# COVID-19 and Contractual Disputes in India: *A Law and Economics Perspective*

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**Abstract:** The Covid-19 pandemic has unleashed a catena of contractual disputes. Several companies and firms have cited Covid-19 as force majeure to suspend the promised supply of goods or services, triggering legal claims of compensation from the counterparties. Employers have refused the promised employment, borrowers have expressed their inability to service debt contracts, and insurance companies have denied compensation for business income losses. Even governments have been found wavering in honoring the very social contract that brings the State and Government into existence.

In this article, we synthesise the Indian Contract Act and relevant case laws to present a legal position on issues concerning *force majeure, frustration of contract* and contractual gaps. By drawing up the economic analysis of law, we examine contractual disputes from various sectors—including power-purchase agreements, construction and transportation contracts, rental contracts, and event management and hospitality contracts. We analyse these disputes from a legal and economic-efficiency point of view. We categorise contractual disputes where the use of force majeure or frustration of contract is justified—from the cases where it is not. We have used economic analysis to draw the attention of courts and policymakers towards the economic implication of their decisions. Our analysis of the recent court orders on Covid-related-disputes suggests that in some cases, courts seem to under-appreciate the long-term economic consequences of their rulings. Finally, we argue that public policy, rather than judicial remedies, is better suited to address issues arising from disputes over long term contracts such as debt, employment and insurance contracts.

**Keywords:** Covid-19, force majeure, frustration of contract, act of god, act of government, contractual disputes, court orders, Indian Contract Act, public policy

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## 1. Introduction

Various considerations motivate people for entering into legal agreements. Employment contracts ensure supply of labour to the employer and income to the employee. Production contracts secure the future supply of goods and services. Debt contracts provide consumers with purchasing-power, and producers and traders with working-capital. Insurance contracts shift the burden of risk from the insured to the insurer. Indeed, contracts serve as bedrock for exchanges related to production, commerce, and trade.

However, the Covid-19 pandemic has unleashed a catena of contractual disputes. Lockdowns, widely adopted to contain the pandemic, have made it costly for many companies and enterprises to meet their contractual obligations. In various cases, they find it impossible to meet the terms of the contract. Borrowers are finding it difficult to service the debt; contractors cannot deliver projects on schedule; many employers have refused to provide the promised employment benefits; and suppliers have delayed the supply of goods or services—consequently triggering legal claims of compensation from the counter-parties.

In doing so, several parties have invoked Covid-19 as a force majeure (FM) event—*an occurrence that is beyond the control of the parties involved and renders contractual performance impossible.*[1]Most contracts contain an FM clause to catalogue events like war, riot, strike, etc., in which the parties would prefer to either terminate the agreement or put it on hold. 'Acts of God,' such as flood, cyclone, earthquake, hurricane, epidemic, etc., and 'Acts of government,' like a prohibitory lockdown to contain Covid-19, are some events listed under the FM clause. Mentioning such a clause in a contract effectively reduces the scope of any dispute between the parties involved in case of an FM event's occurrence. The problem is, more often than not, the clause contains ambiguous and catch-all phrases like, *'events including but not limited to the ones listed herein'*—which can be exploited by one of the parties involved in the agreement. Predictably enough, such contractual ambiguities are being exploited by many contracting parties during the pandemic. They are seeking termination or suspension of business deals by citing Covid-19 as either an FM event or the reason for invoking frustration of contract. Furthermore, ambivalent statements by government agencies regarding the pandemic have added to the bewilderment.

Recent orders of the Bombay and Delhi High Court (HC) suggest a tendency among contracting parties to use the crisis in a self-serving manner. OYO's decision to suspend payments to partner hotels citing commercial unprofitability due to loss of revenue; demands for rental waivers by retailers and other commercial-tenants due to the closure of shopping malls; various electricity distribution companies (DISCOMs) withholding monthly payments to power-producers citing reduced consumer demand, suggest that the FM clause is being invoked rather arbitrarily. Therefore, how courts and regulators adjudicate such contractual disputes will determine the distribution of losses among the disputants, and more importantly, the quantum of the economic cost of the pandemic.

In this article, we synthesise the Indian Contract Act, 1872 and relevant case laws to evolve the legal position on issues concerning *force majeure, frustration of contract* and contractual gaps. In the light of the synthesised contract law, we examine claims and counterclaims of parties in power-purchase agreements, construction contracts, air-transportation contracts, rental contracts, and event management and hospitality contracts, among many others. We identify the contexts in which contracting parties are using the pandemic disingenuously to extricate themselves from their contractual commitments. Besides, we analyse the merits of contractual-disputes triggered by Covid-19, from an economic efficiency point of view. The motivation behind the economic analysis is to

[1] For an interesting analysis of FM in the context of dispute between the Centre and the States over GST shortfall, see Pandey (2020a).

draw the attention of courts and policymakers towards the important economic implication of their decisions.

Additionally, we examine recent rulings by the Indian courts on FM and frustration of contract from an efficiency point of view. We find that some of the court orders seem to under-appreciate the long term economic consequences of Covid related disputes.

Finally, we examine debt contracts, employment, and insurance contracts. We argue that these long-term contracts are quite different from typical short-term, transactional contracts. We discuss why public-policy, rather than court interventions, is better suited to mitigate the economic-losses faced by the insureds, debtors, and employees.

