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Contractual Liability of State in India- An Analysis

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Abstract: ***It has been said that the question of liability of the State is a matter which brings a feeling of majority response whenever the government assumes the role of a welfare state in any democratic country. Contractual Liability is 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. The concept of liability of state for breach of contract is not new in India. The researcher believes that today large number of individuals is entrusted by the Government for various purposes in the form of Government contracts which raises a possibility of Government functioning in an arbitrary manner and the need was felt to regulate and protect the interests of an individual wealth. The researcher further believes that the main reason this issue arises here is to determine whether the individual whose rights are affected or who suffers injury by the Acts of the State is entitled to remedy by the state. There are Constitutional provisions in India which talks about contractual liability of the state. The Supreme Court in R D Shetty v International Airport Authority of India case has also laid down certain prepositions with respect to government contracts.***

The researcher will also be focusing on the following aspects in this paper:-

Contractual Liability of State in India- An Overview
Constitutional Provisions with respect to the Contractual Liability of the state
Principles Underlying Contractual Liability of the State
Position in Other Countries
Judicial Review in Contractual matters
Conclusions

The researcher will be using non- doctrinal and empirical research technique of research methodology. This paper will highlight the plight of the prisoners in police custody in India and various human rights of the prisoners.

Keywords: Contractual Liability, Government, Individual wealth, breach of contract.

I. INTRODUCTION

In India the concept of state has been defined under Article 12 of the Constitution of India which says that state includes the Government and the Parliament of India and the Government and legislature of each of the states and all local and other authorities within the territory of India and under the control of Government of India. An individual while exercising his rights is affected by the Acts of the State and its officials in one way or the other. This question of liability of the State is a matter which brings a feeling of majority response whenever the government assumes the role of a welfare state in any democratic country. These Acts are 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. The state is also subject to law and it cannot violate individual rights. So the main issue that arises here is whether the individual whose rights are affected or who suffers injury by the Acts of the State is entitled to remedy by the state. So there are certain options which are available to an individual to have recourse:-

i. He may proceed against the officer concerned or
ii. He may sue the government on whose behalf the officer was acting.

Liability of the State differs in different countries as the different countries have different legal systems.

In India the Union or the States are legal persons and they can be held liable for breach of contract. The concept of liability of state for breach of contract is not new in India. This concept was incorporated by the Royal Charter at the time of the East India Company. It was clearly laid down in this concept that merely because East India Company exercises sovereign functions they could not be immune from being sued in its own courts. Even the Government of India Acts, 1915 and 1935 empowered the Government to enter into contract with private individuals. Government contracts have a significant place in the modern economy and it is becoming important day by day. Today large number of individuals is entrusted by the Government for various purposes in the form of Government contracts which raises a possibility of Government functioning in an arbitrary manner. So the need was felt to regulate and protect the interests of an individual wealth.

A contract is an agreement enforceable by law. Government contracts are the contracts to which the Central Government or the State Government is a party. In this paper I will emphasize upon the law relating to Government contracts and the contractual liability of state in India. Government contracts have been accorded constitutional recognition. It provides that the executive power shall extend to the carrying on of trade or business and acquisition, holding and disposal of property and making of contracts for any purpose.

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II. CONTRACTUAL LIABILITY OF STATE IN INDIA

The liability of the Government for the breach of contract was recognized even before the commencement of this Constitution. When the East India Company was established mainly for the purpose of commercial activities in India it was said that the fact that East India Company exercised the sovereign functions it cannot be said that they could be immune from being sued in its own courts to the Company.1

The liability of the Government had been recognized in the number of statutes also. Thus the provisions were made in the Government of India Acts of 1833, 1858, 1915 and 1935.2

In P. & O. Steam Navigation Co. V Secy. Of State3- it was held by the Supreme Court that no action would lie against the state where the contract was entered into in exercise of sovereign functions of the state. The Calcutta High Court observed and followed the decision of this case in Nobin v. Secy. Of State4 where it was held by the High Court that the Government was not liable for refusing to grant a licence to the plaintiff for the sale of ganja as the sale of ganja was related to sovereign function. But the Nobin v Secy Of State's decision was refused on the ground that P.& O. Case was a case of torts and no question of contractual liability was involved.

