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Energy Watchdog v Central Electricity Regulatory Commission and its Impact on Section 56 of the Contract Act

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Under Section 56 of the Indian Contract Act of 1872[1], the section relating to contract frustration is quite significant. Knowing the many circumstances that arise while attempting to frustrate a contract requires expertise. The authors of this article attempt a detailed analysis of the Energy Watchdog v Central Electricity Regulatory Commission (CERC) case (2017)[2]. By outlining the case's facts, the issues in the appeal, the arguments put forth, and an analysis of the precedents the court utilised to reach its decision, the article also shows the many facets of contract frustration under Section 56[3]. Additionally, the case's importance has been discussed, Major takeaways have been outlined, and an exception to the rule has also been explained. Finally, the authors analyse the many features of the Adani Case[4] and how it has influenced more than 265 cases in the Supreme Court over the past five years.

Keywords: *force majeure, contract, commercial difficulty, price escalation.*

1 Indian Contract Act 1872, s 56
2 *Energy Watchdog v Central Electricity Regulatory Commission* (2017) 14 SCC 80
3 Indian Contract Act 1872, s 56
4 *Energy Watchdog* (n 2)

INTRODUCTION

The world is facing the impacts that Covid 19 has had on it, while Covid 19 has devastated the lives of many the major repercussions that it has caused are within the contracts of the world. People are now trying to frustrate their contracts due to the impossibility rendered by the effects of Covid 19 on the world. The frustration of a contract can be done under ***Section 56*** *of the Indian Contract Act, 1872*[5]-

Agreement to do an impossible act:

An agreement to do an act impossible in itself is void.

Contract to do act afterward becoming impossible or unlawful -

A contract to do an act which, after the contract is made, becomes impossible, or, because of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

Compensation for loss through non-performance of an 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."[6]The burden of proof to establish that a contract is frustrated is quite high; parties must show that the contract cannot be carried out, not only that it is illogical and worthless from the perspective of the parties' goals and purposes, which is why they are seeking to frustrate it. To learn this concept extensively the case of Energy Watchdog (hereinafter referred to as 'Appellant') v Central Electricity Regulatory Commission (CERC)[7] (hereinafter referred to as 'Respondent') is explained in detail hereunder:-

[5] Indian Contract Act 1872, s 56
[6] *Ibid*
[7] *Energy Watchdog* (n 2)

FACTS OF THE CASE

The government launched the Mundra Ultra Mega Power Project ("MUMPP") to deliver power to Gujarat, Haryana, and Rajasthan through state power procurers. A competitive bidding process was undertaken as per the electricity regulatory laws to determine the tariff for the sale of power. In the competitive bidding process, the bidders had the flexibility to choose between scalable, partly scalable, or non-scalable tariffs (i.e, formula based on tariff fluctuation). **Adani Power** (hereinafter referred to as '**Adani**') and Tata Power Co. (hereinafter referred to as 'Tata') quoted a non-scalable tariff. They made this decision because an increase in the price of coal was the only substantial element that may have influenced their decision to pick a scaled tariff. Price escalation was not a major factor determining the scalability of the tariff because Adani and Tata have long-term coal supply agreements from coal mines in Indonesia at fixed/predictable rates.

As a result, Adani offered the lowest rate, and power producers started selling electricity at that rate after signing Power Purchase Agreements (PPAs) with the state power procurers. Two to three years after the tariff was set, in 2010 and 2011, the Indonesian government issued new legislation that caused the coal prices to be in line with worldwide coal prices rather than the prevailing price, which had remained constant for 40 years. The pricing producers offered their products to the power procurers at much higher rates as a result of the change in Indonesian law; Adani could not afford the new price. Adani provides a non-scalable tariff that can never be implemented.

Adani as a result applied to the Central Electricity Regulatory Commission (CERC) on July 5, 2012, according to Section 79 of the Electricity Act, 2003, with a request to either be released from the PPA's performance as a result of contract frustration or to be put back in the same financial position as they were before the occurrence of force majeure and the enactment of new legislation by creating a mechanism for it. Although the CERC rejected Adani's argument, it held in April 2013 that it has the authority to address power producers' complaints when the larger public interest is taken into account. As a result, the CERC established a committee to investigate the problems power producers are facing and come up with a workable solution.

