

Reciprocal Promises: An Overview

1. Introduction

In most commercial contracts, two or more parties typically undertake to perform certain obligations vis-à-vis each other. Such obligations could be in the nature of reciprocal promises i.e., promises which form part or the entire consideration for each other.¹ In other words, the performance of one party's obligation is dependent upon the other party fulfilling its express or implied obligation. The principles of reciprocal promise often assume significance in government contracts (*energy, infrastructure, etc.*) where the government entity has certain critical obligations which may or may not be expressly captured in the agreements. Even if these are captured, the order and sequence may be unclear leading to a long and expensive dispute resolution process.

This newsletter aims to give an overview of the concept of reciprocal promises and make recommendations that could come in handy at the stage of contract drafting and negotiation.

2. Legal Framework

Sections 51 to 54 of the Indian Contract Act 1872 ("**Act**") are the relevant provisions which specifically pertain to reciprocal promises. While Sections 51 and 52 explain the different situations where a reciprocal promise may be relevant, Sections 53 and 54 pertain to situations where one party fails to perform its obligation.

Reciprocal promises can be of three types:

2.1 Mutual and independent: This concept, though not covered under the Act, has evolved through jurisprudence.² It involves the contracting parties to undertake certain tasks which are independent of each other and their performance is not contingent upon one party performing its part of the contract. However, the performance of these mutual and independent promises is mandatory under the contract. For example, "A", a government entity, enters into a contract with a private contractor "B", where "B" has to build a bridge. If such contract imposes an obligation on "A" to share details of its, say, power projects with "B", where such information has no correlation with building the bridge, then merely because "A" did not share the relevant information, "B" will not be discharged from fulfilling its obligation to build the bridge. The two promises made by the parties to each other, though binding, are mutual and independent. In fact, "A" will be bound to share details of the power projects even if "B" defaults in the bridge work. However, if the contract mentioned that the aforementioned two promises had to be performed in a certain order, then regardless of them being mutual and independent, the terms of the contract would be upheld.

In the landmark case of *Mrs. Saradamani Kandappan vs. Mrs. S. Rajalakshmi and Ors.*³ the Hon'ble Supreme Court upheld the terms of the contract and recognized the reciprocal promises as mutual and independent. Saradamani had entered into an agreement with Rajalakshmi to

¹ Section 2(f) of the Indian Contract Act, 1872

² See AIR 2011 SC 3234

³ Supra

purchase a piece of land for which payments had to be made in multiple installments. Saradamani paid all installments, but, before the last one, asked Rajalakshmi to show the title documents. Rajalakshmi refused and, consequently, Saradamani failed to pay the last installment. Since the last installment was not paid on time, Rajalakshmi terminated the contract. Saradamani filed a case for specific performance and after litigation at multiple forums, the Supreme Court held that the two promises, i.e., payment of the final installment and showing the title documents, were mutual and exclusive. It further held that the contract did not make payment contingent upon reviewing the title documents and, therefore, Saradamani's refusal to pay was not proper. However, since time was of the essence, the Supreme Court held that the contract stood terminated and it directed Rajalakshmi to return the payments received from Saradamani.

2.2 Conditional: This is the most common type of reciprocal promise which is almost always a contentious issue whenever there is dispute arising due to the breach of a government contract. As per this, the performance of one party is conditional upon the performance of an obligation by the other party. If such other party fails to perform its obligation in accordance with the contract, the first party would not be able to honor its promise. The assessment of whether a promise is conditional or not depends upon the facts and circumstances of each case. Let us re-look at the earlier illustration. If the contract between "A" and "B" also stipulated that "A" would build a road leading to the proposed bridge to enable "B" to move heavy machinery and equipment to the site, then breach by "A" of this obligation would impact "B's" ability to perform its part of the contract. Even if the contract did not expressly stipulate that building the road is a pre-condition to commencing work on the bridge, the transaction would still be deemed as a reciprocal promise due to its very nature and purpose, i.e., without the road, work on the bridge can't commence.

