

Force Majeure & Covid-19

The interplay that contracting world needs to know



In light of the economic slowdown and supply chain disruption brought about by the Covid-19 outbreak, the possibility of invoking Force Majeure to avoid liability from delayed, interrupted or otherwise failed performance of contracts is being widely debated.

This note brings out practical aspects pertaining to Force Majeure and analyzes whether Covid-19 can be categorized as a Force Majeure event.

What is Force Majeure?

A creature of contractual innovation, Force Majeure refers to the principle that upon the occurrence of an event or circumstance that is not reasonably within the control of and would not have been avoided or overcome by a party, and which prevents or delays that party from performing some or all of its contractual obligations, that party will be relieved from liability which might otherwise arise as a result of that party's failure to perform those affected obligations.

The intention of a Force Majeure clause is to relieve the affected party from the consequences of something over which it has no control. Its provisions do not suspend the requirement for performance and typically require the affected party to continue to perform its obligations to the extent not prevented by the event of Force Majeure.

Force Majeure and Indian Contract Act, 1872

Force Majeure is essentially a common law principle and there is no statutory definition of Force Majeure under the Indian laws. That said, the principle is embodied in Section 32 & 56 of Indian Contract Act, 1872 which provide that in case any act to be performed pursuant to a contract becomes impossible to perform, then such an act will become void. Judicial precedents have evolved the principle thoroughly over a period of time and the courts, relying on principles of sanctity of contracts, especially those which are commercial in nature, have tested such cases on the touchstone that whether the event giving rise to non-performance is specifically listed as a qualifying force majeure in the clause in such contracts or not.

In several landmark cases including in *Satyabrata Ghose v. Mugneeram Bangur & Co.*¹ and *Energy Watchdog v. CERC*², the Supreme Court has applied the following tests to determine validity of Force Majeure events:

- Whether the event qualifies as force majeure under the contract?
- Whether the risk of non-performance was foreseeable and able to be mitigated?
- Whether performance is truly impossible?

Covid-19 and Force Majeure

Availability of Force Majeure relief cannot be implied into a contract under Indian law. It must be expressly provided for under the provisions of the contract and the nature of protection afforded will depend on the precise language of the provision. Therefore, the answer to the question of whether Covid-19 can be categorized as a Force Majeure event is simple enough – Look in the contract!

Whether Covid-19 could be used to trigger the Force Majeure clause would depend on the specific language of the contract. A contracting party may be able to invoke rights of suspension or termination under this clause if Force Majeure clause provisions specify epidemics, pandemics, quarantines or government intervention/declaration as a result. In addition, presence of terminology such as 'extraordinary circumstances beyond control of contracting parties' or similar phrasing in the contract may also be tested to trigger the clause for outbreak of Covid-19.

In case the Force Majeure clause does not contemplate any of the above scenarios, one may explore whether 'government action/declaration' that has rendered the party unable to perform the contract can be used to expand the ambit of the existing Force Majeure provisions. However, the party should first ascertain whether non-performance is due to the outbreak of Covid-19 itself or the resulting government action for controlling infections such as limitations on transportation, self-quarantines, closures of premises, etc.

Securing Force Majeure relief

The relief available upon invoking Force Majeure clause will depend upon the provisions laid down in the contract itself. These may include the following:

- Immediate termination of the contract upon the occurrence of the Force Majeure event
- Putting performance on hold until the Force Majeure event is resolved
- Elongation of the contract period
- Specific time period after which either party may terminate the agreement with written notice to the other (i.e. if non-performance caused by the event is prolonged or permanent)
- Allowing for certain obligations to be suspended

¹ AIR 1954 SC 44

² (2017) 14 SCC 80

As a general principle, a party assumes the risk of its own subjective incapacity to perform its contractual duties unless the contract envisions otherwise. Accordingly, unless a particular event may clearly fall within the ambit and scope of Force Majeure Clause under the contract, the judicial forums may not accept the same as a triggering event to provide the desired contractual relief of non-performance (as seen in Energy Watchdog Case).

Whether a party can be excused from performance of its obligations claiming Covid-19 as a pandemic will also depend on the nature of the contract, a party's obligation therein and its duty to mitigate, which will usually entail all reasonable endeavors undertaken a party to perform its obligations.

