Corona virus crisis & Frustration of contract/ impossibility of performance

Dr. Karnika Seth | Follow
Cyberlawyer, Author, Policymake...

With the outbreak of pandemic of Corona virus, human life faces biowar crisis and businesses are adversely affected in an unprecedented manner. The lockdown imposed by the Government of India is in our best interests yet have disrupted the business contracts across all verticals. It is pertinent to elucidate if force majeure clauses can absolve parties from obligations committed under their signed agreements or will such agreement become frustrated under Indian law due to circumstances beyond the control of a party? Will rent be payable despite non use of a commercial premises? EMIs will be suspended or not during the lock down period?

The doctrine of frustration is of great significance in the International Trade transactions, as also, are the Force Majeure clauses since there is a greater element of uncertainty in cross border transactions as compared to purely domestic transactions as they are subject to diverse political and economic influences. While the English Law envisages the doctrine of frustration of contract, the American Uniform Commercial Code provides for commercial 'impracticability' where such impracticability affects the basic assumption on which the contract was made (however in English law the term 'Impossibility' is generally used). The French system admits "Force Majeure" whereas the German advances the notion of "Wegfall der Geschftsgrundslage "- collapse of the basis of the transaction. The principles on which the doctrine of frustration is based are well settled. However, the application of the doctrine sometimes involves complicated analysis. Lord Diplock in *Pioneer Shipping Limited Vs. BTP Dioxide Ltd, the NEMA* expressed his view as under: *"Never a pure question on fact but does in the ultimate analysis involve a conclusion of law as to whether the frustrating event or series of events has made the performance of the contract a thing radically different from that which was undertaken by the contract"*.
Frustration of a contract occurs only where after the conclusion of the contract a fundamentally different situation has unexpectedly emerged. The emergence of some new set of circumstances may make the performance of the contract more difficult, onerous or costly than was envisaged by the parties when entering into the contract, for example, a sudden, even abnormal, rise or fall in prices or the failure of a particular source of supply requiring the seller to obtain supplies from

Cinemas Ltd. However, an important exception was also recognised by the House of Lords in this case that "i*f on the other hand a consideration of the terms of the contract, in the light of the circumstances existing when it was made, shows that they never agreed to be bound in a fundamentally different situation which has now unexpectedly emerged, the contract ceases to bind at that point not because the Court in its discretion thinks it just and reasonable to qualify the terms of the contract but because on its true construction it does not apply in that situation."*

Lord Radcliffe in *Davis Contractors Ltd. vs. Fareham UDC*, reiterated these principles as "*frustration occurs whenever the law recognizes that without the default of either party a contractual obligation has become incapable of being performed because of the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract*".
These principles were applied in many cases such as *Amalgamated Inv and property Co. V John Walker& Sons , National carriers V Panalpina ,etc*

*In Brauer & Co. (Great Britain) Ltd. Vs. James Clerk (Brush Materials) Ltd Denning LJ h*eld that the sellers of the Brazilian Pissava, a woody fibre used in making of the brush and the like, under a CIF contract containing the clause *"subject to any Brazilian Export Licence"* were not relieved of their obligation to procure a licence due to escalation in prices by 20% to 30% in excess of prices agreed upon with their buyers. Denning Ltd., however, stated that if the price was a 100 times high as much as the contract price that would be a fundamentally different situation which had unexpectedly emerged and the sellers would not be bound to pay for the escalated price of the export licence.
On the happening of unexpected events which are beyond the control of the parties such as in case of Government Prohibition of Exportation or Importation or a strike or other industrial actions, sellers often take the benefit of the force majeure clauses that may be expressly provided for in a contract or on the principle of frustration of contract in the domain of general law. In these cases the contract may at the beginning of the event in question merely be suspended and later on become frustrated after lapse of reasonable time when it is evident that the delay caused by intervening event affects the foundation of the contract. Certain other examples that would attract the application of this doctrine have been seen in cases where there is a complete destruction of subject matter in an agreement to sell specific goods, illegality in cases of out-break of war i.e. where the legality of performance of a contract is affected by war or a bio war /pandemic such as Corona virus causing a lockdown for a significant period of time. A contract may also be frustrated because subsequent to its conclusion, the Government has prohibited its performance for instance by placing an embargo on the exportation or importation of goods sold in situation other than wartime which absolutely prevents the seller or buyer from performing a contract. However, sometime the governmental prohibition may be

performance of the contract. In a landmark case popularly known as *Suezcanal case*, the House of Lords analysed a situation wherein Suezcanal was closed on November 2nd, 1956 as a result of military operations between Egypt and Israel and the exporter in east Africa who had sold certain goods for shipment CIF specifying European destination, on the date of performance the Suezcanal was closed could not ship the goods via that route. The House of Lords took the view that it was still possible to ship the goods to their destination via the Cape of Good Hope and the seller could have performed the contract although that route was not only longer but would result in Sellers' incurring considerable expense. The important question which was decided, in the negative, was whether the necessity to ship by alternative route constituted a radical difference in the character of the seller's obligation.

Unlike English law, the United States has abandoned the word "i*mpossible"* and used the term *"impracticable*". The "*impracticability"* of performance of contract includes situations of extra and unreasonable difficulty, expenses, injury or loss to one of the parties. Examples include a severe shortage of raw materials or of supplies due to war, embargo, local crop failure, unforeseen shut down of major sources of supply or the like peculiar situations. According to UCC Section 2 – 611 a need for increased cost alone

does not excuse performance but it is suggested that a price increase well beyond the normal range would lead to discharge (Re-statement 2(d) contract 261 Comment (d).

