

FAQs

FORCE MAJEURE CLAUSE DUE TO COVID-19



1. What is the definition of Force Majeure ("FM")?

Force Majeure ("FM") is a French word which translates to "Superior/irresistible force". The Black's Law Dictionary, defines it as 'an event or effect that can be neither anticipated nor controlled. "It is a contractual provision allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event that the parties could not have anticipated or controlled." Although not codified under the Indian Law, it can be defined as an event beyond the control of either party and of such a nature that it prevents each party to perform its obligation under the contract

2. Is FM supposed to be an exhaustive clause?

There are two ways to draft FM clauses. Mostly the FM clauses adopt the first format which narrates an exhaustive list of events that constitute a FM event such as tornados, earthquakes, fires and any other event which has been stated in the clause and nothing else. The second type of clauses are those which describe the inclusive list of scenario which would constitute such an event, for example "...earthquakes, hurricanes and any such other event which is beyond the control of the parties".

3. What are the obligations of parties while invoking FM clause?

- 1) Any party trying to invoke such a clause must be able to establish that-
 - The event was beyond its control and that the works has been delayed or stopped because of such unprecedented event.
 - There has to be a nexus between the non-performances of the work with the unprecedented event.
 - All measures were taken by the party to mitigate the impact of the event.
- 2) A party must intimate the other party of the occurrence of such an event at the earliest.
- 3) There may be other specific obligations stipulated in the contract between the parties which the parties must perform once a FM event occurs.

4. What happens if FM triggers are defined but contract is silent about the relief in such cases?

FM clause in each contract is to be interpreted strictly in terms of the respective contract. When the contract does not provide for the consequences in case a FM event occurs, the prevalent law of damages will apply as envisaged under the Indian Contract Act. However, if there is a prohibition from claiming damages, it cannot be claimed.

5. Parties have not entered into a formal agreement yet but a Letter of Intent ("LOI") was brought into existence for commencement of work. The LOI does not contain a FM clause. What will be its impact under the present scenario?

Section 56 of the contract Act (Frustration) can be resorted to in case there is impossibility to perform because of unprecedented event. It would be important to mention that an LOI is not the final contract and therefore, a FM clause may be included in the final contract.

6. When can one resort to Section 56? Does onerous contract amount to frustration?

A contract is said to be frustrated if a contract, pending performance becomes impossible to perform i.e. object is frustrated or the object becomes illegal for reasons not under the control of the parties. As early as in the case of *Naihati Jute Mills Ltd. V Hyaliram Jagannath (1967)*, the Supreme Court had settled the position that *the Courts have no general power to absolve a party from the performance of his part of the contract merely because its performance has become onerous on account of an unforeseen turn of events.*

7. Under FM scenario contractor gets Extension of Time ("EoT"). What happens to monetary loss?

It is a matter of fact that mere extension of time during a FM event may not result in mitigation of prolongation cost. As regards entitlement to recover losses suffered by any party, it would depend on the language of the FM Clause. If the clause permits, it can be claimed.

8. Can a FM event cause termination of contract?

Merely the occurrence of a FM event does not amount to termination of contract. The Courts in India as a matter of practice, always encourage the performance of a contract. Therefore, if a FM event is to be followed by termination of the contract, there must be compelling evidence that no other positive steps could be taken in furtherance of the contract. Mere inconvenience of the contract becoming 'too expensive' is no ground for termination in the eyes of law.

9. If the FM clause is not defined in a contract but it is given as an EoT event, then can it be said that COVID-19 would not be covered under FM clause?

Since FM has itself not been defined under the contract, therefore a careful reading of the provisions of the contract would have to be done to understand if the reference under EOT clause would cover the COVID - 19 or not.

10. Does the occurrence of a pandemic itself lead to invocation of the FM clause?

Occurrence of a pandemic itself does not lead to invocation of the FM clause. It is important that a pandemic or allied situation be a FM event in the contract, further such an impact should have hindered the performance of the contract. Additionally, such a clause would have to be specifically invoked (in writing) by a party willing to take its protection.