Having said that, it is reasonable to state that any party contracting with the Government of India or its agencies/departments can seek relief under the Force Majeure clause in light of Government of India's circular issued in February 2020 stating that for Government contracts relating to procurement of goods and services, Covid-19 outbreak could be covered by a Force Majeure clause on the basis that it is a 'natural calamity', caveat that 'due procedure' should be followed by any Government department seeking to invoke it. Furthermore, the government invoked the Disaster Management Act on March 11, 2020 with retrospective effect from January 17, 2020. Additionally, MNRE on March 20, 2020 instructed all implementing agencies to treat delay on account of disruption of supply chain due to Covid-19 as Force Majeure and grant extension of time based on evidence/documentary proof by developer in support of their claims.

The following are key considerations for affording a party force majeure relief:

- **Burden of proof:** The affected party carries the burden of proving the validity of its claim through supporting evidence that an event of force majeure has indeed occurred.
- **Scope and interpretation:**
 - Contracts typically identify and list a series of events or circumstances that can legitimately be claimed by a party as an event of Force Majeure. Usually, such events can include an act of god or natural disasters, adverse weather conditions, fire, war or war-like situations, labour unrest, strikes, epidemics, pandemics, etc.
 - Force Majeure provision may exclude outright certain events such as changes in either party's market factors, a party's inability to finance its obligations under the agreement or the unavailability of funds to pay amounts when due, breakdown or failure of plant or equipment caused by normal wear and tear or by a failure to properly maintain such plant or equipment from constituting events of force majeure.
 - In the context of the ongoing pandemic, courts and tribunals would examine whether in each case, impact of Covid-19 pandemic prevented or delayed the party from performing its contractual obligation. In disputes arising out of complex contracts, they will also carry out a textual natural and ordinary interpretation of the Force Majeure provision in order to ascertain its objective meaning.
 - **Causation:** Depending on specific provisions, it is for affected party to demonstrate that an event of Force Majeure delayed performance of the contract or caused failure in performance of the contract notwithstanding the commercially reasonable efforts of the affected party to overcome or mitigate the effect of the said event.
- **Notification:** A Force Majeure provision commonly contains a time-bound notification requirement, which can operate as a contractual condition precedent to relief. Such provisions are generally enforceable, and so complying fully with all notice requirements will be important for parties seeking to invoke force majeure.

Limitations on securing relief

The extent of Force Majeure relief will be affected by the following considerations:

- **Duty to mitigate:** In the unlikely event that an express duty to mitigate is absent, a duty to do so may be implied albeit on commercially reasonable terms, which can be ousted only by clear and unequivocal language. Provisions may specify the extent to which a party declaring Force Majeure must mitigate not only the event of Force Majeure but also its effect.
- **Certifications:**
 - Force Majeure certificates issued by governmental agencies may aid an affected party's efforts in securing relief, but they may not prove determinative.
 - The categorisation of the outbreak as a 'pandemic' by WHO may be of significant persuasive value in cases where Force Majeure provision contains appropriate language.
 - The Department of Expenditure, Ministry of Finance, Government of India on February 19, 2020 issued a cryptic office memorandum stating that the outbreak that has caused disruptions in the supply chain should be considered as a case of 'natural calamity' and Force Majeure provisions may be invoked 'wherever considered appropriate'. This memorandum may persuade pliant counterparties, but it is debatable whether such certificates have force of law.

Contracts not having Force Majeure clause

While the above analysis deals with contracts having a defined Force Majeure clause, many contracts do not contain this provision. In such instances, it becomes important to consider whether the parties to such contracts continue to be bound by performance obligations or they have a recourse in cases such as the outbreak of Covid-19.

In absence of a specific Force Majeure clause, parties may seek the benefit embedded under Section 56 of the Indian Contract Act, 1872 by factually demonstrating before a court that the purpose and underlying principles of the contract have been eroded/frustrated and the performance under the contract has become impossible. The essential element for a claim of frustration is impossibility of performance of the contract and the party claiming frustration carries the burden of proof. In this context, it is important to remember that it settled law that abnormal rise in price, onerous conditions or change in circumstances do not lead to frustration of contract (*Alopi Parshad and Sons Ltd. v. Union of India*³) – it will have to be proved on facts that the frustrating event has led to the fundamental basis of the contract being dislodged.

For claiming frustration of contract for the outbreak of Covid-19, party would have to factually prove that the present lockdown and consequent disruption has made it impossible to perform the obligations under the contract. Having said that, the outcome would depend on the facts of each case.

