Niceties of Contract in Government Companies & Limits of Judicial Interference

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Probably Commercial Contract precedes the theory of Social Contract advocated by Rousseau in 18th Century. From small trading shop to multinational corporate giant, the contract is the foundation of every activities. In Indian economy, the Government Companies are destined to play a crucial role to ensure socio-economic development of the Nation. Though in the liberalized era, privatization is gaining momentum, but still a considerable resources of the country are possessed by these companies. In the world of Commerce, the importance of Contract can hardly be overemphasized. From purchasing the stationary items to modernization and even the disinvestments process, the contract is the instrument to carry out the objectives.

The concept of "State" under Article 12 of the Constitution includes the Government Companies pursuing trade and business in different spheres of commercial activities of a welfare interventionist state. Since they are "State instrumentality", Public Sectors are amenable to writ jurisdictions of the Supreme Court and High Courts. (Ramana Dayaram Sheity V International Airport Authority of India, AIR, 1979, SC, 1628) The new economic policy has changed the Socio-economic and Industrial scenario in the country. Under the new Industrial policy, government companies have been exposed to the market economy. They have to compete with the Private Corporate world, but the existing law and public policy expect something more from them. They are there to accumulate wealth, to generate employment and to ensure distributive socio-economic Justice. They are not only the model employers, but also the model business house. They should do their business with procedural fairness and due openness in decision-making process.

Many of the Government Companies are going through the share disinvestment process.

But such dis-investment policy is not sufficient to declare that these companies are not coming within "State" u/Art. 12 of the Constitution. Even now, every principal policy decision and control continues to be that of Central or State Government as the case may be. The judiciary is not yet ready to accept that such dis-investment has in any way changed the status of these Government Companies. (Workmen of Hindustan Steel Ltd vs HSL, 1984, SCC Supp, 554).

These companies stand different from its private Counterpart. Prof. H.W.R Wade in his commentary on contract laws has very rightly observed: "The powers of public authorities are therefore essentially different from those of private persons. A man making his will may, subject to any rights of his dependants, dispose of his property just as he may wish. He may act out of malice or a spirit of revenge, but in law this does not affect his exercise of his power. In the same way private person has an absolute power to whom he likes to use his land to release a debtor, or, where the law permits to evict a tenant, regardless of his motives. This is unfettered discretion. But a public authority may be

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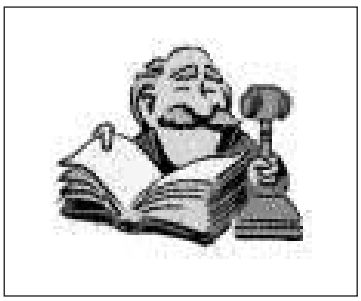
none of these things unless it acts reasonably and in good faith and upon lawful and relevant grounds of public interest."(Administrative Law –H.W.R. Wade, English Language Book Society & Clarendan press, Oxford, 5th ed, 1982, Page 356)

Conflict of interest and duty

A director of a company is playing a crucial role to influence the policy and strategy of a company. To ensure that there should not be any conflict of interest and duty, Section 297 of the Companies Act, 1957 provides that:

"Except with the consent of the Board of directors of company, a director of the company or his relative, a firm in which such a director or relative is a partner, any other partner in such a firm or a private company of which the director is a member or director, shall not enter into any contract with the company –

a) for the sale, purchase or supply or any goods, materials or services; or
b) after the commencement of



this Act, for underwriting the subscription of any shares in, or debentures of, the company:

Provided that in the case of a company having paid up shares capital of not less than rupees one crore, no such contract shall be entered into except with the previous approval of the Central Government".

Section 299 provides that the interested director are required to disclose their interest in any contract or agreement entered into or proposed to be entered into by or on behalf of the company. Section 300 prescribes that interested directors cannot participate in the process and voting on such resolution. Section 301 further provides that the register of contracts shall be open to inspection by any member of the company.

The Accounting Standards 18 issued by the Institute of Chartered Accountants of India on "Related Party Disclosures" Prescribes that the reporting enterprise should disclose details about the transactions in financial statements.

