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## NEWS LETTER | Force Majeure - COVID-19

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## Subject Introduction

Corona virus epidemic began in December 2019 in Wuhan city of Hubei province in the Republic of China. Since then the virus has spread to all continents across the world due to rapid increase of person to person transmission and failed containment measures thereby affecting all major economies, including India. The WHO on 11 March 2020 declared the Covid-19 as a pandemic. In an unprecedented move, Prime Minister of India Mr. Narendra Modi, on 23 March 2020, declared a complete shut-down, with a few exceptions, of the country for a period of 3 weeks.

## How has the covid-19 affected the government?

The Covid-19 has affected all the three organs of the state, i.e. the legislature, the executive and the judiciary. On 16 March 2020, the Supreme Court of India announced that it will hear only urgent matters and similar restrictions were imposed by the several High Courts of the states along with the district courts.

Considering and using the impact of the shutdown on the businesses and the supply chain distributions, it is very likely that performance of the contracts will be delayed or may be even cancelled. Parties to the contracts may use this opportunity to delay and/or avoid their obligations and may also use this situation to terminate contracts either on genuine grounds that the situation has forced them to not perform their obligations or there could be situations where they might use this opportunity to excuse themselves from performing their obligations. In light of the above scenario, it is important to understand and determine if Covid-19 will be considered *force majeure*.

# What is Force Majeure?



The term **"*Force Majeure*"** is a Latin term which essentially translates into superior force in English or an act of God. In business (and legal contracts) it means those uncontrollable events (such as war, labour stoppages, or natural calamities) that are not the fault of any party and that make it difficult or impossible to carry out normal business. It is interesting to note that there is no generic definition of the term *force majeure* in common law. This concept is borrowed from the **Napolean Code** which was established in the **year 1804**. This concept first appeared as a term in a common law country (England) in the case of ***Lebeaupin v Crispin* ([1920] 2 KB 714)** where McCardie J. held that a force majeure clause should be construed in each case with a close attention to the words which precede or follow it, and with a due regard to the nature and general terms of the contract. The effect of the clause may vary with each instrument.

Under English law, contractual performance will be excused due to unexpected circumstances only if they fall within the relatively narrow doctrine of frustration. This doctrine will apply by default unless the parties agree something else in their contract. In general, it only applies where events occur that make the performance of the contract: (1) impossible; (2) illegal; or (3) something radically different from that originally envisioned by the parties. It is not enough that a contract becomes more expensive or onerous than originally contemplated due to events falling short of this. For example, it would not usually be sufficient that a party had been let down by their supplier as they would be expected to source an alternative supplier even if this were hugely more expensive. Where frustration applies, the contract is automatically discharged i.e. any future performance that would otherwise have happened under the contract is released or cancelled. For example, for a partly completed contract to build and deliver an aircraft, the obligation to complete building the aircraft and to deliver it would be released. Another example, a company may insert a force majeure clause into a contract to absolve itself from liability in the event it cannot fulfil the terms of a contract (or if attempting to do so will result in loss or damage of goods) for reasons beyond its control.

The common industry standard contracts/documents may or may not have the term *force majeure* in their template. For example, in the Loan Market Association (LMA), the template documents of LMA do not contain a force majeure clause, but some of the documents, including those for leveraged finance transactions, contain wide material adverse change provisions. A material adverse change constitutes an event of default and is any event that the majority lenders believe has, or is reasonably likely to have, a material adverse effect on the borrower's "business, operations, property, condition (financial or otherwise) or prospects" or ability to perform its obligations under the finance documents. Therefore, if lenders can show that it has caused such a material adverse effect, the **COVID-19 outbreak** could lead to an event of default. The 2002 ISDA Master Agreement defines a "Force Majeure Event" as occurring when a party "by reason of force majeure or act of state" is prevented from making or receiving payment or complying with any other material provision, or where it becomes impossible or impracticable for the party to perform (Clause 5(b)(ii)). The event must be beyond the party's control and the party must not be able to, after using all reasonable efforts (which will not require such party to incur a loss), overcome such prevention, impossibility or impracticality. "Force majeure" is not specifically defined. Therefore, its meaning would have to be determined in each individual case on the basis of general principles but is understood to cover "Act of God" events beyond the control of the parties or their credit support provider. Notwithstanding that the 2002 Master Agreement contemplates "impracticability" as well as "impossibility," the mere fact that the transaction has become significantly more expensive is unlikely to be sufficient to trigger a force majeure.

Under the United Nations Convention on the **International Sale of Goods (CISG) 1990**, any party that fails to perform its obligations under contract is liable to the other party in damages. However, this obligation may also be excused under certain extraordinary circumstances if an unavoidable and unforeseen impediment beyond the control of the defaulting party is responsible for preventing the said performance. The Convention utilises something similar to a doctrine of excuse, but the language used under the Convention is 'exemptions'. These exemptions are contained under Sec IV of the Convention and although there is no explicit mention of the term 'force majeure', the section recognises an excuse for non-performance due to changed circumstances characterised by the same cumulative elements identified earlier in this essay as constituting force majeure. In determining the scope of application of exemption from liability the courts will look to Article 79 (1)-(5) which identifies the circumstances under which a party cannot be held liable for a failure to perform its obligations (even where this failure is caused by a third person), explains the steps that need to be taken by the party seeking to rely on such an excuse, defines the length of time such an exemption would last and also indicates the limit of protection offered by this exemption.

