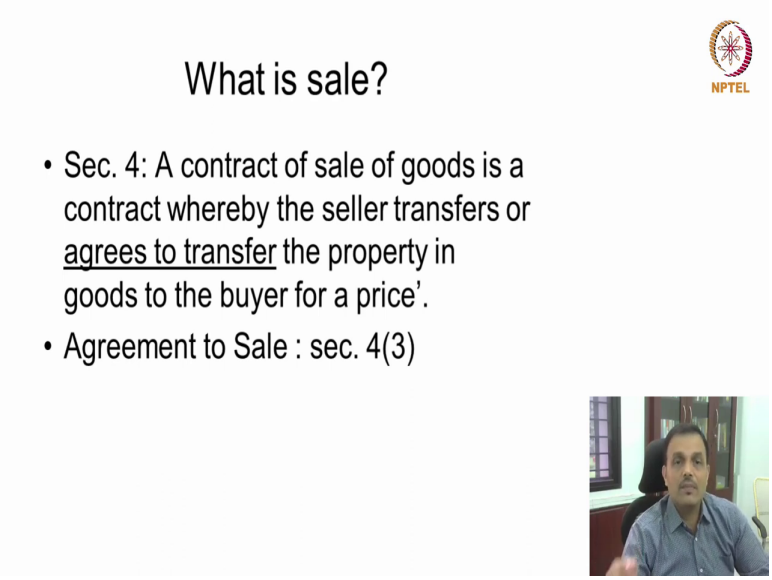
**Advanced Contract, Tendering and Public Procurement**
**Prof. (Dr.) Sairam Bhat**
**National Law School of India University**
**Lecture 42**
**Special Contracts: Sale of Goods - Part 05**

(Refer Slide Time: 00:15)




Moving onto understand what is Sale? And as it is most important context when does sale take place or what constitutes sale. Technically to look at law, it will tell that sale has two things, one is transfer of proprietary right. Proprietary means the right of title, and second is the transfer possessory right, which means the physical possession of the goods.

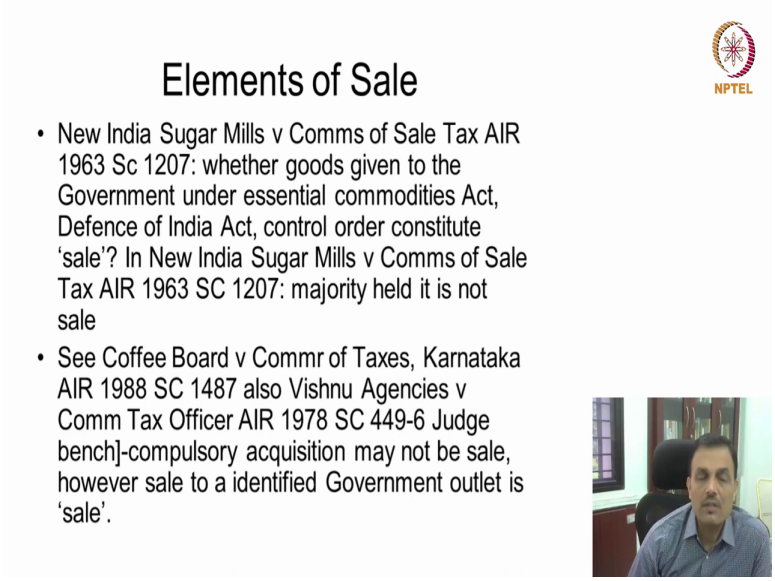
So, sale is a combination of both and interestingly, when such sale happens, proprietary plus possessory, obviously, the sales tax can be imposed. However, to see that in the past the Constitution of India and including, the enactment of what is known as the Hire-Purchase Act of 1972, which was never implemented, rather right now, the Hire-Purchase has been repealed. There was a concept of deferred sale in hire-purchase.

