Implications of Covid-19 Pandemic on the Contractual Obligations in India

Ms. Archana. K*

Abstract

COVID-19 pandemic has caused unprecedented disruptions to business operations and the commercial contracts worldwide. Countries around the world have imposed mass travel bans, temporary lockdowns and extremely restricted human movement thereby bringing an unparalleled halt to domestic and international trade. The measures imposed by the Governments of the respective countries, significantly reduced the capacity of businesses to move goods and services within and across the national borders. It has caused disruption to production and also to supply chain, thereby interrupted the trade across the world. All these developments greatly affected the performance of the contracts of the parties to the contract and thereby reduced their ability to perform their obligations. While some of the contracts could not be performed due to the pandemic situation, some others could be performed at the option of the other party to accept the delayed performance. In such circumstances, the parties claim the common defence of Force Majeure or frustration of contract to avoid the financial liability for breaching the contract. This situation gives rise to several questions: whether this

* Assistant Professor of Law, Karnataka State Law University, Hubballi.

pandemic can be treated as a ground for non-performance under act of god or Force Majeure clauses, to excuse a party for non-performance of contract. If so, what are the consequences of such defence? and what is the role of Courts in such cases of non-performance? In this background, the researcher analyses the provisions of Indian Contract law and its applicability as a defence for non-performance of the contract in India. The paper also focuses on the relevant Indian judicial decision on the same.

Introduction

COVID-19 pandemic has caused unprecedented disruptions to business operations and the commercial contracts worldwide. The lockdown imposed by the Government of India has restricted not only the movement of people but also disrupted supply of goods and services around the world. It has impacted the ability of businessmen to perform their respective contractual obligations, resulted in delayed operations or non-performance of the obligations. In such cases, parties to the contract may cite this pandemic as a ground for exempting and discharging their contracts or for renewing the terms of the contract pertaining to date of performance, considerations to be paid, etc. If there is no concurrence among the parties to the contract, the party may invoke the defence of act of god or *Force Majeure* clause to excuse him from performance of the contract.

In India, in case of contractual performance, the decision of the court will be analysing the contractual terms from the perspective of both the facts and the applicable law in question. The general rule underlying contracts is, *pacta sunt sevanda* or agreement must be kept. Hence, once parties by their disposition elect to be contractually bound with another, in the absence of fraud or illegality, they would not be allowed to cancel the contract or escape the liability for non-performance of the contract. However, the *Indian Contract Act, 1872* permits the parties to avoid the contract or not to perform the contractual obligations under certain

circumstances. Such exceptional circumstances include, the non-performance due to unforeseen contingencies, or on the occurrence of unforeseen future event which makes the contract void. In this background, the researcher analyses the provisions of Indian Contract law in the light of effect of pandemic on Indian commercial market and also explores the requirements to invoke *Force Majeure* clause to claim the defence of frustration of performance of Contracts.

Nature of contract and its Performance

The *Indian Contract Act, 1872*, stipulates basic requirements to form a valid contract and remedies for breach of contract. Though the *Information Technology Act, 2000* was enacted to encourage e-commerce and to validate e- contracts, the said Act is silent as to the requirements of a valid e-contract. Hence, the Contract Act is applicable to e-contracts as well. A contract is legally binding, only when the agreement fulfils the requirements such as, offer and acceptance, consideration, free consent, and capacity of the parties and legality of the object to enter into a contract. If all these essential requirements have been fulfilled, then there will be a binding contract between the parties and the parties thereafter have to perform their respective contractual obligations. Once a party to a contract completes his obligations he is discharged from the contract. The contract comes to an end, when both parties have completed their respective obligations. But if one of the parties fails to perform his part of obligation, then the other party can claim remedy in the form of monetary compensation, injunction or for specific performance of the contract.

To determine whether the act of non-performance in the stipulated time amounts to breach of contract, one has to look into the nature of the contract. In commercial contracts, be it ordinary business agreements or commercial e-contracts, if the performance of the contract at a stipulated time is of utmost importance and parties to the contract at the time of entering the agreement intended to make the “time” as the essence of that contract, then the non-performance at the stipulated time gives the other

