7 SHIELDS TO REDRESS CONTRACT DISTRESS

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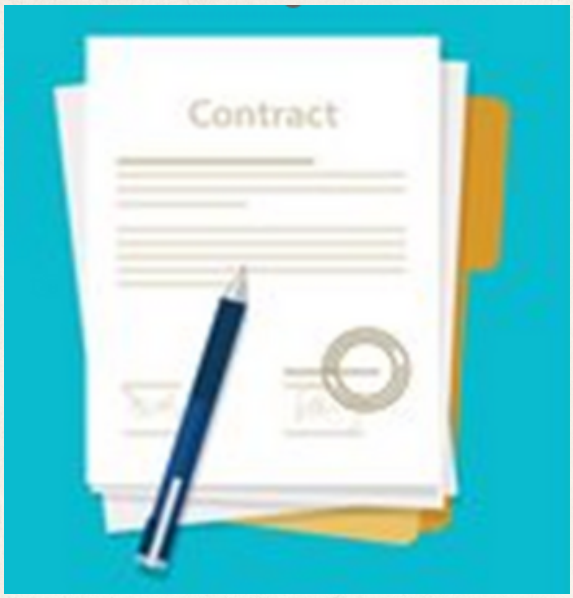

Contracts are extremely important in todays changing times and the possibilities of engaging in business with entities all over the world. The whole idea of a contract is to ensure that the expectations of each party are spelt out correctly and there are enough safeguards to ensure that in case such expectations are not met, the dissatisfied party can invoke remedies easily. [1]

A well drafted contract from a customer's perspective can contain multiple remedies that may be invoked in case the vendor commits a breach or does not perform the duties. While each contract shall have its specifications depending on various factors, the author endeavors to briefly analyze certain important clauses that could be included as safeguards in a contract from the perspective of a customer in this article.

Listed below are seven important safeguards (not in any particular order) that could be incorporated in contracts from a customer's perspective.

1. INDEMNITY:

This is generally the most debated and contested clause during negotiations. Indemnity is provided under section 124 of the Contract Act and is actually an obligation on the indemnifier (the party granting the indemnity) to protect the indemnified party (the one receiving the indemnity) from any loss that the indemnified party may suffer due to certain defined acts or omissions of the indemnifying party. [2]

Parties are at liberty to determine the acts for which indemnity may be granted, the extent of damages, the procedure of indemnification, the nature of losses covered etc. and whether the indemnity extends to the acts of the indemnifying party alone or whether the acts by such party's agents, personnel, employees etc. are also covered.

For example, A (as a seller) agrees to indemnify B, (the purchaser) in case the software provided by A is an infringing software or a software that contains any malware or virus. In case , A does actually provide an infringing software then B shall be entitled to recover the losses incurred by B due to installation of such infringing software ranging due to loss of business, costs paid to any third party (who claimed to be the original owner of the software) etc.

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1. This article reflects the general views of the authors and the views expressed are personal. No reader shoukd act on any statement contained herein without seeking detailed professional advice.
2. A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity." —A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity."

Often, the indemnity clauses incorporated in a contract are wide and unilaterally favoring the purchaser and sometimes the Vendor is expected to indemnify the Purchaser from any acts or omissions that may not even be relevant. For example, if the Vendor is providing certain services related to waste management, an indemnity for intellectual property infringement is totally irrelevant provision, but if insisted just for sake of following the set template, may delay contract negotiations.

Thus, indemnity clauses should be drafted thoughtfully to ensure that the acts which are most likely to impact the purchaser or identified as fundamental to the purpose of the agreement, are included in the scope of indemnity.

From the vendor's perspective, wide indemnity clauses can be countered with adequate procedural and notification safeguards and also by subjecting the obligations of indemnity to be limited to acts which are substantiated or documented with sufficient evidence.

