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A presentation on
COVID-19 - Force Majeure And Its Impact On Commercial Contracts

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**“ Within every
adversity is an equal
and opposite
benefit”**

- Napoleon Hill



Force Majeure?

What Is The Force Majeure Clause ("FMC")?

- **Force Majeure** (French, 'Superior Force') is a clause in the contract that can relieve the parties to the contract from performing their contractual obligations when the circumstances beyond their control arise making their performance either
 - Inadvisable
 - Commercially impracticable
 - Illegal and/or
 - Impossible.

What Happens When There is No Force Majeure Clause In the Contract?

- In the absence of a force majeure clause in the contract, the parties thereto are left to the mercy of the narrow common law contract doctrines such as that of "**Impracticability**" and "**Frustration of purpose,**" that rarely helps the parties from non-performance. This is why experts insist on including a Force Majeure clause instead of relying on Common Law principles per se. A carefully negotiated Force Majeure clause helps better in achieving flexibility during a crisis situation.

Will Covid-19 trigger FMC?

It is evident that in the present scenario, supply chains are continuously and significantly being disrupted and the rights and obligations of businesses' under on-going contracts are coming into a sharp focus. The question that everyone is frequently asking right now is:

“Will a Force Majeure clause excuse the parties from performing their part of obligations or from doing so within the time frame agreed upon in the least?”

- Given the supply chain disruption caused by the Covid-19 pandemic, it is likely that performance under many contracts will be delayed, interrupted, or even cancelled. Counter parties to such contracts may seek to delay and/or avoid performance (or non-performance liability) of their contractual obligations and/or terminate contracts, either because Covid-19 has legitimately prevented them from performing their contractual obligations, or because they are seeking to use it as an excuse to extricate themselves from an unfavourable deal.
- Parties may also mischievously cite Covid-19 as a basis for re-negotiation of prices or on other key contractual provisions.



The **Question** of Law & Scope of FMC

Question of Law

- Whether COVID19 outbreak should and can be treated as 'force majeure' will depend on whether the above said pandemic can be included within the scope of the description of force majeure.?
- The facts and circumstances that point to the fact that the outbreak of Covid19 indeed makes the specific performance of the party's contractual obligation impracticable albeit not impossible.

Description and Scope Of FMC

- Force Majeure clauses generally adopt one of the following approaches to defining the type of events which may, depending on its impact, relieve a party from contractual liability. A typical Force Majeure clause describes it as:
 - An exceptional circumstance that is beyond the control of the parties;
 - An event, which having arisen, such Party could not have reasonably avoided or overcome;
 - That which is not substantially attributable to the other party.
- Force Majeure events include wars, rebellions, riots and natural catastrophes.
- 'Epidemic' is mostly never mentioned as a 'Force Majeure'.

There is no dispute that the outbreak of COVID19 has been beyond the control of the parties and that parties to the respective contracts could not have reasonably foreseen it or avoided and/or overcome a 'lockdown order' issued by the Government of India as well as the State Governments. Neither is the COVID19 outbreak substantially attributable to either of the parties. Therefore it is arguable that the COVID19 outbreak may be treated as force majeure event by virtue of it fitting the descriptions above.

Description and Scope Of FMC

Other Possibilities

- In clauses where the term 'epidemic' or 'pandemic' is used, will clearly cover Covid-19.
- An Act of government has occurred where the governing body has imposed travel restrictions, quarantines, or trade embargoes, or has closed buildings or borders.
- Ambiguity will prevail in the event where the government has only made recommendations instead of giving out strict orders using the legal power bestowed on it.



An **Analysis** Of Contractual Provisions

Analysis

- In case a relevant event is not specifically mentioned, it becomes a question of interpretation of the clause whether the parties intended any such event to be covered within the ambit of the contract in the first place.
- This in turn involves considering whether the list of events included was intended to be exhaustive or non-exhaustive in nature.
- Unless specific words are used to suggest that the given list is non-exhaustive, it becomes difficult to argue that parties who set out a list of specific events, but did not include a particular event, such as an epidemic, nonetheless intended that event to be covered.
- In unprecedented circumstances like in the present, the courts are likely to be generous in their interpretation of this sort of wording when faced with parties who have encountered genuine difficulties in performing their part of the contract.

Analysis

- Having said that it is imminent that such parties will still be needed to show that their non-performance or late performance was truly outside their control and could not have been prevented or mitigated.
- Given the almost unprecedented nature of the Covid-19 outbreak and/or the actions of governments around the world in response, it is likely that Covid-19 would constitute a Force Majeure under most of the generic clauses.
- Again, just because a Force Majeure event has occurred will not necessarily mean that the parties will be protected from their liability or for failing to perform their part or the delay in its performance.

