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IMPACT OF COVID-19 ON INDIA INC.

Background

The COVID-19 epidemic began in early December 2019, in Wuhan, China when 41 patients were diagnosed with pneumonia with no clear cause. Now, as on March 8, 2020, COVID-19 has led to 106,472 confirmed cases globally with 3,600 deaths and a lockdown of China, Italy, Iran and South Korea. With more than 93 affected countries, the global environment seems to be of caution and preparedness to deal with a lingering pandemic. However, the rapid increase of person-to-person transmission and failed containment measures is leading the global economy into a state of flux raising unpredictability and, consequently, market volatility. India currently has 40 (as on March 8, 2020) confirmed cases of COVID-19, spread across New Delhi, Jaipur, Bangalore, Hyderabad and Kerala.

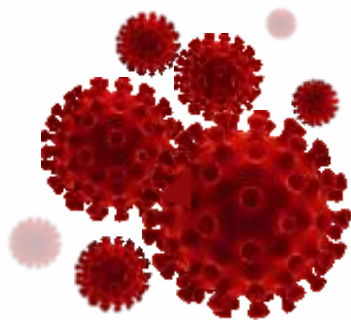
China is a key supplier for several businesses around the world. With large parts of the country being placed under an effective lockdown, businesses globally are facing a future of uncertainty and supply chain disruptions, including for procurement of raw materials for production. Since 18% of India's imports come from China, supply disruptions in key segments is a primary threat being faced by Indian companies. Consumer durables, electronics and solar panels industry, which heavily depend on China for imports, will be largely impacted by the epidemic in the absence of an alternative. Exports to China have also been affected. The impact on Indian exporters of cotton yarn, sea food, petrochemicals, gems and jewellery seems to be inevitable since China is one of the biggest markets for them.

Anticipation of an economic slowdown has already led several US-based businesses to pull back from agreements for fear of non-performance, leading to a fall in the overall volume of business activity in February to the lowest level recorded in the past 6 years.

Although, a slowdown in raw material supply may hurt certain China-dependent industries, it also presents an opportunity for the Indian companies to fill the void around the globe. Indian businesses can offer to replace China in the global supply chain by building ties with companies looking to reduce dependency on China. This could pave the way for more foreign investments in India and promote its '*Make in India*' programme.

Meanwhile, based on the rapid spread of the virus around the globe, the World Health Organization (**WHO**) continues to upgrade its global risk assessment. In addition to the grave health consequences of COVID-19, the virus is having a major negative effect on international business, disrupting numerous global supply chains. The sectors most affected are Aviation, Shipping, Transport & Tourism, Hospitality, Manufacturing & Retail.

Impact of COVID-19 on domestic and international businesses is severe. As a result, our firm is receiving several legal questions arising out of the COVID-19 outbreak. To assist India Inc., we have prepared this note to highlight some of the COVID-19-outbreak related key legal issues that companies should be thinking about in the current environment.





Supply Chain Disruption

– Implications on Contracts

Considering the supply chain disruption caused by the COVID-19 outbreak, it is likely that performances under many contracts will be delayed, interrupted, or even cancelled. Counterparties (especially suppliers) to contracts may seek to delay and/or avoid performance (or liability for non-performance) of their contractual obligations and/or terminate contracts, either because COVID-19 has legitimately prevented them from performing their contractual obligations, or because they are seeking to use it as an excuse to extricate themselves from an unfavorable deal. Further, companies may not be able to perform their obligations under their customer agreements because of their supplier's non-performance and may in turn seek to delay and/or avoid performance (or liability for non-performance) of their contractual obligations and/or terminate contracts. Parties may also cite COVID-19 as a basis for renegotiation of price or other key contractual provisions (e.g. volume of materials exported from or imported into affected areas due to shifts in supply and demand). In this context, it is important to

determine if COVID-19 will be considered as a 'Force Majeure' event.

On February 17, 2020, the China Council for the Promotion of International Trade (CCPIT), revealed that it had already issued over 1,600 'Force Majeure certificates' to firms in 30 sectors, covering contracts worth over USD 15 billion. In India, the Department of Expenditure, Procurement Policy Division, Ministry of Finance issued an Office Memorandum on February 19, 2020, in relation to the Government's 'Manual for Procurement of Goods, 2017', which serves as a guideline for procurement by the Government. The Office Memorandum effectively states that the COVID-19 outbreak could be covered by a force majeure clause on the basis that it is a 'natural calamity', caveating that 'due procedure' should be followed by any Government department seeking to invoke it.

However, COVID-19 is unlikely to give rise to a valid force majeure defense under every contract and in every circumstance, as different contracts and governing laws stipulate different requirements for

different situations. Companies are, therefore, well advised to proactively manage the related legal risk and carefully assess which party must ultimately bear the financial losses caused by COVID-19.

