PROMISE OR SECURITY ? THE DEMISE OF CONTRACT IN INDIA

TIME IS not far when Henry Maine's dictum "status to contract" receives a ceremonial burial. The aphorism reaped its full harvest in the classical era of nineteenth century. It received a universal acceptance not only in America—the triumph of North over South in the American Civil War—but relaxed the bonds of serfdom throughout the world. The "freedom of contract" and "sanctity of contract" were regarded as the necessary instruments in the classical period and the function of the courts was merely to foster the one and vindicate the other.[1] In the striking words of George Jessel:

> [T]here is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice.[2]

The development of modern law with the influence of political and economic theories magnified the weaknesses of freedom of contract. A new thinking that absolute freedom of contract led to shrinking of economic freedom, produced gross inequalities, was taking place with the beginning of the twentieth century.[3] Statutory changes with the avowed object of redressing the balance between the weak and the strong, and the organised and the unorganised were introduced. Maine's theory of "status to contract" received a setback and move towards "status" was propagated.[4]

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1. G.C. Cheshire and C.H.S. Fifoot, *Law of Contract* 21 (9th ed. 1976).

2. *Printing and Numerical Registering Co.* v. *Sampson*, 19 Eq. 462 at 465 (1875).

3. See *supra* note 1 at 23. The writers observe: "The very freedom to contract with its corollary, the freedom to compete, was merging into the freedom to combine; and in the last resort competition and combination were incompatible. Individualism was yielding to monopoly, where strange things might well be done in the name of liberty. The twentieth century has seen its progressive erosion on the one hand by opposed theory and on the other by conflicting practice. The background of the law, social, political and economic, has changed. *Laissez faire* as an ideal has been supplanted by 'social security' and social security suggests status rather than contract."

4. R.H. Graveson, "The Movement from Status to Contract", 4 *M.L.R.* 261 at 266-67 (1940), states: "On the one hand the movement in domestic status is away from dependence on the head of the family, with its corollary of vicarious liability, towards full individual capacity; on the other, State interference in the terms and conditions of employment in industry has given rise to a new type of personal legal condition which bears many of the features of a status."

Maine cannot, however, be blamed for the failure of his thesis. He has qualified his statement by using the phrase "hitherto".

In the light of the above developments, an endeavour is made in this paper to highlight the impact of modern and changing trends on the freedom of contract.[5]

The first such pronouncement was made by the Supreme Court in *New India Sugar Mills* v. *Commissioner of Sales Tax*.[6] In this case the assessee owned factories in Bihar and in pursuance of the orders of the sugar controller under the Sugar Products Control Order 1946 despatched certain quantity of sugar to the State of Madras. In assessment proceedings, the assessee sought to escape from the liability to sales tax on the ground that there was no contract of sale but a compliance with the direction of the sugar controller.

The majority of the court observed through Shah J. (as he then was) that the assessees were compelled to carry out the directions and since they had no volition in the matter of supply of sugar to the State of Madras, there was no offer by them to the state government and no acceptance by the latter. The court further held that a contract of sale between the seller and the buyer is a prerequisite to a sale and since there was no such contract, the transaction in question which the Bihar sales tax authorites sought to tax was not exigible to sales tax.

A strong dissenting judgment was delivered by Hidayatullah J. (as he then was). He observed:

> So long as the parties trade under controls at fixed price and accept these as any other law of the realm because they must, the contract is at the fixed price, both sides having or deemed to have agreed to such price. Consent under the law of contract need not be express, it can be implied.... The present is just another example of an implied contract with an implied offer and implied acceptance by the parties.[7]

The judge remarked that controls had to be imposed due to short supply of goods and maladministration and in such cases it could not be said that there was no mutuality on one account or the other. He, therefore, held the sales tax to be leviable in the instant case.

Both the majority and minority judgments have been supported in successive years and two schools of thoughts developed: One, under the influence of laissez faire philosophy, strictly adhered to the majority view,[8]

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5. The author has confined his study to the area of sales tax which, due to different interpretations, has produced two schools of thought in recent years.

