

Impact Of Covid-19 On Construction Sector Considering Force Majeure Under the Contract



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INTRODUCTION

CONSTRUCTION INDUSTRY : FAMOUSLY KNOWN AS "OPEN AIR INDUSTRY"

Construction Industry is dependent more on external factors beyond the control of management / documented contracts and is driven by inputs that tend to vary on practically on daily basis unlike other Industry sectors which run like a fixed assembly line with predefined inputs that have full control with the management with minimal or no external interference therefore this Industry is famously labeled as an open air industry.

SOCIAL IMPACT OF COVID-19 ON THE CONSTRUCTION INDUSTRY

An unprecedented situation because of "Covid-19 / CORONA Virus", which being more serious than an Epidemic has taken the form of a PANDEMIC at a global level therefore causing a major disruption in the Arbitration matters as of March 2020. The Pandemic has warranted Emergency steps by Central Government to declare a LOCK-DOWN at a National level till April 14th 2020 which now stands extended up to May 3rd 2020 at-least to contain the Pandemic from further outspread and consequentially arrest any further economic meltdown.

In an effort to arrest the Pandemic, by way of 'flattening the curve' of the number of infected cases, from causing damaging concerns in India, our honorable Prime Minister has on **23rd March, 2020** announced a nationwide LOCKDOWN.

The Pandemic has resulted in a risk of a financial meltdown even in countries with low number of infected cases.

All major services like the Railways, Flights, Hotel, Sports Events and Restaurants etc have all been cancelled while imposing Section 144 CrPC so as to promote social distancing and break the chain of the VIRUS spread. Further even the schools, colleges, offices and business houses have been shut and only essential services and goods are in circulation. Millions of staffers, daily wagers cum laborers are forced to go without their daily earnings and therefore spend their lives in anguish till such time the crisis is over.

Construction Industry is the backbone of any economy engaging over 70% of the daily wagers / laborer's at a national level which now stands most vulnerable to external forces like Force Majeure being one of them presently.

Due to the nationwide Lockdown, many vendors would not be able to fulfill their contractual obligations or may be delayed. The companies might not be able to honor their contractual promises.

Under such scenarios, each party to the contract would try to find out a way to save themselves **HARMLESS OF THE CONSEQUENTIAL LOSSES** and from legal implications / actions thereof.

It is important to know that under the mitigation of **damages doctrine**, a person who has suffered an injury or loss should take reasonable action, where possible, to avoid additional injury or loss. The failure of a Plaintiff to take protective steps after suffering an injury or loss can reduce the amount of the Plaintiff's recovery.

AREAS OF CONCERN FOR THE INDUSTRY

It is of utmost importance that the Clients or Arbitrator may look at the present situation beyond just the contractual terms rather than within the contractual terms. Following are the areas of concern for the Industry :

1. As you are aware the Pandemic / Epidemic stricken emergency situation declared by the government of India at national level has caused a major setback to the construction sector affecting all of the following :

- a. Entire Work force
 - b. Material Supply Chain
 - c. Utilization & Regular Maintenance of the Tools, Plant & Equipments at sites
 - d. Payment of wages while no work happening, more so on the statutory liability being incurred without work (*basis govt directive*).
2. It is an admitted fact that the government has ordered all to pay full wages & salaries to the entire work force during the declared lockdown even though they have not been deployed at work.
 3. Owing to government announcing a complete lockdown & none in India having ever experienced such a situation like this in last over 100 years apparently caused a panic in the labour force at all India level and therefore causing the labour force to return to their villages even resorting to by way of walking back to the village as all transport was shut.
 4. It is placed on record and informed to you that under the present circumstances and situation of national crisis once the same is normalized from the effects of COVID-19, it may take 1 or 2 months (depending *on the native place of the labour*) to remobilize the labour force causing not only an extra unprecedented expense but also extra time.
 5. Entire supply chains of construction materials like sand, aggregate, bricks etc have been completely disrupted. It is to place on record that it may take 1-2 months at least to reach normalcy of material supply after normalcy is restored from the effects of COVID-19 disruption at a national level. Increase in costs of construction materials resulting from the present force majeure, is imminent which the companies or individuals may be considering for reimbursement.
 6. Government order of complete lockdown has left the consumable materials unutilized which might be rendered unusable upon opening of the project and therefore causing requirement of remobilization of the same materials at an extra cost & time. The details of the same can be informed only upon re-opening of the site.