party the option to treat the contract as void agreement. Further, the law states that the parties to the contract get the right to cancel the contract, only if they had the intention to consider time of performance as the essence of the contract. Otherwise, party can claim compensation for the losses incurred due to the delayed performance.[1] In such cases, the other party may get some time extension for the performance of the contract with the obligation to pay damages for the delay in completion. In certain cases, where the intention of the parties is not to make the performance time bound, but the provisions are inconsistent with the intention of parties to the contract, despite the express provisions to make time the essence of contract, the courts may interpret the terms of the contract otherwise. For instance, if the time for performance was voluntarily extended twice by the party, or the subject matter of the contract is not a commercial undertaking, or date for the completion of the contract was specifically mentioned, but used general words like, as soon as possible it has to be completed, in such circumstances, the courts consider that time is not the essence of that contract.[2] However, if time is intended to be the essence, but delayed performance was accepted directly or indirectly by the other party, although it was not in accordance with the agreement, then the receiving party loses his right to rescind the contract or to claim compensation. If the party choses to consider the agreement as void for not performing it on time, then he has to give notice to the other party in this regard to claim compensation.[3] Hence, intention and actions of the parties has to be looked at and not the letter of the clause. The time is generally considered to be of essence the contract, where:

i. the parties have expressly agreed to treat time as the essence of the contract;

---

1 Section 55 of the *Indian Contract Act, 1872.*

2 *Id*., para (2).

3 *Id*., para (3).

ii. any delay would operate as an injury to the opposite party; and

iii. the nature of the contract requires it to be so construed.[4]

In a recent judgment of *M/S Citadel Fine Pharmaceuticals*, [5] on the issue of significance of time of performance the Supreme Court of India held that, based on the nature and terms of the contract, and the surrounding circumstances it is clear that the parties were willing to consider the time as essence, because clause 9 of the contract mentions the consequences of not performing the contract on the stipulated time.

However, law in certain situations permits extension of time to the contractor, beyond the stipulated completion date. Extension of time for performance can be done only through an agreement between the parties, and extension of time is only a waiver of non- performance by the party in the original time. If the other party did not communicate any acceptance of request to extend the time, the law presumes it to be no extension of time for performance. If the parties agreed to extend the time, such agreement may be in the form of novation or alteration of the original contract. Such extensions are generally made by the parties, if the other party is willing to pay damages or to deduct some portion of the consideration from the payments due to the contractor. If the party fails perform the contract before the lapse of extended time, then the aggrieved party can invoke the remedies mentioned under Section 55 of the Contract Act against the defaulting party.

---

[4] R S Abinraj.(2020) India: Impact Of Covid-19 On Construction And Engineering Sector. Retrieved from: https ://www.researchgate.net/publication/340966338_INDIA_IMPACT_OF_COVID-19_ON_CONSTRUCTION AND_ENGINEERING_SECTOR.

[5] *M/S Citadel Fine Pharmaceuticals v. M/S Ramaniyam Real Estates Pvt. Ltd.* and Ors, (2011) 9 SCC 147, available at, http://www.theindianlawyer.in/blog/2018/06/20/time-essence-contract/.

.

Exemptions Available to the Performance of the Contract

Although the basic requirement of contract law to perform the contractual obligations, by the parties, it allows them from performing the contract under certain circumstances. These circumstances are-

1. Impossibility of performance

If performing the contract becomes impossible due to unforeseeable events beyond the parties' control, then the contract may be avoided by the parties. These supervening events may include a variety of causes such as, natural calamities, act of god, outbreak of war, epidemics, etc. The Contract law permits the parties to avoid the contract if any one of the two causes exists at the time of performance.

Firstly, where the performance of the obligation is dependent on the happening of an unforeseeable event, i.e., in a contingent contract, '*Force Majeure*' event is expressly or impliedly indicated to avoid the performance, on the happening of that stipulated event, the parties can treat the contract as void and the performance of the contract is deemed to be impossible.[6]

Secondly, in case of supervening impossibility mentioned under Section 56 of the Contract Act, party to the contract is exempted from performance. This Section narrates three situations, where the party can consider the contract as frustrated and excused from performance.

a) If nature of the agreement entered by the parties is such that it is impossible to perform, hence, it is void.
b) A contract becomes impossible to perform by reason of happening of some unforeseen event which the promisor could

[6] Section 32 of *the Indian Contract Act, 1872.*

not prevent; or if performed, it would be considered as an unlawful act, then also such agreement becomes void.

c) Where one party to the contract knows, or has reason to believe that the performance is impossible or unlawful, but induces the other party to enter the contract, then the party so induced can declare the contract void and the inducer party must compensate the other party for any loss sustained by the innocent party.[7]

This "supervening impossibility of performance" defence mentioner under Section 56 is not applicable, when non-performance is due to party's own negligence and also in cases, where performance is impossible due to mere temporary circumstances. If the performance is halted due to such temporary circumstances, then the performance may be excused for a term of the existence of the impediment only. Thereafter, the party has to perform the contract, otherwise it would lead to breach of the contract.

