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IMPACT OF COVID-19 ON CONTRACTUAL OBLIGATIONS

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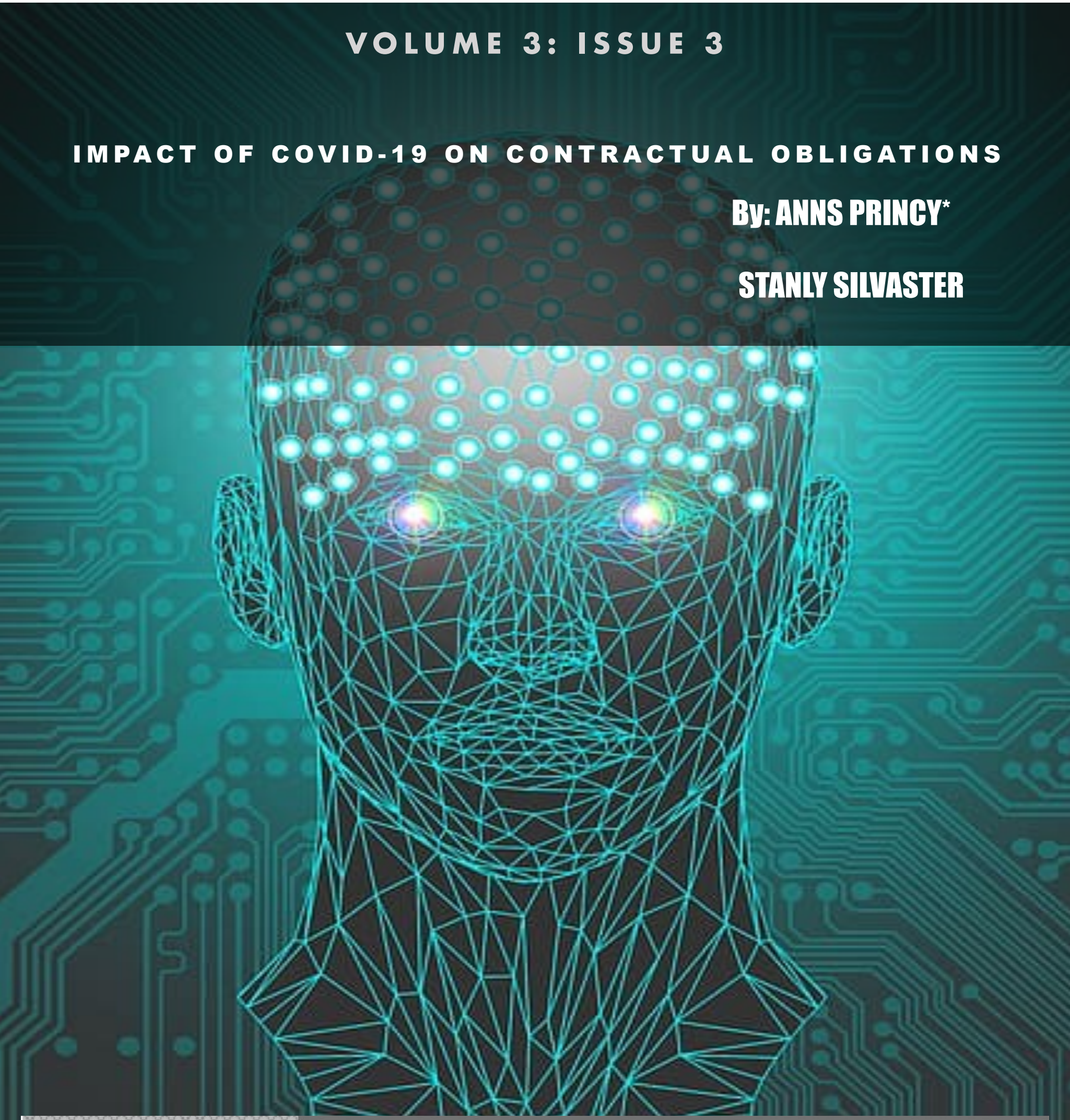

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Abstract:

COVID-19 has caused worldwide unprecedented disruptions to business operations and the commercial turmoil continues. The pandemic has primarily impacted the ability of companies around the globe to maintaining operations and perform their contractual obligations. In light of the situation at hand, companies are finding ways of mitigating, if not escaping the inertia brought forth on contractual obligations. The unanticipated coronavirus has interrupted our personal, professional, financial and commercial lives, to a point of preventing best performance at all levels, so much so that it has rendered performance impossible.