The rest of the paper proceeds as follows. In Section 2, we undertake an economic analysis of the law related to force majeure and frustration of contract. In Section 3, we synthesise the Indian Contract Act, 1872 and relevant case laws, from an economic efficiency point of view, to establish the Indian legal position on force majeure and frustration of contract. In Section 4, we offer a sectoral analysis and discuss claims and counterclaims of parties in power-purchase agreements, construction contracts, air-transportation contracts, rental contracts, and event management and hospitality contracts. In Section 5, we discuss why public policy is better suited to address issues related to debt contracts, employment and insurance contracts. In doing so, we look at some international examples. Lastly, in Section 6, we offer our concluding remarks.

## 2. Force Majeure and Contracts

Legally enforceable contracts and are the foundation of the market economy and a means to enhance trade-related social surplus. As an illustrative example, consider a sales contract where a buyer values a good (X) at 150 (V), and the producer can manufacture X at a cost (C). They enter a contract where the producer promises to supply the goods, six months from now, at a unit price of 120. If C=100 and the promise is fulfilled, they each gain 30 and 20, respectively. This example captures the essence of most contracts—voluntary agreements lead to Pareto superior outcomes, thereby enhancing the social surplus from trade and commerce. Simply put, contracts create complementary pairs of demand and supply for the mutual benefit of contracting parties. A strong culture of enforcement of contracts strengthens incentives to conclude more contracts and fulfill needs that would otherwise remain unmet.

Generally, there is some uncertainty associated with the cost of production (C). So, C may be high or low depending on the economic situation at the time of production. Suppose, C can take values: 50, 80, 100, 130, or 200. From an efficiency point of view, the promise should be fulfilled so long as C < V. Efficiency demands that the supplier delivers the good even if the cost happens to be 130, and the contract price remains 120. This condition follows from a widely used criterion in law and economics, known as Kaldor-Hicks efficiency (Singh 2018).

Legally enforceable contracts provide credibility to surplus enhancing promises, of the types mentioned above. A party in breach of the contract terms must compensate the other side. Accordingly, contract of carriage provides for the refund of ticket amount in case the carrier cancels the flight, due to circumstances beyond its control. A buyer refusing supply of goods at a contractually agreed price must forgo the advance payment or pay a penalty to the promisor. In sum, contracts are useful instruments for minimising the risk of reneging on either side. On top of it, if contract is fair it leads to egalitarian outcome.[2]

[2] Generally, fairness is not guaranteed especially by the *standard form contracts* between unequal parties in terms of ability to negotiate terms of contracts, i.e., where one dominant side – typically government or big business - presents a take-it-or-leave-it type of somewhat one-sided contract to ordinary consumers of goods and services. However, as long as they are voluntary, even these contracts promote efficiency.

Anyway by creating opportunities of mutual benefit, contracts encourage productive investments. A power-producer after signing a power purchase agreement with a distribution company (DISCOM) can make a costly investment in plant-equipment and technology without fearing refusal of supply from the distributor. Similarly, after signing a construction contract, the contractor can invest in the material needed for construction.

However, contracts are not a panacea against all kinds of risks. In some situations, it is simply impossible for the promisor to fulfil the promise. For example, a Covid induced ban on domestic and international travel made it impossible for airline operators to run during the lockdowns. When performance becomes impossible, the social surplus discussed in earlier examples ceases to exist.

For such scenarios, most contracts contain an FM clause. It catalogues events—like war, earthquake, tsunami, riot, strike, etc., that render contractual performance impossible for reasons beyond the control of parties. *Acts of government* such as prohibitory-lockdowns to contain Covid-19 and *acts of God* like flood, cyclone, earthquake, hurricane, a named epidemic are among typical-events listed under an FM clause. If an FM event occurs, the parties prefer to either terminate the contract or put it on-hold. This reduces the scope of dispute between parties, should an FM event occur.

One approach of cataloguing FM events is by having an exhaustive definition for such events. In doing so, contracting parties list all categories of events—such as, tsunami, flood, terror attacks—that may drive contracting agents to exercise the clause. Such binding definitions restrict the relief available to parties to a particular set of events. Besides, it is time consuming and costly for contracting parties to discuss and document every conceivable event that may render performance impossible. Moreover, some events just cannot be foreseen at the time of contracting. As a result, real world contracts are *'incomplete'* about the description of FM events. Therefore, most such contracts contain a list of events, e.g., cyclone, earthquake, tsunami, and hurricane, that the involved contracting parties envisage as a covered event, but then insert a *catch-all phrase* like '*events including but not limited to the ones listed herein'*. This ensures that the definition does not preclude application of the provision to other similar events such as typhoons, tornadoes, volcanic eruptions etc.[3] Simultaneously, catch-all phrases make the contract ambiguous.

At times, an FM event can merely delay performance. An *'act of God',* say typhoons or catastrophic weather, can temporarily disrupt shipping routes and production of goods. An *'act of government'* can briefly call a halt to construction activities leading to time overrun for the project. Similarly, a ban on the movement of non-essentials items—as witnessed under Covid induced lockdowns—can make it impossible for the promisor to ensure timely supply of goods or services as promised. Sometimes, an act of God or government can leave the very purpose of the contract frustrated.

Plausibly, an FM event can also increase the cost of performance or reduce gains from a deal. Covid-19 and the attendant lockdowns have either increased the cost of contractual performance for some or have reduced contractual-profits for others. Thus, many contracting parties have sought to terminate or suspend deals by citing the pandemic as an FM event. As a result, there is a surge in contractual disputes citing Covid as FM or for invoking frustration of contract.

However, the effect of Covid and lockdowns varies across contracts within a sector and also across different sectors. Thus, a question that follows is: what general principle should courts follow to adjudicate contractual disputes?

