Journal of Law, Ethics & Society
A Publication of Jus Dicere & Co.

Issue 2 Publisher: Parag Agrawal

Force Majeure in COVID-19 affecting companies and MSMEs

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Introduction

The Government of India declared a nationwide lockdown which lasted nearly for 69 days from 24 March 2020 till 31 May 2020, in response to the COVID-19 pandemic. This was subsequently followed by various State Governments issuing directions for the same in their respective states. The effect of such a lockdown was unprecedented on both large companies as well as Micro, Small And Medium Enterprises (MSMEs) some which had to temporarily shut their businesses due to the impact of COVID-19 crisis[3], terminate their contracts or renegotiated the terms of the contract using the epidemic as the basis.The likely impact (deceleration) of COVID-19 from best case scenario to worst scenario are as follows: manufacturing sector may shrink from 5.5 to 20 per cent, exports from 13.7 to 20.8 per cent, imports from 17.3 to 25 per cent and MSME net value added (NVA) from 2.1 to 5.7 per cent in 2020 over previous year[4]. The lockdown thus, made these entities reflect upon their contractual arrangements, and the doctrinal issues present in their force majeure clauses and how the courts have evolved this jurisprudence over time and interpreted it.

The Black's Law Dictionary defines the term Force Majeure as an event or effect that can be neither anticipated nor controlled. It is a contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event that the parties could not have anticipated or controlled. Under the Indian Contract Act, 1872, force majeure claims which exonerate a party from performance of its part of the contract are primarily divided under two categories and embodied under Section 32 of the Act (which talks about Contingent Contracts) and Section 56 (which deals with the frustration and impossibility of performance). Section 32 deals with the enforcement of contracts which are contingent on an event happening and it postulates two things (i) the contingent contract

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[3] Survey conducted by Endurance International GroupCOVID-19 impact intense on MSMEs: Survey, Financial Express(June 25 ,2020).

[4]Pravakar Sahoo,COVID-19 and Indian Economy: Impact on Growth, Manufacturing, Trade and MSME Sector, Sage Journals (September 2, 2020).

would be enforceable only on the occurrence of an uncertain event and (ii) if the event, on which the contract is contingent, becomes impossible, the contract becomes void. Section 56 on the other hand talks about agreements which are impossible to perform, and address the issue of force majeure and impossibility directly. Once the event meets the threshold of 'impossibility' the contract stands vitiated/void, as a result of which the performance of the contract is excused without imposing damages. However, when a breach in performance precedes the force majeure event, the party in breach of the contract will not be absolved of his performance and damages may be successfully levied .

In this essay, what is important for us to understand is when can these two sections be invoked to claim relief amidst the pandemic we are dealing with. In various landmark cases starting from ***Satyabrata Ghosh v. MugneeramBangur***[5], the Court has held that in deciding whether a force majeure clause can be a contingent contract (i.e whether it can come under the purview of Section 32 of the ICA) it is essential that a clause in the contract has an implied or expressed reference to the event due to which the party is seeking relief from the court. On the other hand Section 56 of the Act is applicable when the force majeure event occurs dehors or outside of the Contract. However, if the event is outside the scope of the clause or in the absence of such a clause in the contract, Section 56 comes into play. In India, even though the courts have not yet directly ruled that a pandemic (COVID-19) comes under "an act of God" there have been some cases in the past for instance in the case of ***The Divisional Controller, KSRTC vs. Mahadava Shetty***[6] the Supreme Court had ruled '*that the expression "act of God" signifies the operation of natural forces free from human intervention with the caveat that every unexpected natural event does not operate as an excuse from liability if there is a reasonable possibility of anticipating its occurrence.*' This gives us sufficient reason to say that the Courts in India will acknowledge COVID-19 as an act of God and this is one of the major reasons why Section 32 will be applicable to these cases. However, complex fact situations may arise in cases especially where the contract defines force majeure events in a restrictive manner without specifically mentioning either a pandemic or act of God. In such cases Section 56 of the act could be applicable instead of Section 32.

[5]AIR 1954 SC 44 at para 23.

[6](2003) 7 SCC 197.