In one of the recent cases before the Telangana High Court: Bhimrao Jaligma vs Punjab National Bank, the High Court was hearing a batch of writ petitions filed by various valuers challenging the letter of indemnity that was sought by the bank. The valuers alleged that the letter of indemnity was draconian and an unfair provision resulting in an unconscionable contract that warranted an interference by the Court. The Court refused to interfere in the said matter and held that, [3]

It is clear that the amount disbursed by banks as part of their lending activity depends on the valuation of the security that is deposited. This valuation is sine qua non for the bank to determine the amount which shall be disbursed and in case the borrower fails to return the loan amount, the bank is left with no other option but to enforce the security deposited. Therefore, it is justified on the part of the banks to ensure that the property deposited by the prospective borrower is properly valued. To ensure such proper valuation, it is for the banks to determine the criteria that a valuer has to satisfy to seek empanelment with them. The banks may come up with a condition that the valuer shall act reasonably, fairly and take reasonable care while valuing a property. The bank is justified in imposing a condition that if any loss occurs to the bank on account of improper/illegal valuation, the valuer will be called upon to indemnify the bank.

It also held that this was a requirement of the contract and if the valuer so chose they could withdraw from the empanelment.

2. RISK PURCHASE:

This clause generally provides that in case of a breach of supply or services agreement, the purchaser shall be entitled to obtain such products or services from third parties at the costs of the vendor. This remedy ensures that the purchaser is not required to suffer in case the services are critical, and he/she shall be entitled (as a matter of mutual agreement amongst the parties) to obtain the services from a third party.

3. Writ Petition Nos. 2648, 3755, 4235, 4248, 4256, 4257, 4855, 5107, 5577, 5666, 6194, 7420, 8722 of 2021, 23785, 24837, 25292, 25303, 25360 and 33025/2022 decided on 08.11.2022 - TLHC.

A common dispute while enforcing this clause arises when the seller alleges that the purchaser has wrongly obtained products that are of distinctly of superior quality and thus naturally priced much higher rather than purchasing comparable products. Another issue may arise in case the alleged breach by the customer is not really accepted by the vendor. In such cases, the Vendor may interpret the obligation differently and claim that the time of delivery never commenced as the requisite facilities of delivery were never provided by the purchaser like the Vendor could have developed the goods only when the designs were approved by the purchaser and so on and so forth.

Thus, the parties should take care to draft the clause precisely to cover the varied possibilities and the purchaser should also act reasonably while exercising its rights under the clause. The language of the clause is very critical to analyze whether the clause requires any proof of the breach or whether the clause puts any monetary cap on the purchaser on the amount to be spent.

It is generally understood that in case of breach of a contract for supply of goods, the purchaser could claim the difference between the contracted price and the market price of such goods at the place of delivery, as damages. If there is no available market price at the nearest place, the price prevailing in the controlling market could be considered. [4]