However the Government of India Act (1915 and 1935) empowered the Government to enter into contracts with private individuals and the corresponding provision in the Constitution is Article 299(1).

Article 299(1) - prescribed certain formalities for contracts in order to be binding upon the Government. It provided that the person would not be liable if he would make contracts on behalf of the Government. It also provided for the mode and the manner of execution of such contracts which says that This Article also laid down certain requirements which must be fulfilled by the Union or the State:-

i. All such contracts must be made by the President or the Governor;
ii. All such contracts to be executed by such persons to whom the President or the Governor may direct or authorize and
iii. All such contracts which were made in the exercise of the executive power are to be executed on behalf of the President or the Governor.5

1. This Article 299(1) also provided that the contract has to be in writing in order to be valid and if there is an oral contract the same cannot be binding on the Government.6

In Chatturbhuj Vithaldas v Moreshwar Parashram- it was held by the Supreme Court that the Government officers cannot enter into contracts orally or through correspondence. This does not mean that there must be a formal agreement properly signed by a duly authorized officer of the Government. The words expressed and executed have not been literally and technically construed.7

2. Contract must be entered into or executed by a person authorized by the President or the Governor as the case may be.- this article does not prescribe for any mode of authorization so the normal procedure to be considered as proper authorization which is to be followed i.e. by notification in the official capacity.

The court in Bhikraj Jaipuria v Union of India8- observed that the contracts were entered into between the Government and the plaintiff firm. However no specific authority had been conferred on the Divisional Superintendent and in furtherance of the contract the order was placed by the Divisional superintendent and foods grains were supplied to the Railways. However after some time Railway Administration refused to take the delivery of goods on ground that the proper authority here was Secretary to the Railway Board and the evidence showed that officer of the Railway Board was authorized to take delivery, transport it and distribute it. On the basis of such facts the Supreme Court on considering the evidence held that Divisional Superintendent acting under the authority could enter into contracts. Court further held that it is clear that there must be clear formal written contract and the provisions of Article 299 are mandatory and any contravention of it will make a contract null and void. The provisions of this Article 299(1) have not been enacted for mere formality but for safeguarding the Government against the unauthorized contracts and in this case Supreme Court held that the Divisional superintendent had the implied authority to execute the contract.

Again it was held by the Supreme Court in K.P Choudhary v State of Madhya Pradesh9- that there is no scope for implied contract as per the provisions of Article 299(1). No contract can be implied if it was not in compliance with Article 299(1). Then that contract cannot be enforced either by the Government or by the people.

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[1] *Moodalay v E.I Co* [1785] 1 469 (Bro. C.C)
[2] C.K Takwani, *Lectures on Administrative Law* (3rd, Eastern Book Company, Lucknow 2004) 351
[3] [1861] H.C.R 5 (Bom.)
[4] [1875] 1(Cal.) 11.
[5] I.P Massey, *Administrative Law* (8th, Eastern Book Company, Lucknow 2012)
[6] *Chatturbhuj Vithaldas v Moreshwar Parashram* [1954] AIR 236(243) (SC)
[7] Ibid at 352
[8] [1962] AIR 113 (SC)
[9] [1967] AIR 203 (SC)

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3. It provided that the contract must be expressed to be made in the name of the President or the Governor and if the contract was made by the officer authorized by the Government but was not made on behalf of the President or the Governor then the contract cannot be enforced against them.

In Davecos Garments Factory v State of Rajasthan10- it was held that the requirements of article 299(1) have been complied with. Here in this case contract was signed by the Inspector General of Police (IG) for the supply of police uniforms but he did not signed on behalf of the Governor. But the Court held that competent authority signed in his official capacity so requirements have been complied with.

Objectives of Article 299

i. To safeguard the interests of the Government.
ii. To protect the Government against the unauthorized contracts.

