Business Law for Managers
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Module-4: Law of Contract

Lecture - 19
Major Issues Related to Contract

Good afternoon. This brings us to the model 4 lecture 19, Major Issues Related to Contract.

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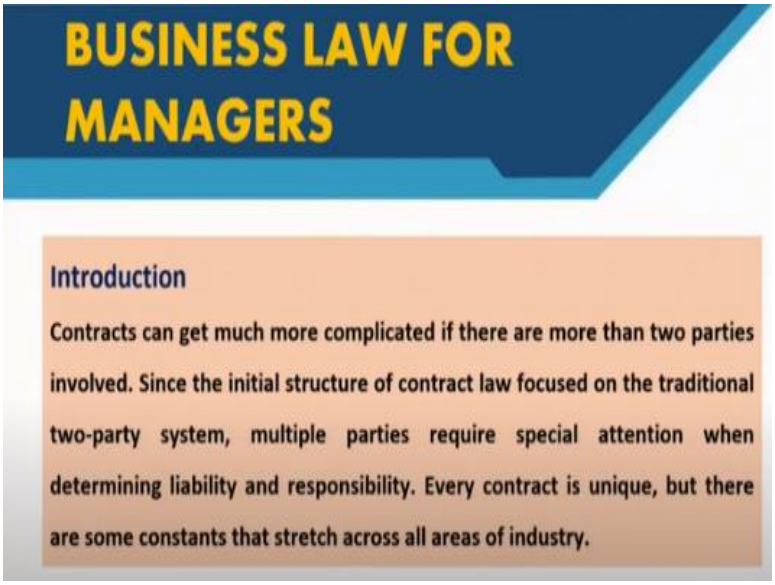

Well, there are lot of issues related to contract, but we are only concentrating on the major issues. Multiple parties are there. Various liabilities are there. Various considerations are there. Various objectives are there. Various purposes are there. So there will be issues and a contract without issues is no contract if you ask me.

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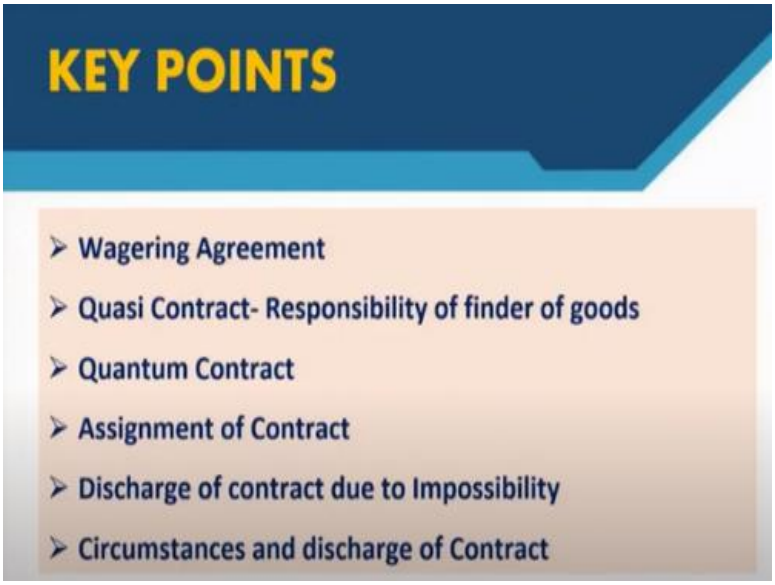

So, you know there is always issues in a contract and long term contracts have long term issues, short term contracts have short term issues. Issues are always there in a contract. But what is important is to understand the contract, perspective of the contract and how best a contract can be drafted. So, nature of contracts will always help to understand the contracts.

Here we have picked up certain types of contracts. Names would be confusing, but actually if we see the slides it will be very simple to understand. Wagering contracts are basically speculative contracts where if you speculate if it rains, I will pay you 1000. Or you enter into contract for you know betting, that is a speculative contract.

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So wagering contracts are illegal contracts. You cannot, you know bank on wagering contracts. You cannot enforce wagering contracts. As I said in lecture 1, that if you try to enforce these kind of contracts, you may be put into the jail. So it better not enter into the contract. And even if you enter into it for any reason, even in a friendly times, do not try to enforce that. If you have lost you have lost.

