

RETHINKING TERMINATION FOR CONVENIENCE CLAUSES IN INDIA: IS THERE A NEED TO IMPORT AMERICAN STANDARDS?

Written by Pranav Kumar

2nd Year BA LLB Student, National Law School of India University, Bangalore, India

ABSTRACT

Drafted termination for convenience clauses in contracts have consistently been gaining traction for the ease at which they allow a party to exit the contractual obligation. However, the Indian system of adjudicating these clauses and their viability, is deeply convoluted and inherently complicated. In light of the same, this essay provides reasons why the Indian jurisprudence must adopt the American system of adjudicating these clauses. It shows how the Indian judges are already using American standards of adjudication – sometimes directly, and sometimes indirectly - to adjudicate cases relating to these clauses in India. Thus, it argues, that it is only prudent to formally recognise such infusion, and if not adopt, acknowledge at least the American standards of adjudicating termination for convenience clauses in India.

INTRODUCTION

The last possibility a person venturing into a new business contemplates, is the setting up of a *modus operandi* to end this new venture. The celebrations around a recently formed partnership, understandably dissuade an exhaustive discussion on the terminating clauses involved. Nevertheless, the perennially transient and uncertain economic weather can easily seed the need to pull the curtain over such partnerships/agreements: for poor performance, delay, or whatever else the reason may be. This makes it imperative to have a way of ending contracts without liability. One way of legitimately exiting a contract without performance, is by terminating it via a drafted termination clause, which places conditions on which the parties can terminate the agreement.

Albeit rudimentary, termination clauses can broadly be put into two categories – terminating a contract *with* reason, and terminating *without* reason. This essay limits itself to exploring the legal contours of a ‘termination for convenience’ clause (“TFC”) – one that terminates a contract *without* reason. It is called so, as the party exercising this option, can terminate the contract at will, sans providing any justification.

This paper argues, that the Indian adjudication of TFCs, is in substance evolving to resemble the American understanding of the same. To that end, the essay shall *first*, map the history of TFC clauses and appreciate its adjudication in the USA and UK. *Second*, it shall attempt to contrast the complexity and judicial subjectivity in Indian standards of TFC adjudication with the relatively clearer American ones. *Finally*, it would show, that the Indian judiciary is not only formulating adjudicatory standards resembling American ones, but is also using American standards verbatim in some cases. Though this resemblance hasn’t been officially recognized yet, this essay would push for such acknowledgement to make TFC adjudication clearer and simpler in India.

HISTORY OF TFCS AND ITS ADJUDICATION IN THE USA

Around the First World War, the US Supreme Court was facing an intriguing problem in the renowned case of *United States vs Corliss Steam Engine*ⁱ. While entering into a contractual relationship, the federal government had inserted a clause allowing it to circumvent its contractual obligation at will, and exit the contract. The court, after considerable deliberation,

upheld the clause by acknowledging, that performance of such contract could end up being against the governments' best interest, or more simply, redundant. For example, contract for the purchase of military equipment stands redundant after peace. Soon this view was extended to most military contracts, and with time, to almost all federal contracts. However, such provisions were often (mis)used to favour governmental interestsⁱⁱ, leaving the other party in a disadvantageous position. Thus, by the 1970s, the justness of letting the government have unfettered use of such clauses was questioned, propelling many varying and often contradictory judgements.

This was until 1982, where the court acknowledged these obvious drawbacks, and set conditions on the usage of TFCs in *Torncello v. The United States*ⁱⁱⁱ. The relevant matter was such: the govt signed a service contract, knowing well that similar services could be availed for a lower price elsewhere. Later, the govt invoked the TFC clause to avail these services at cheaper rates from another vendor. The court rejected such action, and ruled that TFC clauses cannot be invoked to **“merely escape”** contractual obligations, and a **“change in circumstances”** is mandatory. It thus, allowed the wronged party to recover lost profits.

Subsequently, the court in *Questar Builders, Inc. v. CB Flooring*^{iv} further limited the use of TFCs by introducing the **“good faith”** principle. It stated, that invocation of TFC clauses by the government wouldn't pass muster if not done in “good faith”. It further said, that **‘something objective’** was required to prove ‘good faith’, and not mere emotional testimonies. In the same case, the court also considerably curtailed the scope of private entities invoking TFCs^v. It said, that private parties could successfully invoke TFCs only if it objectively proves a **‘change in circumstance’** that could lead to **substantial financial loss or other difficulties** in completing the project if the contract was performed. It also added the obligation of **‘acting reasonably’** and ensuring that a contract doesn't become **‘inconvenient’**. This standard, is followed up to date, and renders itself particularly significant in private contracts.

