

THE STATE'S CONTRACTUAL LIABILITY IN INDIA

Written by *Sanjana Pandey*

4th year B.B.A.LL.B. (Hons) Student, School of Law, University of Mumbai

ABSTRACT

Indian Government, being a welfare state, has been increasingly adopting various economic activities to provide large benefits to the general public. Today, a large number of individuals and business organizations enjoy tons of benefits in the form of government contracts, licenses, quotas, mineral rights, tenders, jobs, etc. This raises the possibility of exercise of power by a government to dispense largess in an arbitrary manner and the need was felt to regulate and protect the interests of an individual and what they would be entitled when the contract is breached by the government. Even when the government, as an entity entering into contracts with corporations, assumes the same rights and obligations as that of B2B (business to business) or individual to business contracts, their liability and requirements change. This paper analyses the position of government contracts, their judicial and statutory recognition and ensuing liabilities by studying provisions of the Constitution, Indian Contract Act, 1872, Limitation Act, 1963, case laws and the principles that govern the contractual liability of the State.

Keywords: *Contractual Liability, Government Contracts, State, Administrative Law, Constitution of India, Contractual provisions*

INTRODUCTION

In modern state, whatever be the form of government, the individual is affected in his everyday life by acts of the State and its officials in various spheres and in different ways. Some of these acts are done by the State as the Sovereign while others are done by the State in trading and other capacities in the same manner as a private individual does.¹

Contractual liability of the State means a liability of the state for the acts done by the state in exercise of its power as a Sovereign as well as in other capacities in the same manner as an individual does. Provided below are the provisions which recognize the Contractual liability in India and the liabilities arising due to this recognition.

CONTRACTUAL PROVISIONS

A contract is an agreement enforceable by law, which offers individual or personal rights, and imposes individual or personal obligations, which the law secures and enforces against the parties to the agreement. Section 2(h) of the Indian Contract Act, 1872 defines a contract as "An agreement enforceable by law". The word "agreement" has been defined in Section 2(e) of the Act as "every promise and every set of promises, forming consideration for each other." The contracts entered into by the Central Government or a State Government in a similar capacity as that of a private individual are called "Government Contracts".

Since in welfare states like India, the government assumes a big responsibility of being the dispenser of various benefits and a large number of individuals and business organisations enjoy largess in the form of government contracts, licenses, quotas, mineral rights, jobs, etc., it raises the possibility of exercise of power by a government to dispense largess in an arbitrary manner. Therefore, there is a necessity to develop some norms to regulate and protect individual interest, structure and discipline the government discretion to confer such benefits.

The Indian Contract Act, 1872 does not prescribe any form for entering into contracts. A contract may be oral or in writing. It may be expressed or be implied from the circumstances of the case and the conduct of the parties. But the position is different in respect of Government Contracts as there can be no implied contracts.

In the case of *State of Bihar v. Majeed*ⁱⁱ, the Hon'ble Supreme Court held that:

"It may be noted that like other contracts, a Government Contract is also governed by the Indian Contract Act, yet it is distinct a thing apart. In addition to the requirements of the Indian Contract Act such as offer, acceptance and consideration, a Government Contract has to comply with the provisions of Article 299. Thus subject to the formalities prescribed by Article 299 the contractual liability of the Central or State Government is same as that of any individual under the ordinary law of contract."

A contract entered into by or with the Central or State Government has to fulfil certain formalities as prescribed by Article 299 of the Indian Constitution as provided below later on. With regards to the interpretation of contract, there is no distinction between the contracts to which one of the parties is the Government and between the two private parties.ⁱⁱⁱ

Though there is hardly any distinction between a contract between private parties and Government contract so far as enforceability and interpretation are concerned, yet, some special privileges are accorded to the Government in the shape of special treatment under statutes of limitation.^{iv}

Section 112 of the Limitation Act, 1963^v contains provision for longer period of limitation of suits on or behalf of the State. The longer limitation period was based on the common law maxim "*nulla tempus occurit regi*" i.e. no time affects the Crown.^{vi}

Some privileges are also accorded to Government in respect of its ability to impose liabilities with preliminary recourse to the courts. This probably is because of doctrines of executive necessity^{vii} and public interest.

