

FAQs on Force Majeure in Commercial Contracts During COVID-19

1. What is force majeure? Would COVID-19 qualify as one?

Force majeure is a French word that means “superior force”. It includes all extraordinary events and circumstances that are beyond the control of a contracting party such as war, strikes, riots, acts of god like natural calamities, etc. Typically, force majeure clauses are included in commercial contracts to suspend obligations of parties, without any (or limited) liability, during an event that is beyond their control. Some contracts would have a detailed clause covering all possibilities and procedures to be followed while others only provide that the contract be suspended till the force majeure event continues.

There is no straight jacket answer to whether COVID-19 will qualify as force majeure under Indian law. For government contracts, Ministry of Finance, on February 19, 2020 issued an office memorandum¹ wherein it stated that COVID-19 will be a force majeure event and considered a case of “natural calamity” per its “Manual for Procurement of Goods”.² However, for private contracts, it will depend on whether the clause is worded broadly and lists illustrative instances of force majeure or is restricted to specific kind of events only.

2. Can force majeure be invoked on account of COVID-19 even if there is no express clause in the contract?

In the absence of an express clause of force majeure in a contract, the parties can rely upon *doctrine of frustration* set forth under section 56 of Indian Contract Act, 1872. Section 56 states that if performance becomes impossible, the contract would become void. Through various judgments, the Supreme Court has held that impossibility under section 56 is not literal impossibility but even something that makes the performance of the contract *impracticable and useless from the point of view of the object and purpose which the parties had in view*. In such a case, the contract would be frustrated and automatically deemed void. The underlying principle is the occurrence of an untoward event or change of circumstance which totally upsets the very foundation upon which the parties entered their agreement. To apply the doctrine of frustration, the party terminating the agreement will have to prove that the event frustrating the contract was “unforeseen” and for which it was not responsible.

3. What are the circumstances when triggering a force majeure or arguing frustration of contract under section 56 is not accepted by courts?

If force majeure is triggered or frustration is argued due to mere inconvenience or difficulty in performing the contract, especially when there exists another practical means of performance,

¹ <https://doe.gov.in/sites/default/files/Force%20Majeure%20Clause%20-FMC.pdf>

² This document contains guidelines for various government organizations (like ministries, departments, etc.) for procuring goods and services

courts will disallow such claims. Once disallowed of the contract, courts may direct the parties to perform the contract and/or award damages for the loss incurred on account of the delay in performance or non-performance. Regardless of whether the courts uphold the existence of a force majeure event or frustration, parties will have an ongoing obligation to mitigate losses.

4. Is there an onus to mitigate losses while invoking force majeure?

Typically when force majeure related disputes go before court, they are in connection with a claim of damages under section 73 of the Indian Contract Act, 1872. Through multiple judicial precedents, the Supreme Court has upheld the principle of mitigation, i.e. the one who seeks damages owes a duty of taking all *reasonable* steps to mitigate and, if he fails to do so, he cannot recover in respect of the damage he could have avoided.³ This onus to mitigate losses is on the party seeking damages and is applicable even during a force majeure event.

For instance, if goods are stored in the open in a warehouse during a force majeure event and monsoons are likely to hit, the party in possession of the goods would be *reasonably* expected to move them in a covered area to mitigate losses since the expectation would be to deliver them once the force majeure period is over. That said, the ability of the party to *reasonably* move the goods in a covered area will also depend upon the specific facts and circumstances.

5. Is there a formal process to invoke force majeure or does it trigger automatically?

The invocation of force majeure is subject to the terms contained in the force majeure clause. Typically, any party relying on a force majeure event is required to notify the other party in writing of the type of force majeure event, duration of the suspension period as well as the extent to which it will be unable to perform its obligations under the contract. For a force majeure to be triggered automatically, it needs to be specifically stated in the agreement and cannot be implied.

