

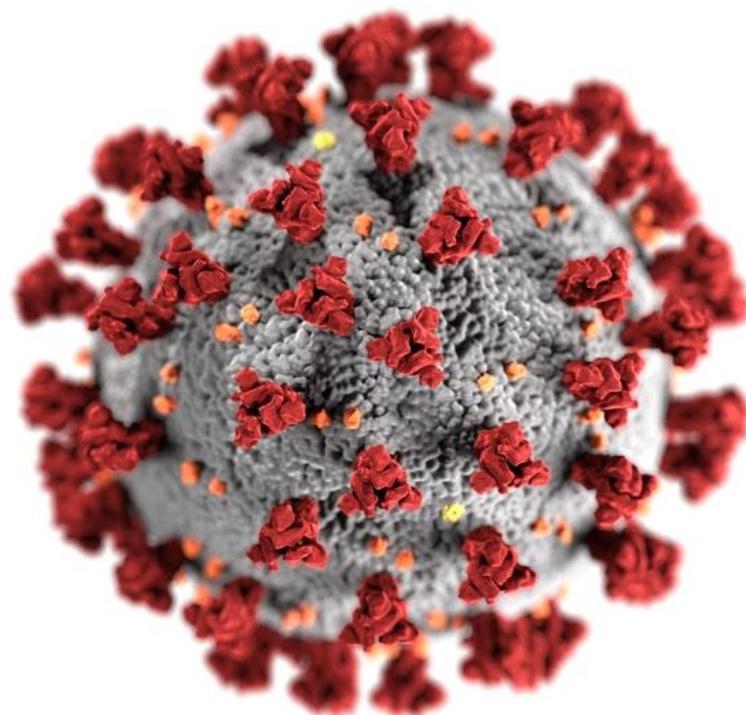
COVID -19 LEGAL FAQ SERIES

FOX MANDAL & ASSOCIATES



COVID-19 GLOBAL PANDEMIC

The sudden outbreak of the pandemic and the nation-wide lock-down has put a heavy constraint on individuals as well as the economy. To minimise the impact of the pandemic on the general public as well as business establishments and ensure minimum disruption in the supply chain, many amendments, advisories and announcements have been introduced which would ideally subsist during the containment period but could have long-term implications. Understanding the ramifications of these developments is essential for the smooth operation of enterprises. We decode the queries that have surfaced appurtenant to the multitudinous notifications that attorneys across our diverse practice domains have responded to.



What is the meaning of a 'Force Majeure' clause in a contract?

The Black's Law Dictionary defines '*Force Majeure*' as '*an event or effect that can be neither anticipated nor controlled*'. It is to be noted that, under Indian law, a '*Force Majeure*' clause must be expressly provided under the contract and protection afforded will depend on the language of the clause. A literal translation of the term '*Force Majeure*' means an '*irresistible compulsion or superior strength*' and in contractual terms, force majeure generally denotes unforeseeable circumstances that prevent a contracting party from fulfilling its obligation under a contract. Some of the typical circumstances identified as a '*force majeure event*' are *act of God such as flood, war, riots, natural or other disasters, act of government etc.* The ambit of *Force Majeure* is contractually defined between the parties and due regard has to be provided for the definition or scope of provisions of force majeure on a case-to-case basis. Further, it needs to be ascertained whether the term is defined as an inclusive or exhaustive definition.

In case of Covid-19, can 'Force Majeure' be invoked by a contracting party?

Courts in India have strictly interpreted the provisions on *Force Majeure* and the burden is always on the party invoking a *Force Majeure* clause to prove that the event in question falls within the scope of such clause. Further note, the Courts in India have opined that in order to take shelter under *Force Majeure*, it must be shown that such an event was unforeseeable by the party and beyond the reasonable control of the party and rendered the contract or its obligation impossible to perform. Further, while analysing the *Force Majeure* clause, it is also necessary to analyse, if best endeavours have been taken to mitigate the *Force Majeure* event. Though supply chains and the market have been affected due to Covid-19 out-break, whether 'Covid-19' by itself can be considered as a factor to invoke a '*Force Majeure*' provision is something which will have to be ascertained on a strict interpretation of the contractual provisions. While some of the clauses, provide for generic provisions such as 'Act of God' or 'natural calamity', whereas in other cases, the clauses may include 'pandemic' 'epidemic' etc. within the ambit of *Force Majeure*. Hence, it is pertinent to always review the clauses to assess whether a party may invoke '*Force Majeure*'.

