

India Update: Client Alert

Fulfilment of obligations under a contract and COVID-19 – Indian perspective

The outbreak of COVID-19, which has been declared as a pandemic by the World Health Organization (WHO), is affecting businesses across the world, leaving many corporates unable to fulfil their contractual obligations. Whether this crisis of COVID-19 would trigger the 'force majeure' clause that would offer protection from liability arising due to the delayed performance or non-performance by the defaulting parties or not, is a concern for many.

Presently, the outbreak in India, is at a stage where given the high possibility of transmissibility, the number of cases is likely to grow exponentially. The impact of the increasingly widespread fear of the COVID -19 pandemic is not only on the public health and safety but also on many businesses of the companies around the world. In the wake of the outbreak, many countries including India, have imposed travel bans and restrictions on entry of foreign nationals. Further, the Government of India, in order to contain the outbreak, has placed restrictions on the local movements, declared lockdowns, quarantine etc. The important points for consideration, amongst others, from the business standpoint, would be obligations of the employers towards their employees, the effect of the crisis on supply chains due to shutdowns on account of the outbreak etc.

Presently, many companies in India are engaged in business across borders and such business obligations have multijurisdictional elements which may have been captured in the business contracts and one of the major impacts of COVID-19, would be inability of the parties to fulfil their contractual obligations due to the same. It is noteworthy that the outbreak of COVID-19, could not have been anticipated or controlled, therefore, it may be prudent to analyse the outbreak as an event of 'force majeure' and if so, the impact thereof, upon parties to a contract invoking the 'force majeure' clause thereof.

Force majeure is a term used to describe a 'superior force' event. It is an express contractual term which intends to excuse performance of obligations of the contracting parties upon happening of certain events/circumstances which are beyond the control of the parties to the contract. Under the (Indian) Contract Act, 1872 ("**Contract Act**"), an event of force majeure gives a contracting party additional time to perform its contractual obligations due to any hinderance in performing the same for the reasons beyond its control, and that upon occurrence of a 'force majeure' event, a party is protected from the liability arising out of its failure to perform its contractual obligation during the subsistence of the force majeure event. It may be noteworthy that typically, force majeure events, include an act of god or natural disasters, epidemics, war, riots etc., which are outside the control of the parties to any contract. Certain contracts specify a prolonged event of force majeure as a ground for termination of such contracts. Taking in account the judicial precedents, the courts have generally construed 'force majeure' clauses obscurely rather than providing clarification on the said clause, meaning thereby, that unless an event falls squarely within the ambit of a 'force majeure' clause, courts may not accept such event for prompting consequences of 'force majeure' i.e. the parties may not be excused from performing their contractual obligations. In addition to the same, the party affected by a 'force majeure' event, would have to immediately notify the other party of such an event, supported by the requisite evidence of the force majeure itself.

In light of spurt in the cases of COVID-19 in India, the Ministry of Home Affairs decided to treat it as a 'notified disaster'. It is pertinent to mention that the Department of Expenditure, Ministry of Finance, Government of India issued the office memorandum dated February 19, 2020¹, clarifying that the disruptions in the supply chain due to spread of COVID-19, would be considered as a case of natural calamity and 'force

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<https://doe.gov.in/sites/default/files/Force%20Majeure%20Clause%20-FMC.pdf>

majeure' may be invoked. The said office memorandum under judicial scrutiny may not have same strength as 'law', however, the same may have persuasive value. Thus, it may be argued that inability to fulfil contractual obligation under contract may be covered as a 'force majeure' event. However, the said argument is yet to be tested before the courts in India.

In addition to the aforesaid, certain contracts may not encompass a 'force majeure' clause and therefore, the parties may rely upon the principle of 'frustration of contract' as embodied under section 56 of the Contract Act. 'Frustration of contract' means any act which is to be performed after the contract is executed, but becomes either unlawful or impossible to be performed and which was not in control of the party which was to perform the contract at the time when the contract was made. In such an event, such act which becomes impossible or unlawful would be void. It has been well established that frustration of any contract automatically brings the contract to an end at the time of the occurrence of the frustrating event. Accordingly, the parties may also choose to invoke section 56 of the Contract Act. In the present scenario of COVID-19 outbreak, in case of frustration of a contract, the burden of proof would be on the party to the contract invoking the said section 56 of the Contract Act to show that COVID-19 changed the landscape and rendered performance of the contract impossible or delayed. It is worthy to mention that mere economic difficulty or not earning sufficient profit as agreed in the contract may not be just cause for invoking section 56 of the Contract Act.

In the foreseeable future, there is a likelihood that the obligations under several contracts may not be fulfilled by the parties thereto and the companies may choose to invoke remedy under the 'force majeure clause' or section 56 of the Contract Act, as explained above. Under such a circumstance, the existing contracts may also be terminated. However, such invocation has to be treaded carefully, keeping in mind the global economic slowdown. The parties to the extent possible must abide by the terms of the contract and the requirements of the 'force majeure clause' and immediate notification regarding trigger of the 'force majeure' event should be made. Further, since India is still at the nascent stage of the outbreak of the said pandemic, the parties to the contracts may also chose to clearly identify the risk due to the outbreak and make efforts to mitigate the loss/damage caused in performing their respective obligations under the same. If any party is facing a hinderance or is being prevented by the occurrence of an event which is beyond its control and the same is resulting in its failure to fulfil its contractual obligations, it must be give a notice to the other party to the contract and use commercially reasonable efforts to resume performance as soon as the same is practical thereby mitigating damages resulting from such failure of performance. In such scenarios, legal advice about the rights available (including termination) in case of happening of any of the force majeure events as per the terms of their agreements should be sought. We suggest that the existing agreements, as well as those under negotiation, are relooked from 'force majeure' perspective and necessary provisions/clauses are incorporated therein to minimise damages arising therefrom.

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