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Analyzing the Enforceability of Force Majeure Clause in Light of COVID-19

Rishabh Soni*

Abstract

Now with the spread of COVID-19 and impositions of lockdown in India, the economy has also suffered; the entire supply chain has broken and businesses are finding it difficult to survive. In these tough times, one most talked about remedy in various types of contracts affecting Businesses, rent agreements, etc., is the emergence of force majeure clause by parties to do away with their contractual liabilities.

Many companies always have a force majeure clause in their agreements to survive during tough times like these. Force majeure clause saves the bonafide party who was very much interested in performing its obligation under the contract but was not able to fulfill its part due to certain factors beyond their control and without any negligence on their part. There are also cases where more and more businesses though not having any force majeure clause in their agreements but are still coming forward to claim the remedy on account of the contract becoming impossible to perform and thus claiming the remedy of frustration of contract.

This paper tries to find out the circumstances under which courts will allow businesses to claim the force majeure remedy in discharging their liability under a contract. Paper also tries to compare the recent judgments given by Court in India and the United States in analyzing the test which needs to be satisfied before granting the remedy of force majeure. The paper also discusses the possible future tussles between insurance companies and businesses in settling claims and losses which the businesses have suffered on account of COVID-19.

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INTRODUCTION

The impact of novel coronavirus (COVID-19) pandemic has not only affected the physical health of humans but at the same time it has also impacted the health of economies of all the nations, and as a result of which businesses are finding it difficult to survive and most of them are unable to fulfill their contractual obligations. Restrictions on travel and imposition of lockdowns have impacted all the industries and more particularly international trade and trade of non-essential items have come to a standstill. In these tough times, the term which is gaining importance as a remedy seeker for businesses is the force majeure clause in business contracts.

Now after the lockdown has started to partially open in a phased manner, more litigations are coming on the subject matter of enforcing this force majeure clause as a defense by businesses to abstain from liability arising from contractual obligations We are seeing that many suppliers either want their contractual obligations to be delayed or their contract should be terminated. Many companies are citing reasons like restriction in movement, stoppage of production, increase in costs, labor shortage, and broken supply chains as the main factors for enforcement of force majeure as a remedy. Even big companies like Gateway terminals, Adani ports, Indian oil, Mangalore refineries, etc. have already invoked force majeure clause and many more are likely to join them.[1] The force majeure remedy which according to many was only a part of formality and rarely used remedy is now proving to be very fruitful and everyone is flipping their contracts to look for force majeure clause.

Many countries worldwide are also issuing force majeure certificates to firms, for instance on Feb 17, 2020, the China Council for the promotion of International Trade (CCPIT), revealed that it had issued about 1600 force majeure certificates to firms in 30 sectors, covering contract worth over $15 billion.[2] Even the Indian government through the department of expenditure, Ministry of Finance vide its order dated Feb 19, 2020, issued an office memorandum for procurement of goods. This memorandum states that COVID-19 could effectively be covered under force majeure clause because it is a natural calamity and directed the departments to enforce the same.[3]

1 Poorvi Sanjanwala and Kashmira Bekliwal, *What is Force Majeure? Legal Term Everyone Should Know During Covid-19 Crisis*, THE ECONOMIC TIMES (May 22, 2020, 10:42AM), https://economictimes.indiatimes.com/small-biz/legal/what-is-force-majeure-the-legal-term-everyone-should-know-during-covid-19-crisis/articleshow/75152196.cms.

2 *CCPIT Issues the Force Majeure Certificates of Novel Coronavirus Disease (COVID-19) for Enterprises*, CHINA COUNCIL FOR THE PROMOTION OF INTERNATIONAL TRADE (May 22, 2020, 10:45 AM), http://en.ccpit.org/info/info_40288117668b3d9b017080e1f9b5072f.html.

3 *Force Majeure Clause Office Memorandum*, DEPARTMENT OF EXPENDITURE (May 22, 2020, 11:00

Meaning of Force Majeure

The term 'force majeure' has been defined in Black's law dictionary[4] as "an event or effect that can neither be anticipated nor controlled". Force majeure is being used as a clause in contractual agreements from the past, but it has started to gain importance only in recent times after the outbreak of the pandemic. *Force majeure is a contractual provision to deal with uncertain situations due to which contractual obligations could not be performed and these situations can't be acknowledged at the time of entering into the contract*. Generally, a force majeure clause provides a temporary reprieve to parties from performing their obligations under the contract if the events mentioned in the force majeure clause are satisfied.

