

Advanced Contracts, Tendering and Public Procurement
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Government Contracts-Part 01: Introduction to Government Contracts

Hello, my name is Madhubanti Sadhya and I currently teach at the National Law School of India University, Bangalore. In this segment, I would be introducing you to government contracts. This is a part of the NPTEL course, on advanced contracts, tendering and public procurement offered by Professor Dr. Sairam Bhatt, Professor of Law and coordinator of CEERA, NLSIU. Now together we will look at what are government contracts, what are the different parameters that need to be borne in mind before government contracts can be entered into, and what are the different prerequisites of entering into a government contract.

With the aid of case laws, we will also see what happens if these criteria are not met. We will also try and see what the consequences of a breach of a government contract are. Now, if we look at government contracts, the most important entity in government contracts is necessarily the government. Now the modern state has expanded its role beyond the customary role of performing sovereign duties. That is to say, it is no longer limited to just governance of its territory, or the maintenance of law and order.

The modern state today is a key player in the commercial arena, and it engages in different activities, such as trade and commerce, either as a procurer or a supplier of goods and services. It also adopts a larger societal role in the performance of public duties or also as the protector of public resources, such as natural resources. The government is considered to be the trustee of natural resources. In doing so, the government is required to enter into a diverse range of contracts and these contracts are entered into not only with individual entities but also with business enterprises.


This brings us to the most obvious question, and that is whether the government as a contracting party should be treated any differently than a private contracting party. If we look at this from the perspective of contract law, the government should not be treated any differently than a private party.

But considering the important role that the government discharges in so far as the protector or the guardian of public resources, or as a body which is responsible to fulfill a number of public duties, the Constitution very clearly delineates the powers and responsibilities of the government in so far as its role in contracting or its power in entering into different kinds of

contracts concerned. That is to say, the Indian Constitution clearly circumscribes the role that the government as a contracting party can play.

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What are Government Contracts?



BACK TO THE BASICS

What are 'Government Contracts'?

- Any contract where at least one party is the government
- It can be the Central or State Government or both
- The contract must fulfill all the basic requirements of a valid contract as under the Indian Contract Act, 1872
 - ❖ Offer
 - ❖ Acceptance
 - ❖ Consideration
 - ❖ Capacity to contract
 - ❖ Free consent of parties
 - ❖ Legality of Object and Consideration



Now, let us go back to the basics and ask ourselves, what are government contracts? It is any contract where at least one party is the government. It can either be the central or the state government or both. The contract must fulfill all the basic requirements of a valid contract under the Indian Contract Act of 1872.

Now, we will see in the subsequent slides, that there are certain specific constitutional provisions that apply to any contract that a government wants to enter into. But irrespective of the constitutional provisions, all government contracts have to adhere to the basic prerequisites that have been laid down under the Indian Contract Act for entering into a valid contract.

What are these requirements? That is, first of all, there has to be an offer, there has to be an acceptance of that offer, there must be consideration involved, the capacity to contract, the free consent of the parties, the legality of the object and consideration. In government contracts offer and acceptance are generally taken in the form of tenders which are floated, and bids which are submitted in response to those tenders, and bids which become successful are usually ones that are accepted and then there is a binding contract that is entered into.


There must be a consideration. The parties that enter into a contract with the government must have the capacity to contract. That is to say, it must be done by an individual who is of sound mind, and has attained the age of majority; in the case of institutions or business enterprises, they must not have been blacklisted, or they must fulfill all the other criteria that have been laid down by the government which is entering into the contract.

The contract must be entered into, with the free consent of the parties. Just because it is a contract that the government is entering into, there cannot be any undue influence or coercion, or any kind of fraud that is involved. The very fact that the government discharges public functions, and most of the contracts that the government enters into, are in pursuance of the public duty that it discharges, government contracts call for a very high level of transparency.

And this makes it all the more important to ensure that there is no force or undue influence or anything that vitiates the free consent of the parties, is involved. And ultimately, the object and consideration of entering into a government contract must be legal. No government contract can be entered into for any illegal object or consideration. So these are the basics of a government contract.

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From where does the government get the power to enter into contracts?




FROM WHERE DOES THE GOVERNMENT GET THE POWER TO ENTER INTO CONTRACTS?