Force majeure – The law relating to Force majeure (a French phrase that means a 'superior force') is embodied under Sections 32 and 56 of the Indian Contract Act, 1872. It is a contractual provision agreed upon between the parties. The occurrence of a force majeure event protects a party from liability for its failure to perform a contractual obligation. Typically, force majeure events include an Act of God or natural disasters, war or war-like situations, labour unrest or strikes, epidemics etc. The intention of a force majeure clause is to save the performing party from consequences of something over which it has no control. Force Majeure is an exception to what would otherwise amount to a breach of contract. Whether a particular contractual obligation can be avoided is a factual analysis. The courts would examine, whether in a given case, impact of COVID-19 epidemic prevented the party from performing its contractual obligation. Indian courts have generally recognised this concept and have enforced it where appropriate. The law in India has been laid down in the seminal decision of the Supreme Court in the case of *Satyabrata Ghose vs Mugneeram Bangur & Co.* (AIR 1954 SC 44). The entire jurisprudence on the subject has been well summarised by Justice R.F. Nariman of the Supreme Court in a the recent decision in the case of *Energy Watchdog vs CERC* (2017) 14 SCC 80.

In particular, the following aspects should be kept in mind:

- **Outline of force majeure** - The general concept means that events or conditions beyond the reasonable control of one party should not cause them to be held liable under the terms

if that event or condition prevents the performance of the obligations of the contract. Some contracts list examples of force majeure events that automatically meet the standard. Others list events that must still meet the definition of force majeure. One may also rely on generic clauses usually included in *force majeure* clauses, such that the COVID-19 is an 'Act of God'.

- **Force majeure provisions vary widely** - The language used in most contracts vary widely and, therefore, it is important to review these clauses carefully.
- **Duty to mitigate and exercise reasonable diligence?** - If a 'duty to mitigate' obligation is imposed under the contract, then the meaning of 'reasonable diligence' becomes important. This is a subjective standard and will be interpreted on a case-to-case basis. It also needs to be analyzed if there are any obligations to use 'best endeavours' to mitigate the effects of a force majeure event.
- **Does the event have to be foreseeable?** - Most contracts provide that for an event to qualify as force majeure, it must be unforeseeable or not reasonably foreseeable.
- **Notification requirements** - Most contracts require notice to the other party to invoke a force majeure provision. Some also provide deadlines for making such notice to make the claim effective.
- **Can the contract be put on hold or canceled?** - Some contracts provide that it can be put on hold until the force majeure event is resolved. Some contracts provide for limitations in time after which either party may cancel the agreement with written notice to the other. Others require the

contract to remain in effect until the force majeure event is resolved.

- ***Burden of proof*** - The party that relies upon the force majeure event generally has the burden of proof and such clauses are construed strictly by the courts.
- ***Keep records*** - Copies of critical correspondence and other communications should be maintained if disputes arise later. This can be particularly important in establishing that the company has done all that was reasonably possible to mitigate the losses.
- ***Approach to potential dispute resolution*** -
 - The contract's dispute resolution clause should be checked to identify which court or tribunal would decide a dispute and how it is likely assess the situation.

If the contract does not have a force majeure clause - If the contract does not include a force majeure clause, the affected party could be to resort to the doctrine of frustration under Section 56 of the Indian Contract Act, 1872. However, in order to claim that the contract is frustrated, it must be shown that performance of the contract is entirely impossible and that it has become fundamentally different from the arrangement contemplated at the time of executing the contract.

Other possible consequences for contracts – Counterparties may attempt to invoke other contractual clauses like price adjustment clauses, material adverse change (MAC) clauses, limitation or exclusion clauses, to limit or exclude liability for non-performance. The ability to invoke such other grounds will depend on the wording of the relevant clause, and how the clause is construed by courts or tribunals.



Impact on M&A Transactions

The outbreak of COVID-19 may impact M&A transactions. The parties to M&A transactions should carefully examine the terms of their transaction documents and consult with their counterparties to promptly address the challenges brought by COVID-19 outbreak. Some of the key issues are highlighted below.