This article focuses on impact of Covid-19 on performance of contracts, governed by Indian law and possible remedies to it.

Keywords – COVID-19, Contractual obligations, Indian laws & Remedies.

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1. INTRODUCTION

A Contract is "an agreement enforceable by law".[3] In other words, a contract is an agreement[4] between two or more parties creating obligations that are enforceable or otherwise recognizable at law. Execution of these obligations may be affected or interrupted by unforeseen or supervening events, i.e., events which are unexpected or incapable of being known in advance by either of the parties from their contractual obligations. The novel coronavirus is one such unforeseen event that has affected the contractual obligation that has to be performed by the parties to the contract. Of all the business hurdles in the world history, COVID-19 or Coronavirus apparently is unprecedented owing to its very nature of mass community spread and prolonging global and national lockdown resulting to shutdown of all industries. Having emerged as public health crisis the pandemic has now become a threatening factor for business across globe. Experts are trying to figure out ways to combat the issue. Though the pandemic is unique, the nature of suffering by the parties of the contract is felt to be alike the past crisis comprising of, but not limited to Gujarat earthquake in 2001 and the Indian Ocean Tsunami in 2004, etc. This includes delay in contract enforcement and impossibility of performance of contractual obligation. Thus the following applications can be used to assess the extent to which their performance can either be excused without liability or compelled with the force of law.

2. IMPOSSIBILITY OF PERFORMANCE

The unanticipated has made performance of a contract either difficult or impossible. While some parties face hardships in performing their contractual obligation, some has become incapable of performing the obligation at all. The doctrine of impossibility refers to a situation when it is impossible for a party to a contract to perform the promised obligation. Section 56 of the Indian Contract Act, 1872 (ICA) provides for impossibility of performance after execution of a contract. Section 56[5] is contained in chapter IV of the ICA which relates to performance of contracts and professes to deal with one category of circumstances under which performance of a contract is excused or dispensed with.

It provides:

(1)Contracts to do act afterwards becoming impossible or unlawful- 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.

(2)Compensation for loss through non-performance of act known to be impossible or unlawful- where one person has promised to do something which he knew, or, with reasonable diligence, might have known, and which the promise did not know, to be impossible or unlawful, such promisor[6] must make compensation to such promise for any loss which promisee[7] sustains through the non-performance of the promise.(emphasis supplied)

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[3] Section 2(h) of the Indian Contract Act, 1872

[4] Section 2(e) of the Indian Contract act, 1872 defines 'agreement' as every promise and every set of promises, forming the consideration for each other is an agreement

[5] Section 56. Agreement to do impossible act- An agreement to do an impossible act in itself is void

[6] Section 2(c) states when the proposal is accepted, the person making the proposal is called as promisor and

[7] The person accepting the proposal is called as promisee

At first, the statutory provision emphasised in para 2 of section 56 would appear to come into play in the Covid-19 scenario, but when examined this "impossibility" of performance may sweepingly render every other contract void under Indian Law. Here, it is crucial to mention the fact that the party may not be able to use the doctrine of impossibility as a defence to non-performance if the party:

(i) knew of the facts, at the time the contract was executed, that made performance impossible;

(ii) assumed the risk of impossibility; or

(iii) Could have acted to prevent the event rendering performance impossible.