6. A.I.R. 1963 S.C. 1207.

7. *Id.* at 1226-27.

8. See *Chittar Mal Narain Das* v. *Commissioner of Sales Tax*, A.I.R., 1970 S.C. 2000 [under the U.P. Wheat Procurement (Levy) Order 1959, wheat procured was held to be

and the other, conscious of the new and changing trends, followed the progressive approach of Hidayatullah J.[9]

The mounting plethora of cases with divergent views led the Supreme Court to constitute a larger bench to set at rest the judicial controversy. This opportunity was seized by the court in *Vishnu Agencies* v. *Commercial Tax Officer*.[10] In this case, the provisions of the Cement Control Order 1948, issued under the West Bengal Cement Control Act 1948, and the Andhra Pradesh Paddy Procurement (Levy) Orders came up for consideration. The sole question before the court was whether in the context of the control order issued by the Government of West Bengal for regulating the supply and distribution of cement, the transaction was a contract of sale.

The majority of the court, speaking through Chandrachud J. (as he then was), followed the dissenting opinion of Hidayatullah J. in *New India Sugar Mills* as being the true position in law. He observd that though the terms of the transaction are

> predetermined by law, it cannot be said that there is no area at all in which there is no scope for the parties to bargain....The circumstance that in these areas, though minimal, the parties to the transactions have the freedom to bargain, militates against the view that the transactions are not consensual.[11]

The transactions were, therefore, held to be exigible to sales tax.

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a compulsory acquisition and not sale; the order contained "a bald injunction to supply wheat of the specified quantity day after day" to the controller]; *Jagatjit Distilling and Allied Industries Ltd.* v. *The State*, (1972) Tax L.R. 1891; *Food Corporation of India* v. *State of Punjab*, (1976) I.L.R. 2 Punj. & Har. 587 (procurement of foodgrains by the government from dealers/producers was held to be in the nature of acquisition); *A.R.F. Mills* v. *Union Territory of Chandigarh*, 39 S.T.C. 547 (P. & H.) (1977).

9. *Indian Steel and Wire Products Ltd.* v. *State of Madras*, A.I.R. 1968 S.C. 478; *Andhra Sugars Ltd.* v. *State of Andhra Pradesh*, A.I.R. 1968 S.C. 599; *State of Rajasthan* v. *Karam Chand Thappar & Bros.*, A.I.R. 1969 S.C. 343; *Salar Jung Sugar Mills* v. *State of Mysore*, A.I.R. 1972 S.C. 87; *State of Orissa* v. *Kameshwari Associated Rice Mills*, 36 S.T.C. 561 (1975); *Vijayalakshmi Rice Mill Contractors Co.* v. *State of A.P.*, 38 S.T.C. 19 (1976); *Oil and Natural Gas Commission* v. *State of Bihar*, A.I.R. 1976 S.C. 2478.

10. A.I.R. 1978 S.C. 449 [a seven-judge bench decision; the majority judgment delivered by Chandrachud J. (as he then was) for himself and Bhagwati, Krishna Iyer, Untwalia, Fazal Ali and Kailasam JJ., Beg C.J. concurring with the conclusion].

11. *Id* at 461. The court observed: "[I]t is not obligatory on a trader to deal in cement nor on any one to acquire it. . . the decision of the trader to deal in an essential commodity is volitional . . . . The consumer too, who is under no legal compulsion to acquire or possess cement, decides as a matter of his volition to obtain it on the terms of the permit or the order of allotment issued in his favour. . . . Thus, though both parties are bound to comply with the legal requirements governing the transaction, they agree as between themselves to enter into the transaction on statutory terms . . . It is therefore not correct to say that the transactions between the appellant and the allottees are not consensual They, with their free consent, agreed to enter into transactions."