In this regard, it is to be noted that, effective from March 25, 2020 a national lock-down was imposed in India across the country wherein all commercial and industrial establishments across sectors were required

to close down with a few exceptions to essential services. (Refer [Order No.1-29/2020-PP \(PtII\)](#) dated 24.03.2020 issued by the National Disaster Management Authority read with the Order No. [40-3/2020-DM-IA](#) dated 24.03.2020 issued by the Ministry Home Affairs). Given the same, in the event a party is unable to perform its obligations or there would be a delay in fulfilment of obligations arising as a result of such lock-down, the party may take refuge in circumstances where the *Force Majeure* clause includes 'Governmental orders' or 'change in law' or 'act of government'. However, as stated above, whether the clause '*Force Majeure*' can be invoked has to be analysed carefully and the wording around the clause must be reviewed on a case-to-case basis to determine the same. Further note, it is advisable for the party to look into other aspects under the contracts such as roles and responsibilities of parties during *Force Majeure*, provisions on termination, governing law and dispute resolution etc. (Explained further *in the Query below*)

What are the other key considerations while invoking 'Force Majeure'?

As stated above, a '*Force Majeure*' provision has to be considered on a case-to-case basis and due consideration must be provided to the contractual terms agreed between the parties. Some of the common factors are as follows:

- (i) Ambit of '*Force Majeure*' and Governing Law: The parties must assess the scope of '*Force Majeure*' clause having regard to the governing law of the contract. It is also pertinent to take into consideration such aspects under the contracts which can be performed so as to avoid any dispute between the parties.
- (ii) Duty to Mitigate: Most provisions for '*Force Majeure*' stipulate a duty on the party invoking the *Force Majeure* to undertake 'reasonable' measures to mitigate such event and its effects. Some common examples include procuring alternative sources of supply of goods at the same or reasonable price etc.
- (iii) Requirement for Notification: Most clauses provide for a notification requirement and may also state that an event must continue for a specified period of time beyond which if the party is unable to perform, then only a *Force Majeure* may be invoked by intimating the other party of the existence of such event. In these circumstances, it is always advisable to follow the due process which has been contractually agreed and also to maintain proper records of such notices and documents, to substantiate the party's position in the event of any dispute.
- (iv) Roles and Responsibilities of Parties: Some of the clauses on *Force Majeure* specify the extent to which each party is required to perform its obligations in case a *Force Majeure* event has been triggered. Further, the parties also have to consider what are the contractual remedies available to them in case a force majeure is invoked, which is outlined in the following queries.

It is advisable to consider that these factors have to be analysed on the basis of each contractual terms agreed between the parties.

What other remedy is available to a party if the contract does not contain a clause on 'Force Majeure'?

In the event that the contract does not expressly provide for a provision on 'Force Majeure', the party which is unable to perform its obligations due to or arising from Covid-19, may rely on the remedy under Section 56 of the Indian Contract Act 1872. Kindly note, Section 56 of the Indian Contract Act, 1872 provides for the impossibility of performance after the execution of a contract. The section states that a contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the party could not prevent, will be void. Here it is pertinent to understand that, such an act must be 'impossible' to perform.

The Indian courts have considered 'impossibility' from the terms of practical feasibility. *'The impossibility contemplated by s. 56 is not confined to something which is not humanly possible. If the performance of a contract becomes impracticable or useless having regard to the object and purpose of the parties then it must be held that the performance of the contract became impossible'* (Refer *Sushila Devi And Anr vs Hari Singh And Ors 1971 AIR 1756*). Further, the section provides that such a contract becomes void. Hence, it will have to be ascertained whether it was 'impossible' for the party to perform the obligations under the contract as a result of the Covid-19. Here, it may be relevant to rely on Governmental Orders which may have resulted in a temporary closure of the operations of the party leading to incapacitation in performance of obligations, however, it needs to be kept in view that this must have resulted in the performance being practically 'impossible' and the same has to be interpreted in light of the contractual terms.



In light of the above, to what extent can a party consider 'Material Adverse Effect'?

The meaning of the term 'Material Adverse Effect' has to be derived based on the underlying nature of the transaction where it has been used and is often used interchangeably with *Material Adverse Change*. On general parlance, the term is used to refer to an 'occurrence, event or change in condition which is or reasonably could affect the ability of parties to consummate the transaction'. Generally, in case of an M&A transaction or financing transactions, the term is used as a material threshold to measure the negative effect of some event on the target business/company. The scope of 'Material Adverse Effect', including its exceptions, depends on the nature of the transaction, the industry/ sector, the market conditionalities etc. and differs from one arrangement to another. In most cases, a party claiming the impossibility of performance arising as a result of *Material Adverse Effect*, would have the contractual right of termination of the agreement.

