

## Contractual Liability of the State in India: An Analysis

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*In the modern era of a welfare state, government's economic activities are expanding and the government is increasingly assuming the role of the dispenser of a large number of benefits. Today a large number of individuals and business organisations enjoy largess in the form of government contracts, licenses, quotas, mineral rights, jobs, etc. The paper discusses the origin as well as current position of government contract in other countries like the UK, US etc. and then subsequently moves on to the Indian perspective. It analyses the position of government contracts in India, their statutory as well as judicial recognition and the liabilities on the State owing to the said recognition. Furthermore, the paper discusses various common law principles that govern the contractual liability of the State and make it a necessity in the modern times. The paper criticises the role of the executive and the legislative organs of the government and concludes that there is a necessity to develop some norms to regulate and protect individual interest in such wealth and thus structure and discipline the government discretion to confer such benefits.*

### Introduction

#### Contractual Liability of the State

In modern state, whatever be the form of government, the individual is affected in his everyday life and in the exercise of his civil rights 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.<sup>1</sup>

Hence, the subject of government contracts has assumed great importance in the modern times. In the modern era of a welfare state, government's economic activities are expanding and the government is increasingly assuming the role of the dispenser of a large number of benefits. Today a large number of individuals and business organisations enjoy largess in the form of government contracts, licenses, quotas, mineral rights, jobs, etc. This 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 in such wealth and thus structure and discipline the government discretion to confer such benefits.

A contract is an agreement enforceable by law, which offers personal rights, and imposes personal obligations, which the law protects and enforces against the parties to the agreement. The general law of contract is based on the conception, which the parties have, by an agreement, created legal rights and obligations, which are purely personal in their nature and are only enforceable by action against the party in default.<sup>2</sup> 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." A contract to which The Central Government or a State Government is a party is called a "Government Contract".

Government contracts have been accorded Constitutional recognition<sup>3</sup>. The Constitution, under Article 298<sup>4</sup>, 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". The Constitution therefore, provides that a government may sue or be sued by its own name. A similar provision is found in the Code of Civil Procedure 1908 under Section 79<sup>5</sup>.

## **Position in other Countries**

### **Britain**

According to Common Law, before 1947, the Crown could not be sued in a Court on a contract. This privilege was traceable to the days of feudalism when a lord could not be sued in his own courts which had arisen out of the theory of irresponsibility of the State as propounded by Roman Law.<sup>6</sup> Another maxim which was pressed into service was that the "King can do no wrong". A subject could, however, seek redress against the Crown through a petition of right in which he set out his claim, and if the royal fiat was granted, the action could then be tried in the Court. The royal fiat was granted as a matter of course and not as a matter of right, and there was no remedy if the fiat was refused.

The Crown Proceedings Act, 1947, abolished this procedure and permitted suits being brought against the Crown in the ordinary courts to enforce contractual liability, a few types of contracts being, however, excepted.<sup>7</sup> It follows, therefore, that regular proceedings now lie against the Crown for breach of contract, in those cases in which the petition of right earlier lay.<sup>8</sup>

### **United States of America**

in the United States, the principle of immunity of the State as a sovereign power was imported from England.<sup>9</sup> This led the Congress to enact the Federal Tort Claims Act, 1946, to abrogate, largely, the immunity of the Federal Government from Tortious liability, subject to specified exceptions. The application of this Act has been further liberalised by the Judiciary in various cases like *Hathley v. U. Section*<sup>10</sup>, *Rayonier v. U. Section*<sup>11</sup>, *India Towing Co. v. U. Section*<sup>12</sup> etc.

### **Australia**

The Judiciary Act, 1963 lays down the law relating to government liability. In the case of *Sargood Bros. v. Commonwealth*<sup>13</sup> it was held that an action lies against the Commonwealth in contract or tort, in the ordinary manner, by a subject or a state. Similarly, in the case of *Commonwealth v. New South Wales*<sup>14</sup>, it was held that a State may be sued in contract or in tort without its consent. Thus

the maxim, the King can do no wrong, has not been applied in Australia.

