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IMPACT ON COMMERCIAL CONTRACTS DUE TO COVID-19

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INTRODUCTION

Since doctors first identified a new strain of the corona virus (COVID-19) in China last December, the virus has rapidly spread throughout the world leaving government officials, non-governmental organizations, health care workers and the general population scrambling. By January 30, 2020, the International Health Regulations Emergency Committee of the World Health Organization (WHO) had declared the outbreak a "Public health emergency of international concern" and on March 11,2020 declared it as a "Pandemic". Since then the international community is a prey to the deadliest virus which arose in Wuhan, China as disease pneumonia with unknown cause on December 31, 2019.[1]

With the pandemic continuing to slain the globe, its impact can be witnessed in almost all the sectors of the economy i.e. real estate, energy sector, hospitality, insurance etc. Every sector has been unable to perform their part of performance which will in a way lead to litigation of all such matters at national and international level. At this point of juncture it becomes crucial to understand the law of contracts because the remedy as to whether to perform or not to perform is hidden between its texts and left for interpretation. In simple words, contracts are legal binding document between two contracting parties. The fundamentals of valid contract are enshrined as: - All agreements are contracts if they are made by free consent of the parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.[2] This makes it clear that when a contract is entered upon by free will of the parties it makes it compulsory for each of them to complete their part of their performance, but

[1] https://www.who.int/emergencies/diseases/novel-coronavirus-2019/events-as-they-happen
[2] Section 10 of The Indian Contract Act,1872

there are exceptions to it. And the upcoming question arises as to whether pandemics be classified as one of the exception for the performance of contract.

The effect of pandemics can be understood from the figure illustrated below:-

Serial No.	Country	Cases	Deaths
1	United states	4,68,895	16,697
2	Spain	1,52,222	15,447
3	Italy	1,43,226	18,279
4	Germany	1,18,235	2,607
5	France	1,17,749	12,210
6	China	81,907	3,336
7	Iran	66,220	4,110
8	United Kingdom	65,077	7,978
9	Turkey	42,282	908
10	Belgium	24,983	2,523

As on: - 10/04/2020[3]

And the lethal effects which might be caused by the noxious virus has also a perspective under the Sanskrit shlokas and which is described below: -

यथाह्यल्पेनयत्नेनच्छिद्यतेतरुणस्तरुः।
सएवाऽतिप्रवृध्दस्तुच्छिद्यतेऽतिप्रयत्नतः॥
एवमेवविकारोऽपितरुणःसाध्यतेसुखम्।
विवृध्दःसाध्यतेकृच्छ्रादसाध्योवाऽपिजायते॥

English Translation

[3] Worldometer.info

Just as a tender plant is easy to cut down, the same requires much more effort when fully grown. Likewise, any disease is manageable in the early stage; it becomes almost incurable when it grows.[4]

It is significant to understand the consequences if such a large scale lockdown are not implemented. When every country passes through the third phase the amount of infected people is increasing at a tremendous pace. Meanwhile, it would be in larger public interest to maintain a strict lockdown and co-operate with the government and abide by the rules set down by them.

When understanding commercial contracts, it is pertinent to know that when such supervening or irresistible force comes in the way as to making it impossible or merelyimpracticable the performance of the agreed contract, they who have made every effort to complete the performance are waived of from performing the contract.

It has been illustrated in the legal system in two different ways

1. Using the Force Majeure clause in the contract itself and shall be mentioned as to under which circumstances it might apply to: -

i. Act of god
ii. Natural disaster
iii. Warlike situations
iv. Labour unrest
v. Epidemics
vi. Pandemics

2. If there is no force majeure clause then the doctrine of frustration would be applied as under by different law systems.

Understanding the Force majeure clause

[4]Charak Nidaan 5 / 13-16/ resanskrit

Force majeure is a clause that is included in contracts to remove liability for natural and unavoidable catastrophes. It also encompasses human action such as armed conflicts. Force majeure is used in some event which is unforeseen and unstoppable and which renders the performance of contract impossible, the intention is to save the performing party from consequences over which he has no control. It is an exception to the breach of contract.