Thus, the date of entering into the agreement of contract has to be scrutinized before applying the doctrine of impossibility to the parties. In the present scenario, the COVID-19 was declared characterised as a pandemic on March 11, 2020[8]. Given this, it is obvious that before entering into an agreement the parties would have anticipated the impact of the pandemic on their obligations. If so, as aforesaid, the parties to contract cannot use this doctrine as a defence to their non-performance. So any contract that is entered on or after March 11, 2020 should not be granted the doctrine of impossibility of performance. Also, even before the novel coronavirus was declared a pandemic, it was well known before a few weeks that the virus will have impact over the coming days. In that case, even the contracts entered into much before March 11, 2020 cannot be considered for granting the doctrine. This is a general assumption. The ambit of 'impossibility' and the authority best placed to determine it is under question. The concepts of contingent contracts, force majeure and frustration are necessary in order to understand the remedies available to the parties under their contracts in the covid-19 scenario.

2.1 FORCE MAJEURE

"Force majeure"[9], in Latin, means "superior force". The term "force majeure" has been defined in Black's Law Dictionary[10] as 'an event or effect that can be neither anticipated nor controlled.' The term includes both acts of nature (e.g. floods and hurricanes) and acts of people (e.g. riots, strikes and wars). Black's Law Dictionary defines force-majeure clause as 'A contractual provision allocating the risk if performance becomes impossible or impractical, esp. as a result of an event or effect that the parties could not have anticipated or controlled.' Thus force majeure aims at exempting a party from a contract which has become impossible for performance due to intervention of a superior force. Majority of the contracts expressly contain a term according to which the contract would be suspended or discharged on the happening of a certain circumstance. In that case, the dissolution of the contract would take place under the terms of the contract itself. While force majeure has neither been defined nor specifically dealt with in Indian statues, some references can be found in section 32[11] of the contract act[12] envisages that if a contract is contingent on the happening of an event which becomes impossible, the contract becomes void. A classic force majeure clause would require that the disruption of performance be beyond the invoking party's reasonable control and that the event was not reasonable foreseen. Whether COVID-19 would qualify a force majeure event will depend on each particular contract i.e. the way force majeure is worded in the contract or what all contingencies have been captured (explicitly and impliedly) in force majeure clause occurrence of which would qualify as a force majeure event. The burden of

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[8] The novel coronavirus was identified on 7 January 2020 and was temporarily named "2019-nCov" and was subsequently named the "COVID-19 VIRUS". World Health Organisation announced COVID-19 outbreak as a pandemic on 11 March 2020

[9] French term equivalent to "Vis majeure"

[10] Black's Law Dictionary Eighth Edition, First South Asian Edition 2015

[11] Section 32. Enforcements of contracts contingent on an event happening- Contingent contracts to do or not to do anything if an uncertain future event happens, cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.

[12] Indian Contract Act, 1872

proof rests on the party invoking the force majeure clause. The said burden can be effortlessly discharged where force majeure clause in the contract explicitly provides for such events like epidemics, pandemics and government restrictions. Under Indian law, force majeure derives its existence for the contract. The basis of this clause[13] is to save the performing party from consequences of breach of contract resulting from an event over which it has no control. Therefore, it can be said as an exception for breach of contract. The nature of the general terms of the contract, the vents that precede or follow it and the facts of the case determines whether the clause can be invoked to excuse liability of the party from non-performance.

The question of whether force majeure clause be interpreted to cover a pandemic may arise, the term 'Act of God' is often seen in force majeure clause. 'Act of God' is defined as an extraordinary occurrence or circumstance, which could not have been foreseen and guarded against. This could include floods, hurricanes, earthquakes etc. Further, the clause is held to contain a more extensive meaning that the oft-quoted 'Act of God' terms, and includes occurrences like strikes, riots, wars, administrative breakdown, "lockdowns" and effects of such events such as shortage of supply owing to war, war-time difficulty in shipping, refusal of export licence etc. Some force majeure clauses could contain generic terms[14] such as "any other happening". Here clearly the worldwide lockdown due to the pandemic comes in the ambit of 'Act of God'. The lockdown has significantly affected the production rate resulting in shortage of supply, difficulty in shipping and refusal of export licence akin to a war as mentioned above. Thus the pandemic comes under the ambit of 'Act of God' and hence the force majeure clause can be invoked. However, this would depend upon the language of the clause and the rules of legal interpretation of force majeure clause as included in the agreement to contract by the parties.

