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Examining the Legal Effects of COVID 19 on Lease Agreements in India

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ABSTRACT

The coronavirus 2019 (hereinafter, COVID 19) has had an unprecedented impact on world health and economy. Since the onset of the pandemic small business owners and tenants have become financially fragile, incurred massive losses and relocation. The cash crunch has inevitably put a strain on landlord-tenant relations and their lease agreements. Even large business owners such as PVR and Reliance Retail are unable to fulfill their rental obligations. Many tenants have moved to invoke the force majeure clause and the doctrine of frustration in their contracts. This paper aims to study the legal effect of COVID 19 on lease agreements. The present research study is mainly analytical. It draws on case laws from India and common law jurisdictions to determine the applicability of the provisions of the Transfer of Property Act (hereinafter, TPA), 1882 vis à vis concepts of the Indian Contract Act, 1872 (hereinafter, ICA) on lease agreements.

I. INTRODUCTION

In India, lease agreements fall under the TPA, 1882. A lease agreement is an accord whereby the owner (lessor) from his bundle of rights, transfers the *right of enjoyment* in the immovable property to the tenant (lessee), for an ascertained period of time, in exchange of payment, payable as per the terms of the lease agreement.² An essential covenant and material term of any lease is the payment of rent. Leases are usually for a longer period of time. Thus, in many cases, lessees may be committed to serving leases that do not provide for early termination. Lease contracts can allow for various kinds of payment such as one that becomes payable monthly (short term lease) or revenue sharing agreements. There can be long term lease contracts that incorporate a force majeure clause or ones where payment is made yearly from sales turnover percentage. Due to COVID 19, many of these agreements have come into contention as tenants are unable to pay the rent leading to questions of waiver, suspension, or remission of rental payments.

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² Section 105 & 106, The Transfer of Property Act, 1882.

II. FORCE MAJEURE CLAUSE

Section 32 of the ICA governs force majeure. It is understood as a contractual exemption whereby a party can be exempted from performing a contract when it becomes impossible to do so due to the occurrence of an unexpected event.³ A typical force majeure clause defines the events that constitute supervening circumstances or exigencies and the consequences that follow when such an event takes place. Generally, force majeure clauses are not present in short term leases. Further, in Indian law, a force majeure clause is not implicit in a contract and the courts cannot into it more than what is not expressly stipulated.⁴

For lease agreements, this means two things: *firstly*, a lease will have to stipulate a force majeure clause that envelops pandemics and epidemics specifically. *Secondly*, even if by a government notification COVID 19 is declared as a force majeure, the clause itself will have to be included in the agreement. Finally, the lessee will have to prove that such an exigency was unanticipated or as popularly known as an ‘Act of God’, and that the event “itself has caused the lessee to fail to perform its responsibility.”⁵ So, to invoke force majeure, a lease agreement may have an independent force majeure clause stipulating for exigencies such as a pandemic or epidemic.

III. FRUSTRATION OF CONTRACT

Where an implied or expressed force majeure condition is absent from the agreement and a “force majeure event occurs dehors the contract, it is dealt with by a rule of positive law under Section 56 of the Contract Act.”⁶ Section 56 relates to the doctrine of frustration of contract which means a contract stands invalidated when it becomes ‘impossible’ to perform such a contract.⁷ The ‘impossibility’ to perform means that some part of the contract is yet to be performed and during the subsistence of the contract, it has become impossible to do so. Frustration is not a technique by which a party can be absolved from a difficult situation, neither is it a plea of equity to do justice; it stands to terminate a contract.

In terms of a lease agreement, frustration would mean that an impossibility has been created by COVID 19 such that the right to enjoy the property or possess it has been taken away by an unforeseen event that is permanent in nature. There are fewer cases on whether the inability to pay rent due to an epidemic will qualify as an ‘impossibility’ leading to

³ Section 32, The Indian Contract Act, 1872.

⁴ P.V. Kapur, *Tenancy Agreements and COVID-19 Lockdown: A ‘Majeure’ Headache*, The Wire (May 28, 2020), <https://thewire.in/law/tenancy-agreements-covid-19-lockdown-force-majeure>.

⁵ *Id.*

⁶ *Energy Watchdog v. CERC & Ors.*, (2017) 14 SCC 80.

⁷ Section 56, The Indian Contract Act, 1872.

frustration a lease. But some common law cases can be helpful in understanding when a lease agreement can be frustrated.

