
Impact of COVID-19 on Business Transactions following Lockdown

FREQUENTLY ASKED QUESTIONS

Dear Readers,

The present FAQs cover the following:

- A. Force Majeure
- B. Performance of Contracts
- C. Law of Limitation
- D. Impact on Cheque Bounce Cases
- E. Impact on Insolvency and Bankruptcy Code and proceedings

A. Force-Majeure

1. What is the meaning of the term “force majeure”?

Force Majeure in general parlance means any event or circumstance (or combination thereof) that wholly or partly prevents or causes unavoidable delay in the performance of contractual obligations or makes the performance of the obligations unlawful.

To claim an event of force majeure, the following ingredients must be established:

- The impossibility of performing contractual obligations is directly related to the happening of such events or circumstances;
- The circumstances were not within the reasonable control, direct or indirect, of the parties and;
- The party/parties had taken all reasonable care and/or prudent steps to ensure the performance of contractual obligations, and still failed to do so.

2. Whether the outbreak of COVID-19 can be considered as a “force majeure” event?

To determine whether a party may claim that the spread of COVID-19 amounts to an event of “force majeure”, the following vital aspects are to be looked upon:

- Whether the contract has a “force majeure” clause or not?
- Whether the “force majeure” clause includes events like an epidemic/pandemic/virus outbreak, in expressive terms?
- Whether the performance of the contractual obligations has become **impossible** directly due to the outbreak of COVID-19?
- Whether the parties took all the reasonable and prudent steps to ensure the performance of the contractual obligations, despite the occurrence of the force majeure event?

If the answer to the all the four questions is “yes”, in that case we are of the view that outbreak of COVID-19 can be considered as a force majeure event subject to terms and circumstances of the contract.

In the event the contract does not contain a “force majeure clause” or does not define the pandemic/lockdown to be an event of “force majeure”, then the contract will be governed

by the provisions of Indian Contract Act, 1872, as well as the terms of the contract and intent of the parties.

3. Whether the lockdown announced by the Government can be considered as a “force majeure” event?

The government had issued strict directions imposing country-wide lockdown, restricting the movement across state-borders and closing down various factories and businesses. As a result, any activities involving manufacturing, supply, delivery, traveling, construction, etc. (except for essential services) have been exempted from the lockdown, all others are deemed to be unlawful and therefore any delay/default in performing the contractual obligations during the period of the lockdown may be considered as a “force majeure” event.

4. Can a force majeure clause be implied under a contract?

A force majeure clause cannot be implied under a contract. In the event the contract does not either provide for a force majeure event or does not expressly provide for “pandemic” to be a force majeure event, in that case the party may seek refuge under Section 56 of Indian Contract Act to prove that the performance of the contract has become impossible/unlawful.

Succinctly, if epidemic/pandemic is defined as an event of force majeure in the contract, the parties can take refuge under the force majeure clause. Otherwise, the parties will have to satisfy the conditions of Section 56 of Indian Contract Act to establish that it was impossible/unlawful for the parties to perform their contractual obligations.

5. Upon whom does the burden of proof lie to establish a force majeure event?

The burden of proof lies upon the party asserting the force majeure event as a defence for non-performance of its contractual obligations.

6. What is the effect on the contractual obligations of the parties who enter into a contract during the outbreak of COVID-19 while being fully aware of the situation?

If the parties enter into a contract knowing fully well that due to the spread of COVID-19 the States are in a temporary lockdown, then in the event any of the parties commits default in performing their contractual obligation, it cannot claim refuge under force majeure as the parties were aware of the risks which was foreseeable at the time when they entered into the contract.

7. What is the legal consequence of non-performance of contractual obligations that have become impossible to perform due to government guidelines/restrictions issued to curtail the spread of COVID-19?

In case the contractual obligations become impossible to perform due to the restrictions imposed by the government, its legal consequence is that the non-performance will be considered as an event of force majeure unless the contractual obligations are relating to “Essential services”.

However, it is important to note that such a claim may be sustainable only during the time period for which the relevant guidelines are in effect and not before or after that.

8. Whether the obligation to make payments under the contract can be delayed or withheld due to the lockdown?

No. The obligation to make payments under the contract cannot be delayed/withheld due to the lockdown. It has to be kept in mind that the banking system is effectively functional. Considering the same, the party defaulting in making timely payment can be held liable for interest on delayed payments and other consequences.

9. Whether a force majeure event is time specific or parties can take refuge for the entire period the pandemic continues despite lifting of lockdown by the Government?

