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**COVID-19: A SITUATION FOR RAMIFICATION OF COMMERCIAL CONTRACTS**

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## COVID-19: A SITUATION FOR RAMIFICATION OF COMMERCIAL CONTRACTS

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It was on 12<sup>th</sup> March 2020 when the World Health Organisation had declared COVID-19 as a worldwide pandemic. At this time, the devastating virus referred to as COVID-19 has changed our lives drastically. This pandemic has caused the world to come to a standstill with more than three lakh deaths and more than four million people being infected from this virus all around the world. Apart from the medical issues, this pandemic has wrecked the International Trade and Commerce.<sup>1</sup> The whole global supply chain mechanism has been disrupted because of this virus. With the termination and cancellation of contracts, this has led to a downfall of business relationships in the market. The effect of this virus is not

limited to the parties to contract but also to the employment agreements, insurance agreements, loan agreements etc. Contractual issues in relation to force majeure clause are consequential due to this virus attack. The virus has caused many potential implications on the economy of our country. The COVID-19-wave has adversely affected the economy of many developed and developing countries. This pandemic has led to the situation of lockdowns and curfew in many countries which has caused people to remain closed in their homes, subsequently, put a halt on the economy and businesses have crumbled down because of the constant incurring losses by the lockdown. In the times of such lockdown there were many contracts and agreements which were yet to be performed by the parties but the current situation has made it impossible to perform these contracts. This article focuses on impact of COVID-19 on Commercial Contracts.

### **COVID -19 PANDEMIC: A THREAT TO FINANCIAL STABILITY**

The COVID-19 pandemic has caused an unprecedented threat to the financial stability. This virus has triggered an

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<sup>1</sup>Vishesh Gupta, A saviour in the time of distress: Analysis of Act of God, I-pleaders (March 26, 2020)

<https://blog.ipleaders.in/a-saviour-in-times-of-distress-analysis-of-act-of-god-provisions-in-law/>.

economic downturn. The global financial stability report shows that the financial system has already reached at stake and this could be worst in the coming days.<sup>2</sup> Thus, this pandemic will certainly have more impact on financial relations, trade and commerce all round the world. As per the report of the United Nations Organisations the global economy would shrink up to 1% in 2020 due to the COVID-19. It has also predicted that a reversal downfall of 2.5 % would occur in the business market with this virus. Millions of workers in many countries are facing a bleak prospect by losing their jobs. Governments on the other hand are carrying out large stimulus packages to avert the sharp downturn of their economies which could potentially plunge the world into deep recession. In the worst scenario the world economy would contract by 0.9 % in 2020.<sup>3</sup> The analysis noted before the outbreak of the COVID-19, the world output was expected to expand at a modest pace of 2.5% but now the world is under the crisis of financial instability with the pandemic COVID-19. A sharp decline has been observed in the

consumer spending in the European countries which will further reduce imports of consumer goods from developing countries.

### **COVID-19 VERSUS COMMERCIAL CONTRACTS**

The COVID-19 pandemic has affected a wide range of contracts resulting in many businesses to default their loan payment and banks on the other hand are forced to extend the period of repayment of loans.<sup>4</sup> In this line the COVID-19 pandemic has been widespread throughout the world and every country has posted the board as 'Closed' on their official work address. Due to this virus all flights, hotel bookings, sport events, conferences, meetings, competitions, public gathering functions have been cancelled and India has forced into 21 days' lockdown so as to promote social distancing in order to prevent the spreading of this virus. This virus has posed great challenging threats to global and commercial markets. As a result of this lockdown and curfew global stock markets have crashed down adversely which has

<sup>2</sup>Tobias Adrian and Fabio Natalucci, COVID-19 Crisis Poses Threat to Financial Stability (April 14, 2020), <https://blogs.imf.org/2020/04/14/covid-19-crisis-poses-threat-to-financial-stability/>.

<sup>3</sup> The Economic Times, Global Economy would shrink by almost 1% in 2020 due to COVID-19 Pandemic: United Nations, (April 02, 2020 11:20 AM)

<https://economictimes.indiatimes.com/news/international/business/global-economy-could-shrink-by-almost-1-in-2020-due-to-covid-19-pandemic-united-nations/articleshow/74943235.cms>.