The provisions of Article 299(1) are mandatory and not directory and they must be complied with. The provisions had been inserted not merely for the sake of form but also to safeguard the Government against the unauthorized contracts and if the contract is unauthorized or in excess of authority then the Government must be protected. If the contract is not in compliance with the condition then it is not a contract.

It was held by the Supreme Court in Union of India v A.L Rallia Ram 11- that no formal document need to be executed although the word "Expressed" suggest that government contract must be in particular form. Further it was observed that if the provisions of article 299(1) are complied with then the contract is valid and it can be enforced by or against the Government and the same is binding on the parties.12

However there are certain exceptions to the rule that a contract in contravention of Article 299 is void.

i. There are certain provisions of Contract Act which provides for some relief to either party even where the contract is void.
ii. Invalidity of a contract for contravention of Article 299(1) cannot be set up to nullify the provisions of statutes relating to collateral matters.
iii. The private party may be estopped from questioning the validity of the conditions imposed by an invalid contract, when he has obtained benefit under it.13

Article 299(2)-it provided that Government could not be held liable under Article 299.In other words it can be said that neither the President nor the Governor shall be held personally liable in respect of the contract executed for the purpose of the Constitution or the purpose of any enactment relating to the Government of India.14 It also provided personal immunity to the person if he makes contract on behalf of the President or the Governor.

Earlier when the conditions of Article 299(1) was not complied with suit could not be filed against the Government as the contract was not enforceable but now the Government can accept the liability by ratifying it. But the Supreme Court in Mulamchand v State of M.P 15held that there is no applicability of doctrine of ratification. It further said that if contract was not in accordance with the constitutional provisions, there was no contract at all and the question of ratification did not arise.

In Ramana Dayaram Shetty v International Airport Authority of India and Ors16- the notice was issued for inviting tenders for putting up and running a second class restaurant and two snack bars at International Airport at Bombay by the first respondent and the 4th respondent was awarded contract .However the 1st respondent set aside the requirement of 5 years experience and proceeded with the 4th respondent. The appeal was rejected by the High Court and the issue raised was whether the state was entitled to deal with its property in any manner it liked or award a contract to any person it chose, without any constitutional limitations upon it. It was held by the court that when 1st respondent entertained tender of 4th respondent despite their inexperience, then, others were denied equality of opportunity. Thus the acceptance of tender of 4th respondent was invalid as being violative of equality clause of Constitution as also of rule of administrative law inhibiting arbitrary action.17 In this case the following principles emerge:-

i. Government does not have open and unrestricted choice in the matter of awarding contracts.
ii. Government to exercise its discretion in conformity with some reasonable and non- discriminatory standards or principles

[10] AIR 1971 SC 141
[11] AIR 1963 SC 1685: (1964)3 SCR 164
[12] *State of Bihar v Abdul Majid* [1954] AIR 245 (SC)
[13] *Timber Kashmir v Conservator* [1977] 151 (S.C)
[14] C.K Takwani, *Lectures on Administrative Law* (3rd, Eastern Book Company, Lucknow 2004) 356
[15] [1968] AIR 1218 (SC)
[16] [1979] AIR 1628 (SC)
[17] 'Ramana Dayaram Shetty v International Airport Authority of India and Ors.' (www.manupatra.com) <http://www.manupatrafast.in/Pers/Personalized.aspx> accessed 2-11-2014

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iii. Government is bound by standards laid down by it.
iv. Government can depart from these standards only when it is not arbitrary to do so and the departure is based on some valid principle which in itself is not irrational, unreasonable or discriminatory.

Since Ramana's case Supreme Court laid down prepositions in respect of Government Contracts. There was a change in judicial approach and it was held in this case that government no longer enjoys absolute discretion to enter into contract with anyone it likes and now the Government is a private individual and the Government is bound to follow constitutional law principles if it violates Fundamental rights and then it is subject to writ jurisdiction of the court. Any contract or award by state can be challenged if it violates fundamental rights and it is subject to writ jurisdiction of the court.