In *M/s Shanti Builders vs. CIBA Industrial Workers' Co-Operative Housing Society Ltd.*,⁴ a dispute arose in connection with certain construction work that had to be done by Shanti Builders. CIBA alleged that Shanti Builders had not completed the construction work in accordance with the contract which led them to suffer heavy losses. Shanti Builders, on the other hand, alleged that it had not been given a plot of land as the contractually stipulated payment for the construction work already completed, and till such payment was not made, it would not be in a position to complete the next phase of work. After hearing the parties, the court upheld the contentions of Shanti Builders and took the view that if the performance of a contract requires a certain sequence (*even if it is not explicitly stated*) then such sequence must always be followed. It further held that where reciprocal promises are dependent upon each other, one party cannot insist on the performance of a promise if it has not performed its corresponding promise.

2.3 Concurrent: This is, yet again, a common form of reciprocal promise where parties have to, expressly or impliedly, perform their obligations simultaneously. The party willing to perform its promise will be exempted from doing so if the other party is not "ready" and "willing" to perform its respective obligation. In *J.P. Builders vs. A. Ramadas Rao*,⁵ the Hon'ble Supreme Court held that "readiness" refers to financial capacity and "willingness" refers to the conduct of the aggrieved party wanting performance, and generally the former is backed by the latter. To understand this, let us go back to the original illustration. If "A" had to engage vendors through a tender process to source some raw materials for "B", all of which, including those sourced by "B", had to be used together, then if "A" was not "ready" and "willing" to issue tenders on time, "B"

⁴ (2012) 4 Mah LJ 614

⁵ (2011) 1 SCC 429

could discharge itself from performing its obligation. Concurrent performance of the reciprocal promises of “A” and “B” is, in this illustration, integral to the overall performance of the contract.

3. Breach and Remedies

Whenever one party fails to perform its obligation under a reciprocal promise, it cannot claim the non-performance by the other and the non-breaching party is entitled to compensation for any loss that it sustains. Further, in case a party prevents the other from performing its promise, the contract will also become voidable at the option of the party so prevented. In both such situations, the contract can be terminated and damages be sought. However, in certain instances, it may not be possible to ascertain damages due to the nature of the transaction. The aggrieved party may have to get the contract specifically performed in order to get an “effective” relief.

Since performance of reciprocal promises and its breach have to be evaluated based on specific facts and circumstances, the question of “who was in breach” is often adjudicated by courts. We have analyzed this below in view of two key reliefs available to the promisor who is not in breach and/or is “ready” and “willing” to perform its obligations.

3.1 Specific performance: Specific performance of a contract is done in accordance with the provisions of the Specific Relief Act, 1963 (“SRA”). It is enforceable in some of the following key circumstances, namely:

- (i) when the actual damages due to the non-performance of the contract cannot be ascertained;⁶
- (ii) when monetary compensation will not afford adequate relief;⁷
- (iii) the contract, by its very nature, is not determinable and does not contain minute details that make it difficult to enforce its material terms;⁸
- (iv) the party seeking relief has never performed nor has been “ready” and “willing” to perform the essential terms of the contract.⁹ This is in sync with Section 51 of the Act.

It is noteworthy that proceedings under the SRA are typically initiated where reciprocal promises are between private parties. For most government contracts, damages are quantifiable and, therefore, SRA does not apply. In *Chandulal K. Shah and Ors. vs. Haridas Laxmidas Ashar and Ors.*¹⁰ the parties had entered into a contract for the sale of an apartment for which consideration had to be paid in two installments before stipulated dates. Chandulal paid the first installment, which was to be utilized by Haridas to repay a mortgage taken on the apartment. At the time stipulated for the payment of second installment, the mortgage had still not been repaid. Chandulal sued Haridas for specific performance of the reciprocal obligation to repay the mortgage and execute the sale. Haridas claimed that Chandulal was not “ready” and “willing” to pay the second installment. After hearing the parties, Court held that Haridas had failed to discharge his reciprocal obligation and issued a decree for specific performance.

⁶ Section 10(a) of SRA

⁷ Section 10(b) of SRA

⁸ Section 14(b) & (c) of SRA

⁹ Section 16 of SRA

¹⁰ Judgment dated September 04, 2017 of the Bombay High Court in CS(OS) 2543 of 2012

3.2 Damages: The most common relief sought in cases of breach of reciprocal promise is damages. Damages are granted under Section 73 and 74 of the Act. Section 73 allows the aggrieved party to claim compensation for losses or damages which naturally arise due to the breach. However, all remote and indirect damages/losses are excluded.¹¹ Section 74, on the other hand, provides for instances where the quantum of damages is already contemplated in the contract in the form of liquidated damages. In such cases, it is irrelevant as to what “actual” damages were suffered by the aggrieved party. In fact, courts have held in multiple judgments that where the right to recover liquidated damages under Section 74 exists, no question of ascertaining damages arises.¹² Needless to say, the issue of damages will only arise once it has been determined which party was in breach. The more complex the agreement with multiple obligations, the more difficult it gets to ascertain the existence and nature of reciprocal promises to determine breach.