Performance of Contractual Obligation

Affected Party's Ability to Perform His Part Of The Contractual Obligation

- For a moment, let us assume that the Covid-19 pandemic or a related consequence such as the government's action is the type of event that is covered by Force Majeure clause in the contract, our next query is about the impact of it on the affected party's ability to perform his contractual obligations.
- It is commonplace for Force Majeure clauses to specify the impact that the event or circumstance in question must have/will have in order for the clause to be triggered. Classic examples of such are ***prevented, hindered and/or delayed*** the performance. The aforesaid terms require different levels of impact on the performance before the party is eventually relieved from his liabilities.

Performance of Contractual Obligation

Detailed Analysis Of The Terms Prevented, Hindered or Delayed

Prevented

- "Prevented" means that it must be physically or legally impossible to perform. This is a high bar. It is not enough that performance is more difficult, more expensive, or less profitable.
- Even when the word "prevented" has not been specifically used, the courts have in the past interpreted Force Majeure clauses as only applying to cases where the performance is impossible and in circumstances where such clauses state that the "party is to be excused on the occurrence of causes beyond their control"; and where the contract provides for "delivery unforeseen contingencies excepted".
- Similarly, it is common to see wording such as "unable to perform" and this is likely to be treated in a similar fashion by the courts.

Performance of Contractual Obligation

Detailed Analysis Of The Terms Prevented, Hindered or Delayed

Hindered

- "Hindered" or "impeded" or "impaired" or "interfered with" is a lesser standard than 'prevented' and may in appropriate circumstances be triggered by performance being made substantially more difficult.
- In cases where there is shortage of raw material caused by a force majeure event, it may hinder the performance of a manufacturing contract if those materials need to be obtained at a higher cost but performance would also mean breaking of other contracts.
- However, the fact that performing would simply be less profitable due to higher costs of procuring such raw material, for instance sourcing of alternative supplies of materials and/or labour is generally unlikely to be sufficient to absolve the party in question of his liability to perform.

Performance of Contractual Obligation

Detailed Analysis Of The Terms Prevented, Hindered or Delayed

Delayed

- Proving that performance has been "delayed" should be less onerous than proving it is legally or physically impossible.
- It is not necessary to show that obligation has been "impossible" to perform or "prevented" for a period of time, just that complying as quickly as required under the contract is substantially more difficult.

To Sum Up

A Force Majeure clause must also show that:

- The event was the cause of the inability to perform or that it delayed the performance;
- The non-performance was due to circumstances beyond the control of the party; and
- There were no reasonable steps that could be taken to avoid or mitigate the event and/or its consequences.



The **LITMUS** Test

The Litmus Test

- When a party anticipates falling into difficulty with meeting its obligations, for example due to staff shortages through self-isolation in accordance with government guidelines or issues with the supply of materials, it is crucial to explore whether alternatives, such as alternative sources of labour or materials, are reasonably available – including procuring them at higher costs, unless this involves breaching other existing contracts.
- Similar to the test for "prevention" of performance under Force Majeure clause, the fact that the performance has been made more difficult or costly is not enough. In addition, it is questionable whether an epidemic or even a pandemic would be considered to be unforeseeable, given previous recent epidemics and warnings that further epidemics or pandemics are likely to occur. However, what is greatly possible is the argument that the unprecedented extent of the global government's enforced lockdown was unforeseeable.

The Litmus Test

The arguments regarding abatement of rent in the event that a tenant cannot use the rented space.

- Simple! The Tenant is not getting what it bargained for, i.e. the rental premise where he can operate his business. Under the current circumstances, the tenants are not receiving the benefit of the bargain and the Courts might consider it to be inequitable for landlords to receive full payment more particularly when the operations to support the business as 'going concern' is highly restrained.
- In the case of closure of shopping malls, the retail tenants are expected to advance an equitable argument for rent abatement by stating that the landlords have failed to provide a space for them to operate their business.
- A business that is seeking to rely on a force majeure clause must comply with the procedural requirements under the contract. There may be a requirement to give notice of its intention to rely on the 'clause' to the other party within a particular timescale including any formalities that will be required for the service of notices. Some of the clauses may also require update to be provided and/or an express an obligation to mitigate.



The **Remedies** to be prayed
for in such events.