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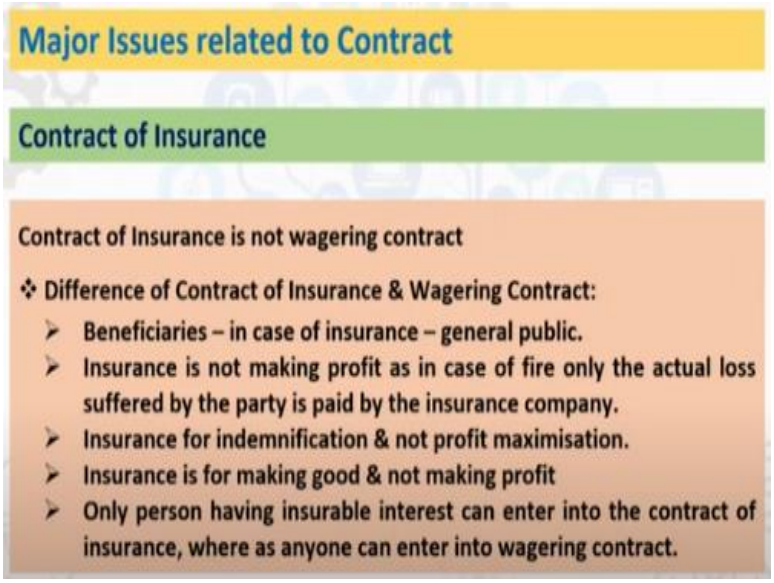

Now contract of insurance always says whether a contract for insurance is a wagering contract. Absolutely not. Insurance is a valid contract. It is an absolutely viable valid contract. Why? Because insurance is a contract in which there is an insurable interest. In a wagering contract, there is no insurable interest. It is a game. It is a game. It is a gamble. Insurance is not a gamble.

It is a property and there is a cover, there is a risk and there is a cover. There is a death inevitable for a person, which has got a cover. So, there is an insurable interest in every aspect. So, it is never a wagering contract. Insurance again is for indemnification, risk mitigation. We will go to insurance in the next slide and that is my last slide, I believe and we will understand that insurance is never for making profits.

Insurance is not from the insurance company's angle. It is for making profit. A Bajaj or a Lombard or HDFC or a Reliance or for as a PSUs they all look for profits. But insured never look at insurance as a profit. It is never a profit center for an insurance.

It is a risk mitigation, is an indemnification. It is for making good not for making profit. But in the gamble, it is only profit because you have nothing to make good.

You are playing. You have no risk, you have no liability, you are just making a gamble. So, insurance is not a wagering contract.

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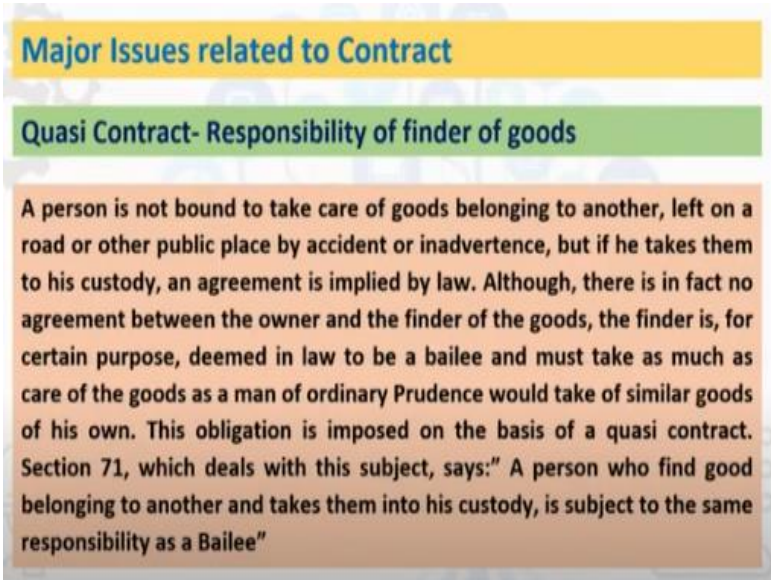

Quasi contract, responsibility of finder of goods. There is no contract but deeming contract. By your action, it becomes a contract, it is an implied contract. You leave certain goods at a certain place, a person takes that good, uses those goods, implied they have entered into a contract. Later on, if it is found out that you have used those goods, you have to pay for those goods.

But you might say I have not entered into a contract, you have not given it to me, there is no relation between you and me. You have not offered it to me, I have not accepted it, all fine. But you have taken somebody's goods. It is not your goods. And thereafter, you have also used those goods. Now return, question of return does not arrive because you have used it also.

So that becomes a clear case of responsibility of finder of goods and you have entered into a quasi-contract. Quasi because it is a dummy, it is semi contract. That is called a quasi-contract, implied by action.

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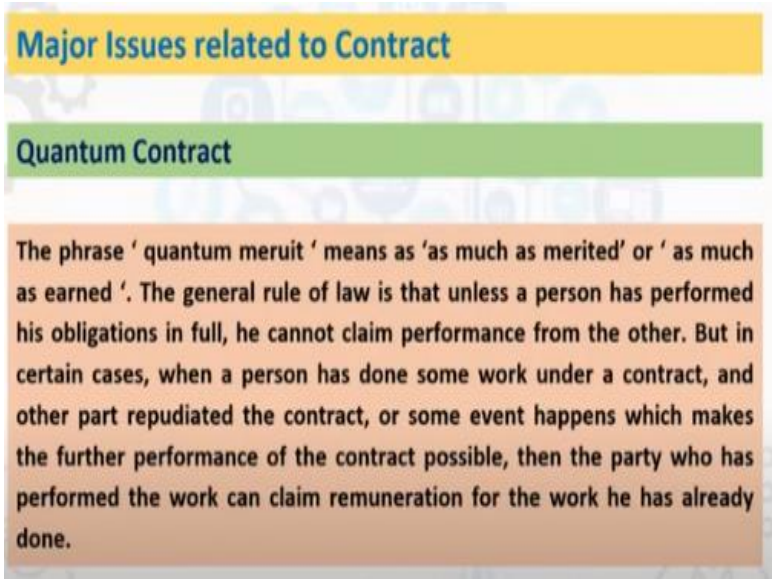