In the event a party is intending to consider triggering a *Material Adverse Effect* clause on account of Covid-19, the burden will be on such a party to prove that the pandemic has materially affected its performance of the transaction or obligation. It is also advisable for a party invoking the *Material Adverse Effect* clause to follow the due process (such as serving of notice, observing cure period if feasible etc.) before initiating any action thereon. Considering that the Covid-19 has affected most businesses across sectors, it is advisable for the parties to a contract to enter into mutual negotiations and look at alternative remedies (such as price adjustments, limitation of liability etc.) before initiating termination of the arrangement.

Does the current lockdown have any impact on the Limitation Period?

Limitation period is the maximum period prescribed by law within which legal action can be initiated, or a right can be enforced. According to Section 2(j) of the Limitation Act, 1963, 'period of limitation' means the period of limitation prescribed for any suit, appeal or application by the Schedule under Limitation Act, 1963, and 'prescribed period' means the period of limitation computed in accordance with the provisions of Limitation Act, 1963. In India, suits relating to contract including for specific performance of a contract has a limitation period of 3 (three) years.

On 23rd March 2020, the Hon'ble Supreme Court of India has passed an order in *Suo Moto Writ Petition (Civil) No. 3/2020, inter alia*, extending the limitation period taking into cognizance the situation arising on

account of the spread of Covid-19 and resultant difficulties that may be faced by the litigants across the country in filing their petitions/applications/suits/appeals/all other proceedings within the period of limitation prescribed under the general law of limitation (i.e. Limitation Act, 1963) or under Special Laws (both Central and/or State). Through this *Suo Moto* Order, the Hon'ble Supreme Court has extended the period of limitation with effect from 15th March 2020, until further orders, for all filings before all forums including Tribunals, irrespective of the limitation prescribed under the general law on limitation (i.e. Limitation Act, 1963) or special laws, whether condonable or not.



What other contractual legal consequences needs to be considered?

In addition to the foregoing, parties to a contract may look at alternative contractual remedies available such as clauses on price adjustments, limitation or exclusions of liability, termination etc. Some of the points of considerations are as follows:

- (i) The parties need to assess the roles and responsibilities primarily with respect to the liability of parties on account of non-performance, termination provision and governing law /dispute resolution mechanism.
- (ii) Some contracts, especially in case of financial transactions, M&A transactions or equity investment transactions, contain provisions on representations and warranties and continuity of business (*during the time period between execution and closing of the transaction*). The disruption caused due to the Covid-19 outbreak may result in certain representations or warranties and covenants

given by a party to be no longer valid or accurate, when repeated at closing. This could result in right being available to the other party to invoke termination of contract and even claim for damages arising out of breach of contract. It is advisable to consider the ramification of non-performance of clauses under the contracts, especially provisions on liquidated damages.

- (iii) Another aspect of contract which parties need to consider is disclosure requirements under a contract. In view of current disruptions due to Covid-19, the parties need to assess if the changes in the business environment due to Covid-19 in future are likely to adversely impact the ability to discharge their obligations under the contract and the extent of disclosure requirement by such party who is unable to perform its obligations. This is more relevant in financial transactions where contractual arrangements mandate the target company or investee company to make prompt disclosures to the investor of all such potential events, which the party should promptly do in order to avoid a resultant event of default under the contract.
- (iv) While conducting due diligence exercise in a financial transaction or M&A transaction, it is advisable for the lender/ investor (as the case may be) to take into account the borrower's / target company's preparedness to mitigate the adverse effect of Covid-19, and for such purpose, specific disclosures may be sought pertaining to Covid-19 from the party.
- (v) It is to be noted that the current disruptions due to the Covid-19 may cause a delay in closing under financial transactions or M&A transactions, say, for instance, in case if the target company/investee company is unable to perform/fulfil the condition precedents on account of enforcement measures undertaken by the Governmental authorities. In these circumstances, in order to avoid a resultant breach of the contract, parties may look at amicable mutual discussions to extend on the long-stop date of transaction or considering certain items as a condition subsequent to the closing.
- (vi) Continued delay or failure to perform the obligations under a contract arising from the Covid-19, resulting in a breach of contract may also trigger an event of termination. In this regard, the provisions on termination including the cure period, the liability to mitigate and the extent of liability to compensate the other party in case of a resultant termination have to be analysed on a case-to-case basis.

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