Remedies Prayed

The usual remedy when a Force Majeure clause is invoked is that one or more of the parties be excused from its obligations and/or liability under the contract without any damages to be paid. Force Majeure clauses can sometimes also provide for

- Extension of time,
- Suspension of time, or
- Termination in the event of continued delay or non-performance.

A right to terminate can be commercially important as it may provide a leverage to re-negotiate the terms of the contract.

Remedies Prayed

- Today, in the wake of this outbreak, the Government of India has imposed a lockdown for a period of 21 days. However, the Ministry of Home Affairs has issued an Addendum specifically giving exceptions in the form of
 - operation of Seaports of cargo movement and
 - Inter-state movement of goods in order to ensure regular supply of essentials.
- Nevertheless, the Ministry of Shipping has issued specific guidelines to Major ports on exemptions/remission on penalties, demurrages charges, and fees, rentals levied on any Port user for any delay in Berthing/Loading/unloading operations or evacuation/arrival of Cargo caused due to lockdown measures which is expected to continue till 14th April 2020.
- Additionally, the Ministry has also permitted major ports to extend the completion of any project under implementation in Public-Private Partnership mode or otherwise. **Applying the same logic to commercial contracts could avoid unnecessary legal complications.**

Remedies Prayed

- If there is no Force Majeure clause, the affected party can look at other provisions of the contract for potential route out of difficulties.
- If the contract does not provide any such routes, it may in certain circumstances be possible to rely on the **Doctrine of Frustration of Contract**.



Step by Step Guide

To Help You To Seek Remedy
In Case You Want To Rely On
The Force Majeure Clause

Guide

- Consider in detail the precise wording of the Force Majeure clause; the contract as a whole and the circumstances that have presently arisen. Determining whether performance is excused by the Force Majeure clause therein can be a difficult and highly fact-sensitive exercise; **seek professional help at the earliest.**
- Explore alternate means of performing, reducing delay or minimising any loss to the other party. This may require considering alternative suppliers or alternative methods of delivery even if that ensues higher costs to you.
- Serve any notices as required under the contract and as soon as possible and in accordance with the contractual provisions. Carefully consider what are the events or circumstances that you allege constitutes Force Majeure event taking into account the wording of the clause and the timescale required for the service of notice; the outbreak of Covid-19 itself and/or the government's restriction put in place.

Guide

- Do not attempt to rely on increased costs to excuse non-performance or delay. **This will usually NOT be sufficient.**
- Prepare documentary records - particularly of why performance was impossible, hindered or delayed as the case may be; the steps that were taken to find the alternatives and to mitigate loss; and the service of any notices.
- If there is no Force Majeure clause, consider 'Frustration', but beware of the high bar of establishing that a contract has been frustrated.
- Consider other routes and remedies either under the contract or through agreeing binding variations to contracts with other parties.
- In exercise of powers under the Epidemic Diseases Act, 1897, the State Government has already issued regulations for the prevention and containment of the spread of COVID-19 which grants exemptions from restrictions to certain establishments like hospitals, dispensaries, clinics, pharmaceuticals, petroleum and gas stations, ATM machines, banks, and several other essential services units.

Guide

- The Tenant MUST mentally take note that the Landlords could be depending on their rental income for the purpose of fulfilling their own obligations towards banks or other contractors and third parties. Therefore, the exempted establishments that are functioning in rental premises cannot be allowed to rely on “Force Majeure” clause alone.
- The Government should also focus on framing extensive regulations for safeguarding the interests of companies that were on the verge of becoming insolvent during the lockdown period and eventually expose itself to proceedings under the Insolvency and Bankruptcy Code post-lockdown period.
- One of the important issues that need to be addressed is that the burden imposed on employers by Central and State Government’s regulations that makes it mandatory for employers to make payments of wages/salaries to workers/employees on daily wage basis for instance: construction workers.
- Buyers who are part of chain of supply may themselves need to invoke the Force Majeure clause in the event that the supplier relies on it in order to avoid being in breach.

Guide

- Real estate industry may find itself at crossroads. The declarations and supported affidavit stating the time period within which the project or the specific phase will get completed in accordance with the Real Estate (Regulation and Development) Act, 2016, is most likely to be breached. In consequence, the date of handing over the possession and the rate of interest in the event of default will be required to be re-worked.
- The home buyers finding that the committed date of delivery is too far may opt not to purchase the apartment and become entitled to a refund of the advance amount paid. This in turn would put the real estate sector in great peril. Looking closely at the penalty and compensation clauses will be very helpful.

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“ If you have a **strong belief** in yourself, in what you are doing and what you want to do, no adversity is too difficult to overcome.

- Napoleon Hill

THANK YOU

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