In August 2013, a committee was established, and in its final report, it advised giving Adani a compensation tariff. Following the committee's recommendation, the CERC went on to award Adani a compensation tariff in February 2014. The Appellate Tribunal for Electricity received appeals and cross-appeals submitted in opposition to the ruling (APTEL). According to the argument, Adani consciously chose to list energy prices as non-scalable to be competitive and won the contract tender as a result. Adani was unable to convert this into a scalable tariff while claiming that it was harmed by force majeure. It was argued that there had been no change in the law since Indian law, not Indonesian law, was affected.

THE ISSUES INVOLVED IN THIS CASE

- Whether or not the respondents had the right to invoke and receive the benefit of force majeure?
- Does a modification in Indonesian law constitute a change in the law?

ARGUMENTS ADVANCED

Appellant's Arguments

It was argued that there has been an increase in pricing as a result of a change in Indonesian law regarding coal export prices, which had been set for the previous 40 years. The appeals team argues that there was a change in the legislation or that there was a case of force majeure.

Respondent's Arguments

- It was argued that to be competitive and win the contract, it was stated that Adani Enterprises deliberately chose to quote energy rates as non-scalable. It cannot change this into a scalable price at this time by claiming that it is impacted by force majeure.
- Additionally, they claimed that Adani Enterprises' proposal was not authorised since it included just the import of coal from Indonesia and that because this was the case, they were free to obtain coal from any other source. A contract does not fail only because it becomes commercially burdensome since the price of coal is the price of the raw material.

THE JUDGEMENT

The Supreme Court ruled that although "Force Majeure" is discussed in *Section 32 of the Indian Contract Act of 1872*[8], which dehors (beyond the purview of) contracts, it is dealt with by the rule of positive law in *Section 56 of the Contract Act*[9]. It is argued that the promisor finds it hard to carry out the deed that he had pledged to carry out if an unforeseen incident or change in circumstances upends the entire basis upon which the parties signed their agreement.

The following situation cannot be covered by the philosophy of frustration since PPAs' core principles remain the same. The PPAs do not specify that coal must be purchased just from Indonesia at a specific cost. The individual that constructs the power plant must pay the whole cost of the coal supply. The inclusion of the coal supply agreement serves solely to demonstrate that the plant's necessary raw materials are in place. Companies willingly filed their non-scalable tariff proposals while being aware of the danger they were taking. The producing business is therefore responsible for the risk of providing power at the stipulated cost.

The force majeure clause in no way eliminates the potential of unanticipated occurrences occurring in addition to or instead of natural and/or non-natural events. The phrase "hindered" must be interpreted in light of words that come before and after it, as well as the nature of the contract's general provisions, to decide whether or not the force majeure clause is relevant. By doing this, it becomes obvious that something must exist that partially hinders the fulfillment of the agreement's requirement. A simple price increase that makes the contract more expensive to carry out will not qualify as a "hindrance."

PRECEDENTS

The Supreme Court while delivering the judgement has relied on the presence of the case of *Satyabrata Ghose v Mugneeram Bangur & Co*[10]. In this situation, a contract must be fundamentally altered for it to be frustrating. The Supreme Court refused to allow the contract to be terminated,

[8] Indian Contract Act 1872, s 32
[9] Indian Contract Act 1872, s 56
[10] *Satyabrata Ghose v Mugneeram Bangur & Co* [1954] SCR 310

despite the army's claims that the lands on which the roads were ordered to be built had been taken by official order. This had taken place at a time of conflict. According to the Supreme Court, the building might have proceeded even after the conflict was concluded and the parties were aware of the conditions that made war very possible at the time. It stated that "*the events which have happened here cannot be said to have made the performance of the contract impossible and the contract has not been frustrated at all.*"[11]

Further, in the case of *M/s Alopi Parshad & Sons Ltd. v Union of India*[12], The Supreme Court ruled that circumstances that none of the parties to a contract could have imagined frequently arise, even if such circumstances are normal. In such circumstances, the parties may find themselves in a worse situation than when they first entered into the contract. Unexpected turn of events is an inherent risk that the parties to a contract must accept in commercial arrangements; yet, unexpected circumstances cannot in and of themselves excuse the parties from their contractual obligations. The court further emphasised that a contract's performance cannot be cancelled only because its requirements have grown burdensome. In India, the courts frequently accept impossibility as a condition that frustrates the contract only when the impossible is great; if the impossibility has just made the conditions more onerous owing to price escalation than the initial agreement, then the claim for frustration does not stand.