Quantum meruit. It means as much as merited. A was supposed to sell 200 kilos of rice to B by 31st of December. A sold only 150 kilos of rice by 31st December, nothing more. Now B used those 150 kilos of rice. Now by virtue of that, B has actually accepted a modified contract, instead of 200 kilos 150 kilos now stands as the contract. He has to pay. He cannot say I will not pay because my contract was for 200.

He could have said it has he not used that 150 kilo. Since he has used that 150 kilo of, by his own action, by implication, he has accepted the contract. That contract is called quantum meruit, as much as merited.

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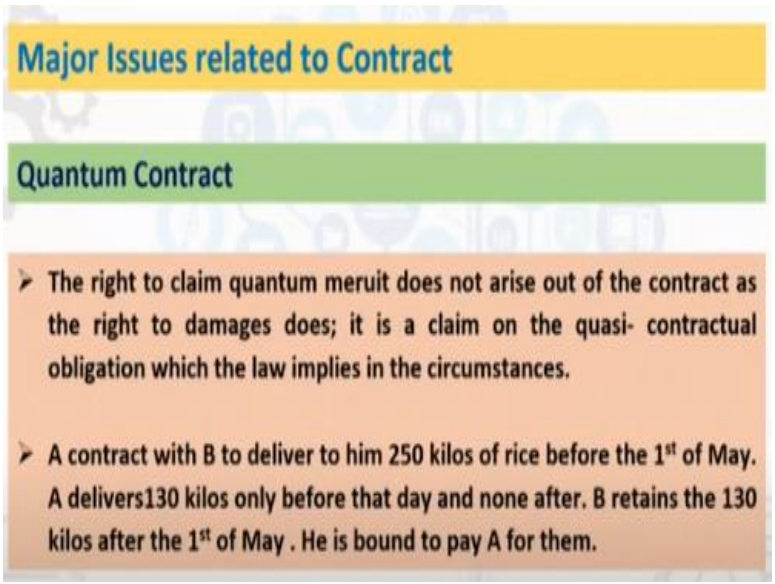

250, 200, 1000 whatever will be the kilos, the action is, has he used it or not? Since he has used it, he is bound to pay.

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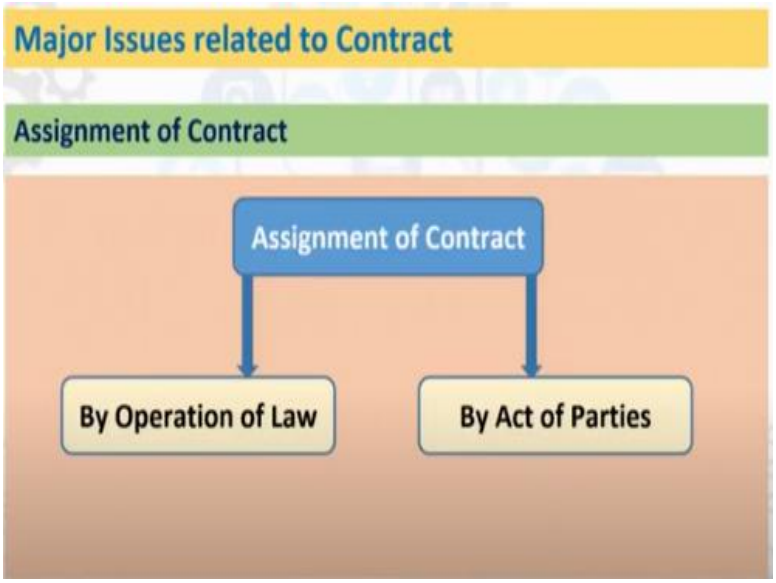

Assignment of contracts is important in a contract to know. How do I assign a contract? Assignment means supposing A enters into a contract with B. Now one of the terms of the contract may be that B may assign the contract to C to perform and in that case, A will not have any objection. Now this can be written itself in the contract. A enters into contract with B or any of its assignees.

If the contract writes any of its assignees later on A cannot challenge that. But if it is not written, then if it is assigned then concept of A has to be taken. But if you have put it or it assigns, sometimes the word is done or it is permitted assigns, the word permitted is added before assigns, what happens is you can assign but prior to that you have taken my permission that you can assign that.