*2.1 What does Economic Analysis tell us?*

[3] It is also common for parties to expressly exclude certain events from coverage.

Delayed or ambiguous rulings can aggravate the outbreak's economic cost by disrupting supply chains beyond the lockdown time period. By contrast, clear and consistent judgments are a public good. They discourage opportunistic-behaviour and encourage pre-trial negotiations, thereby avoiding unnecessary litigation that has huge attendant social costs and favours the relatively rich party.[4]

Economic analysis of law applied in the current context, offers the following three propositions:

*Proposition 1: Covid-19 and lockdowns should be treated as FM only if performance of contractual obligations has become impossible or has caused inevitable delay.*

The proposition suggests a clear and consistent criterion for dealing with FM related disputes. It implies, courts should allow waiver of performance, 'if and only if' contractual performance has become completely or temporarily impossible. Moreover, courts should apply the principle of '*ejusdem generis'* while interpreting ambiguous or catch-all terms in an FM clause—'*where general words follow an enumeration of particular things, those general words are construed of the nature or class as those specifically mentioned*'.[5]

Granting waivers where performance is possible, but has become costlier, will encourage opportunistic litigation, and may even be inefficient. For example, if due to Covid-19, cost (C) rises from 100 to 130, it will be inefficient to grant a waiver, as the cost is still less than the buyer's valuation V = 150. Where possibility of performance gets merely delayed, as in the case of construction contracts, the promisors should not be absolved from their obligations. They can be provided some extra-time for performing their respective contractual obligations.

As to the claim of compensation for economic losses caused by Covid-19 or the lockdowns, it is difficult for a court, a third-party, to correctly assess contractual disputes related to such economic losses. While on the one hand, the contracting parties will know whether C has gone up or if V has come down, the courts on the other hand would usually not. Profits and losses are salient to most business and commercial contracts. Hence, contracting parties are generally fully aware of the implications of various such events on their business or individual welfare. Generally, one party is in a better position to reduce the risk. In other cases, one of the contracting parties is more capable of bearing the risk.

Presumably, contracting parties know which party is in the best position to deal with a risk. It stands to reason that while negotiating terms of the contract, contracting parties will allocate risk to the party who can reduce or eliminate the risk at a lower cost. This minimises the cost of risks and maximises the surplus from contract. In other words, contracts are used by parties for efficient allocation of risk arising in the normal course of business. Moreover, the contract price factors in the allocation of the relevant risks between the parties. In contrast, it is very difficult for courts to identify the least-cost-risk-bearer of the loss as it does not possess the relevant economic information (Posner and Rosenfield 1977). Therefore, courts should avoid changing terms of the contract and by implication changing the risk allocation implicit in the contract. In reference to disputes related to the cost of the pandemic to the contracting parties, our law and economic analysis prescribes:

*Proposition 2: Courts should interpret the contract narrowly.*

[4] Refer (Singh 2004) on the effects of inconsistent rules and (Singh 2012) on how the relatively rich tend to get a better deal from litigation.
[5] For details refer *State v Eckhardt* (1910).

Narrow interpretation of contract means that courts should apply the *'Four Corners Rule'* and stick to the letter of contract for any interpretation (Posner 2004). Claims of compensation should be allowed only if the contract explicitly mentions events like epidemic and lockdown. When the contract is silent about a risk, courts can use clearly defined and articulated default rules to study the dispute brought forward in front of them (Cooter and Ulen 2012).[6]

A narrow interpretation of contracts along with a clearly defined default rule is efficient on the following counts: One, it reduces the possibility of error by courts in assigning risk to a party least suited to bear it. Two, it discourages litigation by encouraging the contracting parties to list relevant risk and allocating them to one of the parties. This will result in increased efficiency of the contract in terms of risk-allocation and reduced frequency of litigation. Besides, narrow interpretation of contracts helps secure the function of contract as a legally enforceable promise.

Sometimes, the courts change or modify the terms of the contract. Modification in contractual terms can be justified if the contract violates the law of the land or infringes upon rights of third parties or if public interest is at stake. However, economic analysis of contract law prescribes that courts must refrain from changing terms of the contract to redistribute gains and losses arising from a contractual relation or for the objective of perceived social welfare. Such issues are better addressed through public policy.

*Proposition 3. The issue of equity of burden or distress caused by economic losses should be addressed through public policy.*

Policy matters require a high degree of participation, consultation, and collaboration; consider the case of claims for Business Interruption Losses (BIL) caused by Covid. Pandemic-related economic losses tend to be highly correlated. If the courts allow BIL claims on grounds of perceived public interest, it may potentially bankrupt the insurance industry. In contrast, public policy is better suited to balance the interests of various participants such as the insurer, insured, and re-insurers, as opposed to matters of interest to one person or a small group of people.