In light of the pandemic, on February 19, 2020, the Ministry of Finance issued an office memorandum on 'Force Majeure Clause' providing that coronavirus should be considered as a case of natural calamity and force majeure may be invoked, whenever considered appropriate, following the due procedure (in the office memorandum).[15] It provides that "force majeure clause does not excuse a party's non-performance entirely, but only suspends it for the duration of the force-majeure". In the present scenario, the party's performance remains suspended as the pandemic hasn't come to a standstill yet. But, owing to the national unlock, the parties of certain contracts that may be able to perform can carry on their performance. The memorandum further stated that the firm[16] has to give notice of force majeure as soon as it occurs and it cannot be claimed ex-post facto[17]…If the performance in whole or in part or any obligation under the contract is prevented or delayed by any reason of force majeure for a period exceeding ninety days, either party may at its option terminate the contract without any financial repercussions on either side. This option of termination has created huge disruptions in the contractual agreements. Since the pandemic has exceeded the period of ninety days already, almost all the contracts entered into may be terminated by either of the parties. The contract workers of major and mid-level companies have already started receiving emails and telephone calls informing them the termination of their contracts. However, the order implies that the memorandum applies only to government contract, which again would affect the vulnerable sect of people in the private sector as mentioned above.

2.2 DOES 'ACT OF GOD' IN FORCE MAJEURE CALUSE INCLUDE A PANDEMIC?

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[13] A typical force majeure clause in contracts reads as: 'none of the parties shall be liable for any delay, failure in performance, loss or damage due to force majeure events. During the performance of the agreement events of force majeure may occur, such as, but not limited to, war, fire, flood, earthquake, accident, riot , strike, explosion, lockout, act of God, act of government authority, accidents and/or damage, decision from the customer, or any event beyond the reasonable control of any of the parties, by which their effects render impossible or hinder the performance of any obligation or the exercise of any rights under this agreement or the normal operation of the company's industrial installations, or the failure or omission to comply with this agreement'

[14] A word or a phrase that is used to describe a general group or class, rather than a specific thing

[15] Office Memorandum No.F. 18/04/2020-PPD titled 'Force Majeure Clause', issued by Department of Expenditure, Procurement Policy division, Ministry of Finance

[16] The business companies under which such contracts are entered into

[17] It is a law that respectively changes the legal consequences (or status) of actions that were committed or relationships that existed, before the enactment of the law

Courts in the United States of America and the United Kingdom have specifically held that the expression 'Act of God' includes a pandemic/ epidemic.

In Lakeman v. Pollard,[18] a labourer at a mill left his job early during a cholera epidemic[19] due to concerns for contracting the disease and, therefore, failed to complete his work contract. In an action by the mill owners seeking compensation for work done by the labourer, it was argued that the work contract had been breached. The supreme court of Maine held that the cholera outbreak was an 'Act of God' and the labourer was thus not in breach of his contract since duty to perform under the contract was discharged.

Similarly, in Coombs v. Nolan[20], the district court for the Southern District of New York excused a delay in the discharge of cargo where the defendant couldn't obtain enough horses to unload a ship on time due to a then prevalent horse flu pandemic[21] on the ground that the horse flu pandemic fell within the ambit of 'Act of God'[22].

In Sandry v. Brooklyn School District[23], the Supreme Court of North Dakota considered an appeal pertaining to claims by school bus drivers for their wages/ compensation under their transportation contracts during the period that the schools were shut owing to the influenza outbreak. The Supreme Court of North Dakota discharged the school district from paying the bus drivers during the period that the schools were shut down due to influenza epidemic. It is pertinent to note that the reasoning was based on the fact that the contract had become impossible to perform due to the shut-down.