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Core Conceptual Issues

It is important to note that only one-third of the force majeure claims actually succeed; this is due to the high threshold the courts have set while deciding claims encompassing Force Majeure so that it cant be used as an excuse for non-performance in bad bargains . Thus, it is important for the parties to bear in mind what constitutes the doctrinal threshold of force majeure, impossibility and frustration. The most significant of them being the *unforeseeability* of events, i.e., whether the event that has rendered the performance impossible could be anticipated by the parties while contracting or not. The enforceability of the contract is determined by the extraordinary nature of the event as well as its subsequent consequence. This is adjudged by the courts by inquiring what was within the commercial contemplation of the parties while negotiating the contract. For instance, the claims of natural calamities, change in law, foreign disturbances and injunction orders by the courts have been regarded as unenforceable by the courts and thus have been regarded as force majeure events. The unenforceability of a contract can also be adjudged by the scope of the force majeure clause, i.e., the events covered under the clause also prove as a guide to indicate the nature of events which the parties to contract considered as a basis of a force majeure. Secondly, in addition to the event being unenforceable it should be such that it significantly impacts the very purpose for which the contract was entered into. The courts while determining whether the purpose of the contract has been materially impacted analyze the essential obligation of each of the parties to the contract and determine if they have been rendered impossible in such a way that no other recourse is available to the parties. It is important to note at this point that the legal test of impossibility is not satisfied on the grounds that the event is impracticable, burdensome or causes hardship to the part responsible for its performance and is not a valid force majeure claim. The court assumes that while contracting parties do accept a certain amount of risk and normal disruptions like price fluctuations and disruptions in regular business activities do not constitute a valid claim.

Moreover, the parties seeking to rely on a Force Majeure event to excuse the non-performance of the contract will have to prove that it was unable to perform its part of the contract despite having taken reasonable efforts to perform the contract by alternate means or to mitigate the effect of the force majeure event. If the event does not fundamentally alter the contract but makes it more difficult to perform it, cannot be considered to be frustrated. More importantly, a direct and proximate link between the event and non-performance has

to be demonstrated by the party seeking an injunction or a relief and the language of the force majeure clause can have a bearing on establishing this link.

Although there is no obligation under either section 32 or 56 of the Indian Contract Act to notify the counter party on the occurrence of a force majeure event; Courts have in certain cases like ***Housing Development and Infra Ltd v. Mumbai Airport Intl Ltd***[7]and ***Babasaheb v. Vithal***[8]dismissed the claim of a force majeure on the grounds that the occurrence of the force majeure event was not promptly (at first instance) communicated to the counterparty. *This is because in force majeure clauses in commercial contracts impose clear and timebound obligations to notify counter parties, either when the force majeure event arises or when performance has been rendered impossible as a result of such an event.* Recently in the case of ***MEP Infrastructure Developers Ltd. v. South Delhi Municipal Corporation***[9]the Ministry of Road Transport and Highways had issued a circular in which it classified 'pandemic' as a force majeure event. The Court observed that on account of the supervening nature of the pandemic and its explicit classification by the Circular as a *force majeure* event, there was no requirement for a distinct and separate notice postulating the occurrence of the *force majeure* event[10]. Therefore, before bringing a force majeure claim it is important for the parties to examine whether there exists a notice obligation.

The impact of COVID-19 pandemic has been severe on trade, joint ventures and M&A deals, manufacturing sector as well as on MSMEs. This in turn has led to an economy slowdown, to battle which on 24th March the Finance Minister announced various reliefs and relaxations under Insolvency & Bankruptcy Code (IBC) such as increasing the threshold limit from the existing Rs. 1 Lakh to Rs. 1 Crore to prevent triggering of Insolvency proceedings against MSMEs, the announcement also held that force majeure could be invoked under IBC if COVID-19 continued after 30th April 2020, then Section 7, 9 and 10 of the IB Code shall be suspended for a period 6 months. The Central Board of Direct taxes also announced tax refunds to the tune of INR 7,760 Crore to help ensure that MSMEs could carry on their business in an efficient and effective manner without laying off workmen and pay-cuts.

[7] 2013 SCCOnlineBom 1513

[8] 2009 SCCOnlineBom 1378

[9] W.P. (C) 2241/2020 order dated 12 June 2020.

[10] COVID-19 as Force-Majeure in Construction Contracts: What the High Court of Delhi has held,https://www.barandbench.com/columns/covid-19-as-force-majeure-in-construction-contracts-what-the-high-court-of-delhi-has-held.

