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CRITICAL ANALYSIS OF THEORY OF FUNDAMENTAL BREACH**Abstract**

The doctrine of fundamental breach limits the use of exemption clauses in a contract, when a party in whose favour the exemption clause is drafted commits a breach fundamental to the objective of the contract. This theory is mostly applied in cases of standard form contracts where the terms of the contract are predefined by one party. Different courts of different jurisdictions have different interpretations of this doctrine, but generally it is not considered to be a rule of law but a rule of construction and whether an exclusion clause will apply in a situation or not varies from case to case and depends upon the intention of parties. Though there is no statutory recognition of this theory in the Indian law, it can be explained and applied through various case laws which have been mentioned in this paper. This paper also talks about how the doctrine is applied to exclusion clauses in case of breach and in case of delay of performance and also analyses the cause of application of this theory.

Keywords- *fundamental breach, standard form contracts, exemption clauses, limitation of liability, delay in performance of contract*

Introduction

Law of contracts is a private law wherein the parties to a contract are allowed to enter an agreement as per their and draft the terms of a contract in such a way that it is suitable to them and their needs as long as the terms of the contract, its object and its consideration are consistent with the law of the land. It is due to this reason that parties to a contract are also

allowed to form clauses which help them to escape their liability in case of non-fulfilment of duties under the contract. But these clauses could be misused for the benefit of only one party, especially in cases of standard form contracts wherein one party lacks bargaining power in deciding the terms of the contract. In such a situation if the party with stronger bargaining power breaches the contract and causes damage to the weaker party, will it be exempted from paying compensation because of an existing clause which helps it escape liability?

What are standard form contracts?

In simple contracts whenever two or more parties enter into an agreement to do or not to do something for a certain consideration, both the parties are at consensus at idem and for that all aspects of the contract are discussed and negotiated between the parties, and in ideal situations the parties are at the position of equal bargaining power. However as business organisations grow and deal with a huge number of customers every day, it becomes difficult to prepare different contracts as per the requirements of each and every customer, so companies prepare a standard contract for all its customers and pre decide all the terms, which the customers have to sign and abide by the terms. In such situations there is no equal bargaining power and customers have to either have to accept all the terms or not accept any, making it a 'take it or leave it' situation. Such contracts are standard form contracts or contracts of adhesion.

Exemption and limitation Clauses- In order to escape liability in case of non-performance, partial performance or negligent performance of a contract, a party may draft an exemption clause in a contract.¹ These clauses may be very useful in business organisation as they predict future contingencies which hinder performance and provides for allocation of risk between the parties to the contract. ² Exemption clauses specifically state what liability it seeks to exclude, of which party and how much of it can be excluded. Limitation clauses

¹MP Ram Mohan & Anmol Jain, *Exclusion Clauses Under the Indian Contract Law: A Need to Account for Unreasonableness*, 13 NUJS L. Rev. 4 (2020)

²SIR JACK BEATSON ET.AL, ANSON'S LAW OF CONTRACT 178 (Oxford University Press 2010)

however simply limit or reduce the compensation which the party may have to pay, but do not completely exclude liability.³

Doctrine of fundamental breach

The doctrine of fundamental breach aims to control unreasonable consequences of exemption clauses. IF the party in favour of whom the exemption clause has been drafted commits a fundamental breach of contract, then the exemption clause would not apply or they would not be excluded from liability under the contract, as per the doctrine of fundamental breach⁴ This doctrine was evolved in English law, and it does not have any statutory recognition in Indian law but has been evolved from judicial precedents.

Justice Denning LJ stated in *J. Spurling Ltd V Bradshaw*, “*These exempting clauses are now a days all held to be subject to the overriding proviso that they only avail to exempt a party when he is carrying out his contract, not when he is deviating from it or is guilty of a breach which goes to the root of it. Just as a party who is guilty of a radical breach is disentitled from insisting on the further performance by the other, so too he is disentitled from relying on an exempting clause*”⁵

It can be interpreted from Lord Denning LJ that in order to enforce a contract, it is important for the party imposing it to fulfil their part of the contract and not commit a breach which goes on to the root of the contract. In order to constitute fundamental breach the party must have breached the core or the root of the contract and not merely the less important clauses.

