

'FORCE MAJEURE' DURING PANDEMIC OR LOCKDOWN

A SWORD OR A SHIELD?



Contracts facilitate the smooth running of businesses and ensure good order for the contracting parties to set forth their mutual rights and obligations.

Force Majeure is a common clause in contracts that essentially frees both parties from liability or obligation when an extraordinary event or circumstance beyond the control of the parties, prevents one or both parties from fulfilling their obligations under the contract. In practice, most force majeure clauses do not excuse a party's non-performance entirely, but only suspend it for the duration of the force majeure.

A bespoke contract may even go the extra length, setting forth therein, all forms of apprehensions and contingencies that may have a bearing on the performance of the contractual obligations, in due course of time, with special reference to the kind of transactions agreed upon by the contracting parties, including such clauses which may deal with unforeseeable situations and/or circumstances, which may be beyond the control of the contracting parties. Such clauses are typically termed, 'Force Majeure'. Is "Force Majeure" during COVID-19 pandemic or lockdown – a sword or a shield?



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IS “FORCE MAJEURE” DURING PANDEMIC OR LOCKDOWN – A SWORD OR A SHIELD?

The COVID-19 pandemic and the resulting crises has given rise to unprecedented circumstances with heavy impact on trade and commerce and therefore on performance of contracts. Contracting parties have therefore started to review terms of their respective contracts - more essentially, the force majeure clause. Inasmuch as the presence of such a clause enables parties to determine the fate of the contract, in certain circumstances it may also restrict the ability of the parties to perform.

In this article, an attempt is made to determine the impact of the circumstances following the COVID-19 pandemic and the legal implications.

2. FRUSTRATION OF CONTRACTS AND THE COVID – 19 PANDEMIC

A contract is a set of legally enforceable promises. However, at times performance of such promises may become difficult or impossible, and that is when a contract is said to be frustrated. The concepts of frustration of contracts are analogous in common law and civil law.

2.1 Force Majeure and Frustration - The Common Law Perspective

In common law, force majeure is used as defence for a party unable to perform its obligations due to the mere impossibility of such performance – such impossibility being caused by an unforeseen event beyond the control of the party seeking the defence.

One of the earliest references to frustration of contract could be found in the landmark case of *Taylor v Caldwell*, where, even as a party had hired a music hall, the party was subsequently found to be not liable to pay for the same, as the music hall had burned down prior to the proposed date of use of the music hall.

The defence of force majeure, however, is not absolute. In certain circumstances the performance of a contractual obligation may not be entirely frustrated, and the parties may still have the option of performing their respective obligations after some time i.e., the event of frustration is temporary and after the same is over. Also, this may not serve as a defence if the risk involved had been foreseeable.

Thus, in *Metropolitan Water Board v Dick Kerr and Co Ltd*, where works under a contract were ceased by order of the Minister of

Munitions, it was held that the interruption was of such nature and duration as fundamentally to change the conditions of the contract, and could not have been in the contemplation of the parties to the contract when it was made, and accordingly, the contract had been frustrated.

However, in *National Carriers Ltd v Panalpina (Northern) Ltd*, where a tenant stopped paying rent as access to the rented premises was closed by the local authority, through a restrictive order, passed for surrounding buildings, it was held that notwithstanding the circumstances the lease had not been frustrated. The doctrine of frustration was, in principle, applicable to leases in exceptional circumstances, which did not significantly include the interruption of 20 months in a 10-year lease.

2.2 Force Majeure and Frustration- The UAE Laws’ Perspective

The general legal framework in the United Arab Emirates (UAE), follows the civil legal system. However, certain jurisdictions like the Dubai International Financial Centre follow the common law system. The perspectives with reference to both systems prevailing in the country are summarily discussed, hereinafter.

2.2.1 The Federal Laws

The federal laws of the UAE recognise the concept of force majeure in respect of bilateral contracts. Thus, upon occurrence of such an event if performance of an obligation becomes impossible, then the corresponding obligation is extinguished and the contract as a matter of fact becomes rescinded. However, if there are partial impediments, then the consideration for the impossible part shall be deemed to have been extinguished and the applicable part may be continued, provided the contracting parties have informed each other about the

same. The applicable provisions occur under Article (273) of the Federal Law No. (5) of 1985 On the Civil Transactions Law of the United Arab Emirates (the “UAE Civil Transactions Law”).