Beg C.J. reached the same conclusion as the majority but for different reasons. He disagreed with the dissenting note of Hidayatullah J. He observed:

> What could be implied, upon the facts of a particular case, must still be a consent to a proposal if the transaction is to be construed as a 'sale.' Mere compliance with an order may imply an acceptance of an order but acceptance of a proposal to purchase or sell is of a juristically different genus.[12]

To escape from a different conclusion, Beg C.J. drew a distinction between a compulsory acquisition and a mere regulation order. The former did not amount to a sale, whereas the latter, even if it circumscribed the area of free choice, did not take away the basic character or core of 'sale' from the transaction.

The distinction, it is submitted, is erroneous. Both compulsory acquisition and a mere regulatory order impose limitations on the freedom of contract. A contract in the classical sense does not admit of any conditions or limitations. It is also difficult to appreciate the ratio of the judgment of Beg C.J. for his having, on the one hand, hesitated to hold the majority view in *New India Sugar Mills* as erroneous and, on the other, for concurring with his other brethren who held the minority view of Hidayatullah J. as the true position in law. The majority opinion in *New India Sugar Mills* is irreconcilable with the majority opinion in *Vishnu Agencies*. Being conscious of the economic inequalities and the recurrent crisis produced by the doctrine of the freedom of contract such a judgment by Beg C.J. is unwarranted.[13]

The majority in *Vishnu Agencies* reviewed the entire case law on the subject, traced the history of freedom of contract from Adam Smith's *Wealth of Nations* down to the present and observed: "Towards the close of the nineteenth century it came to be realised that private enterprise, in order to be socially just, had to ensure economic equality."[14]

Referring to the observations of Cheshire and Fifoot[15] and Anson,[16]

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12. *Id.* at 454.

13. Beg C.J. cited the following passage from his earlier judgment in *Commissioner Sales Tax* v. *Ram Bilas Ram Gopal*, A.I.R. 1970 All. 518 at 524. "It is too late in the day, when so much of the nation's social and economic activities are guided and governed by control orders, allotment orders, and statutory contracts, to contend that mere State regulation of the economic sphere of life results in the destruction of the nature of the transactions which take place within that sphere."

14. *Supra* note 10 at 470.

15. *Supra* note 1.

16. W.R. Anson, *Law of Contract* 3-4 (23rd ed. 1969). Anson observes: "Freedom of contract is a reasonable social ideal only to the extent that equality of bargaining power between contracting parties can be assumed, and no injury is done to the economic interests of the community at large. In the more complicated social and industrial conditions of a collectivist society it has ceased to have much idealistic attraction. It is now

on the concept of freedom of contract, Chandrachud J., speaking for the court, observed:

> [W]ith the high ideals of the Preamble and the directive principles of our Constitution there has to be such a fundamental change in judicial outlook. Instances given in Cheshire and Anson have their parallels in India too, wherein freedom of contract has largely become an illusion.[17]

The Indian courts have been conscious of these changes and have often struck warning notes.[18] This gradual erosion of the laissez faire philosophy was marked in other countries as well and it was felt that in view of the modern conditions and serious intervention with contractual liberty, a realistic study of its operation in the world today is imperative.[19]

The opinion of Hidayatullah J. was, if not hailed, accepted by jurists, academicians and critics[20] as a long felt need of the time and received full

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realized that economic equality often does not exist in any real sense, and that individual interests have to be made to subserve those of the community. Hence there has been a fundamental change both in our social outlook and in the policy of the legislature towards contract, and the law today interferes at numerous points with the freedom of the parties to make what contract they like."

"This intervention is especially necessary today when most contracts, entered into by ordinary people are not the result of individual negotiation. It is not possible for a private person to settle the terms of his agreement with the British Railways Board or with the local electricity authority. The 'standard form' contract is the rule. He must either accept the terms of this contract *in toto* or go without. Since, however, it is not feasible to deprive oneself of such necessary services, the individual is compelled to accept on those terms. In view of this fact, it is quite clear that freedom of contract is now largely an illusion."

17. See *supra* note 10 at 470.

18. In *Andhra Sugars Ltd.*, *supra* note 9 at 604, Bachawat J. observed: "The canegrowers scattered in the villages had no real bargaining power. The factory owners or their combines enjoyed a near monopoly of buying and could dictate their own terms. In this unequal contest between the canegrowers and the factory owners the law stepped in and compelled the factory to enter into contracts of purchase of cane offered by the canegrowers on prescribed terms and conditions."

