

IMPLICATIONS OF COVID-19 PANDEMIC ON PERFORMANCE OF CONTRACTS

Brief Background

The COVID-19 crises have engulfed almost all countries causing major human and economic loss. The outbreak of this epidemic began in early December 2019, in Wuhan, China when 41 patients were diagnosed with pneumonia with no clear cause. World Health Organization (“WHO”) on 30th January 2020, identified the outbreak as ‘Public health emergency of International concern’ and directed that all countries should ensure that they are prepared for Containment and management of onward spread of COVID-19 infection.¹ The situation further deteriorated and on 09th March 2020, WHO stated that the threat of COVID-19 ‘has become very real’ and declared that the spread of the disease has reached ‘pandemic proportions’.² The member countries, in order to contain the onward spread of the infection, resorted to varied emergency measures depending on the magnitude of impact on the countries.

Pertinently, even after ensuring emergency measures such as travel bans, stringent screening measures at the airports and isolation of infected patients the onward spread of the COVID-19 infection rapidly escalated and as on 23 March 2020 the COVID-19 is affecting 192 countries and territories around the world and 1 international conveyance (the Diamond Princess cruise ship harbored in Yokohama, Japan), more than 2,94,110 people have contracted the novel coronavirus and at least 12,944 people around the globe have lost their life because of the infection³.

The Organization for Economic Cooperation and Development (OECD) in its report has warned that COVID-19 potentially presents a danger to the global economy which is greater than the 2008 financial crisis as there are lockdowns in various states and region of different countries.⁴ While the world is coping with the health issues presented by the virus, it remains to be seen how and to what extent we are ready to cope with the economic impact of the impending crisis.

India’s Response

The extent of the damage, of course, depends on how soon and how effectively the outbreak is contained. Currently, as on 23.03.2020 there are 415 active cases of COVID-19 in India with 7 fatalities⁵. In order to mitigate the impact of the outbreak in India the Ministry of Health and Family Welfare (“MoHFW”) has been coordinating the efforts of the federal Government. On March 11, 2020, the Group of Ministers determined that the MoHFW shall instruct all state and union territories to invoke section 2 of the Epidemic Disease Act, 1897, so that all advisories being issued by the MoHFW, are enforceable by the states and union territories. Simultaneously, the union government invoked section 69 of the Disaster Management Act, 2005⁶, to delegate powers of the Home Secretary, who is chairman of the National Executive Committee (NEC),

¹ Statement on Second Meeting of International Health Regulations (2005) Emergency Committee regarding the outbreak of novel corona virus, available at: [https://www.who.int/news-room/detail/30-01-2020-statement-on-the-second-meeting-of-the-international-health-regulations-\(2005\)-emergency-committee-regarding-the-outbreak-of-novel-coronavirus-\(2019-ncov\)](https://www.who.int/news-room/detail/30-01-2020-statement-on-the-second-meeting-of-the-international-health-regulations-(2005)-emergency-committee-regarding-the-outbreak-of-novel-coronavirus-(2019-ncov))

² WHO Director General’s Opening Remark at the media briefing on Covid-19 dated 09.03.2020, available at: <https://www.who.int/dg/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---9-march-2020>

³ Corona Virus disease outbreak situation available at: <https://www.who.int/emergencies/diseases/novel-coronavirus-2019>

⁴ Coronavirus: The world economy at risk, available at: <http://www.oecd.org/berlin/publikationen/Interim-Economic-Assessment-2-March-2020.pdf>

⁵ Government of India Tracker of Covid-19 available at: <https://www.mygov.in/covid-19/>

⁶ Government of India, Ministry of Home Affairs (Disaster Management Division Order bearing F. No. 40-2/2020 DM-I (A) dated 11.03.2020

which is a coordinating and monitoring body for disaster management, to the secretary of the MoHFW.

Unlike the Epidemic Disease Act, this law “provides for an exhaustive administrative set up for disaster preparedness.” The Epidemic Diseases Act, 1897, which was enacted to provide for the better prevention of the spread of dangerous epidemic diseases, empowers the Central and State Governments to undertake firm actions when they are satisfied that the State, country or any part thereof is visited by, or threatened with an outbreak of any dangerous epidemic disease and the ordinary provisions of law for the time being in force are insufficient for the purpose. The Central Government’s power is limited to ships/vessels and ports, the State Government is empowered to take, or require any person to take any measures, and by public notice, to prescribe temporary regulations to be observed by the public, or any class of the public.