What happens in hire-purchase is that when certain goods are taken on hire with the condition that it is purchased after payment of equal installments. So, the when the sale is deferred until unless the complete price was paid, it would not be considered a sale. In turn it was a problematic situation, because sales tax would then be imposed after the last installment in hire-purchase has been paid, that is when sale will take place.

Unfortunately, suppose when the buyer returns the good or stops payment of the hire-purchase tax, then the goods have to be returned back to the seller. And this was a transaction

that was a problematic because sales tax could not be imposed. And that is probably some of the reasons where this concept of a deemed sale was introduced in the Constitution. To notice that today, a hire-purchase transaction can be considered as a deemed sale. To enter to hire-purchase contract, it is sale for all practical purposes, irrespective of the fact that you want that ownership to be transferred after the last installment has been paid. So, these are the aspects of understanding what is the concept of the sale for the purpose of contract and sales tax, this has specific meaning and hence, one will have to understand it in that context itself.

(Refer Slide Time: 02:49)




To look at the elements of sale to understand what are the challenges in sale. Which interestingly, it is noticed quite often, that the government has several legislations including what is called as the Essential Commodities Act. There could be a sugar control order, it could be the government passing an order saying only an agency called A can have the business and not to agency B. So there may not be free market forces.

Now, if there are no free market forces, then can we consider that to be sale? That is the real question in some of this context. So, to notice that the courts have essentially looked at compulsory purchase or compulsory sale, and they have actually evaluated, whether it can be brought up the Sale of Goods Act.

Because the kind of freedom that parties ought to have may not be there in such kinds of sale or purchase that is done under some of the statutory legislations. So, should we consider it to be sale or not? Suppose, if the government is selling through the public distribution system. Can it be considered a sale? Now it is subsidized. The actual price is not paid. The question

now is how is that related to the contract? The PDS (public distribution system) notice that those grains that are given from the public distribution system be of merchantable quality. Can there be breach of contract?

Even if the people are paying less than the market price, even though it is subsidized, whether the contract law can actually work or whether it is the state-citizen relationship that should work. So, in these contexts, it is important that the courts have looked into this matter. When it comes to some compulsory acquisitions, it should not be considered it to be sale.

But, the courts have also said that they have no problem in considering it a sale because what the government is doing is also buying. and there is no necessarily absolute freedom of contract in all cases, in all contexts. So, it is important to understand the same as well. So, this is something that is important to notice again and again, the question is whether the sales tax can be imposed, in such transaction.

(Refer Slide Time: 05:33)


Now moving ahead, looking at the distinction of sale and contract of work, what is important is the contract of work, where labor and skill is more. But in the final sense, there may be some tangible commodity or article that has been given. But because the dominant nature of the contract with dominant intention of the contract is of work, the contract will be treated as works contract and not sale. That is what the court started balancing the interests of the state governments and the central government.

Now, if it is a works contract, it can be considered service and service tax can be imposed on the same. Take an instance of contracted work. For example, when your portrait to be painted by a painter, he is giving the service of his skill, his labor, his standard. How does he actually deliver the service, he may actually give it to on the page or sheet or the cloth in which the portrait is actually being made. The final outcome may be something that is tangible in terms of quantity or article, but because the dominant intention was hiring the painter's service, it will be treated as a contract of work. Similarly, what is a contract of sale? To definitely go and buy a painting, whatever the painting that is available, it is something that is tangible, it is the format that can be bought and sold.

So, may be buying the painting, the painter's work, but it is already painted is a contract of sale. The same example can be distinguished as sale and contract of work. The only thing is, how do you apply the "dominant nature test" that the courts have evolved in India. For example, say manufacturing of coaches. Now in manufacturing of coaches everything is tangible. Only thing is how to fit in the different parts. What order or customization have to be done? Say, it is a bus, which 2 plus 1 seater, luxury seating, sleeper coach, I just fit all this material. But the dominant intention in that case, may being a contract of work.