<sup>4</sup> M. Arjun, How the Corona Virus Pandemic impacts, Commercial Contracts (March 20, 2020) <https://blog.ipleaders.in/how-the-coronavirus-pandemic-impacts-commercial-contracts/>.

impacted the economy and commercial business all around the world.<sup>5</sup>

### **COVID-19 VERSUS IMPACT ON CONTRACTUAL BARGAINS**

Indian Contract Act, 1872 provides for 'Act of God' as a ground for impossibility to perform the contract. Under Section 32 and Section 56 of the Act, 1872 states that when any obligation makes the contract impossible to perform then in that circumstances the contract stands void. This is known as frustration of contract which has been elaborated further in this article. A breach of contract occurs when parties to contract fail to perform in accordance with the terms and conditions of the contract. Under the Contract Act, 1872 specifically under Section 37 it provides that it is mandatory on part of the parties to abide by the terms of the contract. When a contract has been breached by either party to the contract the right to sue is vested in the hands of the other party to claim for the damages from the party who is at the default for the non-performance of the contract. But this section also provides with two exceptions as well:

1. The contract must have been performed already by the said party and
2. When the person is excused under the law. (Defence that can be taken under certain circumstances)

The defence can be taken by either party to contract for the non-performance of the contract. Thus, the defence taken by the party against the suit for the breach of contract relieves a party from all kinds of liability. Basically the defence that can be taken is force majeure.

### **FORCE MAJEURE: A MECHANISM OF CONTRACTUAL RISK**

Force Majeure: In the event of any unforeseeable circumstances or an Act of God, either party can be prevented to perform the obligations of the contract. For example: A enters into a contract with B, where B has to deliver the possession of a house by 14<sup>th</sup> April 2019. Due to unforeseeable circumstances i.e. a natural calamity occurs which has destroyed the whole property and now it is impossible for the other party to deliver the possession of house. In these circumstances no party to the contract can claim for the damages or compensation as this contract falls within

<sup>5</sup> Akarsh Tripathi, Impact of Corona Virus on Global firms, I- Pleadings, (1<sup>st</sup> April 2020),

<https://blog.ipleaders.in/impact-of-coronavirus-on-global-law-firms/>.

the exception enumerated in this section. There are three important tests in order to determine the force majeure situation and they are:

1. Those unforeseen circumstances that have originated from external sources and it was not in the hands of the parties to control such events,
2. Those unforeseen circumstances were unpredictable and there was no anticipation known to the party that it would be likely to happen,
3. Those unforeseen circumstances were irresistible and parties to the contract could not have avoided such circumstances.

In simple terms the force majeure is a ground in the Indian Contract Act, 1872 which exempts the party from performing the obligations which has either become impossible or impracticable due to unforeseeable circumstances. In the case of **Taylor v Caldwell**<sup>6</sup> it was held by the Court that in the event of unforeseen circumstances which makes the performance of contract impossible the contract need not to be performed, as

insisting the party on the performance of the contract would be unjust. Under the Indian Contract Act, 1872 the term force majeure has not been expressly defined but the essence of the term can be inferred from Section 32 and Section 56 of the Indian Contract Act. Section 32 of the said Act defines contingent contracts whose enforceability depends upon the happening and non-happening of certain events. Whereas Section 56 of the Act defines frustration of contracts under which the subsequent happening of certain events makes it impossible for the party to contract to fulfil the contractual obligations.<sup>7</sup>

### COVID-19 VERSUS DOCTRINE OF FRUSTRATION

The doctrine of frustration of contract has been defined under Section 56 of the Indian Contract Act of 1872. The principle is based on the Latin maxim, 'les non cogit ad impossibilia' which means that a man cannot be compelled by law to do what he cannot possibly do. The essential condition to claim this defence is as follows:<sup>8</sup>

<sup>6</sup> Taylor v Caldwell 1861 All ER Rep.24

<sup>7</sup> Live Law Research Team, Force Majeure, Act of God and Doctrine of Frustration (28<sup>th</sup> March 2020, 01:56 PM), <https://www.livelaw.in/know-the-law/force-majeure-act-of-god-doctrine-of->

[frustration-under-indian-contract-act-explainer-154452?infinite-scroll=1](https://www.livelaw.in/know-the-law/force-majeure-act-of-god-doctrine-of-frustration-under-indian-contract-act-explainer-154452?infinite-scroll=1).

<sup>8</sup> Rajat Chawla, Legal Consequences of Corona Virus Out break on Contracts, (April 02,2020), <https://blog.ipleaders.in/legal-consequences-coronavirus-outbreak-contracts/>.

1. The very first important condition is that the contract must be existing between the parties and must be valid and enforceable.
2. The contract must be performed partially and there is still some part of it which is to be performed yet.
3. Contract becomes impossible to perform after it is entered into.

### **COVID-19 AND FORCE MAJEURE**

Force majeure is a common clause in legal contracts which allow a party to limit their liability in extraordinary circumstances. In the business community the force majeure clause describes all such unforeseen circumstances which are beyond human control and such events has been described as the Act of God. Thus, a contract having force majeure clause absolves both the parties from contractual obligations. In the present scenario of the COVID-19 the world has come to a standstill which has resulted in many contracts being delayed, interrupted and/or cancelled.

