AN ANALYSIS OF FORCE MAJEURE CLAUSES AND THEIR IMPACT ON REAL ESTATE PROJECTS

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ABSTRACT

The paper discusses almost all the aspects of force majeure and their implications on real estate projects. To understand what effect a force majeure clause may have, it is important to discuss the statutory framework set in India. The Contract Act that has been governing the country for over a century does not mention force majeure. However, there are two sections that deal with the same. Every day, so many contracts are formed. The industry that sees the highest number of contracts is the real estate industry. It is therefore important to study what impacts the invocation of force majeure may have on real estate projects. Obviously, invoking force majeure on real estate contracts impacts all the parties involved in the project – the builder or the project company, the contractor, and the home buyer. The million-dollar question that arises now is what should happen to the consequences arising out of the frustration of the contract or who should bear the risks of the contract. Finally, the paper will also suggest what measures must be taken by the party or parties if a force majeure clause is invoked on the project.

Keywords – Force Majeure, Homebuyer, Developer, Contractor

Introduction

To understand Force Majeure, two questions need to be addressed: What is Force Majeure and how have courts interpreted Force Majeure to resolve disputes. This section will briefly introduce us to the concept of force majeure and through the course of this paper we shall discuss important authorities that will help us understand force majeure better.

In simple words, Force Majeure is an unforeseeable event which, when it takes place, prevents either party from performing the contract. Force Majeure Clauses can be found in any contract, however, one industry that sees the highest occurrence of these clauses is the Construction and Real Estate industry.[1] The clauses are put into the contracts with the main aim of addressing unintentional events like natural disasters, labor strikes, trade tariffs and any other act that may delay or make the project impossible to complete.

In this regard, the Supreme Court in *Energy Watchdog v. Central Electricity Regulatory Commission & Ors*[2] has laid down some guidelines that must be given importance during the invocation of a force majeure clause:

1. The event should be unforeseeable at the time of Contracting.
2. The event should be beyond the control of either of the parties.
3. A non-performance of a promise must have happened by such an unforeseeable event.
4. Efforts were taken to mitigate the aftermath of such an event.
5. The event has made the performance impossible or illegal.

Most contracts will have force majeure contracts that will try to cover the events that might fall under the scope of force majeure, with respect to that contract. These clauses will have mentioned all the events which if they occur may render the performance of the contract impossible or frustrate the contract. These clauses will leave no room for further interpretation and will not include any other unforeseeable event as a force majeure event. Such clauses can be referred to as Specific Force Majeure Clauses (exhaustive). The other type of clause is an open-ended clause. Such clauses have language like “not restricted to” or “including but not

[1] J. Hunter Robinson, J. Christopher Selman, Whitt Steineker & Alexander G. Thrasher, “Use the Force? Understanding Force Majeure Clauses” *44 AM. J. TRIAL ADVOC. 1* (2020).
[2] (2017) 14 SCC 80

just limited to" or "similar other events" or "any event outside the reasonable control of the parties," etc. Such clauses are referred to as Catch All Phrase Clause (non-exhaustive) and are open to interpretation during negotiation itself or during litigation[3].

To further understand Force Majeure with respect to Indian Jurisprudence, we must understand the Doctrine of Frustration and the legal framework according to the Contract Act in place in this country. The sections of utmost importance to us are Sections 32 and 56.

Doctrine of Frustration

In the Indian Contract Law, Doctrine of Frustration is recognized as a principle that makes a proviso of the impossibility of the performance of the contract which the parties could not have foreseen during contracting. If it is recognized that the force majeure event prevents one party from completing or performing its obligations under the contract and it is not possible to continue the contract further, the contract is considered void and both the parties are freed from their respective obligations and neither party can sue the other party for the breach of the contract and cannot seek damages.

In some contracts, however, time is not of the essence and if it is established that when the force majeure event is over and the party can complete its obligation thereafter, such a delay will not be considered as frustration of contract.

