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MANAGEMENT OF POTENTIAL DISPUTES FOLLOWING THE LOCKDOWN PERIOD

1. Contractual relations in this unforeseeable period: Force Majeure clauses, renegotiation and postponement

This period has noticed companies attempting to exit contractual obligations that were or are now no longer favorable to be acted upon. From citing reduction in profitability, to impracticality, to literal impossibility, companies have given legal practitioners a wide spectrum to test the boundaries of the 'Force Majeure' clause. The law on the impossibility of performance is divided into, instances covered by a 'Force Majeure' clause and those outside the purview of such clauses or where there the clause itself is absent.

Section 32 of the Indian Contract Act (ICA) covers instances where a force majeure clause provides recourse in the form of discharging parties from performance by stating, *"Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened. If the event becomes impossible, such contracts become void"*.

The enforceability of such a clause will depend on whether the instance contested is included within the force majeure clause. The viability of the clause in the current pandemic situation is reliant on the express inclusion of an epidemic/pandemic under the clause, or the scale of generality of the clause (catch-all phrases like any event not within the control of the parties).

Although Indian courts have not made any decision on whether an epidemic/pandemic constitutes an 'Act of God', courts in the US and UK have held cholera and influenza epidemics to constitute an 'Act of God'.[1] It can be argued that the human intervention involved in epidemics/pandemics is not a relevant consideration, thereby opening a door for the application of the force majeure clause. An official memo

[1] Lakeman V/s. Pollard 43 Me 463 (1857); Coombs V/s. Nolan 6 F Cas. 468; Sandy V/s. Brooklyn School District 182 NW 689

issued by the Ministry of Finance on the 19th of February 2020 on the subject of 'Force Majeure Clauses' directed statutory corporations to include the COVID-19 pandemic within 'natural/other supervening events discharging performance'.[2]

Notwithstanding the inclusion of 'pandemic' under a force majeure clause, it is applicable only when the impossibility to perform is directly linked to the pandemic. This clear distinction was made by the Bombay High Court in ***Standard Retail v. G.S. Global Corporation***.[3] Here, a consortium of steel importers purchased cargos of steel components from a company located in South Korea. The cargo was successfully shipped from South Korea and reached the specified port in India. Once arrived, the steel importers sought to discharge themselves from the delivery on account of the transport restrictions imposed by the COVID-19 outbreak. The court stated that the party could not show that the restrictions imposed due to the COVID-19 outbreak made it impossible to receive the goods. It pointed out that the port and transport facilities remained partially functional and at most, there would be a delay in receiving the goods. This example makes it clear that courts will not interfere in cases where the outbreak is taken as an opportunity to get out of an unfavorable bargain.

In the case of ***Energy Watchdog v. CERC***,[4] it was held that an increase in the price of source materials, affecting the practicality of contract, did not cause the extent of hindrance required to discharge the parties. The case also touched upon the alternative nature of the applicability of sections 32 and 56 of the ICA. In the absence of a force majeure clause, it found section 56 of the ICA to be applicable, which states, *"A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful"*.

With respect to impossibility, English Courts have lowered the threshold of impossibility to give effect to the clauses of the contract.[5] However, Indian courts have refrained from expanding the ambit of the section. They have not only excluded this principle when a contract includes a force majeure clause but have also maintained the strict requirement of near to literal impossibility.[6] In the context of the COVID-19 outbreak, only those parties who demonstrate a complete impossibility to perform their obligations will be

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[2] Ministry of Finance, Office Memorandum on Force Majeure Clause dated 13th May 2020. It can be accessed at https://doe.gov.in/sites/default/files/Force%20Majeure%20Clause-%20FMC%20.pdf

[3] Standard Retail Pvt. Ltd. V/s. M/s. G.S. Global Corp, Order of Bombay High Court dated April 8th 2020Commercial Arbitration Petition (Lodging) No. 404 of 2020.

[4] Energy Watchdog v. CERC (2017) 14 SCC 80

[5] The Sea Angel 2007 EWCA Civ 547; F.A. Tomplin Steamship Co. Ltd. v/s. Anglo-Mexican Petroleum Products Co. Ltd. 1916 2 AC 397

[6] Naihiti Jute Mills Ltd. V/s. Hyaliram Jagannath 1968 AIR 522, Satyabrata Ghosh V/s. Mugneeram Bangur 1954 SCR 310.

successful in discharging themselves from an obligation of performance, where a force majeure clause is absent/does not cover pandemics.

