure" and "frustration of a contract", the importance of the same in businesses, the difference between the two and the repercussions of COVID-19 on contracts in India in light of "force majeure" and "frustration of a contract".

➤ **Force Majeure**

The term '*force majeure*' has been defined in Black's Law Dictionary, as '*an event or effect that can be neither anticipated nor controlled*. It is a contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event that the parties could not have anticipated or controlled.' While force majeure has neither been defined nor specifically dealt with, in Indian statutes, some reference can be found in Section 32 of the Indian Contract Act, 1872 (the "Contract Act") envisages that if a contract is contingent on the happening of an event which event becomes impossible, then the contract becomes void.

From a contractual perspective, a force majeure clause provides temporary reprieve to a party from performing its obligations under a contract upon occurrence of a force majeure event. A force majeure clause typically spells out specific circumstances or events, which would qualify as force majeure events, conditions which would have to be fulfilled for such force majeure clause to apply to the contract and the consequences of occurrence of such force majeure event. As such, for a force majeure clause to become applicable (should any force majeure event occur), the occurrence of such events should be beyond control of the parties and the parties will be required to demonstrate that they have made attempts to mitigate the impact of such force majeure event. If an event or circumstance comes within the ambit of a force majeure event and fulfils the conditions for applicability of the clause then the consequence would be that parties would be relieved from performing their respective obligations to be undertaken by them under the contract during the period that such force majeure events continue.

A force majeure clause in a contract would typically include an exhaustive list of events such as acts of God, war, terrorism, earthquakes, hurricanes, acts of government, explosions, fire, plagues or epidemics or a non- exhaustive list wherein the parties simply narrate what generally constitute force majeure events and thereafter add "and such other acts or events that are beyond the control of parties". Further consequential liabilities, depending on the language of the clause, the parties maybe required to issue a notice formally intimating the other party of the occurrence of such

event and invocation of the force majeure clause. Some contracts also contain a provision that if such force majeure event continues for a prolonged time period, the parties may be permitted to terminate the contract.

❖ **Importance of Force Majeure concept in Businesses.**

Force majeure clauses can usually be found in various contracts such as power purchase agreements, supply contracts, manufacturing contracts, distribution agreements, project finance agreements, agreements between real estate developers and home buyers, etc. This provision is important for businesses as it relieves the parties from performing their respective obligations and which are to be undertaken under the contract and consequential liabilities, during the period that force majeure events continue provided that the conditions for clause to become applicable (which have been discussed above) are met.

❖ **Matters wherein Force Majeure may not be invocable**

Force majeure is not intended to excuse negligence or other malfeasance of a party, as where non-performance is caused by the usual and natural consequences of external forces, or where the intervening circumstances are specifically contemplated. It would also be important to note that force majeure cannot be invoked just because the contract has become financially or commercially more difficult to perform.

In order to seek reliance on a force majeure clause, a party will be required to demonstrate that the event of force majeure was beyond control of the party, that it has taken all reasonable steps (*which may be commercial or financial in nature, like disbursing some additional money, hiring extra manpower, seeking alternative manufacturing lines or suppliers, etc.*) to overcome or mitigate the event and its consequence, and that there are no alternate means for performing under the contract. However, the reasonableness of mitigation would depend on a case-to-case basis and the subject matter of the contract.

If a contract does not include a force majeure clause, the parties would have to ascertain in light factors such as the nature of the contract, the nature of event and so forth, as to whether Section 56 of the Contract Act (which deals with agreements between the parties to do an impossible act) and which has been briefly discussed below, can be applied to such contract so as to discharge the parties from their contractual obligations.

➤ **Frustration of a Contract**

If performance of an act becomes impossible or unlawful, after a contract has been executed, and such impossibility is due to an event which the party undertaking the performance could not prevent, then such contract itself becomes void or one can say that the contract becomes 'frustrated'. Hence, frustration is the happening of an act outside the contract and such act makes the completion of performance of a contract impossible.

Under the Contract Act, the doctrine of frustration of contract is envisaged in Section 56, which states that an agreement to do an act impossible in itself is void. On a plain reading of Section 56 of the Contract Act, it is evident that the section envisages some impossibility or unlawfulness of the performance of the act, which the parties had not contemplated at the time when they entered into the contract. It leads to a pertinent question as to what is such impossible act that would lead to frustration of contract.