Section 32 of the Indian Contract Act

"Section 32 of the Indian Contract Act: 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. —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."

Section 32 of the Indian Contract Act says that if a contract mentions that a certain event will happen in the future, the contract cannot be enforced until that event happens and the contract

[3] Dr. Raj Kumar, Seema Deshwal, "Principle of Force Majeure – An Assessment of Commercial Contracts in India in Context of Covid-19"

will be void when the event does not happen. If that contract is considered void, the parties will have no obligation to perform their promises in the contract.

The Supreme Court looked at the clause in the event of a force majeure event and said that it should be governed by Section 32 and not Section 565. Because of a force majeure clause, it can be hard to figure out whether it can be a contingent contract. The main thing to consider is how the obligations of the parties will change if that event happens. The test of impossibility would be used if there is no such clause, or if the event does not fall within the reach or scope of the clause, then Section 56 will be applied.

Section 56 of the Indian Contract Act

"Section 56 of the Indian Contract Act: Agreement to do impossible act. —An agreement to do an act impossible in itself is void. —An agreement to do an act impossible in itself is void." "Contract to do act afterwards becoming impossible or unlawful. —A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful. 1 —A contract to do an act which, after the contract is made, becomes impossible, or, by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.2 Compensation for loss through nonperformance of act known to be impossible or unlawful.—Where one person has promised to do something which he knew, or, with reasonable diligence, might have known, and which the Promisee did not know, to be impossible or unlawful, such promisor must make compensation to such Promisee for any loss which such Promisee sustains through the non-performance of the promise. —Where one person has promised to do something which he knew, or, with reasonable diligence, might have known, and which the Promisee did not know, to be impossible or unlawful, such promisor must make compensation to such Promisee for any loss which such Promisee sustains through the non-performance of the promise."

Section 56 talks about force majeure and impossibility. According to this section, if the contract does not have a force majeure clause to account for the possibility that an event could make the contract impossible to perform. Parties cannot agree on a thing that is not possible. Even more so, when someone cannot or will not do what they agreed to do after they signed the contract, the contract is not valid anymore. The section says that the event must be impossible for some reason. As soon as the event makes the contract impossible to perform, the contract is said to

be frustrated or declared void. Because of this, the contract is not going to be fulfilled, and no damage will be owed to the other party.

If Section 56 is invoked, the entire contract will be terminated immediately. This could prove very fatal and lead to a lot of losses for both the parties contracting, especially in a real estate project. Therefore, it is best to invoke the force majeure clause in the contract. Doing so will save the performance and the obligations of the parties under the contract will be delayed or pushed to a later period.

After reviewing the Sections above, we can see the narrowness of the Indian legal framework on the concept of force majeure in contracts. However, with the brilliant interpretation of these sections and with the aid of other acts, the Indian judicial system has been successful in addressing force majeure clauses and their impact on a contract.

In Satyabrata Ghose v. Mugneeram Bangur & Co.[4] The court defined the word impossibility. It opined that impossibility may not simply mean a literal or physical impossibility but even the sense of fulfilling the obligations as per the contract may amount to impossibility. It gave liberal leeway to the application of force majeure in contracts even if there was no FMC in the contract, as it held that the non-fulfilment of promises due to impossibility will be governed by Section 56 of the Indian Contract Act.

In the case of Energy Watchdog v. CERC[5], the Hon'ble Supreme Court said that if a contract has a Force Majeure Clause, as was one of the highlights of this case, then Section 56 will have no application. Therefore, if a Contract has an force majeure clause, they will have to dissolve the contract as per the scope of that clause.

What events may be considered as Force Majeure

Natural Disasters

A force majeure clause if often referred to as the "Act of God" clause. It is said so because generally such clauses contain all the major events that may prevent the performance of the contract. Act of God is an important principle in tort law which is used as a defense to escape liability. A person cannot be held liable if he took all the precautions and still some damage

[4] AIR 1954 SC 44
[5] (2017) 14 SCC 80

occurred. It is a broad term that includes natural disasters[6]. The same principle can be applied in contract law.

