

# A STUDY OF STANDARD FORM OF CONTRACTS

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## INTRODUCTION

### A. General

Contracts bloomed into their fullness during the laissez fair era when the concept of volitional freedom of the individual reached its zenith. Then it became the accepted legal norms that two individuals were free to enter into any contract and agree to any terms thereunder, and they would be given effect to. In its essence, contract is that concept of law and in that way, a unique concept of law which permits two individual to make law for themselves; parties are free to enter into and agree to, any terms and undertake any obligations under a contract, and once they do so, they have got to abide by them. The terms of contract and obligations accepted there under are enforceable.

It was in the latter half part of the first half of the 20<sup>th</sup> century that, it was realized that “meeting of minds” may not in every case; be real. It may happen that one of the two parties of the contract has not freedom no volition, he merely signs on dotted lines. This is literally what happens in standard form contract and in many other deals. A labourer, who hires himself on daily wages in more often than not, has no freedom; he accepts whatever wages are often offered to him. In the modern world of shortages, in fact the consumer has no volition, no freedom of choice. Hence, came the consumer protection laws. In standard form contracts access to the full terms may be difficult or impossible before acceptance. Often the document being signed is not the full contract; the purchaser is told that the rest of the terms are in another location. This reduces the likelihood of the terms being read and in some situations, such as software license agreements, can only be read after they have been notionally accepted by purchasing the good and opening the box. These contracts are typically not enforced, since common law dictates that all terms of contract must be disclosed before the contract is executed.

Standard form contracts may exploit unequal power relations if the good which is being sold using a contract of adhesion is one which is essential for the purchaser to buy, then the purchaser might feel they have no choice but to accept the terms. This problem may be mitigated if there are many suppliers of the good who can potentially offer different terms. Another factor which might mitigate the effects of competition on the content of contracts of adhesion is that, in practice, standard form contracts are usually drafted by lawyers instructed to construct them so as to minimize the firm’s liability, not necessarily to implement manager’s competitive decisions. Sometimes the contracts are written by an industry body and distributed to firms in that industry, increasing homogeneity of the contracts and reducing consumer’s ability to shop around.

The law of contract thus, is the meeting point and common ground of law, ethics, politics, philosophy and economics. The institution of contract is the product of two factors viz. moral and economic. As moral ideas advances and economic forces changes, the institution of contract is bound to be influenced and modified by these changes and the law governing contracts must by necessity come forward to reflect these changes.

### B. Classical concept of freedom of contract and its sanctity

The classical law of contract was constructed on the foundation of the two principles, viz. freedom of contract and the sanctity of contract. Both were the product of the doctrine of ‘Laissez Faire’ and the philosophy of natural law and natured rights in the 18<sup>th</sup> and 19<sup>th</sup> centuries. But even at the time of their day, the concept of freedom of contract suffered from many weaknesses and that of sanctity of contract was subject to certain limitations. With the passage of time with its attendant fundamental socio-economic ideologies, these fundamental assumptions of the classical law of contract began to be challenged from all sides. The doctrine of freedom of will was confronted with the social pressure and economic compulsions of all sorts and the principle of formal equality of the two contracting parties became an instrument of oppression and injustice in the face of inequality.

The philosophy of welfare state has converted the state into a giant business and industrial corporation. The almost universal faith in economic planning has reduced beyond recognition, the scope of the freedom of contract. The process of mass production and distribution has given birth to the standard form contracts which have so largely made freedom of contract a fiction. All these forces have brought

about the fundamental transformation in the nature of functions of contract in the modern society. The law is in the words of Krishna Iyer, J. is not a prodding omnipotence in the sky, but a pray matic instrument of social order. It is an operational art controlling economic life. If the law is to play its allotted role of serving the needs of society, it must reflect the ideas and ideologies of that society. It must keep time with the heartbeat of society and with the needs and aspirations of the people. The law must therefore, in a changing society, march in the time with the changed ideas and ideologies.