## 3. The Indian Legal Position

### *3.1 Force Majeure*

The Indian Contract Act (ICA or the 'Act') does not define Force Majeure. However, the Supreme Court (SC) in various cases such as *Satyabrata Ghose v Mugneeram Bangur* (1954), *Energy Watchdog v CERC* (2017) and *NAFED v Alimenta* (2020) has held that when there exists an express or implied FM clause in a contract, it is governed *u/S 32* of the Act that deals with enforcement of contingent contracts.[7]

For Covid-19 or the lockdowns to qualify as an FM event will require a case-specific-evaluation: subject to facts, nature, and subject of the contract in question. Once the invoking party establishes that the occurring event was catalogued and rendered performance impossible, it can seek suspension or termination of the contract, subject to language of the provision.[8]For each case, the courts will have to individually assess: (i) whether the contract cannot be performed under any circumstance?; (ii) whether the impossibility of performance can be attributed to Covid-19 or the lockdowns; and

[6]A default rule is applied by courts to interpret a contract when it is silent on an issue under-dispute.
[7]One of the very first judgements on the concept of force majeure is Edmund Bendit And Anr. vs Edgar Raphael Prudhomme ( AIR 1925 Mad 626).
[8] For instance, in *Standard Retail Private Ltd. v G.S Global Corp.* (2020) the contract only allowed the seller to either terminate the contract or delay its performance for a reasonable time period.

(iii) whether appropriate steps were taken to avoid, overcome or mitigate the event and its consequences?

For instance, in *Halliburton Offshore v Vedanta Ltd.* (2020)the contract explicitly listed *'pandemic*' as an FM event. Accordingly, the Delhi HC accepted Covid-19 as an FM event according to terms of the contract, however, refused to excuse non-performance of contractual obligations by the plaintiff contractor (Halliburton) who had missed several deadlines much before the Covid outbreak.

Most real-world contracts are incomplete about cataloguing the list of FM events. Generally, Indian courts tend to use principles of *'ejusdem generis'* while interpreting catch-all provisions in an FM clause.

*3.2 Frustration of contract*

The ICA does not define the word 'frustration'. The SC in *Boothalinga Agencies v V. T. C. Poriaswami* (1969) has held that the doctrine comes within the purview of *Section 56* of the ICA (which provides that an agreement to do an impossible or illegal act, after the contract is made, is void).The doctrine provides relief to parties in the absence of an FM clause.[9] In *NAFED v Alimenta* (2020) the SC has held—"Section 32 of the Contract Act applies in case the agreement itself provides for contingencies upon happening of which contract cannot be carried out […] In case an act becomes impossible at a future date, and that exigency is not provided in the agreement […] the contract becomes void as provided in Section 56[…]".

Indian courts offer relief *u/S 56,* on grounds of subsequent impossibility, in cases wherein an ex-post event, that was beyond the control of parties, has destroyed the entire purpose or basis of contract. Mukherjee J. in *Satyabrata Ghose v Mugneeram Bangur* (1954) has explained that "[…] the word 'impossible' has not been used in the sense of physical or literal impossibility. The performance of an act may not be literally impossible, but it may be impracticable and useless from the point of view of the object and purpose which the parties had in view. Therefore, if an untoward event or change of circumstances totally upsets the very foundation upon which the parties rested their bargain, it can very well be said that the promisor finds it impossible to do the act which he promised to do […]."

In other words, to allow a claim of frustration, the courts test the extent to which the occurrence of an ex-post event has upset the foundation of the bargain that was agreed or contemplated at the time of contract formation.[10]

As to the interpretation of the contract, in the spirit of the *four corner rule* Section 92 of the Indian Evidence Act, 1872, says that oral evidence is not admissible to contradict or vary the terms of a contract. Finally, the ICA does not explicitly deal with the issue of economic unaffordability of a contract. However, in several notable judgments including *Alopi Parshad v Union of India* (1960)[11]and *Naihati Jute Mills v Hyaliram Jagannath* (1968)the SC has held that a contractual obligation becoming economically arduous is not a ground for absolving a party of its commitment.[12]

[9] However, relief under frustration is not available: (i) if frustration is self-induced; (ii) or about completed contracts of lease. See, *Raja Dhruv Dev v Harmohinder Singh* (1968) where the SC held: "Section 56 is not applicable where the rights and obligations of the parties have arisen under an agreement of lease". Also, see *Ramanand v Girish Soni* (2020).

[10]For greater details refer *Energy Watchdog v CERC* (2017).

[11] In this case the SC held that the promisor (supplier of ghee) could not wriggle out of his pre-war contract merely because World War II had increased his costs. It held that commercial difficulty did not amount to impossibility to perform.

[12] This is true in the internationally. E.g, see Tsakiroglou & Co Ltd v Noblee Thorl GmbH [1962] AC 93. The appellants/seller had agreed to ship groundnuts by sea to Hamburg. The seller argued that he could not ensure supply as after signing of the contract, the Suez Canal was closed to navigation due to the military operations by the Great Britain and France against Egypt. The contract had a force majeure clause. However, the court held that closing of Suez Canal did not make the delivery impossible. Appellant goods

## 4. Litigation over contractual disputes: Sectoral analysis

### *4.1 Power Purchase Agreements*

Citing Covid related reasons, DISCOMs have invoked FM under their power purchase agreements (PPAs) by suspending payments to power producers. Power-producers, on the other hand, have argued that the lockdown has not affected the distribution companies' ability to off-take electricity as power-generation and distribution was an essential service and faced no restrictions during the lockdowns.[13]

Covid-19 or lockdowns have not made performance of contractual obligations temporarily or completely impossible, therefore it cannot be treated as an FM event under requirements mentioned in Proposition 1. Moreover, as discussed, an agreement becoming commercially onerous or an instance of reduced demand do not qualify as FM or serve as a ground for termination of contract. The SC in *Energy Watchdog v CERC* (2017)has reinforced this view by observing that an increase in the cost of coal or the agreement becoming onerous to perform are not FM events.[14]

### *4.2 Construction Contracts*

The contract between home buyers and developers are governed by the Real Estate (Regulation and Development) Act (RERA), 2016. The RERA Act provides for a penalty for non-performance or delayed delivery of the apartment/building/plot. Due to the lockdowns, construction activities in real-estate projects came to a grinding halt. So, promoters have cited Covid for invoking FM u/S 6 of the Act and have filed an application for extension of registration to avoid liability for delay in giving possession (Section 18).

