



NATIONAL JUDICIAL ACADEMY

NATIONAL WORKSHOP FOR HIGH COURT JUSTICES ON COMMERCIAL LAW



# INTERPRETATION OF CONSTRUCTION AND INFRASTRUCTURE CONTRACTS

Presented by:

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On

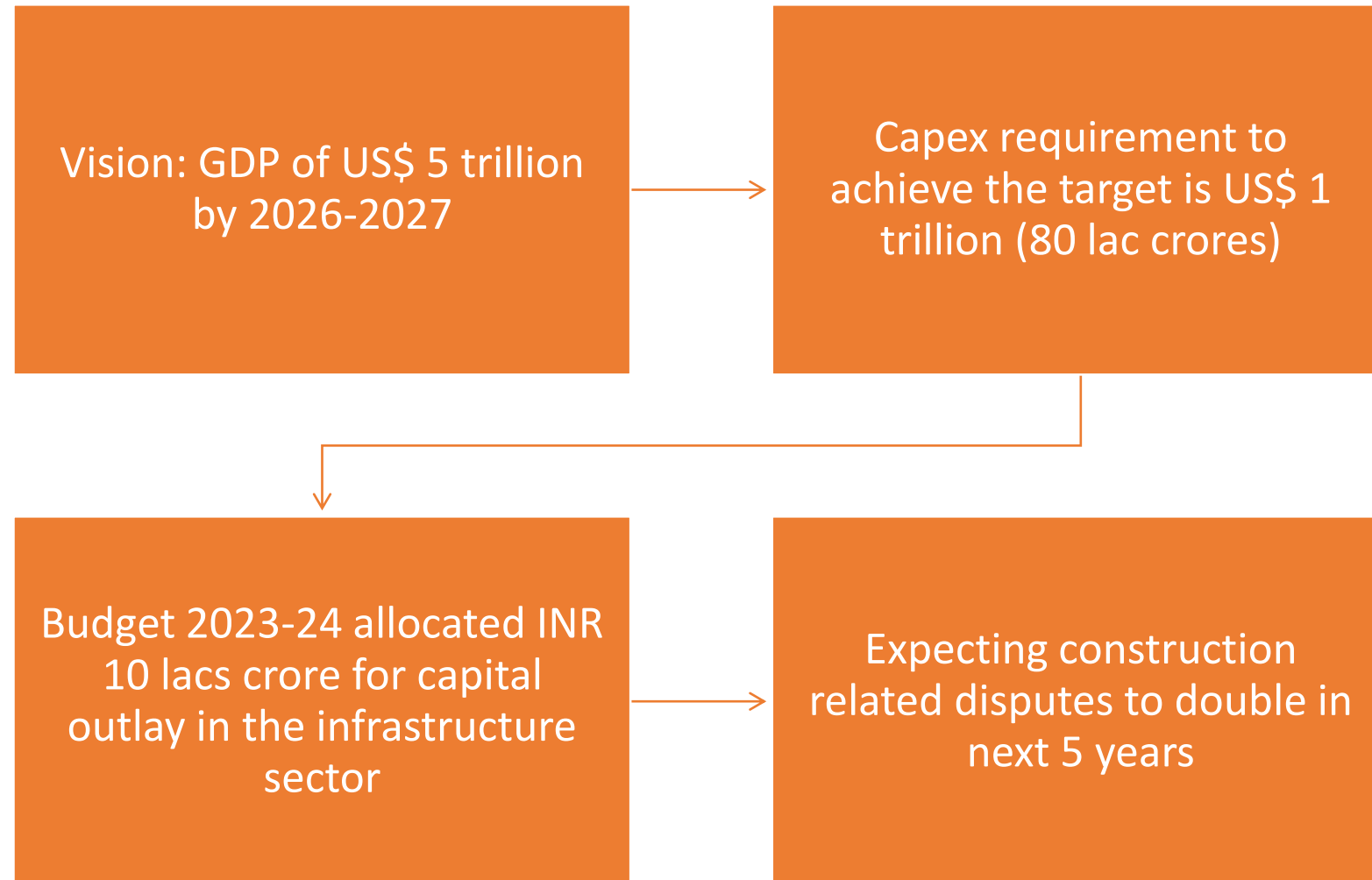
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## OUTLINE FOR DISCUSSION