Black's Law Dictionary[5] defines a force majeure clause as "a contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event or effect that the parties could not have anticipated or controlled."

The clause has been highlighted under the Indian law under The Indian Contract Act, 1872; the wordings of the section are as follows: -

"Contingent contracts to do or not to do anything if an uncertain future event happens, cannot be enforced by law unless and until that event has happened." If the event becomes impossible, such contracts become void."[6]

The pandemic has caused global disruption and the use of the clause can be observed across varied jurisdictions. Every country in a way have disrupted businesses and incomplete performance of contracts where everybody is on the move to apply for force majeure notice, but under different legal systems it has same understanding in a different manner. While force majeure is implied in civil law jurisdictions, it has to be expressly mentioned under the common law jurisdictions emphasis can be traced back to the French law; it applies 3 tests as to whether a defence can be regarded as a force majeure; unforeseeable, external and irresistible.

But the general rule of law suggests certain common criteria as to what a court must consider while taking into consideration the applicability of the force majeure: -

1. The event qualifies as a force majeure under the specified contract
2. The risk of non-performance was unforeseeable and unable to be mitigated.
3. Performance is truly impossible

However force majeure cannot be invoked if: -

[5] https://www.wardandsmith.com/articles/covid-19-and-force-majeure-what-businesses-should-know

[6] Section 32 of The Indian Contract Act,1872

1. It is foreseeable and mitigate the potential non-performance
2. It is merely impracticable or economically difficult rather than truly impossible.

Classification as to pandemics or epidemics will free the non-performing party or shall be excused from performing their part of the activity, but where clauses are silent upon the pandemics, epidemics or other viral outbreaks are likely to be inefficient for force majeure defence unless the courts liberalize the force majeure analysis. Indian courts have guided with a clear understanding of the force majeure clauses with landmark judgements.

In *Dhanrajamal Gobindram vs Shamji Kalidas And Co.*[7]**, the Supreme Court dealing with FM held that,**

has given an account of what is meant by "force majeure" with reference to its history. The expression "force majeure" is not a mere French version of the Latin expression "vis major". It is undoubtedly a term of wider import. An analysis of rulings on the subject into which it is not 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. This is the widest meaning that can be given to "force majeure"

Also in *Energy Watchdog vs. Central Electricity Regulatory, Civil Appeal Nos.*[8]**, the Supreme Court held that,**

Force majeure" is governed by the Indian Contract Act, 1872. The Supreme Court held: "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. The performance of an act may not be literally impossible but it may be impracticable and useless from the point of view".

This gives a clear understanding as to when there is an absence of force majeure clause it is governed by the local law of the country and in India is governed by "Doctrine of frustration" enshrined under the Indian Contract Act.[9]

[7] *AIR 1961 SC 1285*
[8] *5399-5400 of 2016*
[9] Section 56 of The Indian Contract Act,1872

Foreign judgements and analysis

Although the global response to COVID-19 is unprecedented, epidemic-related force majeure disputes are not. In the late 1800s, a French court considered an actor's claim that a typhoid epidemic in a city excused him from performing there even though the theatre remained open. Another court evaluated whether a cholera outbreak excused non-performance of a food sale contract. Still another assessed whether an influenza epidemic excused a contractual commitment to deliver fabric.

In more recent times, a Chinese court affirmed that, for a month in 2003, SARS constituted a force majeure and contracting parties were not liable for losses during that period. And during the 2014 Ebola crisis, a manufacturer announced it was suspending an iron ore expansion project in Liberia due to the deadly Ebola epidemic in West Africa – a force majeure that freed both parties from liability or obligation because the crisis was beyond the control of the parties and prevented performance.[10]

In some jurisdictions precedents have been settled down in the following manner.

Sole effective cause

In *Seadrill Ghana Offshore v Tullow* [2018] EWHC 1640 (Comm), Teare J confirmed that, in order for a party to rely on an event of force majeure, it must be the sole operative cause of the inability to perform. That means that if you are affected by COVID-19, but there is also some other reason why you cannot perform your obligations, then you cannot rely on the force majeure clause.