Interestingly, during the SARS epidemic, a Hong Kong court adjudged a case on residential lease. Hong Kong as an exception to the Chinese mainland administers the principles of English law. In the case of *Li Ching Wing v. Xuan Yi Xiong*, a residential lease was executed for two years during which the tenant had to vacate the residence due to an isolation order as the area was infected by SARS.⁸ The question was whether the tenant could terminate the lease and if it would stand frustrated by way of the isolation order. The court placed emphasis on the *duration of the frustrating event* vis-à-vis the stipulated duration of the lease. Since the isolation order was only for 10 days, the court held it was “quite insignificant in term of the overall use of the premises” that was for 2 years.⁹

Similarly, in the English case *National Carriers (NCL)Ltd v Panalpina (Northern) Ltd.* (also cited in *Li Ching*), a ten-year lease for a warehouse was granted out of the which the tenant could not access it for 20 months as a road was closed due to dangerous conditions of the nearby property.¹⁰ The tenant did not pay the rent claiming the lease had been frustrated. The court held that although ‘*a lease is more than a simple contract because it creates an interest in the land*’, the doctrine is applicable, but in this case, the interruption of 20 months is not significant enough to destroy the contract or discharge the parties from any further performance.¹¹ In another English case, Lord Russell has said:

*"The contractual obligations [under a lease] of each party are merely obligations which are incidental to the relationship of landlord and tenant created by the demise, and which necessarily vary with the character and duration of the particular lease."*¹²

So, in addition to the *duration of a lease, a temporary or impermanent change* cannot lead to frustration of a lease. Thus, it is unlikely that COVID 19 will render long term lease agreements frustrated even in common law nations.

IV. THE FRUSTRATION OF CONTRACT VIS À VIS THE TPA, 1882

While some common law jurisdictions may allow the possibility of frustration in lease agreements, the Indian courts have held that section 56 of the ICA does not apply to lease

⁸ (2004)1 HKC 353.

⁹ *Id.*

¹⁰ (1981) AC 675.

¹¹ *Id.*

¹² *Leightons Investment Trust Ltd. v. Cricklewood Property Ltd.*, 1943 KB 493.

agreements. Lease agreements are contractual in nature but section 56 and doctrine of frustration are applicable to contracts that are yet to be concluded.

In *Raja Dhruv Dev Chand v. Harmohinder Singh*, the Supreme Court makes a remarkable distinction between a “completed conveyance” and an “executory contract”.¹³ In this case, a tenant sought a refund of rent for the agricultural land he had leased in Punjab that could not be used due to the 1947 Partition. The court said that frustration under section 56 is a ‘positive rule’ applicable to contracts. However, a lease is more than a mere contract for performance as it creates an exclusive interest in the favour of the lessee. Thus, once the lessee is in possession of the leased land, the contract becomes a ‘completed conveyance.’ Therefore, the provisions relating to the discharge of a contract such as frustration could not invalidate a “concluded transfer” or a completed transfer such as a lease. Further, the court held that section 4 of the TPA¹⁴ which relates to contracts that are part of ICA cannot be read as enacting the provisions of the ICA into the TPA.

Again, in *Amir Chand v. Chuni Lal*, the Punjab and Haryana High Court held that the rights and liabilities of the parties in a lease agreement rest in the lease provisions of TP so, section 4 of TPA is not applicable to lease. Consequently, frustration (section 56, ICA) would not apply to the cases of lease as those are governed by the TPA.¹⁵

In *Hotel Leela Venture Ltd. v. Airports Authority of India*, the court explains this situation with an example:

“A a retailer of shoes purchases shoes from 'B' who is the manufacturer of shoes. The agreed quantities of shoes are delivered and part sale consideration paid. On account of change in import policy the market is flooded with imported shoes which are much cheaper vis-a-vis the price payable by 'A' to 'B'. 'A' cannot plead frustration requiring the Court to reduce the price and relieve him the obligation to pay the balance sale consideration to 'B'.

A contract for lease whereunder the lessee obtains possession from the lessor is an executed contract and during the duration of the lease, since it is a term of the agreement that consideration shall be rendered periodically, the agreed consideration has to be paid and it hardly matters that rents have fallen in the meanwhile. The result of a lease is the creation of a privity of estate inasmuch as lease is the transfer

¹³ AIR 1968 SC 1024.

¹⁴ Section 4, The Transfer of Property Act, 1882.

