

Indian Law
On
“Frustration of Contracts” and “Force Majeure”
in the wake of COVID-19 Pandemic
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With the World suffering from Novel Coronavirus outbreak and government’s imposing lockdown and travel restrictions to contain the situation the businesses have come to a standstill. The lockdown and other restrictions within the country has caused unusual delays in performance of contractual obligations by the contracting parties that may result in Breach of Contract, at the least if not complete frustration of contracts.

The Indian Contract Act, 1872 has provided protections for the parties during such extraordinary and unforeseeable situations by the inclusion of force majeure & similar clauses whose effects entirely depend on how such clauses are drafted in the contract. During such global Covid-19 pandemic, the parties can invoke these clauses under section 32 and section 56 of the Indian Contract Act, 1872.

“Contingent Contract” Vs “Frustration of Contract”

Section 32 of the Indian Contract Act, 1872 envisages if a contract is contingent on the happening of an event which event becomes impossible to perform, then the contract becomes void. The Indian Contract Act, 1872 does not specifically define the “frustration of contract” doctrine however Section 56 envisages that an agreement to do an impossible act is void in itself and also if that act becomes impossible afterwards which the obligator could not prevent and was unforeseeable it becomes void or unlawful. The doctrine of frustration results in the contract automatically coming to an end. The parties to the contract will no longer be bound to perform their future obligations under the contract.

Grounds for Frustration of Contracts

- a) Destruction of the subject-matter
- b) Change of circumstances

- c) Non-occurrence of contemplated events
- d) Death or incapacity of party
- e) Government, administration or legislation intervention
- f) War

What is ‘Force Majeure’?

Force Majeure is a French term meaning Superior Force. According to Black’s Law Dictionary Force majeure is ‘*An event or effect that can be neither anticipated nor controlled*’. A force majeure clause relieves one or both the parties from liability to perform contractual obligations when performance is prevented by an event or circumstance beyond the parties’ control. Typically, force majeure events include an Act of God or natural disasters, war or war-like situations, labor unrest or strikes, epidemics etc. The intention of a force majeure clause is to save the performing party from consequences of something over which it has no control. Force Majeure is an exception to what would otherwise amount to a breach of contract.

“Force majeure” is governed by the Indian Contract Act, 1872. In so far as it is relatable to an express or implied clause in a contract, such as the PPAs before us, it is governed by Chapter III dealing with the contingent contracts, and more particularly, Section 32 thereof. In so far as a force majeure event occurs de hors the contract, it is dealt with by a rule of positive law under Section 56 of the Contract.¹

Applicability of Force Majeure in current COVID-19 outbreak and advise for the Businesses

In order to seek the applicability of the “force majeure” in current Covid-19 outbreak, Businesses are advised to consider the following steps:

- Outline of force majeure - Some contracts list examples of force majeure events that automatically meet the standard. Others list events that must still meet the definition of force majeure. One may also rely on generic clauses usually included in force majeure clauses, such that the COVID-19 would be treated as an ‘Act of God’ coupled with the fact that there are legislative and administrative interferences; The general concept means that events or conditions beyond the reasonable control of one party

¹ Energy Watchdog vs CERC (2017)

should not cause them to be held liable under the terms if that event or condition prevents the performance of the obligations of the contract;

- Force majeure provisions - The language used in most contracts vary widely and, therefore, it is important to review these clauses carefully.
- Duty to mitigate and exercise reasonable diligence - If a 'duty to mitigate' obligation is imposed under the contract, then the meaning of 'reasonable diligence' becomes important. This is a subjective standard and will be interpreted on a case-to-case basis. It also needs to be analyzed if there are any obligations to use 'best endeavors' to mitigate the effects of a force majeure event;
- Foreseeability of the event - Most contracts provide that for an event to qualify as force majeure, it must be unforeseeable or not reasonably foreseeable;
- Notification requirements - Most contracts require notice to the other party to invoke a force majeure provision. Some also provide deadlines for making such notice to make the claim effective;
- Fate of the contract - Some contracts provide that it can be put on hold until the force majeure event is resolved. Some contracts provide for limitations in time after which either party may cancel the agreement with written notice to the other. Others require the contract to remain in effect until the force majeure event is resolved; It is important to deal with this aspect of the contract diligently.
- Burden of proof - The party that relies upon the force majeure event generally has the burden of proof and such clauses are construed strictly by the courts;
- Record Keeping - Copies of critical correspondence and other communications should be maintained, just in case, a disputes arise later;
- Dispute Resolution Clause - The contract's dispute resolution clause should be checked to identify which court or tribunal would decide a dispute and how it is likely to assess the situation;
- In case of absence of a force majeure clause- If the contract does not include a force majeure clause, the affected party could resort to the doctrine of frustration under Section 56 of the Indian Contract Act, 1872. However, in order to claim that the contract is frustrated, it must be shown that performance of the contract is entirely impossible and that in the present scenario it has become fundamentally different from the arrangement contemplated at the time of executing the contract;
- Other recourse – Counterparties may attempt to invoke other contractual clauses like price adjustment clauses, material adverse change (MAC)

clauses, limitation or exclusion clauses, to limit or exclude liability for non-performance. The ability to invoke such other grounds will depend on the wording of the relevant clause, and how the clause is construed by courts or tribunals;

- New Contracts - if new contracts are being entered into, provisions covering the eventualities should be strategically drafted;
- Finding the balance - consider negotiating a "win-win" situation as opposed to ending the relationship;

It is important to mention here that the Indian government and its organizations have administratively recognized the event of COVID-19 as a force majeure event and have taken possible steps to ensure the minimum possible hardships to the common people. The Finance Ministry had on February 19, 2020, clarified that the meaning of force majeure shall include the present pandemic as a case of natural calamity and hence if the contract mentions natural calamity in the force majeure clause then non-performance of contract can be exercised by the contracting parties stating COVID-19 as a force majeure event.

There is no one-size-fit-all solution as the legal consequence of the coronavirus outbreak on any contractual relationship will vary depending on the nature of the contract, the type of obligations, the circumstances in which the obligations are to be performed and the foreseeability of the change in circumstances. Affected businesses should therefore carefully consider the terms of their contracts and the applicable laws in formulating their responses to safeguard their interests in the wake of the coronavirus outbreak.