COVID19 – RISKS AND CONTRACTUAL RELIEFS FOR INFRASTRUCTURE PROJECTS

A sense of anxiety looms as the lethal novel coronavirus (**COVID-19**), termed as a 'pandemic' by the World Health Organization, spreads across the world. Apart from the devastating effects on health and safety of people, fears of the impact to livelihoods and the global economy also prevail, adding to the unease. While Governments across the world announce stimuli packages and tax breaks to alleviate hardships caused by COVID-19, businesses in all sectors are studying its impact and taking mitigation steps accordingly.

The infrastructure sector is inextricably linked to the health of an economy. Indeed, big bang reforms announced for this sector in this year's budget have underpinned this sector as an important lever to generate growth and employment. Regrettably, the effects of COVID-19 will have a significant impact on the infrastructure sector, regardless of their stage of completion.

This article lays out important legal considerations and risks which businesses in this sector need to be mindful of.

Revisiting contracts

The exigencies of the present situation have resulted in contracting parties across the globe revisiting their contractual arrangements and assessing the enforceability of their obligations and contractual addressal of risks. Most parties are clamoring to know whether COVID-19 qualifies as a "force majeure" event (**FME**).

FMEs include events beyond the control of parties causing inability to perform contractual obligations. A causal link to the inability to perform would need to be established to claim relief under an FME provision. Noticeably, typically infrastructure agreements specifically include "epidemic" or "plague" as a FME, leading to a suspension of performance obligations and in some cases, hastening contract termination. Even where epidemics are not specifically included in the list of FMEs, language including generic terms such as 'events beyond reasonable control of parties', 'Act of God' and 'natural calamities', could arguably stretch to include the effects of COVID-19.

Such a stand can find support from the Office Memorandum issued by the Ministry of Finance (**MoF**) on February 19, 2020. The MoF acknowledged that disruption of supply chains by reason of COVID19 can be covered in force majeure clauses as a 'natural calamity' and that the clause may be invoked 'wherever considered appropriate' .Pursuant to the MoF's memorandum, a similar office memorandum was issued by the Ministry of Renewable Energy on March 20, 2020 for grant relief in renewable projects renewable energy implementing agencies.

Provisions relating to 'change in law' may also be adverted to, in light of various government advisories in relation to safety standards, labour and facility closures pursuant to COVID-19. Such provisions permit the developer to seek monetary recompense or other contractual relief in the event of a change in law that has a significant impact on the commercial considerations of a party. Even where no claim for an FME would lie, the impact of a change in law could be shared with the authority, thereby de-risking the developer.

FME versus Frustration?

A FME is a contractual right which defers performance until a stipulated time and does not absolutely excuse parties from performing their obligations. Frustration of a contract is a statutory right envisaged under the Indian Contract Act, 1872, which, as originally formulated, results in termination when the performance of the contract is rendered impossible or unlawful for reasons beyond the control of the promisor. The doctrine has been expanded by the Supreme Court in the matter of *Energy Watchdog v Central Electricity Regulatory Commission and Anr. (2017) 14 SCC 80*, wherein impractability of a contract has also been recognized as a ground for frustration. Where an FME is not specifically covered under a contract, frustration may be claimed by the affected party. However, where an event is covered by an FME, frustration cannot be claimed. Therefore, the two operate independently, even though the rights may arise due to the same or similar events.

FME provisions permit suspension of obligations and extension of time corresponding to delays caused by the relevant FME. In infrastructure contracts, depending on the kind of FME, sharing of costs between the developer and authority is also provided for (although usually indirect costs and losses are not accounted for).

FME provisions often permit the termination of the agreement in case of persistence of FMEs beyond a particular time. Infrastructure contracts provide for termination payments to developers. Such provisions would need careful consideration to determine whether the developer can recoup its investments and honor its obligations to its contractors and financiers. In contrast, termination on frustration would not entitle the recovery of any amounts.