RERA and Force Majeure

It is noteworthy that Real Estate (Regulation and Development) Act, 2016 (**RERA Act**) specifically provides for extension of period for completion of the project and the registration, in addition to defining Force Majeure. RERA envisages two situations within which the registration granted to a project can be extended:

- In case of Force Majeure: Explanation to section 6 of the RERA Act has defined Force Majeure to mean ‘a case of war, flood, drought, fire, cyclone, earthquake or any other calamity caused by nature affecting the regular development of the real estate project.’
- As per proviso to Section 6 of the RERA Act, extension up to a maximum period of 1 year can be granted under reasonable circumstances.

Whether the period of extension of a maximum of 1 year as stipulated in proviso is mandatory or directory came to be tested in *Neel kamal Realtors Suburban Pvt. Ltd. & anr. v. Union of India & ors.*³, wherein the Bombay High Court whilst upholding the constitutionality of the various provisions of the RERA Act and mandatory nature of section 6, observed that a harmonious and balanced construction of the provisions relating to extension of time as encompassed in section 6 of the Act shall suffice the purpose of dealing with a situation where a genuine promoter, after making good efforts, is unable to complete the project within the time stipulated at the time of initial declaration or under extended period. The Court referred to the scheme of RERA Act and interpreted the provisions of Sections 6, 7(3), 8 and 37 of the RERA Act to advance the proposition that the RERA Authority shall be entitled to take into consideration reasons and circumstances due to which the project could not be completed within the extended aggregate period of one year as prescribed under Section 6. Thus, it may be legally tenable to contest Covid-19 as a Force Majeure event.

It is pertinent to note that information has emerged from news items that Confederation of Real Estate Developers Association of India (**CREDAI**), the apex body of private Real Estate Developers, has asked the Government to declare Covid-19 as Force Majeure event under Section 6 of the RERA Act.

In the altered landscape of Force Majeure events or other extraordinary situations and events as encapsulated herein impacting the performance of a contract and leading to delays and defaults, it just may be the need of the hour to get to the drawing board and rework the agreements and arrangements, Force Majeure definitions and other necessary contractual provisions to build in safeguards for mitigating damages and addressing future ambiguities.

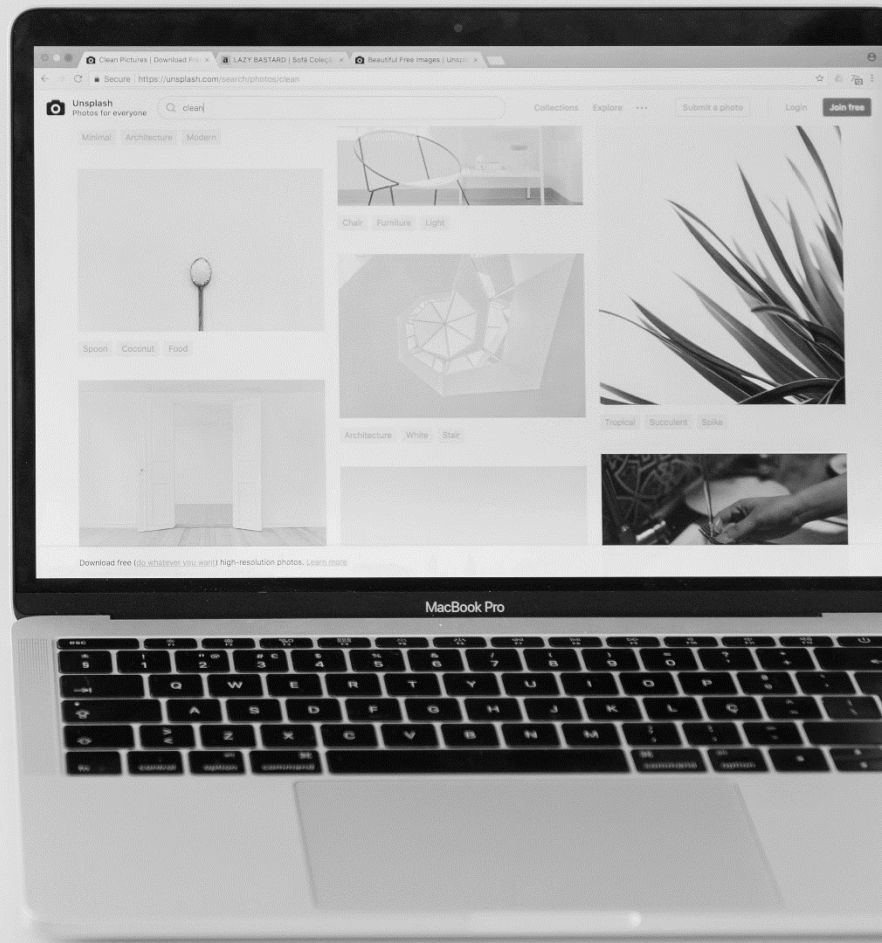
³ AIR 1960 SC 588

Key considerations for startups



On account of the Covid-19 pandemic, new investment deals will be few and far between as most VCs and early stage investors are focusing on their current portfolio companies and ensuring that their run-way requirements are being supported.

