



In an effort to combat the threat of the 2019 novel coronavirus (officially renamed, “COVID-19”) outbreak, numerous countries have instituted stringent policy measures to prevent the spread of the outbreak. While, for now, such policy measures comprise of widespread travel restrictions, workplace closures, city-wide lockdowns and mandatory quarantines, with the *World Health Organization* having declared COVID-19 as a pandemic, there are growing concerns of restrictions on trade with infected regions being imposed soon.

As crucial as such policy measures are in curtailing the rampant spread of this outbreak, business operations of companies, both, inside and outside of China, are facing considerable commercial disruption as a consequence of these measures. Disturbances in global supply and production chains are expected to result in lower production in India, with significant impact in sectors such as pharmaceuticals, technology and automobile manufacturing, which are heavily reliant on China for raw materials and / or for the completion of their assembly lines.

In the context of these recent developments, obligations of parties under an unprecedented number of commercial contracts are expected to be affected by the COVID-19 outbreak. Set out below is a brief analysis of key contractual considerations, with respect to Indian law, in relation to such affected contracts.

### Invocation of Force Majeure Clause

Frequently observed in commercial contracts (especially long-term supply agreements), a *force majeure* clause allows for the non-performance of contractual obligations by a party to be excused without frustrating the contract, if such non-performance is caused by a supervening event, which is beyond such party’s control.

- **Express provision:** Indian contract law, unlike civil law, does not recognize *force majeure* as a general legal principle in the absence of an express *force majeure* clause in a contract. As such, relief from performance of a contract on the grounds of *force majeure* needs be expressly provided for in a contract.

- **Scope:** The nature and scope of the protection provided by a *force majeure* clause will depend upon the actual construct and drafting of such clause. Typically, *force majeure* clauses cover extraordinary events / circumstance beyond the control of the parties, and include events such as terrorism, war, riots, strikes, natural disasters and “acts of God.” As per Indian judicial precedent, an “act of God” refers to an extraordinary occurrence due to natural causes, which is not the result of any human intervention, and which could not be avoided by any amount of foresight and care.<sup>[1]</sup>
- **Consequences:** Following the declaration of a *force majeure* by a party, contracts typically require that the counterparty(ies) be notified. Depending upon the construct of the *force majeure* clause in a given contract, the consequences of declaration of *force majeure*, could range from suspension or delay in performance of the contract, to termination of the contract.
- **Non-applicability:** If there is no *force majeure* clause in a contract, or if the *force majeure* clause in a contract is not “attracted to the facts”<sup>[2]</sup> that are interfering with the discharge of the contract, under Indian law, the doctrine of frustration (*discussed below*) may be applied to such contract.
- **Impact of force majeure declarations:** A blanket declaration by a government that COVID-19 amounts to a *force majeure* event may not be sufficient, by itself, to shield businesses from fulfilling contractual obligations. Ultimately, whether an event qualifies as a *force majeure* event is a question of contractual construction. Furthermore, under international law, such declarations would be considered sovereign acts, and if such acts unlawfully interfere with contractual relationships, they could become the subject of claims by foreign investors under bilateral investment treaties concluded by India.

In order to conclusively ascertain whether a *force majeure* clause under a commercial contract can be invoked in light of the COVID-19 outbreak, and in order to ascertain the various options and remedies available to the parties to such contract, the underlying *force majeure* clause would have to be specifically assessed and analyzed. While it is fairly uncommon for typical

1 P.K. Kalasami Nadar v. Alwar Chettiar and Ors. (AIR 1962 Mad 44).

2 Energy Watchdog v. Central Electricity Regulatory Commission (2017 14 SCC 80 39).



*force majeure* clauses to include pandemics, epidemics or public health emergencies, in the event that “act of God” is covered by the clause in question, further analysis of whether the COVID-19 outbreak constitutes an “act of God,” would need to be undertaken.

## Application of Doctrine of Frustration

The doctrine of frustration of contracts is codified under Section 56 of the Indian Contract Act, 1872. As per the position of this doctrine under Indian law, if a contract to do an act becomes impossible or unlawful after the contract is made, such contract is rendered void and is considered discharged by “frustration.”

