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LEGALLY SPEAKING

Covid-19 and commercial contracts: Is force majeure invocation the panacea or another pandemic?

It must be established that Covid-19 caused the failure to perform a contractual obligation. Just the cover of the disease's global spread won't be enough.

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Covid-19 and commercial contracts: Is force majeure invocation the panacea or another pandemic?

The outbreak of the Covid-19 pandemic has caused widespread disruption of businesses and severely affected commercial supply chains. The pandemic has impacted the ability of businesses around the globe to maintain operations and fulfil existing contractual obligations. As governments across the world struggle to contain the pandemic, unprecedented measures are being implemented aimed at minimizing its spread. In India, such measures include a drastic nationwide lockdown imposed by the Central

government for a period of 21 days, which has been extended further in varied degrees nationwide.

These measures raise a host of legal issues and concerns for businesses. In general, the pandemic could affect parties' ability to comply with their contractual obligations, or adversely affect their operations. The Covid-19 outbreak also poses additional risks in the form of financial distress or potential insolvency of contracting parties, which may result in automatic termination of business contracts. In this series of columns, we seek to analyze the contractual mechanism of force majeure clauses and how contracting parties may resort to such clauses to pragmatically ameliorate the adverse impact of Covid-19 on their commercial relationships. In the next two columns, we will discuss situations where a contract does not include a Force Majeure Clause and lastly the way forward by way of our suggestion for legislative changes.

What is Force Majeure?

It is important to note that there is no generic definition of force majeure in Common Law. A force majeure clause is a common provision in contracts and widely used as a mechanism for legal risk management in commercial contracts. Simply put, it is a way of allocating the risk of loss if performance under the contract becomes impossible or impracticable, especially as a result of an event that the parties could not have anticipated or controlled. It is an unexpected event that prevents a party from doing or completing something that it had agreed to do. Generally, a force majeure clause must include the specific event that can allegedly prevent performance under the contract. Parties negotiate which specific events qualify as force majeure events such as, acts of God (e.g., natural disasters or fires), wars, terrorism, riots, labour strikes, embargos, acts of government, epidemics, pandemics, plagues, quarantines, lockdowns and boycotts. If the specific event, such as an epidemic, pandemic or lockdown, is included in the force majeure clause and such event occurs during the subsistence of the contract, then the parties may either be relieved from further performance or performance may be temporarily suspended as stipulated.

Depending on their drafting, force majeure clauses may have a variety of stipulated consequences, typically including: excusing the affected party from performing the contract in whole or in part; excusing that party from delay in performance, entitling them to suspend or claim an extension of time for performance; or giving that party a right to terminate. For a counter party, a right of termination and/or suspension could be commercially important, as it may provide leverage to renegotiate contractual terms in the altered market landscape. Whether a force majeure clause covers an epidemic or pandemic, such as Covid-19, depends largely on the language of the contract and its contextual interpretation. Force majeure clauses:

What must parties bear in mind?

Contracting parties should review their contracts to determine which party bears the risk of loss if performance becomes impossible or impracticable due to an event, especially the Covid-19 pandemic or pursuant government actions such as travel restrictions and lockdown. First, it should be determined whether the contract contains a force majeure clause. Second, it should be determined whether the force majeure clause specifically identifies an epidemic/pandemic, or a similar term, that explicitly excuses or suspends performance under the contract on the happening of such an event.

Third, if the clause does not specifically identify an epidemic/pandemic as a force majeure event, it is yet to be determined conclusively whether the clause containing 'act of god' as a force majeure event, would include Covid-19 outbreak or not. Fourth, if the clause does not identify an epidemic, pandemic, lockdown or act of God as a force majeure event, it should be determined whether the clause contains a catch-all phrase that might apply to an epidemic/pandemic. A catch-all phrase may have similar language to "including, but not limited to." If the force majeure clause contains a catch-all phrase, the courts may apply the principle of contract construction called *ejusdem generis* to include all items of the same class/nature as those listed in force majeure clause but not specifically mentioned therein. Accordingly, if it is determined that Covid-19 pandemic is similar enough to the other events listed in the force majeure clause, it may be considered a force majeure event. However, it is imperative to note that force majeure clauses are not always boilerplate provisions in the contract and can vary significantly across different contracts, based on leverage of the negotiating parties and other factors. For contracts currently under negotiation, parties must bear in mind that the protection afforded by force majeure clauses for Covid-19 related claims may be quite limited due to issues of foreseeability. Given the inescapable awareness of the Covid-19 outbreak and potential scale of the pandemic today, such claims may be unlikely to satisfy the standard test of foreseeability and may therefore be excluded as a force majeure event. However, parties may agree to claim relief under force majeure clauses in situations where the spread or impact of Covid-19 and the subsequent impact on workforce and supply chains reaches a threshold that is unforeseeable. Covid-19 outbreak:

Whether force majeure can be used as a shield?