The provisions of Article (273) of the UAE Civil Transactions Law as referred hereinabove, read:

“Article (273)

1. In bilateral contracts, if a force majeure arises that makes the performance of the obligation impossible, the corresponding obligation shall, be extinguished and the contract ipso facto rescinded.

2. If the impossibility is partial, the consideration for the impossible part shall be extinguished. This shall also apply on the provisional impossibility in continuous contracts. In both instances the creditor may rescind the contract provided the debtor has knowledge thereof.”

The occurrence of a force majeure event which makes performance of contractual obligations impossible, may be ground enough for the contract itself to be rescinded. However, in cases of partial impossibility the impossible parts of the obligations may be deemed to have been rescinded. Although in both cases, the ‘creditor’ or the beneficiary may elect to rescind the contract altogether, provided the ‘debtor’ or the performing party has been informed of the same. However, the UAE Civil Transactions Law also provides that in the event of unpredictable circumstances, where the performance of contractual obligations

is burdened by incurring heavy losses or economic impact, it may be left to the court to reduce such burdens to reasonable limits, keeping in view the interest of both parties and in the interest of justice. This is in accordance with Article (249) of the UAE Civil Transactions Law, which reads:

“Article (249)

If public exceptional unpredictable circumstances shall arise, and their happening has resulted in making the execution of the contracted obligation, if not impossible, has become burdensome to the debtor in such a manner as to threatening him with heavy loss, the judge may, according to circumstances and by comparing the interests of both parties, reduce the burdensome obligation to reasonable limits, if justice so requires. Any agreement to the contrary is void.”

2.2.2 The Dubai International Financial Centre (DIFC) Laws

In the DIFC, the laws pertaining to contracts are to be found in the CONTRACT LAW - DIFC LAW NO.6 OF 2004 (the “DIFC Contract Law”). In the PART 8 [NON-PERFORMANCE] thereof, provisions are to be found in respect of situations where performance of obligations may not be possible due to certain circumstances. Article 82 relates to force majeure, and it reads:

“82. Force majeure

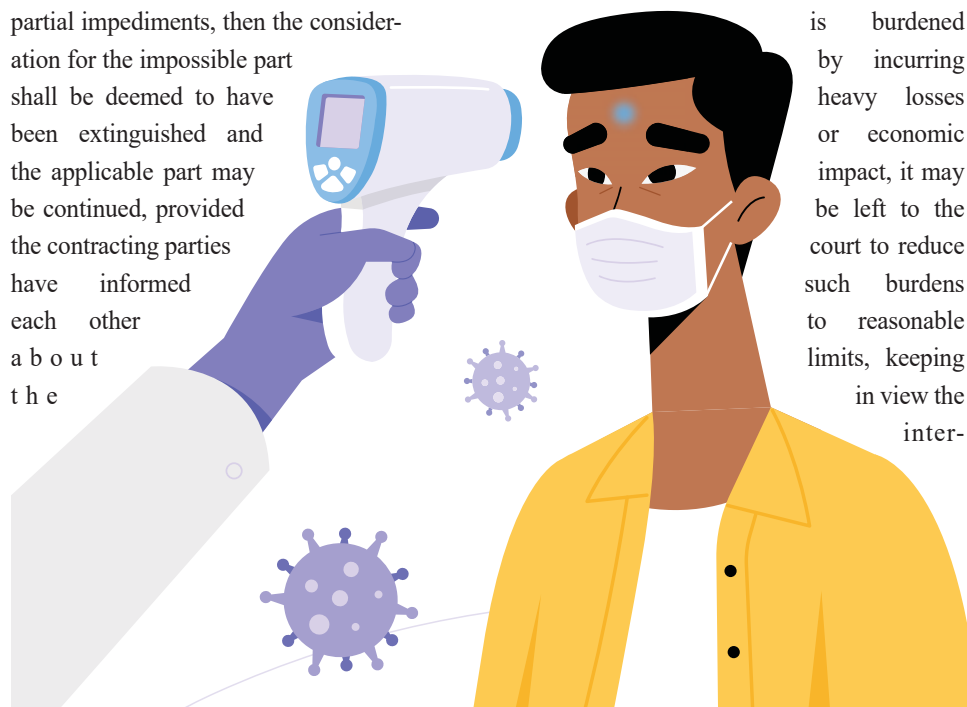
(1) Except with respect to a mere obligation to pay, non-performance by a party is excused if that party proves that the non-performance was due to an impediment beyond its control and that it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

(2) When the impediment is only temporary, the excuse shall have effect for such period as is reasonable having regard to the effect of the impediment on performance of the contract.