## The Indian Position

The words 'had not this Constitution been enacted' in Article 300(1)<sup>15</sup> indicate that the basis of sueability of the state in India is historical.<sup>16</sup> In order to appreciate the significance of these words, we must trace the history of the Indian Administration from the time of the East India Company, when the Court was of the view that even though the East India Company has sovereign powers, if it contracts in civil capacity and if it breaks its contract it would be held answerable.<sup>17</sup> Later the Government of India Acts (Section 30 of Act of 1915 and Section 175 of Act of 1935) expressly empowered the Government to enter into contracts with private individuals and the corresponding provision in the Constitution is Article 299(1). In all these Acts it was provided that the person making the contract on behalf of the Government would not be personally liable in respect thereof.

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. A contract entered into by or with the Central or State Government has to fulfill certain formalities as prescribed by Article 299 of the Indian Constitution. In the case of *State of Bihar v. Majeed*<sup>18</sup>, 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."

As regards 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.<sup>19</sup>

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.<sup>20</sup> Section 112 of the Limitation Act, 1963 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.<sup>21</sup> 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 and public interest.<sup>22</sup>

The executive power of the Union of India and the States to carry on any trade or business, acquire,

hold and dispose property and make contracts is affirmed by Article 298 of the Constitution of India. If the formal requirements required by article 299 are complied with, the contract can be enforced against the Union or the States. 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). There has been a plethora of cases on this point, yet the law is still not well settled.

**Article 299 of the Constitution provides :**

"(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".

It has been held by the Hon'ble Supreme Court in the case of Bhikaraj Jaipuria v. Union of India<sup>23</sup> :

"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."

The provisions have been embodied to protect the general public as represented by the government. The terms of the Article have therefore been held to be mandatory and not merely directory. In 1962, the Court repelled the foregoing view taken in the case of Chaturbhuj v. Moreswar<sup>24</sup> and came to lay down in the case of Bhikaraj v. Union of India<sup>25</sup> that the provisions of Article 299 are mandatory and a contravention thereof, would render the contract void. If so, the pettiness of the contract or the administrative practice was of no avail.

In view of Article 299(1) there can be no implied contract between the government and another person, the reason being 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.<sup>26</sup>

It was held by the Hon'ble Supreme Court in the case of K.P.Chowdhary v.State of Madhya Pradesh<sup>27</sup> that :

"In view of the provisions of Article 299(1) there is no scope for any implied contract. Thus no contract can be implied under this Article. If the contract between the Government and a person is not in compliance with Article 299(1), it would be no contract at all and would not be enforceable as a contract either by the Government or by the person."

The Court justified this strict view by saying that if implied contracts between the government and other persons were allowed, they would in effect, make Article 299(1) a dead letter, 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 pleading that an implied contract be inferred from the facts and circumstances of the case.

However, the Courts have also realised that insistence on too rigid observance of all the conditions stipulated in Article 299 may not always be practicable. Hundreds of government officers daily enter into a variety of contracts, often of a petty nature, with private parties. At times, contracts are entered through correspondence or even orally. It would be extremely inconvenient from an administrative point of view if it were insisted that each and every contract must be effected by a ponderous legal document couched in a particular form.<sup>28</sup>

### **The judicial attitude to Article 299 has sought to balance two motivations**

On the one hand, to protect the Government from unauthorised contracts; and

On the other hand, to safeguard the interests of unsuspecting and unwary parties who enter into contracts with government officials without fulfilling all the formalities laid down in the Constitution.

Under Article 299(1), a contract can be entered into on behalf of the Government by a person authorised for the purpose by the President, or the Governor, as the case may be. The authority to execute the contract on behalf of the government may be granted by rules, formal notifications, or special orders; such authority may also be given in respect of a particular contract or contracts by the President/Governor to an officer other than the one notified under the rules. Article 299(1) does not prescribe any particular mode in which authority must be conferred; authorization may be conferred ad hoc on any person.<sup>29</sup>

### **Article 300 provides that :**

(1) The Government of India may sue or be sued by the name of the Union of India 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.