CONSTITUTIONAL PROVISIONS

- Government contracts have been accorded Constitutional recognition.^{viii} Article 294 states that "all rights, liabilities and obligations of the Government of the Dominion of India and of the Government of each Governors Province, whether arising out of **any contract** or otherwise, shall be the rights, liabilities and obligations respectively of the Government of India and the Government of each corresponding State"
- The Constitution, under Article 298, clearly lays down that the executive power of the Union and of each state extends to "the carrying on of any trade or business and to the acquisition, holding and disposal of property and the making of contracts for any purpose."

"298. The executive power of the Union and of each State shall extend to the carrying on of any trade or business and to the acquisition, holding and disposal of property and the making of contracts for any purpose: Provided that –

(1) the said executive power of the Union shall, in so far as such trade or business or such purpose is not one with respect to which Parliament may make laws, be subject in each State to legislation by the State; and

(2) the said executive power of each State shall, in so far as such trade or business or such purpose is not one with respect to which the State Legislature may make laws, be subject to legislation by Parliament.”

This Article gives the government the executive power to enter into contracts with corporations and individuals to carry on any trade or business, acquire, hold and dispose property and make contracts.^{ix}

- Article 299 provides the formal requirements that need to be fulfilled for a Contract entered into by the government be held valid and enforceable.

“(1) All contracts made in the exercise of executive power of the union or a state shall be expressed to be made by the President or by the Governor of the State as the case may be, and all such contracts and all assurances of property made in the exercise of that power shall be executed on behalf of the President or the Governor by such person and in such manner as he may direct or authorise.

(2) Neither the President nor the Governor shall be personally liable in respect of any contract or assurance made or executed for the purpose of any enactment relating to Government of India hereto before in force, nor shall any such contract or assurance on behalf of any of them be personally liable in respect thereof.”

If the formal requirements required by article 299(1) are complied with, the contract can be enforced against the Union or the States.

It has been held by the Hon'ble Supreme Court in the case of Bhikaraj Jaipuria v. Union of India^x that the requirements are mandatory and not directory:

"it is clear from the words "expressed to be made" and "executed" that there must be a formal written contract... The provisions of Article 299(1) are mandatory in character and any contravention thereof nullifies the contract and makes it void. The provisions of Article 299(1) have not been enacted for the sake of mere form but they have been enacted for safeguarding the Government against the unauthorised contracts. The provisions are embodied in the constitution on the ground of public policy on the ground of protection of general public and these formalities cannot be waived or dispensed with."

Earlier, the view taken by the Supreme Court^{xi} was that when a contract does not comply with the provisions of Article 299, a suit could not be filed against the government but they could accept liability by ratifying it.^{xii} But in *Mulamchand v State of M.P.*^{xiii}, the Supreme Court held that if the contract was not in accordance with the constitutional provisions, in the eye of law, there was no contract and the question of ratification did not arise. Therefore, the contract would also not be enforceable as per section 230(3) of Indian Contract Act, 1872.^{xiv}

The requirements for the Government contracts are mandatory and not directory for two reasons: to protect the general public as represented by the government and to prevent the government from claims of liability ensuing from the requirements not being complied with. A contravention of the same would leave the contract void. (Article 299 and other articles are in pari materia with the provisions having the same effect, with respect to Contractual liability of the state, in the Government of India Acts 1833, 1858, 1915 and 1935)

It can be established from the text of the statute and from cases with conflicts regarding compliance of Article 299 that the requirements are:

1. It should be expressed to be made/ executed.

It was seen in *Bhikaraj Jaipuria v. Union of India*,^{xv} which is a significant case for determining the ambit of Article 299, where the plaintiff firm and the government (through Divisional Superintendent, East India Railway) had entered into a contract. The contract was held to not be in compliance with Article 299 for various reasons including the fact that it was not a written contract. It was seen in *Union of India v Rallia Ram*^{xvi} that any form of offer and acceptance along with compliance of Article 299 would be a valid contract, which includes the condition that the contract be in writing. Therefore, there can be no implied contracts.