11. For the purpose of arbitration, should letters pertaining to FM etc. be written now?

Yes. Any party desirous of taking the benefit of FM clause must intimate the opposite party of the event at the earliest. All such communications play a major role during the dispute resolution process arising in relation to/during the FM event.

12. There is no exclusive FM clause in Government contracts. What to do?

If a contract does not include a FM clause, the parties would have to ascertain certain factors such as the nature of the contract, the nature of event and so forth, as to whether Section 56 of the Contract Act would be applicable or not to such contract in order to discharge the parties from their contractual obligations.

If the performance of an act becomes impossible or unlawful, after a contract has been executed, and such impossibility is due to an event which the party undertaking the performance could not prevent, then such contract itself becomes void or one can say that the contract becomes 'frustrated'.

Hence, frustration is the happening of an act outside the contract and such act makes the completion of performance of a contract impossible.

As per Section 56 of the Contract Act, it is evident that the section envisages some impossibility or unlawfulness of the performance of the act, which the parties had not contemplated at the time when they entered into the contract. However, it is pertinent to mention here that a mere commercial hardship does not amount to frustration of contract.

The courts in India have held that the word 'impossibility' used in Section 56 of the Contract Act must be interpreted in a practical form and not in its literal sense. Thus, a contract would come under the purview of Section 56 of the Contract Act even if it is not an absolute impossibility, but the contract has fundamentally changed, which the parties had not contemplated at the time of making the agreement. This principal has been upheld by the Supreme Court of India in the case of Satyabrata Ghose versus Mugneeram Bangur & Co & Anr (AIR 1954 SC 44).

We wish to state that the preceding response is on the assumption that the querist is referring to a contract which doesn't contain any FM clause.

13. Is price adjustment clause applicable during FM period as EoT is granted?

Whether or not these clauses can be invoked would depend entirely upon the language and wordings of the Contract. The ability to invoke such grounds would depend on the wording of the contract and courts will accordingly draw inference on what the intention of the parties was when entering into the contract.

14. If lockdown period alone is taken as a period of FM, then how to address the post pandemic problems like scarcity of labor, increase in construction cost etc.? How to calculate the rate of progress?

Under the Indian law, the applicability of FM and its consequences is specific to respective contracts and depends on the FM clause set out in the contract. Thus, the reliefs or the measures available to the parties post the FM event, in a particular contract, can be ascertained based on the relevant FM clause under the said contract.

15. In FM scenario (assume COVID-19 is considered as FM and Contract has FM clause), whether Liquidated Damages (“LDs”) and Penalties should continue to be imposed on the Contractors for delays or non-performances during the FM duration? –

If COVID-19 is considered as FM and the contract has a FM clause, the imposition of the LDs and penalties for delays and non-performance during the FM duration, will depend on the language of the FM clause. For instance, if the FM clause, suspends the obligations of the parties during the FM period, then imposition of LDs and penalties may not be tenable.

16. If a contract is entered during the pandemic, thereunder acknowledging the pandemic, can FM still be claimed?

If the contract is entered during the pandemic, then the principle of estoppel may be averred stating that the parties were fully aware about the pandemic at the time of signing of the contract hence, estopped from claiming FM. However, it will be subject to the extent of knowledge about the pandemic that the parties had at the time of entering the contract and the language of the FM clause in the contract.