The Naresh Chander Committee Report on corporate audit & Governance, 2002 keeping in view the aforesaid checks and balances recommended that requirements for government approval may be dispensed with. The committee in his Recommendation 5.6 prescribes:

- Section 297 of the Act should be amended to provide for prescription of rules.
- Government should frame rules in a manner that prior approval of Government is not normally required, subject to certain safeguards that would protect public / stakeholder interest.

In any case, section 297 should not apply to private limited companies.

However the proposed and subsequently withdrawn Companies Amendment Bill 2003 provided that

Contract in Government Companies

To pursue its business, a government company is required to enter into various types of contracts regularly with indigenous and foreign parties for the purpose of purchasing raw materials, marketing the products and by products, maintenance, renovation, modernisation and technology transfer. A government company is required to publish advertisements inviting tenders, holding negotiations if so required and to take policy decisions as to finalization of the contracts.

Under Art 19(1)(g), all citizens shall have the right to practise any profession, or to carry on any occupation, trade or business and Article 21 has been liberally interpreted to include right to livelihood. (Vijay Kumar Ajay Kumar vs. SAIL AIR 1994 A11, 182, Olga V. Bombay corporation, AIR 1986 SC 180, D.T.C. vs Mazdoor AIR 1991, SC 101)

A most remarkable feature of this expansion of Art. 21 is that many of the non-Justiciable Directive Principles embodied in Part IV of the Constitution have now been resurrected as enforceable fundamental rights by the magic wand of Judicial activism, playing on Art. 21. (D.D. Basu-Shorter Constitution of India, Prentice Hall of India Pvt. Ltd, New Delhi, 12th Edition, 1996, page-172)

Though the freedoms enshrined in Art. 19 are available only to citizens, but the protections under Art. 14 in respect of right to equality or 21 in respect of life and liberty are available to any person, citizen or alien within the territory of India.

the provision of section 297 of Companies Act, in respect of contracts in which Directors are interested, be extended to contract for sale, purchase or lease of any property, by inserting clause (aa) in section 297(1). Sections 78, 79, 80 & 81 of the Concept Paper on Companies Law issued by the Department of Company Affairs provides provisions for (i) Disclosure of Interest of Directors, (ii) Related Party transactions, (iii) interested directors not to participate or vote in Boards Proceedings & (iv) Register of interest of directors & contracts respectively. These provisions are more exhaustive to address the issue of Conflict of interest.

Power of writ courts in contractual matters

To carry out the business or trade, the unfettered right to freedom of contract is not available to a "State Instrumentality". But it does not means that a government company has no freedom or power to make a policy decision in the realm of contract making. Some discretion and free play in the Joints of Contract making are inevitable for the smooth running of these Govt. Companies.

Art. 32 of the Constitution of India confers powers on the Supreme Court to issue certain direction or orders for the enforcement of fundamental rights conferred by Part III of the Constitution. Article 226 empowers every high Court to issue such writs, directions or orders for the enforcement of fundamental rights or "for any other purpose".

Art. 226 is counched in comprehensive phraseology and it exfacie confers wide powers on the High Courts to address injustice, wherever it is found (M.G. Ramachandran, Law of Writs, Eastern Book Co., Lucknow,4th edition, page –247)

Under Article 298 of the Constitution, the Executive power of the Union and State extended to the carrying on of any trade or business and to the acquisition, holding and disposal of property and the making of contract for that purposes.