In furtherance of protecting their interests, parties should be prompt in complying with the formalities required and in communicating the arising of a force majeure event. Furthermore, other clauses of the contract providing for price adjustment and delayed performance should be taken advantage of. Most importantly, companies should point at renegotiating contractual relations in light of the changed circumstances.

2. Waiting-Que to knock on doors of the courts: sigh of relief for debtors but what do creditors do?

The outbreak has stretched to impact almost every sector, and with increasing debt, coupled with growing costs to keep businesses alive, the grave consequences of mass insolvencies were to be avoided at any cost. Acknowledging that various companies have incurred substantial debts in a bid to remain in business, and that the impact of legal proceedings was that of only further adding onto the concerns of these companies, the government made certain adjustments to the recovery framework to allow these companies to find some stable ground.

On the other hand, courts had to intervene to make sure that entities were not penalized by limitation periods for delays not attributable to them.

i. Putting a leash on Insolvency proceedings by placing a moratorium and increasing the threshold

The Insolvency and Bankruptcy Code of 2016, was introduced to give creditors a quick mode of recovery and to that end, it served its purpose effectively. With strict time limits and stringent application, a corporate debtor[7] was either forced to return the amount owed or forced into liquidation. This quick resolution would have proven too quick and effective for this period where companies have increased leverage to sustain their activities. Allowing a swarm of creditors to initiate insolvency proceedings would have proven disastrous and ensured the closure of thousands of companies, which in turn would have led to mass unemployment and recession. Wary of the negative effects, the Indian government decided to suspend insolvency processes and reduced its scope for the foreseeable future.

By adding section 10A to the Code, the government has imposed a moratorium on filing new insolvency processes for an initial period of 6 months, which may be extended to a maximum of 1 year. While

[7] Section 3(8), Insolvency and Bankruptcy Code 2016, A corporate debtor is an entity, incorporated under the Companies Act 2013, which owes any debt.

suspending insolvency proceedings is in line with the measures taken in other parts of the world,[8] the ordinance further states that no application shall ever be filed in respect to defaults occurring in the period of moratorium (also known as 'COVID related defaults'). It plainly evident that is too drastic a measure and one which will create great confusion when the moratorium is lifted. While it may be defended as being introduced to avoid backlogs at the time of opening, we should wait for a challenge of this provision.

The moratorium even covers voluntary insolvency processes, where the corporate debtor itself initiates the insolvency process. In the absence of that recourse, companies requiring to file for voluntary liquidation may do so under the Companies Act of 2013.

That being said, the moratorium is not applicable to insolvency/bankruptcy proceedings against personal guarantors. The State of Bank of India has recently taken Reliance Communication's Anil Ambani to the NCLT for a personal guarantee of loans worth USD One Hundred and Fifty Million.[9]

The underlying objective is, firstly, and with respect to viable companies, to protect them from initiation of insolvency proceedings and secondly, and with respect to non-viable companies, to avoid situations where there are no takers for the insolvent company at the time of liquidation.

In addition to the moratorium and with a view to further safeguard smaller companies from being dragged into liquidation, an amendment was made to section 4 of the Code which provides the minimum default amount for which proceedings can be initiated. This limit was increased from Rupees Hundred Thousand to Rupees Ten Million, thereby restricting any petition for a claim of less than Rupees Ten Million from the date of the ordinance i.e. the 24th of March.[10] A clarification was made in the case of ***Arrow Lines Organic Pvt. Ltd.***[11] that the increase in the threshold was prospective in nature and did not apply to pending proceedings.

With respect to on-going insolvency proceedings, the National Company Law Tribunal has stated that this period shall be excluded in light of the 330 days' limit for resolution of an insolvency application.

ii. Extension of limitation period: slight confusion with the interpretation of the extension

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[8] For example, Italy has only declared inadmissible any bankruptcy proceedings instituted between the 9th of March to 30th June 2020.