The parties to a contract cannot take refuge of a force majeure event to justify non-performance of the contractual obligations merely on account of the outbreak and continuation of COVID-19 even after the lockdown period is over. In order to take refuge, it is strictly to be proved by the defaulting party that:

- The time period within which the obligation was to be discharged was physically impossible/unlawful due to the outbreak of COVID-19; and
- It was not merely onerous/expensive/inconvenient/burdensome but specifically impossible and/or unlawful to perform; and
- The defaulting party took all the reasonable steps to discharge the contractual obligation during the specific time period despite that it was still prevented from discharging the contractual obligation, wholly or partly.

10. What are the consequences of a force majeure event?

Depending upon the terms of the contract, triggering of the force majeure clause may result in immediate termination of the contract. However, the parties may mutually decide that an additional time period may be provided for performing the contractual obligation; or may decide to put the contract on hold till the event is over or resolved; or such other stipulation as the contract may provide for.

11. In the event the parties are facing practical difficulties in performing their contractual obligations due to the lockdown, what steps need to be taken by the parties to mitigate the losses?

The most important step to be taken is to immediately issue a notice to other party to the contract specifically setting out:

- The nature of the unforeseeable events which have made it impossible for the affected party to perform its contractual obligations;
- Estimated time period till when the affected party will not be able to perform its contractual obligations;
- Inform the other party of all the steps taken by the affected party to perform its obligations.

12. Company A is receiving letters from parties invoking force majeure or communicating the intention to invoke it. How should company A deal with such letters. Whether such letters need to be replied?

In the event Company A receives letters/notice from the affected party invoking force majeure, Company A should respond to such letters appropriately after considering the terms of the contract and assessing the legal implications whether or not there is such a situation leading to force majeure condition or not.

B. Performance of Contracts

13. If a vendor procures raw material from the supplier, however due to the lockdown/outbreak the vendor is unable to manufacture the final goods for selling in the market. Is he still liable to make payment to the supplier for the raw material procured?

Yes, the vendor is still liable. The inability of the vendor to manufacture final goods for sale due to the lockdown /outbreak of COVID-19 will not absolve the vendor from its payment obligations to the supplier. Needless to say, however, that specific terms of the contract shall determine the actual liability.

14. Company A receives advance from an entity B for discharging its contractual obligations under a contract, however due to the complete lock-down, Company A fails to discharge its obligations totally/ or within time. What recourse do both the parties have?

Before determining the recourse available to both the parties, it is also relevant to see whether time is the essence of the contract or not:

If time is not of essence to the contract: If the contract did not stipulate a particular time-period within which it must be completed, the parties may re-negotiate the terms of the contract so as to enable Company A to discharge its contractual obligations accordingly.

If time is of essence to the contract: In the event, the contract becomes impossible to perform or meaningless due to expiry of the time period, irrespective of the current situation, the contract stands frustrated as per Section 56 of the Indian Contract Act, 1872 and Company A will have to refund the advance received, and if it fails to do so, then Company B can resort to take taking legal recourse.

However, onus would be on Company A to establish that:

- The impossibility to perform the contractual obligations are directly related to the happening of such events or circumstances; and
- The circumstances were not within the reasonable control, directly or indirectly, of Company A and;
- Company A had taken all reasonable care and/or prudent steps to ensure the performance of its contractual obligations, and still failed to do so.

In the event Company A fails to establish the above three conditions, then Company A can be subject to legal proceedings by Company B for claiming damages.

15. Company A incurs additional costs in procuring labour and raw material as a result of the lockdown and outbreak of COVID-19, making the performance of the contract onerous. Does that make the contract impossible to perform under Section 56 of Indian Contract Act, 1872 and dissolves the contractual arrangement?

No. Company A may not be able to claim that the performance of the contract was frustrated on account of additional costs being incurred in arranging labour/raw material. The contract may have become onerous to perform, but not impossible. The performance of a contract generally does not get “frustrated” merely because it may become onerous qua one of the parties, even if on account of some unforeseen event.

16. Company A had an alternate option available for performing its contractual obligations towards Company B during the period of lockdown, but Company A fails to avail of that option as it could have resulted in extra costs. Can Company A still take refuge of a force majeure clause alleging lockdown?

Company A, in our view, may not be able to take refuge of lock down and/or outbreak of COVID-19 as a force majeure event in cases where the contract itself provides for an alternative mode for performance of the contract, Therefore, Company A, depending upon the facts and terms of the contract, may be liable for breach of contract and the other party may be entitled to claim liquidated damages, and other legal remedies.

17. In a contractual arrangement between Company A and Company B, where Company A fails to perform its contractual obligations and Company B chooses to procure the same goods from a third-party. Can Company A still be made liable for non-performance?

If Company B can establish that the third party was able to perform the same obligations, in the same circumstances, in which Company A failed to do so, then Company B may be able to sustain an action for damages against Company A not otherwise.

