INVOKING 'FORCE MAJEURE' CLAUSE FOR NON-PERFORMANCE OF CONTRACT- A PREDICAMENT CREATED BY THE PANDEMIC

Written by ***Sridevi Krishna***

Asst. Professor, Vidyavardhaka Law College, Mysuru, Karnataka, India

ABSTRACT

The drastic ill effect of pandemic is felt by almost all the sectors of the industry. Globally the governments declared lockdown to control the spread of deadly virus. The borders of all nations are closed and as result trading activities has come to a standstill. There is an increasing financial burden coupled with an impending uncertainty, over the performance of commercial contracts and this has led to the breach of agreed obligations. The impact of COVID-19 has incapacitated the parties to fulfill their respective obligation under the commercial contracts, as it calls for a diverse nature of resources and services for its performance. In this background this paper ponders over the force majeure clause to be invoked as a defence for non-performance of contract keeping in mind the consequences of such situation. An analysis of present Indian laws on non-performance of contract is also discussed in the light of present policy measures undertaken by the authorities.

INTRODUCTION

In the course of carrying out a contract the parties often face with a turn of events which they did not anticipate. May it be an unexpected obstacle to execution of the contract or the like, but it does not in itself affect the bargain they have made in the contract.[i] This age old observation made by the England Court of Appeal reminds us about the impossibility of performance of court which is due to the unavoidable circumstances as stated in the maxim '*les non cogit ad impossibilia*- the law does not compel the impossibility.' But the House of Lords expressing their disapproval stated that "it is a matter of construction of clauses in the contract."[ii] Today, the unforeseen impact of pandemic has interrupted our personal and professional life one hand and financial and commercial lives on the other, to a point that performance of agreed obligations under the contract is almost impossible and also there is inability to perform it at all levels. In the light of recent judgments there is a lot deliberation amongst the legal community as to implication of frustration of contract and force majeure clauses in the contract. This has led to various questions as to the liability of party for committing breach of contract and the specific relief available to the other party. But, the argument moves forward with the agreed clauses by the parties under the contract and also with the understanding of terms like force majeure and frustration of contract.

FORCE MAJEURE CLAUSES AND FRUSTRATION OF CONTRACT

According to Black's Law Dictionary Force Majeure is an event or effect that can neither be anticipated nor controlled. It can be described as an Act of God or natural calamity or a situation unforeseen. A force majeure clause in the contract exempts the parties from liability when prevented by such an unforeseeable event and it does not always except a party from non-performance, but only suspends it for the duration of the event happening.

Under English law, *force majeure* is a contractual provision under which a party is entitled to cancel the contract or is excused from performance upon the occurrence of specified events beyond the party's control. The key factor is to establish a direct link of causation between the

event and the impossibility of performance in order to demonstrate that the event is the sole cause of inability of the party to perform under the contract.[iii]

Under Indian law, akin to English law, force majeure derives its existence from the contract. The basis of this clause is to save the performing party from consequences of breach arising from an event over which it has no control. It is therefore an exception for breach of contract. Whether force majeure can be invoked to excuse liability for non-performance would depend on the nature and general terms of the contract, the events which precede or follow it, and the facts of the case.

In a situation envisaging force majeure, it is upon the party to elect to invoke the force majeure clause in the contract in order to excuse itself from performance under the contract.[iv] In a situation envisaging force majeure, it is upon the party to elect to invoke the force majeure clause in the contract in order to excuse itself from performance under the contract.

In light of Covid-2019, on February 19, 2020, the Ministry of Finance issued an Office Memorandum on 'Force Majeure Clause' providing that-

"Coronavirus should be considered as a case of natural calamity and force majeure may be invoked, wherever considered appropriate, following the due procedure". It provides that "a force majeure clause does not excuse a party's non-performance entirely, but only suspends it for the duration of the force majeure. The firm has to give notice of force majeure as soon as it occurs and it cannot be claimed ex-post facto. If the performance in whole or in part or any obligation under the contract is prevented or delayed by any reason of force majeure for a period exceeding ninety days, either party may at its option terminate the contract without any financial repercussion on either side".[v]

Although the parties ought to honor the office Memorandum, it may not be binding. If any dispute arises as to acceptance or rejection of office memorandum it is left to the court or tribunal to interpret the force majeure clause and asses if it covers office memoranda in order to prove the case.

The Common law doctrine of Frustration under English Law and Impossibility of Performance under Indian Law are distinct and different considerations apply as to its interpretation under the respective Laws.