The courts in India have held that the word 'impossibility' used in Section 56 of the Contract Act must be interpreted in a practical form and not in its literal sense. Thus, a contract would come under the purview of Section 56 of the Contract Act even if it is not an absolute impossibility, but the contract has fundamentally changed, which the parties had not contemplated at the time of the agreement. This principal has been upheld in **Satyabrata Ghose versus Mugneeram Bangur & Co & Anr** (AIR 1954 SC 44).

It would be important to note that frustration of a contract, may not be applicable in situation of (i) self-induced frustration, and (ii) where in a contract, parties have, expressly agreed that the contract would stand despite such intervening circumstance or event.

❖ **Restitution.**

The concept of restitution as set out in Section 65 of the Contract Act also assumes significance in the context of the frustration of contract. Section 65 states that when an agreement is discovered to be void, such as in case of a contract getting frustrated, the person who has received any advantage under such agreement is 'bound' to restore it or to make compensation for it, from whom he received it. Thus, one of the consequences of frustration of a contract is restitution whereby parties are to be put in the same position they were if the contract had never been executed.

➤ **Difference between Force Majeure and Frustration of a Contract**

Under the doctrine of frustration, impossibility of a party to perform its obligations under a contract is linked to occurrence of an event/circumstance **subsequent to the execution of a contract** and which was not contemplated at the time of execution of the contract. However, under in case of a force majeure, parties typically identify, **prior to the execution of a contract**, an exhaustive list of events, which would attract the applicability of the force majeure clause.

Frustration of a contract to be invoked and applied requires that the entire subject matter or underlying rationale for the contract be destroyed. Doctrine of Frustration renders the contract void and consequently all contractual obligations of the parties cease to exist. Frustration of a Contract is a test de hors of contractual provisions and is the end result of events arising after the contract was executed. Whereas a force majeure is contractual provision contemplating an event, which can result in deferment of performance of contractual, obligations and therefore rights of parties thereunder until such event continue and typically does not absolutely excuse parties from performing their obligations.

Typically, where a force majeure event is not specifically covered under a contract, frustration of a contract may be claimed by the affected party, however, if the case is opposite and a particular event is covered as a force majeure event under a contract, frustration of such contract cannot be automatically claimed.

➤ **Our View on the impact of Force Majeure and Frustration of Contract on Businesses in times of COVID-19**

COVID-19 has affected cross-border trade, real estate market, specifically the developers, the home-buyers and the commercial lease arrangements, EPC (engineering, procurement & construction), joint-venture agreements as well as M&A deals in India. It has also impacted the parties ability to meet their contractual obligations due to restriction in movement, stoppage of production, increase in costs due to scarcity of raw materials components, labour shortages, shortage of funds, disruption in the supply chains.

With widespread disruption in business, manufacturing and transport, due to COVID-19 the stage seems set for India to see a flood of 'force majeure' invocations. It is expected that over a period of time more and more Indian companies may invoke 'force majeure' clauses in their contracts resulting perhaps in a spew of litigations should parties not come to a workable understanding. Of course, in such events, the courts and arbitrators will have to evaluate and decide each dispute on individual merits, which would be based on the terms of the contract, the intent of the parties, steps taken to mitigate. Further, in cases where a contract does not have an explicit clause on force majeure, there could be scenarios where

parties may try to seek shelter under Section 56 of the Contract Act and seek frustration of a contract. The courts will then have to ascertain whether the contract has become impossible to perform and whether the doctrine of frustration of contract could be made applicable to such a contract.

How the courts will interpret COVID -19 in relation to force majeure provisions will be interesting to watch out in the course of this year once the impact of COVID-19 settles. Presently, the Ministry of Finance has by way of an office memorandum (O.M. No. 18/4/2020-PPD) issued on February 20, 2020 clarified that the disruption of the supply chains due to spread of coronavirus in China or any other country should be considered as a case of natural calamity and "force majeure clause" may be invoked, wherever considered appropriate, following the due procedure. However, such clarification has been provided only with respect to the disruption of the supply chains and as indicated above, invocation of force majeure provisions in light of COVID-19 will have to be assessed on a case-to-case basis depending on the terms of the contract entered into between the parties.

It will also be interesting to see the stand which the insurance companies will take vis-a-vis insurance policies taken by companies to cover loss arising due to certain unforeseen circumstances in their businesses, and whether COVID-19 will be covered under these policies. A recent ET article also indicates that experts have said that most insurers will also fall back on the Force Majeure, or "Act of God" clause.

(This Dejure contains extracts reproduced from an article published in ETRise which can be viewed here: <https://economictimes.indiatimes.com/small-biz/legal/what-is-force-majeure-the-legal-term-everyone-should-know-during-covid-19-crisis/articleshow/75152196.cms?from=mdr>)

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