In *Government of Andhra Pradesh vs. V. Satyam Rao*,¹³ the Government awarded a contract to Rao for the lining of a canal which was to be completed within a year. Rao was unable to complete the work as the Government failed to stop the flow of water in the canal. Rao cancelled the contract and asked for the settlement of his accounts and compensation. An arbitration panel was formed, which awarded compensation to Rao since it could not have completed the lining work with water flowing. When this award was challenged, the high court upheld it and stated that the compensation given to Rao was due to the non-performance of the Government’s reciprocal promise.

4. Recommendations

As mentioned above, the existence of reciprocal promises as well as determination of breach depends upon the relevant facts and circumstances. Some key questions that often come up are (i) who delayed the performance? (ii) was one party’s performance impliedly dependent upon the other performing its obligation? (iii) what was the sequence of promises? (iv) did one party, directly or indirectly, prevent the other from performing its obligation? (v) was the aggrieved party “ready” and “willing” to perform its corresponding obligations? All these questions assist the court in addressing the most critical issue- who was in breach of the contract?

While each case is different, it provides unique learnings on how contracts should have been drafted and negotiated. Some practical recommendations, subject to the nature of the contract, are as follows:

4.1 Order of promises: One common problem in government contracts is that the obligations of the government entity are not in as much detail as that of the private contractor. It is in the interest of both parties to detail even the most obvious obligations and the order in which they have to be performed. For instance, in an EPC contract, the government entity might retain the right to procure raw materials from its own vendors. However, the process of placing these orders and the corresponding time frame is almost never captured in detail. On the other hand, if the timelines and impact on the private contractor’s work is negotiated in detail, the risk of a potential long-drawn, expensive arbitration/litigation on this issue can be minimized.

¹¹ *Pannalal Jankidas vs. Mohanlal* AIR 1951 SC 145

¹² *Chunilal Mehta & Sons Ltd. vs. Century Spinning & Mfg. Co. Ltd.* AIR 1962 SC 1314

¹³ AIR 1996 AP 288

4.2 Force majeure clauses: Often parties pay the least attention to force majeure clauses while negotiating contracts and consider them “standard”. However, the delaying party often places reliance on it to justify its inability to perform its promises. For instance, there could be a situation where a force majeure situation occurs, thereby suspending the contract for a long duration. When the contract revives, the prices of raw materials may have gone up significantly, demanding a re-negotiation. However, the contract would also have a clause which would restrict the private contractor’s ability to revise prices once approved by the government entity. Therefore, the interplay of the force majeure clause with various other commercial clauses should be deliberated upon during negotiations.

4.3 Auto-termination clauses: Due to the subjectivity surrounding reciprocal promises, it can also be difficult for parties to determine who is responsible for the breach. There have been instances where neither party has performed the contract due to complexities surrounding their performances. For instance, “A” delayed its performance by seven days that consequently resulted in a delay of six months by “B”. The issue of whether “A” can be held entirely liable for “B’s” delay may prevent “A” to proactively pursue dispute resolution. This can result in neither party undertaking any task for a significantly long period of time. In such situations, it may be worth exploring whether the contract should auto-terminate, pressurizing the parties to resolve their dispute or get it formally adjudicated. This could be useful when the contract pertains to essential services where any delay in completion has a significant impact on the beneficiaries of such services/taxpayers.

5. Conclusion

Government entities are infamous for the rigid and inflexible contracts that they execute with private companies, often with blanket immunity. They leave little or no scope for negotiation in spite of having arbitrated/litigated on similar clauses in the past. This results in brewing of excessive disputes which end up being extremely expensive for the state as well as private parties. Therefore, government entities should be open to negotiating contracts with an open mind to resolve ambiguities upfront. This will only prove to be efficient and cost effective in the long run for all concerned.

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