[9] The State Bank of India approached the National Company Law Tribunal to appoint a resolution professional for personal guarantees made by Mr. Ambani. The Tribunal reserved its order on the 30th of June 2020. To read more https://economictimes.indiatimes.com/news/company/corporate-trends/nclt-reserves-order-against-anil-ambani-in-a-plea-filed-by-sbi/articleshow/76708670.cms?from=mdr

[10] The Insolvency and Bankruptcy (Amendment) Ordinance, 2020. The same can be accessed at https://ibbi.gov.in//uploads/legalframwork/741059f0d8777f311ec76332ced1e9cf.pdf

[11] M/s. Arrowline Organic Products Pvt. Ltd. V/s. M/s. Rockwell Industries Ltd. IBA/1031/2019. The judgement can be accessed at https://ibbi.gov.in//uploads/order/29d97fa84cefe57a39fa97d491c061a1.pdf

With respect to other civil proceedings and limitation to institute suits, the Delhi High Court passed an order which was superseded by the decision of the Supreme Court.[12] The Delhi High Court stated that the lockdown/suspension of work of Courts shall be treated as 'closure' within the meaning of section 4 of the Limitation Act (Section 4 of the Act states that if the last day to pursue an action falls a day closed on which the court is closed, the period shall be extended to next day that the court is open). However, this order was superseded by that of the Supreme Court which states that the period of limitation in all such proceedings, irrespective of the limitation period prescribed under any general or special law whether condonable or not, stands extended. Some confusion has arisen due to the vagueness of the notification with some asking whether limitation periods, completed prior to the lockdown, shall be reopened.

While a clarification would be beneficial, a reasonable interpretation would point towards its applicability solely to causes whose limitation period that extends into the lockdown. At the same time, many courts have successfully shifted online and that has been a relief to many.

3. Avoiding conflicts with labor: what are the laws to guide companies in this period?

During the lockdown, many companies and industries found it difficult to keep their staff on payroll, with many employees, at all levels, having to take a salary cut. There have been many instances of laying off and some of these did not go over smoothly.

On the 29th of March, the Ministry of Internal Affairs emitted a notification which stated, "All employers, be it in the Industries or in the Shops and Commercial Establishments, shall make payment of wages to their *workers*, on the due date, and without any deduction, for the period their establishments were under closure during the lockdown."[13] This was supplemented by a notification of the State Ministry of Maharashtra which warned companies of coercive action in cases of non-compliance with the requirement to pay their workers.

The use of the term "workers" is to signify the applicability of the definition of "workers" under the Payment of Wages Act, the Factories Act, the Industrial Disputes Act and the Shops and Commercial Establishments Act, which form the pith of labor laws in India. Collectively, these Acts define a "worker" as an employee earning less than 24,000 rupees a month and not having a role of a managerial nature. All together signifying that the notifications were applicable to only such kind of employees.

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[12] Suo Moto Writ Petition (Civil) No. 03/2020. The order can be accessed at https://main.sci.gov.in/supremecourt/2020/10787/10787_2020_1_12_21570_Order_23-Mar-2020.pdf

[13] Ministry of Home Affairs, Order under section 10(2)(i) Disaster Management Act, 29th of March 2020 (ceased to have effect of the 18th May 2020). It can be accessed at https://www.mha.gov.in/sites/default/files/MHA%20Order%20restricting%20movement%20of%20migrants%20and%20strict%20enforement%20of%20lockdown%20measures%20-%2029.03.2020.pdf

However, in the matter of ***Nagreeka Exports v. UOI***,[14] the Supreme Court scrapped the notification and directed the government to refrain from taking any coercive action against companies not paying their workers. While not appreciated by everyone, the order of the court was welcomed by smaller companies that had no means to pay their employees.

But apart from the legal requirements, companies have been advised to make any decisions on cutting and suspending salaries, in a clear and transparent manner, to avoid conflict. With the survival of entire families, many companies have tried their best to maintain steady payment of salaries. The government, while temporarily reducing employer contributions, has also allowed an advance partial withdrawal of an employee's provident pension fund to enable unpaid employees an access to some funds.

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For further information and specific requests, please fill the form at the page Contact us on our website or write an email to milano@eptalex.com

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[14] Nagreeka Exports Ltd. V/s. Union of India, W.P.(C) No. 471/2020.