(2) If at the commencement of this Constitution :

(1) any legal proceedings are pending to which the Dominion of India is a party, the Union of India shall be deemed to be substituted for the Dominion in those proceedings; and

(2) any legal proceedings are pending to which a Province or an Indian State is a party, the corresponding State shall be deemed to be substituted for the Province or the Indian State in those proceedings.

### **Principles Underlying Contractual Liability of State**

(1) Reasonableness, fairness : 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.

It is indeed unthinkable that in a democracy governed by the rule of law the executive Government or any of its officers should possess arbitrary power over the interests of the individual. Every action of the executive Government must be informed with reason and should be free from arbitrariness. That is the very essence of the rule of law and its bare minimal requirement. 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.<sup>30</sup>

In the case of *Y. Konda Reddy v. State of A.P.*<sup>31</sup> it was held that like all its actions, the action even in the contractual field is bound to be fair. It is settled law 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 settled principle of law that the Court would strike down an administrative action which violates any foregoing conditions.<sup>32</sup>

In a democratic society governed by the rule of law, it is the duty of the State to do what is fair and just to the citizen and the State should not seek to defeat the legitimate claim of the citizen by adopting a legalistic attitude but should do what fairness and justice demand.<sup>33</sup>

(2) Public Interest: Public interest is the paramount consideration. There may be situations where there are compelling reasons necessitating the departure from the rule, but there the reasons for the departure must be rational and should not be suggestive of discrimination. 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.<sup>34</sup> If actions bear insignia of public law element or public character they are amenable to judicial review and the validity of such action would be tested on the anvil of Article 14. Distinction between public law and private law remedy is now narrowed down.<sup>35</sup> Appearance of public justice is as important as doing justice. Nothing should be done which gives an appearance of bias, jobbery or nepotism.<sup>36</sup> Person holding public office must exercise his power in public interest and for public good.<sup>37</sup>

(3) Contractual Liability: 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 fulfills the requirements under Article 299 (1).<sup>38</sup> The governmental liability is practically the same as that of a private person, subject, of course, to any contract to the contrary.<sup>39</sup>

The Courts have adopted this view on practicable considerations. 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. In such a case, if what has been done is for the benefit of the government for its use and enjoyment, and is otherwise legitimate and proper, Section 70<sup>40</sup> of the Indian Contract Act, 1872 should step in and support a claim for compensation made by the contracting parties notwithstanding the fact that the contract in question has not been made as per the requirements of Article 299. 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.<sup>41</sup>

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.<sup>42</sup> If the Government has made any void contracts it can recover the same under Section 65 of the Act.<sup>43</sup>

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. What Section 70 prevents is unjust enrichment and it is 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.

## **Conclusion**

The State cannot, therefore, act arbitrarily in entering into relationship, contractual or otherwise

with a third party, but its action must conform to some standard or norm which is rational and non-discriminatory. The action of the Executive Government should be informed with reason and should be free from arbitrariness. The test of liability of the State should not be the origin of the functions but the nature of the activity carried on by the State. Despite the clear mandate for legislation provided under Article 300, nothing has been done in this regard. Even the Government (Liability in Tort Bill), 1967 which was introduced in the Parliament had not been passed due to the resistance of various State Governments.<sup>44</sup> The Government was of the view that the financial burden on the State would be more than it could possibly handle. 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. 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. 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. The judicial power of review is exercised to rein any unbridled executive functioning. The restraint has two contemporary significances. One is the ambit of judicial intervention; the other covers the scope of the Court's ability to quash an administrative decision on its merits. These restraints bear the hallmark of judicial control over administrative action. Judicial review is concerned with not reviewing the merits of the decision in support of which the application for judicial review is made, but the decision making process itself and therefore judicial review can be a sufficient tool to decide the ambit of contractual liability of the State.