The maxim "The King can do no wrong" never accepted in India. The Union and States are juristic persons and they are liable for breach of contract as well as in the tort. But contractual rights cannot be said to be fundamental rights. (Satish Chandra vs. Union of India, AIR 1953, SC, 250)

Hence in case of any breach of the terms of a contract by the Government, the aggrieved party must seek his remedies under the law of contract and not under writ jurisdiction of the Supreme Court or a High Court, where there is no case of violation of any constitutional provision such as Art. 14 or it involves the violation of any Statutory provisions, apart from the contract. (Harshankar Vs DY. Excise Comr., AIR, 1975, SC 1121, Premji vs D.D.A., AIR 1980, SC 738, Radha Krishnan v. State of Bihar, AIR 1977, SC 1496)

The freedom of the Government to enter into business with anybody it likes is subject to the conditions of reason, fair play and public interest. But the State has a wide range of permissible policy options and the Court is not empowered to decide which is better. (Kasturi Lal Vs State of J&K AIR 1980 SC 1992, Mahajan Vs J.M.C., AIR 1991, SC 1153)

The Government Companies have separate and distinct legal personality from the Government and have the right to enter into contract independently and to acquire property in its own name. They can sue and be sued in their own names. But as a "State Instrumentality" they are liable to follow the same principles as of Government in the realm of contract making.

Though the power of the High Court under art. 226 is very wide, but when there is no violation of enforcement of fundamental rights, the exercise of the power is not obligatory but discretionary.

In Mohammd Hanif Vs State of Assam (1969) 2 SCC, 782, Justice Ramaswami has very rightly observed: "The jurisdiction of the High Court U/A 226 is an extraordinary Jurisdiction vested in the High Courts not for the purpose of declaring the private rights of the parties, but for the purpose of ensuring that the law of land is implicitly obeyed and that the various tribunals and public authorities are kept within the limits of their jurisdiction".

The Supreme Court has divided the cases involving breaches of alleged obligations by the State or its agents into three categories:

(i) Where a petitioner makes a grievance of breach of promise on the part of the State in cases where on assurance or promise made by the State he has acted to his prejudice and predicament, but the agreement is short of a contract within the meaning of Art. 299 of the Constitution.

(ii) Where the contract entered into between the person aggrieved and State is in exercise of statutory power under certain Act or Rules framed thereunder and the peti-

tioner alleges a breach on the part of the State and

(iii) Where the contract entered into between the State and the person aggrieved is not statutory but purely contractual and the rights and liabilities of the parties are governed by the terms of the contract and the petitioners complains about the breach of such contract by the State.

The first type of obligations were held to be enforceable under Art. 226 of the Constitution by applying the doctrine or Promissory estoppels. (U.O.I. Vs Anglo Afghan Agencies, AIR, 1968, SC, 718; Express Newspaper PVT. Ltd Vs Union of India, AIR, 1986 SC 872)

The Second category covers those cases where the contract is entered into between an individual and the State in the exercise of some statutory power. In these cases, the breach complained is of a statutory obligation. If the claim of the petitioner is not merely contractual, which can be enforced only in the civil court, but the action which is being challenged is of a Public Authority vested with statutory power, the Court in the exercise of its writ jurisdiction, can grant relief to the aggrieved person. (Radhakrishnan Agarwal Vs state of Bihar, AIR, 1977 SC, 1496)

In respect of third category of cases, where there is no question of exercise of any statutory power and the rights of the parties flow from mere terms of the contract entered into by the authorities of the State, a party to such contract cannot invoke writ jurisdiction of the High Court under Article 226 for the purpose of enforcement of contractual rights and obligations. Court have

always called upon such petitioners to seek their remedy in a civil court since it is apparent that in such cases there cannot be adjudication without evidence on point.(R.K. Agarwal Vs State of Bihar, AIR1977, Pat 71)

In Divisional Forest Officer –vs- Biswanath Tea Co., AIR 1981 SC 1368 the Supreme Court observed that a right to relief following from a contract has to be claimed in a civil court where a suit for specific performance of contract or for damages could be filed.

Object of judicial review

The principles of judicial review would apply to the exercise of contractual powers by Government Company in order to prevent arbitrariness or favoritism. Judicial review is not an appeal from a decision but a review of the manner in which the decision was made. It is concerned with reviewing not the merits of the decision but the decision making process itself. In the guise of judicial review, the courts cannot substitute their own decisions for the decisions of the executive. In the name of preventing abuse of power by the executive, the Court itself should not be guilty of usurping power. The provisions of Judicial review in the Indian Constitution empowers the Judiciary to struck down the law, substantive or procedural which is ultra-virus to the Constitution and under Article 13 law includes any ordinance, order, bye-law, rule, regulation, notification, custom or usage having in the territory of India the force of law.

