Contracting Out Amidst a Pandemic - A Force Majeure or Doctrine of Frustration

The outbreak of coronavirus or COVID-19 and its unprecedented spread has caught the world off guard in its preparedness of dealing with such a large pandemic. Nothing like this has been faced by mankind in its recent past and people are drawing learnings from the 2008 financial crisis during which some countries were financially less affected than the others or even the 1918 outbreak of Spanish Flu when the world was substantially different than the world we live in today.

The uncertainty of the timeline of its curtailment is resulting in more and more state and local authorities implementing extreme precautionary measures of quarantine and enforcing closure of schools, private enterprises and locking down entire cities – except for essential services. With this, businesses are struggling to fulfil their contractual obligations and are also faced with situations completely unforeseen where the counterparties to their contracts are failing to fulfil their obligations as well.

Some obligations are impacted by the regulators – such as the RBI which has given a moratorium on certain payments. Others where the sectoral regulator has not intervened, parties will need to resort to contractual provisions such as invocation of the Force Majeure clause written in to the contract or where that is nonexistent or inadequate are examining the doctrine of frustration of contract under Section 56 of the Indian Contract Act, 1872 (**Act**).

Force Majeure

"Force Majeure" is loosely translated to mean 'Act of God.' It is not a term defined in the Act and hence relies on what is written in the contract. Given that a virus outbreak that has brought the entire world to a virtual standstill is unprecedented – way beyond a black swan event - it is unlikely that it will be explicitly mentioned in any Force Majeure clause. Nevertheless, in light of the mandatory lock down orders given by the Government, it may well be that the clause can be given effect to, on the basis of those unequivocal orders and typical drafting of Force Majeure clauses which use the latin term '*inter alia*' (meaning amongst others) or exemplify events by using the language *'including but not limited'* to or *'such as.'*

Courts in India have taken the view that a Force Majeure Clause will not normally be construed to apply where the contract provides for an alternative mode of performance, even though that may entail a bigger financial burden. The Hon'ble High Court of Delhi in ***Ram Abhoshan Vs. PEC Limited*** has held that "Force Majeure clauses are to be narrowly construed and a mere rise in price (in the present case a fall in price) rendering the contract more expensive to perform (in the present case, more onerous to perform) will not constitute force majeure."[1] In certain circumstances the courts will use Force Majeure to allow a party to delay payment of dues provided that interest is added to such delayed payment to compensate for the losses suffered as a consequence of the delay, but not terminate the contract.

Where a Force Majeure is not written into a contract, parties will have to examine whether the 'Doctrine of Frustration' may be relevant to the facts at hand – in the present instance where the Governments have made it illegal for certain businesses to operate, that certainly may be arguable, of course depending on the particular facts.

1 MANU/DE/2869/2018 at page 4

Doctrine of Frustration

The concept of frustration of a contact is as old as contract law itself and is now so well evolved that it has evolved in to a 'doctrine'. However, the term 'frustration of contract', explicitly, is not found in the Indian statute.

Section 56 of the Act, itself, embodies the Doctrine of Frustration through the impossibility of performance of a contract. Section 56 states that subsequent to entering a contract, **if it becomes impossible**, or, by reason of some event which the promisor could not prevent, becomes unlawful, then the contract immediately becomes void. The Hon'ble Supreme Court in ***Satyabrata Ghose Vs. Mugneeram Bangur and Company and Ors***. has held that the "doctrine of frustration of contract is really an aspect or part of the law of discharge of contract by reason of supervening impossibility or illegality of the act agreed to be done and hence comes within the purview of Section 56 of the Indian Contract, Act"[2]

In the case of ***Joseph Constantine Steamship Line Limited v. Imperial Smelting Corporation, Ltd*** the doctrine of frustration is a "doctrine" of special case of the discharge of contract by an impossibility to perform it[3]. The question was considered and discussed by a Hon'ble Division Bench of the Nagpur High Court in ***Kesari Chand v. Governor General in Council*** and the Court stated that " We agree that the doctrine is a special case of "impossibility" and as such is dealt with in section 56 of the Indian Contract Act." [4.]