3. BANK GUARANTEES

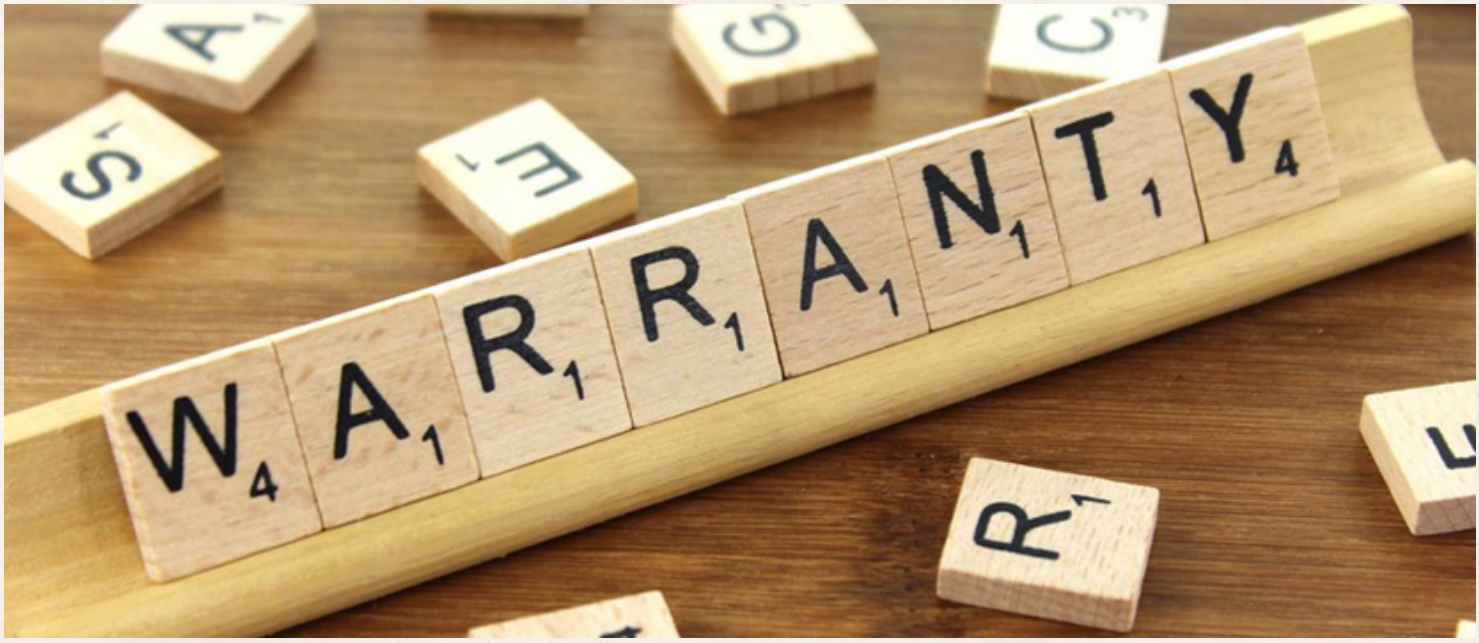
4. Tata Iron and Steel Company Ltd vs Ramanlal Kandoi ((1971) ILR 2Cal493

Bank guarantee is a special provision which can be agreed in case of high-stake contracts. Bank guarantee is one of the surest ways of ensuring that in case of default, purchaser shall be entitled to invoke the bank guarantee as an independent obligation through the bank.
To ensure easy invocation, the terms of the bank guarantee should be set out clearly. Often if the bank guarantee is invoked wrongly by the purchaser, the vendor is likely to litigate the same and attempt to obtain an injunction order on such invocation though the interference of the courts has been minimum.

The Supreme Court in the case of Andhra Pradesh Pollution Control Board Vs. CCL Products (India) Limited had the occasion to deal with the aspect as regard to the invocation of bank guarantee. The Supreme Court after relying upon the various judicial precedents had held that except in case of fraud, irretrievable injustice and special equities, the Court should not interfere with the invocation or encashment of a bank guarantee so long as the invocation was in terms with the bank guarantee. ..... It is settled law that bank guarantee is an independent and distinct contract between the bank and the beneficiary and is not qualified by the underlying transaction and the validity of the primary contract between the person at whose instance the bank guarantee was given and the beneficiary. "[5]

Bank guarantees may be either conditional or unconditional and the invocation rights shall be strictly construed basis the language of the bank guarantee. Recently, in Union of India vs Nayak Infrastructure Private Limited , the purchaser had obtained an injunction from the lower court which was promptly vacated by the High Court on the innovation of bank guarantee on the aforesaid principles. [6]

4. REPRESENTATIONS AND WARRANTIES :



5. Civil Appeal No 7005 of 2017: (2019) 20 SCC 669
6. High Court of Gauhati: Arb.A./5/2020

Every contract is unique and needs explicit representations and warranties which are identified by the parties specifically. If the business teams expect certain quality specifications, or representations then the same should be recorded clearly including warranty periods if any. If any specific SLAs or timely discharge of obligations is expected from the vendor, then the purchaser must clearly incorporate the same in detailed schedule. It should be remembered that unless the expectation is set clearly through the contract (and not through emails) it is difficult to establish a breach and invoke any remedy for breaches etc.

For instance, if the contract requires the Vendor to perform certain obligations but does not put in strict timelines on the Vendor, then it would be very difficult to establish the breach thereon. Obligations in a contract are required to be drafted clearly to ensure that the parties have consented to the obligations with a clear mind and intention.