Natural disasters can range from floods to droughts. It can be easy to prove that flood was a force majeure event under a contract. However, proving that a flood preventing the party from performing the contract can be difficult. In *Gulf Oil Corp. V. F.E.R.C*[7]., a gas supplier, argued that due to the occurrence of a hurricane, it failed to deliver oil on time. The court agreed that hurricanes could be inferred as a force majeure event from the contract, however, it failed to see how it could prevent the party from performing the contract. Unless the courts could infer that the hurricane had caused damage to the machinery that delayed the gas delivery, the party could not excuse non-delivery of gas on time.

With regard to real estate projects, the party seeking exemption from its obligations under the contract, the onus on creating and proving a nexus between the event and its failure to perform the contract lies solely with them. The natural disaster may not necessarily have to cause damage on the project site. The occurrence of a natural disaster in some other part of the world may also indirectly impact the project. An earthquake or a flood or a fire or any other such event may disrupt the supply chain industry. This would make it difficult for the project companies difficult to continue with their project as they may feel there is a shortfall of some necessary material. This was seen in the case of *Associated Acquisitions LLC v. Carbone Properties of Audubon LLC*[8].

Government or Political Action

It is quite common to see an act of the government affecting the performance of a contract. The government may pass some order which may impact one party's obligations. This could be an act of not issuing or delaying the issue of a permit or license, or not allotting or delaying the allotment of land required for a real estate project, etc. Therefore, the main question in such

[6] J. Hunter Robinson, J. Christopher Selman, Whitt Steineker & Alexander G. Thrasher, "Use the Force? Understanding Force Majeure Clauses" *44 AM. J. TRIAL ADVOC. 1* (2020)

[7] 706 F.2d 444 (3d Cir. 1983)

[8] 962 So. 2d 1102, 1103-04 (La. App. 4th Cir. 2007)

cases is whether the government act was the cause of disruption to performance and can it amount to a force majeure event.

One of the leading authorities in this matter is *Metropolitan Water Board v. Dick Kerr*[9], where a group of contractors along with the Water Board, contracted to construct a water reservoir within six months. However, due to the onset of war, the Government served them a notice to stop their work, to which the contractors immediately obliged. The House of Lords held that the intervention in the construction had "ceased the contract to be performative."[10]

However, an intervention by the government which halts the performance of the contract for a temporary period cannot be considered a force majeure event. This was seen in the case of *Satyabrata Ghose v. Mugneeram Bangur & Co*.[11] where the plaintiff hired the defendant company to build infrastructure on the plot. However, the government requisitioned the land citing military purposes arising out of the Second World War. The company tried to cancel the contract as it felt that performance had become impossible. However, the Hon'ble Supreme Court noted that the requisition was temporary and the company could complete its performance afterwards.

In the context of Real Estate projects, government plays an important role, from allocating land to seeking various permits. Any action of the government can cause a disruption in the project's execution. This can be through an increase in taxes on materials needed for construction or in the form of sanctions imposed on imports from other countries. In *Kyocera Corp v. Hemlock Semiconductor LLC*[12], a Japanese company that manufactured solar panels entered into a contract with an American silicon supplier to make solar panels. After the contract was executed, the Chinese government introduced incentives for its local manufactures that would help them sell cheap solar panels to the world. This resulted in the American government imposing tariffs on China. The trade war lowered the price of silicon and the manufacturer informed the supplier that it would cease payments because the actions of the Chinese government was a force majeure event[13].