Scope of judicial review

The Court, while exercising the power of Judicial review in respect of contracts entered into on behalf of state or State instrumentality, is empowered to judge as to whether there has been any infirmity in the "decision making process". By way of judicial review the Court cannot examine the details of the terms of the contract which have been entered into by the Public bodies or the State. But at the same time the Court can certainly examine whether "decision making process" was reasonable, rational, not arbitrary and violative of Art. 14 of the Constitution. If the contract has been entered into without ignoring the procedures which can be said to be basic in nature and after an objective consideration of

different options available taking into account the interest of the State and the Public, then Court cannot act as an appellate authority by substituting its opinion in respect of selection made for entering into such contract. But, once the procedure adopted by an authority for purpose of entering into a contract is held to be against the mandate of Art. 14 of the Constitution, the Court cannot ignore such action saying that the authorities concerned must have some latitude or liberty in contractual matters and any interference by Court amounts to encroachment on the exclusive right of the executive to take such decision.

In the Sterling Computers Ltd. –vs- M/s. M&N Publications, AIR, 1996, SC, 51 the Supreme Court has made out the scope of the judicial review in the following points:

The duty of the court is to confine itself to the question of legality. Its concern should be :

1. Whether a decision-making authority exceeded its powers?
2. Committed an error of Law;
3. Committed a branch of the rules of Natural Justice;
4. Reached a decision which no reasonable Tribunal would have reached; or
5. Abused its powers.

Therefore, it is not for the Court to determine whether particular policy or particular decision taken in the fulfillment of that policy is fair. It is only concerned with the manner in which those decisions have been taken. The extent of the duty to act fairly will vary from case to case. Shortly put the grounds upon which an administrative action is subject to control by judicial review can be classified as under

(i) Illegality – This means the decision maker must understand correctly the law that regulates his decision making power and must give effect to it.

(ii) Irrationality, namely, Wednesbury unreasonableness. (Wednesbury Principle – Supreme Court practice 1993 volume, 1 page 849-850 at para 4 quotes the judgement of Associated Provisional Picture Houses Limited Vs. Wednesbury Corporation (1948) 1KB 223 :(1947) 2AIIE.R. 680 to explain the 'Wednesbury Principle'. Per Lord Greene M.R. – "A decision of a public authority will be liable to be quashed or otherwise dealt with by an appropriate order in judicial review proceedings where the court concludes that the decision is such that no authority properly directing itself on the relevant law and acting reasonably could have reached it").

(iii) Procedural impropriety.

The above grounds are not exhaustive and it does not rule out addition of further grounds in course of time.

Lord Diplock in Council of Civil Services Unions -vs- Minister of the Civil Services, (1985) AC 374, (408) has very rightly held that administrative action is subjected to control by Judicial review on the ground of illegality, irrationality and procedural impropriety.

Limits of Judicial Review

In awarding contracts, a government company has the liberty to choice better parties and can impose reasonable restrictions or conditions for increasing the efficiency, for a better output and for improvement of proficiency. And to ensure these, even if it restricts the field of eligibility, that could not be said to be discriminatory or violative of Article 14 of the Constitution of India. Discrimination under this is discrimination among the same class of persons similarly placed, not among different class of persons dissimilarly placed.(M/s. Vijay Kumar Ajay Kumar Vs SAIL, AIR 1994 A11,186)

The Supreme Court in M/s C.J. Fernandez v. State of Karnataka AIR 1990 SC 958 has held that condition of sufficiency or otherwise of experience of a contract in the matter of tender could not be held to be illegal.

