Commercial Contracts: Parties Intent Matters

1. Introduction

Under Indian law, the two primary legislations governing contracts of sale and warranties are the Sale of Goods Act ("**SOGA**") and the Contract Act. In any sale of a product, both the buyer and seller are concerned with the warranties although from different perspectives. Depending on the product, the type of warranty varies and, of course, every company has a different approach plus timelines during which they can guarantee the quality and functionality of the product supply. So, warranties remain an important subject and contracting parties invest a significant time on it during negotiations, whereas the business wonders why lawyers get stuck with the legalese! But, in the event of a dispute it is always the fine nuances of drafting such provisions which stems from a clear understanding of the ever-evolving jurisprudence in this space.

This newsletter discusses the key principles of Indian law on warranties, remedies for defective products, implied warranties, and the interplay amongst them.

2. Know the Difference: A Condition or Warranty

The terms and conditions surrounding warranties always vary, depending on the sale which could be of a simple product for home use or building a metro, with different constituents of supply. For simple products, the warranty term could be 6-12 months from the date of the sale but in large and, particularly, EPC contracts the period is likely to be 18-24 months from commissioning or 24-36 months from delivery. Additionally, there is a further replacement warranty for repaired or replaced products with a final cut-off date. Frequently, questions that arise relate to remedies of the buyer i.e., will the obligation to repair the defect or replace a defective product be an exclusive remedy, where it is stated so and even if the contract is silent. In the event repair or replacement does not solve the problem what should the seller do while factoring the remedies a buyer can seek? To understand the complexities surrounding this area, it is essential to briefly set out the legal framework and highlight the difference between conditions and warranties as the remedies are somewhat different.

2.1 Legal Framework: At the outset, it is necessary to briefly describe certain basic concepts. Section 12 of SOGA defines "conditions" and "warranties." The former has been defined as a stipulation essential to carry out the main purpose of the contract, while the latter is a stipulation that is collateral to the main purpose of the contract. Whether a stipulation constitutes a warranty, or a condition depends upon the interpretation and construction of the contract. While a contractual stipulation may be termed as a "warranty," courts' may actually interpret it as a "condition." The question whether a contractual term is a *condition* or *warranty* has to be determined from the intention of the parties and based upon the facts of each case. Breach of a condition entitles the non-defaulting party to repudiate the contract. In contrast, breach of warranty entitles the non-defaulting party to **(a)** rely on the breach and set-off damages, to the extent possible, against the price without a right to reject the goods or repudiate the contract or, **(b)** sue for damages for breach of warranty.

Section 13 includes situations wherein a condition has to be treated as a warranty i.e. **(a)** where the buyer waives the seller's condition or elects to treat the breach of the condition as a breach of a warranty, or **(b)** where a contract of sale is not severable and the buyer *accepts* the goods or part

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thereof. Once the buyer accepts the goods, he can only treat the seller's breach of the condition as a breach of warranty. A buyer is deemed to have accepted goods[1] when he notifies the seller that he has accepted them, or when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller, or when, after lapse of reasonable time, he retains the goods without notifying the seller that he has rejected them.

2.2 Defective Product: To evaluate the situation that arises when a product is defective, it is essential to go back to the contract which provide remedies for breach of a warranty. But, if they do not (*and, in some cases even when they do*) it is important to evaluate whether the stipulation regarding defective products is a "condition" or a "warranty." The rights flow from that initial assessment. Assume a stipulation is a "warranty," and a breach occurs during the warranty period and the contract states that repair or replacement of the defect will be the customer's sole remedy. In this case, the buyer will be entitled to: **(a)** repair and replacement during the warranty period; **(b)** seek reduction or extinction of price *or* sue the seller for damages; **(c)** sue for additional damages suffered as a consequence of the breach. If the facts remain the same as above but the breach occurs after the warranty term expires, the buyer could always use equitable principles to make a claim despite the sole remedy provision.

While "repair or replacement" satisfies the stipulation of quality of the product but it may not necessarily remedy the consequential damages that a buyer may incur, particularly if they are foreseeable. Despite an express statement of "sole remedy," as a matter of public policy the buyer may have recourse if it could establish that the seller knowingly made a material misrepresentation i.e. engaged in fraudulent conduct. Since India is a common law jurisdiction, certain level of subjectivity will come in and any judicial forum will look at the totality of the facts and circumstances and the loss caused. Further, usually all EPC contracts provide for performance guarantees and if that be so, then the sole remedy provision may not necessarily protect the seller. Exclusive remedy clauses are inserted in contracts to limit liability. It is always better for a contract to state that repair or replacement will be the sole remedy because the circumstances in which it may be used could impact the buyer's rights. It is noteworthy to state that despite repair or replacement is the stated sole remedy, yet other potential liabilities could arise. This would depend on the facts and circumstances of the case and an aggrieved party can also claim damages under tort under "strict liability" or "no-fault liability" and "absolute liability".

3. Implied Warranties

For sellers, often issues arise regarding implied warranties, particularly when the buyer is a state agency that usually considers its contractual arrangements to be turnkey, even if they are not. The question then is if warranties can be implied under Indian law even if waived expressly in the contract.