18. Company A has terminated the contract of Company B and as a consequence, Company B had to return the possession of goods, inventory, machine, etc. to Company A. However due to COVID-19 and lockdown, Company B fails to do so. Whether failure of Company B to handover possession due to COVID-19 and/or lockdown despite the termination of contract can result in any claim against it?

It is assumed that a termination notice must have been sent to Company B and the same was properly communicated in terms of the Contract. In the event Company B still fails to comply with the terms of termination notice due to COVID-19 spread or lockdown, then it has to be specifically established by Company B that:

- It was impossible for Company B to comply with the terms of termination notice due to the happening of such events or circumstances; and
- It was not within the reasonable control, directly or indirectly, of Company B; and
- Company B had taken all reasonable care and/or prudent steps to ensure the performance of contractual obligations, and still failed to do so.

In case Company B is able to establish as stated above, it will be able to avoid any claim being brought against it by Company A but not otherwise.

19. In case of a lease agreement, whether the lessee is liable to make payment of rent for the time period it did not use the leased property for its purposes in view of the lockdown and spread of COVID-19?

The liability of the lessee to pay rent for the period it did not occupy the space for its profitable purposes does not, ordinarily, absolve the lessee from its obligations under the lease agreement. However, one has to look into the terms and conditions governing the lease agreements.

C. Impact on the Law of Limitation

20. Whether the time period during which there is an outbreak of the COVID-19 and consequent lockdown of the country, including the courts, will this time period be excluded while computing the days for the purpose of law of limitation?

The Hon'ble Supreme Court in "*In Re: Cognizance for extension of limitation*", Suo Moto Writ Petition (Civil) No. 3/2020 has directed that the period of limitation in all proceedings before the courts/tribunals, shall stand extended w.e.f. 15th March, 2020 till further orders. The said order is available at https://main.sci.gov.in/supremecourt/2020/10787/10787_2020_1_12_21570_Order_23-Mar-2020.pdf for ready reference.

21. Whether the effect of the said judgment applies to timelines fixed for completion of pleadings or/and refiling of pleadings before courts/tribunals?

The effect of the judgment of Hon'ble Apex Court ordering for exclusion of the duration of lockdown while computing the period of limitation, to our understanding, also applies to timelines fixed for completion of pleadings and/or refiling of pleadings before the courts/tribunals.

22. Whether above judgment of the Hon'ble Supreme Court extending the period of limitation applies to the arbitration proceedings?

The period of limitation, to our understanding may also stand extended w.e.f. 15.03.2020 to arbitration proceedings. However, it is up to the Arbitral Tribunal to agree for extending the period of limitation.

23. In a situation where the period of limitation for taking a legal action by Mr. A against Mr. B has expired during the lockdown, in that case, whether in light of the Hon'ble Supreme Court judgment the period of limitation will start afresh?

Considering the above situation where the period of limitation was expiring on 20.03.2020, in view of the Apex Court judgment, the legal right of Mr. A **for taking a legal action** will continue to exist even after 20.03.2020. However, that does not mean a fresh period of limitation has started for Mr. A, and as soon as the courts re-open for taking up the cases, Mr. A. will only have 5 days to exercise its legal right against Mr. B.

D. Impact on Cheque Bounce cases under the Negotiable Instruments Act 1881

24. Whether the time period of 30 days for issuing a Demand Notice under Section 138 of Negotiable Instruments Act, 1881 shall stand extended in view of the judgment of Hon'ble Supreme Court in the matter of *In Re: Cognizance for extension of limitation*", *Suo Moto Writ Petition (Civil) No. 3/2020*?

Although the Hon'ble Apex Court does not specifically clarify on the position extension of time period in respect of proceedings that are not before the court/tribunal. Issuance of Demand Notice in case of cheque dishonour does not require any physical filing before any court and therefore, in the absence of any specific clarification of the Hon'ble Apex Court on this issue, parties should at least issue Demand Notice within 30 days by way of email, if the physical delivery through speed-post is impossible despite best efforts or communicate it through other e-modes and preserve it for record purposes.

25. Whether the time period of 30 days for filing Complaint under Section 142 of Negotiable Instruments Act, 1881 shall stand extended in view of the judgment of Hon'ble Supreme Court in the matter of *In Re: Cognizance for extension of limitation*", *Suo Moto Writ Petition (Civil) No. 3/2020*?

The Hon'ble Supreme Court *In Re: Cognizance for extension of limitation*", *Suo Moto Writ Petition (Civil) No. 3/2020* has observed that in order to ensure that lawyers/litigants do not have to come physically to file proceedings in courts/tribunals, the period of limitation is extended. Therefore, the time period from 15.03.2020 to such date as yet to be notified by Hon'ble Apex Court shall stand excluded while computing the period of limitation of 30 days for filing the complaint.

