KHAITAN & CO
Advocates since 1911

UPDATE

ERGO

Analysing developments impacting business

COVID- 19: KEY CONSIDERATIONS FOR THE INDIAN INFRASTRUCTURE SECTOR

25 March 2020

COVID-19 has posed unprecedented challenges and in many cases business continuity plans are being put to test for the first time. The scenario is deteriorating in India with more than 560 positive cases being officially reported. The 'lockdown' has been extended to all districts in India till the 14th of April 2020. The restrictions on construction activities, decreased workforce and supply chain disruptions will have a cascading impact on contractual obligations relating to infrastructure projects. Complex contractual arrangements with (i) back-to-back contracts between numerous, unconnected parties, or (ii) multiple independent contracts between related parties as part of a composite transaction are typical of the infrastructure sector in India.

Proper planning and effective implementation of the key issues discussed below, will be a key differentiator. In order to plan and mitigate the challenges, affected parties need to carefully evaluate these considerations and plan accordingly.

(i) Force Majeure under the Contract: Certain contracts such as concession agreements entered with National Highways Authority of India specifically include an 'epidemic' as a force majeure event. Other contracts namely, power purchase agreements for renewable projects entered with Solar Energy Corporation of India Limited do not specifically include an 'epidemic' as a force majeure event.

It is worth noting that the Department of Expenditure, Ministry of Finance on 19 February 2020 has issued an office memorandum stating that COVID-19 should be considered as a 'natural calamity' and force majeure may be invoked wherever considered appropriate. The office memorandum issued by the Ministry of Finance is not applicable to all government contracts since force majeure clause in each contract is to be interpreted strictly by terms of the respective contract. However, in the event of any future dispute the office memorandum may be of persuasive value. Following the office memorandum of Ministry of Finance, on 20 March 2020, Ministry of New & Renewable Energy issued a similar office memorandum recognising supply chain disruption due to the COVID-19 outbreak as a force majeure event and directed all renewable energy implementing agencies to grant a suitable extension of time to project where the force majeure clause is invoked.

(ii) Relief under Applicable Law: In the event COVID-19 is not specified as a force majeure event or the contract itself does have an express force majeure clause, an affected party may claim relief on the grounds of frustration / impossibility (to perform an obligation or execute work) under Section 56 of the Indian Contract Act ,1872. In *Energy Watchdog* v. *Central Electricity Regulatory Commission,* the Supreme Court while interpreting Section 56 of the Contract Act emphasised that the threshold of 'impossibility' does not refer to physical or literal impassivity but to what is 'impracticable' and 'useless' from the point of view of the object and purpose of the parties.

(iii) Procedural requirements for claiming Relief on account of Force Majeure and Duty to Mitigate: An affected party must ensure procedural compliance as most force majeure clauses provide a notice requirement as a condition precedent for claiming relief. Such contractual notification requirements are usually time bound, failing which parties may be barred from claiming relief.

Typically, the force majeure provisions require an affected party to show that it has taken all reasonable efforts to avoid or mitigate the event and its effects. For instance, a project developer is generally required to prove that it had sought alternate sources of supplies in case its supply chain is disrupted. Similarly, project owners must reduce the variable costs associated with the projects. For example, if it is expected that construction work would be hampered for a long period, it may be commercially beneficial to ask contractors to demobilise construction equipment. In such event, only one time additional charges for mobilisation of equipment may be required to be paid but would avoid payment by the project owners for rental costs associated with such equipment.

(iv) Suspension, Extension of Time, Cost Escalation and Damages: The affected party needs to closely evaluate and plan for suspension of work including payment of mobilisation / demobilisation costs and the impact due to extended force majeure resulting in termination of the contract. The suspension of the contract or extension of time may not result in mitigation of additional prolongation costs or additional compensation. As large infrastructure contracts have various stakeholders, it is important for a developer to ensure that subcontracts have adequate back to back arrangements to mitigate the risks. If required, parallel discussions with an employer may be initiated for clear future course of action.

(v) Change in Law: As discussed in the preceding paragraphs and as part of social distancing measures, most states in India have issued regulations invoking the Epidemic Diseases Act, 1897 severely restricting commercial activities and movement of public. The resulting disruption in workforce and materials may be interpreted as a change in law event if the contract provides for a change in law provision. The relief for change in law can extend to price adjustment or extension of time period for completion of obligations or both.

(vi) Insurance: It will also be relevant to carefully examine the insurance policies to see if certain losses can be mitigated pursuant to such policies. This will help in formulating the overall strategy and course of action.

(vii) Financing Arrangements: Pursuant to the standard financing documents, a force majeure event may not exclude debt servicing obligations and a borrower is expected to service the debt under the relevant financing documents. Developers of leveraged projects must report the effects of the pandemic to the lenders and initiate discussions for rescheduling of repayment instalments and waiver for any breach of covenants or financial ratios due to the pandemic.

- *Dibyanshu (Partner), Prateek Bhandari (Principal Associate) and Sathyajith Nair (Associate)*

For any queries please contact: editors@khaitanco.com

We have updated our Privacy Policy, which provides details of how we process your personal data and apply security measures. We will continue to communicate with you based on the information available with us. You may choose to unsubscribe from our communications at any time by clicking here.

Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com