- Growth: Opportunities and Challenges
- Concept of Project Finance
- Project Finance: Key Challenges for Project funded based on limited recourse
- Government Initiatives:
  - Specific Relief Act
  - Improving Cash Flow
  - Improving Contract Enforcement
- Key Issues involving Construction Contracts
- Conclusion

# Growth: Opportunities & Challenges



## IMPORTANCE OF INFRASTRUCTURE: ECONOMIC SURVEY - CHINA COMPARISON

- Per capita income in 2021:
  - India: US\$ 2256.6
  - China: US\$ 12556.3
- In 1980, per capita income in India was more than per capita income in China.
- Infrastructure projects will play a key role in improving productivity and per capita income

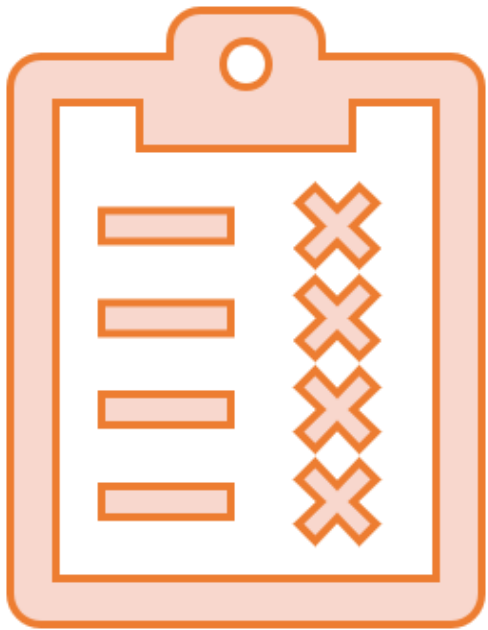
# CONCEPT OF PROJECT FINANCE

## Economic Survey of India 2021-22:

'To achieve \$5 Trillion GDP by FY 2025, India needs capital expenditure over \$1 Trillion (INR 80 Lac Crore) on Infrastructure Development'

- Indian corporates and/or Indian Government do *not have the **balance sheet*** to support this level of investment.
- Premise of project finance – lenders lend money for the development of a project solely based on the ***project's specific*** risk and ***future cash flows***.
- Lenders to the project have full recourse to the Project Asset and ***limited recourse to*** sponsors of the project

## Project Finance Mechanism Fails in Case of:



- *Delay in construction/commission of projects & consequent cost overrun;*
- *Delay in payment and consequent payment default;*
- *Downward Tariff renegotiations and question of viability ;*
- *Delay in contractual enforcement of rights.*

# GOVERNMENT INITIATIVES:

## Specific Relief Act, 1963 - Amendments 2018



Makes ***specific performance of contract a general rule rather than exception*** subject to certain limited grounds.



***Substituted performance of contracts*** where a contract is broken (at the ***cost and expense of defaulting party***).



***Courts shall not grant injunction*** in any suit, where it appears to it that granting injunction would cause impediment or delay in the progress or completion of such infrastructure project. (Section 20A).



It is ***mandatory for the Party filing*** the suit to ask for specific performance or substituted performance. Compensation can only be provided as an ***additional remedy***.



***Special Courts*** to be set up by State Government to exercise jurisdiction and to try a suit under the Specific Relief Act in respect of contracts relating to infrastructure projects.