Moreover, in the *Sea Angel case*[13], it was held by the UK Court of Appeal that "*the application of the doctrine of frustration requires a multi-factorial approach.*"[14] The court hinted in its statement that several factors influence the theory of frustration. Only when the majority of the circumstances relevant to the conditions fundamentally change, or when an incident entirely alters the nature of the contract and is therefore deemed to be Force Majeure, may a contract be considered frustrated. Risk distribution is typically the primary goal of commercial contracts; unfortunate events frequently occur, and they do not invalidate the agreement. The court also observed that "*the doctrine is not to be lightly invoked; that mere incidence of expense or delay or onerousness is not*

[11] *Ibid*
[12] *M/s Alopi Parshad & Sons Ltd v Union of India* 1960 (2) SCR 793
[13] Sea Angel Case 2013 (1) Lloyds Law Report 569
[14] *Ibid*

sufficient; and that there has to be as it were a break in identity between the contract as provided for and contemplated and its performance in the new circumstances."[15] It was determined in a different case in India[16] that a contract cannot be cancelled solely because it is challenging to carry out.

SIGNIFICANCE OF THE CASE

In today's world, where coronavirus has caused major havoc across the globe, it is pertinent to note the impact of the clarification given by the Supreme Court in the Adani case. Trade and commerce have already been disrupted all around the globe due to the coronavirus. Businesses have already feet hampered in fulfilling the obligations that they undertook due to the actions that the government has undertaken. If the businesses feel hampered then that could lead to the termination of the contracts. Along with the cancellation of the contract, businesses will also have to go through a lot of burden of litigation. The aggrieved parties will invoke a wave of cases against such businesses seeking either injunction or specific performance from the defaulting party. Furthermore, arising from the frustration of the contracts will be a flood of cases by the parties who seek damages.

The notion that the terms of the contract are binding and that the parties must honour their agreement forms the basis of contractual law. The parties may also include in their agreement particular occurrences or events, such as price changes, so long as they do not change the parties' obligations under the contract. The parties may also include certain exceptions and even exclusions in the contract that they believe would affect their performance of their obligations under it. They must acknowledge, however, that they may not always be able to anticipate or control the performance of certain aspects of the contract. These clauses, like force majeure, have become more important over time and are being stressed more now because of the current pandemic.

A force majeure clause may be all-inclusive or specific conditions that are outside the control of the promisor and/or the promisee, depending on the wording used by the parties. The

[15] *Ibid*
[16] *Today Homes and Infrastructure Pvt Ltd v Jitender Singh* OMP 13/2012 (Delhi High Court)

execution of the contract may be terminated or invalid if the specified/covered event or circumstance happens. The force majeure provisions, which are also known as the "act of God" clauses, have been known to cover events like natural disasters, floods, riots, strikes, war, etc. However, force majeure provisions must also be interpreted strictly in the legal sense.[17]

Contracts with clearly stated force majeure provisions typically include specific language describing the steps to be followed as well as the party's rights and responsibilities in such a circumstance. If there is no force majeure provision (or one that is not clearly stated or all-inclusive), the parties will need to determine whether the SARS-CoV-2 epidemic or the resulting limitations render it "impossible" for them to fulfill their commitments. Invoking the theory of frustration may be the only alternative available to such parties that are unable to fulfill their contractual duties, depending on the facts and circumstances, to defend any action taken against them.