That is a better way of drafting the contract or it is permitted assigns. This kind of assignment we call by operation of law. It can happen. Suppose A is a company B is a company. A enters into a contract with B for supply of goods. Now B will supply goods to A. A will pay money to B. Now B went into liquidation or some kind of business difficulty or he has been acquired by Z.

So, all the business of B has been acquired by Z plus Z's own business. Now in the natural course, this contract will go to Z. A and Z will not have to enter into contract. Permanent assign means, permitted assign means, it goes to Z and A agrees. Then the

contract becomes by operation of law assignment. By act of parties. How that happens? A person dies. He was to perform a contract.

He was to perform; his personal presence was required. But he died. Nobody else is there to do the function or discharge the contract. In that case, the assignment cannot happen if it is a personal program. Say for example, some contract has been given, some tickets have been sold that x will sing in that function and people have bought all the tickets.

Unfortunately, x is not well that day, he cannot come. So, in that case it cannot be assigned to somebody else. Who will sing on his behalf, that assignment cannot happen. So where personal involvement is there assignment cannot take place. But act of parties, by act of parties' assignment takes place only when it is accepted by the other party. We will see to it as it unfolds.

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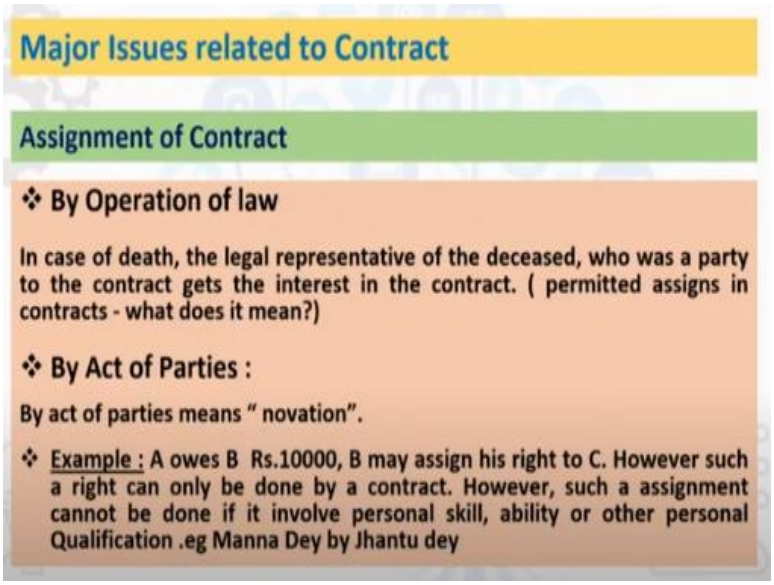

Operation of law. In case of death who has a party of contract gets interest in the contract. Permit assigns in contracts, what does it mean? It means exactly what I told you. It is permitted means it is permitted and therefore you do not have to go to him again for permission. Or there is another example of a legal representative of deceased is like a company or it can be like this.

A contract is entered into between A, not a company, A and B, B or any of its legal representatives. In case B is not there his legal representatives would be there to

discharge the contract. So, in that case also if B for any reason passes away it automatically flows to its legal representatives. The contract goes on. There is uninterrupted contract. But if it is only B, in that case this contract will break.

With the legal representative fresh contract has to be entered into. By act of parties, A owes Rs. 10,000. B may assign his right to C. A owes B Rs. 10,000. B may assign his right to C. However, such right can only be done by a contract. However, such assignment cannot be done if involve personal skill, ability of the example I gave of a singer. That assignment cannot take place.

But in this case, I was supposed to pay 10,000 rupees to B. B might say instead of me you pay it to C because I have a due towards C. So, if you pay to C that will be enough discharge. But only saying will not do, there has to be a contract, in which he will write your payment to C would tantamount to your payment to B and will be relieved from your payment obligation.

It will be discharged. I do not owe any money once payment is made to C. That is called action of parties, assignment by operation of by act of the parties. Not by operation of law, by act of the parties. Because there is no law, it is an understanding. The other one death is an understanding. Agreement in which you are mentioning by permitted assigns is an operation of law. This is an act of the parties.

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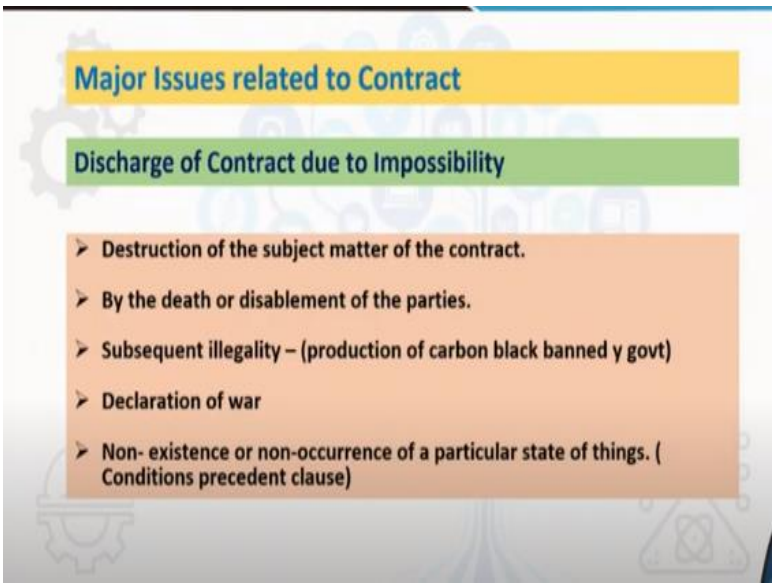