## GOVERNMENT INITIATIVES: Improving Cash Flow in Construction Contracts

- In 2019, the Cabinet Committee on Economic Affairs approved measures for implementation on initiatives to revive the Construction Sector
- Following proposals by NITI Aayog's was approved
  - Govt entities will need opinion of Law Officer i.e. Attorney-General for India, in consultation with Dept. of Legal Affairs to initiate proceedings to set aside arbitral award and prefer an appeal.
  - Where Govt. entities challenge an arbitral award and amount of arbitral award is not paid – the govt entity should pay 75% of such award against a bank guarantee
    - Bank guarantee is only for the said 75% and not for its interest component.



# GOVERNMENT INITIATIVES:

## Improved EoDB but Contract Enforcement still a challenge

### World Bank report (October 2019): Enforceability of Contracts

- India ranked **63 (out of 190 countries)** in the 'Ease of Doing Business' 2020 rankings.
- Enforcement of Contracts, India ranked **163** in the world (out of 190 countries).
- On an average it takes **4.25 years** for a company to resolve a commercial dispute through a local first-instance court, almost 3 times the average time in OECD high-income economies.
- Costs incurred **are 31% of the claim value** (21.5% for OECD high income countries).

### Urgent Need to Amend Substantive Law on:

- Damages (s.73 of Indian Contract Act, 1872)
- Ability of Court to award exceptional damages in case of intentional breach
- Ability of court to award interest based on cost of borrowing

# KEY INFRASTRUCTURE PLAYERS: FINANCIAL HEALTH IN LAST 10 YEARS

INDIAN BANKS	INDIAN DEVELOPERS	INTERNATIONAL PLAYERS
<p>Large lenders have been saddled with and are grappling with <b>NPA</b>s on their bank.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>▪ State Bank of India</li> <li>▪ Canara Bank</li> <li>▪ IDBI Bank</li> <li>▪ Punjab National Bank</li> <li>▪ Bank of India</li> </ul>	<p>Infrastructure developers in India are very stressed and lack ability to develop a project.</p> <ul style="list-style-type: none"> <li>▪ IL&amp;FS Group</li> <li>▪ GMR group</li> <li>▪ GVK group</li> <li>▪ Reliance Infrastructure</li> <li>▪ Jaypee Infratech</li> <li>▪ Lanco Infratech</li> </ul>	<p>Almost absent</p> <ul style="list-style-type: none"> <li>▪ Foreign Commercial Banks</li> <li>▪ Export Credit Agency</li> <li>▪ Foreign Developer except in Solar &amp; Wind Power</li> </ul>