Another issue that arises was that if a person enters into contract with the Government and is entitled to certain benefits there under, he can approach a court of law. But then the dispute arises in course of performing the contract whether the party can move the Supreme Court under Article 32 or the High Court under Article 226 of the Constitution of India. It was said that if it is award and the Government fails then it can be challenged and if the award is valid or justified thereafter the contract is subject to contract law and that contract is in realm of private law. It was further said that Government contract is subject to the Indian Contract act, 1872 and if in course of discharge of contract dispute arises and the public law element is involved then it is subject to the writ jurisdiction of the court.

Article 300- it provides that the Government may sue or be sued by the name of the Union of India or the Government of a State subject to any provisions made by Act of Parliament or of the State Legislature 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.

III. CONSTITUTIONAL PROVISIONS WITH RESPECT TO THE CONTRACTUAL LIABILITY OF THE STATE

Article 294- provides for the succession to property, assets, rights, liabilities and obligations to the present Government of the Union and the State.

Article 298- says that Government can enter into contract for the purpose of carrying out the functions of the State.

Article 299- it deals with the certain essential formalities which the Government must fulfil while entering into a contract.

Article 300- speaks about the manner in which the suits and proceedings be instituted by the government.

The contract entered into by the Government cannot be complete unless the Government besides satisfying the requirements of the Article 299 of the Constitution also fulfils the requirements of the section 10 of the Contract Act, 1872 dealing with the essentials of the valid contract.18Section 73, 74 and 75 of the Contract Act, 1872 is also applicable while dealing with the government contracts. However the Indian Contract Act, 1872 did not provide for any specific form for entering into a contract. It says that contract may be expressed or implied which can be inferred from the circumstances of the case and from the conduct of the parties. The contract may be oral or in writing. The position is however different with regard to the Government Contracts. It was held by the Supreme Court in State of Bihar v Majeed19- that the Government Contracts are also governed by the provisions of the Indian Contract Act, 1872 like any other contract. In addition to that Government Contracts has also to fulfil the requirements of Article 299 of the Constitution. The contractual liability of the Government will be the same as that of any other individual. Article 300 of the Constitution also points out that the extent of liability of the Union of India will be same as that of Dominion of India and the provinces under the Government of India Act, 1935. The Act of 1935 refers to Act of 1915 which further refers to Government of India Act, 1858 that means in order to determine the extent of liability of today East India Company must also be referred to. Before 1947 the Crown in U.K enjoyed immunity from being sued in its own courts but this immunity does not extend to East India Company. Government of India Acts 1858, 1919 and 1935 also provides for the manner in which government contracts must be made.

IV. PRINCIPLES UNDERLYING CONTRACTUAL LIABILITY OF THE STATE

1. Reasonableness, fairness
2. Public interest
3. Equality, non-arbitrariness

Reasonableness, fairness

This principle is an essential element of equality and non- arbitrariness which has been laid down in Article 14 of the Constitution. It must characterize every state action whether under the authority of law or in exercise of executive power without

[18] I.P Massey, *Administrative Law* (8th, Eastern Book Company, Lucknow 2012)
[19] [1954] A.I.R 786 (S.C)

making of law.20 It further provides that state must not act arbitrarily while entering into contractual relationship with the third parties and it must conform to rational or non- discriminatory norms.

Fairness- this requirement further implies that even administrative authority must act in good faith and without bias. It is a settled principle of law which says that the Court would strike down an administrative action which violates any foregoing provisions.21 This doctrine of fairness was established in administrative law to ensure Rule of Law and to prevent failure of justice.

Public Interest

This concept of public interest is of prime importance. There are circumstances which necessitate us to depart from public interest rule but those circumstances must be fair and rational. Every public authority is required to act in the public interest. Nothing should be done which shows biasness from their side. They must exercise their power in public interest and in public good.

Equality and non- arbitrariness

According to positivist equality is antithesis to arbitrariness. When an act is arbitrary it is implicit that it is unequal and violative of Article 14. The principle of reasonableness which is an essential element of equality and non- arbitrariness pervades Article 14 and its procedure is laid down in Article 21.