COMMON LAW ADJUDICATION^{vi}

Common law has a relatively clearer stance on the issue of TFC adjudication as compared to the States, or India (as we shall see). Under English law, there exists no requirement of ‘good faith’ or ‘change in circumstances’^{vii}. The parties have the complete freedom to invoke TFCs

without giving any reason, unless the TFC clause itself provides such conditions^{viii}. This stance was recently reiterated in the case of *TSG Building Plc v. South Anglia Housing Ltd*^{ix} where it was held that such right to terminate is unconditional insofar as there aren't any conditions mentioned in the contract itself.

LEGAL STANDING OF TFC CLAUSES IN INDIA

At the outset, the judgements and statutes in India don't boast of the clarity found in American or English understanding of TFCs. One thing, however, is clear. The courts do not follow the common law stance on TFC adjudication, but largely resemble the American process instead. That is, the courts have rejected the English approach of providing unfettered liberty to the parties invoking TFCs, and have set certain conditions for a successful invocation of the same. The challenge, however, is to trace these requirements.

This part of the essay, would first discuss the set principles of statutory law around TFCs, and second, attempt to *infer* through judgements, the mentioned requirements that need to be fulfilled in order to validly invoke TFC clauses. The method adopted involves looking at case laws in their chronological order, and tracing the broad developments over time. This would further the essay's argument, that the Indian adjudication process has grown to resemble the American one, along with providing a window into the relatively convoluted process of TFC adjudication in India.

WHAT WE KNOW FOR SURE

One of the foremost laws that reign over TFC adjudication, is the Specific Relief Act of 1963 ("SRA"). More specifically, Section 14(1)(c) which deals with contracts that can't be specifically enforced. It reads:

The following contracts cannot be specifically enforced, namely:

(a)...

(b)...

(c) a contract which is in its nature *determinable*

As expounded in *Rajasthan Breweries Ltd. vs The Stroh Brewery Company*^x, determinable contracts are those that can be ‘put to an end’. Reiterating what the court said, “all revocable deeds and voidable contracts may fall within "determinable" contracts”. Specific performance in determinable contracts is redundant, as the Court wouldn’t “go through the idle ceremony of ordering the execution of a deed or instrument, which is revocable at the will of the executant”. Similarly, the court isn’t empowered to issue injunctions for breach in this respect too as iterated in Section 41(e), SRA^{xi}.

The Supreme court, in cases like *Indian Oil Corporation Ltd. v. Amritsar Gas Service*^{xii} and *Her Highness Maharani Shantidevi P. Gaikwad v. Savijbhai Haribhai Patel*^{xiii}, held that an agreement containing a terminating clause was "determinable" and thus, specifically unenforceable^{xiv}. Since TFCs belong to a category of terminating clauses, it would logically follow that a contract containing a TFC clause would be “determinable” too, and hence not specifically enforceable. Though specific performance would’ve been a better remedy in certain cases, its unavailability doesn’t close all doors. Damages for the loss caused can certainly be claimed. The court has, in some cases also awarded expected profits to the wronged party^{xv}.

Does this mean *all* contracts having TFCs can’t be specially enforced? Theoretically, yes. Doctrinally, no. This is where the process convolutes.

WHAT NEEDS FIGURING OUT

The court has in certain cases, decided not to declare a contract “determinable” despite the existence of a TFC clause, or has sometimes ordered specific performance even after recognizing the “determinable” nature of the contract. This has considerably serpented the adjudication process, as now a new set of requirements need to be dealt with^{xvi}. As mentioned, this essay argues that the newly formed requirements are in substance, similar to the ones in American law, and that the Indian adjudicatory process could lose its complexity and confusion by formally acknowledging the same. Since these ‘requirements’ aren’t clearly stated in one judgement or statute, and we must at times *infer* from the case laws as we proceed. We best look at the cases in their chronological order, to understand this well.

BARGAINING POWER AND UNREASONABILITY (1986)

In 1986, the Supreme court birthed one of the first, (and arguably, the most interesting) exceptions to the general “determinable” contract rule (i.e. ‘contracts with TFCs aren’t specifically enforceable’) in the celebrated case of *Central Inland Water Transport Corporation Ltd v. Brojo Nath Ganguly*^{xvii}. The judges, while scrutinizing a TFC clause, held that in a contract between ‘unequal persons’, TFC clauses unfairly empowering one party are to be deemed ‘unreasonable’ and must be held void. It also discussed the doctrine of unconscionability, and iterated that when parties possess grossly unequal bargaining power, TFCs alone can’t successfully terminate the agreement.

In the language of the court, contracts that are entered into by parties possessing superior bargaining power, with a “number of persons who have less bargaining power” would be injurious to “public interest” if the terms are “unconscionable, unfair and unreasonable”. Thus, such a contract/clause must be declared void. However, this decision won’t apply to parties having similar/equal bargaining power (like most commercial transactions are). Since it’s only applicable to matters where larger public interest and superior bargaining power can be established, the scope of the decision is reduced considerably in everyday TFC adjudication.