Alternative methods of performance

Classic Maritime Inc v Limbungan Makmur SDN BHD [2018] EWHC 2389 (Comm), another case decided by Teare J, confirmed that principle that if there are alternative methods of

[10] https://www.pillsburylaw.com/en/news-and-insights/coronavirus-force-majeure.html

performance, then you must explore alternative modes of performance (provided the contract does not provide for a single mode of performance).

Reasonable endeavours

Some contracts may also specify that parties must use "reasonable endeavours" to overcome a force majeure event. What is "reasonable" will depend on the nature of the contract and the contractual obligation that is impacted by the force majeure event. In *Seadrill Ghana Limited v Tullow Ghana Limited* Teare J held that Tullow, as the party having to prove that it had used reasonable endeavours to overcome the force majeure event, had to weigh its own business interest against the business interest of Seadrill.[11]

Doctrine of frustration

It is evident that if no mentioning of the crisis is dealt in the force majeure clause the parties are left with no option but to avail the remedies under the local law, where generally the doctrine of frustration comes into play. The main and the only difference between force majeure and the doctrine of frustration is that in force majeure it may provide for extension of time rather than relieving the parties from performance.

Doctrine of frustration comes into play in two types of situations: -

1. The performance is physically cut off
2. The object has failed.

Section 56[12] of the act applies to both the situations.

The principle of frustration of contract, or of impossibility of performance is applicable to a great variety of contracts. It is, therefore, not possible to lay down an exhaustive list of situations in which the doctrine is going to be applied so as to excuse performance. The law upon the matter is undoubtedly in process of evolution. Yet the following grounds of frustration have become well established.

[11] https://www.haynesboone.com/alerts/is-the-coronavirus-covid-19-outbreak-a-force-majeure-event
[12] Supra (9)

1. **Destruction of the subject matter-**The doctrine of impossibilities applies with full force "where the actual and specific subject-matter of the contracts has ceased to exist.
2. **Change of circumstances-**A contract will frustrate "where circumstances arise which make the performance of the contract impossible in the manner and at the time contemplated.
3. **Non-occurrence of contemplated events-**Sometimes the performance of a contract remains entirely possible, but owing to the non-occurrence of an event contemplated by both parties as the reason for the contract, the value of the performance is destroyed.
4. **Death or incapacity of the party-**A party to a contract is excused from performance if it depends upon the existence of a given person, if that person or becomes too ill to perform.
5. **Government, administration or legislation intervention-**A contract will be dissolved when legislative or "administrative intervention has so directly operated upon the fulfilment of the contract for a specific work as to transform the contemplated conditions for a specific work as to transform the contemplated conditions of performance.
6. **Intervention of war-**Intervention of war or warlike conditions in the performance of a contract has often created difficult questions. If the intervention of war is due to the delay caused by the negligence of a party, the principle of frustration cannot be relied upon.

In Satyabrata Ghose Vs. Mugneeram Bangur and Co. and anr.[13], Mukherjee J., a Single bench of Supreme Court illustrated the doctrine of frustration and also dealt with Section 56 at length as under

<u>On Section 56</u>

"The first paragraph of the section lays down the law in the same way as in England. It speaks of something which is ***impossible*** *inherently or by its very nature, and no one can obviously be directed to perform such an act. The second paragraph enunciates the law relating to discharge of contract by reason of supervening impossibility or illegality of the act agreed to be done. The*

[13]**AIR 1954 SC 44**

wording of this paragraph is quite general, and though the illustrations attached to it are not at all happy, they cannot derogate from the general words used in the enactment. 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 useless 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 found it impossible to do the act which he promised to do.***

Hence, it is clear that under commercial contracts if any unlikely situation arises which beyond the parties control, they can dodge it by the shield of force majeure and if not possible may file for doctrine of frustration. It is to be kept in mind that those who apply for such defences shall have the burden to prove the essentials.

Application of force majeure around the globe

THE U.S

The Uniform Commercial Code ("UCC") provides standard rules that apply to sales of goods. Under the UCC, a seller of goods may be excused from performance under certain circumstances. Circumstances where this doctrine might be invoked during the current crisis are outlined below.