The principle of pacta sunt servanda, i.e. agreements entered into must be respected and followed in good faith, has an axiomatic significance in any system of law of contract. This principle, however, requires a fundamental change due to the influence of the standard form contracts. Contract is the result of an agreement with other essentials. Gradually the objective approach to the question of agreement and intention became stronger. But slowly the contract law grew large in its dimensions and its complexities increased, with the growth of trade and commerce. Consequently, the theory that the contract rules were based on the parties intentions became more and more fiction.

The expression “freedom of contract” is used to refer the general principle that the law does not restrict the terms on which parties may contract, i.e. law will not give relief merely because the terms of the contract are harsh or unfair to one of the parties to the contract.

In the last century, in the light of laissez fair philosophy it was wrong to interfere with private agreements on such grounds. This term ‘freedom of contract’ may also be used in another sense, i.e. in general, a person is not by law compelled to enter into any contract. He is free to refuse to contract and to do so on any ground on which appears to him to be sufficient.

In simple words, “freedom of contract” is as under :-

- i. that man have an inalienable right to make their own contracts for themselves;
- ii. that the law should interfere with persons as little as possible and
- iii. that person should be left to make their own contract unhampered by judicial interference.

The idea of freedom of contract is based upon two closely connected but distinct concepts. There are :

- i. that contract was based on mutual agreement; and
- ii. that the creation of contract was the result of the free choice.

But, the classical concept of ‘freedom of contract, suffered from certain grave weaknesses. The concept took no account of social and economic pressure which in many circumstances might virtually force a person to enter into a contract.

Today, the position is seen in very difficult light. ‘Freedom of contract is a reasonable social ideal only to the extent the equality of bargaining power among the parties can be assumed and no injury is done to the economic interests of community at large. In the more complicated social and industrial conditions of a collectivist society it has ceased to have much idealistic attraction. It is now realized that economic equality often does not exist in any real sense and that individual interests have to be made to subserve those of the community. The law today interferes at numerous points with the freedom of the parties to make what contract they like due to the fundamental change both in our social outlook and in the policy of the legislature towards contract.

### **C. Standard Form Contract:**

#### **Necessity and Implications:**

In the changing economic conditions, the trade and commerce has increased tremendously worldwide which has given rise a “large scale and wide spread practice of concluding contracts in standardized forms. This standard form contract has become the universal necessity in the modern world of trade and commerce. For example, LIC of India has to issue thousands of insurance covers every day. Similarly, the railway administration of India has to make innumerable contracts for carriage. It would be difficult for such large scale organizations to draw up a separate contract with every individual. So, standard form contract becomes necessary for them. Such standardized contracts contain a large number of terms and conditions in fine print which restrict and often exclude liability under the contract.

In such type of contracts, terms are drafted by are party at its own choice and the other party can hardly bargain with such massive organizations and therefore, his function is to accept the offer whether he likes its terms or not. The other party has no choice to negotiate but only has to accept to or go without it.

In these circumstances, courts have found it very difficult to come to rescue of the weaker party; particularly where he has signed the documents. In such cases the courts have been constrained to hold that he will be bound by the documents even if he never acquainted himself with its terms. For example, in case of DHL Worldurdi express v. Bharthi Knitting company, the Apex consumer court held that by signing on the consignment note at the time of handing over the packet to the courier the consumer had agreed to the

term and conditions that limited the liability of the courier in case of loss or damage to the consignment, to 100 dollars. The consumer court therefore could not award any damages over and above this amount. This was upheld by the Supreme court.

#### **D. Consumer Protection and Standard Form Contracts :**

Consumer includes all people irrespective of their group or sectional denomination. It is said that consumer is always right. He is the King. It is argued that if the consumer is the king he must be responsible for his actions and cannot blame others but can blame himself if he buys a bad product on account of his ignorance or foolishness. The fact remains that the consumer is not a king or even near a king in the market.