Entire Jurisprudence on force majeure has been beautifully summarized by Justice RF Nariman of the Supreme Court in the case of *Energy Watchdog v. CERC*.[5] Generally, a force majeure clause includes events beyond the control of parties to contract like an act of God, earthquake, fire, flood, terror attack, epidemics, etc. and the circumstances which are necessary to be fulfilled for the applications of this particular clause and also the aftermaths of enforcement of this clause like whether the contract will be permanently frustrated or is being only delayed for a particular period. In the Indian context, although there is no direct mention of the term force majeure, some linkage to it can be drawn from the concept of contingent contracts[6] as laid down under the Contracts act. Section 32 mainly deals with a situation when a particular contract is contingent on happening of an event and when this event becomes impossible then indirectly contract also gets impossible to perform. Force majeure clause is a very important aspect of any contract and its absence can lead to a very difficult situation for parties. This clause is now being seen to be a part of various types of contracts like power purchase and manufacturing contracts, real estate contracts, supply contracts, etc.

AM), https://doe.gov.in/sites/default/files/Force%20Majeure%20Clause%20-FMC.pdf.

4 *Meaning of Force Majeure*, BLACK'S LAW DICTIONARY (May 22, 2020, 01:15 PM), https://blacks_law.enacademic.com/11167/force_majeure.

5 Justice Nariman in *Energy watchdog v. Central Electricity Regulatory Commission and Ors.*, (2017) 14 S.C.C. 80 (India), quoted "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, 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".

6 Section 32, The Indian Contract Act, 1872, No. 09, Acts of Parliament, 1872 (India).

Method of Enforcing Force Majeure Clause and the Effect of it on Contracts

Generally in the original contract, only the method of enforcing the force majeure clause should be mentioned and it is up to parties to bilaterally agree on the method for its enforcement, but most of the times parties prefer to enforce this clause by giving notice to the other party and intimidating him/her about the enforcement of same. This notice can be given by one party informing the other about the occurrence of such an event or it can also be given if the force majeure event continues to happen for a prolonged period. These two methods of enforcement will differ with different contractual agreements. Now coming to the effect of this enforcement party enforcing it generally has 2 remedies:

a. Party will be allowed an extension of the period to fulfill his contractual obligations.
b. Party will be allowed to terminate the contract and settle their monitory concerns.

Alternate Remedy Available to Parties in case of No Force Majeure Clause in their Contract and the Doctrine of Frustration of Contracts

There are various cases in which the original contractual agreements between parties do not have any force majeure clause and yet they are unable to fulfill their contractual obligations. So in these particular cases, the only remedy which is generally available with the parties is that of the frustration of contract as governed by Sec. 56.[7] Section 56 is based on the maxim *"les non cogit ad impossibilia"* which means that the law does not compel a man to do what he cannot possibly perform. This doctrine seeks to protect the interest of the party who has suffered on account of the subsequent impossibility of the subject matter of contract.[8] It means that every contract is based on the assumption that parties to contract will be able to perform the same when the due date of the performance arrives. Now if because of some event, the event has either become impossible or unlawful, then the contract becomes void, and liability of the party will also be terminated and the essence of the contract will be frustrated.

The courts in India have held in numerous cases that the word "impossibility" as used in Section 56 should always be interpreted in a practical sense and not in the literal and strict

7 Section 56, The Indian Contract Act, 1872, No. 09, Acts of Parliament, 1872 (India).

8 *Ibid*. 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.

sense and courts should always try to ensure that the object of a contract is fulfilled even if certain changes need to be done. In the leading English law case of *Tsakiroglou & Co. Ltd. v. Nobel Thorl GmbH,*[9] House of Lords observed that even though the contract had become more onerous to perform, it was not fundamentally altered and in this case, the contract was very much possible to perform but at the cost of an increase in freight price.

Moreover, the majority of eminent reference work on contract law has concluded that a rise in cost or expenses has been stated not to frustrate a contact.[10] Thus, to justify this statement a contract will always come under the purview of Section 56 even if it is not an absolute impossibility, but the contract has been fundamentally changed. This particular principle was given by the court in the *Satyabrata Ghose* case.[11] Further, in this case, the Court held that the changed circumstances make the performance of the contract impossible and the parties are absolved from further performance of it as they did not promise to perform an impossibility.

Now the question arises as to what will happen to partial obligations that have been performed before the contract became fundamentally frustrated. To this particular question, Indian law is very much clear with no doubts that if a particular contract is declared void after entering into it then it will be governed by the concept of restitution as laid down in Section 65.[12] So basically Sec. 65 provides that a party who has received any advantage before the contract became void, then he/she is bound to restore that benefit so that parties can be put in the same position as they were in if the contract had never been executed.