In England, dicta to the effect that a contract may be discharged if its performance becomes impracticable are occasionally found in some cases such as *Horlock Vs. BEAL , the Furnace Bridge , Andre & cie v Tradax Export SA* .

It is pertinent to note that , by and large the English precedents illustrate the view that impracticability is not generally sufficient to frustrate a contract in English Law. In *Davis Contractors Ltd. Vs. Fareham* contractors agreed to build 78 houses for a local authority in eight months for £ 94,000. Because of labour shortages the work took 22 months and cost the contractors £ 115,000. They claimed that the contract had been frustrated and that they were entitled to extra remuneration but the House of Lords rejected the claim as the events which caused the delays were within the ordinary range of commercial probability and had not brought about a fundamental change of circumstances.

In *Exporttelise V Rocco Giveppe & Figlisoc.coll cas*e, an organ of Argentine State which was sole buyer of bread wheat extended its monopoly to include the 1973/74 crop of candal and/or taganrog wheat. No exceptions were made for existing contracts and the monopoly was maintained throughout the period of shipment. The Argentine Exporter so as to export wheat had to obtain from Juntu at a price higher than the price at which the Argentine exporters had resold the wheat. The Court held that this act of the Government did not render every method of fulfilment of the contract impossible and the sellers could still have bought the wheat necessary to fulfil their obligations under the contract.

sellers could not be covered under the force majeure clause merely by showing that they were required to pay more for the goods than the price at which they had agreed to sell them, that goes no farther than showing that in the events which happened they have entered into an unprofitable contract which provides no answer. It was important to note that the sellers could have performed the contracts if they had paid the higher minimum price since there was no physical or legal prevention from doing the same but only an escalation of prices of export licence to be procured by the sellers in order to duly perform the contract.

In *Wild Handel NV Vs. Tucker and Cross* , the sellers invoked the force majeure clause of the contract of sale of Chinese frozen rabbits. The sellers contended that the imports of Chinese frozen rabbits were at all material time much smaller in quantity than the amount called for under their contract. The Court held that there was no finding from the arbitrator that they were unable to buy the Chinese frozen rabbit from some supplier other than the one with whom they have a contract. Justice Donaldson expressed that unless they could do that they are unable to show that they were prevented from fulfilling the contract by a cause beyond their control.

In the light of the above discussion, it follows that there are certain important factors that require consideration at the time of analysing whether an unexpected event could be said to cause frustration of contract or whether the force majeure clause is attracted as per and/or within the meaning of the terms of the contract.

Under Indian law, force majeure clauses cannot be automatically implied if not present in the contract/agreement and if present, rights and duties of a party will be interpreted as defined therein. The law in India has been laid down in the landmark decision of the Supreme Court in the case of *Satyabrata Ghose vs Mugneeram Bangur & Co*. In *Satyabrata Ghose* case it was held that frustration of contract under Section 56 of contract Act can be invoked where the entire purpose of contract stands defeated by the supervening circumstances -illegality or impossibility of act agreed to be done and contract can be discharged.But if supervening act was envisaged earlier which made it a contingent contract, it would be discharged under Section 32 of Contract Act.

The entire law on the subject has been well elucidated in a recent decision in the case of *Energy Watchdog vs CERC* .In E*nergy Watchdog v Central Electricity Regulatory Commission,* the Supreme Court held that an increase in coal prices due to a change in Indonesian law could not be cited as a force majeure event by power-generating companies that were buying coal from Indonesia simply because performance became more onerous.

Thus, some of the important questions that require consideration may be enumerated as under:

Is there a force majeure clause provided under the contract? Does it require a party to give notice on occurrence of force majeure event to other party?

Is it a contingent contract as described or is supervening illegality outside clauses of contract?

Does the contract contemplate that if 'X' fails to supply the goods to the seller, the seller is obligated to procure the specific goods from any other alternative source(irrespective of the fact

mentioned in the contract or is it only a one sided contemplation?
4. Does unexpected escalation in freight charges render the price abnormally excessive or the contract execution impracticable; such that it would amount to a contract fundamentally different from one contemplated by the parties?

5. Is there any Government regulation that prohibits the export/ importation of goods? Is it temporary or exists upto the period of performance of contract. Does it absolutely prevent the seller or the buyer from performing the contract or make the performance of contract illegal?

6. Is the payment of unexpected /escalated higher price reasonably foreseeable by the parties at the time of entering into the contract?

7. Is this supervening unexpected event beyond the control of the parties?

To conclude, these factors are in fact requisites to attract the doctrine of frustration of contract and force majeure clause contained in any contract, in particular, a sale of goods contract . Both under English Law & Indian law, whereas the decisions rendered by the Courts could vary on principal facts of the case, however, the basic principles that attract the doctrine of frustration and force majeure clauses by and large remain the same.

Bibliography

1.The Law and Practice of International Trade-Schmitthoff's Export trade- Sweet & Maxwell 2000 Edn.
2.The law of Contract- Treitel-Sweet & Maxwell- Ninth Edn.
3. Sale of Goods- Benjamin, Sweet & Maxwell-Second Edn
4.Halsbury's Laws of England- Vol 9 (1) Fourth Edn.
5.Chitty on contracts- Specific contracts- Sweet & MAxwellTwenty Eighth Edn.
6.The Sale of goods Act -Aiyar-UBA Seventh Edn.

Dr Karnika Seth is a practising Advocate in the Supreme Court of India and the Delhi High Court and specialises in Cyberlaws, business laws,IPR and International trade laws. She is the founder of Seth Associates , an established law firm in India advising clients from across the globe since over two decades.

Published By

Dr. Karnika Seth
Cyberlawyer, Author, Policymaker &...