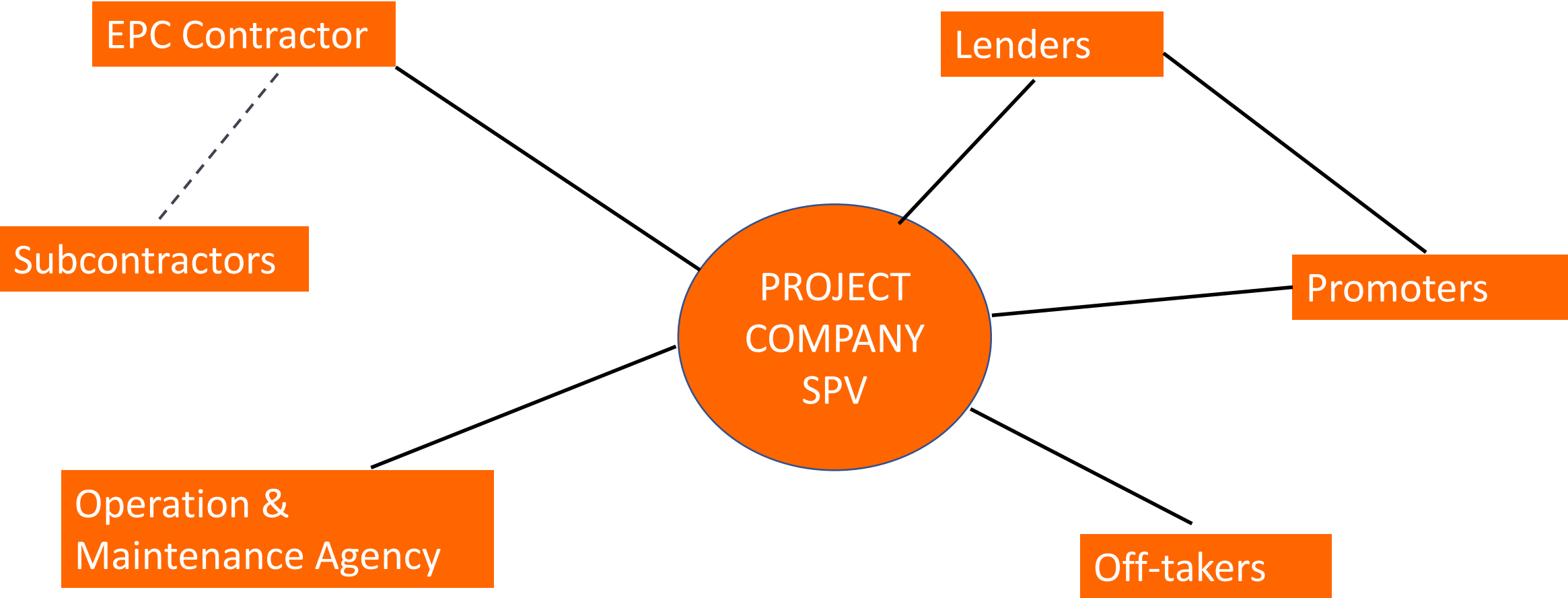
\*Infrastructure investments are growth multipliers\*



# PPP - REGULATORY FRAMEWORK

- *No central statute* pertaining to grant of PPP projects.
- *Sector specific legislations* such as the Electricity Act 2003; National Highways Act 1956; AAI Act 1994; Major Port Trusts Act, 1963; Urban Development Authorities Act etc.
- Some *State Governments* have enacted *specific legislations* to govern PPP Projects such as:
  - Andhra Pradesh Infrastructure Development Enabling Act, 2001;
  - Gujrat Infrastructure Development Act, 1999;
  - Punjab Infrastructure Development and Regulation Act, 2002;
  - Assam, Goa, Karnataka, Orissa, and West Bengal have Policy Framework;

# PROJECT CONTRACTUAL FRAMEWORK



# CONTRACTUAL FRAMEWORK FOR INFRASTRUCTURE PROJECTS: Key Principles

1. *Back-to back risk coverage;*
2. *Risk to be borne by the entity best suited to manage the risk;*
3. *Fixed Term, Fixed Price Turnkey* construction contract;
4. *Uninterrupted cash flow* during the operation of the Project;
5. No surprises (*Cancellation of Telecom licenses/ coal blocks, renegotiation of Renewal Power Tariff in AP/Telangana*);
6. Ring fencing of the cash flows (*TRA mechanism*);
7. *Lenders control over assets* (through creation of security);

# IMPLIED TERMS OF THE CONTRACT

## *Nabha Power Ltd. vs. PSPCL and Ors. (2018) 11 SCC 508*

Supreme Court held contract should be read as per its *explicit terms*.

Court cautioned that:

- It should ***not*** be the endeavour of commercial courts to look into *implied terms of contract*;
- Implied terms are necessitated only when the *Penta-test* comes into play. There has to be a strict necessity for it.

The Judgment provides a “*five condition test*” for an implied condition to be read into the contract. The test requires the following conditions to be satisfied:

- (i) reasonable and equitable;
- (ii) necessary to give business efficacy to the contract;
- (iii) it goes without saying, i.e., the Officious Bystander Test;
- (iv) capable of clear expression; and
- (v) must not contradict any express term of the contract.