- **Determination:** To determine whether a contract has been frustrated, Indian courts objectively look to, amongst other things, the construction of the contract, the effect of the changed circumstances on the parties’ contractual obligations, the intention of the parties and the demands of justice.<sup>[3]</sup> In a recent ruling, the Supreme Court of India has endorsed the adoption of a multi-factorial approach, considering various additional factors, including the terms and context of the contract, the parties’ knowledge and expectations at the time of entering into the contract (in particular, as to risk), the nature of the supervening event, etc.<sup>[4]</sup>
- **Limitations:** Indian courts do not apply the doctrine of frustration without limitation – courts have identified a plethora of situations in which the doctrine does not apply, including cases where the doctrine is resorted to, in order to excuse the performance of a contract that has become more burdensome, onerous or unprofitable than the parties to such contract originally anticipated. Indian courts have clearly established that the “impossibility” that triggers the applicability of this doctrine does not include commercial impossibility, i.e., extreme / unseen costs or difficulty of performance.

As such, if a commercial contract becomes impossible to perform due to the COVID-19 outbreak, it needs to be analyzed whether the contract has been frustrated as a consequence of the outbreak, and is, therefore, rendered void. It is, however, imperative to note that the doctrine of frustration may not apply to a failure in fulfilment of a contract that is otherwise capable of being performed, merely by reason of the contract

becoming more onerous or costly as a result of the outbreak.

## Triggering of MAC Clauses

Certain kinds of agreements (especially acquisition agreements and financing agreements), contain material adverse effect / material adverse change (“MAC”) clauses.

- **Contingency provisions:** MAC clauses essentially act as contingency provisions, and depending upon the nature and purpose of the agreement, a MAC clause may serve to entitle a party to any nature of rights if there is a substantial adverse change in relation to the counterparty and / or its business, operations, revenues, etc. MAC clauses under acquisition agreements typically entitle parties to the agreement to a right to either walk-away prior to consummation of the acquisition contemplated under such agreement, or to claim indemnity after such acquisition is consummated.
- **Consequences:** A broad range of rights may be triggered upon the occurrence of a MAC under the terms of an agreement, including the rights to alter commercial terms of the transaction (prior to the consummation of such transaction), to terminate such agreement and / or to claim an indemnity arising from the breach of any MAC-related representations and warranties in such agreement.

Whether the impact of the COVID-19 outbreak on a particular commercial contract constitutes a MAC under such contract, will largely have to be determined by assessing and analyzing the actual construct and drafting of the applicable MAC clause.

## Assessing Impact – Key Strategies

Certain key strategies for making a pragmatic assessment regarding the impact of the COVID-19 outbreak on commercial contracts, are set out below.

- **Review of material agreements:** Review all material agreements that may be effected by the COVID-19 outbreak, including all customer / supplier / distributor agreements, acquisition agreements, financing agreements and insurance policies.
- **Identification of impacted clauses:** Identify key provisions of material agreements that may be impacted by the change in circumstances due to the COVID-19 outbreak – this may

3 *Satyabrata Ghose v. Mugneeram Bangur and Co (AIR 1954 SC 44 14).*

4 *Energy Watchdog v. Central Electricity Regulatory Commission (2017 14 SCC 80 39).*



16 March 2020

include *force majeure* and MAC clauses, dispute provisions, representations and warranties, conditions and other covenants.

- **Evaluation of any requirements / rights triggered:** Evaluate whether any requirements (such as notice or intimation requirements), or rights (such as suspension or termination rights) under the material agreements have been triggered pursuant to the change in circumstances due to the COVID-19 outbreak.
- **Proactive mitigation:** Plan proactive steps to mitigate the issues and concerns resulting, and expected to result, due to

the COVID-19 outbreak. To the extent possible, formulate alternate plans to meet contractual obligations.

- **Seeking legal advice:** Seek legal counsel regarding treatment of contractual issues anticipated due to the COVID-19 outbreak. Appropriate legal assistance is also needed for undertaking an assessment and analysis of key contractual clauses, and for obtaining advice on next steps – for example, for advice on the question of whether a *force majeure* clause can be invoked in the context of the applicable fact scenario.

#### **Disclaimer**

This article is provided by Shardul Amarchand Mangaldas & Co for informational purposes only, and is not intended to provide, and does not constitute, legal advice.

© Shardul Amarchand Mangaldas & Co

Please feel free to address any further questions or request for advice to: [COVID-19.updates@AMSShardul.com](mailto:COVID-19.updates@AMSShardul.com)

If you do not wish to receive our mailers on COVID-19 Updates, please [click here](#) to unsubscribe.