- If the seller must suspend operations due to a governmental regulation or order, it may be excused pursuant toUCC § 2-615.[14]
- Similarly, if certain contingencies occur that render the seller's performance impracticable due to unforeseen events beyond its control, its obligations may be excused pursuant to UCC § 2-615.[15]

[14]https://www.law.cornell.edu/ucc/2/2-615
[15] Supra 14

ITALY

Article 1256 of the **Italian Civil Code** provides that the obligor may evade its responsibility by proving that its failure to perform, or its delay in performance, has been caused by an inability to perform due to a cause which "is not ascribable" to him.[16]

U.K.

In *Aviation Holdings Ltd v Aero Toy Store LLC*[17], which concerned a contract for the sale of a Bombardier executive jet aircraft, Hamblen J stated that a seller unable to deliver the aircraft on time due to a pandemic causing a dearth of delivery pilots would be able to bring itself within the wording of a force majeure clause which provided "any other cause beyond the seller's reasonable control".

The party must prove the following, and this checklist must be applied to any COVID-19 force majeure argument:

1. The occurrence of an event identified in the clause;
2. It has been prevented or hindered (as the case may be) from performing the contract by reason of that event;
3. Its non-performance was due to circumstances beyond its control; and
4. There were no reasonable steps that could have been taken to mitigate the event or its consequences.

UAE

[16]Article 1256
[17] [2010] 2 Lloyd's Rep 668

Article 273(1) of the Civil Code provides that if a force majeure event supervenes that renders performance of a contract impossible, all contractual obligations will cease and the contract will be automatically cancelled. Under Article 273(2), in cases where the force majeure event renders only part of the obligations impossible to perform, only that part of the contract will be extinguished and the remainder will continue in effect.[18]

SWITZERLAND

The Swiss Code of Obligations does not explicitly regulate force majeure, but this principle is nevertheless recognised in case law and is subsumed under Art. 119 CO. If performance has become impossible due to circumstances beyond the debtor's control, Swiss law considers the claim to be made impossible under Art. 119 CO[19]

The question of whether a global health risk such as epidemics and pandemics can also be considered a force majeure event has not yet been conclusively clarified. This is particularly the case in combination with an official order or ban.

THAILAND

The concept of force majeure is codified under civil and commercial code ("CCC"). "Force majeure denotes any event the happening or pernicious results of which could not be prevented even though a person against to whom it happened or threatened to happen were to take such appropriate care as might be expected from him in his situation."

There are few cases in Thailand involving epidemics being used as the basis for a force majeure claim. In 2009, the Supreme Court ruled on an event related to the H5N1 "bird flu". In that case (Supreme Court Decision No. 5353/2552), due to the outbreak of the novel flu virus, a farmer was ordered by the relevant authorities to slaughter his chickens; after complying with this order, the farmer was unable to deliver the chickens to his customer under an existing supply agreement.

[18] Article 273 of Civil Code
[19] Article 119 of Swiss Code of Obligations

The court agreed with the farmer's position that the governmental order in response to the epidemic constituted an event of force majeure under the circumstances, meaning he was lawfully excused from performing his contractual obligation.[20]

SPAIN

Under Spanish law it is governed by the maxim "***Rebus sic stantibus"***: this entails that if the circumstances at the time of performance are substantially different from those on the basis of which the parties concluded the contract, the obligations therein cannot be maintained in the form in which they were agreed.[21]

CONCLUSION

In order to pen down my thoughts in concluding lines, it is noteworthy that in such dangerous circumstances where the control is not in the hands of party, it shall be very important to analyse the term force majeure and its availability in different jurisdictions, because most of the contracts have it in one or the other form. Several notifications have been made out for the purposes of contractual understandings.

Where in the Indian government has considered the outbreak of COVID-19 as force majeure.[22]

[20] Thailand (26/03/2020) Mori Hamada matsumoto
[21] https://blog.ipleaders.in/doctrine-rebus-sic-stantibus-international-law/
[22] **office memorandum vide F.18/4/2020-PPD**