Example: A contract may set out obligations in below manner:
A represents that A shall provide products in a timely manner to B.
OR
A represents that A shall provide new, original, and non-infringing products to B, within [ ] days of receipt of PO, time being essence of contract.
The second language is a clear obligation and to establish breach thereof is possible easily.

Further, sometimes the contract is entered into by a subsidiary of the group company and if any representation is expected at the vendor's group level, then the same should be cogently mentioned and if possible, the relevant entities should be made signatories to the agreement.

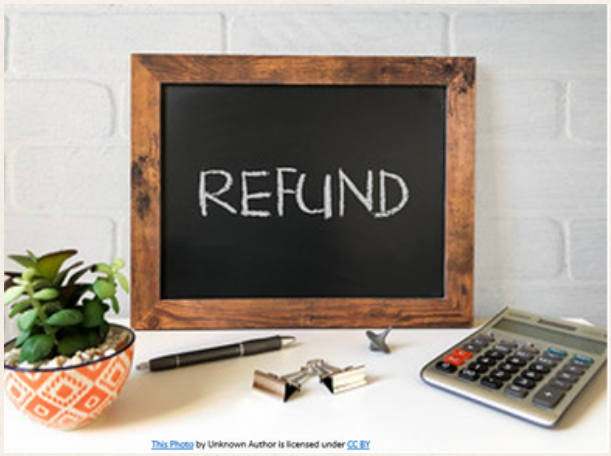
In one of recent cases Cox and Kings Limited v. SAP India Private Limited & SAP SE GmBH , which is pending before the Supreme Court of India for adjudication, the group of companies' doctrine is being reconsidered. The Applicant entered into four agreements with the Indian entity of SAP. The German entity was not a signatory to any of the agreements. However, there were repeated correspondences amongst the parties.[7]

Ultimately, when disputes arose, SAP GmbH did not join the arbitration as it was not a signatory to any of the contracts. This stand was contested by Cox and Kings in view of the group doctrine , but matter is now under consideration before the Supreme Court. [8]

7. Supreme Court of India: Arbitration Application (Civil) 38 of 2020

8. This doctrine was upheld by the Chloro Controls case wherein it was held that in certain exceptional cases even non signatories to the agreement could be bound by the arbitration agreement., (2013) 1 SCC 641

5. REFUND / REPAIR/ EXCHANGE:



Refund is a common remedy available which is now incorporated in most of the low-ticket contracts as well. This ensures that in case of any default, the Purchaser is entitled to a refund of complete money if paid in advance. The clause should be clearly drafted and also refer to a pro rata refund in case part services have been received by the customer to avoid any conflict.

The agreement can also contain clear repair obligations that may entitle a purchaser to seek a repair of the products. In certain cases, customer may also seek an exchange of the products if repayment is not possible.

6. INSURANCE:

Insurance is an important obligation that can be imposed upon the vendor to obtain specific insurance to reimburse any losses. Depending on the nature of the agreement, purchaser may require the vendor to incorporate specific insurances like Errors and Omissions insurance, directors and officer's liability insurance, fidelity insurance, natural perils insurance etc. and so on and so forth. The purchaser may also request purchaser to be named as co-insured in critical cases basis negotiations amongst the parties.

7. DAMAGES CLAUSE:

The purchaser may decide to impose damages for specific defaults, delays or breaches. The right to recover damages under a contract is also codified under section 73 of the Contract Act. It is accepted that the party suffering from the default or breach is generally entitled to seek damages to compensate the actual damage suffered and not resort to using this clause to recover remote or consequential losses, which did not arise in the ordinary course of things. [9]

For example,

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9. When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it. Such compensation is not to be given for any remote and indirect loss of damage sustained by reason of the breach

If A promises to deliver certain specific equipment to B which is essential for completion of the project. Relying upon A's promise, B has committed to C (the ultimate customer) that the project shall be completed by the specified date. However, A is not aware of any such further commitment. A fails to deliver the equipment and consequently the project is delayed. B may recover the damages from A for the failure to provide the equipment but shall not be liable for the entire damages that were imposed by C.