7. Government order of complete lockdown has left our tools, plant & equipment unserviceable which might be rendered unusable upon opening of the project and therefore causing requirement of complete service of the T&P / equipments at an extra cost & time.
8. Further as soon as normalcy is restored from COVID-19 the monsoon rains shall set in from June-September 2020 resulting into further set back of 2/3 months. This will further add financial burden and idle costs of our work force, T&P, equipment and machinery etc.
9. All of the above times will add to the Force Majeure and additional costs.
10. 'Force Majeure' might be the only rescue method available to the industry / contracts affected by COVID-19 unless the government comes to rescue. Under the present circumstances the company that invokes the force majeure clause timely and in a proper manner may be able to salvage itself from catastrophic losses and consequential contractual fallouts.
11. **Further, it would be best suitable to explore and invoke clauses like that of escalation, price adjustment, damages and such so as to avoid the suffocation of the amount involved in commercial contracts and get the amount in circulation.**

FORCE MAJEURE – ITS MEANING & IMPLICATION ON THE SECTOR

WHAT IS FORCE MAJEURE? Certain events, beyond the control of the parties, may inhibit the parties from fulfilling their duties and obligations under the project agreements. To avoid the resultant breach of contract, parties may prefer to excuse contractual obligations to the extent that they have been so inhibited.

Different legal systems have developed different theories in response to this need, including the doctrines of impossibility and frustration in England and the United States and force majeure in France. Under French law force majeure is an event that is unforeseeable, unavoidable and external that makes execution impossible.

In order to avoid the uncertainties and delays involved in relying on the applicable law, parties to contracts often prefer to provide for a specific regime for force majeure, along with a definition of which events shall qualify for special treatment. Generally, force majeure means what the contract says it means.

Are force majeure clauses standardized? - NO

Force majeure is often treated as a standard clause that cannot be changed. However, as the clause excuses a party from carrying out its obligations, it needs to be carefully thought through and tailored for the project in question.

Force Majeure Can Be Classified Into Two Categories

1. **Natural Events** : These may include earthquakes, floods, fire, plague, Acts of God (as defined in the contract or in applicable law) and other natural disasters **These are events which are not within the control of the Government**. The parties will need to look at the availability and cost of insurance, the likelihood of the occurrence of such events and any mitigation measures which can be undertaken. For example, although the grantor will be best placed to appreciate the ramifications of common natural disasters, the contractor should be able to obtain insurance for the majority of this risk or otherwise mitigate the occurrence of the risk.
2. **Political and Special Events** : These may include terrorism, riots or civil disturbances; war, whether declared or not; strikes (usually excluding strikes which are specific to the site or the project company or any of its subcontractors), change of law or regulation (this is often dealt with separately from Force Majeure), nuclear or chemical contamination, pressure waves from devices travelling at supersonic speeds, failure of public infrastructure.

It May Be Appropriate For Us To Understand The Following:

1. **Compensation Events** (where authority takes responsibility and contractor is compensated),
2. **Relief Events** (which relieve the contractor from termination for failure to perform but not of the financial effects of delays) and

3. **Force Majeure Events** (which relieve the affected party from liability for breach and where the parties share the financial effects of delays)

While force majeure has neither been defined nor specifically dealt with, in Indian statutes, some reference can be found in Section 32 of the Indian Contract Act, 1872 which envisages that Enforcement of contracts contingent on an event happening

- 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 Requirements Of Force Majeure Are:

- a) It must proceed from a cause not brought about by the defaulting party's default;
- b) The cause must be inevitable and unforeseeable; and
- c) The cause must make execution of the contract wholly impossible.

Important aspects to observe :

1. **No Liability.** Neither party will be liable for performance delays nor for non-performance due to causes beyond its reasonable control, except for payment obligations.
2. **Best Efforts to Cure.** In the event of a threatened default or default as a result of any cause beyond its reasonable control, the defaulting party shall nonetheless exercise its best efforts to avoid and cure such default.
3. **Right to Terminate.** In the event such an event prevents performance there under for a period in excess of ninety (90) days, then the non-defaulting party may elect to terminate this Agreement and/or cancel or suspend any Purchase Orders there under by a written notice to the defaulting party.

Termination for extended force majeure : Should there be termination in case of extended force majeure events? Should a maximum period be identified during which the effects of one single event or an aggregate duration of force majeure events over the period of the concession may last before one or both of the parties can act to either remove itself from the project or obtain compensation for damages

incurred. **Nota Bene (NB)** – watch out for wording which talks about continuation of the force majeure event for a period – what is important is the duration of the inhibiting effects of force majeure. The theory is that **parties will have insurance** and other resources to tide them over for some period of force majeure, but eventually they should be entitled to terminate. Often if both parties agree to continue with the project despite continuing force majeure, the project company's compensation during force majeure may increase accordingly to create an incentive to remain.

The present widespread of corona-virus falls within the ambit of Natural Events Force Majeure Events and the COVID-19 could make performance of the contractual obligations to be more difficult.

NOTICE OF AN EVENT OF FORCE MAJEURE :

If a Party wishes to claim protection in respect of an Event of Force Majeure, it shall, subject to clause, as soon as possible following the occurrence or date of commencement of such Event of Force Majeure, notify the other Party of the nature and expected duration of such Event of Force Majeure and shall thereafter keep the other Party informed until such time as it is able to perform its obligations. The Parties shall use their reasonable endeavors' to:

- (i) Overcome the effects of the Event of Force Majeure;
- (ii) Mitigate the effect of any delay occasioned by any Event of Force Majeure, including by recourse to alternative mutually acceptable (which acceptance shall not be unreasonably withheld by either Party) sources of services, equipment and materials; and
- (iii) Ensure resumption of normal performance of this Agreement as soon as reasonably practicable and shall perform their obligations to the maximum extent practicable, provided that neither Party shall be obliged to settle any strike, lock out, work stoppage, labour dispute or such other industrial action by its employees.