An FM claim by real-estate developers has merit because it directly halted the construction activity for real-estate projects. Therefore, the developers are justified in asking for the relief of extension and waiver of liability payments.

Moreover, even after the lockdowns are lifted or relaxed, the supply chain of construction material has remained broken in addition to shortage of labour. Hence, the delay in completing projects. Although theMinistry of Home Affairs (MHA) did allow construction work, it was subject to on-site worker availability with no workers to be brought from outside.[15] This obstructed the timely completion of work, and therefore qualifies as an FM event (satisfying requirements of Proposition 1). Therefore, the Finance Minister was spot-on in providing a six-month extension—on account of the lockdowns, an act of government—for all real-estate projects registered under the Real Estate Regulatory Authority.

However, the defence of lockdowns should not be allowed to justify pre-Covid delays. In *Halliburton Offshore Services Inc. v Vedanta Ltd.* (2020) the Delhi HC categorically stated— "[…] Every breach or non-performance cannot be justified or excused merely on the invocation of Covid-19 as a Force Majeure condition." It further added, "[…] a Force Majeure clause is to be interpreted narrowly and not broadly. Parties ought to be compelled to adhere to contractual terms and conditions and excusing

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could have shipped around the Cape of Good Hope, even though this route was almost twice as long and the freightage would have cost much more.

[13] See Annexure to the MHA order dated 24 March, 2020.

[14] The SC observed this while referring to *'exclusions to an FM clause'* in the PPA. Such exclusions to FM (e.g., agreement becoming commercially onerous) are present in most PPAs.

[15]See Ministry of Home Affairs order dated 1 May, 2020.

non-performance would be only in exceptional situations […]". Accordingly, the court denied relief to the contractor who had breached terms of the contract even before the lockdowns.

*4.3 Air-Transportation Contracts*

A booked air-ticket is a contract between the airline and the passenger. Government-mandated lockdowns placed a ban on domestic and international air travel. Citing FM, airline operators cancelled the tickets booked for travel during the period of ban. Instead of refunding the ticket amount—airlines have sought to convert them into credit shells usable only for buying future tickets from the same carrier even when Civil Aviation Requirements clearly provide for refunding of ticket amount to the customers. They have justified their actions on grounds of zero revenue and reduced global earnings. On the other hand, customers have filed claims for refund of the full amount for cancelled tickets, either booked in advance or during the lockdown. They have argued that offering credit shells instead of refunds are unjustly enriching the airlines.

The lockdowns made it impossible for the airlines to fly customers. So, the airlines are fully justified in cancelling the booking. However, restitution of the advanced payment goes hand-in-hand with termination of contract, that is, cancellation of the booked tickets.[16]Restitution prevents a party to a void contract from retaining received benefits. Airlines have violated this principle. Moreover, they have violated Civil Aviation Requirements which says that "*the option of holding the refund as a credit shell is the prerogative of the customer*." Furthermore, efficiency suggests that airlines are the least-cost-risk-bearer.

The Ministry of Civil Aviation (MoCA) ordered the airlines to provide a full refund for tickets booked during the first lockdown period. However, there was no relief for customers who booked tickets before the lockdown was announced on March 24, 2020. That is why, a petition was filed by *Pravasi Legal Cell* (see *Pravasi Legal Cell v Union of India* (2020)) seeking relief for the refund of air tickets, booked prior to the lockdown. While dealing with the issue, the SC has asked the airlines to try hard to refund the tickets booked by passengers before the lockdown within a period of 15 days. In case the airlines are unable to do so, they are required to create a credit shell that will remain valid until 31 March 2021.

4.4 Rental Contracts

Lease agreements or leave and license agreements, depending upon the case, serve as contracts between commercial tenants (such as: restaurants, retailers, multiplexes) and premise owners. In the aftermath of Covid-19, tenants have sought rental-waivers from premise owners, citing FM due to government-ordered closure of non-essential businesses.

Lease agreements ordinarily contain an FM clause. However, a virus outbreak or a pandemic are not among the typical elements of the FM clause. Unsurprisingly, the Delhi HC in *Ramanand v Girish Soni* (2020)has observed that claims for waiver of rent by the tenants are only permissible if FM clause expressly provides for it. In the absence of an FM clause, the relationship between parties is governed by u/S 108 (B)(e) of the Transfer of Property Act, 1882 which requires the property to be '*wholly destroyed or rendered permanently unfit for use'* for invoking a waiver. In *Raja Dhruv Dev v Harmohinder Singh* (1968), the SC interpreted the phrase *'substantially and permanently unfit'* and held that temporary non-use does not entitle a tenant to invoke this section.

[16] A similar logic applies to transportation contracts between Indian Railways and its passengers and freight customers, and road transport agencies and their customers.

Thus, there is no contractual relief available to the commercial tenants. The issue of equity of burden or distress caused by such economic losses should be addressed through public policy, as discussed in Proposition 3.

*4.5 Event Management and Hospitality Contracts*

Public gatherings were made illegal during the lockdown period. This sudden change in law was an FM event for the promising parties to event contracts—caterers and event managers, venue-owners, wedding planners, and vendors for decor & entertainment—who could not have provided the promised service. It was no surprise that the lockdowns resulted in cancellation of a substantial amount of pre-scheduled events, such as weddings.