17. What happens if FM clause is absent or ill drafted in the lease agreement? Can there be frustration?

- 1) While dealing with FM in the realm of tenancy and lease agreements, the following points are of paramount importance:
- 2) It is a settled position of law that section 56 of the Indian Contract Act (Doctrine of frustration) does not apply to lease deeds.
- 3) Section 108(e) of the Transfer of Property act, 1882 (lease, sale, mortgage etc) gets attracted in such cases.
- 4) In terms of section 108(e) of the Transfer of Property Act in case the property in question is destroyed or rendered unfit for usage, only then, the lease, the deed is void.
- 5) No question of suspension of deed on account of FM or Frustration.
- 6) Financial difficulty to pay rent cannot be covered under FM.
- 7) However, the parties in the present situation can enter into discussion with the Landlord for modification of the terms of payment of Lease Rent as the COVID- 19 has everyone under distress.

CONTRACTUAL OBLIGATIONS

18. Would the current pandemic situation amount to change in law?

Lockdown rules have all traits of law. Thus, the introduction of such rules amounts to a 'change in law'. Such change in law would thus entail a proportionate extension of time for completion. However, the other conditions have to be met to claim benefits because of such change of law.

19. Will the contractor get compensation/damages if there is a concurrent delay related to FM and client default?

The Indian position on concurrent delay is not certain. However, it is imperative to note that even if the FM clause is invoked or the contract stands frustrated in view of the COVID-19 pandemic, the parties would still not be absolved from performance obligations during such COVID -19 periods. However, a nexus of non-performance with the unprecedented event would have to be established. Eg: if there is a breach /delay in a contract for delivering hand sanitizers, then the party defaulting or delaying will be liable even for the default during the occurrence of the FM event.

20. In case of a manpower supply contract, if the contractor has subcontracted. Can the contractor stop paying the sub-contractor or should payment be made and thereafter be claimed from the employer?

While it may be pertinent to read the contract clauses to understand better the arrangement between the employer, contractor and sub-contractor but on a plain reading of the proposition, the employer cannot be held responsible for any arrangement between the contractor and sub-contractor, as such it is a distinct contract from the one entered into by and between the employer and the contractor. However, there are certain obligations under labour laws for which the principal Employer would be held responsible. Further as regards payment to be made to the subcontractor by the contractor, once again the payment terms envisaged in the contract between the contractor and sub-contractor will have to be interpreted.

21. Can payment be claimed for idle manpower under a Contract during COVID-19 period?

Yes, if the contract permits it can be claimed. However, the idling of resources would have to be established based on evidence available from site.

22. What precautions are to be kept in mind while getting into an infrastructure contract with other countries?

Key clauses must be incorporated while contracting with a party overseas and the same would depend on the specific country that one is targeting. Each country has its own specific guidelines and laws for infrastructure which need to be kept in mind as well as the Indian Laws on the subject.

23. Contract is on FIRM price basis. If, due to the pandemic, there is a decrease in price of raw materials, can an employer ask the contractor for price reduction?

It would depend on the wording of the contract. If there is no clause for change in price, there can be no unilateral price reduction. Generally both the parties after evaluating everything enters into such firm price contract. As such the Department cannot force decrease in the price.

24. Contractors have been bearing all the cost presently. Can liability be shared between contractor and developer?

It would depend on the wording of the contract as well as the arrangement between the contractor and the developer. These arrangements would have to be mutually agreed and discussed between the parties.

25. Duty on goods imported has already been paid, however, shipments were held at clearing yard. CFS has charged demurrage. Can we counter under FM?

The Government of India's Ministry of Shipping has issued guidelines to Major Ports on March 31, 2020 regarding exemptions/ remission on penalties etc. and issues relating to FM arising due to COVID-19.

Noting that there is an inevitable impact or delays in evacuation of cargo and inability to fulfil obligations by parties due to effect on downstream services, the major ports were directed to ensure that no penalties, demurrage, charges, fee, rentals are levied by the Major Ports on any port user (traders, shipping lines, concessionaires, licensee etc.) for any delay in berthing, loading/unloading operations or evacuation/arrival of cargo caused by reasons attributable to lockdown orders from March 22, 2020 to April 14, 2020.