CLAUSE AVAILABALE

If the Clause of force majeure is available in the contract, any of the party to the contract can invoke the said clause as per the procedure agreed between the parties. The party claiming force majeure is usually under a duty to show that it has taken all reasonable endeavors to avoid or mitigate the event and its effects. This will be interpreted on a case-to-case basis. A party claiming force majeure is typically required to establish that it was the force majeure event that caused the party to be unable to fulfill its contractual obligations. Force majeure clauses commonly provide for a prompt and time bound notice requirement, which can operate as a contractual condition precedent to relief or not. Such provisions are generally enforceable, and so complying fully with all notice requirements will be important for parties seeking to invoke force majeure.

There are two possible instances, which may suggest that a force majeure clause covers a pandemic :

- if the contractual definition of a force majeure event expressly includes a pandemic; or
- if the force majeure clause covers extraordinary events or circumstances beyond the reasonable control of the parties.

Therefore, if it is determined that the factual circumstances caused by the pandemic are beyond reasonable control of the affected party it will be covered under the said clause. Hence, treatment of COVID-19 under Force Majeure clause will depend on each particular contract and the language of the clause mentioned in those contracts.

CLAUSE NOT AVAILABALE

If the contract does not include a force majeure clause, the affected party could claim relief under 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 established that the performance of the contractual obligations has become impossible by reason of some event which the claiming party could not prevent and that the impossibility is not self-induced by the claiming party or due to his negligence. Under the doctrine of

frustration, impossibility of a party to perform its obligations under a contract is linked to occurrence of an event/circumstance subsequent to the execution of a contract and which was not contemplated at the time of execution of the contract. However, in case of a force majeure, parties typically identify, prior to the execution of a contract, an exhaustive list of events, which would attract the applicability of the force majeure clause.

It can be stated that there is also a risk involved on the party who intends to invoke the force majeure clause in the contract. If a party declares force majeure but is not contractually entitled to do so, it may expose itself to a claim for repudiatory breach of contract and the other party may be entitled to claim damages as a consequence.

It is important to note that **doctrine of frustration**, though similar in effect to the doctrine of force majeure, is more restrictive. Courts will generally not allow a party to use the doctrine of frustration as a tool to escape a bad bargain. The doctrine of frustration will also not relieve a party from performing a contractual obligation, simply because the event complained of, has made the performance more difficult or expensive. Economic hardship is not a ground for invoking the doctrine of frustration.

Further, in cases where a contract does not have an explicit clause on force majeure, there could be circumstances where parties may try to seek shelter under Section 56 of the Contract Act and seek frustration of a contract, however, in those cases the Indian courts will then have to ascertain whether the contract has become impossible to perform and whether the doctrine of frustration of contract could be made applicable to such a contract.

It will be interesting to see the stand which the insurance companies will take vis-a-vis **insurance policies** taken by companies to cover loss arising due to certain unforeseen circumstances in their businesses, and whether COVID-19 will be covered under these policies.

GOVERNMENT CONSIDERATION & DIRECTION

The Procurement Policy Division of Department of Expenditure, Government of India has issued an Office Memorandum dated 19.02.2020 wherein the MOF has clarified the doubt raised by the captains of the industry in regards to the **Manual for Procurement of**

Goods, 2017', wherein the Government has clarified that the disruption of the supply chains due to COVID-19 shall be considered as a case of natural calamity and (FMC) force majeure clause may be invoked following the due procedure.

However, due & timely application of mind is a must for any company or an individual to apply the above mentioned Office Memorandum and that the same cannot be made applicable for every contract as the clause needs to be interpreted based on different circumstances

PROTECTION OF FORCE MAJEURE CLAUSE

A force majeure clause cannot be implied under Indian law. It must be expressly provided under the contract and protection afforded will depend on the language of the clause. In the event of a dispute as to the scope of the clause, the courts are likely to apply the usual principles of contractual interpretation.

CONCLUSION

Since, it depends on what has been stated and incorporated in the clause of force majeure in the contract; it becomes utmost necessary at this point of time of pandemic situation to analyze the key contracts and the clauses inculcated therein.

Further, it would be best suitable to explore and invoke clauses like that of escalation, price adjustment, damages and such so as to avoid the suffocation of the amount involved in commercial contracts and get the amount in circulation.

It is crucial that businesses and consumers are aware of their rights under the contracts they have entered into, under the common law and under statute so that they are prepared when confronted with an inability to perform their contractual obligations as a result of COVID-19. It is always advisable to seek the advice of an EXPERT in such circumstances.

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NOTE : Views are personal. (The author is practicing Technical Arbitration Expert cum Consultant).