The impact is likely to be more severe in relation to growth (Series A and Series B) and late (Series C and above) stage deal-making. In these uncertain circumstances, startups must re-think how they do business with their partners, analyze specific considerations while executing/negotiating business deals, and their own business functioning.



Business contracts

In relation to existing business contracts, we have highlighted some important considerations for startups to investigate/assess:

- **Material Adverse Effect:** Whether Covid-19 would be categorized as a 'material adverse effect', and what would be the implications under contract.
- **Suspension of performance/ mutuality clauses:** Whether Covid-19 provides an opportunity to suspend performance for a temporary period of time?
- **Event of Default and Force Majeure Clauses:** Nature of obligations that may become impossible to execute due to the ongoing Covid-19 restrictions and whether such non-compliance would result in an event of default or invocation of a force majeure?
- **Indemnity/damages risk:** Whether the counterparty may enforce contractual indemnities/damages, irrespective of the ongoing Covid-19 situation?
- **Business risks:** Whether the insolvency of any third-party supplier or supply chain vendor enables the startup to hire other third-party suppliers or supply-chain managers.
- **Renegotiation of terms:** Whether any existing contracts enable the startup to re-negotiate its existing terms?

Co-Founders agreement

For mitigation of downside risks in times like these, a co-founder's agreement could be a useful tool to ensure business continuity in relationships between founders. A well-structured co-founder's agreement can help plan for, inter alia, founder exits in cases where businesses become tough to operate.

- **Board Composition and Administration:** What shall the role of the co-founders on the board and how will decisions be made at the board level, and which actions should be delegated to the authority of the larger shareholder body?
- **Deadlock Resolution:** How will the co-founders resolve disputes between themselves at the board level in case of deadlocks?
- **Appointment of the CEO:** Who shall be the CEO of the company and what should be the role of the CEO?
- **Exit:** Mechanism for enforcing exits and share transfers? What shall be the rights of a founder in case of only a partial exit?

Insolvency risks

Startups may consider insolvency scenarios of its suppliers or vendors or retailers and may further draft provisions for:

- Finding alternative suppliers in case of an insolvency scenario for its suppliers and vendors
- Identify alternative methods to collect payments, if such suppliers and vendors are unable to repay
- Where applicable, retain title of the goods until monies have been repaid in full.

In the event the startup in question owes monies to other service providers, care must be taken to draft credit extension clauses in force majeure situations and provide for latitude in credit terms to account for such cases.

Managing intellectual property (IP)

With respect to IP, early stage start-up must consider the following as a part of their larger IP strategy:

- Identify 'core IP' in relation to the products/services of the startup.
- Conducting research and development and developing new IP such as trademarks, copyrights and patents.
- Implement IP Assignment Agreements between the startup and its employees/ freelancers or independent contractors, wherein such employees/freelancers or independent contractors assign all work product or IP to the company.
- Register with appropriate authority and under applicable law all of the IP of the startup.
- Put in place an IP licensing policy and have standard IP licensing agreements drafted.

Dealing with employee compensation and leaves

An employee who is in self-quarantine needs to be compensated and given leave (if leave has been extinguished) in case the self-quarantine is due to the employee travelling on business on behalf of the start-up. Alternatively, employees may use existing leaves for self-quarantine.

Employees infected with Covid-19 may seek special compensation in cases where they can establish that they contracted Covid-19 in the course of employment.

Employees who may have been exposed to the Covid-19 virus must be given work from home as they cannot be forced to take leaves from home.



Certain sectors like F&B, travel, co-working and co-living, shared mobility, student housing, food delivery, home services, sports and recreation have altogether lost sheen overnight, so investment deals in those sectors are likely to witness a funding winter spell for an extended period till things settle.

Such companies must think of ways to pivot their existing business models and re-think/re-negotiate their business contracts, employee relationships to successfully weather the storm.

Enterprise risk

The Board's perspective



With the outbreak of the Covid-19, corporate India has stepped up to render assistance either by way of donations to relief funds or creating infrastructure to help the victims.