And a contract of work, yes, the final outcome could be in the form of a tangible commodity or article, but because the majority of the contract looks to be a contract of work, it will be treated as contract of work. So, notice that in government, they also interestingly issue what is known as the purchase order. The purchase order is for sale or purchase of goods, whereas work order is for contract for work.

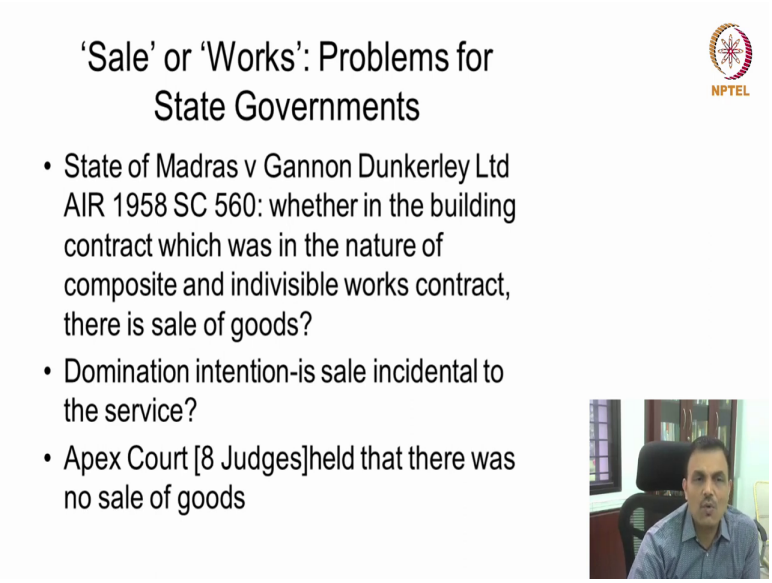
So, there is a need to clearly understand the dominant intention, or the nature of the contract to actually apply the distinction between sale and work. Interestingly, to take consideration of this matter. This is the most important case of what we call as the Gannon Dunkley case of 1958. And later on, again decided in 1993, where the Supreme Court again had to inquiry in the nature of construction work. Now construction work is using a lot of mortar, it is using bricks, cement, steel, wood, plumbing and so on and so forth. All these are articles, commodities and materials. How would the that fit the same unit that is labor? Labor is the dominant nature in some of these contracts. And without labor, nothing of this could actually look to be in a tangible, artistic, livable manner.

So, the dominant nature in works contract, construction work is the contract. Now, over the period of time, the courts, to balance the interest between the state and the center, to tax these contracts, had to come up with a very interesting test called the composite nature test.

What it said was, look, in the same contract, why do not we distinguish between sale and work? Because this is a combination, it is a composite character in the contract. Let both governments have a share in taxing the value of the contract. Some in terms of work, say 60 percent of it could be works contract and 40 percent can be material contract for which the state government can also tax. So, the composite character of the contract was brought into place in terms of the taxation matter and this composite tax was applied in contracts which had sale as well as work, and both the governments got their revenue from these kinds of contracts.

What is relevant to understand here is the whole idea of the goods and services tax, GST, comes from these kinds of cases, where to club the right of both the governments to tax the contract, to ease taxation law, to facilitate commercial transaction, to clarify down some of how to treat this contract is it 60:40 What is sale, what is works contracts, what percentage of taxation should be applied? Because notice that in sales tax, different states have different percentage of taxation. And this also meant that there was something called industry forum shop. Industries would actually go to those states where the sales tax was less so that their goods become competitive in the market, because of lower price. So, to avoid all of that, to have a uniform, one nation one tax regime, the GST law was also implemented, and it directly reflects to the discussion about understanding contract of sale vis-à-vis the contract of work.