Under the UK law, it has been held that the inability of a party to deliver an aircraft on time due to a pandemic causing a dearth of pilots fell within the catch-all residuary wording of a majeure clause.[24] Thus, in light of the aforesaid cases, the COVID-19 pandemic does come into the ambit of 'Act of God'. However, when force majeure cannot be invoked failing to provide the required terms in the agreement to contract, doctrine of frustration can be invoked. It is discussed in detail below.

2.3 DOCTRINE OF FRUSTRATION

Doctrine of Frustration is covered under section 56 of the Indian Contract Act 1872[25]. The doctrine of frustration is based on the legal maxim '*Lex non cogit ad Impossibilia'* which literally means 'Law does not compel the Impossible'. The essential idea upon which the doctrine of frustration of contract is based is that of the impossibility of performance of the contract by the parties. More often, 'impossibility' and 'frustration' are used as interchangeable expressions. Later on, the changed circumstances make the performance of the contract impossible, and the parties are absolved from the further performance of it as they did not promise to perform an impossibility.

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[18] 43 Me 463 (1857)

[19] The major outbreak of cholera (1846-60) that was considered to have the highest fatalities of the 19th century epidemics

[20] 6 F Cas. 468, 7 Ben. 304 (1874)

[21] On October 25, 1872, The New York Times reported on the extent of the outbreak, claiming that nearly all public stables in the city had been affected, and that the majority of the horses owned in the private sector had essentially been rendered useless to their owners

[22] See also the decision of the District Court for the Southern District of Indiana in Rexing Quality Eggs v. Rembrandt Enterprises 360 F. Supp. 3d, 817 where the court made an observation that a drop in the supply of eggs due to the avian flu may be an act outside of the reasonable control of a party (and thus constitutes an 'Act of God'); and SNB Farms Inc. v. Swift & Company 2003 WL 22232881 where the District Court of the Northern District of Lowa (Eastern Division) held that Porcine Reproductive and Respiratory Syndrome affected hog production and triggered the Force Majeure Clause. However, the Court in this case held that due notice had not been given to the counter party of the force majeure event.

[23] 182 NW 689

[24] Aviation Holdings Ltd. v. Aero Toy Store LLC [2010] 2 Lloyd's Rep 668

[25] Ibid.

The parties shall be excused if substantially the whole contract becomes impossible of performance or, in other words, impracticable by some cause for which neither was responsible. In the present scenario, clearly, none of the parties can be held responsible as it comes under the ambit of 'Act of God' and law shall not compel the impossible owing the same. Rightly, compensation for loss through non-performance of act in circumstances like this is known to be impossible or unlawful. Where one person has promised to do something which he knew or, with reasonable diligence, might have known, and which the promisee did not know, to be impossible or unlawful, such promisor must make compensation to such promise for any loss which such promisee sustains through the non-performance of the promise. But when neither of the party, through reasonable diligence, did not know the impossibility, like in the present case, the parties shall not be held responsible for the loss led by non-performance. It is important to understand that the common law doctrine of frustration as propounded in English law is distinct from the statutory provision of supervening impossibility and illegality under the Indian law.