Under English law, frustration is so much concerned with the change in circumstances that it cancels the base of the contract as a whole or in case of performance makes it different with that which was in consideration by the parties in the beginning and is concluded by the legal order.[vi] In order to excuse oneself from impossibility of performance under an English law governed contract on account of Covid-2019, the party will need to prove frustration of contract. Does a particular contract make room for application of the doctrine of frustration depends on legal theories formulated by English Courts? These involve (a) implying terms into the contract; (b) vesting courts with power to determine what is just and reasonable under certain circumstances; (c) engaging in construction of the contract based on intention of parties.[vii]

However, under Indian law, the statutory provision under Section 56 sets out a positive rule of law on supervening impossibility or illegality that renders performance impossible in its practical and not literal sense. [viii] Relief is given by the court on the ground of subsequent impossibility when it finds that the whole purpose or basis of a contract was frustrated by the intrusion or occurrence of an unexpected event or change of circumstances which is so fundamental as to be regarded by law as striking at the root of the contract as a whole. The contract would then automatically come to an end.

The court undoubtedly would examine the contract and the circumstances under which it was made. The belief, knowledge and intention of the parties are evidence, but evidence only on which the court has to form its own conclusion whether the changed circumstances destroyed altogether the basis of the adventure and its underlying object. In such a sense, frustration merely becomes a sub-set under the larger doctrine of supervening impossibility. Indian courts will apply Section 56 objectively to assess whether a particular situation has rendered performance impossible and frustrated the contract, without delving into party intention, justness and reasonableness etc.

Under Indian law, the doctrine of frustration is an aspect or part of the law of discharge of contract under Section 56 by reason of supervening impossibility or illegality of the act agreed to be done. While Section 56 envisages impossibility of performance leading to avoidance of the contract, it does not statutorily encapsulate the concept of unforeseen contingencies which result in temporary suspension of performance and resumption of the contract. The concept of force majeure comes into play in such situations. Unlike a force majeure clause where the non-performing party needs to elect or choose to invoke the clause, either by means of a notice or otherwise, frustration of contract under Section 56 operates automatically from the date of the impossibility and puts the contract to an end. [ix]

Since the ICA is exhaustive upon impossibility of performance under Section 56, it would not be permissible to import the principles of English law on doctrine of frustration and legal theories, de hors these statutory provisions. Under Indian law governed contracts and disputes, the decisions of the English Courts would possess only a persuasive value and may be helpful in showing how the English courts have decided cases under circumstances similar to those which have come before Indian courts.[x]

Thus, frustration of contract is an aspect of Section 56, where performance is absolutely impossible and the contract comes to an end automatically from the date of impossibility. In the any event if unforeseen event renders performance impossible, parties need to assess if the event has resulted in a destruction of the object and purpose of the contract, or has caused a fundamental difference in the way the contract now stands, far beyond the contemplation of the parties.

THE HARDSHIP CAUSED BY COVID 19 AND THE REMEDY

Before evaluating the remedy one has to ponder over the question what is the impact of pandemic over business and performance of contractual obligation. Has it resulted in complete failure to perform or just caused commercial hardship? In any situation a party may not be absolved from the performance of the contract merely because its performance has become onerous on account of unforeseen turn of events. Thus, claiming of frustration difference from

case to case. In case of force majeure clause, it contains words that indicate the extent of impact on performance to invoke it, such as delay, prevent, hinder. These words are interpreted differently and given the meaning through the rule of interpretation '*Noscitur a Sociis'* which means known by the company it keeps and also by the general terms of the contract.[xi] The Indian Contract Act provides the remedies based on the effect of an unforeseen event on the contractual performance. It is left to the parties to agree that if on account of unforeseen event it is impossible to perform a contract, a party would compensate the other for the efforts made notwithstanding that it is impossible to fully perform the same. In such circumstances the contractual provisions prevail over section 56 which is also subject to the defense of failure to meet the notice requirement.

Similarly, if the parties have agreed on liquidated damages contemplating the impact of intervening circumstances which might affect the performance of the contract, but have expressly stated that the contract would stand despite such circumstances, there can be no case of frustration because of the contract would be to demand performance despite the happening of the event. Excuse of performance would be difficult in such circumstances. But still defenses are available to the parties seeking excuse of non-performance, one of them having unequal bargaining power between the parties to the contract.[xii]

In some cases, where parties may have expressly provided for the case of a limited interruption through force majeure, but a supervening event renders performance indefinitely impossible for an indefinite period, a party could make a claim for frustration of the contract. To assess whether Covid-19 could trigger the relevant force majeure clause, or frustrate the contract, it will be critical to evaluate the operational aspects of the relevant commercial transaction and the type of force majeure clause in the contract.

A defaulting party to a contract may also be claimed through specific performance or payment of damages through Court or Tribunal which would then have to necessarily fall back on the provisions of Specific Relief Act for appropriate remedies to be provided. It is possible that courts may, in certain situations, find it more equitable to direct payment of damages as opposed to granting specific relief. Unfortunately, with the amendments to Specific Relief Act[xiii], courts barely have any discretion in the matter.