In view of Article 299(1) there can be no implied or oral contract between the government and another person.^{xvii} The reason for such a strict approach is that if such implied contracts between the government and another person were allowed, they would in effect make Article 299(1) useless, for then a person who had a contract with the government which was not executed at all in the manner provided under Article 299(1) could get away by saying that an implied contract may be inferred on the facts and the circumstances of the particular case.^{xviii} The same inference was seen in *K.P. Chowdhary v. State of Madhya Pradesh*^{xix} by the Supreme Court.

2. It has to be executed by a person authorized by the President/Governor.

The contract can be entered into on behalf of the government by a person authorised for that purpose by the President or the Governor as the case maybe.^{xx}

In *Union of India v N.K. (P) Ltd.*^{xxi}, the Director was authorized to enter into a contract on behalf of the President. The contract was entered into by the Secretary, Railway Board. It was held by the Supreme Court that the contract was entered into by an officer not authorized for the said purpose. Therefore, the contract is not valid and not binding.

3. It has to be expressed in the in the name of the President/Governor.

The last requirement is that the contract has to be expressed in the name of the President for the country or Governor for the states. Therefore even if a contract has been entered into by an authorized person but it is not expressed to be made on behalf of the government, it is not enforceable.

In *Bhikaraj Jaipuria v Union of India*, the contracts entered into by the Divisional Superintendent, East India Railway were not expressed to be made on behalf of the Governor General. Hence the contract was not binding on the Government, even though it was entered into by an authorized person.

It was also similarly seen in *Davecos Garment Factory v State of Rajasthan*,^{xxii} where a contract was entered into by a contractor and the government through the Inspector General, in his official status without stating that the agreement was executed “on behalf of the Governor,” that such a contract is not enforceable as it does not comply with the provisions of Article 299.

Article 299(2) immunises the President, or the Governor, or the person executing any contract on his behalf, from any personal liability in respect of any contract executed for the purposes of the Constitution, or for the purposes of any enactment relating to Government of India in force. This immunity is purely personal and does not immunise the government, as such, from a contractual liability arising under a contract which fulfils the requirements under Article 299(1).^{xxiii} The governmental liability is practically the same as that of a private person, subject, of course, to any contract to the contrary.^{xxiv}

- It also provides that a government may sue or be sued by its own name under Article 300(1)-

“(1) The Governor of India may sue or be sued by the name of the Union and the Government of a State may sue or be sued by the name of the State and may, subject to any provisions which may be made by Act of Parliament or of the Legislature of such State enacted by virtue of powers conferred by this Constitution, sue or be sued in relation to their respective affairs in the like cases as the Dominion of India and the corresponding Provinces or the corresponding Indian States might have sued or been sued if this Constitution had not been enacted”

- A similar provision is found in the Code of Civil Procedure, 1908 under Section 79.

“79. Suits by or against Government: In a suit by or against the Government, the authority to be named as plaintiff or defendant, as the case may be, shall be- (a) in the case of a suit by or against the Central Government, [the Union of India], and (b) in the case of a suit by or against a State Government, the State.”

QUASI-CONTRACTUAL LIABILITY FOR GOVERNMENT CONTRACTS

The issue in Administrative Law mainly arises where the Departmental Authorities and public officials, owing to their inertia or ignorance, enter into informal contracts which do not comply with the requirements of Article 299(1). The courts have realised that a rigid observance of Article 299(1) is not always practicable.

Modern government is a vast organization. Officers have to enter into a variety of petty contracts, many a time orally or through correspondence without strictly complying with the provisions under Article 299. The provisions of Article 299(1) of the Constitution [section 175(3) of Government of India Act, 1935] are mandatory and if they are not complied with, the contract is not enforceable at the instance of any of the contracting parties. In such a case, to protect innocent persons, if what has been done is for the benefit of the government, for its use and enjoyment, and is otherwise legitimate and proper, courts have applied Section 70 of the Indian Contract Act, 1872 to compensate the other party on the basis of quasi-contractual liability, notwithstanding the fact that the contract in question has not been made as per the requirements of Article 299.

“70. Obligation of person enjoying benefit of non-gratuitous act. - Where a person lawfully does anything for another person, or delivers anything to him, not intending to do so gratuitously, and such other person enjoys the benefit thereof, the latter is bound to make compensation to the former in respect of, or to restore, the thing so done or delivered.”