Article 298, Constitution of India
Power to carry on trade, etc. - The executive power of the Union and of each State shall extend to the carrying on of any trade or business and to the acquisition, holding and disposal of property and the **making of contracts** for any purpose

Provided that (a) the said executive power of the Union shall, in so far as such trade or business or such purpose is not one with respect to which Parliament may make laws, be subject in each State to legislation by the State; and

(b) the said executive power of each State shall, in so far as such trade or business or such purpose is not one with respect to which the State Legislature may make laws, be subject to legislation by Parliament



A fundamental question from the perspective of contract law relates to the capacity of persons who enter into contracts. Now, when we talk about persons, we do not only mean natural persons but also juristic persons like corporations or companies, including the

government. Now, as per section 11 of the Indian Contract Act, a natural person is free to enter into a contract or rather has the capacity to enter into a contract, if he has attained the age of majority, according to the law to which he is subject, if he is of sound mind, and if he is not disqualified from contracting under any other law to which he is subject.

So, this relates to a natural person. Now, what about the government? From where does the government get the power or the capacity to enter into contracts? The answer to this question lies in Article 298 of the Indian constitution. Now, let us see what Article 298 says. The executive power of the union and each State shall extend to the carrying on of any trade or business and to the acquisition, holding and disposal of property, and the making of contracts for any purpose.

So, when we look at the three organs of the government, the executive, the legislature and the judiciary. So, the legislature is given the task of drafting and enacting legislations, the executive has to take necessary steps to enforce those legislations and the judiciary has the power to adjudicate on matters that come before it, which more or less relate to these legislations that have been drafted by the legislature or have been executed by the executive.

So, when we look at the power of contracting or the power of entering into contracts, it seems quite logical that it is the executive which has been given the power to make contracts. Now, it would be extremely inconvenient if the executive had to wait for legislative approval every time it wanted to enter into a contract. Because considering the diverse range of activities that the executive engages in, it would be extremely cumbersome, that the executive would have to wait for a law to be enacted and only then it would get the power to enter into a contract.

Hence the constitutional scheme is such that it has given the executive the power to enter into contracts for the purposes of carrying on trade and otherwise. But there are certain restrictions on the power of the executive to enter into the contract and these restrictions are laid down under the proviso to article 298. There are two provisos-proviso A and proviso B.

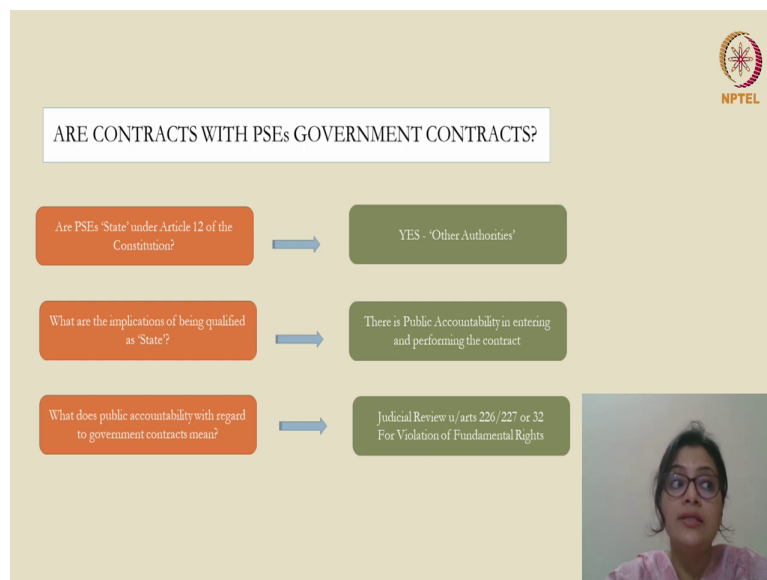
The essence of these provisos is basically that, whenever the union government or a state government is trying to enter into a contract, it would first have to see that the subject matter on which it is entering into a contract is a matter that features in the Union list or the State list. Now, why are we talking about these lists? We know that Schedule 7 of the Indian Constitution distributes powers of enacting laws between the central and the state governments.

So, if I have to explain this with the help of an example, suppose in a state, there is a law that has been drafted by the state government on water, because water is a state subject. Now the central government wants to enter into a contract on something to do with the water in that particular state. The power of the state government to enter into a contract on a matter that relates to water would be subject to the legislation that the state government has already enacted on the subject. So, it is only in this respect, that the power of the Union government would be curtailed.