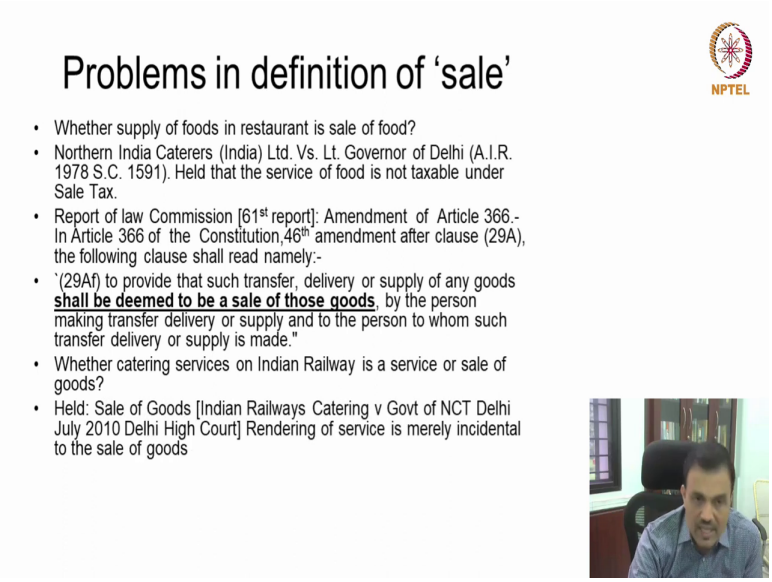
(Refer Slide Time: 11:25)




Now, this is the case that is construction contract. If suppose when the contract cannot be divided as works or sale contract, because there shall certainly be either sale or work. But if it is something that is divisible in the nature of how much can be taxed as a service contract or service tax.

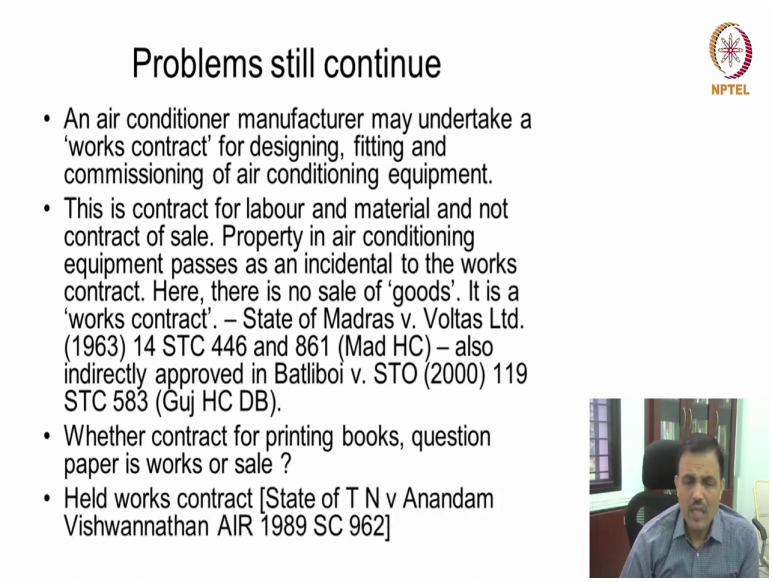
So, that is how the Gannan Dunkerley in 1958 was decided by eight judges, they decided at that point of time that construction work is not sale of goods because it could not be divided at that point of time. So, the dominant intention and nature of tests was applied in 1958, which was later on changed to what is called as the composite nature test.

(Refer Slide Time: 12:17)




To understand the Sale and the definition of sale and how it resulted in a constitutional amendment, for example the look at supply of food in a restaurant. Now, consider a supply of food in restaurant a sale of food. Unfortunately, as it is decided then, this is service of food. So, if the food was pre packed, if it is available off the shelf, say a biscuit packet, that is sale of goods. But if the biscuit is made to order and to sit in the restaurant and actually eat it or consume it, that would be considered as supply of services. That is how the pre constitutional amendment rule was. And that is when the 46th Amendment was brought in. Clause 29A was brought to Article 366 of the Constitution, which clarified all of these, and introduced what we call as the Deemed Sale. So, today, notice that catering services will be considered as deemed sale.