Conditions laid down under section 70 are:

1. A person should lawfully do something for another person or deliver something to him;
2. In doing so, he must not intend to act gratuitously; and
3. The other person for whom something is done or to whom something is delivered must enjoy the benefit thereof.

All that Section 70 provides is that if the goods delivered are accepted, or the work done is voluntarily enjoyed, then the liability to enjoy compensation for the said work or goods arises.^{xxv} What Section 70 prevents is unjust enrichment and it is applicable as much to individuals as to corporations and governments. It needs to be emphasized that Section 70, Contract Act, does not deal with the rights and liabilities of parties accruing from that from relations which resemble those created by contracts.^{xxvi}

If Section 70 was to be held inapplicable, it would lead to extremely unreasonable circumstances and may even hamper the working of government. Like ordinary citizens even the government should be subject to the provisions of Section 70.^{xxvii}

Similarly, if under a contract with a government, a person has obtained any benefit, he can be sued for the dues under Section 70 of the Act though the contract did not conform to Article 299.^{xxviii}

If the Government has made any void contracts, it can recover the same under Section 65 of the Act.^{xxix}

“65. Obligation of person who has received advantage under void agreement, or contract that becomes void.—When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it

to the person from whom he received it. — When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it to the person from whom he received it.”

PRINCIPLES UNDERLYING CONTRACTUAL LIABILITY OF STATE

(1) Rule of Law: India is a democracy governed by the rule of law, which is the antithesis of arbitrariness, therefore, it is unimaginable to think that the executive Government or any of its officers would possess arbitrary power over the interests of the individual. The principle of reasonableness and rationality which is legally as well as philosophically an essential element of equality or non-arbitrariness is projected by Article 14 and it must characterize every State Action, whether it be under the authority of law or in exercise of executive power without making of law.^{xxx}

Every action of the executive Government should be reasonable as and should be free from arbitrariness. And to the application of this principle it makes no difference whether the exercise of the power involves affection of some right or denial of some privilege^{xxxii}

In the case of *Y. Konda Reddy v. State of Andhra Pradesh*^{xxxii} it was held that like all its (state's) actions, the action even in the contractual field is bound to be fair. It is well settled that the rights and obligations arising out of the contract after entering into the same is regulated by terms and conditions of the contract itself. It is also settled by principle of law that the Court would strike down an administrative action which violates any foregoing conditions^{xxxiii}

(2) Public Interest: Public interest is the paramount consideration. There may be circumstances where there are compelling reasons necessitating the departure from the rule, but there the reasons behind the departure must be rational and should not be suggestive of discrimination.^{xxxiv} Every action of the public authority or of the person acting in public interest or any act that gives rise to public element, should be guided by public interest. The consideration to weigh in allotting a public contract are and have to be different than in case of a private contract as it involves expenditure from the public exchequer. The action of the public authorities thus has to be in conformity with the standards and norms which are not arbitrary, irrational or unreasonable. If actions bear insignia of public law element or public character and they don't conform to such standards and norms, they are amenable to judicial review and

the validity of such standard/norm/action would be tested on the anvil of Article 14 and actions which are found arbitrary, unreasonable and unfair and prone to cause a loss to the public exchequer and injury to public interest can be struck down. Nothing should be done which gives an appearance of bias, jobbery or nepotism.^{xxxv}

CONCLUSION

An analysis of the extent of the liability of Government contracts shows that the Government has the same liability as a private individual or corporation when the contract is enforceable in the Courts. The enforceability depends upon the provisions of Article 299(1) as they are mandatory. The requirements for a valid contract are that they need to be expressed to be made and not implied, they need to be entered into by a person authorised for the same and they need to be in the name of the President or the Governor as the case maybe. Where such provisions are not complied with, provisions of unjust enrichment (section 70) and obligation of a person gaining advantage under void agreement (section 65) apply as Quasi-contractual liabilities.

The real extent of contractual liability is constantly developing by each case to keep up with the balance between the relief that innocent parties should receive and the protection that the government should also receive from unauthorized contracts to prevent the public funds from being placed in jeopardy due to contracts made by public servants without express sanction of law. This balance is visible in the judicial pronouncements where on one hand, the constitutional provisions are required to be strictly followed and on the other hand, unjust enrichment is grounds enough to receive compensation. They supplement each other. Judicial quest in administrative matters has to find the right balance between the administrative discretion to decide matters contractual or political in nature, or issues of social policy and the need to remedy any unfairness.