E. Impact on Insolvency and Bankruptcy Code, 2016:

26. Will the period of the country-wide lockdown be included while calculating the timeline of the CIRP process?

Insolvency and Bankruptcy Board of India has introduced Regulation 40C in IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 specifically stipulating that the period of lockdown shall not be counted for purposes of time-line for any activity that could not be completed in relation to CIRP. However, it is important to note that only the period of lockdown is excluded and not the entire time during which the pandemic may continue to affect the normal course of business.

Further, Hon'ble NCLAT in *Suo Moto Company Appeal (AT) (Insolvency) No. 01/2020* has ordered that the period of lockdown shall be excluded for the purpose of counting of the period for 'Resolution Process under Section 12 of the Insolvency and Bankruptcy Code, 2016, in all cases where 'Corporate Insolvency Resolution Process' has been initiated and pending before any Bench of the National Company Law Tribunal or in Appeal before this Appellate Tribunal. The said order is available at https://images.assettype.com/barandbench/2020-03/456d23ca-9b1c-4c61-99c7-b47f6f893bc7/NCLAT_March_30_order.pdf for ready reference.

27. Whether the effect of Regulation 40C of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 shall apply on liquidation proceedings?

Since, the regulation is introduced for CIRP proceedings, technically speaking it will not apply on liquidation proceedings. However, it is very likely that Tribunals may take a lenient view considering the world-wide impact of COVID-19.

28. Whether the interim order/stay order passed by Hon'ble NCLAT shall continue to be in effect during the lockdown period?

Yes, Hon'ble NCLAT in *Suo Moto Company Appeal (AT) (Insolvency) No. 01/2020* has ordered that the interim orders/stay orders passed by this Appellate Tribunal in Appeals under Insolvency and Bankruptcy Code, 2016 shall continue in all cases till next date of hearing.

In case the courts continue to remain closed on account of COVID-19, such interim orders/stay orders may be further extended beyond the next date of hearing, by a separate notification. However, it is clarified that till the date of this document no such notification was received.

29. Will the post-lockdown period, lead to some relaxation in the timeline of the CIRP process?

While there is no circular or notification in this regard, if there is difficulty in convening COC, inviting and submitting EoI and plans, such period ought to be excluded, going by the judgments of the Hon'ble Supreme Court. However, it will have to be demonstrated just how the pandemic prevented adherence to the stipulated timelines, and whether all possible efforts for convening COC or inviting and submitting EoI and plans were made via video-conferencing etc.

30. Whether the effect of Regulation 40C of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 is such that it extends the period of limitation for issuing a Demand Notice under Section 8 of IB Code, 2016?

Although the Hon'ble Apex Court does not specifically clarify on the position of proceedings that are not before the court/tribunal we are still of the view that the effect of the judgment shall also apply on issuance of Demand Notice under Section 8 of IB Code, 2016 in view of the unprecedented situation arising out of spread of COVID-19. However, it is still advisable that Demand Notice under Section 8 must be issued within the period of limitation, irrespective how long the period of lockdown continues.

31. Whether the IRP/RP is under a strict duty to convene COC meeting even during the period of lockdown?

IRP/RP are not under any strict obligation as Regulation 40C of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 provides for exclusion of the time period of CIRP activity during the period of lockdown. However, if IRP/RP and the COC should make the effort to conduct COC meetings through electronic means.

32. Whether the time limit for obligations under the resolution plan which has already been approved by the Adjudicating Authority gets extended by Regulation 40C of IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016?

The benefit of Regulation 40C would not extend to the time limit in implementation of an approved plan, as in a strict sense the “CIRP process” is deemed to be completed upon the approval of the Resolution Plan. It is advisable to comply with the obligations under the Resolution Plan within the stipulated time-limit.

33. What is the revised minimum threshold default amount statutorily required for triggering the provisions of IB Code, 2016?

The Ministry of Finance has amended the provisions of IB Code, 2016w.e.f. 24.03.2020 to the extent that the minimum default amount for triggering the provisions of IB Code, 2016 has been increased from Rs. 1 Lakh to Rs. 1 Crore in case of both Operational as well as Financial Creditors. However, subject to any view taken by Adjudicatory Authority while dealing with the pending cases as on the date of notification, we are of the view that the revised threshold shall be applicable only to those cases where the application is filed after the date of the notification not otherwise.

34. Can parties still trigger provisions of IB Code, 2016 in cases where the date of default can be established to be way before the outbreak of pandemic even though the amount of default is less than Rs. 1 Crore?

No, they cannot, since the law of the land as on date states that the provisions of IB Code, 2016 can only be invoked when the amount in default is more than Rs. 1 Crore therefore even in cases where the date of default dates back to way before the outbreak of COVID-19, the creditor cannot trigger the proceedings under IB Code, 2016.

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