- **Material adverse change** - The impact of COVID-19 and whether it would trigger a MAC (generic or specific) would need to be examined. Whether a MAC has or has not been triggered would need to be assessed on a case by case basis, depending on the impact of the event on the company and would depend heavily on the specific wording of the MAC clause and the particular circumstances of the business at issue.
- **Pre-completion undertakings** - Sellers should check if they can comply with pre-completion compliance of business covenants, whether general commitments about ordinary course of business or trading, or specifically linked to contracts, production or employees.
- **Warranties and repetition** - Buyers should consider requesting warranties around risk assessments, scenario planning and adverse impact of COVID-19. Sellers conceding these should seek knowledge and materiality qualifiers.
- **Warranty limitations** - Sellers should consider a general COVID-19-related exclusion of liability. Ring-fencing of such clauses should be considered, such that COVID-19-related claims can only be made under specific warranties and not under general warranties. Buyer's knowledge, changes in law and other limitations may also be relevant in this context.
- **Disclosure** - Sellers should carefully consider the need for COVID-19-related disclosures (for example against material contracts warranties), being as specific as possible to satisfy any requirement for 'fair' disclosure.
- **Data rooms and due diligence** - Sellers should consider including information in the data room about the

possible impact of the epidemic on the target including, where relevant, appropriate mitigation and contingency plans. Buyers should consider conducting due diligence on the level of risk and on the target's scenario planning. Further, the COVID-19 outbreak may cause delays to due diligence activities, including the impossibility to conduct on-site due diligence, audits and inspections, and exercising the relevant access rights. The opportunity to negotiate a later long-stop date, allowing extra time to complete the due diligence, should also be explored.

- **Delayed Closing** - The challenges posed by the COVID-19 outbreak may cause delay in closing of M&A transactions. The parties required to satisfy any closing conditions that may be delayed should consult with their counterparties to manage expectations and negotiate the appropriate waivers,

moving certain closing conditions to the post-completion covenants, or extending the long-stop date.

- **Breach of reps & warranties** - The disruption brought by the COVID-19 outbreak may also result in certain representations and warranties given by a seller and target company no longer being true when repeated at closing. All parties should conduct a comprehensive assessment of the impact that the COVID-19 outbreak may have on the representations and warranties.
- **Termination events** - The persistence of the COVID-19 outbreak may lead to the occurrence of a range of termination events. The parties should assess carefully if a termination event has occurred or is likely to occur, due to the present situation and its foreseeable impact.



Insolvency

The spread of COVID-19 has already resulted in an increase in companies experiencing financial distress as they try to mitigate the financial impacts of supply chain issues coupled with lower customer demand. Companies with already high debt levels are finding existing credit lines withdrawn at a time when they are needing to pay suppliers who are able to deliver on time while not receiving customer payments. Likewise, planned refinancing

and distressed M&A activity is being delayed (as a result of travel restrictions and other measures), with the result that companies are finding it more challenging to execute and implement time-critical turnaround plans. Consequently, companies may be forced to seek formal and informal protection from their creditors, and we expect to see, in more distressed cases, increased insolvency on the horizon.



Corporate Governance & Disclosures

- What Should The Boards Do?

Against the backdrop of the COVID-19 outbreak, it is critical that the Board of Directors understand the scope and extent of their statutory and fiduciary duties. Directors are required to exercise reasonable care, skill and diligence, and to act in the best interest of the company. Below are some key considerations for the Board of Directors:

- **Business Continuity Risk** – The Board needs to get engaged with the management team to evaluate the business continuity risk, in case supply chain is disrupted for any critical raw material and empower the management team to take quick decisions in situations requiring immediate action.
 - **Be Informed** - The Board has an obligation to be reasonably informed and use good faith efforts in overseeing a company's operations. A critical responsibility of the board in this regard is its oversight of material risks to the company. Management should keep the Board sufficiently well informed and engaged to enable the
- Board to consider and understand the material risks posed by the COVID-19 outbreak and their potential magnitude, as well as management's plans to mitigate and address those risks.
 - **Fast-Action Plans** - The Boards should ensure that the management teams put in place fast-action plans in order to deal with the COVID-19 outbreak. The management team should contemplate situations where supply will be disrupted for prolonged periods and should liaise with suppliers to understand the extent to which their ability may be hampered. At the same time, the Board should empower the management team to commence negotiations with alternate suppliers in different countries to mitigate all possible risks.
 - **Consumer Connect** - A constant communication with consumers should be maintained in order to keep them abreast of any disruption of services and allowing them the opportunity to secure alternate source of supply. The

company may also consider the possibility of offering an alternate supply link to the customer. If the company is engaged in providing vital products or services, it should also be prepared to deal with possible litigations, if the company is not able to meet orders or experiences significant delays.

- ***Shareholder's Interest*** - It is vital for the Board to communicate with shareholders regarding the company's assessment of potential impact of the COVID-19 and the company's action plan to tackle the same. Re-assessment of revenue and profitability projections may be required. It is of utmost importance to maintain confidence of shareholders particularly for companies which have suffered disproportionate impact of this epidemic.
- ***Regulatory Disclosures*** - Listed entities would need to ensure that if there is a material effect on the business or operations of the company like closure of an important

manufacturing facility due to supply chain disruptions, the required intimation needs to be sent to the Stock Exchanges where the company's shares are listed. Disclosures and communication about the impact of the COVID-19 outbreak on the business and operation should be planned and coordinated with the legal teams to ensure compliance with applicable law.

