

Analysis - Invoking force majeure provisions in contracts in light of the COVID-19 pandemic

The central government in India, on 24 March 2020, announced a 21-day national lock down. This means, amongst others, that all non-essential manufacturing and services will have to be halted. People movement is severely restricted and more than 1.3 billion people (with a few exceptions) have to 'shelter in place'.

While the humanitarian impact of this measure is the overriding primary concern, this brief analysis deals with one aspect of the economic impact – contractual implications on entities on providing services (non-essential) and manufacturing goods (non-essential) and those that are recipients of such services and goods.

The COVID-19 pandemic has and will undoubtedly cause disruption in manufacture and supply of non-essential goods and services (referred to simply as goods and services henceforth). However, companies have BCPs and DRPs specifically to deal with these situations. In many cases, for services especially, work from home becomes an important element of the BCP. In manufacturing, the impact may be more significant with limited mitigation measures that may include inventory management or spares management.

The key question that suppliers and buyers will have to decide is whether the pandemic has created a force majeure (FM) situation. The definition of FM is more or less settled for this situation, and each entity will have to apply that definition, evaluate its BCP/DRP mitigation measures and decide whether the service/goods delivery has fallen to an extent that requires invocation of FM. This is a very crucial call, in that invocation of FM may have many implications:

1. It suspends parties' obligations (most of them) under the contract;
2. It also suspends parties' right to receive payment or make payment, as the case may be; and most importantly,
3. It may give a right (usually to the buyer) to terminate the contract if the FM extends beyond a certain amount of time.

As a service provider or supplier, the dilemma will be the ability to keep servicing the contract (which will be a question of fact in many cases) vs. the inability to do so, declare FM and run the risk of losing the contract. This risk is heightened in cases where the contract is discretionary in nature or the contract is not making commercial sense to the customer thereby giving the customer a "way out". Service providers and suppliers should therefore carefully evaluate their BCP/DRP measures and see what best they can do to avoid triggering FM. However, most BCPs/DRPs have inherent resilience limitations and this could quickly become a question of time only.

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As customers, especially those that have critical service requirements or goods that are critical components of supply chain, it is important that the BCPs/DRPs are robust and are implemented in order for the contract to be serviced. FM invocation is the last measure, and this means that either there was no possibility of a BCP/DRP or that it failed. Most often than not, BCPs/DRPs look better on paper than when applied. Situations such as the current pandemic will test these plans. Notwithstanding how good the BCPs/DRPs are, customers will do better if they work with their suppliers and mitigate contractual impact (where possible) rather than taking a legalistic view of the suppliers' inability to stick to the contract in toto. This may involve out of the box solutions such as third-party sourcing, sharing IP, delayed timetables, special exception approvals (for work from home, confidentiality etc.). Lack of viable alternatives may force many customers to get creative.

In summary, both customers and suppliers will have to be result oriented rather than process oriented in administering contracts if they seek to come out of this period with relatively lower impact. Some examples are:

1. Agree to email amendments to contracts and stick by them. It may be difficult to get paper amendments done from specific people and then get them signed;
2. Check insurance covers of suppliers and if that is sufficient, consider exception approvals for work from home, use of non-company property to provide services etc.;
3. Take a commercial view on service levels and milestones and see what leeway is available;
4. Plan ahead (for 2 to 3 months given the current situation) for supply chain management and cash flow management. Be creative in both these areas. We have already seen some large conglomerates agreeing to advance payments to their SME suppliers to alleviate their cash flow issues;
5. Hold off invoking bank guarantees, or parent company guarantees if there is a reasonable chance of the contract getting back on track post this period;
6. Test BCP/DRP plans of suppliers for long term viability and on the flipside, suppliers should plan for medium to long term resilience of these plans;
7. Prioritize parts of the contract that should not be deviated from and focus on keeping those service levels alive; and
8. Appoint crisis managers to deal with contractual and project execution issues. Be available and open to dialogue on all aspects of the contract and enable quick decision-making process in a volatile and changing environment.

Indian courts will take a considered view of disputes coming out of this situation, once things come back to normal. They are unlikely to award huge damages if sufficient mitigation measures are taken. Any bad faith behavior during such period (by either party) will be seen dimly in case of future disputes. Having said that, courts will continue to apply the traditional tests and yardsticks to deal with FM related disputes.

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