In the case of Kasturi Lal –Vs- The State of J.K. AIR 1980 SC 1992 the Supreme Court observed:

The Court cannot lightly assume that the action taken by the Government is unreasonable or without public interest, because, there are a large number of policy considerations which must necessarily weigh with the Government in taking action and therefore the court would not strike down government action as invalid on this ground, unless it is clearly satisfied that the action is unreasonable or not in public interest. There is always a presumption that the Government action is reasonable and in public interest and it is for the party challenging its validity to show that it is wanting in reasonableness and is not informed with public interest.

In Ramdas Shriniwas Nayak Vs Union of India, AIR 1995 SC 1992 , the Apex Court further held that it is not for the Court to determine whether a particular policy or a particular decision taken in the fulfilment of a policy is fair. The Court should not enter into the merits of Government actions,

more so, in economic matters unless the same is unreasonable and is not in public interest.

In Tata Cellular –vs- Union of India, AIR, 1996 SC 11, the Supreme Court has again explained the true scope of Judicial Review:

"The Judicial power of review is exercised to rein in any unbridled executive functioning. The restraint has two contemporary manifestations. One is the ambit of Judicial intervention, the other covers the scope of the court's ability to quash an administrative decision on its merits. These restraints bare the hallmarks of Judicial control over administrative action. Judicial review is concerned with reviewing not the merits of the decision in support of which the application for Judicial review is made, but the decision-making process itself.

On the other hand, the Government cannot act in a manner, which would benefit a private party at the cost of the state: such an action would be both unreasonable and contrary to public interest. The Government, therefore, cannot, for example give a contract or sell or lease out its property for a consideration less than the highest that can be obtained for it, unless of course, there are other considerations which render it reasonable and in public interest to do so.

Generally, in a Contract, tender process is an integral part. When the tenderer is the State, law demands transparency & openness. In a State, which is governed by rule of law, every tender process set in motion by the State or its instrumentalities should undoubtedly be transparent, fair and open. The Supreme Court in Dutta Associates Pvt. Ltd. -vs- Indo Merchantilies Pvt. Ltd., 1997 (1) SCC 53 reiterated the law laid down by the Court in Shiv Sagar Tiwari -vs- Union of India, AIR 1997 SC 483: "….We reiterate that whatever procedure the Government proposes to follow in accepting the tender must be clearly stated in the tender notice. The consideration of the tenders received and the procedure to be followed in the matter of a acceptance of a tender should be transparent, fair and open".

If the decision is within the confines of reasonableness, it is no part of the Court's function to look further into its merits. The purpose of Judicial review is to ensure that the individual receives fair treatment and not to ensure that the authority, after according, fair treatment reaches on a matter which it is authorised or enjoined by law to decide for itself a conclusion which is correct in the eyes of the Court. [Chief Constable of the North Wales Police Vs Evans (1982) 3 All E.R. 141]

By way of Judicial review the Court cannot examine the details of the terms of the contract, which have been entered into by the public bodies or the State.

The Supreme Court in Tata Cellular v Union of India has propounded the following principle on the scope of Judicial Review:

The Principles deductible relating to scope of judicial review of administrative decisions and exercise of contractual powers by Government bodies are: -

(1) The modern trend points to Judicial restraints in administrative action,

(2) The Court does not sit as a Court of appeal but merely reviews the manner in which the decision was made.

(3) The Court does not have the expertise to correct the administrative decision. If a review of the administrative decision is permitted, it will be substituting its own decision, without the necessary expertise which itself may be fallible.

(4) The terms of the invitation to tender cannot be open to Judicial scrutiny because the invitation to tender is in the realm of contract. Normally speaking, the decision to accept the tender or award the contract is reached by process of negotiations through several tiers. More often than not, experts make such decisions qualitatively.

(5) The Government must have freedom of contract. In other words, a fairplay in the joints is a necessary concomitant for an administrative body functioning in an administrative sphere or quasi-administrative sphere. However, the decision must not only be tested by the application of Wednesbury principle of reasonableness but must be free from arbitrariness not affected by bias or actuated by malafide.

(6) Quashing decisions may impose heavy administrative burden on the administrative and lead to increased and unbudgeted expenditure.