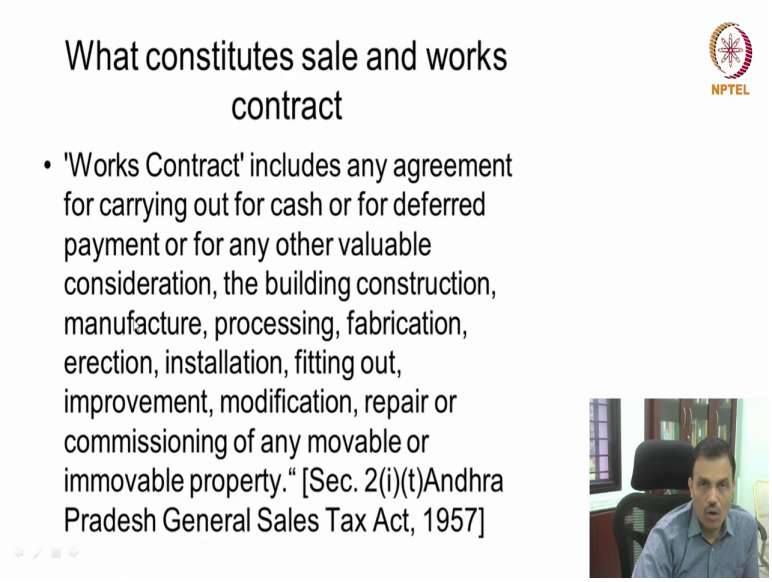
(Refer Slide Time: 13:22)




And, any of the other kinds, a licensing agreement or a transfer of right to use can also be considered as a deemed sale. However, to look at certain issues like fitting of an air conditioner. To buy a standalone product, say 1 ton or 1.5 tons, it can be fitted in and that could be sale of goods.

However, if any central air conditioning in the office, what kind or nature of the contract it will be? If it is a works contract or it is a composite contract. So, this is where the challenges still will remain because an element of labor skill is there, the material is just incidentally going to be transferred. So, in central air conditioning, the works contract concept becomes a very critical to appreciate and understand. Similarly, whether contract for printing of books, question paper, whether it is works contract or sale contract. The final element is in the form of paper, but it is printing and printing is labor or is it skill. And Courts in 1989 said that printing of books is a works contract.

(Refer Slide Time: 14:44)




What is a Works Contract? Just to understand it from tax law perspective, works contract includes any agreement for carrying out of cash or deferred payment, payment or price is not relevant. Or for any other valuable consideration. The building construction is works contract as per Andhra Pradesh Sales Tax. So, the definition can also say what is works and what is not.

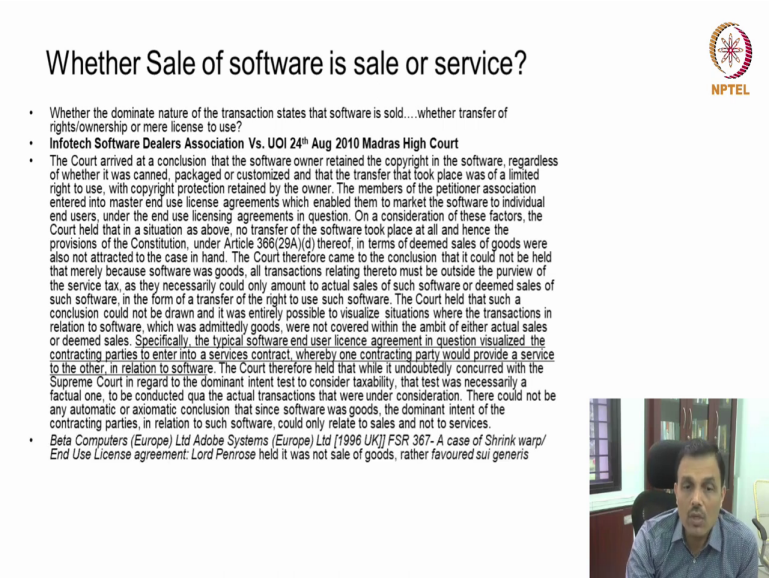
If you are processing food, or you are processing any other material, fabrication is works, erection of say, towers and buildings, installation, fitting, improvement, modification, repair or commissioning of any movable or immovable properties constitute works contracts. So, this is to segregation of sale from works. So, all of these involve labor and skill and that is why they are not sale of goods, they are works contract.