- ***Disclosures under financing documents*** – The company would need to carefully monitor if it is in compliance with various financial covenants under the borrowing documents and also assess the need to change or re-negotiate such terms with the lenders. If due to material adverse impact on the company's financial performance, the company is unable to meet any financial covenants under the borrowing documents, the same needs to be intimated immediately to the lenders. In the event the security provided to the lender becomes inadequate due to any reason, additional security may need to be provided.



Workplace Issues

The COVID-19 outbreak could begin to throw up a variety of employment law issues relating to travel, health and safety concerns, sickness and absence. Below is a high-level overview of the key workplace related issues that employers should consider:

- **Employer's obligations** - Employers are generally obligated to ensure a safe and healthy work environment for their employees, temporary workers, trainees and staff. To ensure a safe and healthy working environment, employers should do 'everything reasonably possible' to ensure prevention. Employers may consider the following actions:
 - Check with official sources (*e.g. website of the Ministry of Health and Family Welfare, Government of India, official sources such as the World Health Organization*) to see if there is an official recommendation and implement them.
 - Inform employees unambiguously about steps, including measures (to be) taken including certain hygiene guidelines.
 - Keep the lines of communication open. Educate the staff without causing panic by keeping them up-to-date with factual and accurate information from reliable sources.
 - Make provision of specific equipment such as hand sanitisers and face masks, if the risk becomes real.
- **Travel** - The Indian government has issued an advisory to Indian travelers to refrain from travelling to China, Iran, South Korea and Italy and advised to avoid non-essential travel to other COVID-19-affected countries. The Government has also decided to start universal screening for all passengers flying into the country from abroad for the virus at the airports besides testing people coming in through open borders. India has temporarily suspended visa on arrival for nationals of Japan, China, Iran, Italy and South Korea and has cancelled all flight operations to and from China, Hong Kong and Iran.

Employers should review how best to protect staff travelling on business, especially if they are travelling abroad, when tailored guidance and support may be appropriate. Further it would need to be considered whether measures are in place to deal with staff being quarantined or falling ill when abroad. Can they be easily repatriated, or moved to a safer place? How will the employer's travel insurance policies respond in those situations? Employers should review whether travel is necessary, and whether meetings can be conducted by video link.

- **Leave entitlement** - There is no legal requirement under Indian law to grant leave for COVID-19 patients in excess of what is statutorily mandated or contractually agreed upon.. Given the communicable nature of the disease, it may be advisable for the employers to allow affected employees to proceed on paid leave.
- **Termination** - It is advisable that the employers do not terminate any employee on the ground of he/she being a COVID-19 patient or suspected patient.
- **Work from home** - The employer may, in principle, allow an employee to

work from home. The employer may audit available IT hardware and software, and close any gaps if required to ensure that the IT system is robust and functional during such remote access. It needs to be determined if there are any data-security issues to consider and how best to address them.

- **Entry into workplace** - An employer has a legal right and an obligation to prevent an employee who is suffering from communicable diseases like COVID-19 from entering the workplace for the protection of other employees.
- **Respect Employee Privacy and Avoid Discrimination** - Employers should treat employee health information as confidential and should ensure that their policies apply to all employees equally and not single out those of a particular nationality, ethnicity or other protected class, or those perceived to have contracted COVID-19.

The key need for employers is to plan ahead and behave proportionately, reasonably and consistently. A failure to do so will not only risk legal claims, it may also impact adversely on staff morale and damage future employee relations.



Check Your Insurance

Every company impacted by the COVID-19 outbreak would need to consider if adverse financial consequences of business interruption resulting from COVID-19 can be claimed under the insurance policy. Companies should review their existing business interruption insurance policies to protect themselves against any losses sustained from exposure to the epidemic. The extent of insurance cover available to

a company will depend on the specific terms of each policy.

The company may also need to notify to the insurance company any material event which may result in the company being required to make an insurance claim and such notification requirement under the insurance policy needs to be strictly adhered to.

Conclusion

While the full impact of the COVID-19 outbreak on businesses is not clear at the moment, and the outbreak is likely to spread in the coming days, this is an issue which is seemingly becoming critical by the week.

If you would like to discuss any of the issues highlighted in this paper or any other legal implication in relation to the COVID-19 impact, please feel free to reach out to us.

Disclaimer:

This report has been sent to you for informational purposes only and is intended merely to highlight issues. The information and/or observations contained in this publication do not constitute legal advice and should not be acted upon in any specific situation without appropriate legal advice.

The views expressed in this report do not necessarily constitute the final opinion of Cyril Amarchand Mangaldas on the issues reported herein and should you have any queries in relation to any of the issues reported herein or on other areas of law, please feel free to contact us at cam.publications@cyrilshroff.com.

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