Major issues related to contract. Discharge of contract due to impossibility. A contract cannot be performed by the date or disablement of the parties. Two parties were there, one of them died. So obviously contract cannot be entered into. Subsequent illegality. Supposing production subsequently is banned by the government. No, you cannot produce any further of this kind of drug.

Certain drugs actually can be you know in very short supply, because it is required for some lifesaving medicines. So, government may stop certain companies in manufacturing certain drugs. It is very common in various countries. Government takes the control of production of that kind of drugs, because those are lifesaving drugs. And for which some pharma companies also were producing that.

Now they have been stopped to produce. Now if they have been stopped to produce, they cannot perform any of the contracts they have entered into subsequently to supply. So, it is a clear case of force majeure and discharge of contract duty impossibility of performance. Declaration of war. Of course, during war you cannot perform contracts.

So, discharge of contract also during war, of course is remained suspended as I told you remain suspended. When the war is over, you can again enter into a contract. Conditions precedent clause. Non-existence or non-occurrence of a particular state of things.

If you do not get the approval, regulatory approval before the start of the contract, if you do not get the approval of the environment clearances for certain contracts of sale of power or for that matter for sale of you know goods, you require certain environment clearances. If those are not received, the contract does not take effect. So whatever contract you have entered into gets discharged.

Because nobody will wait long term for those kinds of things to happen. So finally, both parties agree no conditions precedent clause is not being met. It is almost six months, 12 months. So let us terminate the contract.

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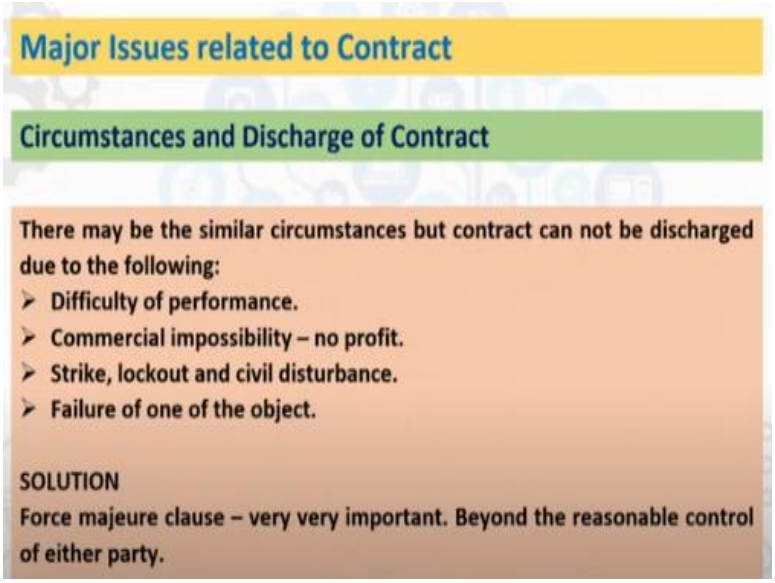

Circumstances and discharge of contract. There may be similar circumstance, but contract cannot be discharged due to the following. Difficulty of performance. Difficulty of performance cannot be a case of discharge of a contract. I will give an example. Supposing a company was to produce power and he was to import coal from Australia.

Now import of coal from Australia, because of the huge freight cost almost has become commercially unviable. Yes, it has become difficult now to perform the contract, but what is the alternative? Coal is available in Indonesia. Why not the company is bringing coal from Indonesia and trying to perform the contract.

It cannot be a case where please discharge me from the contract I have no liability in that contract. In a court of law, it will not be there. If it can be shown that Australia coal has become unviable because of the freight and the cost has become so that the contract is commercially impossible to perform. No profit is there. It still can be a case. I will come to the next point later.

But difficulty of performance is when, when you are getting it from an alternative source, you are not trying that. You are straight coming to the court and saying sorry, discharge of performance, discharge me from my contract, because coal is unviable, coal is not available in Australia. Or even if available, the price is such it is impossible to get. That will not happen. You have to find out sources to perform the contract.

Difficulty or performance is not acceptable. Commercial impossibility, no profit is both yes and a no. If it is seen it is temporary, then obviously court will not interfere. But if it is seen that there is no other way to continue this contract because of the nature of the increase in prices all over, not in one place, all over it has increased like this, the raw material is not at all available at that price.