In furtherance of the powers enshrined by the Epidemic Disease Act, 1897 several states issued advisories on management and containment of COVID-19. Some of the Regulations are reproduced herein below:

- Karnataka Epidemic Diseases, COVID-19 Regulations, 2020, as notified on March 11, 2020,
- Haryana Epidemic Diseases, COVID-19 Regulations, 2020, as notified on March 11, 2020,
- Delhi Epidemic Diseases, COVID-19 Regulations, 2020, as notified on 12, 2020,
- Maharashtra COVID-19 Regulations, 2020, as notified on March 14, 2020.

The COVID-19 threat has become eminent and with failure of emergency containment measures and rapid rise in infection and impending fear of community spread, the Government at both Center and State levels have resorted to announcement of lockdown in order to curb the spread of the COVID-19 infection. The notifications/ orders of state governments and central government are mentioned in the Annexure A.

These lockdowns, partial or complete, would inevitably adversely affect Indian corporate sector and their abilities to honor commitments under commercial contracts as these deterrence measures would have adverse impact on availability of raw materials and manpower. The adverse impact of COVID -19 with regards to delay, interruption, or even cancellation in performance of contracts was and is unexpected and unforeseeable. Henceforth, it is eminent that current situation is analyzed keeping the failure to perform the contractual obligations into perspective.

Failure to perform contractual obligation owing to COVID-19

Business entities in India are facing practical issues in performing their contractual obligation owing to the steps taken by the various State Governments and by the Central Government whereby the Government had imposed either partial lockdown or complete lockdown of the territories of certain badly affected districts. Force Majeure Clause in contracts is intended to shield a performing party in events where it fails to honor its obligations under the contract due to reasons beyond its control. It is an exception to non-performance of whole or part of the contracting parties’ obligations under the contract. Force majeure events typically, include an Act of God or natural disasters, war or war-like situations, labor unrest or strikes, epidemics, pandemics, etc. On February 19, 2020, the Department of Expenditure, Procurement Policy Division, Ministry of Finance has notified an Office Memorandum⁷ in relation to the government’s manual namely, ‘Manual for Procurement of Goods, 2017’, which serves as a clarification for procurement by the government. The aforesaid Office Memorandum stipulates that *“the COVID-19 outbreak could be covered by a force majeure clause on the basis that it is a ‘natural calamity’, caveating that ‘due procedure’ should be followed by any government*

⁷ Office Memorandum No. F. 18/4/2020-PPD, dated February 19, 2020 of the Government of India, Ministry of Finance, Department of Expenditure, Procurement Policy Division

department seeking to invoke it". Furthermore, this memorandum signifies that the Indian government considers COVID-19 to be a natural calamity and hence, it should be covered under the principles of Force Majeure. One of such Force Majeure clause within the terms of the public procurement contracts of the Government of India is reproduced below:

"Force Majeure

Act of God, including but not limited to lightning, drought, fire and explosion, chemical or radioactive contamination or ionizing radiation (to the extent of the fire, explosion, chemical or radioactive contamination or ionizing radiation originate from a source external to the Power Station Land), epidemic, earthquake, volcanic eruption, landslide, flood, cyclone, typhoon, tornado, or exceptionally adverse weather conditions which are in excess of the statistical measures for the last hundred (100) years."

The Force Majeure clause is covered under the provisions of Section 56 of the Indian Contract Act, 1872. At numerous instances, Supreme Court of India has dealt with the interpretation of the section 56 and invocation of Force Majeure clause in a corporate transaction. The Hon'ble Apex Court in a leading case of *Satyabrata Ghose Vs. Mugneeram Bangur and Co. and Anr.*⁸ while interpreting the provision of Section 56, has held that the first paragraph of the provision stipulate such actions which is inherently impossible to perform and thus, no one should be compelled to perform such acts. The Apex Court further stated that the impossibility to perform any obligation may not be literal impossibility but can also be impractical and useless with respect to the objects and purpose of a contract is concerned.

Commercial contracts in general are read strictly with minimal judicial intervention. The standard commercial contracts can be divided into two broad heads for addressing the issue of performance of contract due to COVID-19. While agreements contain each minute detailing, there are some contracts that contain express or implied Force Majeure clauses, such contracts fall under the ambit of Section 32 of the Indian Contract Act 1872. Section 32 provides for Enforcement of Contract Contingent on an event happening. It is pertinent to mention that such contracts are read strictly as per the terms of the contract. The courts in such cases are inclined to strictly cover only events that are specifically mentioned in the contract hence the wording of the contract becomes prominent in such cases for deciding liabilities of the parties involved.