Impossibility as interpreted by Courts

The Hon'ble Supreme Court further goes on to interpret the term "impossible" under Section 56 as follows:

"*This much is clear that the word "impossible" has not been used here in the sense of physical or literal impossibility. The performance of an act may not be literally impossible but it may be impracticable and unless from the point of view of the object and purpose which the parties had in view; and if an untoward event or change of circumstances totally upsets the very foundation upon which the parties rested their bargain, it can very well be said that the promisor finds it impossible to do the act which he promised to do*." [5]

Therefore, one may argue that a contract has become impossible to perform in a given set of facts and circumstances, and therefore becomes void.

Whether a more onerous method of performance would trigger frustration/Impossibility of Performance?

A more onerous method of performance (including a rise in cost) would not trigger frustration or impossibility of performance. The Hon'ble Supreme Court of India has settled the law and has held in ***The Naihati Jute Mills Ltd. Vs. Khyaliram Jagannath***, that '[t]he Courts have no general 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.[6]" This is a well-established common law principle as well and was laid down in the case of ***Tandrin Aviation Holdings Limited v Aero Toy Store LLC*** [7].

2 AIR1954SC44, MANU/SC/0131/1953 at page 6
3 L.R. 1942 A.C. 154 at 168 (referred to at Page 5 of Kesari Chand v. Governor General in Council (MANU/NA/0147/1947)
4 [1949]ILRNag718, MANU/NA/0147/1947 at page 6
5 AIR1954SC44, MANU/SC/0131/1953 at page 5
6 AIR1968SC522, MANU/SC/0348/1967 at page 6
7 [2010] EWHC 40 (Comm), MANU/UKCM/0073/2010 at page 13

Interplay between the Doctrine of Frustration / Impossibility of Performance and a Force Majeure clause

Since a Force Majeure provision is a contractual remedy, the parties to the contract will have to be bound by and limited to the explicit provisions contained in the clause. If the wording of a Force Majeure clause does not cover the events and circumstances in question or if there is no Force Majeure clause incorporated in the contract, then the parties would have to examine if the events and circumstances in question are of such a nature that would render the performance of the contract impossible, thereby permitting the parties to invoke provisions of Section 56 of the Act.

Consequences of taking recourse to Section 56

Before considering taking refuge under Section 56, it is important to bear in mind that the said Section 56 renders a contract void, independently of the volition of the parties upon occurrence of an impossible event. The Hon'ble High Court of Delhi stated this in ***State Bank of India Vs. Earnest Traders Exporters, Importers & Commission Agents*** as follows:

"It is well settled that the supervening frustrating event immediately puts an end to an agreement independently of the volition of the parties without either party being conscious of the fact that what has happened has snapped their contractual bonds[8]."

Consequently, the said contract shall not be enforceable in the court of law and correspondingly all the financial and legal implications flowing from such contract shall also be void. No future performance of the contract may be envisaged through the same agreement, and a fresh agreement would necessarily have to be entered into for the same. Under the circumstances therefore, what appears to be a beneficiary tool at a first glance, may turn out to be disadvantageous for the affected party as the non-affected party may undertake unfavorable actions against the affected party.

In Conclusion

Therefore, while the circumstances arising and evolving continuously at the behest of COVID-19 overwhelm businesses with the need to take immediate action, it is advisable that the affected party should reasonably and objectively ascertain all possible measures in order to combat a situation of uncertainty.

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Note : This article is one amongst a series Business Continuity articles which ELP has instituted in light of COVID-19. Through these articles we hope to address legal and regulatory issues which will have an impact for doing business in and with India. To read our other articles please click here.

8 1997IIIAD(Delhi)467, MANU/DE/0542/1997 at page 3