Prior to the decision in Taylor vs. Caldwell[26], the law in England was extremely rigid. A contract had to be performed, notwithstanding the fact that it had become impossible of performance, owing to some unforeseen event, after it was made, which was not the fault of either of the parties to the contract. This rigidity of the common law in which the absolute sanctity of contract was upheld was somewhat relaxed by the decision in Taylor vs. Caldwell in which it was held that if some unforeseen event occurs during the performance of a contract which makes it impossible of performance, in the sense that the fundamental basis of the contract is destroyed, it need not be further performed, as insisting upon such performance would be unjust. 'Impossibility' under S.56[27] doesn't mean literal impossibility to perform (owing to strikes, commercial hardships, etc.) but refers to those cases where a supervening event beyond the contemplation and control of the parties (like the change of circumstances) destroys the very foundation upon which the contract rests, thereby rendering the contract 'impracticable' to perform, and substantially 'useless' in view of the object and purpose which the parties intended to achieve through the contract. In the seminal decision of **Satyabrata Ghose v. Mugneeram Bangur & Co.,** [28] the Hon'ble Apex Court had adverted to Section 56 of the Indian Contract Act. The Supreme Court held that the word "impossible" has not been used in the Section in the sense of physical or literal impossibility. To determine whether a force majeure event has occurred, it is not necessary that the performance of an act should literally become impossible, a mere impracticality of performance, from the point of view of the parties, and considering the object of the agreement, will also be covered. Where an untoward event or unanticipated change of circumstance upsets the very foundation upon which the parties entered their agreement, the same may be considered as "impossibility" to do as agreed. Subsequently, in **Naihati Jute Mills Ltd. v. Hyaliram Jagannath,**[29] the Supreme Court also referred to the English law on frustration, and concluded that a contract is not frustrated merely because the circumstances in which it was made are altered. In general, the courts have no power to absolve a party from the performance of its part of the contract merely because its performance has become onerous on account of an unforeseen turn of events.

In **M/s Alopi Parshad & Sons Ltd. v. Union of India**[30], the Supreme Court, after setting out section 56 of the Contract Act, held that the statute does not enable a party to a contract to ignore the express covenants[31] thereof and to claim payment of consideration, for performance of the contract at rates different from the stipulated rates, on a vague plea of equity. Parties to an executable contract are often faced, in the course of carrying it out, with a turn of events which they did not at all anticipate, for example, a wholly abnormal rise

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[26] [1863] EWHC QB J1, (1863) 3 B&S 826, 122 ER 309

[27] Indian contract act, 1872

[28] 1954 AIR 44, 1954 SCR 310

[29] 1965 AIR 522, 1968 (1) SCR 821

[30] 1960 AIR 588, 1960 (2) SCR 793

[31] A type of agreement analogous to a contractual obligation in which a promise to engage in or refrain from a specified action is made

or fall in prices which is an unexpected obstacle to execution. This does not in itself get rid of the bargain they have made. It is only when a consideration of the terms of the contract, in the light of the circumstances existing when it was made, showed that they never agreed to be bound in a fundamentally different situation which had unexpectedly emerged, that the contract ceases to bind (like the present unanticipated pandemic). It was further held that the performance of a contract is never discharged merely because it may become onerous to one of the parties.

The Supreme Court in its latest judgment in **Energy Watchdog vs. Central Electricity Regulatory Commission and Others**[32] dated April 11, 2017 laid down the guidelines with respect to applicability of sections 32 and 56 of the Indian Contract Act, 1872 to a contract. In the said judgment, the Supreme Court also made references to previous landmark judgments of the Supreme Court of India and also drew references from common law judgments and held that in so far as it is relatable to an express or implied clause in a contract, it is governed by Chapter III dealing with contingent contracts and more particularly, Section 32 thereof. In so far as a force majeure event occur *de hors*[33] the contract, it is dealt with by a rule of positive law under Section 56 of the Contract Act.

2.4 DIFFERENCE BETWEEN SECTION 32 AND 56 OF ICA[34]

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. Even if the agreement to contract doesn't involve any specific circumstances before its execution that may render the performance impossible, this doctrine would be application and would excuse the parties from its liability of non-performance. The events of this sort include the most unanticipated ones like the present pandemic. 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. However, 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. It 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 do not absolutely excuse parties from performing their obligations. However, if the specific event due to which the performance was hindered is not mentioned in the list, the force majeure clause cannot be invoked. In the case of COVID-19, the clause should contain terms such as 'act of god' or 'pandemic' or 'lockdown' or all of these in order to invoke the clause. 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.

3. COVID-19 THROUGH JUDICIAL LENS

The spread of the COVID-19 pandemic and lockdowns imposed by several nations have made performance of contracts challenging and/ or impossible. India was until recently, under a complete lockdown since 23rd March 2020. All commercial activities saving a few 'essential services' were suspended. Resultantly, Indian courts have started witnessing the onslaught of contractual disputes inter-alia revolving around the doctrine of frustration. The initial approach of the Indian Courts has varied from case to case as can be seen from the recent Orders of the Bombay High Court and the Delhi High Court. Some of the recent judgments are summarised below.