The other kind of contracts are those where there is no express Force Majeure Clause, in such a scenario a party may have to look beyond the clauses of the contract. The principals of frustration of contract as enshrined in the Section 56 of the Indian Contract Act 1872, come into prominence in such situations. In order to claim respite under this provision the performing party need to show that the prevailing situation is fundamentally different from the time of execution of contract and the obligation is impossible to perform.

It is pertinent to note that mere economic feasibility or loss cannot be considered as a ground to invoke section 56 of the Indian Contract Act 1872. The Apex court in the case of *Energy Watchdog vs Central Electricity Regulatory*⁹ reiterated this principle and observed that:

"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 of the object and purpose of the parties."

⁸ AIR 1954 SC 44

⁹ Civil Appeal Nos.5399-5400 of 2016, decided on 11.04.2017

It is pertinent to note that in the aforesaid case of *Energy Watchdog*, force majeure clause in the Agreement between the parties clearly omitted any upsurge in the cost of the plant, machinery, equipment, materials, spare parts, fuel or consumables for the project from the purview of Force Majeure. The escalation of prices of the resources required for the performance of the contract does not render the contract itself impossible to perform. The Supreme Court rightly reiterated that the ambit of force majeure cannot be stretched to a probable difficulty or loss caused to the entity obligated to perform the contract. The Hon'ble Apex Court concluded by stating:

“that the word “impossible” has not been used in the Section 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 of the parties. If an untoward event or change of circumstance totally upsets the very foundation upon which the parties entered their agreement, it can be said that the promisor finds it impossible to do the act which he had promised to do.”

From the foregoing, what can be thus ascertained is where need arises and where parties to the contract wish to seek protection under the principles of frustration of contract, the parties need to abide by the terms of the contract. The parties should also act promptly and should notify the opposite party about its inability to fulfill the obligations under the contracts and invocation of Force Majeure clause.

It may be however noted that Force Majeure may not be owing to COVID-19 outbreak for every contract and hence, it would be necessary to identify and ascertain if non-performance of a contract can be claimed because of the COVID-19 pandemic subject to the terms and conditions of the contract and more so, having regard to the subject matter/nature of the contract.

ANNEXURE A

Notifications of Lockdown		
Dated	Location	Implications
22.03.2020	NCT of Delhi	No. F.51/DGHS/PH-IV/COVID-19/2020/prsecyhfw Complete lockdown in place till 31.03.2020
22.03.2020	Haryana	Order bearing Endst No. 81-90/Covid/2020 Lockdown in seven Districts till 31.03.2020 (Faridabad, Sonapat, Panchkula, Panipat and Gurugram)
23.03.2020	Maharashtra	Lockdown in Ahmednagar, Aurangabad, Mumbai, Nagpur, Mumbai Sub-Urb, Pune, Ratnagiri, Raigad, Thane and Yavatmal till 31.03.2020. Notification bearing No.- DMU UNIT/152/2020 for closure of industries and private sector in Pune district till 31.03.2020 Order by Office of Commissioner of Police bearing CP/XI (6)/144/Prohibitory Order/2020 dated 22.03.2020 for imposition of S.144, Cr.P.C. in Mumbai and complete Lockdown. Notification bearing No. DMU/2020/CR.92/DisM-1 ordering Lockdown in entire state.
21.03.2020	Rajasthan	Notification No. P 1 (1) Department of Medicine and Health/Group-2/2020 Complete Lockdown till 31.03.2020.
22.03.2020	UP	Lockdown in 15 districts till 25.03.2020 Noida lockdown till 31.03.2020 vide a notification issued by central government dated 22.03.2020
22.03.2020	North Goa	Imposition of section 144 Cr.P.C.
22.03.2020	Bihar	Lockdown in several districts
21.03.2020	Punjab	Memo No. CSO/2020/363 dated 22.03.2020 Lockdown till 25.03.2020
22.03.2020	Gujrat	Lockdown in several districts till 31.03.2020
22.03.2020	Karnataka	Order No. DD/SSU/Covid-19/17/19-20 Lockdown till 31.03.2020
22.03.2020	Jharkhand	Notification No. 98/HSN Lockdown till 31.03.2020
22.03.2020	West Bengal	Notification No. H&FW/120/20 Lockdown till 27.03.2020

Note: There was a Notification issued by Central Government dated 22.03.2020 whereby the Government locked down 75 high risk districts till 31.03.2020.