(Refer Slide Time: 15:36)


The changing nature or the dominant nature test, is discussed in the Kone Elevators case. So, it was argued that lifts and elevators cannot be delivered like air conditioners, they are not standard units. They have to be manufactured, supplied and directed and installed, involving labor and skill, and there is a technical know how to the same, and that was what was argued in this case as well.

So, these are certain very interesting questions that one will have to raise for example, supply of railway wagons. Should it can have considered Sale or to be considered it as works contracts. So, these are the numerous challenges that came for the definition of sale as against works contract

(Refer Slide Time: 16:28)




Now, coming to software, the interesting character of software in the Tata Consultancy Services with the State of Andhra Pradesh case where the court said that branded software can be considered goods because it can be delivered, it can be stored, it can be transferred.

So, that is something that the Tata Consultancy Services case did say. But remember, the judges in the TCS case did not deal with the definition of sale. They just dealt with the aspect of goods, can software be considered as good? But finally, one should notice that even if a, software is goods, then what about the software in a CD during that time. Today, everything is downloadable, everything is online.

And everything is a transfer of the right to use. So, notice that, let us assume that it is in a CD. Now what do you do? When you buy the CD, you consider is to be goods. You think it is liable or applicable to sales tax in case the government wants to apply it. Then, you take the CD and put it in the CD drive.

Like, I have a CD drive over here. I will load it. After a couple of seconds, one dialog box opens, scroll it down, to click the agree button, after which the software loads. That is how usually when software was given in the form of goods. In a dialog box that opens to which you click the, I agree button. Notice that what was shown to click was the license agreement. The terms and conditions of the license agreement to which “I agree” was clicked and only after which, actually that kind of a software was loaded

Interestingly, there are two buttons two boxes that you can actually choose to click. One is for the “I agree” button Now, none will probably click the “I disagree” button because probably if its clicked it, the software will not be loaded. But is there a choice to return the CD back? This is where to bring in the aspect of electronic contracts where it is called as shrink wrap and click wrap, I think. Shrink wrap means that the CD have a wrapper and it says that once you open the wrapper, the CD is yours. That is the first stage in which a contract in the electronic nature of transaction used to happen, shrink wrap. Open the wrapper that the copyright in the CD cannot be borrowed.

Once the wrapper is open, the CD will not be recalled backwards, returned back, no refund. So, they may have certain terms and conditions as the wrapper to the CD as well. So, that is called shrink wrapper, the stage of the agreement was called shrink wrap and the other agreement was called as click wrap.

To say “I agreed” agreeing to the terms and conditions of the contract. So, that is the stage in which the second level of contract is made when a CD is bought. To say a click wrap means agreeing to the terms and conditions. This is like a forceful, what is called as the standard form of contract. It is standard, the terms and conditions are standard. They do not change, do not amend, they are standard terms and conditions. The standard form of contract, exist in most places. In today's business context, the standard form of contract is most common. This becomes unfair sometimes, because looking at the 199$^{th}$ Law Commission Report, it has said that a standard form of contract is, could be unfair on two grounds.

One, it could be procedurally unfair. Now, what is procedural unfairness? It means the way contract and the consent is taken, itself is unfair. When there should be two boxes that is “I agree and I disagree.” Now, to click “I disagree” even though there is a shrink wrap contract that has already been made, but even to say “I disagree” the shrink wrap contract should not say that the CD cannot be back. Having to use, unless you read the terms and unless and then to disagree. So, that is an unfair procedural consent that is usually taken in a contract. This procedural unfairness in standard form is visible in most places. For example, in hospitals, there is a necessity to agree the consent form. That is like an implied contract with the hospital or an express contract that creates an obligation between the patient and doctors. Now in most cases, people do not have even time to read it and it will be like forced to sign. They say, unless you sign, we will not treat the patient. That is a procedural unfairness.