Similarly, if a state government wants to enter into a contract on a matter that pertains to the Union list or on a matter where there is already a central legislation in place, the power of the state government to enter into the contract would be restricted to such an extent, insofar as the law that has been drafted on the central matter relates. So, this is in essence, defines or talks about the provision from where the government gets the power or the capacity to enter into contracts. So, the power lies or the source of this power to enter into contract lies in Article 298 of the Indian constitution.

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Are contracts with PSEs Government Contracts?



Before we delve into the finer nuances of government contracts, let us first try and understand a few other important aspects. Are contracts with public sector enterprises government contracts? Now, what do I mean by public sector enterprises? PSEs or PSUs that are public sector undertakings are companies or corporations, which are funded or controlled by the

government. To give an example, it could be SAIL-Steel Authority of India Limited or HAL-Hindustan Aeronautics Limited or Bharat Heavy Electricals Limited.

So, these are different PSUs and or public sector enterprises, so the question is whether any contract that these enterprises enter into would be considered to be a government contractor not. To answer that question, we need to first see whether PSEs are State under Article 12 of the Constitution. The answer is yes, they fall under 'other authorities under Article 12. So, what could be the implication of being qualified as state? '

So, what exactly happens if a public sector undertaking is understood as State under Article 12 and if they enter into a government contract, so, what could be the implications of it? The implication is that there is public accountability in entering and performing the contract. So, these contracts would not be considered as any contract that two private entities enter into, because here there is a public purpose or a public good that is involved.

So, there is public accountability. By this, I mean that these entities would be answerable to the public, just like the state, or just like the government, when they are performing their obligations under any government contract that they have entered into. So, what does public accountability with regard to government contracts mean?


So, by public accountability, what we generally mean is that the actions that these public sector undertakings take under the contracts or the government contracts that they enter into are amenable to judicial review before the High Court or the Supreme Court for violation of fundamental rights.

To again, give you an example here, suppose any contract or government contract that the public sector undertakings have entered into, is resulting in the violation of say the right to equality, or the right to life, so, in these circumstances, these government contracts can be placed before the High Court or the Supreme Court for judicial review, under Articles 32, 226 or 227 of the constitution.

So therefore, contracts with public sector undertakings are government contracts, they would be answerable to the public in performing their obligations and they could also be amenable to judicial review before the Supreme Court or the High Court if any action that they take under these government contracts result in the violation of fundamental rights of the citizens or group of citizens in the country.

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Formation of Government Contracts



FORMATION OF GOVERNMENT CONTRACTS

Article 299, Constitution of India

Contracts

(1) All contracts made in the exercise of the executive power of the Union or of a State shall be expressed to be made by the President, or by the Governor of the State, as the case may be, and all such contracts and all assurances of property made in the exercise of that power shall be executed on behalf of the President or the Governor by such persons and in such manner as he may direct or authorise

(2) Neither the President nor the Governor shall be personally liable in respect of any contract or assurance made or executed for the purposes of this Constitution, or for the purposes of any enactment relating to the Government of India heretofore in force, nor shall any person making or executing any such contract or assurance on behalf of any of them be personally liable in respect thereof



Juristic persons such as the state, the government or a corporation do not act on their own. So, they necessarily act through natural persons. In terms of contract formation, a crucial question that needs to be answered is under what circumstances can a natural person, such as a government official bind the government and a third party into a contractual obligation so as to create contractual rights, to bind the government and the third party?

This would essentially depend upon whether the government official who was acting on behalf of the government was even authorized to enter into the contract, to create binding obligations and rights with a particular third party. Under these circumstances, what we need to look at is Article 299 of the Constitution because Article 299, prescribes a set of formalities that need to be complied with before a government contract can be entered into so as to ensure that the government is not made liable for any kind of contract that it did not authorize in the first place.

Since the government acts through natural persons in the form of officials, it has to lay down certain criteria to ensure that it does not become responsible for unauthorized acts of these officials. And this is where Article 299 of the Constitution becomes relevant. Article 299 essentially talks about contracts.

And it says that all contracts made in the exercise of the executed power of the union, or of a state shall be expressed to be made by the President, or by the governor of the state, as the case may be, and all such contracts and all assurances of property, made in the exercise of

that power, shall be executed on behalf of the President or the Governor, by such persons and in such manner, as he may direct or otherwise.