# Force Majeure

- **Civil law concept** - Common law contract often contain contractual provisions to cover FM events
- FM events are broadly **unforeseeable events** which cannot be prevented by exercise of **reasonable care and caution**
- **Critical issues**
  - What events **qualify** as FM event; ( FM Clause to be interpreted narrowly – *Halliburton Offshore Services Inc. v. Vedanta Limited and Ors*(2020) SCC OnLine Del 542)
  - **Impact** on account of an FM event – i. extension of time; ii. Payment of additional cost (contractual)
  - **Excused** only to the extent affected & **compensated** to the extent provided by the contract (*GMR Hyderabad Vijayawada Expressways Pvt. Ltd. v. National Highways Authority of India, (2020) SCC OnLine Del 923*)
- Several Government Department circulars and High Court judgements recognize **Covid-19 pandemic as a force majeure event.** (*MEP Infrastructure Developers Limited v. South Delhi Municipal Corporation & Ors. (2020) SCC OnLine Del 728*)
- **Common law concept - Frustration of contract** – Impossibility or illegality (Section 56 of Indian Contract Act, 1872)



## **ENERGY WATCHDOG V/S CERC (2017) 14SCC 80**

- Bidder quoted non-escalable tariff;
- Force Majeure clause specifically excluded rise in fuel cost or agreement becoming onerous to perform;
- Definition of Law only included Laws of India;
- SC: Performance under the PPA was not excused in account of Force Majeure.

## **DDA V/S KENNETH BUILDERS & DEVELOPERS LTD. (2016)**

### **13 SCC 561**

- DDA auctioned land for *residential* purpose;
- Development Agreement – Responsibility of getting approval/consent was on developer;
- *MOEF* – Part of Delhi Ridge and hence could not be developed;
- *Satyabarta Ghosh v/s Mugneeram Bargum (SC)* impossible used in Section 56 of ICA has not been used in the sense of *physical or literal impossibility*;
- It ought to be interpreted as *impractical and useless* from the point of view of the object.

## Change Orders

- Dispute is whether a *particular scope of work* is part of the originally envisaged scope or not
- *Variation clause* in the agreement needs to be examined strictly
- In case of dispute, courts need to *facilitate payment* of the *undisputed amount*.

- Sovereign right to change laws
- Question is – “who bears the financial impact of such change in law”?
- Contractual provisions need to be strictly examined
- *GMR Hyderabad Vijayawada Expressways Pvt. Ltd. v. National Highways Authority of India, (2020) SCC OnLine Del 923*

## WHETHER TIME IS OF THE ESSENCE?

- **Presumption** - Like English Law, Time is not the essence in a construction contract.
- *Hind Construction Contractors v/s State of Maharashtra (1979) 2 SCC 70 and*
- *Welspun Specialty Solutions Limited vs. ONGC, LL 2021 SC 646*
  - “...‘whether time is of the essence in a contract’, has to be culled out from the reading of the **entire contract** as well as the surrounding circumstances. Merely having an explicit clause may not be sufficient to make time the essence of the contract.”
  - Other contractual provisions like **LDs and Extension of Time (EoT)** negate express stipulation.

## Jurisprudence on 'Time is of the Essence'

### *Kailash Nath Associates vs. DDA (2015) 4SCC 136 (6YRS)*

- If time is essence of a contract, then **waiver** requires consent of **both** the parties

### *State of Gujarat vs. Kothari Associates (2016) 14 SCC 761*

- In a **work contract, delay occurs**, and this is why time is considered to be not of the essence.
- Where, **extension is requested & is granted**, there must be a clear and discernible stand on behalf of either of the Parties that the extension is granted and /or accepted without prejudice to the **claim of damage**.

