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## COVID – 19, A FORCE MAJEURE / MAC EVENT & ITS IMPACT ON CONTRACTS

The unprecedented outbreak of the Novel Coronavirus Disease (COVID-19) across the globe has made compliance and performance of contracts impracticable and in many situations impossible.

### 1. General

The term '*Force Majeure*' means an event or effect that can be neither anticipated nor controlled and in common parlance is described as an 'Act of God'. The Force Majeure event shall mean and include an event or circumstance or combination of events or circumstances that adversely affects, prevents or delays a party in the performance of its obligations under a contract. In other words, a Force Majeure event provides a relief to the party, during the Force Majeure period, in performance of its obligations under the contract.

It is advisable to include a boiler plate Force Majeure clause in all contracts to account for delays in performance.

While a Force Majeure event may include situations such as fires, storm, flood, lightning, earthquake, cyclone or other natural disasters, however, as a result of

actual practical circumstances the drafting of definition of Force Majeure event has evolved to include certain additional events which have caused delays or impossibility in the performance of a contract. These *inter alia* include, revolutions, war, terrorism, civil disturbances, acts of enemies, epidemic, pandemic, famine and closures resulting as a result of such events.

### 2. Meaning of 'Force Majeure' in terms of Applicable Indian Laws

The term "Force Majeure" means extraordinary events, situations or circumstances beyond human control such as an event described as an act of God or superior force. A force majeure clause in a contract is an expressed provision to identify those circumstances or situations in which performance under the contract by either one or both the parties may be delayed or become impossible to be carried out.

However, the term force majeure is not a defined term under Indian laws. Therefore, the legal meaning of the term and interpretation thereof is derived from judicial precedents. The Hon'ble Supreme Court in the matter of **Ganga Saran v. Ram Charan, 1952 S.C.R. 36** held that the courts must look primarily to the law as embodied in section 32 and

section 56 of the Indian Contract Act, 1872.

Section 32 of the Indian Contract Act, 1872 (“**1872 Act**”) deals with ‘Contingent Contracts’, performance of which is dependent on happening or non-happening of an event. Section 32 of the 1872 Act reads as under:

“Enforcement of Contracts contingent on an event happening - *Contingent contracts to do or not to do anything if an uncertain future event happens, cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void.*”

A few illustrations as detailed under the 1872 Act provides:

Illustration 1: A makes a contract with B to buy B’s horse if A survives C. This contract cannot be enforced by law unless and until C dies in A’s lifetime.

Illustration 2: A makes a contract with B to sell a horse to B at a specified price, if C, to whom the horse has been offered, refuses to buy him. The contract cannot be enforced by law unless and until C refuses to buy the horse.

Illustration 3: A contracts to pay B a sum of money when B marries C. C dies without being married to B. The contract becomes void.

In view of the above, it is explicitly clear that the enforcement of certain types of contracts dependant on happening or non-happening of a certain future event is impossible unless and until that event has happened. If the event becomes

impossible, the contract is treated to be void.

In addition, Section 56 of the 1872 Act embodies the “Doctrine of Frustration”. It provides:

- (i) an agreement to do an act impossible in itself is void;
- (ii) a contract to do an act which, after the contract is made, becomes impossible, or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

Two illustrations from that Section may be relevant in the present context:

Illustration 1: A contracts to take in cargo for B at a foreign port. A's Government afterwards declares war against the country in which the port is situated. The contract becomes void when war is declared.

Illustration 2: A contracts to act at a theatre for six months in consideration of a sum paid in advance by B. On several occasions A is too ill to act. The contract to act on those occasions becomes void.

In view of the above, Section 56 of the 1872 Act provides the parties with a situation under which the performance of a contract may be exempted.

### 3. **Material Adverse Change under a Contract**

A 'MAC' means any act(s), the consequence of which bring about a change or cause an event or a development or a condition or a circumstance or state of facts which is materially adverse to, or is reasonably likely to have, a material adverse effect on the business, assets, liabilities, condition (financial or otherwise), results, operations or prospects of the target company and its valuation.

A MAC event is usually a negotiated clause under acquisition / investment financing contracts entered into between the parties and includes provisions that the acquirer / investor feels may impact the viability of the business of the seller between signing and closing of a transaction, and in cases of part acquisition and financing, even thereafter.

Whether a MAC event has occurred shall depend on the MAC provision under the contract and the event which is claimed as a MAC event by the acquirer. In addition, the acquirer will have to demonstrate impossibility of its performance as a result of occurrence of the MAC event in terms of the 1872 Act.

#### 4. **Judicial Precedents analysing the Doctrine of Frustration & Performance of a Contract**

**Satyabrata Ghose v. Mugneeram Bangur & Co., 1954 SCR 310**

A landmark judgement which explains the ambit of Section 56 of the 1872 Act.

The Hon'ble Supreme Court held:

(i) The word "impossible" in Section 56 does not mean physical or literal impossibility;

(ii) Contract can be held to be frustrated if its performance is "impracticable" and "useless" from the point of view of the object and purpose of the parties, though the performance is not literally impossible;

(iii) If the untoward event totally upsets the very foundation upon which the parties entered their agreement, the contract can be held to be frustrated.