Service providers have claimed FM, citing impossibility of contractually agreed performance. On the other hand, clients who had provided security deposit/initial booking amount to service providers filed claims for refund due to frustration of contract for those pre-scheduled events that were upended due to the government order.

Since an act of government made contractual performance by service providers impossible, it thus qualifies as an FM event (meeting requirements of Proposition 1). At the same time, from the side of the clients the contract is frustrated. The purpose for which the contract was entered into no more exists. For example, holding a private wedding after the government order was passed—destroys the older contract with the venue owner—which was entered to host a party.

Similarly, measures to contain Covid-19 have impacted the hospitality sector. For example, OYO has cited Covid-related reasons for claiming frustration of contract with partner-hotels signed under the *minimum-guarantee deal*—a model that guarantees revenue regardless of business generated. It claimed that in a post-Covid world, it was impossible to discharge contractual obligations under minimum guarantee.

Affected hotels have argued that OYO was in default of paying its minimum guarantee, since December 2018, [17] and was using the pandemic to brush away its contractual obligations.

For reasons cited earlier, OYO cannot renege on its contractual obligations on account of reduced profits due to Covid-19, unless the contract explicitly allows such a termination. If OYO has been in default since 2018, then it is using the pandemic disingenuously to extricate itself from its contractual commitments. Furthermore, OYO seems to be the superior risk bearer because: (i) terms of the minimum guarantee deal were framed by OYO (Hung et al 2018). Thus, it could have spread the risk of such pandemic-related business losses through insurance.

## 5. Contracts versus Public Policy

In most cases, one party contracts with one other party. In other instances, a legal person contracts with multiple parties For example, an insurance company offers a standard form insurance contract to many others; a commercial bank signs a standard contract with many debtor individuals or small firms. In such scenarios, the losses caused by FM tend to be highly correlated. That is, an FM event can simultaneously affect several contracting parties from one side of the contract. For this reason, standard insurance policies normally do not allow compensation for epidemics. On the other hand, an all risk/open-peril commercial insurance policy designed for epidemics asks for a higher premium.

[17] See *The Financial Express* 4 April, 2020 [Accessed 5 July, 2020].

The premium charged under an insurance policy is theoretically a function of risk covered, higher the risk covered, higher the premium. It is no surprise that such policies have found very few takers.[18]

Moreover, loan contracts, employment contracts, and insurance contracts are quite different from typical contracts. In such atypical cases, one party to a contract—such as banks, employers and insurance companies—have much deeper pockets compared to those of debtors, employees, and the insureds. It can be tempting for the courts to allocate the burden of Covid related loss to the side with a deeper pocket.[19]

In rest of this section, we consider these contractual issues one by one.

*5.1 Insurance Contract*

Mall owners, airline operators, wedding venue-owners have filed claims for BIL due to government-ordered closures, which they claim is an FM event. On the other hand, insurance companies argue that BIL can only be claimed for financial losses arising out of damage to business equipment or premises, unless the insurance is a comprehensive all-risk/open-peril policy—without the exclusion of pandemics.[20]

Most insurance policies require a physical loss to trigger coverage from perils such as fire, windstorm, burglary, and loss of income from machinery breakdown. Neither the lockdown nor the pandemic have caused actual physical damage to the property. For example, if a shopping mall closes operations to keep safe from contamination, such business closures do not amount to direct physical loss to the property.[21] Therefore, from a legal viewpoint, insurers are not liable for BIL. In this context, the '*rule of contra proferentem'*[22] cannot be helpful to the insured. The SC in *Sushilaben Indravadan Gandhi v The New India Assurance Company* (2020)has observed that the '*rule of contra proferentem'* is to be applied only if there is real ambiguity in the wording of the policy, which is not the case in the matter at hand. In fact, as far as accident insurance is concerned, the SC has tended to interpret insurance contracts strictly,[23] in the spirit of Proposition 2. From an economic efficiency point of view, a similar approach is incredibly important while dealing with insurance claims for correlated business losses.

*5.2 Debt Contracts*

A debt contract is a commercial arrangement between a lender and the borrower at a specified rate of interest. In the wake of Covid-19, many debtors have found themselves to be incapable of servicing their loan. In view of the severity of the crisis, the Reserve Bank of India (RBI) allowed a moratorium on equated monthly instalments (EMIs) for all term loans for six months.[24]

However, in *Gajendra Sharma v Union of India* (2020)and other connected petitions, several borrowers have filed a petition u/A 32 of the Constitution to declare the RBI notification ultra vires

[18]In 2018, an insurance product called Pathogen RX was offered by Marsh in collaboration with Munich Re and Metabiota to protect businesses in the U.S from an infectious-disease outbreak.[Accessed 3 June 2020]. Although, it was unable to sell a single policy for months, see *The New York Times*5 March 2020 [Accessed 14 June 2020].

[19] As such, employment contracts are governed by a number of labor laws limiting the negotiation space between the employer and employee and therefore the flexibility within employment contracts.

[20] Generally pandemics are excluded from coverage. One of the reasons being; during the SARS outbreak, insurers paid BIL worth $16 million to a hotel chain in Asia; see*The Washington Post* 2 April 2020 [Accessed 13 June, 2020].

[21]*Alanduraiappar Koil Chithakkadu v T.S.A. Hamid* (1962) the Madras HC

[22] A rule of interpretation where ambiguity in the wording of the policy/contract is to be resolved against the party who prepared it.