In daily life the consumers are confronted with enormous problems like monopolistic, restrictive or unfair trade practices, adulteration, poor consumer service and by exemption clauses in standard form contracts. At the time of necessity, a consumer has to buy any available goods from a seller. Traders exploit the situation of consumer's necessity by resort to standard form contract in swindling money from the honest consumers. In such contracts consumer assumes a servient position and has no option but to either accept or reject such terms and conditions. If the consumer elect to reject such terms and conditions, unilaterally imposed, he will be left to suffer for want of number of necessities. In such cases, it is left with no alternative but to accept all pre-settled standard terms imposed by the supplier. His volition or desire, or intention is of no account. In India, consumer disputes Redressal Agencies are established under the consumer protection Act, 1986. Keeping in mind the socio-economic consideration, these agencies are virtually courts with special power for solving the consumer disputes at the district, state and national levels. They may prove to be powerful engine of socio-economic justice in India.

The bargaining power of the dealer is usually far more greater than that of a consumer and even that of the small dealer. The consumer and the small retailers can form or join organizations and thus use their collective bargaining power against the whole seller in order to at least gain the minimum requisite protection. These collective contracts can be imposed collectively by the members of the consumer organizations, upon the dealers, for the advantage of the consumer. After attaining protection, the consumer groups will be in a position to dictate favorable contracts to the dealers in the same fashion as are now-a-days dictated to the employers by the workers trade unions. The supplier than have no choice but to accept the terms and conditions of such contracts. If is not possible for a single consumer to successfully face the litigation against a big organization but jointly they would be in a position to do so conveniently.

Standard form contracts are rarely read. Lengthy boilerplate terms are often in fine print and written in complicated legal language which often seems irrelevant. The prospect of a buyer finding any useful information from reading such terms is correspondingly low-coupled with the often large amount of time needed to read the terms, the expected pay of from reading the contract is low and few people would be expected to read it. Sometime a standard form contract may literally be dispensed from a vending machine to drivers sitting in line to enter a parking garage which means that stopping to read the contract risks provoking road rage.

#### **E. Legislative and Judicial Control over Standard Form Contracts**

In order to protect weaker parties, particularly consumers against such one sided contracts and agreements, we need to have a specific law or regulations that prohibits unfair terms in contracts. In India, there is no specific law which protects the interests of the consumers. The Indian Contract Act, 1872 represents the same principles and philosophy which was there in 1872 and no much amendments have been made to make it upto date. The Indian Contract Act, 1872 has its root in the judge made English law of contract and at that time standard form contracts had not created that problems which they are creating in the modern time. However, the English law of contract, which is still a judge made law has been greatly modified by various enactments. In England, such protection is given through the unfair contract terms Act, 1977 which together with sale of goods makes some forms of exclusion clauses null and void, in all circumstances.<sup>1</sup>

In addition, there is unfair terms in consumer contracts regulations which apply to standard contract terms used with consumers. Under these regulations a consumer is not bound by a standard term in contract with a seller or a supplier if that term is unfair this also provides powers to the office of fair trading and other qualifying bodies such as the utility regulations and consumers association, to stop the use of unfair standard terms by businesses. In the absence of a specific law there is a possibility of controlling these

<sup>1</sup> For example see :

- i) The misrepresentation Act, 1967;
- ii) The unfair contract terms Act, 1977
- iii) The consumer credit Act, 1974, iv) Sale of Goods Act, 1979

standard contracts either under section 16 of the Indian Contract Act, 1872, on the ground of undue influence or under section 23 of this Act, as being opposed public policy. The courts in India, however, try to provide relief to the weaker party by using the above sections of the Act. The Act provides that where one party is in a position to dominate the will of other and the transaction appears on the face of it or on the basis of evidences produced to be unconscionable, a presumption of under influence would arise there. The party who is in a dominating position has to prove that he did not exercise under influence in that case.<sup>2</sup>

The Indian Contract Act, 1872 also declares an agreement void where the object and consideration of such agreement is opposed to public policy.<sup>3</sup> The term public policy is not defined in the Act. It is the duty of the court to expound the meanings of the term. The true meaning and extent of the term public policy is a controversial question. Subha Rao, J. has observed in *Cherular Parekh v. Mahadev Das*<sup>4</sup> :