2. Frustration of the Purpose

Although Section 56 of the Act has not considered frustration of the purpose, Indian judiciary added it as one more ground of exemption under the Section. This exemption rule is applicable, where due to external factors, not caused by the non-performing party, very purpose of the contract itself fails, then the parties will be excused from performance. The frustration must be substantial and caused by a change in fundamental assumptions on which the contract was made. In *Satyabrata Ghose v. Mugneeram Bangurn & Co & Anr*[8] it was held that, the principle of frustration is not confined to physical impossibilities. The court observed that, the word 'impossible' used in Section 56 does not confine the scope of the section to physical impossibility nor requires the impossibility to be literal and if an unprecedented event or change of

[7] *Id*.; Section 56, para 2.

[8] *Satyabrata Ghose v. Mugneeram Bangurn & Co & Anr,* 1954 SCR 310.

circumstances, causes the total failure of the object for which that contract was entered into, or the fundamental purpose for which the parties negotiated to enter the agreement, then it should be treated as impossibility of performance, because, even though it can be physically performed by the promisor, but such compelled performance would put him to great hardships or makes the contract impracticable and useless. Therefore, if the object of the contract is lost, the contract has to treated as frustrated.

Covid-19 Pandemic as Defence for Non-performance

The COVID-19 Pandemic attack on the country and subsequent lockdown affected supply chains, movement of the goods, and as a result many contracts ended unperformed. When some contractors could not perform the entire contract, some of them ended with delayed performance. Generally, when the contractor failed to perform the contract, unless there is an exemption provided either by the contract or by law, the injured party can claim remedies. Can the defaulting party claim Covid-19 Pandemic and lockdown situations as defence for non-performance is the debated issue. The law allows to claim the pandemic as an excuse, if pandemic is considered as Act of god or *Force Majeure* event either by law or by the contract deed.

i. Conditions to Treat Covid -19 Pandemic as Force Majeure Event

Force Majeure in the context of a contract means, "an unexpected event or situation that can neither be anticipated nor controlled, which prevents the person from doing or completing the promise he or she had promised to under a contract". The commercial contracts, generally include "*Force Majeure* clauses" to excuse non-performance of contract in cases of events beyond their control. These clauses will be added to the contract as an obligation and it includes the consequences of choosing that clause by one of the parties. Generally, these clauses specifically

mention one or more grounds as, *Force Majeure* events, such as, natural calamities, outbreak of war, labour agitation, epidemics, etc. In the present scenario, if the contract deed contains the word 'epidemic' or 'pandemic' in the *Force Majeure* clause, then under Section 32 of the Contract Act, the event, which was unforeseeable future event at the time of entering the contract will be treated as contingent event to perform the contract and the performance is deemed to be impossible due to the occurrence of that event, hence that agreement becomes void.[9] The existence of such situation may excuse the performance in its entirety or suspend the performance temporarily depending upon the occurrence and duration of existence of that extraordinary events. If the impediment caused by the pandemic comes to an end before the purpose of the contract gets frustrated, then there is still a duty to perform the contract by the promisee. To treat the occurrence of an unforeseeable event as *Force Majeure* event certain conditions should be fulfilled. They are-

a. **The contract becomes impossible to perform due to such unexpected event**– to consider an event as '*Force Majeure* event' it should prevent the parties from performing the contract either because of physical impossibility or the basic objective of entering that contract has to fail. Then only such event or change in circumstance will be considered as ground for frustration and it will be deemed that the event makes the performance impossible. To apply this rule to Covid-19 Pandemic, the party should prove the impossibility of performance due to the total restraint on the supply of the subject matter or difficult situation which prevented the performance, the only he can invoke the defence of *Force Majeure*.

---

9 https://www.conventuslaw.com/report/india-a-closer-look-at-force-majeure-frustration/

g. **Doctrine of Frustration does not consider economic hardship alone as ground to invoke *Force Majeure* defence**– If the consequence of unforeseeable event is nothing more than a rise in cost or expenses in performing the contract, then it cannot be called as *Force Majeure.* The Covid-19 pandemic has crippled the economy for some time and party to the contract may face the consequences of increase in the cost for performance of contract. But, mere economic hardships to perform the contract cannot discharge the party from performing the contract. Although the party has to bear the burden of additional expenses, it is possible to perform the contract, then the courts will not consider the *Force Majeure* claim. Hence, if the party takes the defence of the Covid-19 pandemic, he has to prove that, the event made the performance impossible not mere commercial hardship.

