

COVID-19 – An Event Frustrating Contractual Performance?

With the outbreak of COVID-19 reaching pandemic scale, India is on high alert with almost all State governments calling for a temporary lock-down of all but essential services.

Sensex and Nifty have also taken a historic plunge and has since been showing increased volatility.

Naturally, contracting parties are either unable to fulfill their contractual obligations or finding that these obligations would be delayed till the present lock down situation normalizes. In such an event, contracting parties will have to rely on the Force Majeure clause in their contract to arrive at the consequences of such delay or non-performance of contract. However, contracting parties would be faced with an issue if the contract does not contain a force majeure clause or other similar provision providing for delayed performance.

The Doctrine of Frustration

Indian law excuses the performance of a contract upon the frustration of a contract. The term frustration signifies a change in circumstances that arise after a contract is entered into, rendering the performance of the contract – by either or both party, and through no fault of theirs – impossible.

This doctrine stems from Section 56 of the Indian Contract Act, 1872, which reads as follows:

Agreement to do impossible act. – An agreement to do an act impossible in itself is void.

Contract to do act afterwards becoming impossible or unlawful. – 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.

Simply put, if circumstances so arise, making it impossible for a contracting party to fulfill its part of the contract, such non-performance will be excused and the contract will be rendered void.

Where the contract envisages circumstances, which delay or render impossible the performance of contract, the contract will govern the procedures and consequences that follow such non-performance. Hence, contracts often make provision for a *force majeure* clause, expressly stating the various events that may be deemed to be a force majeure event or render a contract frustrated, and the agreed consequences thereto.

If the event frustrating the performance of the contract is not contemplated in the *force majeure* provision, then the clause cannot come to the assistance of the affected party, and a non-performance may result in a breach of contract. Hence, if a *force majeure* clause is absent in a contract, the party cannot be said to be absolved from the obligation to perform under the contract, and the non-performing party would have to claim impossibility or unlawfulness of the performance under the doctrine of frustration as stated above.

Impossibility

Impossibility does not mean only physical or literal impossibility, but that which also frustrates the practical intent and purpose of the contract. Further, mere commercial impossibility, namely, extreme or unpredicted cost or difficulty of performance shall not qualify as impossibility.¹

The leading judgments with respect to frustration are *Satyabrata Ghose v Mugneeram Bangur & Co.*,² where the Hon'ble Supreme Court has adverted to the second paragraph of Section 56 of the Contract Act and *Energy Watchdog v Central Electricity Regulatory Commission & Ors.*,³ where the Hon'ble Supreme Court considered Section 56 in the context of long-term contract. It was held 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. It was further held that where the Court finds that the contract itself either impliedly or expressly contains a term, according to which performance would stand discharged under certain circumstances, the dissolution of the contract would take place under the terms of the contract itself and such cases would be dealt with under section 32 of the Act. If, however, frustration is to take place de hors the contract, it will be governed by section 56.

Hence, if despite the frustrating events leading to impossibility, the object and purpose of the contract is not rendered useless, and the contract can be performed substantially in accordance with the original intent of the parties, even if not literally, then such contractual obligation will not be rendered frustrated.

Simply put, a contract will stand frustrated if an event has occurred due to no fault of either party, due to which:

- (a) it becomes impossible for a party to perform its obligations under the contract and/or destruction of the subject matter;
- (b) the object underlying the contract or for which the contract was entered into i.e. the foundation of the contract, has failed.

In particular, the following are not considered grounds for frustration of a contract:

- Commercial hardship;

¹ Suresh N sarain Sinha v Akhauri Balbhadra Prasad, AIR 1957 Pat 256

² AIR1954SC44

³ 2017 (6) SCJ 398

- An intervention of a temporary nature that does not defeat the foundation/object of the contract;
- Any period of time after the force majeure event ceases (*in this case the lock down*) and the direct or indirect consequences thereof.

For example, in the current lockdown situation:

- (a) if a service to be provided under a contract could be provided through alternate modes, i.e. via electronic mode or through remote access, it would not be considered as a frustration of contract; or
- (b) if a party is unable to make payment under a contract considering online banking channels are open, such non-payment may not be considered as frustration of contract.

It flows from the above that, where the lockdown situation does not frustrate the object and purpose of a contract and the same can be achieved albeit in a delayed manner or with some inconvenience to the contracting parties, the parties may not be able to take shelter under Section 56 of the Contract Act.

It is also pertinent to note that the consequences of non-performance under Section 56 are rather grave, rendering the contract automatically void thereby discharging the non-performing party from liabilities for non-performance and resulting in likely huge loss to the party affected by the non-performance. Courts are therefore inclined to take a narrow view in the application of Section 56 to a circumstance or event deemed to frustrate a contract.

The absence of a *force majeure* clause or similar provision for a party to be excused for non-performance, is beheld extremely conservatively by the Courts. Without a *force majeure clause* the burden of proof for the party claiming frustration shall be much higher than if the *force majeure* clause was present. Parties will have to show a direct correlation of the non-performance to the said event i.e. COVID-19 state of emergency, and that the non-performance was not due to any other factor like the economic slowdown or a lack of funds. Hence, each case will be reviewed in accordance with the facts and circumstances of that particular case to determine *bona fide* frustration.

**- Anagha Subramaniam, Partner and Pratik Bhat, Associate,
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