

Client Alert

Impact of COVID-19 on commercial lease agreements

The ongoing contagion of COVID-19 has posed unparalleled challenges and, in many cases, is affecting business continuity. In order to contain the pandemic, the Indian government had imposed a 21-day-long nationwide lockdown till April 14, 2020 which was extended until May 3, 2020, and has now been further extended till May 17, 2020 (with some relaxations). The ripple effect of the current lockdown orders can be felt across industries, and many corporates are struggling to meet with their monthly commitments towards their employee/ staff salaries, rent etc. The impact of the current situation on commercial leases has become a matter of concern for both the lessors and the lessees in these testing times.

The Ministry of Home Affairs vide its order dated March 29, 2020, in exercise of its powers conferred under Section 10(2)(l) of the Disaster Management Act, 2005, directed all State/Union Territory governments and State/Union Territory authorities to take necessary actions and issue necessary orders, *inter alia*, for waiver of rent for workers/ students/ migrants by landlords for a period of one month. However, this order does not apply to commercial leases.

Extraordinary circumstances call for extraordinary measures, and over the course of the past few weeks, there have been a surge in the requests being made by lessees to their respective lessors for forgoing payments of their monthly rent on account of no revenue/sales being generated by them. The legal contention to be examined in the

present circumstance is whether or not a lessee can invoke the force majeure clause, citing the COVID-19 pandemic as the force majeure event, under a commercial lease agreement for its inability to perform its obligation to pay rent, and justify non-payment of rent till the subsistence of the said event.

The term 'force majeure' means occurrence of an event which could not have been anticipated by the parties at the time of entering into the contract. It is an agreed term to allocate risk between the parties, in the event of an unforeseeable event which makes fulfilment of an obligation impossible or impracticable for a party to a contract. A force majeure clause generally defines events of force majeure, the obligations of the parties upon the occurrence of such events, and the remedies available to the parties therefor. To answer the question whether the COVID-19 pandemic forms a force majeure event or not under a commercial lease, several factors need to be analysed, such as (i) the specific force majeure clause under the commercial lease agreement; (ii) position under the Indian Contract Act, 1872 ("**Contract Act**") and the Transfer of Property Act, 1882 ("**TPA**"); and (iii) the connection between the pandemic and the lessee's inability to fulfil its obligations.

Typically, a force majeure clause in a commercial lease agreement is in the context of destruction and damage of the leased premises. As the situation of prevention of use of the leased premises is not usually

covered, the remedy of suspension of rent or termination of the commercial lease agreement may not be available or applicable under force majeure clauses in such agreements. As force majeure is a term that the parties contractually agree to, the said clause must be carefully analysed as the lessee cannot claim excuse of its obligation to pay as a matter of right in the absence of a situation that is covered by the force majeure clause, or an express right available to the lessee therefor under the contract.

In this context, it is pertinent to mention that in case of commercial contracts that do not contain a force majeure clause, the parties may seek remedy under section 56 of the Contract Act relating to ‘frustration of contract’. However, the said remedy under section 56 of the Contract Act does not automatically apply to commercial leases. The same is governed by a specific law relating thereto i.e. section 108 (B)(e) of the TPA. The said position under the law was affirmed by the Supreme Court of India in the case of Raja Dhruv Dev Chand v. Raja Harmohinder Singh¹. The observed that:

“The doctrine of frustration would not apply on lease deeds/agreements as the same applies only in cases where certain obligation or part of the contract is yet to be performed under the contract and such performance due to an event has become impossible or impracticable”.

In the absence of the applicability of section 56 of the Contract Act, section 108(B)(e) of the TPA would apply, which provides that the lease, at the option of the lessee, shall be void if a material portion of the property is wholly destroyed or rendered substantially and permanently unfit for use due to events

like fire, tempest or flood or violence of an army or mob or any other irresistible force. Further, it is important to mention that the treatment of the COVID-19 pandemic as a force majeure event or as an ‘irresistible force’ as per section 108(B)(e) of the TPA by the courts in the context of commercial lease agreements would be done on the basis of the factual matrix of each case. However, the key argument to put forth would be ‘how the said pandemic has caused substantial or permanent destruction or damage to the leased premises which would excuse the performance of the obligation under the commercial lease agreement’. It is also important to mention that it is a settled legal position that mere financial difficulty would not be treated as a basis for invoking the force majeure clause under a commercial lease agreement or seeking remedy under section 108(B)(e) of the TPA.

Although, based on the relevant judicial precedents, it is clear that the monetary obligations would be excused at the option of the lessee only when the property is destroyed or damaged substantially or permanently, it may be worthwhile for the lessee to make an attempt before the courts to argue that due to the restrictive orders pertaining to the lockdown by the government, the lessee was unable to use the leased premises, and thus, the payment obligations may be excused as the intent under the agreement was to occupy the leased premises to ‘use’ the said premises. However, the strength of the said argument is yet to be tested before the courts.

In light of the above, some important considerations with regard to commercial

¹ (1968) 3 SCR 339: AIR 1968 SC 1024

lease agreements, in light of this pandemic, are as follows:

- a. The parties should consider reviewing the existing force majeure clause to include pandemics as force majeure events for future cases;
- b. The parties may also choose to include covenants that provide a remedy in case use of the leased premises is restricted, and provide for obligations of both the lessor and the lessee at the time of occurrence of such an event; or

- c. In the event the existing force majeure clause in a commercial lease agreement does not adequately provide for the remedy in the context of the existing circumstances, then negotiations between the parties to resolve the way forward can be held in order to reach an equitable solution.

As the events relating to the pandemic are still unfolding, a close watch should be kept on how lessees are invoking the force majeure clauses under their commercial lease agreements and the result thereof *inter se* the parties, and judicial precedents that may be pronounced on such matters.

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Contact

Sakshi Arora | Rupali Srivastava

Chadha & Co.
Advocates & Legal Consultants
S – 327, Greater Kailash II
New Delhi – 110 048
India

Tel: +91 11 4163 9294, +91 11 4383 0000
Fax: +91 11 4163 9295
Email: sakshi@chadha-co.com
Website: www.chadha-co.com

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