3.1 Legal Framework: Section 14 of SOGA provides for implied warranties whereby the buyer is entitled to enjoy quiet possession of unencumbered goods. Section 16 provides the general principle that there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale, subject to certain exceptions. *Firstly,* section 16(1) provides for an implied condition that goods shall be reasonably fit for a particular purpose where (a) the buyer informs (expressly or impliedly) the purpose for which the goods are required, (b) buyer relies on the seller's skill or judgment, and (c) goods are of a description which it is in the

[1] This is covered under section 42 of SOGA

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course of the seller's business to supply. *Secondly,* section 16(2) states that where goods are bought from a seller who deals in them there is an implied condition that the goods shall be of merchantable quality. The only requirement to trigger this implied condition is that the goods must be purchased by description from a seller who deals in goods of that description. In such case it is the seller's responsibility to supply goods of "merchantable quality." Goods are said to be of merchantable quality if they are fit for any one of the several purposes for which they may be ordinarily used. However, when the buyer examines the goods before purchase there is no implied condition with respect to the defects which the examination ought to have revealed. It is important to note that this exception only applies in cases where the defect is obvious to the eye and apparently noticeable. *Thirdly,* section 16(3) further provides for an implied warranty or condition as to quality or fitness for a particular purpose may also be annexed by the usage of trade.

3.2 Implied Terms: Under common law, usually terms and conditions may be implied[2] to give effect to the presumed intent of the parties, where the contract does not deal with a matter expressly. Where minds meet terms are stated expressly, but even implied terms require meeting of minds. There are three types of implied terms i.e. implied by fact, by law and custom.

(a) Terms implied by fact are those which were not expressly set out in the contract but which the parties must have intended to include. To add a term implied by fact, two tests are considered *officious bystander* and *business efficacy*. As the name suggests, the former test is such that a proposed term will be implied if it is so obvious that it goes without saying and if an officious bystander suggested to the parties that they include it in the contract, they would react with a common "Oh, of course."[3] Regarding the latter, courts would readily imply a term into a contract if it aims to give a business efficacy to the contract and without the addition of the implied term the contract becomes unworkable. This test was propounded in a landmark judgment[4] where the defendant, a wharf-owner, executed an agreement with the plaintiff allowing him to unload his ship at the wharf. In the process, the ship got damaged due to shallow water, a dispute arose and it was held that the defendant was liable for damage as they were in breach of the implied condition that they would take reasonable care to see that the wharf was safe. The court stated *"In business transactions…. what the law desires to effect by the implication is to give such business efficacy to the transaction as must have been intended at all events by both parties who are business men; not to impose on one side all perils of the transaction, or to emancipate one side from all the chances of failure, but to make each party promise in law as much, at all events as it must have been in the contemplation of both parties that he should be responsible for in respect to those perils or chances."* The principle of business efficacy has gained currency with its application in plethora of judgments. The courts will not imply a term merely because it would be reasonable to do so or improve the contract which the parties made for themselves; rather, the focus is necessity on implied terms. The established view is that an express term can be added if, and only if, the court finds that the parties must have intended that term to form part of their contract. It is not enough for the court to find such a term would have been adopted by the parties as reasonable men if it had been suggested to them; instead, it must be a term necessary to give business efficacy to contract, a term which, although tacit, formed part of the contract made by the parties.

[2] Black's Law Dictionary states that an "implied" condition is used in contrast to an "express" condition, i.e. where the intent about the subject-matter is not manifested by explicit and direct words, but gathered by implication or necessary deduction from the circumstances, the general language, or parties conduct
[3] Shirlaw v Southern Foundries (1926) Ltd [1939] 2 KB 20
[4] The Moorcock (1889) 14 P.D. 64

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(b) Terms implied by law refers to terms imported by operation of law, although the parties may not have intended to include them but are linked with wider questions of policy. Terms implied by fact differ from those implied by law. Implication of a term in fact is based on the inference that the parties intended to incorporate the term into their contracts; but no such inference is required for the implication of a term in law. The terms implied by law could also be construed as legal duties arising out of certain classes of contract. While deciding a term implied by law courts are guided by general policy considerations; therefore, the issue of fairness and reasonableness is considered.

(c) Implied by custom or usage refers to terms which are sanctioned by custom, whether commercial or otherwise, although not expressly mentioned by the parties. However, the custom should not be inconsistent with the express terms or the nature of the contract. If the custom is inconsistent with the express agreement, then it is termed as "unreasonable." Only reasonable terms are binding on both parties, whether they knew of it or not. To qualify as a valid trade usage capable of forming part of the bargain between the parties, a usage must satisfy four conditions i.e. **(a)** it must be notor*ous. It should be so well known in trade that persons who make contracts of a kind to be effected by such trade usage must be taken to have intended that such usage should form part of their contracts; **(b)** it must be certain. The usage should have same degree of certainty as other contract terms. The issue of certainty is a matter of law; **(c)** it must be reasonable. This is also a question of law. A usage cannot be held as reasonable if unless it is fair proper and such as honest and right-minded men would adopt; and **(d)** it must not be contrary to law. A usage which is illegal or contravening the intention or policy of the statute would be void.

Section 16(4) of SOGA provides that an express warranty or condition does not negative an implied warranty or condition unless express terms are inconsistent with the implied ones. This means parties may include any express warranties or conditions as per their choice in their contract, but such warranties or conditions cannot exclude the warranties and conditions implied by law, unless that is specifically stated. For a term to qualify as an implied term it should have the following five key attributes i.e., it should **(a)** be reasonable and equitable; **(b)** be essential to give business efficacy to the contract so that no term will be implied if the contract is effective without it; **(c)** be so obvious that *it goes without saying;* **(d)** be capable of clear expression; and **(e)** must not contradict any express terms of the contract

4. Conclusion

An extremely complex subject, both express conditions and warranties and implied terms play an important role in commercial transactions. It is also clear from the foregoing that express warranties or conditions do not exclude implied ones unless express terms are inconsistent with the implied warranties. Further, while courts have judicial power to remedy omissions, but such power should not and is not exercised unduly but in extraordinary circumstances when it is essential to remedy a defect caused by an omission to express. In other words, the courts try to circumscribe their ability to interfere and set their own limits while focusing on the parties' intent.

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