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Liquidator's Claims against Exclusion Clauses in Contracts

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INTRODUCTION

The Liquidator of a company represents the entire body of creditors of the company and its workers.[1] He is the person to collect all dues and receivables of the company under liquidation and distribute them in an equitable manner, subject to the constraints imposed by the law. Under the Insolvency and Bankruptcy Code, 2016 (IBC/Code) numerous rights, duties, privileges and obligations of the Liquidator are set out. In terms of section 36 of the Code, the liquidation estate shall include any assets over which the corporate debtor (CD) has ownership rights as well as any other property belonging to the CD. Along with the power to recover all claims of the CD, he has the power to avoid certain transactions.

The CD, as part of its business dealings, would have entered into numerous contracts with a number of parties. The rights and liabilities of the CD and consequently that of the Liquidator will be governed by such terms. Such contracts may include those which impose certain obligations and consequent liabilities on third parties on different occasions, e.g., delivery of defective goods and lack of quality in services. When the company is in liquidation and such a liability from a third party accrues in favour of the CD - be it flowing out of explicit contractual provisions or implied terms of contract - the Liquidator has to step in and claim the dues. For collecting the receivables from a contracting party, in the normal situation, the Liquidator will proceed as per the terms of contract entered into between the CD and the third-party contractor.

Sometimes however, questions may arise on the extent to which a Liquidator can proceed to collect dues from the contracting party, if the terms of contract specifically exclude any liability or limit the liability by an explicit cap. The freedom of the Liquidator gets constrained as he is stepping into the shoes of the CD, which has entered into the contract with open eyes and free mind, and his rights and liabilities cannot be more than that of the CD in liquidation. It would be of interest and significance to consider the position of Liquidator *vis-ā-vis* a contracting third party, whose liability has been made nil or substantially toned down by contract.

The law attaches a good measure of sanctity to a contract. It is the outcome of a consensus of two or more parties. It needs to be kept in mind that in the absence of fraud, a person who signs a document knowing that it is intended to have legal effect is bound by its terms. Though the terms of a contract have to be read in context, the words and ideas put therein are afforded great weight by judicial authorities.

There are different factors that prevail with the contracting parties when they enter into a contract. One of the parties may be in dire need of getting some work done or getting a contract. One party might be in a dominant position and would be able to call the shots and make the terms completely in its favour.

There may be other cases where impermissible tactics are used by one of the parties to the detriment of the other. Indian Contract Law declares certain contracts as voidable and certain others as *per se* void. There are plenty of judicial precedents to guide us on the treatment of void and voidable contracts.

When two parties in the commercial field of comparable financial strength and sophistication enter into contracts, it is difficult for any Court to conclude that one dominated the other and it was an unfair contract. In such a contract, it is common for the Courts to go by the terms of the contract and approve the same. The Liquidator will not be in a position to avail more beneficial terms than what the CD had bargained for, unless the contract falls within the avoidance clauses set out by the IBC. It is interesting to see how the Courts have dealt with conditions limiting liability through contracts.

AVOIDABLE CONTRACTS UNDER THE CODE

There are some provisions in the Code which enable a Liquidator to avoid certain types of contracts. These are explicitly provided in the statute itself and therefore does not pose the kind of problems which otherwise come forth in ordinary contracts. Since these are based on statutory provisions, a contract to the contrary may not have any effect on them. The importance of these provisions lies in the fact that the Liquidator is able to get an outcome from contracts and transactions, different from the one that would have ordinarily followed, in the absence of such provisions.

Extortionate credit transactions

IBC postulates[2] that where the CD has been a party to an extortionate credit transaction involving the receipt of financial or operational debt and the terms of such transaction requires exorbitant payments to be made by it, the Liquidator may make an application to the Adjudicating Authority (AA) for avoidance of such transaction. One condition for invoking this provision is that the transaction should have been made within a period of two years preceding the insolvency commencement date.

Preferential transactions

The Liquidator can apply to the AA for avoidance of preferential transactions made during the relevant time[3].

Undervalued transactions

The Liquidator will be able to avoid an undervalued transaction made during the relevant time, by making an application to the AA[4].

Defrauding creditors

Where the CD has entered into an undervalued transaction for defrauding the creditors and the AA is satisfied about it, the Liquidator may be able to avoid its effect, partially or fully[5].