V. POSITION IN OTHER COUNTRIES WITH RESPECT TO CONTRACTUAL LIABILITY OF STATE

UNITED KINGDOM

Under the Common Law the situation was however different. The State has been granted immunity based on two maxims:-

i. "The King by his writ cannot command itself."22 It says that no legal process or the proceedings can be instituted against the Crown.

However in certain exceptional circumstances the action can be taken against the Crown and the person can get a relief only by a petition of right not as a matter of right.

This petition of right can be laid down against the Crown in few circumstances:-

a) To recover the lands, goods or moneys wrongfully gone into the possession of the Crown where the suppliant demands either restitution or compensation.
b) To recover liquidated or unliquidated damages for breach of contract by the Crown.
c) For moneys payable to the suppliant under a grant of the Crown
d) To enforce the statutory duty.23

Similarly petition of right did not lie against the Crown where a remedy is provided by the statute, with regard to the Acts of State and for torts.

ii. The maxim Rex non potest peccare states that "The King can do no wrong." It means that King is not answerable to any Court. Neither he can be prosecuted in a criminal case nor he can be sued in a civil case in any Court of Law. Hence this immunity does not prevent him entering into any contract and no action can be brought against the Crown or its officials for breach of contract and the only remedy available to him was by a petition of right.24

However this petition of right was abolished by Crown Proceedings Act, 1947. It provides that now the individual is entitled to bring an action against officials of the State. Under the Common law after the enactment of the Crown Proceedings Act, 1947 now officers concerned were held liable. Now the regular proceedings lie against the Crown in those cases in which petition of right lay for breach of contract25. This was the condition in the earlier times when the officers concerned were treated as ordinary citizens' .But with the paradigm shift in the government powers now the officer's liability has been changed into "State Liability" on whose behalf the individual acts. In England the law does not provide for any special formalities with the Government or public authorities and under the Crown Proceedings Act, 1947 the Crown is liable in the same manner as an ordinary individual provided the person who acted on behalf of the Crown had authority, express or implied to enter into a contract on behalf of the Crown.26

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[20] http://www.legalserviceindia.com/article/l42-Government-Contracts.html > accessed 28-10-2014
[21] *M/S Pyrites ,Phosphates & Chemicals Ltd. V Bihar Electricity Board* [1996] 1 AIR 1 (Pat)
[22] *Sadlers Company Cases* [1588] 4 Rep 54b
[23] Durga Das Basu, *Administrative law* (6th, Kamal Law House Kolkata, Kolkata, 2006)372
[24] *Macbeth v Haldimand* [1786] 1 T.R 172
[25] *Windsor& Annapolus Ry. Co. V Counties Ry. Co* [1886] 11 App. Cas. 607
[26] *A.G for Ceylon v Silva* [1953] A.C 461 (P.C)

In R v Lord Chancellor27- it was laid down concerning the decision of the defendant that not to award to the claimant a contract for reporting services in certain courts, it was held that although there had been unfairness in the conduct of the tendering process, the decision lacked a sufficient public law element to render it amenable to judicial review.28

UNITED STATES OF AMERICA

In U.S.A immunity was granted to the State as a sovereign power. This concept has been taken from England even though the Constitution was republican. It was however an established principle in U.S that a sovereign state cannot be sued in its own courts or in any other court without its order and permission but it may waive its privilege and permit it to be made a defendant subject to certain terms and conditions on which it consents to be sued and the manner in which suit shall be conducted and may withdraw its consent whenever it may suppose that the justice to the public requires it.29This led the Congress to establish Federal Tort Claims Act, 1946 to abrogate the immunity of Federal Government from tortuous liability subject to certain exceptions. The application of this Act has been liberalized by the judiciary in various cases.

In Hathley v U.S30 – it was held that the application of the Act has been liberalized by holding that the Act imposes liability on the Government for negligent as well as wrongful acts done without negligence. Provided it is done by the Federal Employee or agent acting within scope of employment.