“INSTRUMENTALITY OF STATE” (2006)^{xviii}

In the case of *Atlas Interactive v. Bharat Sanchar Nigam*^{xix}, the court provided a new set of requirements that government contracts must follow. The petitioner in this case, had relied on the contract to procure expensive custom-made equipment. The defendant (an “instrumentality of the state”) terminated the contract by invoking the TFC clause mentioned therein. The Court, instead of disallowing specific performance due to the “determinable” nature of the contract, provided three reasons to allow such specific performance instead:

- The **object** of the contract required the purchase of equipment **unusable elsewhere**.
- By virtue of being an “instrumentality of state”, the respondent’s actions must be **reasonable and not arbitrary**.
- Even if one were to award damages, there’s no way of calculating the loss caused.

Thus, it was held that this contract would be specifically enforceable.

“OBJECTIVE MATERIAL”, “ESCAPE ROUTE” (2012)

The Supreme court in *Rattan Lal v. S.N. Bhalla*^{xx} was faced with a TFC clause that automatically terminated the agreement if the requisite approvals weren't procured under six months by either party. Instead of declaring the agreement “determinable” and disallowing specific performance, the Supreme Court observed that TFC clauses aren't meant to be used as an ‘**escape route**’ if the party invoking it has failed to perform its own contractual obligation. Moreover, there must be some ‘**objective material**’ to prove that the party invoking TFCs has made ‘**positive efforts**’ towards fulfilling its contractual duties. If such proof doesn't exist, there would be a presumption that the TFC is being used as an ‘escape route’, and the agreement will be held to be wrongfully terminated. Meaning, specific performance may be ordered.

A quick summary of the judicial requirements are as follows:

<p style="text-align: center;">America</p>	<ul style="list-style-type: none"> • “Good faith” principle and ‘something objective’ to prove ‘good faith’. • Shouldn't use to “merely escape” obligations, and “change in circumstances” is mandatory. • Private parties can invoke TFCs only if they objectively prove a ‘change in circumstance’ that could lead to substantial financial loss or other difficulties. • Obligation of ‘acting reasonably’ and ensuring that contract isn't ‘inconvenient’.
<p style="text-align: center;">India</p>	<ul style="list-style-type: none"> • Shouldn't be used as an ‘escape route’ along with ‘objective material’ to prove the same. • Agreement with TFCs is “determinable” and specifically unenforceable. • ‘Unreasonable, unfair and unconscionable’ TFCs between ‘unequal

	<p>persons' is injurious to "public interest" and void.</p> <ul style="list-style-type: none">• Actions of "instrumentality of state", must be reasonable and not arbitrary.
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Thus, it is clear that the requirements themselves are similar in substance. There's no doubt, that developing a general principle akin to the one in *Questar* ("good faith") is helpful if not necessary. In fact, authors have argued that the Courts in decisions like *Atlas* have already indirectly applied the "good faith" principle. This is so, since, the Indian requirement of ensuring that TFCs aren't used as an 'escape route' using objective proof of 'positive efforts', can easily be read into American the requirement of 'good faith'.^{xxi} In India, however, the requirement of acting in a 'fair, just and equitable manner' is limited to the 'State or its instrumentalities'. Nevertheless, considering the historical trajectory in America, one can reasonably expect the courts to soon pose a similar condition on TFC invocation in private contracts too.

INSA Vs. ONGC (2019)^{xxii}

This recent case puts the lid over our study, and proves extremely useful in furthering the argument of this essay. It has been demonstrated that the exceptions and requirements churned by the Indian judiciary around the "determinable" rule, is similar in substance, and is evolving to resemble the ones in the States. However, this case law concretizes that point, as it adjudicates the case *primarily* using the American model, due to its substantive similarity to the one at home. That is, it relies on the American model of ascertaining the validity of the TFC instead of the Indian one outlined above. The matter was such:

A TFC clause was alleged to have been invoked in an 'abusive manner' by the petitioners. While scrutinizing such grievance, the court first constituted a committee, which started off by examining if the requirement of '**good faith**' was met. After such ascertainment, it stated that the "Opposite Party was justified in terminating the contract to prevent itself from incurring **further losses**", which the committee claimed, showed a '**material change in circumstance**'. Quoting the court, "provision of termination for convenience itself is not uncommon and

shouldn't generally be construed as unfair or abusive, unless it is specifically used in an unfair manner **without meeting** the legal tests of 'good faith' and 'change in circumstances'."