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Contracts often contain a force majeure clause which includes activities such as acts of god, wars, terrorism, riots, labour strikes, embargos, acts of government, epidemics, pandemics, plagues, quarantines, and boycotts. If any of the alleged events prevent a party from performing the contract, the affected parties may be relieved from performance if no other alternate means to fulfill such an obligation is available. Certain contracts in addition to specifically mentioning events contain a catch all phrase like "*including, but not limited to*" or "*any cause/ event outside the reasonable control of the parties*". The court in ***Md. Serajuddin v. State of Orissa***[11]held such catch-all phrases to be '*ejusdem generis*'. Further in ***InteroreFertichem Resources SA v. MMTC of India Ltd***.[12] it is seen how courts while interpreting contractual clauses adopt the principle of '*ejusdem generis*', to ascertain whether certain unenumerated events like the present COVID-19 is analogous with events which are enumerated in the force majeure category to enable application on the clause. Therefore, depending on the width of the language of the catch-all phrase COVID-19 could be construed to fall under the ambit of the force majeure clause. However, even in the absence of such a catch-all phrase COVID-19 can be contended to be an *Act of God*, and fall with the ambit of '*Vis Major'/ 'Act of God*' mentioned in the force majeure clause. For, instance as in the case of ***Lakeman v. Pollard*** [13] a factory worker left his shift early due to concerns of contracting the cholera pandemic and could not finish his work contract. In an action brought about the mill owner for compensation from the workmen the Supreme Court of Maine held that the pandemic was an '*Act of God*' and the labourer was discharged of his obligation from performing the contract. In***Sandry v. Brooklyn School District***[14] a claim for wages/compensation was filed by school bus drivers during the period for which the schools were shut in light of an influenza outbreak, under their transportation contract with the school district. The Supreme Court of North Dakota held that the School District was not liable to pay the bus drivers as an influenza outbreak would fall under the category of a Vis major event. The pandemic is now being used as an argument for breach of contracts. In construing this pandemic as a force majeure event, the Courts have relied on the facts of the case and the different contractual obligations of the parties but having said that, what is evident from the Court's judgements in the recent cases is that termination of the contract will be the last step if the pandemic continues beyond the time period mentioned in the contract. The courts have been reluctant to terminate the contracts during COVID and have

[11]AIR 1969 ORI 152.
[12]2007 SCC OnLine Del 1400.
[13]43 Me 463 (1857).
[14]182 NW 689.

instead given relaxations to parties by extending the time period for the fulfillment of their obligations which were impacted by the pandemic. This trend has been visible in various recent judgements during the COVID-19 lockdown including ***Anant Raj Ltd v. Yes Bank***[15]***, TransconIconicaPvt Ltd. v. ICICI Bank***[16] ***and Ramanand v. Dr. Girish Soni***[17]***.***

Conclusion

Finally, a close scrutiny of the approach adopted by the courts in India on the issue of Force Majeure indicates that there are no straight jacket principles when it comes to the applicability of this concept and the courts are examining the issue based on the facts of the case before them. However, it is clear that Courts have been very careful and have allowed a very narrow and strict interpretation of force majeure clauses (as was seen in ***Halliburton Offshore Services Inc. v. Vedanta Limited and ors***[18]and many other cases). This is also important because the force majeure clause in contracts can be used as a double edged sword - while it does give some leeway and assistance to companies reeling from the after effects of unforeseen events, it can also be misused by companies to escape obligations and excuse non-performance in bad bargains. Having said that, we also need to recognize the fact that MSMEs are the economic pillar of a developing country like ours and there is a need to protect them especially in unprecedented times like this and for that, it is crucial that contracts have a well-designed force majeure clause that can clearly absolve them from their obligations in circumstances beyond their control. Moreover, only the invocation of the clause will not in itself guarantee a respite and the onus would lie with the companies which want to use the force majeure clause to establish the existence of the event which has made performance of the contract impossible. There is an intuition that the number of force majeure claims will rise as businesses try to renegotiate their existing contractual obligations, as the economy opens up and tries to rebalance itself after the disruptive effects of the COVID-19 lockdown. For the development of the law of impossibility, frustration and force majeure COVID-19 have proved to be a fertile ground. However, it will be interesting to see how the law develops in the future and the departure, if any, from where it currently stands.

[15]2020 SCC OnLine Del 543

[16]2020 SCC OnLineBom 626

[17]RC. REV447/2017, order dated 21-5-2020

[18]O.M.P (I) (COMM.) No. 88/2020 ('*Halliburton Offshore Services*')