6. Does any party have the onus to prove whether a force majeure event has taken place or not?

The onus lies on the party which is relying and claiming that a force majeure event has occurred. In fact, the court may direct such a party to provide tangible evidence and demonstrate how it was unable to perform its obligations during the force majeure event. For instance, a builder unable to deliver possession of a flat to a buyer due to “force majeure” will have to prove in court by showing specific instances and evidence (*shortage of labor, building material, civil unrest, prohibitory orders on using ground water, lockdowns, etc.*) that prevented it from performing its obligations.

7. If a force majeure clause expressly states that neither party will incur any costs and if one party is paying storage, rental, demurrage costs, can it recover these from the other party?

This often depends upon specific facts and circumstances and, perhaps, also on other terms of the contract. That said, the general rule that has been upheld by the Supreme Court in *Energy Watchdog v. Central Electricity Regulatory Commission and Anr*⁴ is that force majeure cannot be stretched

³ P. Radhakrishna Murthy v. NBCC Ltd. AIR 1962 SC 366

⁴ (2017) 14 SCC 80

to make good loss caused to a party. Therefore, unless mentioned otherwise in the text or spirit of the contract, if the force majeure event is resulting in overheads for one party, such party will have to incur them without being able to claim it from the other. For example, if a force majeure event inadvertently results in one party paying for storage and/or demurrage on account of restriction on movement of goods, chances are that such party will have to absorb this cost unless the contract mentions otherwise.

8. If a force majeure situation resolves in 1-2 months but the hit on a business is long lasting, can the benefit of force majeure be taken for such longer period as well? For instance, a real estate company may not get access to capital to complete its project on account of the overall economic situation in the country. This may result in delays of over 6-12 months in projects. Can this entire period then be covered under force majeure?

A standard force majeure clause stipulates suspension of performance till subsistence of the trigger event. Once situation becomes normal, the affected party may not be able to avoid performance of its obligations on account of economic slowdown. In fact, Indian courts have consistently held that delays in performance due to financial hardships, non-availability labor or raw material, and government restrictions would not qualify as force majeure events, especially, in contracts where time is of essence.

Notwithstanding the above, some respite may be available to real-estate projects registered under RERA. Under section 6 of RERA, a developer may seek extension of the project for up to 1 year on account of force majeure event which includes “war, flood, drought, fire, cyclone, earthquake and *any other natural calamity* affecting regular development of a project.” Considering the prevailing circumstances, developers registered under RERA could seek extension of their project in order to protect themselves against economic consequences of COVID-19.

For other sectors, the assessment of whether benefit of a temporary suspension can be taken even beyond the force majeure period will depend upon the facts and circumstances as well as language of the contract.

9. What other commercial clauses should be re-looked on account of COVID-19?

Upon triggering a force majeure event, parties should also re-look at clauses related to price escalation, price adjustments, material adverse change, limitation or exclusion of liability, termination and its consequences, etc.

10. Is a party obliged to pay rent for its commercial premises when its office is closed and business is not operational?

Yes, a tenant’s obligation to pay rent under a commercial lease deed would continue during the period of lockdown and non-operation of its business. However, tenants may approach landlords to seek suspension of rent or make staggered payments during the force majeure event. Multiple companies have, in this Covid-19 crises, written to their landlords and got a waiver or reduction in rent.

Summary:

In view of the ongoing COVID-19 crises, we recommend all companies to:

- Review their commercial contracts, especially provisions related to force majeure;
- Ensure that occurrence of a force majeure event has been communicated in writing to the other party in accordance with the contract;
- If price escalation or termination is a likely result of an extended force majeure, start planning for it;
- Maintain all documents and records of all costs incurred due to COVID-19;
- Take all reasonable measures to mitigate losses. If there are doubts as to what would be deemed “reasonable”, consult with counsels;
- Engage in discussions with vendors and customers where significant delays are likely. Communication is the best tool to avoid conflict during this unprecedented situation;
- Lastly, plan ahead. The COVID-19 crises can impact business not just for a couple of months but, perhaps, for the whole year or even longer. Have contingencies and strategies in place.

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