In *Alexander v Railway Executive*, the plaintiff has deposited his luggage at the parcel office of a railway station and the defendants had put up a condition stating that they won't be liable for any losses. The defendants however let the plaintiff's friend take the luggage, and the plaintiff sued them for breach. It was held that taking care of goods was an essential part of the agreement and by handing over the goods to an unauthorised person the defendants have committed fundamental breach. Hence the exemption clause was not applied.⁶

In *Karsales (Harrow) Ltd v Wallis*, Wallis wanted to purchase a second hand Buick motor car and after proper inspection entered into a hire purchase agreement to buy the car. In that agreement there was a clause stating “*No condition or warranty that the vehicle is*

³SIR JACK BEATSON ET.AL, ANSON'S LAW OF CONTRACT 182 (Oxford University Press 2010)

⁴AVTAR SINGH, CONTRACT AND SPECIFIC RELIEF 79 (Eastern Book Company 2017)

⁵ J. Spurling Ltd v Bradshaw, (1956) 1 WLR 461

⁶Alexander v Railway Executive, (1951) 2 KB 882

roadworthy, or as to its age, condition or fitness for any purpose is given by the owner or implied herein". But when the car reached MR. Wallis, it was in deplorable condition with old tires, radio removed, missing chrome strips round the body and there were faults in the engine too. The claimant in this case was not allowed to rely on the exemption clause as there had been a fundamental breach of contract.⁷

There have been different interpretations of this doctrine by different courts of different jurisdictions, with its main objective being providing fairness to the weaker party and its major disadvantage being the limits it puts on freedom of contract.

The doctrine of fundamental breach is not a rule of law, but a rule of construction and is based on what the contracting parties intended to do. "It involves the implication of a term to give to the contract that business efficacy which the parties reasonably must have intended it to have" Exemption clauses should be constructed in a way that they do not apply in events of fundamental breach.⁸

In *Suisse Atlantique Societe D'Armement S.A. v N.V. Rotterdamshe Kolen Centrale*, An agreement between the plaintiff and the defendant let the defendant charter the plaintiff's ship for carriage of coal from the United States of America to Europe for two years and it stated that in case of any delays in loading of ship the defendant will pay a demurrage at the rate of one thousand dollars a day. Delays were caused and plaintiff admits breach of contract but still let the defendant use the ship and claimed damages due to delays. But it was held that there was no fundamental breach. When the defendant committed breach the plaintiff affirmed it. The demurrage clause just determined liability in case of breach of contract and did not exempt the liability; hence doctrine of fundamental breach cannot apply here. Lord Upjohn explained the term "*there is no magic in the words "fundamental breach" [it] is no more than a convenient shorthand expression for saying that a particular breach or breaches of contract by one party is or are such as to go to the root of the contract which entitles the other party to treat such breach or breaches as a repudiation of the whole contract. Whether such breach or breaches do constitute a fundamental breach depends on the construction of the contract and on all the facts and circumstances of the case.*" In this case the court said that the doctrine of fundamental breach restricts the freedom of contract.⁹

⁷Karsales (Harrow) Ltd v Wallis, (1956) 1 WLR 936

⁸UGS Finance Ltd v National Mortgage bank of Greece (1964) Lloyd's rep 446

⁹Suisse Atlantique Societe D'Armement S.A. v N.V. Rotterdamshe Kolen Centrale, (1967) 1 AC 361

In *Photo Productions Ltd v Securicor Transport Ltd*, Securicor had contracted under its own standard terms to give a night watch administration at Photo Productions manufacturing plant. A proviso in Securicor's standard terms expressed that: “*under no circumstances shall the Company be responsible for any injurious act or default by any employee of the company unless such act or default could have been foreseen and avoided by the exercise of due diligence on the part of the Company as his employer*”. The security officer on the night being referred to began a fire that spread out and therefore torched an enormous piece of the manufacturing plant. He was appropriate for the work, and Securicor was not careless in utilizing him. The trial judge acknowledged that the exemption statement applied and held with Securicor. The Court of Appeal, in any case, held that there was fundamental breach in this situation and that because of that the exemption clause will not apply. The House of Lords reversed the decision of the Court of Appeal. The House affirmed that parties to a contract are free to modify any clauses and enter into a contract as per their needs.¹⁰ Since the provision was clear and unambiguous there was nothing to forestall its utilization and it along these lines shielded Securicor from risk for its worker's activities. It was held that whether an exemption clause applies in case of breach of contract depends upon how the contract was constructed and that depends on the intention of the parties, and that it is not a rule of law.

Doctrine of Fundamental Breach- An Analysis

Doctrine of fundamental breach was developed in the 1950s and early 1960s by the Court of Appeal that where one party had committed a fundamental breach of the contract, he was not permitted to rely on the provisions in the contract which excluded or limited his liability.¹¹ As business models were becoming more and more complex, the use of standard form contracts also increased. Those standard form contracts usually had an exclusion clause or a limiting clause which exempted or limited the liability of the company in case of breach of contract or they gave the company an escape from any future liabilities which may arise. This in various situations gave the company an upper hand and it led to them misusing the clause as the other party does not have any negotiating power. They either have to accept all the conditions and enter into a contract or accept none. Hence the doctrine of fundamental breach was introduced as held in *J. Spurling v Bradshaw*.