## Indian Perspective

In India, *Force Majeure* is not defined in any of the statute however, the Indian Contract Act 1872 (the "**Act**") allows that any agreement which is impossible to perform would be void. The first paragraph of section 56 of the Act states that **"an agreement to do an act impossible in itself is void"**. The second paragraph of section 56 of the Act states that *"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."*

The first paragraph mentioned above lays down a simple principle of initial impossibility and the second paragraph lays down the effect of subsequent impossibility. Sometimes, the performance of a contract is possible when the contract is made but becomes impossible or unlawful upon happening of an event which could not have been prevented. The above doctrine is called the Doctrine of Frustration which is an English law doctrine which essentially lays a positive rule relating to frustration. There can be no agreement on altered circumstances.

The alternation of circumstances *must be such as to upset altogether the purpose of the contract.* A situation may be classified as a commercial hardship and may make the performance unprofitable or more expensive but is not sufficient to excuse the performance as it does not fundamentally change the situation as to frustrate the contract. This doctrine of frustration or impossibility shall not apply to a situation so as to excuse the performance but where the performance is practically cut off. Change of circumstances is a valid ground for a contract to get frustrated. **In *P.D. Mehra v Ram Chand Om Prakash* [AIR 1952 Punj 34],** it was observed that if there are unanticipated change of circumstance, it will have to be considered whether this change of circumstances has affected the performance of the contract to such an extent as to make it virtually impossible or extremely difficult. It was held in ***Satyabrata Ghose v. Mugneeram Bangur & Co.* [1954 SCR 310]** that 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. Law has to adapt itself to the changing circumstances. A marginal change in price could be ignored but if the prices escalate out of proportion from what could have been reasonably expected by the parties and thus making the performance of the agreement impossible, the law would have to offer relief to the party. This rationale was recognised in ***Tarapore & Co. v Cochin Shipyard Ltd* [(1984) 2 SCC 680].**

The application of force majeure has again been elaborately explained by the Supreme Court in the case of ***Energy Watchdog v CERC and Others* [(2017) 14 SCC 80]** where RF Nariman J, held that "..once held that clause 12.4 applies as a result of which rise in the price of fuel cannot be regarded as a force majeure event contractually, it is difficult to appreciate a submission that in the alternative Section 56 will apply".

## Do you have a Force Majeure clause in your contract?

A Force Majeure clause is a standard clause which is usually seen in almost all contracts either by specifying specific examples of force majeure events that automatically meet the standard upon the happening of such event, or by using a very generic language in such clauses.

## What if you don't have a *Force Majeure* clause in your contract?

If the contract does not include a force majeure clause, the affected party could claim relief under the doctrine of frustration under Section 56 of the Indian Contract Act, 1872. However, in order to claim that the contract is frustrated, it must be established that the performance of the contractual obligations has become impossible by reason which could not have been prevented.

## What are the remedies available under *Force Majeure*?

The remedies available under such clause is dependent upon the language of the clause. Some contracts could provide for a suspension of contractual obligations; or be excused from liability for non-performance or delay; or terminate the contract; or launch an extension of time to target dates; or renegotiate the terms of the contract; or instigate remediation and/or contract governance measures.

# Is Covid-19 a *Force Majeure* event?

On 30 January 2020, the World Health Organization declared that the coronavirus outbreak constituted a public health emergency of international concern. The Ministry of Finance under the Government of India, through its notification dated 19th February 2020 has clarified that the disruption of supply chain due to the spread of corona virus will be covered in the *force majeure* clause and it shall be considered as a natural calamity. In addition to the above, Grid Solar Power Division of the Ministry of New and Renewable Energy under the Government of India vide notification dated 20 March 2020 has also allowed the renewable energy implementing agencies to grant suitable extension of time for projects, on account of coronavirus, based on evidences / documents produced by developers in support of their respective claims of such disruption of the supply chains due to spread of coronavirus in China or any other country. There are also media reports that the Government of India has, through its shipping ministry, issued a letter allowing ports to consider the coronavirus pandemic as valid grounds for invoking force majeure on port activities and operations. The same approach has been adopted by container terminals in India. Indian petrochemical companies have also invoked force majeure clause and given notices to foreign companies cancelling shipments as the demand for fuel has gone considerably down due to the lockdown announced by the Government of India. The same approach has been adopted by the Ministry of Railways and has declared the current situation of shutdown due to the corona virus scare as a *force majeure* event. Several Indian companies, including Indian Oil Corporation have declared the current shut down as a force majeure event and have accordingly informed their Middle Eastern suppliers.

Looking at the current scenario, it would be not incorrect to term the current coronavirus outbreak as a *force majeure*. China has invoked the force majeure clause to protect its businesses and according to the state media Xinhua, China Council for the Promotion of International Trade, China has issued 4,811 force majeure certificates as of 2 March 2020 due to the epidemic. Those contracts were worth 373.7 billion Chinese yuan ($53.79 billion), according to the report. It would be, however, difficult for the Chinese companies to invoke the *force majeure* clause for international agreements as most of such agreements are governed by English law and under English law, force majeure can be invoked only when there is an express provision in the agreement. According to media reports, French petroleum giant Total and Shell have rejected a force majeure notice from Chinese companies.

## CONCLUSION

Force majeure scenarios will always be very fact sensitive and highly dependent on the wording of the relevant contract. In instances where there is a need to invoke the force majeure clause of the contract or seek protection under section 56 of the Act, it would be imperative to look into the terms of the contract and the requirements of such clause. The affected party may have to notify the other party about such an event to defer or terminate its obligations and such steps should be taken promptly to mitigate the risk of losses and/or damages.

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