Prior to the Amendment Act, specific performance was an exceptional remedy that could only be granted when actual damages caused by non-performance could not be ascertained or would not afford adequate relief. This restriction has been removed. Specific performance is now available as a remedy by choice. The non-defaulting party can, therefore, claim specific performance without having to demonstrate the inadequacy of damages. Moreover, the wide discretionary powers to refuse specific relief enjoyed by courts under the un-amended Specific Relief Act have been taken away. These amendments were aimed at improving contracting culture in India by encouraging performance by a contracting party. The intention is indeed laudable. However, the manner in which it has been effectuated in the Amendment Act is disquieting.[xiv]

The Amendment Act followed an Expert Committee Report that was submitted to the government in June 2016, but not made available in public domain. The Expert Committee had *inter alia* suggested two significant changes, one is that, *Specific performance and injunction for breach of contract should no longer be exceptional remedies but remedies by choice; Second, Specific performance should no longer be a discretionary remedy and courts would be able to refuse these remedies only on stated grounds. For that purpose, the grounds contained in Sections 14 and 20 of the un-amended Specific Relief Act should be merged into one section viz. Section 14.* Thus, while proposing availability of specific performance as a remedy by choice, the Expert Committee was conscious that specific relief unlike damages should not be an absolute remedy and must be subjected to certain restrictions. To that end, the Expert Committee had proposed inclusion of a single provision viz. the proposed Section 14, containing an exhaustive list of all negative grounds or exceptions based on which specific relief could be denied. By the Amendment Act, the government accepted the Expert Committee's proposal to make specific performance available as a remedy by choice without, however, incorporating the proposed necessary safeguards. In fact, the government went a step further and removed most of the safeguards that already existed in the un-amended Specific Relief Act.[xv]

The deletion of Section 20 of the un-amended Specific Relief Act and exclusion of safeguards proposed by the Expert Committee completely stripped away the courts' powers to refuse specific relief on equitable grounds. The language used in the Amendment Act is clear-

"*specific performance of a contract shall be enforced*" subject to limited exceptions provided in the amended Specific Relief Act. The relief of specific performance is no longer discretionary, and the courts are now obliged to allow specific performance subject to Section 11(2), Section 14 and Section 16 of the amended Specific Relief Act, has also been confirmed by the Supreme Court in *B Santoshamma & Anr v. D Sarala & Anr.* [xvi] The limited exceptions provided in Section 11(2), Sections 14 and 16 cannot be stretched enough to accommodate the circumstances that the courts would have to now deal with due to COVID-19. To the contrary, under the amended scheme, the courts or tribunals would have to mandatorily enforce specific performance notwithstanding the fact that it would be inequitable. The party disabled from performing its contractual obligations for reasons completely beyond its control would be subjected to unforeseen and unreasonable hardship.[xvii]

Thus, it may be said that the courts can still exercise their extraordinary jurisdiction to do equity. But with respect to arbitral tribunals, it would be bound by the strict provisions of law, giving no scope to the unique challenges that the contracting parties have been compelled to face due to pandemic. The safeguards proposed by the Expert Committee would have undoubtedly given courts and tribunals the requisite flexibility to consider and balance the interests of all parties while determining a claim for specific performance. One may even argue that the earlier regime provided a more suitable remedy for the present circumstances.

FORCE MAJEURE CLAUSE TO COVER PANDEMIC

The term 'Act of God' is defined as an extraordinary occurrence or circumstance, which could not have been foreseen and guarded against, either due to natural causes, directly and exclusively without human intervention; and which could not by any amount of ability have been foreseen, and if foreseen, could not have been resisted.[xviii] This could include floods, hurricanes, earthquakes etc.

However, force majeure is held to have a more extensive meaning than the often seen 'Act of God' term, and includes occurrences such as strikes, riots, wars, breakdown of administrative machinery, lockdowns, and effects of such events such as shortage of supply owing to war,

war-time difficulty in shipping, refusal of export license etc. Some force majeure clauses could contain generic terms such as "any other happening".[xix]

Whether a pandemic such as Covid-19 can be interpreted as an 'Act of God'? Whether the effects of shutdowns due to Covid-19 trigger the force majeure clause in contracts? This would depend on the language of the clause and the rules of legal interpretation of force majeure clauses.