And it is not a small increase, it is a huge jump. No company can run with this cost. So, the judgment would be revising the contract, make the price viable or terminate the contract. But much before that only commercial impossibility, no profit temporarily would not be the case. It has to be for almost impossible to perform.

That is no way there is any line of sight the raw material cost will come down and business will remain profitable. No way. It is only being seen that the business cannot be run at the price agreed upon because of the raw material prices all over the world. Nowhere, no place is there where it is possible to buy at a reasonable price and make some business profit.

In that case it is still considered, yes, it is almost like a force majeure, impossibility of performance. But only some commercial impossibility or for example, not no profit less profit. I was expecting a margin of say Rs.10 per unit whereas the margin has come down to Rs.5. That cannot be a commercial impossibility. You have still a plus 5. Or for that matter it is no profit zero, but only temporary.

It can be after three months different. Let us see after three months what happens. Or is there any other source from where you can source the material or everywhere is the same? Strikes, lockouts and civil disturbance. Well, strikes, lockouts definitely are part of force majeure. Every force majeure contains strikes and lockout. But lockouts again should not be something done deliberately.

It has to be seen what kind of lockout it is. Strikes are to some extent acceptable. But lockout always is to be seen that it is done for what reason? So clearly accepting strikes and lockout as discharge of contract directly no, maybe through force majeure yes. Failure of one of the objects whether business can be viable or not depends on that. Viable means, not commercially viable, whether at all business can run or not?

Commercially viable is not the test for discharge of the contract. Solution, force majeure clause. Very important. Beyond reasonable control of either party. If that contains any of these, there is a way of getting out. But force majeure never contains commercial impossibility. No force majeure will have a commercial impossibility clause. No one will accept.

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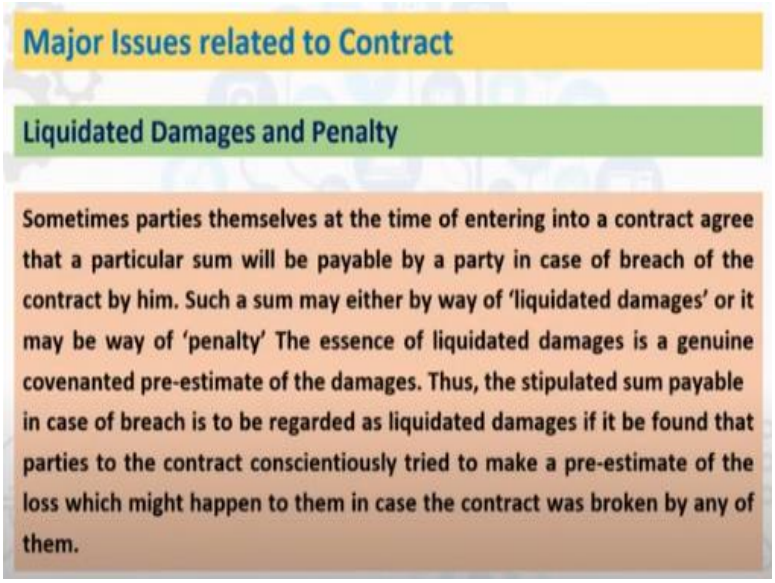

Liquidation damages and penalties are somewhat common in contracts. If you fail to perform the contract, if the other party in spite of providing all what is required to be done from his side, if one party compliant other party is not compliant, because of that other party not being compliant there are breaches on the other party, that one party suffers then obviously damages have to be given.

And which is predetermined what will be the damages. Sometimes, the damages are calculated in advance that this is the amount of damages you have to pay in case you do not supply within so many days, in case you fail to supply the minimum quantity with so many minimum quantities. In case the minimum quantity has to be purchased from outside the differential price has to be given.

So various kinds of damages are, liquidated damages are considered in the contract. Of course, is negotiated. Huge negotiation is there for this kind of liquid damages and penalties. There is no set piece formula. It is all based on negotiation. But whatever is important is properly documenting those liquidated damages and penalties.

Later on, when the dispute arises when the time to invoke this happens there should not be any confusion.

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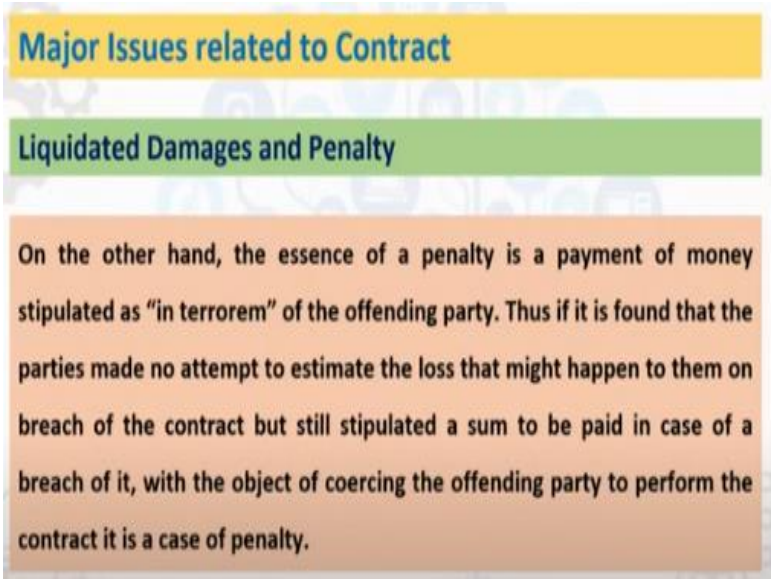