Supply chain risks

The truth remains that despite the glimmer of hope afforded to contractors by FME clauses in some agreements, the liability for delayed performance of contractual obligations, cost overruns, disruption in revenues and unmanageable repayment obligations repeatedly haunts most developers and contractors. With the current conditions on account of COVID-19, global including movement restrictions, production bans, increased costs due to sourcing of components from alternate locations, labor shortages, and lockdowns are leading to critical delays in commissioning of projects. The Central, State and local Governments are urging businesses to not retrench or terminate employment or reduce wages during the outbreak. This is to extend to casual and temporary workers too. It is a Catch- 22 situation for infrastructure companies, which are inevitably facing delays and shortage of funds at one end and a compulsion to pay salaries and wages at the other. All these disruptions and added costs may not find addressal in the project contracts – one option for companies would be to look towards the silver lining of insurance.

Obligations under Financing Documents

Financing documents typically provide that obligations to make payments are not suspended on the occurrence of a force majeure. Financing agreements for project finance have certain nuances specific to infrastructure and are mainly secured by cash flows generated by the project. Accordingly, whether financing documents may stand frustrated (given that no relief for FME is contractually available) is worth considering.

Further, where the FME occurs during the construction period (where there is a moratorium on repayment under financing documents), concession agreements usually provide for extended timelines. Financing documents may not always account for corresponding revision of repayment schedules, thereby exposing the borrower to cash flow risks.

Contractual Pass Through of Obligations

Projects undertaken by private developers or contractors usually involve a chain of contracts, with several obligations being contracted to contractors, who in turn often execute subcontracts. The extent of subcontracting is based on the complexity of the contract requiring the integration of several specialized skillsets not found in a single contractor.

In project documentation, obligations flow down to the relevant contractors to enable the developer or main contractor to manage its risks. It is important for all contracts to be aligned so as to balance the risks between the various parties and to placing of obligations to parties that are best placed to manage the attendant risks. The corollary to this is that any reliefs enjoyed by the developer and main contractor flow down to contractors and subcontractors commensurate to the risk faced by them.

A FME is a prime example as to how it is necessary to ensure alignment between similar provisions across project documentation. Otherwise, it may result in either contractors and subcontractors not being entitled to relief, or no relief being available to the developer or main contractor under the concession agreement or main contract, as the case may be, while the contractor or subcontractors performance is excused. Further, the relief granted should be commensurate and should take into account the actual effect on the relevant contract and subcontractor and not be available as of course, merely by reason of grant of relief to the developer or main contractor.

Alternative measures? – Is there any mechanism to mitigate the contractual difficulties posed by COVID-19?

As a first, it is advisable to review the wording of force majeure clauses under existing contracts to address an unforeseen contingency such as COVID-19 as the success of claims before various adjudicatory forums would largely depend on the plain wording of the force majeure clause.

In cases where contracts are assigned to sub-contractors, work and purchase orders now being issued may need to address COVID-19 and similar contingencies and the losses they entail.

Some thought must also be given to adjusting tariffs under power purchase agreements with a view to account for additional costs occasioned by COVID-19 or other FMEs.

Insurance may also provide relief, depending on the kind of coverage obtained by developers. In particular, business interruption policies that cover disruptions to the operations of a business, could be pressed upon. Loss of revenues and incomes are also often covered under business interruption insurance. However, it is worthwhile to review any exclusions to ensure that epidemics and infections are not excluded, thereby disentitling the insured from recovery.

Besides revenue costs, upgradation of technologies and possible implementation of healthcare measures to protect workers should for instance, be factored in the determination and/or apportionment of force majeure costs.

Conclusion

With contractors and developers, including solar power developers risking missing their scheduled commercial operation dates and the performance of several ongoing projects in abeyance, disruptions in infrastructure projects are likely to be rampant. The pandemic undoubtedly beckons the onset of a recession in the economy, given that a large number of infrastructure projects hinge primarily on time and money. It is clear that the government will need to step in and implement measures to safeguard this sector.

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