So, all government contracts have to be made in exercise of the executive power of the Union or of the state, they have to be made by the President or by the Governor of the state as the case may be. Neither the President, nor the Governor shall be personally liable in respect of any contract or assurance made or executed for the purposes of this constitution, or for the purposes of any enactment relating to the Government of India in force, nor shall any person making or executing any such contract or assurance on behalf of any of them, be personally liable in respect thereof.

So, from Article 299, we gather that these contracts or the government contracts have to be made by the President or by the governor or by any other person who is acting on their behalf. But interestingly, Clause 2 of Article 299 clearly lays down that neither the president nor the governor or any other person who is executing a contract on behalf of Governor or the President is personally liable.

So, it is obviously the office of the president or the Office of the Governor, that is liable, but not them as individual entities or as individual persons. So, Article 299 lays down certain fundamental parameters or certain fundamental criteria for the formation of government contracts that we would be dealing with in greater detail in the subsequent slides.

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Pre-requisites of a Government Contract

PRE-REQUISITES OF A GOVERNMENT CONTRACT

ARTICLE 299 OF THE CONSTITUTION OF INDIA


- (i) they must be expressed to be made by the President, or by the Governor of the State, as the case may be
- (ii) they must be executed;
- (iii) such execution must be on behalf of the President or the Governor by such persons and in the manner as they may direct

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To reiterate the prerequisites of a government contract, or the conditions that need to be fulfilled for a contract to be entered into by the union or a state, as laid down under Article 299 of the Constitution are: that these contracts must be expressed to be made by the President or by the Governor of the state, as the case may be, the contracts must be executed and such execution must be on behalf of the President or by the Governor, by such persons and in the manner as they may direct.

In the subsequent slides, with the aid of different judicial decisions, we will try and see what the finer aspects of Article 299 are and how Article 299 has been interpreted. So we will be learning a lot more about the formation of government contracts with the help of a few case laws in the subsequent slides.

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THERE IS NO VALID CONTRACT IF PREREQUISITES OF ARTICLE 299(1) ARE NOT MET

***State of West Bengal v. B. K. Mondal and Sons* [1962] 1 Supp. S.C.R. 876**

Facts: The respondents were claiming a sum of Rs. 19,325/- for works done by it for the appellant. This claim was made out in two ways. It was alleged that the works in question had been done by the respondent in terms of a contract entered into between the parties and as such the appellant was liable to pay the amount due for the said works. In the alternative it was alleged that if the contract in question was invalid then the respondent's claim fell under S. 70 of the Indian Contract Act. The respondent had lawfully done such works not intending to act gratuitously in that behalf and the appellant had enjoyed the benefit thereof.

Issue: Whether article 299 is a directory or mandatory provision?

Ruling: The word "shall" used in making the provision [Sec. 175(3) Govt. of India Act, 1935 and Art. 299 of the constitution] is intended to make the provision itself obligatory and not directory. The Parliament intended that the state should not be burdened with liability based on unauthorised contracts and the plain object of the provision, therefore, is to save the State from spurious claims made on the strength of such unauthorised contracts.



The courts have generally taken a view that the provisions of Article 299 (1) of the Constitution are based on public policy, and for the protection of the general public. In a number of cases, the Supreme Court has adopted a very strict view of Article 299 (1), that is to say, the Supreme Court has time and again held that the prerequisites laid down under Article 299 (1) are mandatory and not directory and they cannot be dispensed with. So, if there is any contract that is entered into between the government and another third party, where the conditions laid down under Article 299 (1) are not met, then there is no contract to be enforced in the first place.

So that is to say, the contract is null and void. Such a contract cannot be enforced either by the government, nor can the government be held liable to compensate the third party on the

basis of such a contract. So, Article 299 (1) is mandatory, and all conditions laid down under it have to be complied with. To explain this further, I can give you the example of this case, State of West Bengal v. B.K. Mondal and Sons It was decided in 1962.

So, in this case, the respondents were a firm of building contractors. They were doing construction work for the provincial government and they had done certain additional construction work on the request of officials of the provincial government for which they had not been paid. So, they had definitely made a claim before the government and the provincial government had denied the claim.

So, their claim was on the basis of the contract that they had entered into between the officers and themselves. And secondly, they had said that even if they leave the contract aside, they said that their claim fell under Section 50 of the Indian Contract Act. So, they had said that they had lawfully done some construction work. There was no intention to do the work gratuitously. And since they had done the work, and the officials had enjoyed the work that they had done, they were entitled to be compensated.