## Recent Jurisprudence on 'Time is of the Essence'

### *K.K. Krishnan Kutty v. Green Tree Homes and Ventures Pvt. Ltd., MANU/TN/4722/2019:* *(12.06.2019 - MADHC)*

- **Builder contended time was not of the essence of the contract.**
- Relying on Hind Construction, *the builder argued that a mere delay in completion of the project cannot be a ground for termination.*
- The Court rejected the contention and held that “When a person enters a contract and **lure the public** and collect huge amount in several crores **cannot contend that time is not essence of contract.**”

### *Haryana State Industrial Development Corporation Ltd. v. Shushil Kumar Rout,* *MANU/DE/0925/2019: (26.02.2019 - DELHC)*

- **The court did not apply Hind Construction.**
- In this case, **the government entity-owner granted several extensions** to the contractor and therefore the arbitral tribunal held that the time was not of the essence in view of the repeated extensions granted by the owner.
- The High Court gave a finding that the contractor was deliberately avoiding execution of the balance work in the contract and held that **the contract could be terminated** as per clause 2.2(a) of the general conditions of the contract **if due diligence was not shown by the contractor.**

## Recent Jurisprudence on 'Time is of the Essence'

### *S. Daya Singh v. Som Datt Builders Pvt. Ltd., MANU/DE/2261/2019: (16.07.2019 DELHC)*

- One of the **primary reasons** in the arbitral award was that **termination was illegal since time was not of the essence.**
- This finding was set aside by a Single Bench of the Delhi High Court on grounds that the prescribing of a period of **four years for completing the construction**, the conduct of the parties in making requisite applications for **permission to L & DO** and for sanction of plans even prior to the execution of the development agreement and as a precondition for entering into the agreement as also the prescribing of a penalty per month for delay by the builder - all go to show that the **parties contemplated time to be of the essence in the contract.**

### *Devender Kumar v. Parsynath Realcon Pvt. Ltd., MANU/RR/0012/2020: (16.01.2020 - RERA Delhi)*

- The Real Estate Regulatory Authority held time to be of the essence of the contract (even though Hind Construction was cited) on the ground that the **period of extension as per the flat buyer agreement was only 6 months.**
- The case arose out of an agreement to purchase a flat by a consumer. Hind Construction was not distinguished on the ground that the underlying transaction was different from the one which arose in that said case.



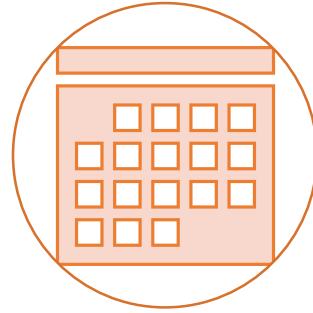
## Delay Claims in India

- General norm is to ask for Extension - without any proper analysis of cause of delay
- Owners habitually grant so called 'provisional' extensions
- General lack of contemporaneous evaluation of work progress and delay events
- Lack of proper record keeping
- An Expert's Analysis of Delay helps bring out an accurate picture of the Project and its progression.

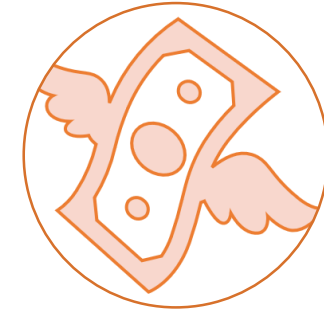
## Types of Delays



Parallel Delays  
(Same Party)



Concurrent Delays  
(Both Parties)



Contractor bears the burden  
of apportioning concurrent  
critical path delay in order to  
recover delay damages



# CONCLUSION

***Dispute*** relating to ***construction contract*** is ***not merely a contractual dispute***;

***Delay in dispute resolution*** in relation to Infrastructure Projects can deprive 700 million people who makes less than Rs. 250 per day - ***opportunity*** for ***growth & upliftment***;

***Monetary compensation cannot help*** millions of families who ***need infrastructure project*** for ***improving their productivity***;

***Any delay in making payment to the project company... Adds stress to the Project!***

# THANK YOU



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