

COVID-19 – Implications for the Indo-German supply chains

June 2020

India's biggest export markets are the US and the EU. In particular Germany and India have an extensive trade history with bilateral trade amounting to Euros 21.9 billion in 2017-2018. Key sectors include IT, automotive, and especially pharma. Germany is one of the main buyers of Indian generics in the EU. Due to the outbreak of the COVID-19 pandemic, India has restricted the export of essential drugs in early March 2020, leading to supply chain disruptions which might also affect Germany in the long-term.

Given the close economic ties and the current supply chain disruptions which might lead to disputes, it has become crucial for a lot of German companies to closely follow the further developments in India and to carefully evaluate the effect of the COVID-19 pandemic on their supply contracts with Indian companies.

The *status quo*: Lockdown and export restrictions

The Government of India imposed a nationwide lockdown on 24 March 2020 under the Disaster Management Act of 2005, in an attempt to curb the spread of COVID-19. The lockdown was initially announced for a period of 21 days, i.e. till 14 April 2020, but was eventually extended till 31 May 2020. The national lockdown imposed a shutdown of all commercial activities except for operations that were described as "essential services" by the government. Outside the severely affected regions, the government has now planned a phased re-opening of the country and issued guidelines on how different sectors of the economy would restart functioning from 8 June 2020.

To cope with the pandemic, the Government had also imposed export restrictions on certain pharmaceutical products. India being the main supplier of generic drugs in the world, is heavily reliant on supplies of raw materials from China. Due to the shutdown of Chinese factories and the resulting non-deliveries, India had rushed to ensure sufficient quantities for its own market. On 6 March 2020, the Government imposed export restrictions for 26 essential drugs and drug ingredients. In April, however, the export ban was partially lifted and the export of "appropriate quantities" of 24 of the previous restricted drugs, including the drug hydroxychloroquine, to certain countries heavily affected by the Coronavirus was allowed again. Paracetamol, a common pain reliever, and its formulations were left out of this lift of restrictions.

Functioning of Indian courts

The judiciary has also restricted its functioning to only urgent matters. At the same time, the courts in India have taken a number of proactive steps to minimise the impact of the lockdown on the litigants:

- The Supreme Court of India, in exercise of its powers to do complete justice provided under Article 142 of the Constitution of India, has extended the limitation period for filing suits or petitions or any other applications before all courts and tribunals across the country with effect from 15 March 2020 till further orders.
- Several state High Courts have also extended the term of all orders that grant interim relief that are likely to expire during the period of lockdown until after it is lifted.
- The Supreme Court has passed directions with respect to conduct of court proceedings through use of video conferencing technologies and issued elaborated guidelines on the Standard Operating Procedure for e-filing. Pursuant to these directions the state High Courts all over India have followed suit and issued directions with respect to conduct of hearings during the lockdown in the respective courts as well as the district courts in the state. As regards the videoconferencing software, for example Vidyo and Cisco Webex are used by the courts.

Currently, only urgent cases are being heard by very few available judges via videoconferencing. Urgency is determined based on an application filed a day before by the petitioner explaining the need for an immediate hearing on a case by case basis. A relevant factor in this decision would be whether monetary relief could compensate for ensuing delay. If the courts are of the opinion that an application for an urgent hearing is obviously not in need of any emergency relief and the petitioner has flagrantly misused the process, then costs may be imposed on the petitioner.

COVID-19 and legal recourses for non-performance under Indian law

The lockdown imposed by the Government of India has brought a number of businesses to a standstill and led to disruptions of several supply chains, especially in the pharmaceutical industry where the government has imposed strict export restrictions on a number of essential drugs. A natural consequence will be the non-performance of several commercial contracts, delivery delays, price increases, etc. In the face of liability claims for such non-performance and delivery delays brought before arbitral tribunals or courts, parties have a possibility of using the defences of force majeure and frustration of contract. These two doctrines are generally used by parties to shield themselves from unwarranted consequences of circumstances that are out of control of the parties. Hence, in the wake of the current pandemic, their scope of application becomes rather significant.

The following sections briefly discuss the position of the doctrines of force majeure and frustration of contract under Indian law and the Indian courts take on them.

Force Majeure

The doctrine of force majeure allows for parties to suspend performance of their obligations due to impossibility in case of any untoward event or change in circumstance which could not have been conceived by the parties when they entered into agreement.

Commercial contracts with Indian parties often include force majeure clauses. With respect to invocation of force majeure, the specific contents of such a contractual clause and whether they

provide for specific examples of the difficult circumstances is key. In this regard, the Indian Ministry of Finance have issued a memoranda clarifying that with respect to government procurement contracts, COVID-19 will be considered as a natural calamity as provided under the force majeure clause in the Manual for Procurement of Goods, 2017. The Manual, however, only serves as generic guidelines for government ministries and departments and is not binding in nature.