h. **The event must be unforeseeable and must not be a temporary situation**– Another requirement of applying *Force Majeure* presumption is that, it must not be an event, which can be anticipated or predicted by a prudent man with ordinary diligence at the time of entering into the contract. If the parties can foresee such risk, '*Force Majeure* clause' is not applicable, even though the contract specifically mentions it. Hence, whenever, the defence of *Force Majeure* is claimed, the court implements the "test of foreseeability". Additionally, if the event or the situation claimed is for a temporary period, after which the conditions return to normality, then also this defence is not available. Applying the test of foreseeability to the present scenario, in case of pandemic defence by a party, who argues that the pandemic and lockdown announcement by the Government prevented him from contract performance, need not be treated as frustrated by the court, because the lockdown is temporary in nature and that contract can be performed after lifting the lockdown orders. At the same time, courts cannot jump to the

conclusion of breach of contract, before finalising their decision, they have to look in to the nature of the contract and situation. In cases where the time is the essence of the contract and performance becomes impossible due to the Covid-19 pandemic situation, then *Force Majeure* defence is applicable, because, the situation is unforeseen and controlling it was beyond the control of the parties.

The recent judgment of the supreme Court in *Standard Retail Pvt. Ltd. and Ors. case,*[10] the question before the court was application of Covid-19 pandemic situation as Force Majeure defence to prevent encashment of Letter of Credits. In this case, a group of Indian Steel importers sought an injunction against South Korean exporters before the Bombay High Court. The petitioners claimed that, *Force Majeure* clause of the contract stipulated "epidemics" as exemption to perform the contract. But, the court concluded that, in the present case, that defence of 'epidemics' is available only to the suppliers and not to the importers, and the suppliers/exporters had already performed their contractual obligation. Further, for transportation of steel there was no restriction during the lockdown period and steel was categorized as essential service. Moreover, on the basis of the contractual terms the Court held that the *Force Majeure* defence is available to the petitioners and the Letter of Credit in question is an independent transaction. Hence, the petitioners are liable for the transaction, thereby the petition was dismissed.

d. **Impossibility of performance must not be self-induced-** The event shall not have occurred by the act or election of the party but it should be the result of subsequent unforeseen event. The

[10] *Standard Retail Pvt. Ltd. and Ors. v. M/s. G. S. Global Corp & Ors*. Comm. Arbi. Petition (L) No. 404 /2020.

test to determine whether the situation is self- induced is called as the "causal test". In the cases, where the party claims the supervening impossibility, the Court examines the whether the supervening event is the proximate cause for non-performance and "but for" such supervening event, whether the party would have performed the contract. This test is most crucial in determining the impossibility of performance, and the parties should produce evidences to prove their case. In the present situation, where *Force Majeure* event of pandemic has occurred, but if the pandemic or the lockdown orders did not have direct impact on the performance of the contract, then *Force Majeure* defence is not available to avoid the contract.

e. **Duty to mitigate the loss caused due to the non-performance of the contract –** A party relying on *Force Majeure* clause has the duty to take all the necessary measures to mitigate the loss caused due to the non-performance. The Supreme Court in *Industrial Finance Corporation of India Ltd.* case[11] held that to invoke the defence of frustration, three conditions should be fulfilled - firstly, there should be a valid existing contract; secondly, either the contract in its entirety or some part of it is not yet performed; and thirdly, after entering into contract, but before the performance it becomes impossible to perform. Besides these requirements, if the parties at the time of contract agreed to comply with additional requirements in the contract, such conditions are binding on both the parties. Generally, the commercial contract deeds would mention the condition that if a non-performing party seeks benefit of *Force Majeure* clause of the contract, then he has to give prior to notice to the other party to minimise the loss. These terms are conditions precedent, and failing to comply with

---

[11] *Industrial Finance Corporation of India Ltd. v. Cannanore Spinning and Weaving Mills Ltd.,* (2002) 5 SCC 54.

such clauses, may not allow the party to take shelter under *Force Majeure* defence.

ii. Difference Between Invoking Force Majeure Defence under Section 32 and Section 56

Application of the 'Covid-19 pandemic situation' as *Force Majeure* event is permitted under Section 32, when the contract deed directly or indirectly specifies that event or situation in the *Force Majeure* clause. But, Covid-19 pandemic is unprecedented, and the lockdown situation was never thought of by the contracting parties, in many cases pandemic situation may not be the part of *Force Majeure* clause of the contract. If the contract does not have Force Majeure clause or the clause does not have 'epidemic' as ground to exempt the performance, then party can rely on Section 56 of the Indian Contract Act to take the pandemic situation as defence. In a recent landmark judgement of the Supreme Court,[12] Justice R.F. Nariman opined that if the event which frustrates the contract is expressly or impliedly mentioned in a clause of the contract, Section 32 of the Act is applicable and if such conditions ae not stipulated in the contract, then Section 56 of the Act is applicable to declare the contract as frustrated.