Each Major Port will exempt or remit demurrage, ground rent over and above the free period, penal anchorage/ berth hire charges and any other performance related penalties that may be levied on port related activities including minimum performance guarantee, wherever applicable.

These exemptions/remissions are over and above the free time arrangement that is currently agreed and availed in contractual terms. Shipping companies are also advised not to impose any new or additional charge.

The Ministry of Shipping has vide order no. PD-13/33/2020-PPP/e-339106 dated 20.03.2020 and letter dated 24.03.2020 already informed Major Ports that the COVID-19 pandemic can be considered as a natural calamity that would entitle invocation of 'FM' provisions in as much as obligations under various contracts (involving Major Ports) are concerned. Such relief was granted in addition to an advisory on embargo for imposition of new or additional charges, to facilitate some financial relief during the lockdown period. The above relaxations have been extended via another order dated April 21, 2020 of the Ministry of Shipping. Therefore, in light of the above, FM provisions can be relied upon for refund of the demurrage.

26. In contracts wherein stipulated time of completion has expired during the lockdown, can the contract be unilaterally extended to keep the contract alive?

At the outset, we wish to clarify that the contract can't be unilaterally extended by one party; any extension has to happen with the mutual consent of both parties.

In case where one of the party is a central government agency, the Finance Minister on 13.05.2020 has announced that an extension of up to six months will be provided by all central agencies — the Railways, Ministry of Road Transport and Highways, and Central Public Works Department.

The relief has been extended to all construction related activities and goods and services contracts. It also covers obligations like completion of work, intermediate milestones and extension of concession period in public-private-partnership contracts. To ease companies' cash flow position, government agencies will partially release bank guarantees. For road sector contractors and PPP concessionaires, a standstill period of six months has been announced with no associated penalties for not meeting project milestones, automatic extension of contract period etc.

If the govt. is not a party to the contract, but a FM clause sets out Extension of Time and it is clearly established that under the contract, COVID - 19 is a FM event then time can be extended, subject to the other specifics in the contract.

27. If Govt. is using your building as a quarantine facility, are you entitled for rent even though there is no contract?

In the absence of any written contract, per Section 106 of the Transfer of Property Act, a lease of immovable property, for any purpose other manufacturing and agriculture, shall be deemed to be a lease from month to month, terminable, on the part of either lessor or lessee, by fifteen days' notice.

Subject to the facts and the applicable background, per the provisions of the Transfer of Property Act, the lessor will be entitled to rent in case the premises are temporarily being used by the Government.

28. If contract is silent as to termination beyond 90 days, can the contract be terminated through FM clause?

The contract may be terminated through FM clause, provided the FM clause gives right to the parties to terminate the contract.

29. Can fixed leased agreements be amended after lockdown opens, given the restrictions that might be imposed after lockdown opens up ?

The lease agreement may be amended after lockdown opens, however, subject to the terms of the lease agreement and mutual agreement between the parties to the lease agreement.

EMPLOYMENT

30. Ministry of Finance ("MoF") issued a notification on 19.02.2020. Has it issued any other notification on 30.03.2020?

No, MoF has not issued any notification dated 30.03.2020. However, there is a notification of the Ministry of Home Affairs dated 29.03.2020 on payment of wages. Also, there is a MoF Press note dated 30.03.2020 which clarifies that there is no extension of the financial year.

31. Are the recent orders regarding payment of wages mandatory?

On 29.03.2020, the Ministry of Home Affairs, Government of India, in exercise of powers contained in Section 10(2)(I) of the DMA, passes an order (No. 40— 3/2020-DM-1(A)) directing for mandatory payment of wages without deduction by employers of private/government establishments to their workers and making any violation of the order punishable under the DM Act. Section 10 of DM Act, is a statutory provision and once an order is passed in compliance of any statutory provision, such order will take the statutory color. Order dated 29.03.2020 will have the effect of law. However, the issue is pending before the Supreme Court. In one of the Petitions pending before the Supreme Court, stay against the aforementioned order passed by the Central Government has been given.