¹⁵ AIR 1990 P&H 345 ¶ 4.

of an interest in immovable property within the meaning of. Section 5 of the Transfer of Property Act, 1882."¹⁶

The judgment goes on to clarify section 108(e) which defines the obligations of a lessee is a special law. So, it would supersede the doctrine of frustration which is part of a general law under section 56, ICA.¹⁷ The Supreme Court has settled the same conundrum in *T. T. Lakshmipathi*, holding that in the absence of force majeure clauses in lease deeds, it is section 108(B)(e) (e) of TPA that would apply and not the ICA.¹⁸ Consequently, one would have to read into the provisions of lease in TPA to determine the course of action.

V. COVID 19 AND SECTION 108(B)(E) OF THE TPA, 1882 IN LEASE AGREEMENTS

As mentioned earlier, the COVID 19 has rendered many tenants unable to pay rent or fulfill their obligations as a lessee. Recently, in May 2020, the question of 'waiver or suspension from payment of rent or suspension of rent' due to COVID 19 came before the Delhi High Court in *Ramanand v. Dr. Girish Soni*.¹⁹ The tenants had leased a shop in Khan Market, Delhi for which a Stay Order directed them to pay the rent monthly lest an eviction decree shall be executed. Due to COVID 19 and the subsequent lockdown, the tenants filed an application seeking suspension of the monthly rent as their business was disrupted.

The court *firstly*, rejected the applicability of force majeure and doctrine of frustration or simply, the applicability of the provisions of ICA in lease agreements. *Secondly*, it said that the applicable law would be section 108(B)(e) of the TPA and analysed it. Section 108 lists out the rights and liabilities of the lessor and lessee.²⁰ In sub-clause B (e), the lessee has the right to revoke the lease in the event of destruction of the property "by fire, tempest or flood, or violence of an army or of a mob, or other irresistible force."²¹ This can be understood as a 'facet of frustration'²² embedded in the TPA. Essentially, it means that any part of the property under the lease must be wholly destroyed, or substantially and permanently damaged by the given causes.

While COVID 19 has affected the tenants economically and rendered them helpless, in law, without any actual destruction to the property, the right of the lessor to recover rent under section 108(c) and the lessee's duty to make timely payments under 108(1) cannot be

¹⁶ 2016 (160) DRJ 186 ¶ 35 & 36.

¹⁷ *Id.* ¶ 10.9; *Kidar Lall Seal & Anr. Vs. Hari Lall Seal*, 1952 AIR 47.

¹⁸ *T. T. Lakshmipathi and Ors. v. P. Nithyananda Reddy*, (2003) 5 SCC 150.

¹⁹ 2020 SCC Online Del 635.

²⁰ Section 108, The Transfer of Property Act, 1882.

²¹ *Id.*

²² *Hotel Leela Venture, supra* note 16 ¶ 23.

trumped. For example, A leases out a property to B for running a restaurant for 30 years. After 10 years, due to recession the restaurant fails. Although, it may not be the lessee's fault that the restaurant has failed or his source of income has been affected, in law, he cannot pray that his rent be excused. How a person runs his restaurant is their concern not the lessor's. The lessor is only bound to transfer the right to enjoyment and possession of the property under section 108 A (b) and expect a reasonable use of the leased property (section 108(B)(e) (o)).²³

So, "unless the lessee so avoids the lease, he cannot avoid his obligation contained in clause (l) of section 108 which states that "the lessee is bound to pay or tender, at the proper time and place, the premium or rent to the lessor or his agent in this behalf".²⁴ The lessor's stance would be that under the lease agreement their obligation is to provide possession so, due to no fault of his, he cannot be disentitled to enjoy the proceeds of the lease. Obligations of lessor and lessee will vary in lease agreements where the payment of rent is linked to profits under rental agreements or devised as a part of the income /profit/sale earned by the tenant from the leased property.

However, the scope of section 108 of the TPA does not envisage exigencies such as pandemics or epidemics. And, to seek recourse under 180(e), the *property itself* must be completely destroyed due to a force majeure event²⁵. The property must be "substantially and permanently unfit" and a temporary non-use of the property will neither give the lessee the right to void the lease, nor can he escape his duty to pay the rent.²⁶ The event must be caused naturally, and the resultant damage should be permanent or (specifically) render the use of the leased area impossible. Similarly, Section 111 (b) of the TPA discusses an automatic determination of the lease "on the happening of some event" such as the ones under section 108(B)(e)(e) amongst others.