In a situation of this magnitude, a lot of individuals will try to ride the force majeure/frustration rush. Some would float, while others might sink. Given that it is difficult to assess whether a contract may be completed, courts may or may not be inclined to be lenient, but this will most likely depend on the details of each case (or is impossible to perform). Determine the type of obligation that must be fulfilled (and whether it is covered by the parties' abecedarian agreement), determine whether an epidemic or governmental action was the major or direct reason the promisor was unable to fulfill the obligation, determine whether the promisor exercised due diligence and explored all options, etc. It is very possible that courts won't see the lockdown as an ipso facto circumstance that makes it impossible to carry out a contract's obligations because it is only temporary.

An essential benefit of a force majeure clause is that it provides the parties with pre-agreed alternatives to take into account in such a situation, such as the termination of contractual obligations, an extension of the time allotted for performing obligations, or even renegotiation

[17] *Ibid*

of the contract's terms. Participants can still agree on the best way to rescue the underlying project or transaction by agreeing.

However, unless the parties can agree to implement them, the aforementioned remedies might not always be available in the absence of a force majeure clause. Frustration may only be used as a defence in actions brought against a party for breach of contract; whether or not the contract is deemed frustrated ex post facto is decided by a court or arbitral tribunal with the proper authority. The contract is deemed invalid if it is determined to be frustrating. In this situation, the party applying the concept will be excused from fulfilling its contractual duties and won't face any additional sanctions. However, *if the contract is discovered to have become void, then any party who has received any advantage under the contract is bound to restore it or compensate the party from whom such advantage was received.*[18]

MAJOR TAKEAWAYS

A Commercial difficulty will not render the contract to be impossible. The Indian Supreme Court[19] has acknowledged the following viewpoint on frustration:

- When a contract is to be frustrated, several factors must be taken into account, including the contract's terms, the circumstances under which it was made, the context in which it was made, expectations from the contract and knowledge of those expectations, an interpretation of the contract's terms, and an understanding of the clauses and their implications. Both parties must agree on the contract's risk.
- Additionally, the kind of supervening event matters, as do the parties' responses to it and how it will alter their duties.
- Moreover, the allocation of risks associated with the agreement is very crucial as this is done on terms that are not clearly defined as "the contemplation of the parties", which in turn makes the application of the doctrine of frustration difficult.

[18] Indian Contract Act 1872, s 65
[19] *Energy Watchdog* (n 2)

- Further, the court suggested the test of 'radically different. This test underlines that a mere change in cost or delay in performance or onerousness of the terms cannot be sufficient to apply the doctrine of frustration. The change has to be such that the identity of the contract on which the contract was entered into collapses.

Analysing the Adani case makes it quite evident that there is a high bar for proving that a contract is frustrating. Being proactive from the beginning is crucial to prevent having to engage in the tedious process of contract frustration, which is frequently irritating in and of itself. The extreme change in circumstances in the Adani case was unprecedented, and while many businesses across various industries may have certain clauses relaxed, this cannot be assumed to apply to all contracts because parties on the defensive end of a force majeure clause will be burdened by the dominant party. Therefore, certain preventative steps should be implemented in case they anticipate a delay in fulfilling contractual duties or that they won't be able to fulfill such responsibilities in full.

- Time is of the essence when it comes to contract frustration, so if the issues are still in their early stages, the party who learns of them should get in touch with the other party and pursue discussions without prejudice about extending the deadline for performance, terminating obligations, or renegotiating the terms of the agreement.
- In such a situation, the other party should be notified of the supervening event causing a delay or preventing the party from performing the obligation entirely. Details regarding the same shall be provided like- lockdown or other temporary measures taken in light of coronavirus.
- The intricacies of possible alternatives present for the parties shall be highlighted and the other party shall be informed about the same, if any part of the contract can be continued as it has been unaffected by the force majeure event like Report submission and account, necessary technical support, etc. then such a part shall continue to be performed.
- If the Force majeure event in the picture is a restrictive measure like a lockdown then the business may not be able to fulfill the delivery of goods within the promised period as its ability to perform has been barred temporarily. If discussions are unsuccessful, you

should formally ask for an extension of time to perform the obligations. In case these formal requests have been rejected, the fact that you made the requests will put you in a far better position and assist you in establishing grounds for the frustration of the contract.