[23] In *Export Credit Guarantee Corporation of India Ltd. v M/S. Garg Sons International* (2014) the SC held: "It is a settled legal proposition that while construing the terms of a contract of insurance, the words used therein must be given paramount importance, and it is not open for the Court to add, delete or substitute any words."

[24] See RBI's Press releases dated 27 March, 2020 and 22 May, 2020.

to the extent that it charges *interest on the interest due on loan amount* during the moratorium period. In these petitions before the SC, a demand for waiver of interest for the period of moratorium has been made. The petitioners have claimed that charging of interest on loans is violative of the right to life and right to livelihood guaranteed u/A 21 of the Constitution since means of livelihood was curtailed due to the lockdown.

Technically, the moratorium does not prohibit servicing of the debt contract. Applying the proposition 2 here suggests that the courts should interpret debt contracts like any other contract and interpret them narrowly. As discussed earlier, the contract price depends on how the risks are allocated between the contracting parties. A bank will charge a higher interest rate if it needs to forgo the interest amount on larger counts of risks faced by the debtors. Therefore, allowing an interest waiver can be counterproductive. It will lead to increased interest rates for future debt contracts, thereby hurting the long-term interest of borrowers and investors. In addition, allowing the demand for an interest rate waiver can jeopardise the stability and financial health of banks, harm everyone in the process.

This is not to say that the predicament of many debtors of personal loans and small and mid-size enterprises (SMEs) is not genuine. However, larger public policy issues are involved here in balancing the interests of borrowers with those of bank depositors and investors, who can be even more numerous than the borrowers. Hence, the only way to help such entities is through additional fiscal support. In a welcome mover, the government has formally notified a scheme under which it will bear the cost of compound interest during the moratorium period for small loans and credit card dues up to Rs.2 crore. [25]

*5.3 Employment contracts*

The above logic also applies to employment contracts that are explicitly based on the principle of 'no-work-no-wage'.[26] Employment contracts ensure supply of labour to the employer and income to the employee. It is a voluntary exchange wherein wages and labour act as consideration for employees and employers, respectively. Due to government-ordered-lockdowns, such exchanges were either prohibited—in non-essential businesses—or limited—in essential businesses. In a notification, the MHA ordered employers to make payment of wages to workers in industries, commercial establishments, and shops without deductions for the lockdown period. [27] Subsequently, the government has withdrawn the order with effect from 18 May, 2020.[28] However, the initial order remains effective for an interim period of 50 days.

Employers have challenged the order in several petitions. In *Ficus Pax Private Ltd. v Union of India* (2020)employers have argued; the order i) interfered with the right of employers by forcing their establishments into insolvency, and even caused a loss of control of business; (ii) violated the principle of 'equal-work-equal-pay' and 'no-work-no-pay' as it did not distinguish between workers not working or workers working in permitted establishments during the lockdown; and (iii) was arbitrary, unreasonable and violative of Article 14, 19(1)(g) of the Constitution.

On strict application of contract law, the contention of employers has merit. Employers are not contractually bound to pay wages to their employees not at work—unless the contract entitled the

[25] Government has also decided that the small borrowers who did not avail the moratorium and paid their dues on time will also be given a cashback by the government to maintain parity between those who availed and did not avail the moratorium. See Pandey (2020b).
[26] For greater details, refer the definition of wages u/S 2(h), Industrial Disputes Act, 1947. Also, see Section 7(2) and Section 9 of the Payment of Wages Act, 1936 which authorises the employer to make deductions for absence from duty grounds. Also, see the SC's ruling in *Airport Authority of India v S.N. Das* (2008).
[27] See the MHA order dated 29 March, 2020.
[28] See the MHA order dated 17 May, 2020.

workers to wages. Moreover, the economic stimulus packages provided to medium scale industries had no explicit concessional component meant for bearing the burden of payment of wages.

Rather than being guided by a contractual perspective, it seems the SC is overly concerned about workers' interests. As an interim measure, the court has held that efforts must be made to sort out differences via negotiation and it has asked the Centre and States not to prosecute private establishments, factories for non-payment of wages. The court has further instructed that if parties are unable to settle the issue through negotiation, a request can be submitted to the concerned labour authority.

The stance of the Aurangabad bench of the Bombay HC is even more curious. In *Rashtriya Shramik Aghadi v State of Maharashtra* (2020)the petitioner—a contract labourers' union—has argued that members of the union were willing and able to work for the Temple Trust in the aftermath of Covid-19. However, due to closure of places of worship during the lockdown, they were unable to do so. The Aurangabad bench observed that the employer cannot use the principle of *'no-work-no-wage'*.

It held that "[...] this Court cannot turn a Nelson's eye to an extraordinary situation on account of the Corona virus/Covid-19 pandemic. Able bodied persons, who are willing and desirous to offer their services in deference to their deployment as contract labourers in the security and house-keeping sector of the Trust, are unable to work since the temples and places of worships in the entire nation have been closed for securing the containment of Covid-19 pandemic. Even the principal employer is unable to allot the work to such employees in such situation [...]"

That is, the court has accepted the fact that the inability of the Trust to employ workers was due to the act of government. Moreover, neither workers nor the court has argued whether the Trust was contractually bound to pay the wages. Still, the court ruled that "the principle of *"no work no wages"* cannot be made applicable in such extraordinary circumstances." It ordered that full wages be paid for the months of March, April and May2020.