(3) The party who fails to perform must give notice to the other party of the impediment and its effect on its ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, it is liable for damages resulting from such non-receipt.

(4) Nothing in this Article prevents a party from exercising a right to terminate the contract or to withhold performance or request interest on money due.”

Thus, the force majeure may be taken as defence when:



- i. performance of the obligation becomes impossible due to an impediment beyond the control of the performing party;
- ii. the event is not temporary in which case the period of the impediment may be excused.

However, it is left to the performing party to notify the creditor in advance in respect of the force majeure event. In the absence of such notifications, the creditor is entitled to damages. Further Article 82 of the DIFC Contract Law enables parties to either terminate the contract altogether, or to withhold performance or request interest on money due, if any.

2.2.3. The COVID-19 pandemic

COVID-19 or Corona Virus Disease affects humans exposed to the highly contagious novel-Corona virus (n-CoV), largely due to social contact between humans. In the absence of an effective drug or vaccine, the only ways to stop the spread of the disease is to minimise human interaction by social distancing.

To minimise the spread of infection and to literally ‘break the chain’, countries globally are taking drastic and strict measures to restrict social human interactions, ranging from nationwide lock-downs, to total stoppage of international flights and public transport and restricting people from stepping out of their homes.

The ongoing crises following the COVID-19 pandemic, has given rise to unprecedented circumstances and there is no denying that businesses have slowed down. Businesses and transactions have been able to run, nonetheless, putting into use the available technological alternatives. Therefore, physical meetings have been replaced with video conferencing, and homes are making way for offices. However, this serves the purpose in sectors where the providing the product and/or service is unaffected by the government’s restrictive measures. Other sectors are not left with much option except for the contracting parties to review terms of their underlying contracts and check the scope and extent of the applicability of force majeure clauses. The COVID-19 pandemic and the preventive measures taken in respect thereof may not be uniformly applicable to every sector.

Thus where, restriction imposed by the governments, have rendered performance of obligations impossible, it may be said that the contract has been frustrated. When a contract is frustrated the parties may invoke the force majeure clause to determine the fate of the contract.

3. FORCE MAJEURE CLAUSES - SWORD OR SHIELD

The ‘force majeure’ clause in a contract holds great significance in the prevailing times of the CoVID pandemic and lockdown. Such a clause usually describes the applicable force

majeure events, like natural calamities, government sanctions, and war, and sets forth the consequential terms for when performance becomes difficult or impossible, during a force majeure event.

Interpreted literally, a typical force majeure clause may not effectively cover all events causing impediments on the performance of obligations, and therefore may not be able to shield the interests of the obligors – who may still be required to perform despite the situation or compensate the other party. An incomplete clause therefore makes positions lopsided with a weak shield for the obligor and a heavy sword for the creditor.

On the other hand, the absence of such a clause, or such clause submitting to the prevailing laws may give parties the option to determine the fate of the contract in accordance with the prevailing laws. However, this may also be marred by its time and cost impact due to the involvement of courts or dispute resolution forums.

Eventually it may rest on the contracting parties to consider the applicable force majeure clause and apply the same in a way so as not to make it too onerous on any one party to the contract.

Article 246 of the Civil Transactions Law prescribes for parties to implement contract in good faith. The provisions read as follows –

“1. The contract shall be implemented, according to the provisions contained therein and in a manner consistent with the requirements of good faith.

2. The contract is not restricted to what is contained therein but shall extend to its essentials in accordance with the law, custom and the nature of the transaction.”