‘Public policy or the policy of law is an illusive concept, the primary duty of a court of law is to enforce a promise which the parties have made but in certain cases the courts may relieve them of their duty on rule founded on what is called the public policy.’<sup>5</sup>

The Supreme Court of India in *Central Inland Water Transport Corporation Ltd. v. Brojo Nath*<sup>6</sup> has also observed :

The principles governing public policy must be and are capable on proper occasion of expansion and modification. If there is no head of public policy which covers a case than the court must in consonance with public conscience and in keeping with public good and public interest declare such practice to be opposed to public policy.<sup>7</sup>

The Supreme Court in the above case struck down a clause in a service contract whereby the services of a permanent employee could be terminated by giving them three months notice or three months salary. The court regarded it as unreasonable and against public policy and void under section 23 of the Indian contract Act, 1872. Similarly, the Madras High Court struck down a clause in a dry cleaning contract as unreasonable and against public policy which provided that in the case of loss or damage to the clothes the dry cleaners liability was only upto 50% of the cost.<sup>8</sup> But these are some decisions which show the inadequacy of the Indian contract Act, 1872 in providing relief to the weaker party against the exemption clauses. For example, in *Indian Airlines v. Madhuri Chowdhai*,<sup>9</sup> the plaintiff’s husband was killed in a plane crash. In an action by plaintiff to claim compensation the question before the court was regarding the exemption clauses contained in the air ticket exempting the defendant completely from any liability. Court shows its inability to grant any compensation on the ground that the liability of carrier was governed by common law of England and, therefore, no question of testing the validity of this clause with reference to section 27 of the Indian Contract Act can at all arise.<sup>10</sup>

The legislature and the courts have attempted to provide methods for the protection of interests of the weaker parties but some questions relating to standard form contracts and exemption clauses remains unanswered. Interpretation devices that have been followed by the courts to check the misuse of these contracts have failed. Courts could not develop any coherent judicial philosophy in England, U.S.A. and India to cope with the problems of these contracts. Legislatures in these countries have concentrated their attention towards reforms in individual branch of law instead of developing a general provision of law. It is felt that this is a very long procedure and will take too much time to redress the abuse of these contracts.<sup>11</sup>

As in England, in India, we also need to have a specific law to control standard contracts and some regulations which apply to standard form contracts used with consumers to protect them from unfair terms. However, Indian courts have come forward and have evolved some modes of protection which we will discuss in the text of this study.

<sup>2</sup> Section 16 (3), The Indian Contract Act, 1872

<sup>3</sup> Section 23, The Indian Contract Act, 1872

<sup>4</sup> A.I.R. 1959 SC 781

<sup>5</sup> Id at 795

<sup>6</sup> A.I.R. 1966 SC 1571

<sup>7</sup> Id at 1612

<sup>8</sup> See Lilly White v. Manuswami, A.I.R. 1966 Mad. 17

<sup>9</sup> A.I.R. 1965 Cal. 252

<sup>10</sup> Id at 259

<sup>11</sup> Singhivi, S.S., Some Reflections on the Problems of Adhesion Contracts, A.I.R., 1979, 22 Jour. at 25.

## **F. Object and Scope of the Study**

The law of contract in recent years has to face a problem which is new and wide dimensional. The problem has arisen out of the large scale practice of concluding contracts in standardized form. In standard form contract; contracting parties are not in equal bargaining position. In such type of contracts, one party drafts the terms and conditions of the contract which generally favour to that party and the other party has to sign on dotted lines without any choice to negotiate. The terms of contract, so drafted are less favourable to the party who is at the receiving end and much favourable to the drafting party. In some cases, this may go to the extent of exempting themselves from all liabilities in case of any loss or damages.

In India there is no specific law to protect the interest of the weaker party. Provisions to regulate standard form contracts, are mainly scattered in different statutes. However, Indian courts have evolved same modes of protection. The object and scope of this study is to make analysis of various aspects of standard form contracts and its legislative and judicial control. An attempt has also been made to suggest improvements in the existing laws with a view to eliminate the problems created by the standard form contracts.

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