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1. Basu, D. D., Administrative Law, 6th Ed., Kamal Law House, Kolkata, at p. 371

2. Avatar Singh, Contract and Specific Relief, 10th Ed., Eastern Book Company, Lucknow, 2008 at p. 6

3. Sathe, Section P., Administrative Law, 7th Ed., Lexis Nexis Butterworths, New Delhi 2004 at p. 578

4. 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.

5. 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.

6. Basu, D. D., *Administrative Law*, 6th Ed., Kamal Law House, Kolkata, at p. 371

7. Jain, M. P., *Outlines of Indian legal & Constitutional History* by M.P. Jain, Wadhwa and Co. Nagpur, New Delhi, 2006 at p. 1801.

8. *Windsor & Annapulus Ry. Co. v. Counties Ry. Co.*, (1886) 11 App. Cas. 607

9. *Supra* Note 4 at p 375

10. (1956) 351 U.Section 173

11. (1956) 352 U.Section 315

12. (1955) 350 U.Section 61

13. (1910) 18 CLR 258.

14. (1923) 32 CLR 200.

15 Article 300 provides that: The Government of India may sue or be sued by the name of the Union of India 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.

16. *Supra* Note 4 at p. 380

17. *Moodalay v. E.I. Co.*, (1785) 1 Bro. C.C. 469

18. AIR 1954 SC 786

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

20. *Navrattanmal v. State of Rajasthan*, MANU/SC/0035/1961: AIR 1961 SC 1704

21. *Andhra Pradesh v. Challa Ramkrishna Reddy*, MANU/SC/0368/1200: (2000) 5 SCC 712.

22. *Supra* Note 3 at p. 382

23. MANU/SC/0045/1961 : AIR 1962 SC 113.
24. MANU/SC/0092/1954 : (1954) SCR 817 (835)
25. MANU/SC/0045/1961 : AIR 1962 SC 113.
26. Union of India v. Rallia Ram, MANU/SC/0003/1963 : AIR 1963 SC 1685
27. MANU/SC/0023/1966 : AIR 1967 SC 203: (1966)3 SCR 919 see also Chandra Bhan Singh v. State of Bihar, AIR 1967 Pat 15
28. Supra Note 4.
29. State of Bihar v. Karam Chand Thapur, MANU/SC/0002/1961 : AIR 1962 SC 110
30. Ramana Dayaram Shetty v. International Airport Authority of India, MANU/SC/0048/1979 : (1979)3 SCC 489 : AIR 1979 SC 1628
31. MANU/AP/0018/1997 : AIR 1997 AP 121.
32. M/Section Pyrites, Phosphates & Chemicals Ltd. v. Bihar Electricity Board, AIR 1996 Pat 1
33. (M/Section) Hindustan Sugar Mills v. State of Rajasthan, MANU/SC/0442/1979 : AIR 1981 SC 1681
34. Supra Note 4 at p. 421
35. LIC v. Consumer Education and Research Centre, MANU/SC/0772/1995 : (1995) 5 SCC 482
36. Shri Sachidanand Pandey v. State of W.B., MANU/SC/0136/1987 : AIR 1987 SC 1109
37. State v. P.C. Mishra, 1995 Supp (4) SCC 139
38. State of Bihar v. Sonabati, MANU/BH/0174/1954 : AIR 1954 Pat 513
39. State of Bihar v. Abdul Majid, MANU/SC/0120/1954 : AIR 1954 SC 245: 1954 SCR 786
40. 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.
41. State of West Bengal v. B.K. Mondal, AIR 1962 SC 152; see also New Marine Coal Co. v. Union of India, MANU/SC/0051/1963 : AIR 1964 SC 152
42. State of Orissa v. Rajballav, AIR 1976 Ori 79
43. Pannalal v. Deputy Commissioner, MANU/SC/0031/1973 : AIR 1973 SC 1174; see also Union of India v. J.K Gas Plant,

MANU/SC/0100/1980 : AIR 1980 SC 1330.

44. Veena Gopalakrishnan, Government Contracts, <http://www.legalserviceindia.com/article/I42-Government-Contracts.html>