19. See G.W. Paton, *A Text Book of Jurisprudence* (3rd ed. 1964).

20. See I.C. Saxena, "Offer and Acceptance—A Centennial Survey", *J.I.L.I.*, Special Issue 116 at 119 (1972). He states: "The emphasis on the conceptualism of proposal (offer) and acceptance so strongly made in the majority judgment of the *New India* case has in later decisions of the Supreme Court, waned virtually to the point of extinction, irrespective of the similarity or dissimilarity of the factual situations. In essence, the statutory doctrine of offer and acceptance has yielded to a judicial doctrine of mutual assent, interpreted too widely. What was hitherto considered as essential for a valid contract, *i.e.*, volition (at least non-compulsion) on the part of the parties to enter into a bargain and liberty of fixing up the price of goods as they like, do not any longer hold the sway. Henceforth the minimum amount of contractual freedom, despite the absence of these two factors and their regulation by law, is sufficient to label a transaction as contract, provided the parties are competent to contract and there are no vitiating causes like fraud."

endorsement in *Vishnu Agencies*. The floodgate thus opened in *New India Sugar Mills* was closed down by a larger bench of the Supreme Court with full force. The latter years witnessed only two cases on the subject. In *State of Punjab* v. *Dewan's Modern Breweries*,[21] the Supreme Court extended the rationale of *Vishnu Agencies* and held the sale exigible to sales tax, but in *Krishna Rice Mills* v. *State of Haryana*[22] the Punjab and Haryana High Court ruled otherwise.

It is submitted that the decision of the Punjab and Haryana High Court is not correct. In *Vishnu Agencies* the Supreme Court also considered the Andhra Pradesh Paddy Procurement (Levy) Orders and held that transactions between the rice-millers and the wholesalers or retailers are sales and exigible to sales tax.[23] The judges, under the banner of freedom of contract, seem to have failed to appreciate the rat o in *Vishnu Agencies*. The unwarranted decision of the Punjab and Haryana High Court also seems to be so because of the uncertainty left behind by the Supreme Court itself. As was observed in *Vishnu Agencies*:

> The policy of our Parliament in regard to contracts, including those involved in sale of goods, has still to reflect recognition of the necessity for a change, which could be done by a suitable modification of the definition of 'sale' of goods.[24]

When kicking the ball from the court to Parliament one has to see whether it is hit back or is allowed to remain at rest with the goal-keeper. Modification of the definition of sale of goods is, it is submitted, unwarranted. A contract of sale of goods does not come into existence unless the general principles of the law of contract are complied with. In *Andhra Sugars Ltd.* v. *State of Andhra Pradesh*,[25] Bachawat J., speaking for the Supreme Court, observed:

> The consent of the occupier of the factory to the agreement is not caused by coercion, undue influence, fraud, misrepresentation or mistake. His consent is free as defined in Section 14 of the Indian Contract Act though he is obliged by law to enter into the agreement. The compulsion of law is not coercion as defined in Sec. 15 of the Act.[26]

The provisions of the Indian Contract Act 1872 apply with equal

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21. A.I R. 1979 S.C. 1158.

22. A.I. R. 1980 Punj & Har. 278 (F.B.).

23. The facts on which the A.P. Paddy Procurement (Levy) Orders were adjudicated upon are not given in the report.

24. See *supra* note 10 at 470.

25. *Supra* note 9.

26. *Id.* at 604.

force to contracts for the sale of goods.[27] In the present context, when we find a contract of sale void, it is because there is no free consent (volition). A modification in the definition of sale of goods shall not serve a fruitful purpose, unless that aspect is modified which invalidates sales. The better course would be to modify section 15 of the Contract Act which defines coercion.[28] A draft modification to the section after "Explanation" is attempted below:

> Notwithstanding anything contained in the section, the state shall not be precluded from making contracts in the public interest.