A Hypothetical Example Highlighting Force Majeure Clause in a Contract

Company A of (Ludhiana) entered into a contract with Company C of (Mumbai) on 15 February 2020 for the supply of 600 tons of steel. For fulfillment of delivery, a time period of 2 months was given. There was also a force majeure clause in the contract entered in between both the parties in which they both agreed that in case of any uncertain event beyond their control affecting the subject matter of the contract, a grace period of 1 month will be given. But this was subject to notice being given by party affected within 10 days from happening of that event. Now on 25th March 2020 nationwide lockdown was announced by the government, thereby affecting the supply of non-essential goods. As a

9 *Tsakiroglou & Co. Ltd. v. Nobel Thorl GmbH*, [1962] AC 93.

10 JOSEPH CHITTY, CHITTY ON CONTRACTS (31st ed., 2012).

11 *Satyabrataghose v. Mugneerambangur & Co. & Anr.*, 1954 S.C.R. 310 (India).

12 Section 65, The Indian Contract Act, 1872, No. 09, Acts of Parliament, 1872 (India).

result of this event A's consignment was struck for about 20 days on the border of Gujarat and Maharashtra. On 13th April 2020, A sent an email to B conveying him about the actual situation and enforcing the force majeure clause and demanding grace of another 1 month as the consignment was sent back to Ludhiana (Punjab). So now in this particular case, A will be allowed to enforce the force majeure clause as the delay was not in his hand and he made all possible efforts to fulfill the contractual obligations on his part.

Exceptions to the Applicability of Force Majeure Clause in Contracts

Generally, force majeure clauses are applicable without any restrictions, but at the same time, a party cannot hide its negligence and mal intention behind the force majeure clause. So where the non-performance is caused by the usual and natural consequences and not the uncertain consequences which are beyond the control of parties, their force majeure cannot be enforced under those cases. Further force majeure can also not be invoked simply because the contract has become financially and commercially more difficult to perform[13]. So parties taking shelter under the force majeure clause need to convince the court that the force majeure event was beyond their control and the event could not be stopped even after ensuring due diligence & taking all possible steps. These steps will vary as per the facts of each case. However, generally, these include looking for alternate suppliers, an alternate mode of transport and funding, etc. Now broadly analyzing, the event of force majeure must pass the following 3 test:-

a. Unpredictability- It involves that the event amounting to force majeure should be unpredictable and unforeseeable.
b. Irresistibility- The event of force majeure must make the execution of contractual obligations impossible.
c. Externality- It means that the force majeure event must not be created by the default or negligence of the party.

The Increasing Possibility of Businesses Claiming Loss Caused to them from Insurance Companies

There is a greater chance of various big companies claiming the losses suffered by them from insurance companies and trying to bring the claims within the ambit of business interruption insurance policies. It would however be very interesting to see in the coming

13 *Punj Sons Pvt. Ltd. v. Union of India,* A.I.R. 1986 Del 158 (India).

times as to what stand courts take on these claims by companies. Now if we look at the business interruption policies in general, we find that these policies can very much be issued as a separate stand-alone policy.

But in India these are incorporated in Fire policy or machinery loss policy and offer protection to the net profit, compensating for the increase in the working costs, etc.[14] So for the business interruption policy to cover the loss on account COVID-19, experts believe that it is necessary for the property insured to suffer physical damage due to covered perils, and it is very unlikely that such policies would cover losses caused due to COVID-19.

It also needs to be noted that the courts in the U.S have held that if a particular condition deprives the use of insured property, then that particular condition will be covered in sanctioning the claim for the loss occurred to the property. But the similar reasoning for approval of claims will not be applicable in India, firstly because of the specific wording in the insurance contracts in India and secondly US decisions would only be applicable if there is a presence of COVID-19 at the insured property, it also needs to be looked into here is that here in India most of the businesses are suffering losses not on account of being closed as a result of the presence of COVID-19 on their premises, but due to lockdown restrictions being imposed by the government.[15] Now we need to see in the coming times what view will the courts adopt in these matters and there may be some cases in which courts also adopt liberal view.

The Courts of the U.S.A and Force majeure

Many US states have given a narrow interpretation to force majeure as a remedy and have clarified that force majeure will qualify as a defense only if the contract specifically mentions for it to include events like pandemics etc. However, the state of Idaho have interpreted force majeure clauses more broadly and in a recent Idaho Supreme Court case, the court found that denial of building permit will be qualified as a force majeure event where the contract specially defined to include other events which are beyond the control of parties to contract.[16] Another major consideration that courts in the US are giving is that of foreseeability of the event. It is very much clear that COVID-19 as such cannot be foreseen

14 Manish Jha, *An Expert Explains: Can Business Interruption Insurance Cover COVID-19 Claims?*, THE INDIAN EXPRESS (April 16 2020, 07:57AM), https://indianexpress.com/article/explained/explained-can-business-interruption-insurance-cover-covid-19-claims-6363831/.