Generally, it's a norm that vendors include monetary limitation of liability to recover the damages and thus the exceptions to the monetary limitation should be carefully debated by the parties considering the nature of the agreement. Sometimes, parties may also be inclined to impose liquidated damages for delay.
Parties may also choose to impose a requisition for specific performance if the nature of the contract so warrants. [10]

PROCEDURAL SAFEGUARDS EQUALLY IMPORTANT:

One must remember that drafting lengthy indemnities with unilateral language will not be of much help if the obligations are not clearly drafted or if there are certain issues with formation of the contract. In one of the recent Supreme Court cases Padia Timber Company (P) Ltd. vs The Board of Trustees of Visakhapatnam Port Trust , the applicability of risk purchase clause was considered and presents an interesting read wherein after 23 years of litigation, the Supreme Court held that the contract was never concluded. [11]

Respondent Port Trust issued a Tender for the delivery of wooden sleepers. The Appellant filed a conditional bid, declined clauses 15 and 16 of the Tender, and deposited Rs. 75,000. The main point of contention was the site of inspection and parties ensued into correspondence on the site of inspection. While the port insisted that the inspection should occur at their site, the Appellant insisted that the inspection could take place at their factory to avoid transportation costs etc.

Thereafter, the appellant also sought to withdraw its bid as the prices had risen. However, simultaneously a PO was issued to the Appellant. The Respondent Port trust insisted that the contract was concluded, and the Appellant was under an obligation to supply the wooden sleepers and in case of any failure, the Respondent port trust shall forfeit the sums and also invoke risk purchase clause.

After ten months, the Respondent-Port Trust invoked the risk purchase clause and placed an order for supply of wooden sleepers on an alternative supplier at a much higher rate. Thereafter, the respondent port trust filed a suit before the II Additional Subordinate Judge, Visakhapatnam against the Appellant, seeking damages for breach of contract to the tune of Rs.33,19,991/- along with interest thereon. A counter suit was filed by Appellant to recover the earnest money. The two suits were clubbed and the respondent port trust won its suit and the appellant lost the counter suit. The appellant litigated further and again lost before the High Court.

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10. More information on this topic can be obtained here: Orange and White Mionimalist The King Magazine Article (ynzgroup.co.in)
11. Civil Appeal No. 7469 of 2008

Ultimately, the matter reached the Supreme Court, and it was held that the contract was never concluded and thus the respondent port trust had no right to recover any damages in the nature of risk purchase clause sought by them.

Both the Trial Court and the High Court over-looked the main point that, in the response to the tender floated by the Respondent-Port Trust, the Appellant had submitted its offer conditionally subject to inspection being held at the Depot of the Appellant. This condition was not accepted by the Respondent-Port Trust unconditionally. The Respondent-Port Trust agreed to inspection at the Depot of the Appellant, but imposed a further condition that the goods would be finally inspected at the showroom of the Respondent-Port Trust. This Condition was not accepted by the Appellant.

It could not, therefore, be said that there was a concluded contract. There being no concluded contract, there could be no question of any breach on the part of the Appellant or of damages or any risk purchase at the cost of the Appellant. .... The earnest money shall be refunded within four weeks with interest @ 6% per annum from the date of institution of suit No.450 of 1994 till the date of refund thereof." [12]

CONCLUSION

Parties should take adequate care while entering into the contract to ensure that the purpose of the contract is met appropriately. The clauses listed above are just important clauses from a customer's perspective and for the contract to be complete there are standard clauses which are always required in a contract like dispute resolution, IPR arrangements, scope, payment terms etc. While incorporating various remedies, the agreement should clearly record that each contract is a separate and distinct remedy to be available to purchaser 'without prejudice to each other' under the contract for different breaches of the contract.

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About Aarti
Aarti is experienced in corporate legal matters having specialization in drafting, vetting and negotiation of agreements. By qualification she is an advocate and a solicitor

12. More information on the acceptance of contract can be obtained here : Microsoft Word - 2-Topic -1 Acceptance of Contract _V3.0_Final.docx (ynzgroup.co.in)