The provincial government denied this claim. To give you further details of this case, it was in February 1944, so this is a case which predates independence and the drafting of the Indian constitution. What was in operation back then was the Government of India Act of 1935, which is *pari materia* to the Indian constitution, particularly section 175 of the Government of India Act.

So, the respondents at that time had mentioned that in February of 1944, they had offered to put up certain temporary storage godowns in Arambag, in the district of Hooghly for the use of the civil supplies department of the state of Bengal. And this offer was taken up by the department by a letter, and the work was done and eventually, the payment for this work was also done in the month of July 1944.

In the meantime, sometime in the month of April, there was a similar request, which was made by the Sub Divisional Officer of Arambag to construct a kutcha road, a guard room, a storage room, a kitchen, a clerk office for the Department of Civil supplies. The respondents, B.K. Mondal and Sons, alleged that the additional deputy director of civil supplies had visited Arambag and they had instructed the constructors to go ahead with the construction.

So, they had gone ahead and done this work. Similarly, a few days down the line, there was another similar request, which was made by the sub-divisional officer to come up with

another storage shed and that work was also completed. And the outstanding bills for these two subsequent works, that is the second and the third work were not paid. And when this claim was made, the provincial government denied it.

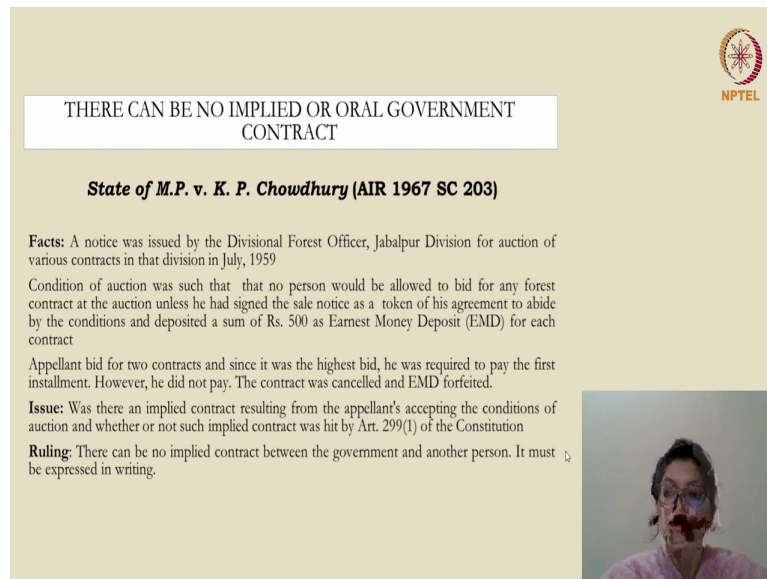
And they said that the request on the basis of which B.K. Mondal and Sons had gone ahead and made these constructions were, unauthorized. So, the provincial government defended itself by stating that it had not authorized its officers to go ahead and make these constructions. So, there was no authorization given to them. And since there was more authorization that was given to them, there is no contract under Section 175 (3) of the Government of India Act, as it then existed.

So, the entire issue of this case was whether Article 299 is a directory provision, or is it a mandatory provision, the court ruled that the word shall, which is used in making the provision is intended to make the provision itself obligatory, and not directory. So, it is not something that the government may or may not do, it is a mandatory provision. The Parliament intended that the state should not be burdened with liability based on unauthorized contracts. And the plain object of the provision, therefore, is to save the state from spurious claims made on the strength of such unauthorized contracts.

So, if the subsequent construction orders that were given to B.K. Mondal and Sons were authorized by the provincial government, then there would not have been a problem. But the provincial government denied that and they said that look, the sub-divisional Officer of Arambag and their additional and Deputy officers, had just gone ahead and given this construction order, but we had not authorized it and hence, there is no contract and hence, we cannot be asked to compensate B.K. Mondal and Sons. So, from this case, we learn that there is no valid contract, if the prerequisites of Article 299 (1) are not met.