The burden to prove that the circumstances of the force majeure claim are met will lie on the party making the claim. The Delhi High Court has recently clarified that financial distress caused due to COVID-19 is not sufficient to invoke the force majeure clause.

If a party decides to rely on the force majeure clause it must provide a timely notification for the same and inform the counter party of the exact impact of the pandemic on the party's ability to perform its contractual obligation. The clause cannot be invoked ex-post facto as a defence against contractual liability for non-performance.

Frustration of contract

Section 56 of the Indian Contract Act incorporates the common law concept of frustration of contract due to impossibility of performance which basically allows parties to escape performance by pleading impossibility due to a previously unforeseen event beyond their control.

However, the Delhi High Court has clarified that the relief of Section 56 is available to the parties only in the absence of a contractually stipulated force majeure clause. The judgement is demonstrative of the general approach of the courts to enforce the bargain struck by the parties. The same approach was also witnessed in a recent Bombay High Court order where the Court did not allow one of the parties to rely on COVID-19 to escape from meeting its payment obligations for the steel it had purchased from the Respondent.

In general, with respect to both the above discussed doctrines, it is evident that the parties cannot use the pandemic as an excuse to simply escape from their contractual obligations without establishing a concrete impact on their business.

Resolution of Indo-German disputes in the wake of COVID-19

The above mentioned doctrines do offer parties a way out of their legal and contractual obligations but a thorough legal analysis of the contractual terms is vital to be able to rely on them successfully. Therefore, companies that have concluded contracts with Indian businesses should carefully review their agreements in order to determine their respective rights and obligations, in particular:

- What kind of dispute resolution clause does the contract include, if any: An arbitration clause or a choice of court clause?
- Which law governs the contract?
- Does the contract include a force majeure clause? And if so, is COVID-19 arguably covered by it?

However, beyond these two doctrines, the COVID-19 crisis has created significant challenges for businesses and their contractual relationships. All supply relationships are currently under a high pressure. The consequences and burdens of the past weeks and months must be shared between the parties. Contracts should be adapted as soon as possible to the "new normal" and to a future

that is to a large extent very uncertain. In many cases, this will not only require a change of the prices or the quantities of supplied or purchased goods and services, but a comprehensive adjustment of the complete contractual relationship as such will become necessary.

In general, businesses are in need of quick solutions to resolve their conflicts. Already before the outbreak of the COVID-19 pandemic, there was a huge backlog of cases pending before Indian courts and sometimes, it takes a decade or even more to resolve a dispute by way of litigation in India. With the current situation in which the Indian courts are only operating under severe restrictions, it is to be expected that after the Corona crises, the backlog of pending cases and the duration of court proceedings will even increase.

If the respective contract does not include a dispute resolution clause, state courts will be the competent authorities to adjudge any dispute arising out of it. In light of the above, it might be in the interest of the parties to modify their contracts in order to quickly adapt and find solutions to the problems caused by the current extraordinary situation. Therefore, parties are well advised to consider dispute resolution beyond the traditional court systems.

If the problems cannot be solved by negotiation, the use of other alternative dispute resolution (ADR) procedures such as arbitration or mediation can be useful:

- **Arbitration:** If the parties are interested in a quick yet binding solution, they might wish to agree on arbitration.
- **Mediation:** Because of the uncertainties caused by COVID-19 and ambiguity as to the parties' positions on certain issues, a neutral facilitator (mediator) may help to determine the areas where parties may compromise. Such an approach often allows the parties to find a quick and commercially reasonable solution without engaging in a lengthy and costly proceeding, and to preserve their business relationship.

If the parties renegotiate their existing contracts or conclude new contracts, the above ADR mechanisms and the inclusion of appropriate clauses should be considered. An agreement on such mechanisms is possible at any time – after the underlying contract has been concluded, after the dispute has arisen, and even after legal proceedings have been instituted. If proceedings pending before a court cannot be brought to a speedy conclusion, consideration may be given to transferring the proceedings to arbitration.

Conclusion

India, like the rest of the world, is navigating the current situation one step at a time. The country is now trying to open its economy slowly but the rising numbers of COVID-19 infections still pose a huge threat. While the executive and the judiciary have taken active steps to temper the negative effects of the pandemic and the lockdown imposed to curb it, there is no doubt that several businesses are in for a rocky road ahead. In such circumstances, liabilities arising out of commercial contracts can decide the fate of numerous businesses.

Companies that have concluded contracts with Indian businesses should carefully review their agreements in order to determine their respective rights and obligations and to find the right approach to settle any current or future disputes.

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