CONTRACTS WHICH EXCLUDE LIABILITY

As indicated earlier, the transaction avoidance provisions enumerated above are on the basis of clear statutory provisions. Assuming that a particular transaction does not fall within any of the categories mentioned above, but contains clauses excluding the liabilities of third party either fully or partially, a question arises as to how far the Liquidator can avoid such clauses and claim dues to the CD, which he regards as proper and legitimate. The decisions of Indian Courts are meager on this count. It is a

settled law in India that the common law rulings of English Courts on contracts can be adopted, in case there is nothing contrary under the Indian statutes[6]. Commentators like Pollock & Mulla[7] rely on English decisions to explain the possible consequences of such exclusion clauses.

What are 'exclusion clauses' and how they are treated?

> [A]n exclusion clause is one which excludes or modifies an obligation, whether primary, general secondary or anticipatory secondary, that would otherwise arise under the contract by implication of law. Parties are free to agree to whatever exclusion or modification of all types of obligations as they please within the limits that the agreement must retain the legal characteristics of a contract; and must not offend against the equitable rule against penalties; that is to say, it must not impose upon the breaker of a primary obligation a general secondary obligation to pay to the other party a sum of money that is manifestly intended to be in excess of the amount which would fully compensate the other party for the loss sustained by him in consequence of the breach of the primary obligation. Since the presumption is that the parties by entering into the contract intended to accept the implied obligations exclusion clauses are to be construed strictly and the degree of strictness appropriate to be applied to their construction may properly depend upon the extent to which they involve departure from the implied obligations[8].

A clause in a contract excluding liability of a party, when viewed from the perspective of the other, would be one defining his obligations. It can also be seen as a risk mitigation measure by the parties. Any challenge to a clause in the agreement excluding liability of one party may be defended on the ground of estoppel.

Contracts that exclude liability fully

If a contractual exclusion is made in such wide terms, depriving the promise of all contractual force, Courts may treat them as mere 'declaration of intent'[9]. One can find a fair amount of 'judicial hostility' to such conditions[10]. The judicial approach seems to be that the transaction forming the foundation of the contract should remain as it is. For instance, if the contract is for the delivery of a computer, the supply of an instrument which works as a computer is absolutely essential. If the contractual disclaimer allows the supplier to deviate from this basic feature, the contract becomes meaningless. The exclusion clauses in the contract have to be subject to this basic condition.

While considering the issue of breach of contracts, for long, the English Courts have used the term 'fundamental breach' to describe such a contract. Explaining the scope of the term 'fundamental breach', the Court[11] stated:

> The phrases 'fundamental breach' and 'breach of a fundamental term' have been used interchangeably in some of the cases; but in fact they are quite different. There is no magic in the words "fundamental breach"; this expression 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. The innocent party may accept that breach or those breaches as a repudiation and treat the whole contract at an end and sue for damages generally or he may at his option prefer to affirm the contract and treat it as continuing on foot in which case he can only sue for damages for breach or breaches of the particular stipulation or stipulations in the contract which has or have been broken. But the expression "fundamental term" has a different meaning. A fundamental term of a contract is a stipulation which the parties have agreed either expressly or by necessary implication, or which the general law regards as a condition which

> goes to the root of the contract so that *any* breach of that term may at once and without further reference to the facts and circumstances be regarded by the innocent party as a fundamental breach.....

In another case[12], the Court of Appeal in the United Kingdom pointed out the rationale of the principle by stating that the question of 'fundamental breach' is a rule of construction which points to the fact that normally an exception or exclusion clause or similar provision in a contract should be construed as not applying to a situation created by a fundamental breach of contract. The Court further pointed out that this rule is not an independent rule of law imposed by the Court on the parties ignoring the contractual intention.

The common law does not treat contracts in a literalist way. If to give words in a contract, *'their full and complete meaning'*, would produce a result at odds with the main object of the contract then, the court will put upon those words a restricted meaning and may even *'reject words, or even whole provisions, if they are inconsistent with the main purpose of the contract'*[13].

In short, as pointed out by the Supreme Court, the exclusion clause has to be 'read down' in order that it is not *at war with the 'main purpose'*[14]. Effectively, the Liquidator should be able to argue successfully that a complete exclusion cannot stand the scrutiny of law and therefore, the CD should get the dues, compensation or benefit which it would have been eligible to obtain, in the absence of the exclusion clause.

Contracts which partially exclude liability

The so-called judicial hostility is much less intense, when the contract is only partially limiting the liability. The prevailing view appears to be that a clause which seeks to limit the liability of one party to a commercial contract, against the possible claims from other party, should generally be treated as an element of the parties' wider allocation of benefit, risk and responsibility.[15] Such exclusions have to be clear and unambiguous but cannot have any application of special rules of interpretation.[16]

Can a case of negligence be contracted out? The English authorities on the issue seem to agree that it can be done. However, the fact that any liability on negligence also is excluded has to be clearly spelt out in the contract[17] or should come out in the contractual document in a clear way. This is based on the premise that there is an inherent improbability of any party agreeing to a term that the negligence of the person who is bound to perform in a contract will not be liable[18].