In the milestone Judgment of BALCO Employees' Union (Regd.) V U.O.I & Ors., Jt 2001 (10) SC 456 the Apex Court delineated the limit of Judicial review in the matter of Economic Policy:

"Wisdom and advisability of economic policies are ordinarily not amenable to judicial review unless it can be demonstrated that the policy is contrary to any statutory provision or the Constitution. In other words,

it is not for the Courts to consider relative merits of different economic policies and consider whether a wiser or better one can be evolved".

This approach continues in Federation of Railway officers Associations –vs- Union of India AIR 2003 SC 1344, where the Apex Court again observed that matters relating to policy and requiring technical expertise should be left for the decision to those qualified to address the issue and the Court should not interfere unless the decision is arbitrary or irrational.

Conclusion

The Government Companies are at the core of the National economy. They are there to accumulate wealth to ensure socio-economic justice to the Nation. The recent trend of judgement of our Supreme Court has clearly established that in public sector, both capital and labour, are expected to represent public interest directly and have to promote them. (Syndicate Bank & another Vs K. Umesh Nayak, AIR 1995, SC319)

On the other hand, the Courts now recognize that the impact on the administration is relevant in the exercise of their remedial jurisdiction. Quashing decisions may impose heavy administrative burdens on the administration, divert resources toward re-opening decision, and lead to increased and unbudgeted expenditure. The effect on the administrative process is relevant to the Courts' remedial discretion and may prove decisive. This is particularly the case when the challenge is procedural rather than substantive, or if the courts can be certain that the administrator would not read a different decision even if the original decisions were quashed.

In government companies, a number of contracts are being awarded for the different important projects. The public interest will suffer if the contractors are failed to complete these projects in time. The Judiciary is often suffering from over sensitiveness to protect the individual's right to carry a trade or business. The collective interest of the individuals is involved in the smooth functioning of these public sectors.

In the Sterling Computers Ltd. –vs- M/s. M.N. Publications Ltd. & Others AIR 1996, SC 51(61) (para 33), the Supreme Court has sent the following message for the exercise of the power of judicial review in the interest of the public.

"It is a matter of common experience that whenever applications relating to awarding of contracts are entertained for judicial review of the administrative action, such applications remain pending for months and in some cases for years. Because of the interim orders passed in such applications, the very executions of the contracts are kept in abeyance. The costs of different projects keep on escalating with passage of time apart from the fact that the completion of the project itself is deferred. This process not only affects the public exchequer but even the pubic in general who are deprived of availing the facilities under different projects. As such, exercising the power of judicial review in connection with contractual obligations, courts should be conscious of the urgency of the disposal of such matters. Otherwise, the power which is to be exercised in the interest of the public and for public good in some cases become counter-productive by causing injury to the public in general."

The pattern of judicial review in this area reflects reconciliation of two conflicting values. One, since the law has conferred power on an public authority and courts have not been given power to hear Appeals against its decision, it shows that trust has been placed in the judgement of the authority instead of the courts. Two, nevertheless, the authority must act within the bounds of law and power, and since the legislature could not have intended that the executive be the final judge of the extent of its own powers, the courts have to come into the picture to keep the administration within the confines of law. The interactions of these two values determine the scope of judicial review of discretionary powers of the administration. (Principles of Administrative law - MP Jain & SN Jain, 4th ed, Page-550)

In a written Constitution, the provisions of the Constitution delineate the powers of the various organs of the State. The extent of the limitations on these powers has to be determined on an objective interpretation of the relevant provisions of the Constitution. Since the task of interpreting the provisions of the Constitution is entrusted with the Judiciary, it is vested with the power to test the validity of the actions of every authority functioning under the Constitution by the touchstone of the Constitution. The power of judicial review should be exercised to ensure that the authority exercising the power conferred by the Constitution does not transgress the Limitations placed by the Constitution on the exercise of that power. This power of the judicial review is implicit in a written Constitution. [A.K. Kumar & Anr vs Union of India & Anr. (1995) 4 SCC 73] ■