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advocates & solicitors

Dealing with COVID - 19: Invocation of Force Majeure

Read this if you have derivative transactions and are wondering if COVID-19 is a force majeure event….?

1) 'Force Majeure' Clause

(a) Typically, a *force majeure* clause in a contract is included by the parties with the intention to save the performing party from the consequences of happening of any event or anything over which it has no control and/or it did not contribute to the happening of such event. The 'force majeure' clause in a contract, essentially inclusive in nature, is narrowly construed.

(b) It is interesting to note that the 1992 The International Swaps and Derivatives Association (**"ISDA"**) Master Agreement did not contain a *force majeure* clause. However, the 2002 ISDA Master Agreement (**"2002 Agreement"**) contains a *force majeure* clause under Section 5(b)(ii). The clause does become applicable only when the parties have given effect to any applicable provision, disruption fallback or remedy in their documentation including the confirmation.

(c) The crucial questions that must be answered to determine a *force majeure* under the 2002 Agreement are:

(i) Whether the event constituting a "*force majeure or act of state*" occurred after the date upon which the relevant transaction was entered into?

(ii) Whether such event or condition was beyond the control of such party?

(iii) Whether performance by the party becomes impossible/ impracticable as a result of such event?

(iv) Whether all reasonable efforts were used to overcome such impossibility /impracticability?

(d) The 2002 Agreement does not include an exhaustive list of events that would potentially qualify as a '*force majeure'* event. Instead, after referring to "*force majeure event*" the provision specifies the consequences of the relevant event or condition. The clause covers and contemplates *"impracticability"* as well as *"impossibility,"*. It is unlikely that the COVID-19 destruction or the lockdown will make adherence of obligations impractical or impossible. Whether an event is a force majeure needs to be analyzed on a case to cases basis.

(e) Similarly, in the case of trades that are concluded with or through the qualified central counterparties (**"QCCPs"**)/ central counterparties (**"CCPs"**), the laws do not define what would constitute as a *force majeure*. The laws governing the QCCP and the CCP specifies that the CCP shall not be liable for any loss or damage that arises from any error or delay or non-performance due to *force majeure*. The test in such cases usually would be whether the performance of the contract by the non-performing party has become impossible or impracticable. Given that the activities of the trading and clearing are exempted from the lock down imposed, it seems unlikely for the CCP to take the defence of delay/non-performance due to force majeure event (COVID-19).

2) Be mindful of…

(a) The parties should make a careful consideration of the clause while designating a force majeure as a termination event; and

(b) The agreement needs to be reviewed in its entirety.

3) Whether courts in India will uphold this?

(a) Under Indian law *'force majeure'* is governed by the Indian Contract Act, 1872 under section 32 and section 56. Usually a *'force majeure'* clause in a contract is included to capture situations which may make the performance of a contract impossible (or delay the performance of the contract in certain cases);

(b) Impossibility of performance (as provided under section 56) is applicable by application by law and is subject to the provisions of the contract entered into;

(c) *'Force Majeure'* clauses constitute an intrinsic part of modern commercial contracts. In cases where contracts do not provide for such a clause, the test provided under law to safeguard the non-performing party is that whether the performance of the contract has become impossible or impracticable;

(d) In this context, it is apposite to mention that use of the term 'impossible' does not envisage a situation where there is a physical and/or literal impossibility to perform a contract, rather it captures circumstances where the performance of the contract has become impracticable and useless from the point of view of the object and purpose of the parties;

(e) It may not be out of place to mention a recent interim order of the Hon'ble Bombay High Court dated 11th April 2020, in the matter of Transcon Skycity Pvt. Ltd. & Ors. v. ICICI Bank & Ors., wherein, it was directed that the period of 1st March 2020 until 31st May 2020 during which there is a lockdown will stand excluded from the 90-day non-performing asset declaration computation with a condition that the lockdown is lifted completely. The Hon'ble High Court also clarified that this order will not serve as a precedent for any other case in respect of any other borrower who is in default or any other bank and therefore, each of these cases will have to be assessed on their own merits. Therefore, Indian courts will review the contracts in its entirely and on a case-to-case basis; and

(f) It is a settled position of law that merely because performance of contract has become 'onerous' the same would not save a party from consequences of non-performance. Therefore, where the performance of the contract is otherwise possible then the fact that it may be more expensive to perform the contract is irrelevant.

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