In absence of a clear and concise statute that clearly defined the contractual liability of the State, the pronouncements made by the Judiciary assume all the more importance. A State, when it enters into a contract, must do so fairly without discrimination and without unfair procedure; and its action is subject to judicial review under Article 14 of the Constitution of India, as a country that follows rule of law. The judicial power of review is exercised to rein any unbridled executive or administrative functioning generally and the power is also true in

cases of contracts entered into by the Government. This restraint lets judicial intervention keep check on the administrative functions of the state and covers the scope of the Court's ability to quash an executive decision on its merits even in cases of government contracts. These restraints bear the hallmark of judicial control over administrative action.

The Judiciary concerns itself with reviewing the decision-making process of the administrative or executive decisions made by the State which can be seen by the plethora of cases where the Supreme Court has outlined the contractual liability of the State along with its interpretations, requirements and scope. The Supreme Court has and will continue to demarcate the boundaries of the State's liability with respect to contracts effectively which is why judicial review is the perfect tool to lay down the ambit of the state's contractual liability.

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ⁱⁱ AIR 1954 S.C. 786.

ⁱⁱⁱ Ram Lal v. State of Punjab, MANU/PH/0068/1966: AIR 1966 Punj 436.

^{iv} Nav Rattanmal v. State of Rajasthan, MANU/SC/0035/1961: AIR 1961 SC 1704.

^v Any suit (except a suit before the Supreme Court in the exercise of its original jurisdiction) by or on behalf of the Central Government or any State Government, including the Government of the State of Jammu and Kashmir; Period of limitation: 30 years; Time from which period begins to run: When the period of limitation would begin to run under this Act against a like suit by a private person.

^{vi} Andhra Pradesh v. ChallaRamkrishna Reddy, MANU/SC/0368/1200: (2000) 5 SCC 712.

^{vii} According to the doctrine of executive necessity, the Crown (Government) cannot contract to fetter the future exercise of a statutory power or discretion required to be exercised in the public interest or by criteria in the statute.

^{viii} Articles 294, 298, 299 & 300, Constitution of India; S. P. SATHE, ADMINISTRATIVE LAW, 7th Ed., Lexis Nexis Butterworths, New Delhi.

^{ix} R.Kalaivani & R. Dhivya, *Contractual liability of the state in India : an analysis*.

^x MANU/SC/0045/1961: AIR 1962 SC 113.

^{xi} Chatterbuj Vithaldas v Moreshwar Parashram, AIR 1974 SC 236.

^{xii} As per section 296 of Indian Contract Act, 1876 which states that "where acts are done by one person on behalf of other, but without his knowledge, he may choose to ratify or disown such acts. If he ratifies then, the same effects will follow as if they had been performed by his authority."

^{xiii} (1978) 3 SCR 214: AIR 1968 C 1218.

^{xiv} Section 230 reads: Agent cannot personally enforce, nor be bound by, contracts on behalf of principal. — In the absence of any contact to that effect an agent cannot personally enforce contracts

entered into by him on behalf of his principal, nor is he personally bound by them: (3) where the principal, though disclosed, cannot be sued.

^{xv} *Ibid* 10.

^{xvi} MANU/SC/0003/1963: AIR 1963 SC 1685.

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^{xxi} (1973) 3 SCC 388: AIR 1972 SC 915; see also Davecos Garment Factory v State of Rajasthan (1970) 3 SCC 874: AIR 1971 SC 141.

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^{xxxi} RamanaDayaram Shetty v. International Airport Authority of India, MANU/SC/0048/1979 : (1979)3 SCC 489 : AIR 1979 SC 1628.

^{xxxii} MANU/AP/0018/1997: AIR 1997 AP 121.

^{xxxiii} Pyrites, Phosphates & Chemicals Ltd. v. Bihar Electricity Board, AIR 1996 Pat 1.

^{xxxiv} Aastha Mehta, *Contractual Liability of the State*, LexWarrier Article Archive.

^{xxxv} Shri Sachidanand Pandey v. State of W.B., MANU/SC/0136/1987: AIR 1987 SC 1109