¹⁰Photo Productions Ltd v Securicor Transport Ltd (1980) AC 287

¹¹POLLOCK AND MULLA, THE INDIAN CONTRACT ACT, 1872 243 (LexisNexis 2020)

Violation of freedom of contract

Though it is true that by signing a contract it is assumed that a party has accepted all the terms of contracts, but in cases of standard form contracts, the customers or the weaker party lacks any bargaining power and are in a 'take it or leave it' situation¹². So in order to provide fairness to the weaker party, this doctrine of fundamental breach is rightly used, as it makes sure that the party enforcing it has made all its efforts to fulfil its obligation under the contract and if it commits a breach which goes on to the core of the contract it cannot avail the exemption clause as the other party did not have a choice in negotiating the terms of the exemption clause. Parties do have the freedom to make the terms of their contract as long as the object and consideration is lawful and it is entered into by free consent. As per section 14 of the Indian Contract Act 1872, a contract is entered into by free consent if it is not caused by coercion, fraud, misrepresentation, undue influence or mistake¹³. This 'unequal bargaining power' does not fall in any of these categories. As discussed above in, *Suisse Atlantique Societe D'Armemetn S.A. v N.V. Rotterdanshe Kolen Centrale*, the court held that the doctrine of fundamental breach limits the freedom of contract. But in standard form contracts wherein one party does not have say in deciding the terms of the contract, does freedom of contract really exist? The supreme court of India held in *Delhi Transport Corporation v. D.T.C. Mazdoor Congress*, "the 'standard form' contract is the rule. One must either accept the terms of the contract or go without. Since, however, it is not feasible to deprive Oneself of such necessary services, the individual is compelled to accept on those terms. In view of this fact, it is quite clear that freedom of contract is now largely an illusion".¹⁴ Since freedom of contract did not exist at the time when the contract became enforceable, then if the court strikes down an unfair clause in order to benefit the weaker party when the party with greater bargaining party has breached the contract, it cannot violate freedom of contract.

Delay in performance of contract

Apart from breach of performance there are cases wherein a party exempts itself from delay if any caused in the performance of the contract, or that they would not be liable to pay any damages if the work is delayed. There have been different interpretations of this by the

¹²MP Ram Mohan & Anmol Jain, *Exclusion Clauses Under the Indian Contract Law: A Need to Account for Unreasonableness*, 13 NUJS L. Rev. 4 (2020)

¹³Indian Contract Act, 1872, §14, No. 09, Acts of Parliament, 1872 (India)

¹⁴Delhi Transport Corporation v. D.T.C. Mazdoor Congress and Ors., 1991 AIR 101

supreme court of India itself. In *Ramnath Internatonal Construction Ltd v Union of India*¹⁵, the Supreme Court held that because of an exclusion cause which excludes the party from paying damages in case of delay, the other party will not be entitled to any damages for the loss caused by the delay and only extension of time could be given. In *P.M. Paul v Union of India*¹⁶ and in *K.N. Sathypalan v State of Kerala*¹⁷ theory of fundamental breach was upheld as the delay was caused by the party in favour of whom the exclusion clause was drafted¹⁸. However section 55 of the Indian Contract Act states that in contracts where time is of essence a party does not perform its duties under the contract in the stipulated time, the contract will be voidable at the option of the promisee and if time is not of essence in the contract then the party suffering loss is entitled compensation for all the loss suffered from such delay.¹⁹ So it can be seen that in India the law clearly states that a party cannot draft an exclusion clause to escape from liability arising out of delay in performance as they will have to pay compensation to the other party even if the delay was not directly caused by them. Since exclusion clauses are not applicable in case of delays the theory of fundamental breach is also not needed to be applied when the performance of a contract is delayed in India.

Conclusion

Overall the doctrine of fundamental breach exists to limit misuse by big companies and protect the consumers. Even though the principle of caveat emptor wants the buyer to be aware of what they are purchasing and from whom, since they lack the bargaining power to change the terms of the contract, it is fair to enforce the doctrine of fundamental breach when breach of contract is caused by the company. The law grants freedom of contract but it also restricts freedom when the rights given to people are misused. But there is certain ambiguity in this theory as different courts of different jurisdictions have different opinions of it. This ambiguity should be cleared. The very aim of entering into a contract is to commit an act or omission and if one party fails to commit that very act or omission causing loss to the other party then no clause should prevent them from paying damages for the loss suffered by the party.

¹⁵Ramnath Internatonal Construction ltd v Union of India (2007) 2 SCC 453

¹⁶P.M. Paul v Union of India (1989) SCC 368

¹⁷K.N. Sathypalan v State of Kerala (2007) 13 SCC 43

¹⁸Limitation of Liability Clause: Position in India, (2019) 4 SCC J-25

¹⁹Indian Contract Act, 1872, § 55, No. 09, Acts of Parliament, 1872 (India)



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