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Contractual Liability of the State: A Comparative Analysis

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ABSTRACT

The State is a multi-dimensional being that exists and operates in different spheres with different characteristics. In International Law, State is a sovereign which has the power to dictate the Laws by which it would be bound, whereas in Indian Municipal Law or Domestic Law, the Constitution is Suprema Lex and nothing, not even the State is above it. The Constitution of India prescribes and governs the manners in which the Indian State will interact with external stimuli within which includes the existence and functioning of the State as an individual entity that has the capacity to enter into contractual relations with any public, private, or individual entities in the Indian terrain. As in the case of any other entity, a contract entered into by the Indian Government can be enforced against it, provided all the pre-requisites of a valid contract are fulfilled, alongside the public policy element which is an addition to the existing contractual norms when it comes to contractual liability of the Indian Government. This article analyses the Contractual Liability of Indian Government in context of the Constitutional provisions and judgments rendered by the Constitutional Courts of the Country, as well as compares them to different jurisdictions across the globe.

Keywords: *Administrative Law, Constitutional Law, Sovereign Functions of the State, Tortious Liability of the State, Governmental Contracts Enforcement.*

I. INTRODUCTION

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.³

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

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³ Basu, D. D., Administrative Law, 6th Ed., Kamal Law House, Kolkata, at p. 371

government is increasingly assuming the role of the dispenser of a large number of benefits. Today a large number of individuals and business organizations 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.⁴ 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 recognition⁵. The Constitution, under Article 298⁶, 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 79⁷.

(A) Literature review

1. Liability of the State in Modern India by Ganguly, B.

Ganguly, B. (1968). LIABILITY OF THE STATE IN MODERN INDIA. The Indian Journal of Political Science, 29(4), 392-397.

This Article analyses the liabilities placed upon the 'State', and the 'Government' in India by the Constitution and the extent of such liabilities. A major portion of the article is dedicated to Commercial and Private Liability of the State wherein the State can perform Commercial Activities within the territory of India but must abide by the Indian Contract Law and other relevant Statutes *in the manner* a private individual or entity is in the conduct of such business.

⁴Avatar Singh, Contract and Specific Relief, 10th Ed., Eastern Book Company, Lucknow, 2008 at p.6

⁵Sathe, Section P., Administrative Law, 7th Ed., Lexis Nexis Butterworths, New Delhi 2004 at p.578

⁶INDIA CONT., ART. 298.

⁷CIV. PROC. CODE, § 79.

Special emphasis is laid on Art. 299 of the Indian Constitution which specifically deals with the contractual liability of the State in India. The author writes that the State is liable to all civil liability but in terms of criminal liability for violation of any Statute, the State cannot be made liable (for example entering into a contract the terms of which are violative of public policy of India) for 2 reasons: *firstly*, as the very act of State entering into such a contract is evidence of a change in Public Policy of India which in its entirety is the State's purview, and *secondly*, that the punishment for such violation is not fine but imprisonment, and the State cannot be locked up in a prison.

2. Beyond the Indian Commerce Clause by Ablavsky, G.

ABLAVSKY, G. (2015). *BEYOND THE INDIAN COMMERCE CLAUSE*. *The Yale Law Journal*, 124(4), 1012-1090.

This Article uses unexamined historical sources to question this debate's fundamental premise. It argues that the Indian Commerce Clause, open-ended when written, was a minor component of eighteenth-century constitutional thought. This Article instead posits alternate sources for federal authority over Indian affairs, drawing particularly on the Washington Administration. Asserting federal power against the states, the Administration embraced a holistic constitutional reading akin to present-day field pre-emption. With respect to authority over Indians, the Administration, through law-of-nations interpretations, asserted ultimate U.S. sovereignty over tribes, while acknowledging Native autonomy beyond these limitations. Yet these supposedly narrow legal principles ultimately formed the basis for the later elaboration of plenary power over tribes. This Research Paper draws a comparative analysis between India, UK, and USA in order facilitate the understanding of the reader as to the extent of the liabilities of the State.

(B) Research Questions

This article analyses and attempts to resolve the following Research Questions:

- What is the Liability of State and to What extent in India *akin* to the Constitution?
- What are the Differences and Similarities with other nations with regards to the same?

II. BASIC TENETS

(A) Position in other Countries

1. 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

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courts which had arisen out of the theory of irresponsibility of the State as propounded by Roman Law.⁸ 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.⁹ 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.¹⁰

2. United States of America

In the United States, the principle of immunity of the State as a sovereign power was imported from England. 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 liberalized by the Judiciary in various cases like *Hathley v. U. Section*¹¹, *Rayonier v. U. Section*¹², *India Towing Co. v. U. Section*¹³ etc.

(B) Position in India

The words 'had not this Constitution been enacted' in Article 300(1)¹⁴ indicate that the basis of sue-ability of the state in India is historical. 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.¹⁵ 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

⁸Basu, D. D., *Administrative Law*, 6th Ed., Kamal Law House, Kolkata, at p. 371

⁹Jain, M. P., *Outlines of Indian legal & Constitutional History* by M.P. Jain, Wadhwa and Co. Nagpur, New Delhi, 2006 at p. 1801.

¹⁰*Windsor & Annapolus Ry. Co. v. Counties Ry. Co.*, (1886) 11 App. Cas. 607

¹¹(1956) 351 U. Section 173

¹²(1956) 352 U. Section 315

¹³(1955) 350 U. Section 61

¹⁴INDIA CONST. ART. 300(1).

¹⁵*Moodalay v. E.I. Co.*, (1785) 1 Bro. C.C. 469

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*¹⁶, 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.¹⁷

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.¹⁸ 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.¹⁹ 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.

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

¹⁶ AIR 1954 SC 786

¹⁷ Ram Lal v. State of Punjab, AIR 1966 Punj 436

¹⁸ Navrattanmal v. State of Rajasthan, AIR 1961 SC 1704

¹⁹ Andhra Pradesh v. Challa Ramkrishna Reddy, (2000) 5 SCC 712.

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 authorize.

(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 *BhikarajJaipuria v. Union of India*²⁰:

"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 unauthorized 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*²¹ and came to lay down in the case of *Bhikaraj v. Union of India*²² 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

²⁰ AIR 1962 SC 113.

²¹ (1954) SCR 817 (835)

²² AIR 1962 SC 113

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.²³

It was held by the Hon'ble Supreme Court in the case of K.P.Chowdhary v. State of Madhya Pradesh²⁴ 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 realized 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 affected by a ponderous legal document couched in a particular form.

III. 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. 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

²³ Union of India v. Rallia Ram, MANU/SC/0003/1963 : AIR 1963 SC 1685

²⁴ AIR 1967 SC 203

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.