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There can be no Implied or Oral Government Contract



THERE CAN BE NO IMPLIED OR ORAL GOVERNMENT CONTRACT

State of M.P. v. K. P. Chowdhury (AIR 1967 SC 203)

Facts: A notice was issued by the Divisional Forest Officer, Jabalpur Division for auction of various contracts in that division in July, 1959

Condition of auction was such that that no person would be allowed to bid for any forest contract at the auction unless he had signed the sale notice as a token of his agreement to abide by the conditions and deposited a sum of Rs. 500 as Earnest Money Deposit (EMD) for each contract

Appellant bid for two contracts and since it was the highest bid, he was required to pay the first installment. However, he did not pay. The contract was cancelled and EMD forfeited.

Issue: Was there an implied contract resulting from the appellant's accepting the conditions of auction and whether or not such implied contract was hit by Art. 299(1) of the Constitution

Ruling: There can be no implied contract between the government and another person. It must be expressed in writing.

To reiterate, as per Article 299 (1) of the Indian constitution, a contract made in the exercise of the executive power of the Union or the state must necessarily fulfill three mandatory conditions. First, it must be expressed to be made by the President or the governor of the state as the case may be. Second, it must be executed on behalf of the President or the governor. And third, it must be executed by such person and in such manner as the President or the Governor may direct or authorize.

So, one word that appears repeatedly in Article 299 (1) is the word 'executed'. So, how exactly has the court interpreted the word executed? So, what do we mean by an executed contract? We can try to answer this question through this case law that is State of MP v. K.P. Chowdhury is whether there can be an implied or an oral government contract. We will be taking the help of this case because in this particular case, a notice was issued by the Divisional Forest Officer of Jabalpur division for auction of various contracts in July 1959.

So, these contracts all pertained to contracts related to forest and timber. So, in this particular auction, Mr. K.P. Chowdhury was the successful bidder because he had the highest bid, and he managed to secure two contracts. So, because the divisional forest officer of Jabalpur division was not in a position or rather he was not authorized to enter into a contract of the amount that Mr. K.P. Chowdhury had actually bid.

So, the contract amount was quite high, and the divisional forest officer was not authorized to accept that contract, the contract had to be signed by the Chief Conservator of Forest from the

side of the government. But as far as Mr. K.P. Chowdhury was concerned, he had already signed the contract form and he also ensured that there was a surety who signed the security bond.

So, he did his part of the transaction, and this contract form of the auction form was sent to the Chief Conservator of Forest. But before the Chief Conservator of Forest could put in his signature and send back the contract form, Mr. K.P. Chowdhury raised certain objections with respect to the markings on the trees that had been advertised in the auction. And the answer that the Divisional Forest Officer gave him, did not satisfy him.

And hence, since his dispute was not settled, he did not pay up the first installment of the contract. So eventually, he failed to pay up. And because he failed to pay up the Chief Conservator of Forest cancelled his contract. On his contract being cancelled, he was asked to forfeit the earnest money deposit, which was already a part of this transaction and he was also informed that his contracts would be re-auctioned.

So eventually, his contracts were re-auctioned and whatever was the balance amount of the contract after it had been re-auctioned, were to the tune of around five lakh rupees was to be paid up by Mr. K.P. Chowdhury. So, Mr. K.P. Chowdhury again failed to pay up this amount. So, the divisional forest officer of Jabalpur directed the Tehsildar of Jabalpur division to recover this money from Mr. K.P. Chowdhury as arrears of land revenue.

So, now the question was, whether or not there was an implied contract resulting from the appellants, that is Mr. K.P. Chowdhury, accepting the conditions of the auction, and whether or not such an implied contract was hit by Article 299 (1) of the constitution. So, the ruling of the Supreme Court was that there can be no implied contract between the government and another person; it must be expressed in writing.

So, whenever the word executed appears, what the government basically, rather what the supreme court said, is that executed does not necessarily mean an oral or an implied contract, but it has to be expressed in writing. So since there was no contract between K.P. Chowdhury and the government before the bid of the auction, nor was there a contract between him and the government, after the auction was over, there could not have been a binding contract as for Article 299 (1) of the Constitution and since there was no valid binding contract, as per Article 299 (1), there could not have been any question of recovering this money as arrears of land revenue.

So, Mr. K.P. Chaudhary was relieved of this requirement of having to pay up the sum of rupees five lakh as arrears of land revenue, because the court ruled that there was no contract in the first place and since there was no contract, there could not have been any obligations that flowed from it. So, from this particular case, we learn that there can be no implied or oral government contract. The word executed implies that there has to be an expressed contract, which is produced in writing.