[9] 962 So. 2d 1102, 1103-04 (La. App. 4th Cir. 2007)
[10] Avtar Singh, "Contract and Specific Relief" 13th edition, EBC 2022 PG 400 Lucknow
[11] AIR 1954 SC 44
[12] No. 17-2276 (6th Cir. 2018)
[13] J. Hunter Robinson, J. Christopher Selman, Whitt Steineker & Alexander G. Thrasher, "Use the Force? Understanding Force Majeure Clauses" *44 AM. J. TRIAL ADVOC. 1* (2020)

Therefore, an act of government to amount to force majeure depends on the circumstances and facts of the case. From the cases discussed above, it can be concluded that if the intervention of the government is of a temporary nature, it cannot be considered as force majeure.

How can Force Majeure clauses help developers?

We have understood previously that Force Majeure is an unexpected event that prevents someone from doing something written in a contract. It must now be established that there are four main ingredients to classify an event as Force Majeure.

1. The event should have been unforeseeable at the time of entering into the contract.
2. It must be beyond the control of both the parties.
3. The event must have made it impossible to perform the contract.
4. A Force Majeure clause must be included in the contract.

In India, the RERA Act of 2016 specifies what events may be considered as force majeure events. Clause 6 of the same constitutes events like "war, flood, drought, fire, cyclone, earthquake or any other natural calamity affecting the regular development of the real estate project" as a force majeure event. The same clause entitles the regulatory authority to extend the deadline for the completion of the project on a case-to-case basis for a maximum of one year.

Invoking of Force Majeure clause benefits the developer by:

- Extending the period of registration by six months automatically with provision of another three months of extension at the discretion of the authorities.
- Waiver of fees for such an extension.
- Till the time of Force Majeure, the limit for compliances will be automatically extended.
- The period will be considered as a Moratorium period for the purpose of calculating interest for delayed completion and possession.
- The date of possession mentioned in the sale agreements will be extended.

- Extension of dates for other compliances such as transfer of title.

Home buyer's rationale for invoking Force Majeure: A Perspective from the COVID-19 Pandemic

In some cases, if the project is delayed by some period by the invocation of the Force Majeure clause in the contract, by the developer, the buyer would also want to invoke Force Majeure to protect himself from any liability arising out of non-completion of the terms of the contract on his behalf. In simple words, the buyer would simply not want to buy the real estate later, due to the circumstances arising out of a force majeure event. This could be because of a few reasons, some of which have been discussed in this section.

Performance has become more costly

The most important question to be addressed here is whether a contract can be frustrated if the performance of the contract has become costlier. For instance, a project may have been delayed for a year or so and the performance of the contract, I.e., the remaining construction of the property may have become costlier. Can this lead to frustration of the contract? Unfortunately, we are not aware of a case that excuses the buyer from performing his part of the contract. However, we have a case that may suggest the impact higher costs may have on the fulfilment of a contract.

In *Metropolitan Water Board v Dick Kerr*[14], a construction contractor could not complete the work due to the wartime restrictions that were imposed by the government. It was held that the contractor may not be obliged to complete the work even after the war was over, because the new costs for the construction may be drastically different to what they were before the war. In this regard however, Professor Sir Guenter Treitel was right in his insistence that the change in costs was not enough to frustrate the contract but a combination of a prolonged period of temporary impossibility and change in financial conditions was necessary.

Buyer unable to pay for goods or services

After some time, the buyer may be in a position where he cannot afford or does not have the means to pay for the project and therefore cannot proceed with the contract. This can be seen in executory contracts, where the buyer agrees to pay the money in installments to the

[14] 1918 AC 119 (HL)

contractor. The home buyer, after a certain period may be in an unforeseen situation where he can no longer arrange the money to pay the contractor.

This was seen especially during the COVID-19 pandemic. The socio-economic lockdowns imposed around the world led to a lot of economic disruptions, which eventually led to a lot of financial difficulties for home buyers. The effects of a force majeure event may affect the ability of the consumer to keep up with their regular instalments which they are obliged to make under a contract.

Unfortunately, these situations would not amount to frustration of the contract. They are treated as a risk that the buyer would have to take and bear.