The Federal government enjoys additional immunity from suits by any State without its consent. In other words it can be said that Federal Government cannot be sued by a State without the consent of the Federal Government.31

VI. JUDICIAL REVIEW IN CONTRACTUAL MATTERS

A State need not enter into a contract with anyone if it does so it must do so fairly and without any discrimination and following unfair procedure and it is subject to the Judicial Review under Article 14 of the Constitution of India.32 The State while dealing with the contracts has to follow certain standards and norms and those norms must not be arbitrary, irrational or irrelevant. In exercise of the contractual obligation by the State principles of judicial review apply in order to avoid arbitrariness. The extent to act fairly will vary from case to case. A State cannot act arbitrarily in selecting the persons with whom to enter into contracts.33

In G.E. & E. Co. V Chief Engineer34- the Government awarded a contract to a person other than the person with the lowest tender. It was alleged that discrimination has been made against him but the court rejected the contention by saying that the person cannot claim protection under Article 14 as the choice to fulfil the particular contract was with the Government. The Court while exercising the power of judicial review is primarily concerned with the infirmity in the decision making process. The Court will see that the decision making process is rational and not arbitrary and not violative of Article 14 of the Constitution. But once the procedure adopted by the Court was found to be against the mandate of article 14 of the Constitution, the Court cannot ignore that the parties have liberty in contractual matters and any interference amounts to encroachment on the part of the executive to take action.35

It can be thus said that if the decision is found to be reasonable then the court has no function to look into the merits.

VII. CONCLUSION

It can thus be concluded that State is as much liable as an individual is liable to enter into a contract. But the State cannot act arbitrarily in entering into a contractual relationship. So when the State enters into a contract it has to comply with certain formalities which have been enumerated in Article 299 of the Constitution of India like all such contracts must be made by the President or the Governor or to be executed by such persons to whom the President or the Governor may direct or authorize or which were made in the exercise of the executive power are to be executed on behalf of the President or the Governor. All the requirements under Article 299 are mandatory but if the State fails to comply with the provisions of Article 299 of the Constitution of India the contract will be null and void. The provisions of article 299(1) have been enacted for the purpose of safeguarding the interests of the State against the unauthorized contracts and if the contract is unauthorized or in excess of authority then the Government must be protected. If the contract is not in compliance with the condition then it is not a contract. Earlier when the conditions of Article 299(1) was not complied with suit could not be filed against the Government as the contract was not enforceable but now the Government can accept the liability by ratifying it. So now the position is that compliance with these provisions depends upon the cases accepted by the Courts. In many of its judgments court has given its mandate as to strict

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[27] (1993) COD 326
[28] Mark Elliott, *Administrative law* (3rd, Oxford University Press, New Delhi 2007)585
[29] *Jossep v Arkansas*, 20 How. 527;*Railroad Co. V Tennessee*,(1879) 101 (U.S)
[30] [1956] 351 U.S 173(181)
[31] *Kansas v U.S* [1907] 204 331(342) (U.S.)
[32] *Eurasian Equipment & Chemicals Ltd v State of West Bengal* [1975] AIR 266 (SC)
[33] M P Jain & SN Jain, *Principles of Administrative Law* (5th, Wadhwa and Company Law Publishers, Nagpur 2007) 847
[34] [1974] AIR 23 (Ker)
[35] *Sterling Computers Ltd v M/s M&N Publications Ltd* [1996] AIR 51 (SC)

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observance of these provisions. However the position was somewhat different in U.K where it was believed that King can do no wrong but the Crown Proceedings Act, 1947 abolished this practice and now even in U.K the Crown is liable in the same manner as an ordinary individual and there law does not provide for any special formalities with the Government or public authorities.

It can thus be said that the State is not immune from entering into contractual obligations and suit can be filed against it as per the provisions of Indian Contract Act, 1872. So it is required that the State should not act arbitrarily while entering into the contracts and the action of the State is subject to judicial review as per Article 14 of the Constitution of India.

Hence the State must enter into contract non- arbitrarily and judicial review is sufficient to decide the contractual liability of the State.

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