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[32] 2017 14 SCC 80

[33] That which is outside the scope of or not included in the agreement involved

[34] Indian Contract Act, 1872

(i) **Rural Fairprice Wholesale Ltd. & Anr. v. IDBI Trusteeship Services Ltd. & Ors[35]:** In this case the Bombay High Court recognized the market situation pursuant to the COVID-19 and observed that the share market had collapsed due to COVID-19, therefore, it was a fit case to restrain the bank from acting upon the sale notices and a direction to withdraw any pending sale orders for the pledged shares.

(ii) **Standard Retail Pvt. Ltd v. Gs Global Corp and Ors[36]:** In a departure from its 3 April 2020 Order, the Bombay High Court refused to grant interim measures to the Petitioner observing that the commodity in question was an essential item and lockdown is only for a limited period. Consequently, Petitioner cannot withdraw from its contractual obligation of making payments to the Respondents.

(iii) **M/s. Halliburton Offshore Services Inc. vs Vedanta Limited & Anr[37]:** The case pertained to restrain on invocation of bank guarantees. While granting interim relief on the invocation of bank guarantees, the Delhi High Court observed that the country wide lockdown was prima facie, in the nature of force majeure. Therefore, it could be said that special equities do exist, as would justify grant of the prayer, to administer invocation of the bank guarantees.

(iv) **Indirajth Power Private Limited v. UOI & Ors[38]:** In this case the petitioner sought interdiction of the Bank Guarantee inter-alia on account of the lockdown in the country due to spread of COVID-19 pandemic, which could drive the Petitioner towards being declared an NPA[39]. The Court while observing the Petitioner's conduct i.e. despite the extension of 12 months could not fulfil its obligation under the Contract, refused to grant relief to the Petitioner. The Court observed that Petitioner's position under the contract was unaffected by the imposition of the lockdown. Thus, while examining the cases, it is pertinent to consider the prior conduct of the parties to contract and whether the pandemic has indeed affected their non-performance has to be scrutinized.

Therefore, not all the cases can be excused from its performance of contract merely due to the emergence of the unanticipated pandemic. Judicial scrutiny is essential. Factors like the inclusion of terms in the majeure clause, conduct of parties, entire subject matter or underlying rationale for the contract, existence of special equities, and so on has to be examined.

4. CONCLUSION

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35 Decided On 3 April 2020 in the High Court of Judicature at Bombay

36 Decided on 8 April, 2020 in the High Court of Judicature at Bombay

37 Decided on 20 April 2020 in the High Court Of Delhi At New Delhi

38 Decided on 28 April 2020 in the High Court Of Delhi At New Delhi

39 A Non-Performing Asset (NPA) is a loan or advance for which the principal or interest payment remained overdue for a period of 90 days.

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The unprecedented COVID-19 pandemic has led to large-scale disruptions in business sector. As a result, several contractual parties are seeking to retract from their contractual obligations. However, the burden of proof of whether COVID-19 has actually affected performance of the specific contractual obligation in a particular case lies heavily on the party seeking to have its non-performance excused. A deeper scrutiny of the approach adopted by Courts on the issue of force majeure suggests that there are no straitjacket principles with respect to the applicability of the concept to save a party from the performance of contract. The approach of the courts has been to examine the issue based on the facts of each case and relief has been granted to parties accordingly. Therefore, parties should steer away from attempting to demonstrate frustration in a case where performance is otherwise possible. Further, what attains significance is the proximity of the event with the non-performance which is not foreseeable by the parties. The COVID-19 situation could be viewed as temporary, making it difficult for parties to put an end to contracts solely due to frustration or impossibility of performance. Thus, the issue needs alternative remedies to combat the more difficult situations that are to be expected in the near future.

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