Contract no longer serves the buyer's purpose

A common consequence of a force majeure event can be that the reason for which both the parties had initially entered into a contract may have fallen away. The contract may still be performed in its literal sense but would be of no use to either one party or both. For example, a builder decides to come up with a real estate project in a part of a city where other contractors and even the government have agreed to build projects and infrastructure that will improve the quality of life in that area. However, due to certain circumstances, some projects have been called off and the initial purpose for the buyer to invest in the project has been blemished. Buyers may want to frustrate their contract and they may simply argue that they no longer have the need and the desire to invest in that real estate project. Though, from the perspective of the builders, the buyer can still live in their houses.

It has been argued that English Law does recognize the doctrine of frustration of purpose. That means the reason or the intention, outside the terms of the contract, for which either party or both had entered into the contract is lost, the contract may be frustrated. In Krell v Henry, the tenant had entered a contract to rent a room from the landlord, only because the room would overlook the procession route of the king. However, the procession of the king was cancelled. The court held that even though the contract could still be performed in its literal sense, "the foundation of the contract" had been destroyed or because performance in the new circumstances would be radically different.[15]

[15] Hugh Beale, COVID-19 and frustration in English Law (2020) (Unpublished, Pontificia Universidad Catolica del Peru)

Providing an equal footing for Developers and Home Buyers

The aim of policy framework in this regard should work in such a way that it benefits both the developers and the home buyers. Invoking Force Majeure does more good than harm for the developer, as it gives him a good chance to complete the project, rather than having a failed project and reduces a plethora of disputes. It also benefits the home buyer if he has made any earlier investments in the project in the form of installments, as now, after the invocation of force majeure, the developer will most certainly complete the project.

Developers should use this time and opportunity to build a rapport and trust with the homebuyers by using the extension period to speed up and complete any previously pending portion of the project and extend the grace period to homebuyers for payment of the next instalment.

Why should Force Majeure be applied selectively?

The best way to assess the impact of force majeure on real estate projects is the current scenario of COVID-19 on the real estate market. A blog[16] on *Housing.com*, a Mumbai based real estate search engine, gives a very compelling argument on why Force Majeure should be applied selectively on real estate projects. According to a survey by *Track2Realty*, 62% of its buyers have objected to the timeline extension given to those real estate projects whose construction had been stopped way before the lockdown was imposed.

Whereas, they have argued that force majeure should be applied based on the percentage of work done in that project. 70% of the home buyers have expressed disaffection on the blanket invocation of force majeure due to the COVID-19 lockdown on every project. It could be possible that some projects may have already been delayed before the lockdown or they must not have even begun and such a delay will cause further problems in that project's cycle.

Therefore, buyers are objecting to the invocation of force majeure on such projects.

Contract between the Contractor and Employer: Risk in Construction Contracts

A construction contract, in simple terms, can be defined as a document that defines the scope

[16] Ravi Sinha, "Home buyers seek equal protection under real estate's force majeure clause", available at: https://housing.com/news/coronavirus-declared-force-majeure-will-it-help-home-buyers/ *(Last Modified May 29, 2020)*

and terms of a real estate project which is signed between the contractor and the person or the company who hires the contractor to build that real estate project. Force Majeure clauses along in real estate project agreements are quite common. Although, truly little time and effort is spent on negotiating those clauses, which will guide the courts on who should bear the consequences if a force majeure event takes place during the execution of the contract. It is usually assumed that the risk will not affect the party. It may also be assumed by one of the parties that the force majeure clause is a mere legal necessity and does not affect the risk allocation under the contract. It is to be noted that these assumptions are wrong and dangerous.

Risk Allocation

Risk, in the context of a real estate project agreement can be defined as 'an unforeseeable event, which when occurs can have an impact on the aim of the project's objectives.'[17] The most common question arising during the drafting of a contract is who should bear the consequences of a force majeure clause or who should bear the risk if an unforeseeable event happens during the execution of the contract that affects the project. It must be understood that events of force majeure by their nature cannot be controlled by either of the parties, but every risk in question must be carefully assessed and allocated to the party. Some of these risks or unforeseeable events as discussed previously can be events like natural disasters, labor strikes, etc. Therefore, a construction contract will have a set of terms that will allocate the consequences of any such event that may occur during the execution of the contract.

