

## COVID-19: Managing contractual disputes during current challenging times

The coronavirus pandemic has resulted in multiple unprecedented reactions by governments all over the world to tackle the outbreak, including implementation of large-scale lockdowns and disruption of global supply chains. According to leading agencies, the pandemic and the resultant lockdown is gradually pushing the world economy into a recession.

The International Monetary Fund, in its World Economic Outlook published in April 2020, projected global growth to fall to -3% and stated that the resultant lockdown can potentially lead to the worst recession since the Great Depression and an economic setback which is significantly worse than the Global Financial Crisis of 2008-09.

In India, prolonged lockdown, combined with a slowdown in both domestic and global demand, will possibly result in a slower growth than the last few years. Coupled with potential labour shortages, this can result in organisations' supply chains not being able to meet their contractual obligations related to quality, delivery and other vital parameters.

On 19 February 2020, the Indian government declared that disruptions in supply chains due to the outbreak of COVID-19 will be considered as natural calamity and the force majeure clause may be invoked, wherever appropriate, across government contracts.

Although this declaration pertains to government contracts, it is expected that that private contracts for supply of goods and services will be subjected to similar interpretation. As a result, India Inc is likely witness a wave of potential disputes and litigations, which may strain resources and lead to brand and reputational damage for the country.

A larger number of businesses are already reviewing their contracts to check if a force majeure clause has been listed in their contracts. Businesses are also assessing the language of the clause and the extent to which such a clause can be invoked. Therefore, it is important to understand the role of force majeure and how it can impact businesses.

### Force majeure and its role

Force majeure is a legal clause that covers an unforeseeable circumstance/event that prevents someone from fulfilling an obligation. Interpretation of the clause will require the utmost level of diligence, especially with regard to what constitutes the force majeure event and the circumstances under which the clause can be invoked. In such cases, the claimant's counsel or the expert witnesses will highlight that necessary actions, or actions that could mitigate the claimant's loss, were not taken.

The respondent's counsel, on the other hand, will highlight all such events and present them in a manner that demonstrates that despite all actions taken to fulfil the obligations under the contract, it was not practical for the respondent to honour the contract and that the non-performance was on account of an unforeseen/irresistible force or due to occurrence of an event, which was beyond the control of the respondent.

The onus to decide whether there existed an unforeseen/irresistible force or whether an event had occurred which was beyond the control of either the claimant or the respondent and whether or not the breach/ non-performance is attributable to such a force or occurrence of such an event is on the arbitrator/tribunal. A thorough evaluation of circumstances surrounding the non-performance/breach has to be conducted on a case-to-case basis.



## Potential dispute scenarios across industries

It is envisaged that default/non-performance may result in an increase in the number of disputes across sectors, some of which may get resolved by way of litigation, however many of them may find their way to the arbitration forums for resolution. Some illustrative scenarios across key sectors are listed below:



### Sports and entertainment

- Event postponement followed by live streaming without any crowds
- Reschedule of the events with necessary safeguards comes at an unplanned/additional cost
- Broadcasters may intend to terminate the agreement and claim refund as well as damages
- Organisers may claim that:
  - Event stands postponed and is beyond their control
  - No ground for refund or damages as event is not cancelled



### Critical service providers

- IT service providers may find it difficult to meet the agreed service levels due to lockdown
- Increased number of issues faced by end users, as they are working from home
- Service recipient may claim damages of loss suffered on account of disruption of IT services
- Service providers may claim charges for additional services beyond the agreed fee, which the recipient may not agree to
- Seeking of damages due to losses suffered by clients in relation to investment portfolio managed by portfolio management companies



### Travel and hospitality

- The industry is severely impacted due to the ban on travel, resulting in a spike in the number of refund claims with travel operators on account of non-fulfilment of contractual obligations
- Operator may deny claims citing willingness to perform the obligation with modifications
- Operators may grant refunds as credit to be redeemed later
- Aggrieved by the operator, a group of clients may seek to claim damages



### Manufacturing, EPC, construction and infrastructure

- Lockdown has resulted in significant impact on supply chains
- Delays in shipments and implementation of large-scale projects is due to non-availability of resources such as manpower and transport
- Customers may claim damages on account of breach of contractual obligation/significant delays leading to revenue losses



### Internal employee claims due to pay cuts and layoffs

- Slowdown has led to layoffs, pay cuts, leave without pay and reduction in paid leaves
- Employees may file a class suit against the company as this may not be a valid ground as per the terms of employment



### Mergers and acquisitions

- In an M&A deal, the potential investee may not be able to fulfil specific representation/warranties due to the economic slowdown
- Investor may consider this as a breach and claim damages for losses suffered due to a 'bad deal'
- Issues with due diligence service providers



## Here is what the finance leaders should consider as they PLAN to analyse their contracts



### Do your homework

- Seek legal counsel to ascertain the background, specific rights and obligations and related remedies available in the case of breach and grounds for termination of the contract.
- Conduct tabletop exercises to prepare a strategy for response, including arriving at potential best case/walk away scenarios.
- Compute preliminary summary of additional costs for fulfilling terms, statement of losses, etc.
- Revisit relevant clauses of insurance policies and also consult legal counsel/insurance companies to ascertain if:
  - Losses suffered due to COVID-19 are covered
  - Financial outflow/losses due to potential unfavourable arbitral awards would be covered
  - If not, look for alternative methods of financing
- Gather market intelligence to help assess cost benefit analysis of getting into litigation or arbitration and also augment information about underlying events that might help with recovery and claim efforts.



### Initiate proactive discussions

- Reach out to the other party for verbal discussions on arriving at a mutual way forward (follow the path of least resistance).
- Attempt to renegotiate contracts to allow for a wider purview of the termination/penalty clause and a more mutually beneficial force majeure clause that covers unforeseen events, such as COVID-19.
- Extension on deadlines or termination of the agreement, if practical.



### Consider litigation or arbitration as a last resort

- If mutual way forward or alternative arrangements do not work out, consider whether litigation or arbitration should be adopted.
- Consider that litigation proceedings may turn out to be very expensive or time consuming, should both parties agree to arbitration proceedings.
- Both parties must understand that in an arbitration proceeding, the parties may have no chance of appeal against the arbitral award.
- While formulating the statement of claim/defence, the following key factors need to be considered:
  - Intention of the other party
  - Efforts taken by the other party to fulfil their contractual obligations despite the existence of the unforeseen event
  - Position of the contract prior to the occurrence of the unforeseen event

Thoroughly evaluating the above mentioned considerations will help organisations take informed and sustainable decisions, which are best for all concerned entities.



## How Grant Thornton can help

### Grant Thornton's Forensic Investigation Services team

can help you effectively brainstorm fraud risk areas across your organisation and help identify potential areas of activities and priorities that might help prevent integrity breakdowns in these challenging times.



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[Click here to download the recently released Grant Thornton Halt-Plan-Refresh Guide on revisiting business priorities and plans](#)



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