For instance, the Ministry of New and Renewable Energy instructed all renewable energy implementation agencies to allow the applications while taking into account the circumstances of the lockdown period as a force majeure occurrence. The Ministry then said that organisations might request extensions for renewable energy projects for a period equal to the lockdown's duration. Additionally, it suggested an extra 30 days as a normalisation time needed to reverse the lockdown's effects. Numerous ports in India have also declared a state of force majeure in preparation for potential problems with the transportation of people, goods, etc. This will be a welcomed step as the havoc that coronavirus has caused is beyond imagination and to ensure the regular operation of supply chains such a period has to be observed.

The dispute resolution mechanism and the governing law should be accessed thoroughly as in this case, arbitration is the agreed-upon method of dispute resolution, and the procedure followed should conform to the arbitration and conciliation act,1996[20]. If there isn't an explicit arbitration agreement and the case is recognised as a commercial dispute under the Commercial Courts Act, 2015[21], unless the case mandates an urgent requirement of interim relief, Pre-institution mediation is a required step that must be conducted and finished before any legal action is filed.

EXCEPTIONS TO THE PRINCIPLE

Every doctrine has certain exceptions, the doctrine of frustration also has certain exceptions. When the situation made it commercially impossible for the parties to carry out the contract without suffering significant losses, the court has in some circumstances granted the parties' request to frustrate. In the case of *Easun Engg. Co. Ltd. v Fertilizers and Chemicals Travancore Ltd.*[22],

[20] Arbitration and Conciliation Act 1996
[21] Commercial Courts Act 2015
[22] *Easun Engg Co Ltd v Fertilizers & Chemicals Travancore Ltd* 1991 SC 221

supply of power transformers had to be done. A clause for fixation for prices had been included in the contract. A clause in the contract for the set price stated that, in the event of a "force majeure" incident, the harmed party would not be responsible for compensatory damages. Further increases in the price of transformer oil rendered the contract unworkable, making it impossible for the party to deliver transformers. As a result, the other party filed a claim for damages. The court observed that an "*abnormal or exorbitant increase in the price of transformer oil is not a natural and ordinary event but a substantial and drastic event. Therefore, the contract stands frustrated".*[23] Therefore, we see that a drastic change in the cost of the raw material due to force majeure was treated as an essential part of the contract and eventually the contract was frustrated.

Similarly, in the case of *Satyabrata Ghose v Mugneeram Bangur & Co.*[24], The court drew attention to the fact that *Section 56 of the Indian Contract Act, 1872*[25] does not employ the word "impossible" in a way that implies physical or literal impossibility. If we take a closer look at the case of *Naihati Jute Mills v Khyaliram*[26], the Supreme Court stated frustration of the contract would be applicable in case there is a change in circumstance relying on which the parties made the contract.

CONCLUSION

It should be noted that the Adani case has been very helpful to assist the court and advocates all over the nation in overcoming the difficulties related to the application of *Section 56 of the Indian Contract Act, of 1872.*[27] Over 265 lawsuits and various arbitration panels have submitted the Adani dispute since 2017 to the courts. Commercial impossibility cannot be taken to be impossible in the sense of section 56[28] per se. However, it is always possible to determine if section 56[29] might be expanded to cover commercial impossibility by looking at the facts and

[23] *Ibid*
[24] *Satyabrata Ghose v Mugneeram Bangur & Co* [1954] SCR 310
[25] Indian Contract Act 1872, s 56
[26] *Naihati Jute Mills v Khyaliram* 1976
[27] Indian Contract Act 1872, s 56
[28] *Ibid*
[29] *Ibid*

circumstances of the contract, which may include the source of procurement, cost, or even the contract's objective.

If Adani had submitted a proposal purely based on imports from Indonesia that may have been seen as the basis of the contract and could have led to contract failure. The burden of proof to prove that a contract is frustrated is very high; parties must demonstrate that the contract is not only practically useless in light of the parties' goals and purposes, but also that it is impractical to carry out, which is why they are attempting to frustrate the agreement.