One must note, that 'material change in circumstance', 'performance leading to losses' and 'good faith' are American legal tests laid down in the *Torncello* and *Questar* cases respectively. The Indian standard, as mentioned in the *Rattan Lal* case, is to ensure that TFCs aren't being used as an 'escape route' along with 'objective material' to prove the same (*supra*). Though both standards lead to the same conclusion, what concerns us is the fact that courts are using broad American principles to adjudicate TFC clauses in India, though such infusion isn't formally recognized. Such action from the court could be met with two reactions, the first, that criticizes the court for not following the standards set by the Indian jurisprudence; and the second, that ponders over why the American jurisprudence was chosen over the Indian one. This essay falls in the latter category.

The previous sections of the paper have not only shown how complex and convoluted the system of TFC adjudication in India is, but have also demonstrated the relative clarity in the American process. Moreover, the destination both paths lead to, are similar if not same. In such a case, it shouldn't come as a gut-punching surprise that Indian courts sometimes resort to using another form of adjudication. In fact, instead of garnering criticism, such action should be the beginning of the debates and conversations around the perils and advantages of officially recognizing or adopting such American standards into the Indian jurisprudence.

CONCLUSION

It is not contested that the American and Indian standards of evaluating TFC clauses render similar conclusions. Neither is their efficacy under scrutiny. This essay, as mentioned, pushes for a formal acceptance of the American standard (maybe in the form of a test), as it is not only similar in substance to the Indian system, but is also far less convoluted. Consequently, the essay *first*, briefly mapped the history and adjudication of TFC clauses in the USA and UK; *second*, it tried to contrast the complexity and judicial subjectivity in Indian standards of TFC adjudication with the relatively clearer American ones; and *finally*, it argued that the Indian judiciary is not only formulating adjudicatory standards resembling American ones, but is also sometimes using American standards verbatim.

Though the usage of American standards hasn't been officially recognized or accepted yet, this essay would push for such acknowledgement, to make TFC adjudication clearer and simpler in India. As shown, however, even without such formal acceptance, the Indian courts have already used these standards in judgements; sometimes for persuasive value, and sometimes as the major ratio^{xxiii}. One possible reason might be the relatively rich jurisprudence of TFC adjudication in America that has matured the American standard in comparison to its Indian counterpart; the latter, being relatively nascent and convoluted. Thus, the Indian doctrine evolving to resemble the American one might as well be a forgone conclusion. It is only prudent for the courts recognize this, and strengthen the Indian standard of TFC adjudication. How it is to be done, is left to the judiciary.

ENDNOTES

ⁱ *United States vs Corliss Steam Engine* 91 U.S. 321

ⁱⁱ *Torncello v. United States*, 681 F.2d 756 (Fed. Cir. 1982)

ⁱⁱⁱ *ibid*

^{iv} *Questar Builders, Inc. v. CB Flooring* 978 A.2d 651 (Md. Ct. App. 2009)

^v by then, termination for convenience clauses had made their way into private contracts

^{vi} Young, K. Alice (2010) "Recent Developments: Questar Builders, Inc. v. CB Flooring, LLC: The Common Law Principles of Good Faith and Fair Dealing Apply to the Party Exercising Its Discretion to Terminate Private Party Contracts That Incorporate a "Termination for Convenience" Clause," *University of Baltimore Law Forum*: Vol. 40 : No. 2 , Article 10

^{vii} *Hadley Design Associates Ltd. v. Westminster City Council* [2003] EWHC 1617 (TCC)

^{viii} *INSA v. ONGC* AIR 2012 SC 3094

^{ix} *TSG Building Plc v. South Anglia Housing Ltd* [2013] EWHC 1151

^x *Rajasthan Breweries Ltd. vs The Stroh Brewery Company* AIR 2000 Delhi 450

^{xi} An injunction cannot be granted: (e) to prevent the breach of a contract the performance of which would not be specifically enforced

^{xii} *Indian Oil Corporation Ltd. v. Amritsar Gas Service* (1991) 1 SCC 533

^{xiii} *Her Highness Maharani Shantidevi P. Gaikwad v. Savijbhai Haribhai Patel* AIR 2001 SC 1462

^{xiv} Srinivasan, Varun, *Enforceability of Termination for Convenience Clauses in India* (Livelaw, 2017)

^{xv} *ibid*

^{xvi} *ibid*

^{xvii} *Central Inland Water Transport Corporation Ltd v. Brojo Nath Ganguly* 1986 SCR (2) 278

^{xviii} (n 13)

^{xix} *Atlas Interactive v. Bharat Sanchar Nigam* 126 (2006) DLT 504

^{xx} *Rattan Lal v. S.N. Bhalla* AIR 2012 SC 3094

^{xxi} (n 13)

^{xxii} (n 7)

^{xxiii} *ibid*