(iv) If the contract has an express or implied "force majeure" clause, then the situation will be analysed on the basis of that, and not through the application of principles under Section 56.

In terms of Section 56 of the 1872 Act, the doctrine of frustration releases the party of performance of the contract in view of impossibility and impracticality of the terms agreed to between the parties under the contract. The provision does not deal with a Force Majeure situation, i.e. an event or circumstance or combination thereof that adversely affects, prevents or delays in the performance of obligations.

**M/s Alopi Parshad & Sons Ltd. v. Union of India, 1960 (2) SCR 793**

The Hon'ble Supreme Court held:

A contract is not frustrated merely because the circumstances in which it was

made are altered. 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.

In view of the above, a contract is not frustrated merely because its performance becomes onerous.

**Dhanrajamal Gobindram vs. Shamji Kalidas & Co. AIR 1961 SC 1285**

The Supreme Court observed that:

*"17. McCardie, J. in Lebeauvin v. Crispin [(1920) 2 KB 714] has given an account of what is meant by "force majeure", with reference to its history. The expression "force majeure" is not a mere French version of the Latin expression "vis major". It is undoubtedly a term of wider import. Difficulties have arisen in the past as to what could legitimately be included in "force majeure". Judges have agreed that strikes, breakdown of machinery, which, though normally not included in "vis major" are included in "force majeure". An analysis of rulings on the subject into which it is not necessary in this case to go, shows that where reference is made to "force majeure", the intention is to save the performing party from the consequences of anything over which he has no control. This is the widest meaning that can be given to "force majeure", and even if this be the meaning, it is obvious that the condition about "force majeure" in the agreement was not vague. The use of the word "usual" makes all the difference, and the meaning of the condition may be made certain by evidence about a force majeure clause, which was in contemplation of parties."*

**Energy Watchdog v CERC (2017) 14 SCC 8**

In this case, the Hon'ble Supreme Court summarised the jurisprudence on the doctrine of frustration.

Some key points from this judgment are as under:

- (i) If contract has an express or implied 'force majeure' clause, it will apply over the principles under Section 56;
- (ii) Application of the doctrine of frustration must always be within narrow limits;
- (iii) A rise in cost or expense will not frustrate a contract;
- (iv) Doctrine of frustration will not apply so long as the fundamental basis of the contract remains the same; and
- (v) Force majeure clause will not apply if alternative modes of performances are available.

**Madhya Pradesh Power Co. Ltd. vs. Renew Clean Energy Pvt. Ltd. (2018) 6 SCC 157**

In this case the Hon'ble Supreme Court held that time taken by the contracting party on account of 'unavoidable' circumstances is a relevant factor to be kept in mind while ascertaining the overall delay in commissioning of projects.

In view of the above, it is explicitly clear that the frustration of a contraction under the 1872 Act is as a result of

impossibility and impracticality of performance of the contract whereas a force majeure event is a situation which adversely affects, prevents or delays the performance of obligations momentarily during the subsistence of the Force Majeure event.

## 5. COVID – 19 & its Impact

As stated hereinabove, a Force Majeure event is described as an ‘Act of God’. Generally, includes such events which cannot be anticipated and are beyond the human control. However, as a result of evolving circumstances of the world, lawyers have also in parallel advanced contract drafting, to incorporate events such as revolutions, war, terrorism, civil disturbances, acts of enemies, epidemic, pandemic, famine and closures resulting as a result of such events as part of a Force Majeure clause in a contract.

A MAC event affects the assets, business, property, liabilities, and financials of the target company.

The argument whether lockdown declared by the Government to contain COVID – 19 is a Force Majeure event or a MAC event depends on the language of the clause under the contract. However, it is important to note that in February 2020, the Ministry of Finance, Government of India while interpreting paragraph 9.7.7 of the “Manual for Procurement of Goods 2017”, through its Office Memorandum,<sup>1</sup> held that the COVID-19 outbreak is a Force Majeure

event stating the same to be a ‘Natural Calamity’ beyond human control and that the clause may be invoked wherever considered appropriate in accordance with the prescribed procedure. While this interpretation may be limited to government procurements as provided in the aforesaid Manual, it would be reasonable to presume that the situation created by COVID-19, including the nation-wide lockdown, would fall within the purview of Force Majeure event.

However, it is pertinent to mention here that even during the lock-down certain services have been declared as “essential services”, the performance of which cannot be stopped. Accordingly, the defence of Force Majeure may not be available to parties associated with such essential services.

The lockdown declared by the Government has adversely impacted the ability of performance of contractual obligations and whether the performance has been partially impacted or completely impacted is a question of fact. Whether the same will fall under the purview of a Force Majeure or parties can seek relief under the 1872 Act as a MAC event will depend on the analysis of the contract and the circumstances.

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<sup>1</sup> Office Memorandum No.F. 18/4/2020-PPD titled ‘Force Majeure Clause’, issued by Department of Expenditure, Procurement Policy Division, Ministry of Finance.

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