CONCLUSION

The Liquidator of a CD has an obligation to realise the dues to the maximum possible extent and distribute them equitably. When she takes over the affairs of the CD, not much choice is available as far as contracts that have been entered into by the company earlier are concerned. Re-writing the contract would be extremely difficult at that stage. However, she needs to be conscious of the principles laid down by Indian as well as English Courts on the issue of exclusion of liabilities in contracts, so that maximum recovery is ensured.

NOTES

** Views expressed in this article are personal.*

[1] *Rajasthan State Financial Corporation v. Official Liquidator*, 2005 (8) SCC 190.

[2] Section 50, IBC.

[3] Sections 43 and 44, IBC.

[4] Sections 45 to 48, IBC.

[5] Section 49, IBC.

[6] *Bhagwandas Goverdhandas Kedia v. Messrs Girdharilal Parshottamdas, AIR* 1966 SC 543: [1966] 1 S.C.R. 656 ("In the administration of the law of contracts, the Courts in India have generally been guided by the rules of the English common law applicable to contracts, where no statutory provision to the contrary is in force.").

[7] See Pollock & Mulla, Indian Contract Act and Specific Relief Acts, 16th edition.

[8] *Photo Production Ltd. Respondents v. Securicor Transport Ltd.*, [1980] 2 W.L.R. 283. The court also said that "[s]ince the obligations implied by law in a commercial contract are those which, by judicial consensus over the years or by Parliament in passing a statute, have been regarded as obligations which a reasonable businessman would realise that he was accepting when he entered into a contract of a particular kind, the court's view of the reasonableness of any departure from the implied obligations which would be involved in construing the express words of an exclusion clause in one sense that they are capable of bearing rather than another, is a relevant consideration in deciding what meaning the words were intended by the parties to bear".

[9] See the observations of Lord Denning in *Suisse AllantiqueSociete D' Armement Maritime S.A. v. N. V. RotterdamscheKolen Centrale*, [1967] AC361.

[10] *George Mitchell (Chesterball) Ltd v. Finney Lock Seeds* Ltd, (1983) QB 284.

[11] *Suisse Atlantique Société d'Armement Maritime S.A. Appellants v. N.V. Rotterdamsche Kolen Centrale,* [1966] 2 W.L.R. 944.

[12] *UGS Finance v. National Mortgage Bank of Greece,* (1964), 1 Lloyd's Rep 446. Pearson L. J. (The court said that such a rule of construction based on the presumed intention of the contracting parties involving the implication of a term to give to the contract that business efficacy which the parties as reasonable mean must have intended it to have. Though it cannot be regarded as a new rule by any chance, it has gained prominence in recent years due to the "tendency to have standard forms or contract containing exceptions clauses drawn in extravagantly wide terms, which would produce absurd results if applied literally").

[13] *Sirius International Insurance Company (Publ) v. FAI General Insurance Ltd.*, [2004] UKHL 54. See also the comments of Pearson LJ in UGS *Finance Ltd. v. National Mortgage Bank of Greece,* [1964] 1 Lloyd's Rep 446] (Observing that it is not right to say that the law prohibits and nullifies a clause exempting or limiting liability for a fundamental breach or breach of a fundamental term, as it would involve a restriction on freedom of contract. The appropriate view is that on construction of the contract as a whole, it is found that the exempting clauses were not intended to give exemption from the consequences of the fundamental breach.); *Photo Production Ltd. v. Securicor Transport Ltd. [1980] A.C. 827.* ("The doctrine of 'fundamental breach' in spite of its imperfections and doubtful parentage has served a useful purpose.").

[14] *Skandia Insurance Co. Ltd v. Kokilaben Chandravadan,* (1987) 2 SCC 654.

[15] *McGee Group Ltd v. Galliford Try Building Ltd.,* [2017] EWHC 87 (TCC) (QBD).

[16] See: *Ailsa Craig Fishing Co Ltd v. Malvern Fishing Co Ltd* (The Strathallan) [1983] 1 W.L.R. 964, (holding that exacting standards should not be applied in their full rigour considering the effect of clauses as merely limiting liability); *Tradigrain SA v. Intertek Testing Services (ITS) Canada Ltd,* [2007] EWCA Civ 154