However, with all the focus and energy of India Inc. on the corporate social responsibility (and rightly so!), an overlooked vacuum is created which is calculation of the 'enterprise risk'.



The role of Board of Directors in Indian companies has been in the limelight for quite some time and has attracted increased public and governmental scrutiny. The Board's role in monitoring and managing enterprise risk becomes even more critical in the present scenario characterized by continuing global economic slowdown, contraction in domestic economic activity and retrenchment/lay-off fear amongst the workforce.

While risk management should ideally be tailored to the specific company, but, in general, an effective risk management system will include:

- Identification of the material risks that the company faces in a timely manner and processes for transmitting necessary information with respect to material risks to senior executives and, as appropriate, to the board or relevant committees
- Implementation of appropriate risk management strategies that are responsive to the company's risk profile, business strategies, specific material risk exposures and risk tolerance threshold, followed by integration of these strategies in business decision-making throughout the company

Covid-19 and enterprise risk assessment

Anticipating future risk is a key element of risk mitigation and helps avoid such risks manifesting as crisis situations. While several companies with robust risk assessment protocols saw the Covid-19 red flags well in advance, many others were slow to respond. Corporate India has suddenly realized that the unthinkable can indeed happen and needs to be planned for ahead of time. One way of ensuring this is through adoption of best-in-class risk assessment and management protocols which should include ongoing efforts to assess and analyze the most likely areas of future risk for the company and creation of internal response and escalation structures.

In reviewing risk management, the Board or relevant committees should ask the company's executives to discuss the most likely sources of material future risks and how the company is addressing any significant potential vulnerability. Specific types of actions that the Board/appropriate committees may consider as part of their risk management oversight include the following:

- Establish a clear framework for building and maintaining an effective risk appetite framework and providing the Board with regular, periodic reports on the company's residual risk status
- Clear communication of the board's expectations as to each committee's and management's respective responsibilities for risk oversight and management of specific risks to ensure a shared understanding as to accountabilities and roles
- **Conduct a regular review of the following:**
 - Company's executive compensation structure to ensure it is appropriate in light of the company's articulated risk appetite and risk culture and to ensure it is creating proper incentives in light of the risks the company faces
 - Risk policies and procedures adopted by management, including procedures for reporting matters to the board and appropriate committees and providing updates, in order to assess whether they are appropriate and comprehensive
 - Management's implementation of its risk policies and procedures, to assess whether they are being followed and are effective
 - Steps taken by management to ensure adequate independence of the risk management function and the processes for resolution and escalation of differences that might arise between risk management and business functions
 - Internal systems of formal and informal communication across divisions and control functions to encourage the prompt and coherent flow of risk-related information within and across business units and, as needed, the prompt escalation of information to management (and to the board or board committees as appropriate)
 - Reports from management, independent auditors, internal auditors, legal counsel, regulators, stock analysts, and outside experts as considered appropriate regarding risks the company faces and the company's risk management function, and consider whether, based on individual director's experience, knowledge and expertise, the board or committee primarily tasked with carrying out the board's risk oversight function is sufficiently equipped to oversee all facets of the company's risk profile—including specialized areas such as cybersecurity—and determine whether subject-specific risk education is advisable for such directors.

▪ **Review the following aspects with management:**

- Company's risk appetite and risk tolerance, the ways in which risk is measured on an aggregate, company-wide basis, the setting of aggregate and individual risk limits (quantitative and qualitative, as appropriate), the policies and procedures in place to hedge against or mitigate risks, and the actions to be taken if risk limits are exceeded
- Categories of risk the company faces, including any risk concentrations and risk interrelationships, as well as the likelihood of occurrence, the potential impact of those risks, mitigating measures and action plans to be employed if a given risk materializes
- Assumptions and analysis underpinning the determination of the company's principal risks and whether adequate procedures are in place to ensure that new or materially changed risks are properly and promptly identified, understood and accounted for in the actions of the company
- Quality, type and format of risk-related information provided to directors
- Design of the company's risk management functions, as well as the qualifications and backgrounds of senior risk officers and the personnel policies applicable to risk management, to assess whether they are appropriate given the company's size and scope of operations
- Means by which the company's risk management strategy is communicated to all appropriate groups within the company so that it is properly integrated into the company's enterprise-wide business strategy

HSA Emergency Assistance Team

In order to offer real time assistance to clients, for any exigency that might come during the lockdown, HSA has developed a cross-discipline team to render immediate support. For any such assistance please reach us out to helpline@hsalegal.com.

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