15 *Ibid.*

16 Steffan Hasselblad, *How To Tell If COVID-19 Qualifies As A Force Majeure In Your Contracts*, IDAHO BUSINESS REVIEW (June 16, 2020, 01:30 PM), https://idahobusinessreview.com/2020/06/16/how-to-tell-if-covid-19-qualifies-as-force-majeure-in-your-contracts/.

from before and also the majority of cases will come under it. But at the same time courts are not granting defense of force majeure to contracts related to supply of medical goods and contracts entered before December 2019.

Moreover like the recent judgment of Delhi High Court, courts in the US are also not giving strict meaning to the term impossibility in performing the contract and courts in the US have found that an even a 40% change in crop price throughout a single growing season did not make performance impossible.[17] Now concerning the occurrence of an event on account of an act of god, no court yet has examined whether a pandemic such as COVID-19 will qualify as an act of god.

Some Important Recent Judgments of Courts in India Interpreting and Deciding the Ambit of Force Majeure Clause in Light of COVID-19

The first major case interpreting the provision of force majeure after COVID-19 was the case of *Halliburton Offshore Service v. Vedanta Limited & Anr.*[18] (Delhi High Court). In this particular case, in the year 2018, Petitioner Halliburton was granted a contract by Vedanta for integrated development of oil and gas fields in Rajasthan for which he also furnished bank guarantees and the petitioner was given the time by 31st January 2020 to complete the project, which was eventually extended and the date was 31st March 2020.

The petitioner further demanded an extension, however, he was denied the same, and then on March 18, the petitioner sent a letter to respondents stating that he is invoking force majeure clause due to COVID-19 for extension of the deadline to complete the project. However, to these response respondents shown their disagreement and enforced bank guarantees against the petitioner which was extended by the petitioner during the signing of the contract. Petitioners moved Delhi high court to restrain the defendants from invoking bank guarantees.

The main issue in this particular case was whether the Petitioner can restrain respondents from invoking bank guarantees in case of non-acceptance by respondents for extending the deadline regarding completion of the project due to ongoing COVID 19. Delhi High Court noted that the alleged non- performance of the contract cannot be executed on the ground of force majeure as claimed by petitioner. *The Court acknowledged that COVID-19 was very much a force majeure event, but at the same time also held that delay on account of*

17 *Ibid.*

18 *Halliburton Offshore service v. Vedanta Limited & Anr.,* (O.M.P (I) COMM) No. 88/2020 & I.As 3696—3697/2020 (High Court of Delhi, 20/04/2020).

the petitioner was not due to COVID-19 as petitioner was already given 2 extensions to complete the project and that too before the lockdown was announced by the government.

The Court also observed that simply enforcing COVID-19 as a force majeure clause will not absolve the liability of parties to contract and they need to show that the non-performance was the direct result of COVID-19 and therefore this is to be determined from facts & circumstances of each case.

The Court also gave few points which were to be considered in each case before granting the relief to the party claiming force majeure clause on account of COVID-19. These are

a. Conduct of parties before outbreak
b. Deadlines for completion in contract
c. Steps that were taken to complete the contractual obligation
d. Other compliances that were required to be made.

Another important judgment concerning the application of the force majeure clause in tenant-landlord dispute is the case of *Ramanand and Others v. Dr. Girish Soni and Another (Khan market case)*[19].

In this case also, the Delhi High court after analyzing various clauses of the contract entered in between landlord & tenant, came to the decision that as such there was no mention of force majeure event in the agreement, but still, on account of prevailing situations, the Court agreed to allow a time frame to the tenant to pay rent but rejected their request of quashing the rent for a period of lockdown.

Conclusion

Force majeure clause in contracts is proving to be of great help to genuine parties who have suffered without any fault on their party and it can very much be claimed as a defense by a party to contract to abstain itself whether temporary or permanently from performing the contractual obligation, but it needs to be seen here that there is no straitjacket formula which will be applicable in all cases of an force majeure event to save a party from fulfilling its contractual liability. Courts will always analyze the facts & circumstances of each case and will always look into the actual reasons due to which contract was not been able to be performed either temporarily or permanently.

19 *Ramanand and Others v. Dr. Girish Soni and Another,* C.M. APPL. 1848/2020 (High Court of Delhi, 21/05/2020).

After this, if the force majeure event was a reason for causing delay or termination then the court can allow the party to claim shelter under the doctrine of force majeure. But in today's time businesses relying on the force majeure, will be required to show and convince the courts that the actual reason for non-fulfillment of the contract was COVID-19 and they were having no fault on their part. Also, we have seen in the recent judicial pronouncements that courts have adopted a strict approach towards granting relief on account of force majeure clause in contracts, so business solely relying on force majeure needs to be extra cautious and should approach courts only when they have been genuinely affected by the force majeure event and not to hide for their mistake.