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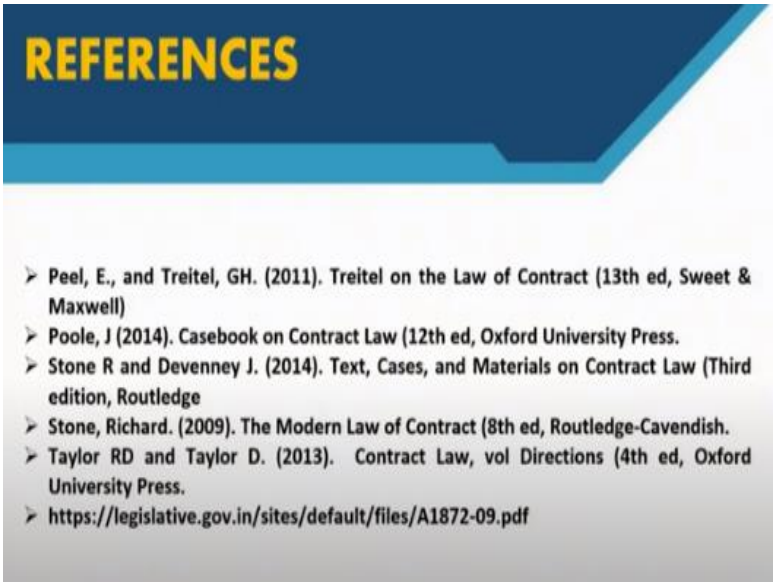

Now in contracts like this where we are having liquid damages and penalty, there is one more provision in contract, which is very important is limitation of liability. Whatever is done in a contract, it is very important that you put a cap on the liability. Business has to be done, risks are to be taken, unforeseen circumstances.

A person can be at the receiving end, a person can be at the often on the other side also. You may not be at the receiving end; you can be at the receiving end as well.

There may be a breach on your side, the breach can be on the other side as well. The breach on your side may be beyond your control. You are failing to supply. Failing to supply not for anything else but you are not getting the raw material.

Why thinking always that the other party will fail to do its job or perform its contract its obligations. It may be that you may also fail to perform your obligations. So how do you protect yourself? The best way to protect yourself is or to protect any contract is put an overall cap on the total liability. We call this the limitation of liability clause. And it is drafted like this, notwithstanding, contain anything herein above.

Whatever is written in the contract, the overriding, notwithstanding contained anything contained herein above. The liability of either party is not your liability only for either party because it is a mirror clause. It will be applicable for both the sides. That the liability for either party shall not exceed, we can put certain percentage of the total transaction, maybe 5%, 10% if the transaction is very big.

But if it is multiple transactions, we can put the clause cannot be more than the transaction value in each case. Even the contract with the consultant. Sometimes the consultant ask for indemnification. That if court case comes to us, we are consultants you are corporates. If somebody files a court case against us for doing your consultancy, then you will indemnify us if the judgment is against our favor, not in favor of us.

We lose, we have to pay a penalty, then you would indemnify us. Now I appoint a consultant, I give him all information. Now while giving all information, obviously I will ensure that information are accurate, but even then, if somebody files a case against him and the company then I have to indemnify, company obviously, I have to take care of by myself, but for him also I have to pay the damages.

Now there is no limit for that those types of claims. So, it is important that when you do this kind of contract with consultants, put a clause that notwithstanding anything herein above the liability in either case, or for either party will not exceed certain percentage of a transaction value. Normally they say 1x. 1x means equal to the number of, equal to the amount of transaction value.

Sometimes big consultants put the figure 2x. Sometimes they put it 3x, all negotiation. 1x, 2x, 3x means one time, two times, three times of the transaction value. But that is important to put the transaction value. Because later on it may so happen that this particular claim may lead the company to bankruptcy. Because one aspect is in getting relief from the court for anything, enormous time, money and effort goes.

The second if a judgment is given in your favor at the very first instance, at the lower court or maybe at the middle court, to get a reverse of the judgment is a very tall task. To reverse the judgment totally at a higher court is a tall task. Once a liability is set on you, then at best the liability can be reduced a bit, but do not think that liability will be totally wiped off. So, it is better to put a cap on the liability.

It is the practice all over for big corporates that if you are entering into a contract with me, fine whatever is there in the contract, overall cap is I will not be liable more than this, for any reason, direct, indirect, consequential, non-consequential, deliberate, non-deliberate, my liability should not be more than this percentage. Fair enough.