Such rulings of the higher judiciary can create obligations for employers well beyond their contractual responsibilities. While big employers can absorb the cost of uncontracted wages, many small and medium employers do not have pockets deep enough to bear the costs imposed on them by such judicial findings. The latter are bound to resist paying wages during the lockdown. The result will be unnecessary litigation that small employers and workers can ill afford.

*5.4 Public Policy*

Lives and livelihoods should trump over financial interests of firms, banks and corporations. However, changing the terms of contract is not the way to go about it! The contractual disputes to reallocate Covid-related losses is a zero-sum game as both parties—debtors & banks, insureds & insurers—are hit hard by the crisis. Reallocating losses from the insured to insurance companies or shifting the burden of lost income from workers to employers or from borrowers to banks will momentarily help many needy people and firms, but will jeopardise their long term interests, as explained above. Importantly, it will reduce the certainty of contractual transactions, a pivot for business and economic activity.

Steering the economy through such large-scale economic losses caused by the pandemic require political, fiscal, and financial policy measures. Therefore, public policy is better suited to protect the welfare of millions of people affected by Covid or lockdowns. For instance, in the United States of America, the proposed Pandemic Risk Insurance Act, 2020 establishes a system of shared public and private compensation of BIL incurred during a pandemic or an outbreak of a communicable disease.

Compensation is paid by the government, if the aggregate-industry-insured-losses exceed the threshold amount fixed by the policy.

Another case in point is Singapore's Covid-19 Temporary Measures Act, 2020 that offers a temporary and targeted protection to individuals and businesses unable to perform contractual obligations due to Covid-19. Instead of absolving contractual obligations, the act suspends performance of obligations for an initial period of six months. This allows the affected parties to work out a solution without the threat of litigation. The rental-relief framework under the Act provides for a 'fair sharing of economic hardship between the Government, landlords and tenants'. This balances the interest of all participants: (i) it offers rental relief to eligible SMEs for two months through government assistance and additional relief for two months supported by property owners;(ii) simultaneously, the Government helps property owners facing cash-flow constraints through deferment of loan payments and waiver of property tax of up to 100%.[29]

Similarly, the Kingdom of Denmark has addressed the impact of Covid-19 through public policy. The Danish Parliament passed a law on salary compensation for companies affected by Covid-19.[30] It offers a temporary wage funding scheme that prevents Covid related layoffs in private companies.[31] Besides, the government has offered a temporary subsidy scheme to recover fixed costs expenses such as: rent, insurance, maintenance in the form of support packages to companies losing at least 35% of their turnover due to Covid-19.

Another good example of using public policy comes from the Republic of Germany. The Bundestag has passed the Covid-19 Mitigation Act to deal with consequences of Covid-19.[32] The new law offers comprehensive protection to companies affected by the pandemic and offers them an opportunity to overcome insolvency. At the same time, it protects lenders from clawback and lender's liability risk.

In contrast, India is yet to witness a Covid related legislation. However, to cushion the economic consequences of the pandemic the Covid-19 Regulatory Package of the RBI has offered a moratorium on EMIs for all term loans, until 31 August 2020 To an extent, the package has mitigated the effect of debt servicing due to the temporary disruption of cash flow. Similarly, the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020, has amended the IBC by restricting the filing of any application for corporate insolvency resolution process for a period of six months.

Such policy moves will surely help maintain the status of businesses affected by Covid and lockdowns without the threat of insolvency. However, it is can be more appropriate to provide banks withan added fiscal stimulus, rather than forcing banks to forgo interest payments and become unviable in the process.

Similarly, the workers who have lost their jobs should be compensated directly by the government through direct benefit transfers or through funds available under Employee State Insurance Corporation or, through economic stimulus packages.

The common and widely shared economic losses addressed through public policy enhance the social surplus and preserves the sanctity of contractual relations and associated benefits.

[29]See Additional Loan and Cash flow Support for Landlords and Businesses Affected by Covid-19. [Accessed 5 September, 2020] Also, refer Overview of the Government cash grant and rental waiver obligations.
[30]Act on the Legal Position of Employers and Employees in Wage Compensation of Companies in connection with Covid-19.
[31]Private companies who were facing a need to layoff at least 30% of their workforce or 50 employees.
[32]Act to Mitigate the Consequences of the COVID-19 Pandemic under Civil, Insolvency and Criminal Procedure Law, 2020.

## 6. **Conclusion**

We have argued that Covid-19 is not *force majeure* per-se! It is the lockdowns and not the virus that has made it impossible for airlines, hotels, caterers and other service providers to deliver as promised; contractors to complete real-estate and infrastructure projects on schedule, among others. Under such contexts, the promising party is justified to use the *force majeure* clause. However, this does not imply that the promisor is excused from fulfilling conditions attendant to the use of *force majeure* clause. In other contractual disputes, such as those involving power producers and electricity distribution companies or OYO it appears that parties have used the *force majeure* clause or invoked the *doctrine of frustration* disingenuously to extricate themselves from their contractual commitments, often to cover continuing pre-Covid defaults.

The economic analysis of disputes covered in the article has attempted to draw the attention of courts and policymakers towards the economic implication of their decisions. We have used the inferences following from economic analysis to explain how clear and predictable judicial rulings can enhance social-efficiency by encouraging parties to settle their issues through bilateral negotiations or other alternative dispute resolution mechanisms, thereby avoiding socially wasteful costs of litigation. However, for multi-party contracts where economic losses are highly correlated, public policy is better suited to cater the interests of all participants. Our analysis of the recent court orders on Covid related disputes suggests that in several cases, courts seem to under-appreciate the long-term economic consequences of their rulings.

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