A force majeure clause should not be construed as a "free pass" not to perform one's obligations. However, it does offer protection against genuine events that prevent a party from performing its contractual obligations, if the party had no alternate means of performance available. A force majeure clause is generally construed narrowly, and its application will require a demonstration of the impact of an event on the inability to

perform contractual obligation(s). Therefore, contracting parties must realise that it may not be commercially prudent or advisable to resort to a force majeure clause on the mere factum of Covid-19 outbreak, when either the contractual performance remains unaffected or may well be discharged using alternative means, albeit more onerous or expensive.

On 11 March 2020, the World Health Organization announced that Covid-19 can be characterized as a pandemic. Thus, if the force majeure clause specifically refers to epidemics/pandemics (or work stoppages, lay-offs or actions of government including lockdowns and travel restrictions) as events of force majeure, then the clause may be activated by the outbreak of Covid-19 and subsequent events. In India, the Ministry of Finance, Department of Expenditure Procurement and Policy Division issued an internal Office Memorandum dated 19 February 2020, bearing no. F 18/4/2020-PPD, wherein the ministry has recognized Covid-19 as a force majeure event. The Office Memorandum effectively states that the Covid-19 outbreak could be covered by a force majeure clause on the basis that it is a 'natural calamity', caveating that 'due procedure' should be followed by any Government department seeking to invoke it. It is imperative to note that the said government circular is an internal direction, which may have no direct impact whatsoever upon private commercial understandings and terms of the contracts specifically agreed between parties.

However, it may still hold some persuasive value in interpretation of contracts by Indian courts, in instances where force majeure clauses specify "natural calamities" as a force majeure event. This position is further bolstered by the invocation of the Epidemic Diseases Act, 1897 by different states and union territories the lockdown order under the Disaster Management Act, 2005 by the Central Government. Contracting parties must consider whether Covid-19 has made performance impossible/fundamentally different or just less convenient and/or more expensive. For example, if the contract requires delivery of goods on a specific date that is now made impossible due to local lockdown measures, that may well be a force majeure event leading to termination of the contract. There must be a genuine failure or likely failure to perform and it must be established that Covid-19 caused the failure to perform a contractual obligation. The simple fact of Covid-19 having spread globally will not be enough to rely on the force majeure provision, if the impact of the outbreak did not actually cause the party's failure to perform the obligations. It must be borne in mind that the onus of proving that the event has prevented performance in manner outlined in the clause lies on the party seeking to avail of the force majeure clause. A force majeure event must not have been foreseen by the parties. For example, a party seeking to rely on widely drafted and non-specific force majeure clause entered into since the outbreak in China came to light, may find it difficult to convince a judge that the

parties did not foresee the risk of Covid-19 impacting the contract. Additionally, a counterparty may try to argue that the Covid-19 outbreak is not unforeseeable, considering the recent SARS outbreak in 2002 as well.

Risks of wrongfully declaring force majeure It is important to note that if a party invokes force majeure wrongfully in contravention of the contractual terms, it may find that it is in breach of contract. Furthermore, if the invocation of force majeure clause amounts to evidence that the party in question no longer intends to perform the contract, this could amount to a repudiatory breach of contract and the other party may be entitled to claim damages as a result. It is, therefore, necessary to proceed with caution when relying on a force majeure clause and a party must essentially seek legal counsel before such invocation to avoid the risk of being sued for damages. The principle of awarding damages in such cases is covered under the provisions of the Contract Act and well settled by the Indian courts. Therefore, it must be borne in mind that Force Majeure clause in the contract is not a golden pass to avoid the obligations under the contract and, if wrongly invoked, may lead to monetary damages being awarded to the other party. It is advisable to obtain sound legal counsel before doing so.

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