### **COVID-19: A FORCE MAJEURE EVENT?**

Now the question which comes to the mind is whether COVID-19 will be considered as a force majeure event? Force majeure clause within its ambit has embodied two aspects which are classified as Natural

force majeure events and Non-Natural force majeure events. The pandemic COVID-19 has led to events of happening of lockdowns in order to prevent its widespread. Thus this pandemic falls within the ambit of non-natural force majeure events which has caused performance of contractual obligations difficult in the times of lockdown. In certain other circumstances the pandemic also depends upon the fact that whether clause of force majeure has been incorporated in the contract. In the event of any dispute between the parties to contract the courts are likely to apply the principle of contractual interpretation. Also looking at the present scenario the Ministry of Finance has issued an Office Memorandum stating that disruption of supply chains due to COVID-19 will be covered under the Force Majeure clause and should be considered as a case of natural calamity invoked under the clause of force majeure by following due procedure. If the contract between the parties has not been expressly provided with the force majeure clause the parties can still depend upon the principle of frustration of contract. The party relying upon such doctrine has to prove before the Court that it is because of the unforeseen circumstances that has made the performance of contract impossible. Non-

performance of contract cannot be claimed if the non-performance of the contract has resulted from the action of the defendant.<sup>9</sup> However, the doctrine of frustration is subjected to a very high threshold and it may envisage a range of factual circumstances of COVID-19 which could be construed as a frustrating event. But in an event where force majeure clause has been specifically mentioned about pandemics or epidemics then the declaration by the World Health Organisation regarding COVID-19 as a pandemic would treat those contracts to fall within the category of force majeure. At this juncture, both parties to the contract have to carefully scrutinise the events leading to the timings of the event when the contract has been entered by the parties corresponding to Government measures that have been taken to prevent its outbreak at a given point of time.<sup>10</sup>

### **FORCE MAJEURE V. DOCTRINE OF FRUSTRATION**

It is worth important to note that the principle of frustration is more restrictive as

compared to that of force majeure. In certain circumstances the court will not allow the parties to use the doctrine of frustration as a tool to escape from a good bargain. The said doctrine will not relieve the parties from the liability as economic hardships are not a ground for invoking the principle of frustration under Section 56 of Indian Contract, 1872.

In the landmark case of **Satyabrata Ghose v. Mugneeram Bangur & Co**<sup>11</sup> the defendant company was engaged in the construction and development of house plots. Here, the plaintiff and defendant had entered into an Agreement for sale of the plot. In the meantime, Second World War had broken out and the plots were acquired by the military. The issue raised before the Court was whether the said Agreement becomes void by virtue of section 56? The Court held that doctrine of frustration cannot be applied as the performance of the contract can be made possible after the world war. The Court further observed that “Actual existence of the war conditions at the time when the Agreement was entered into, the extent of the work involved in the

<sup>9</sup> Ramit Mehta, COVID-19 Crisis: Force Majeure and Impact On Contracts, Live Law, (2<sup>nd</sup> April 2020 05:33 PM), <https://www.livelaw.in/law-firms/articles/covid-19-crisis-force-majeure-and-impact-on-contracts-from-an-indian-law-perspective-154698>.

<sup>10</sup> Anirudh Krishnan & Goda Raghavan, COVID -19 Lockdown and Commercial Impact Series, (March 31<sup>st</sup> 2020, 10:53 AM) <https://www.barandbench.com/columns/covid-19-lockdown-and-commercial-impact-series>.

<sup>11</sup> Satyabrata Ghose v. Mugneeram Bangur & Co. 1954 S.C.R. 310

development scheme and last though not the least the total absence of any definite period of the time agreed by the parties within which the work was completed, it cannot be said that the requisition order vitally affected the contract or made the performance impossible.”

In an another case of **M/s. Alopi Parshad & Sons Ltd. v. Union of India**<sup>12</sup> parties had entered into a contract to supply ghee to the Army personnel. One party to the contract enhanced the rates citing the reason of outbreak of Second World War. But the other party to the contract claimed that amount was above the rates as mentioned in the contract in the year 1942. The Court held that, “A Contract is not frustrated merely because the circumstances it was made in were altered. The Courts have no general power to absolve a party from the performance of his part of the contract merely because its performance has become onerous on account of an unforeseen turn of events.