At least one thing is for sure, this contract the liability for any reason cannot be more than this. Of course, the word deliberate, fraud etc., all are negotiated that if you do something deliberately how can you put a cap? Now if it is deliberate, then you have to argue by saying that if it is deliberate, whether you know it is deliberate or not deliberate, who will decide is it deliberate or non- deliberate?

The court will decide. Now there you have to put the word that only when it is deliberate and it is proved in a court of law of the last appeal. What does mean of the last appeal? That the final court. So, if you start with the division court, it goes to higher court, it goes to High Court, it goes to Supreme Court. So, if Supreme Court determines that yes, it was deliberate, then only the amount of claim would be more.

Otherwise, it will be capped at the transaction value. Even that is acceptable, because if you do something deliberately you are a professional organization, you cannot say I do deliberately something and then I put a cap. I murder somebody and then I say my

sentence will be maximum five years. No death sentence for me. No that cannot happen.

So, you do a deliberate fraud and it is established by a court of the highest court then there cannot be any cap. That is understandable and workable. But anything other than that it will be capped at, capped at the maximum amount can be 1x. That is the transaction value. Normally that is what happens. But if the transaction value is very high, 100 crores, 200 crores, 300 crores, it will be percentage of the transaction value, maybe 1%, 2%, 5%, 10%, like that.

It is again totally negotiable and negotiated but very important to keep in contracts. This is these are certain finer points on contracts which we need to understand though limitation of liability or other things like you know arbitrations are not very looked into very deeply. Because it is thought of these are just routine points.

Confidentially of information is another thing which need to be very properly drafted in a contract. Severalty, another point which needs to be drafted. Severalty means the contract may get terminated by a flex of time, by discharge of the responsibilities, but still the contract remains valid. Certain terms of the contract remains valid. One maybe the confidentiality.

Even after the termination of the contract it will be valid. Confidentially has to maintain for five years. Similarly, that is called the tenure of the contract gets extended at certain provisions of the contract. Jurisdiction clause is another important, where the jurisdiction would be. Similarly, there are provisions. Force majeure already we have discussed is a very important provision on force majeure.

Assignment is another important provision. Now there are another policy another term which comes very well in the contract is anti-bribery policy. Every contract should have an anti-bribery policy very clearly telling the person that our policy is very clear on anti-bribery. We do not encourage any kind of corruption. So, the contract, recording that in the contract is important.

These are more or less the major parts of the contract, which needs to be considered. I have taken references from some of these books. But examples of limitation on liabilities and others that I have shared is shared from my experience. I recall, there was an incident of a car accident in Japan. And that car accident led to the closure of a plant.

I mean not even a plant a corporate in some part of India because they supplied material to that tire and the tire was finally found to be the reason for the accident in a car in Japan. It was a Bridgestone tire and the car which got damaged, the car company raised a claim on the tire company because it was found out the person who got damaged, he raised the claim on the tire company.

Tire company raised the claim on the car company. Car company raised the claim on the tire company. Tire company raised the claim on the manufacturer. And the claim came 10 to 15 times of the amount of carbon black he supplied. So that is why limitation of liability is a very important clause in any contract. Because you may have done business for few crores.

But when the liability comes it comes in 25, 50, 30 times because if there is no limitation of liability. So that is one point which I think which should be considered when contract is done.

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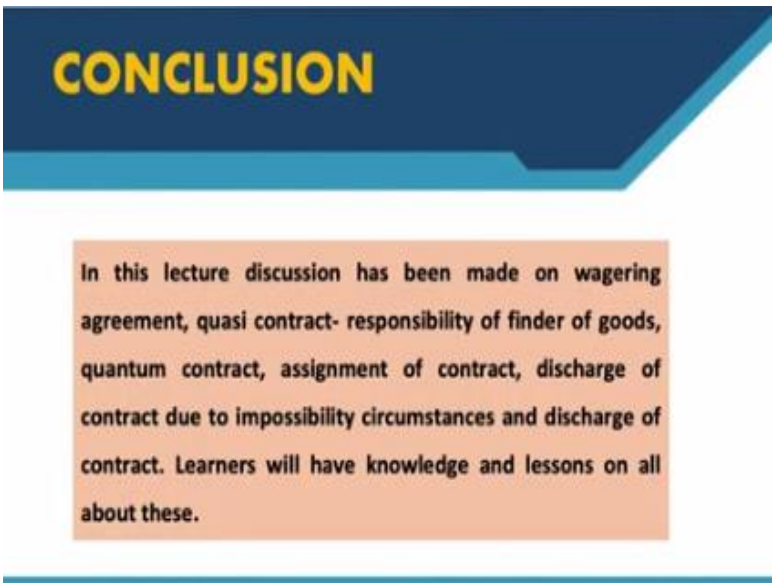

We will discuss more as we go forward. Thank you.