[12] *Energy watchdog v. Central Electricity Regulatory Commission,* 2017 (4) SCALE 580.

Effect of Covid-19 Pandemic Defence on Contracts

In commercial contracts, the Force Majeure clause in the contract, either expressly or in implied terms permits non-performance on the happening of that event, and the consequences of the invocation of the defence. The *Force Majeure* clause may provide for waiver of damages or penalty for non-performance, deduction in payment of consideration, etc., along with the excuse to perform the contract and the defaulting party is bound to adhere to these conditions as set out in the contract. Usually, the clauses of the contracts are tailor suited to suit the requirement of the parties and the consequences of invoking that defence would also be mentioned in the deed.

In the absence of a *Force Majeure* clause, depending on the context, Section 56 of the Contract Act or common law doctrines provide relief in a successful claim of *Force Majeure* defence. In case of impossibility or complete frustration of contract, the contract becomes void and the party who claims the benefit of *Force Majeure* has to restore back the benefits received from the other party.[13] Therefore, the party invoked the defence of frustration, after the declaration, has to return benefits received, be it the goods or services in the form of consideration to the other party.

Besides that, contracts between the governments of the countries were also disturbed by the pandemic situation. This situation had an unexpected impact on the economy of the country as one of the main sources of revenue of the country comes from international trade. In the absence of specific clause to address such situation in the law, the Government of India initiated actions to clarify the status of pandemic in the contractual relations. The disruptions caused by pandemic situation in supply chains has been considered as a "natural calamity" by the Ministry of Finance and has issued a clarification in this regard to give

[13] Principle of restitution requires the party to return any benefits received under that agreement or contract once a contract becomes void or frustrated, to the person from whom he had received it. See, Section 65 of the Contract Act.

effect to the *Force Majeure* clauses by all central Government Ministries.[14] The office memorandum issued by the Department of Expenditure (Procurement Policy Division) of the Ministry of Finance, dated 19 February 2020 in relation to the Manual for Procurement of Goods, 2017 serves as a guideline for procurement by the Government. Para 9.7.7 of the said guidelines to the Manual states that the COVID-19 outbreak to be treated as 'natural calamity' and to be considered under the *Force Majeure* clauses. However, the memorandum clarifies that, "due procedure" should be followed by the Government departments to seek this defence. Although this memorandum is just a direction given to the governmental ministry and departments, it clarifies the status of pandemic situation and gives relief to various institutions and industries working with the government. The Ministry of Finance also reiterated that *Force Majeure* clause shall not be considered as defence to avoid the performance, the pandemic situation provides a temporary relief of suspending the performance during the existence of the impediment due to that event.

A similar interpretation has been adopted by the Ministry of New and Renewable Energy (MNRE) in the office memorandum dated 20 March 2020, in relation to the scheduled commissioning of renewable energy projects. The office memorandum directs all implementing agencies of the MNRE as well as the State Renewable Energy Departments to treat delay in commissioning the projects during this period as *Force Majeure* situation.[15]

---

[14] https://www.conventuslaw.com/report/india-a-closer-look-at-force-majeure-frustration/

[15] Shweta Vashist and Reshma Ravipati (2020). India: COVID-19 And Force Majeure. Retrieved from: *https:// www.mondaq.com /india/litigation-contracts-and-force-majeure/913932/covid-19-and-force-majeure.*

Conclusion

To conclude, Covid-19 pandemic is an exceptional circumstance, which can be brought under the scope of *Force Majeure*. Depending on the nature of the contract, this situation can be used as a defence for non-performance of contract. In the earlier occasions, when the events such as, Ebola, SARS, occurred and impacted performance of contracts, some countries considered it as *Force Majeure* event. The government memorandums to consider Covid-19 pandemic as natural calamity, which allows the parties to such contracts to invoke the *Force Majeure* defence has limited application. Can Covid-19 be considered as *Force Majeure* event to defend non-performance of the contract in ordinary commercial contracts, dependent on the nature of the contract and intention of the parties to that contract. Additionally, the existence of the frustration conditions enables the party to successfully claim the defence of *Force Majeure* for non-performance.