Force majeure in COVID-19, Bombay High Court provides strict interpretation

Standard Retail Pvt. Ltd vs. M/s. Global Corp & Ors.

Commercial Arbitration Petition (L) no. 404/2020, Order dated: 08/04/2020, BOMBAY HIGH COURT

Ratio:

Lockdown cannot come to the rescue of the steel importers so as to resile from their contractual obligations of making payment, since the distribution of steel is an essential service.

Facts of the case:

The Petitioner companies (Steel product importers) approached the High Court under section 9 of the Arbitration and Conciliation Act, stating that the lockdown had rendered the performance of their contract with Respondent companies (South Korea- based Hyundai Corp and GS Global) impossible. The Respondent company was to supply steel products the shipment of which were to be dispatched from South Koreas to the Petitioners at Mumbai. The Petitioner companies invoked the force majeure clause in their contract due to the lockdown declared by the Central Government since they could not receive the steel product shipments and sought directions restraining the Respondent Bank (Well Fargos) from encashing letters of credit. These letters of credit were to stand guarantee in case the purchasers did not make payment for goods.

Proceedings before Bombay High Court:

1. Petitioner companies contended that their contracts with Hyundai Corp and GS global stood terminated as unenforceable on account of frustration, impossibility and impracticability.
2. They relied on section 56 of the Indian Contract Act, 1972 that in view of COVID-19 pandemic and the lockdown declared by the Central Government their contract with Sellers stood terminated.
3. Further they relied upon Supreme Courts' judgment in *Energy Watchdog vs. CERC* and *Satyabrata Ghose vs Mugneeram Bangure & Co.*

Issue before Bombay High Court:

Whether the Force majeure clause can come to the aid of the Petitioner company amidst lockdown so as to resile from its contractual obligation of making payments to the Respondent bank?

Case Laws referred by Petitioner:

In ***Energy Watchdog & Ors vs. Central Electricity Regulatory Commission & Ors (2017) 14 SCC 80;***

Issue before Supreme Court:

Whether an increase in coal prices (due to a change in Indonesian law) could be cited as a force majeure event by certain power-generating companies that were sourcing coal from Indonesia?

Observation:

(i) The doctrine of frustration is inapplicable to the case as the fundamental basis of the Power Purchase Agreement (PPA) remains unaltered, the PPA nowhere states that coal is to be procured only from Indonesia at a particular price, since the fuel supply agreement is only a part of the PPA to establish that fuel supply is available and is in order.

(ii) When the power producers quoted the tariff, they very well knew the existence of the risk of increased prices of Indonesian coal and knowingly took it by quoting a non-escalable tariff.

(iii) The mere fact that power producers quoted non-escalable tariff does not mean that they would be disentitled from raising a plea of frustration if they were otherwise entitled to under law.

(iv) Clause in PPA specifically excluded rise in fuel cost from force majeure, since the fundamental basis of the contract was never dislodged and alternative modes of performance were available even though at a higher price, there was no force majeure. Additionally, there was a specific clause addressing force majeure, Section 56 did not have any application.

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Held:

That if the vital basis of the contract remains unaffected and no frustrating event occurs, except for a rise in coal prices, it could not be held that a sheer increase in prices constituted a force majeure event.

In ***Satyabrata Ghose vs. Mugneeram Bangure & Co. (1954) SCR 310;***

Issue before Supreme Court:

Whether the contract was rendered illegal and hence frustrated u/s 56? If not, what should be reasonable time within which performance of contract was to be given u/s 46?

Observation:

(i) War condition were known to the parties while entering into the contract such they were aware of the possible difficulty in performance of the contract, in such circumstances, the requisition of property did not affect the root of the contract.

(ii) The performance of an act may not be literally "impossible" but may be impracticable and useless from the point of view of the object and purpose which the parties had in mind.

(iii) The delay caused in the performance due to the requisition would not be so great and of such a character as to totally upset the basis of the bargain and commercial object that the parties had in view. The requisition order was of a temporary character and could have been withdrawn at any point of time. Because of this indefiniteness of time period, it could not be said that performance of the contract had become impossible. Hence, the order of requisition did not affect the fundamental basis upon which the agreement rested. It was merely a hardship, which gave no reason for the defendant to avoid the contract.

Held:

Where the contract itself impliedly or expressly contains a term stipulating the circumstances under which the contract would stand discharged, the dissolution of the contract would take place under the terms of the contract itself and under Section 32 of the Indian Contract Act (Act) providing for contracts contingent on the happening or non-happening of an event i.e. contingent contracts. However, if the frustration takes place de-hors or outside the anticipation of the contract, it will fall under Section 56 of the Act which relates to agreements to do an impossible act.

Bombay High Court's Verdict:

The Court declined the plea of the petitioner Company for urgent relief by making the following observation:

(i)Letters of credit are an independent transaction with the bank, thus the bank is not concerned with the dispute between the petitioner company and South Korean sellers.

(ii)Force Majeure was only applicable to Respondent company and petitioner cannot take aid to it.

(iii)Steel products were already shipped from South Korea and failure of petitioner company to purchase the goods cannot be held against the South Korean sellers.

(iv)Guidelines and the notification issued by the Government of India declared distribution of steel as an essential service.

Acelegal Analysis:

- Courts are strictly applying the contractual clause.
- The onus to prove the adverse effect of Force Majeure is on the person who is claiming it.
- If one of the party to the contract has complied with his obligation and performed its part of the contract, the other party cannot shy away from fulfilling its obligation citing incapability in fulfilling the contract, the reason being that it would suffer normal business loss.
- Since the lockdown is for temporary period, it needs to be contemplated that whether the particular timeline has really affected the party to perform its obligations.
- A party placing reliance on lockdown, has to make a note whether the guidelines have restricted their act of business or have declared their services as essential ones.

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