Therefore, for effective application, force majeure clauses may be drafted with the widest possible inclusions like “any pandemic”, “virus/ biotech disasters”, “leakage or spillage of nuclear/ hazardous items”, “biological warfare” and cover situations like “lockdowns”, “restrictions on public/cargo movement” and so on. Further parties may also consider incorporation of a limitation of liability clause to deal with force majeure event. In this regard, Article 390 of the Civil Transactions Law may be referred which reads:

“1. The two contracting parties may fix, in advance, the amount of damages either in the contract or in a subsequent agreement subject to the law provisions.

2. The judge may, in all cases, at the request of one of the parties, amend such an agreement, in order to make the amount assessed equal to the prejudice. Any agreement to the contrary is void.”

4. FINANCIAL IMPLICATIONS OF FORCE MAJEURE

4.1 Force Majeure

The COVID-19 pandemic situation is currently evolving and ensuing, and its far reaching effects are not yet assessed fully. For the time being, it is for the contracting parties to assess their obligations in view of the existing circumstances, with special reference to force majeure clauses, if any. The essential elements regarding

suited to the best interests of both.

4.2. Financial Implication

The exact financial implications of frustration of contracts or application of force majeure clauses following the COVID-19 pandemic may be assessed in view of the implications following either the full rescinding of a contract or the extinguishment of a part of the obligations rendered impossible due to circumstances following the pandemic situation.

However, the implications will also depend on the period that the pandemic continues to exist, and how soon an effective cure is devised.

It may be perceived that the existence of the pandemic for continued periods will likely invite the imposition of greater restrictions, which may have negative multiplier effects on sectors otherwise unaffected by the pandemic situation, and under such circumstances, the financial implications would be far reaching.

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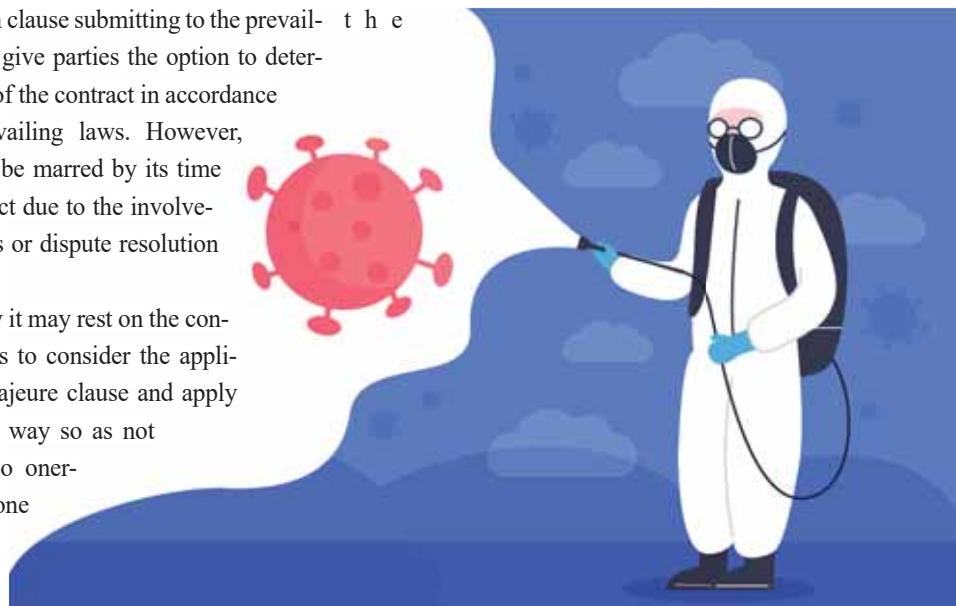
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same are discussed under the following heads.

i. Application

In general, a ‘Force Majeure’ clause provides for the following options upon occurrence of force majeure events:

i. In case of full impossibility, the contract is rescinded;

ii. In cases of partial impossibility, the creditor may choose to rescind the whole contract or extinguish the impossible parts; and

iii. In cases where obligations may be performed, but huge burdens, it may be left with the court to reduce the burden for obligations to be completed in the best interests of the contracting parties and in the interest of justice.

ii. Notification

For the defence of force majeure, it is essential for the obligor to notify the creditor regarding the former’s inability to perform its obligations. In as much as the COVID-19 pandemic has taken the entire world, within its grip, contracting parties even in different jurisdictions would be able to appreciate the impact thereof.

It is therefore essential for the parties to keep communicating about their respective positions, to determine and agree upon terms