But both of these sections provide for the *determination of a lease* on the destruction of the premises due to an irresistible force. They do not speak of a unilateral suspension of payment of rent. Thus, the lessee continues to be liable to pay the rent until a court order or agreement with the landlord excuses or reduces it. Two principles emerge here: 1) for the application of 180(B)(e) of TPA, the *property* has to be permanently destroyed and 2) the provisions of

²³ See *supra* note 20.

²⁴ *Sangeeta Batra Vs. VND Foods & Ors.*, (2015) 3 DLT (Cri) 422 ¶ 27.

²⁵ *Id.*

²⁶ *Raja Dhruv*, AIR 1968 SC 1024 ¶ 17 ; *Ramanand*, *supra* note 19 ¶ 25.

TPA can only terminate the lease and do not speak for a suspension or temporary abatement of rent.²⁷

In the same way, in *Pawan Pathak Prakash v. Bar Council of India*²⁸, the Supreme Court rejected a writ petition filed with the intention to seek a waiver of rent of lawyers' chambers during the lockdown. COVID 19 does not render the property 'permanently unfit'. However, the court directed the Bar Council of India to help/assist its members during these testing times.

VI. SUSPENSION OF RENT AND EQUITABLE JURISDICTION

Based on the principles of justice, equity and good conscience, the doctrine of suspension of rent has emerged. This becomes applicable "if the lessee is dispossessed by the lessor from the leased property" whereby the lessee's obligation to pay rent to the lessor is suspended.²⁹ However, this doctrine requires a deliberate or tortuous act on behalf of the lessor or related causes that stops the lessee from enjoying the possession of the leased property. Some High Courts have held that this doctrine can be applied even in cases where the lessor isn't in the wrong but there is a substantial interference.³⁰ Since seeking a waiver or suspension of rent is not an inherent right of the lessee under the TPA, it is yet to be determined whether this would apply to situations where dispossession has taken place due to the pandemic.

In light of the dire economic created by COVID 19, although the Delhi High Court in *Ramanand* has said that the tenant may "seek suspension of rent by invoking the *equitable jurisdiction* of the Court due to temporary non-use of the premises." Equitable jurisdiction allows the court to extend the doctrine of suspension by considering the following factors:³¹

1. *Nature of the property*: Whether the tenanted premises are in a commercial or secluded location?
2. *Financial and social status of the parties*: This will help determine the comparative hardship between the lessor and the lessee.
3. *Amount of rent*: Whether the lease rates in the surrounding area are higher or lower than the rent in question?
4. *Contractual conditions*: Existing contractual conditions permitting non-payment of rent or force majeure clause covering epidemics.

²⁷ *Ramanand*, *supra* note 19.

²⁸ Writ Petition (Civil) No 10949 of 2020.

²⁹ *Raichurmatham Prabhakar and Others v. Rawatmal Dugar*, (2004) AIR SC 3625.

³⁰ *Budge Budge Co Ltd. v. Jute Corporation of India Limited*, (2001) (2) RC R (Rent) 485.

³¹ *Ramanand*, *supra* note 19 ¶ 26.

5. *Protection under any executive orders*: If the government passes any notifications allowing modifications or relief in lease agreements.

The court also hinted at the possibility of a delayed payment of rent along with stating that since are testing times the lessors and lessees' should negotiate and come to a mutual understanding.

VII. CONCLUSION

It is evident from the catena of judicial pronouncements that in the absence of a force majeure clause or other contractual stipulations that excuse rent (rent abatement clause), section 180(B)(e) of the TPA cannot be invoked. *Consequently*, the suspension of rent due to temporary non-use of premises can only be determined by examining the facts and circumstances of each case under the equitable jurisdiction of the courts.³²

The current situation brings out the lacuna of law in the TPA to account for exigencies such as pandemics and epidemics, and for the relief of suspension of rent in many cases. COVID 19 has also shown the importance of including *Force Majeure* clauses in lease agreements. Various malls, small businesses, retail stores have shut down and many others are seeking for government intervention to pass orders for rent relaxations for leased premises. While the Government of India and state governments have passed orders and advisories relating to rents for poor labourers, migrants and students of residential premises³³, these haven't decreased the burden of commercial leases.

³² *Id.*

³³ *Circulars for Covid 19*, Ministry of Home Affairs, India (2020), <https://www.mha.gov.in/notifications/circulars-covid-19>.