A contract could place a duty on performing party to mitigate the effect of its non-performance on the other party. This duty could be contained in a 'best endeavors' clause. In order to successfully invoke a force majeure clause to excuse liability for non-performance, a party under a contractual duty to mitigate or make best endeavors will be required to demonstrate the efforts it undertook to mitigate the impact of its non-performance. An instance of a force majeure clause with a duty to mitigate will be as follows-

> *"The Party suffering a Force Majeure event shall remedy the situation, with all possible dispatch and use of its best efforts to minimize the effects thereof, insofar as it is possible and/or appropriate."*[xx]

The effect of frustration or force majeure could both result in termination of contract, depending on the terms of the contract. In fact, we have seen cases where a contract containing a force majeure clause was sought to be terminated on the grounds of frustration of the contract, despite the two remedies being mutually exclusive. Thus, under what circumstances can a contract be suspended, what would be the requirements to bring about suspension, would a party need to elect a remedy by express notice, what circumstances could result in extension of suspension to a level of termination, when can termination be sought on grounds of frustration despite presence of a force majeure clause - would depend entirely on the nature and terms of the contract. However, in cases where the performance has merely become commercially more difficult but not impossible, parties could consider whether it would be commercially viable to suspend the contract, or use this opportunity to renegotiate the contract. Some parties may also consider this as an opportunity to put an end to a bad bargain by assessing its options to terminate the contract.[xxi]

In most of the cases where performance of a contract becomes impossible, the party that has received any advantage under such contract at the time when the agreement is discovered to be void, is required to restore such advantage to the person from whom the same was received. This is expressly enacted under Section 65 of the Contract Act. However, this is not an absolute rule. The extent of restitution will depend on a case to case basis, involving an analysis of several factors, such as expenses incurred by the non-breaching party.

Further, parties to contract are free and can expressly provide that the risk of supervening events shall be borne by one of them, or apportion it, or deal with it in various ways such as suspension of performance, compensation, refund, restitution or discharge. Ultimately, if a Party fails to agree on the event being a Force Majeure event, or fails to comply with the provisions of the Agreement under the applicable Force Majeure provisions, or attempts to establish a claim of frustration of contract in presence or absence of a force majeure clause, parties will need to look into the contract and assess legal risk and remedies in terms of litigation or arbitration of the dispute arising out of such disagreement.[xxii]

CONCLUSION

Thus, it can be said that invoking force majeure clauses would depend on the contractual terms. Also, it is critical to understand the commercial operations and transactions of the company in the relevant industry and sector as to the ambit of contractual clauses dealing with impossibility of performance. The judicial interpretation of contracts in disputes involving unforeseen events is most of the times dependent on the nature of the contract and the language of the terms. It is therefore prudent for the parties to know their respective rights and protect themselves on either side of performance, allocate risk properly, formulate proper strategy for renegotiation and save the intention specified in the contract through proper legal advice. The government should also be proactive and take necessary steps to rectify the defects in amended Specific Relief Act.

REFERENCES

- Chitty on Contracts, "General Principals", (Sweet & Maxwell, Vol1) 31st Edt
- Kshama Loya Modani et.al, "Impact of COVID-19 on Contracts: Indian Law Essentials", (India Law Journal) 2020
- Meena R.L, "Text Book on Law of Contract" (Universal Law Publication) 2008
- Mulla & Pollock, "Indian Contract Act, 1872 & Specific Relief Act, 1967", (Lexis Nexis) 15th Edt
- Pooja Gera, "Contract Enforcement During COVID-19: India should brace itself for tackling the amended Specific Relief Act", (Bar& Bench, 1st Nov), 2020

ENDNOTES

[i] *British Movieto-news Ltd. v. London and District Cinemas Ltd. L.R.*, (1950) 2 All E.R 390

[ii] Id. At 84
[iii] Kshama Loya Modani et.al, "Impact of COVID-19 on Contracts: Indian Law Essentials", (India Law Journal) 2020
[iv] Id. At 2
[v] Office Memorandum No.F. 18/4/2020-PPD ('Force Majeure Clause', issued by Department of Expenditure, Procurement Policy Division, Ministry of Finance)
[vi] Chitty on Contracts, "General Principals" , (Sweet & Maxwell, Vol1) 31st Edt
[vii] *Supra* note 4
[viii] Satyabrata Ghose vs. Mugneeram Bangur and Others, (AIR 1954 SC 44), paragraph 17.
[ix] *Supra* note 4
[x] *Supra*
[xi] Energy Watchdog vs. Central Electricity Regulatory Commission and Others,(2017 (4) SCALE 580)
[xii] *Supra* note 4
[xiii] *Specific Relief (Amendment) Act, 2018*
[xiv] Pooja Gera, "Contract Enforcement During COVID-19: India should brace itself for tackling the amended Specific Relief Act", (Bar& Bench, 1st Nov 2020)
[xv] Id. At 2
[xvi] Civil Appeal No. 3574 of 2009
[xvii] *Supra* note 15
[xviii] Meena R.L, " Text Book on Law of Contract" (Universal Law Publication) 2008, pg 213
[xix] Mulla & Pollock , " Indian Contract Act, 1872 & Specific Relief Act, 1967", (Lexis Nexis) page 1181.
[xx] Id. At 1186
[xxi] *Supra* note 14
[xxii] *Supra*