At this point of juncture, we are at point of two extremes. On one hand the person is himself bound by the contract absolutely to do a thing and cannot escape from the liability for damages<sup>13</sup> and on the other hand the party to contract is proving discharge of contract owing to the impossibility on the basis of erosion of fundamental bargain between the parties to contract.<sup>14</sup> Thus at this point of two extremes it is natural that there would be mechanism of risk allocation with regard to the force majeure clause. The United States Supreme Court in the case of **Day v. US**<sup>15</sup> made a beautiful observation stating the position between two extremes in the following words, “One who makes the contract can never be absolutely certain that he will be able to perform it when the time comes, and the very essence of it is that he takes the risk within the limits of his understanding. But when the scope of the understanding is fixed, that is merely another way of saying that the contractor takes the risk of the obstacle to that extent.”<sup>16</sup>

<sup>12</sup> M/s. Alopi Parshad & Sons Ltd. v. Union of India 1960 (2) S.C.R. 793

<sup>13</sup> Paradine v. Jane (1647) 82 E.R 897.

<sup>14</sup> Lebeaupin v Richard Crispin, [1920] 2 K.B. 714; Davis Contractors Ltd v Fareham Urban District Council, [1956] A.C. 696

<sup>15</sup> Day v. US 62 L. Ed. 219 (1917)

<sup>16</sup> Anirudh Krishnan, Hitesh Singhvi & Pranay Prakash, The COVID-19 Pandemic and Government

Lockdown- Are They Force Majeure Event And If So What Is The Effect, Bar and Bench, (April 03, 2020, 05:43 PM)

<https://www.barandbench.com/columns/policy-columns/the-covid-19-pandemic-and-government-lockdowns-are-they-force-majeure-events-and-if-so-what-is-the-effect>.



The clause of force majeure is always mixed up with the concept of frustration but the line of difference between both these concepts is vague. The doctrine of frustration results in the discharge of contract all together whereas the force majeure clause creates a temporary exemption from the performance of contract. In order to take an advantage of the exemption of force majeure clause it is essential to establish the link between the force majeure event and hindrance to the performance of contract. Firstly, it must be demonstrated by the party that it was able to perform its obligations and the force majeure event took place. Secondly, it must be proved that force majeure event was sufficient in ordinary course of business to cause the non-performance of the contract. Applying these two important tests to the present scenario of COVID-19 pandemic the lockdown by way of Governmental Orders dated 24<sup>th</sup> March 2020 for the period of 21 days has rendered the non-performance of certain contracts.

### **JUDICIAL PRECEDENT**

The Supreme Court in the case of **Industrial Finance Corporation v.**

<sup>17</sup>Industrial Finance Corporation v. Cannanore Spinning & Weaving Mills Ltd (2002) 5 S.C.C. 54

<sup>18</sup> Dhranrajmal Gobindram v. Shamji Kalidas & Company A.I.R. 1961 S.C. 1285

**Cannanore Spinning & Weaving Mills Ltd**<sup>17</sup> held that any impediment beyond one's control which was unforeseen and unavoidable in nature shall attract the force majeure clause in the that context.

In the case of **Dhranrajmal Gobindram v. Shamji Kalidas & Company** <sup>18</sup>, it was observed by the Court that

*“Force Majeure is term of wider import. Difficulties have arisen in the past as to what could be legitimately being included in the ambit of force majeure. Judges have agreed that the strikes, breakdown of machinery, which though is not included in vis- major, are included in force majeure. An analysis of rulings on the subject, into which it is necessary in this case to go, shows that where reference is made to force majeure, the intention is to save the performing party from the consequences of anything over which he has no control.”*<sup>19</sup>

The Supreme Court in the **Madhya Pradesh Power Co. Ltd v. Renew Clean Energy Pvt. Ltd.**<sup>20</sup> held that the time taken by the contracting party on account of unavoidable circumstances is a relevant factor to be kept in mind while ascertaining

<sup>19</sup> Lebeaupin v Crispin (1920) 2 K.B 714

<sup>20</sup>Madhya Pradesh Power Co. Ltd v. Renew Clean Energy Pvt. Ltd. (2018) 6 S.C.C. 157.

the overall delay in commissioning of the project.

obligations just like in the present scenario of COVID- 19 Lockdown.

The Supreme Court in the case of **Gujarat Urja Vikas Nigam Ltd. V. Tarini Infrastructure Ltd. Ors**<sup>21</sup> held that an uncontrollable event is a factor that qualifies as an event of force majeure. The Court further observed that:

*“Any force majeure is considered as an uncontrollable factor. In fact, the regulation provides that the approved aggregate gain or loss on account of uncontrollable factor shall be passed through as an adjustment in the tariff over such period as may be specified in order of the commission.”*

### **CONCLUSION**

The pandemic COVID-19 is growing rapidly and many countries have been affected by this virus. At this point of juncture, it becomes more important to analyse the clause of force majeure with that of the other key contracts. It is important that the parties to the contract should be aware of their rights under the scheme of contract so that they be prepared when there are confronted with such situation of non-performance of contractual

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<sup>21</sup> Gujarat Urja Vikas Nigam Ltd. v. Tarini Infrastructure Ltd. Ors (2016) 8 S.C.C. 743.