With the carrying out of this modification, the doctrine of the freedom of contract should receive a ceremonial burial in India. This, however, does not mean that freedom of contract has no role to play. It shall apply with the same binding force to transactions between private parties or enterprises.

To sum up, India is a developing social welfare state, dedicated to secure social, economic and political justice. Deep rooted poverty and large scale illiteracy themselves demand legislative and administrative interventions. The greater the governmental intervention, the lesser the chances of economic inequality or exploitation of weaker sections of the society. The government in modern times has assumed the role of a regulator, dispenser of benefits, and an employer. In the words of K.K. Mathew:

> In the welfare state—if and so long as it can be kept true to its avowed purposes—regulation is not an end in itself but a means of securing a greater measure of economic equality. A statute barring the forfeiture of premiums paid on a lapsed life insurance policy diminishes freedom of contract only in the doctrinaire sense that insurers no longer can impose forfeiture clauses on a "take it or leave it" basis. Because of the inequality of bargaining power, such clauses were never the subject of genuine negotiation between insurer and insurance applicant.[29]

Spiralling prices and short supply of essential commodities from the market force intervention. A strict individualistic approach, in a state

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27. Section 3 of the Sale of Goods Act 1930 provides: "The unrepealed provisions of the India Contract Act, 1872, save in so far as they are inconsistent with the express provisions of this Act, shall continue to apply to contracts for the sale of goods."

28. Section 15 lays down: "'Coercion' is the committing, or threatening to commit, any act forbidden by the Indian Penal Code, or the unlawful detaining, or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter in an agreement."

"Explanation:—It is immaterial whether the Indian Penal Code is or is not in force in the place where the coercion is employed "

29. Upendra Baxi (ed.), *K.K. Mathew on Democracy, Equality and Freedom* 50 (1978).

dedicated to noble ideals enshrined in the Constitution, is not possible. The nineteenth century "will jurisprudence" has no relevance in a progressive, scientifically and technologically advanced twentieth century. It "may hang on here and there for a long time to come, just as the contract jurisprudence of the eighteenth century has been known to darken counsel in out-of-the-way cases even in twentieth century Courts. But as a real force either in the law or in the science of law, the one is now as spent as the other."[30] The approach of a capitalistic country, like the United States managing the transition to deregulation, is unacceptable to India in view of its own socio-economic conditions.[31]

The Indian Contract Act 1872 is more than a century old. Since 1872 there has been a rapid progress in social, cultural, economic, scientific and technological spheres. There has also been a new social awakening and the Act has not kept pace with the march and progress of times.[32] The fetters and limitations imposed by the Act have retarded the progress and created a vacuum which, if not the judiciary, only the legislature can fulfil.[33] As observed by Roscoe Pound:

> [T]oday the stress is on an ideal of cooperation rather than on one of competitive self-assertion. The idea of cooperation is much nearer to the realities of urban life today than the idea of free competitive acquisition.[34]

*A. S. Bhat**

30. See Roscoe Pound, *Jurisprudence*, vol. 1 at 538 (1959) referring to *Sinclair* v. *Brougham*, [1914] A.C. 398.

31. W.A. Magat, "Introduction", 44 *Law & Contemp. Prob.* 1 (1981). "[M]any analysts worry that natural gas prices will never be deregulated completely in 1985, as planned, because the market price of unregulated gas is rising faster than the scheduled increases in the regulated prices (designed to eventually eliminate the price gap)."

32. See Law Commission of India, *Thirteenth Report on Contract Act, 1872* (1958).

33. How in modern era freedom of contract may be trampled by legislative fiat would be visibly clear by the application of the (English) Unfair Terms Contract Act 1977 which permits judicial interference in concluded contracts. In India, the legislation arising as a result of nationalisation policy or taking over of sick mills may evidence an example of interference in concluded contracts. See the Transformer Switchgear Ltd. (Acquisition and Transfer of Undertakings) Act 1983.

34. *Supra* note 30 at 546.

*Reader, Department of Law, University of Kashmir, Srinagar.