❖ **[NOTE: Central government has withdrawn, the order is vacated]**

32. Employers are asking to resume work, does this amount to end of FM?

No. The FM conditions vary from contract to contract and also depend on the nature of work being performed by a party. Merely because an employer is asking its employee to resume works would not mean that FM has ended.

33. Permission to work on site has been granted but labour does not report to work. What to do?

You need to ascertain why the labour is not showing up, whether it is because of travel restrictions or because they are deliberately not showing up. You can issue a warning to the labour if they are not reporting inspite of permission having been granted by the relevant authority to resume construction activities. In case if the problem persists, then you can proceed in terms of options as available under law.

34. Who will bear the cost of feeding labor on site during the COVID-19 which is currently being borne by contractors?

As per the applicable law i.e. Contract Labour (Regulation and Abolition) Act, 1970, it is for the contractor to bear the costs relating to and arising from the project.

35. Is the salary of labor reimbursable to the contractor?

We refer to Sections 20 and 21 of the Contract Labour (Regulation and Abolition) Act, 1970. The principal employer is ultimately liable for the labour engaged by the contractor for execution of the project. If the contractor doesn't pay wages, then the contract labour can approach the principal employer. If paid in advance and the workers have not reported for work, then under the contract agreement between the employer and contractor, the contractor can claim for reimbursement.

MISCELLANEOUS

36. What changes have been brought about to the Insolvency and Bankruptcy Code ("IBC") in view of the ongoing pandemic?

The Govt. vide notification dated 24.03.2020 has raised the threshold under section 4 for raising insolvency under the IBC to Rupees One Crore as against the prevalent Rupees One lac with a view to prevent triggering of such proceedings against micro, small and medium enterprises which have remained to be the worst affected sector due to the COVID-19 pandemic. No fresh Insolvency proceedings would be initiated for one year.

37. Is it true that Non-Banking Financial Company/ Housing finance Company ("NBFC/ HFC") are not getting moratorium and now the matter is in SC.?

Based on the assumption that the question is that whether NBFCs/ HFCs are granting moratorium or not, in our opinion, there is lack of clarity on this subject as on date. While courts in their interim order have suggested that the moratorium direction is mandatory and financial institutions have to grant moratorium to borrowers however, the matter regarding grant of moratorium by NBFC is sub-judice and pending before the Hon'ble Supreme Court and the Hon'ble Court vide order dated 14 May 2020 has issued notice to the Government to clarify on the same. The reply from the Government is awaited.

38. In a situation where a court gives the judgement in favour of the lessor, but lessee cannot pay dues thereby causing insolvency. Does it mean the company is then referred to National Company Law Tribunal ("NCLT") ? How are the different liabilities of the company decided then ?

Subject to the fact that the appeal mechanism has been extinguished, yes, in case the lessee defaults in payment of the decreed amount, the creditor may have an option to approach NCLT to initiate insolvency proceedings under the IBC, against the defaulter, provided all the requisite conditions under the IBC are satisfied. The different liabilities of the defaulter are then ascertained as stipulated under the relevant provisions of the IBC.

39. Can interest accrue on invoice raised during lockdown?

Yes, subject to the terms and conditions of the invoice, the interest can accrue on invoice raised during lockdown. However, these issues can be mutually discussed and resolved between the parties

40. How to avail extension from Maharashtra Industrial Development Corporation ("MIDC") for submission of a building plan?

As per MIDC Circular No.B88123 dated 07 June 2019, Building plan approval for newly allotted plot should be obtained within one year from the date of possession of plot. In case if the building plan approval is not obtained within the stipulated period, the extension can be obtained by paying additional fee @ 5% P.A. on monthly basis till building plan is submitted. However, please note that no extension shall be given after completion of the applicable development period. However, if the delay is because of COVID-19, we are sure that MIDC would take a lenient view and grant EoT.

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