Fair and Equitable Allocation

It may be obvious that the party hiring the contractor for the real estate project may allocate all the risks to the contractor, thus making the contractor liable for any consequences that may happen during execution of the contract. However, this can be a very fatal step. Improper allocation of risk can result in a prolonged period of completion of the real estate project, wastage of resources and an increased chance of litigation. Therefore, it is argued here that a proper allocation of risk takes place on both the parties for the successful completion and delivery of projects.[18] Risks will fall into three criteria:

- Risks within the control of the project company hiring the contractor

[17] Peter Simon, David Hillson and Ken Newland, "Project Risk Analysis and Management Guide" Association for Project Management 17 (1997).
[18] Bryan Shapiro QC, "Transferring Risks in Construction Contracts" 5 (2010)

- Risks within the control of the contractor
- Risks outside the control of both parties

Considering the criteria above, a risk should be allocated to the party if:

- The risk is under the party's control
- The risk can be transferred by the party through means like insurance or others, that reduces the financial damage
- The risk is under the economic benefit of the party in question[19].

This would transpire, that questions like; which party can best foresee the risk, who can best bear the risk, who can control the consequences and which party benefits or suffers when the risk materializes, etc., must be answered correctly and honestly before allocating a risk.

Way Forward

We have seen the consequences of invoking force majeure on real estate projects. Sometimes the parties may go to court without considering all the aspects of the contract when they argue the invocation of force majeure.

Therefore, before pursuing any legal action, the parties must take the following proactive steps:

1) Carefully analyze the force majeure clause mentioned in the contract. The parties must examine the exemption provisions or exclusion clauses mentioned in the contract. This will help them decide whether the alleged unforeseeable event falls into the gambit of force majeure.

2) The party invoking the force majeure must complete its obligation with respect to notifying the opposite party on time of the force majeure clause.

3) Investigate what remedies and rights are at their disposal based on the contract.

4) Carefully assessing the impact, the force majeure event may have on their promise.

[19] Max Abrahamson, Journal of the British Tunelling Society, Vol 5 and 6, November 1973 and March 1974

5) Make efforts to alleviate the risk or the impact the force majeure event may have on their promise or set of promises.

6) Collect evidence that will help determine whether the event is declared as force majeure by the Government. This can be in the form of notifications released by the government.

The party must do everything that is expected to be done by them to mitigate the losses.

Conclusion

We have seen the narrowness of the Indian statutory framework on force majeure. Force majeure is not defined explicitly in the 150-year-old Contract Act that governs all commercial contracts in this country. However, thanks to the Real Estate (Regulation and Development) Act[20] and various interpretations and judgements of the Supreme Court on force majeure matters, it must be concluded that the authorities have been successful in bridging the gap of interpretation of FMC in real estate projects.

We have also seen how a force majeure clause can benefit the builder of the real estate project. However, even the home buyers can be and should be given some convenience at their disposal in such matters.

All contracts are different from each other and the meaning of force majeure may vary from contract to contract. Some force majeure clauses can be very open-ended and some can be very restrictive. The clause is therefore open to interpretation for both parties. Therefore, it is

advised that both the parties negotiate on the force majeure clause before entering into a contract.

There should also be a consensus ad idem even on the risk allocation of the consequences arising on the invocation of the force majeure clause on the real estate project. The risks should be allocated fairly and in a reasonable manner.

There is a lot of scope for development and improvement in this field. With more constructions happening and more real estate projects being planned every day and contracts being entered into every day, the number of cases and litigations are also bound to increase. Hopefully, this

[20] Act 16 of 2016

paper aids the person seeking an overview of the legal aspects involved in the invocation of force majeure in real estate projects.