In insurance, what is the standard form? The terms and conditions are so lengthy, and they are written in such fine print, such minute font that it is unable to read it, to understand it, and do not have enough time, probably need a magnifying glass to actually understand and read those terms and conditions. So, you will notice that these are procedurally unfair, the way the draft is made, the way the contract is printed, it is procedurally unfair. The 199th Law Commission also says that look, in standard form, there is something called substantive unfairness. Now, what is substantive unfairness?

It means that in that standard form of contract, the terms and conditions itself is unfair. Say, procedurally how to make the contract, take the consent and take the signature itself was wrong. Coming to the clauses in which there is substantive unfairness as to what is substantive unfairness? The clauses say that, say they are not going to be liable, exclusion of liability or they limit their liabilities? Are they so reasonable. So, this is substantive. The terms and conditions are to be challenged as being against public policy. What happens in a software licensing agreement, they cannot transfer this license unless you inform them? Even when you load the software and say "I agree" and put the software in the laptop, the license agreement may say you cannot transfer this laptop or sell this laptop unless you have taken the consent of Microsoft. Because they say this is a one-time license agreement, this is end-user license agreement, and this is the non-transferable, non-assignable license agreement.

Now, this is where the substantive fairness or unfairness of such clauses will have to be properly tested. And the Law Commission says these are the challenges that we face in modern day society. Because remember, the power to make these terms and conditions and this contract, lies with agencies like Microsoft, Google or any other software company, because they make it standard for all the work, uniform across the world. And hence, they will use this power, they will abuse it or misuse this kind of power of making unfair substantive clauses in the contract. And all have to be really careful about the same.

There will be the substantive unfairness in standard form content in various stages, in various places. For example, in the insurance sector. The Insurance sector there is regulator called the IRDA, which will probably regulate this unfairness to some extent. The RBI will have the Reserve Bank of India trying to regulate unfairness in banking standard forms contract.

So, the regulators will definitely play the role including the Competition Commission of India, and they will probably bring in an element of public policy that is required in contracts.

But having said all of that, one of the most important issues that the Madras High Court dealt is the Tata Consultancy Services, judges could not deal was the issue about sale of software.

Interestingly the Madras High Court actually evaluated the agreement itself, the licensing agreement, the right to use. Looking at the licensing agreement nowhere there is the intention of sale. Now reading Section 4 of the Sale of Goods Act of 1930, notice that sale is to be understood by the intention of the parties. Unfortunately, the software companies have no intention to transfer, proprietary right in the software. They only give you a user right. So, it is license to use and nothing more than that. And interestingly, to say it is end user, means if any person has started to use it, he is the last person to use it, no one else can actually get a right to use the same.

Now, this is where you notice that the Madras High Court said, it is not a sale, it is only a licensing agreement. So, there is no proprietary interest that is going to be agreed to be transferred in this particular case. And hence, this cannot be considered software agreements to be sale contracts. What the court says is, in this case, very interestingly, the court says that, for such kind of software it is better to come up with some sui generis system, something unique for them because it is neither sale nor the works contract, it is a different element of a contract. So, why not treat it as a different contract. Article 366 there is something called the deemed sale provision and in that deemed sale provision, can you fit a software agreement, The Madras High Court finds it very difficult to define Goods and Sale. And that is why they say that such kinds of contracts cannot be charged with sales tax because there is an element of transfer of the right to use the software, but cannot conclude entirely whether it has been given that complete right to use. The right to use means an assignment, whereas a license agreement is a non-exclusive right. So, it cannot be an absolute right to use, and hence whether it fits within the exception provided under Article 366 29A the court had to evaluate in the software case.