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With this thought, we hereby present to you



EXAMINING EXCLUSION CLAUSES IN THE INDIAN CONTRACT ACT: THE NEED TO TACKLE UNFAIRNESS

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Abstract

The Indian contract law continues to follow the classical contract law model under which parties may, in exercise of their autonomy, limit or exclude their liability for breach of contract. In the absence of any statutory law governing the same the only way by which a party could be relieved from the performance of an onerous contract is by arguing procedural unconscionability. Section 23 of the act deals with situations where the consideration or object of an agreement is unlawful and thus deemed to be void. The law of damages is codified in sections 73 and 74 of the Indian Contract Act, 1872 which provide for damages by way of compensation in case of a breach of contract. An exclusion clause is a beneficial contractual arrangement made in anticipation of future contingencies that might hinder or prevent performance. As long as parties have freely contracted, an exclusion clause remains effective. Because of this, parties have started drafting wide exclusion clauses, highlighting unreasonableness in contracting practices. Exclusion clauses have effects similar to any other clause of a contract and thus, possess a binding nature enforceable in a court of law. A first step in this direction, specifically for consumer contracts, is the statutory recognition of 'unfair contract terms' under the new Consumer Protection Act, 2019. The researcher aims to trace the development and understanding of exclusion clauses as they have evolved under the Indian Contract law and through the adoption of common law by the courts.

Keywords – Consumer contracts, Liability, Onerous, Performance, Unconscionability, Unreasonableness.

1. Introduction: -

An exclusion clause is a useful contractual provision established by either party in a contract to prepare for potential future events that may obstruct or impede contract performance, including negligent performance. These clauses may also be referred to as exemption, exception, exculpatory, or limiting clauses¹. Suppose your dry cleaner damages your suit valued at Rs. 30,000; what amount can you claim in compensation from them? As a customer, you might expect full reimbursement for your suit's loss, but this expectation is unreasonable for the dry cleaner since their service fee typically ranges from Rs. 1,000 to 2,000. Consequently, the dry cleaner provides you with a receipt that includes a statement indicating, "The service provider's liability in any circumstance shall not exceed a specified amount." He minimizes his risk for any accidents by establishing a limit to safeguard himself from having to cover the entire cost of the suit. The provision included by the dry cleaner is referred to as the limitation of liability clause, which anticipates potential breaches of contract and then restricts the liability for those breaches. This illustrates that when entering into any contract, it is crucial to have a clear understanding of how limitations of liability clauses can shield your business from unexpected responsibilities.

Typically, these clauses take various forms, but they primarily function to limit or exempt a party from liabilities that they would otherwise be responsible for without the clause². In different instances, an exclusion clause may outline particular processes for making claims, delineating responsibilities between the parties, restricting the right to terminate the contract in case of a breach, or limiting the timeframe and amount for claiming damages due to a breach³. In *M/s. Texco Marketing Pvt. Ltd. v. TATA AIG General Insurance Company Ltd. And Ors*⁴, the court determined that if the exclusion clauses were not disclosed to the insured in accordance with IRDA guidelines, the insurer would not be able to invalidate the contract. The Insurance Contract must be interpreted in its entirety, and a fragmented interpretation of the agreement is not permissible. If the contract can be executed without one of its sections that is evidently unjust, it will be enforced while the unjust section will be disregarded.

¹ BRYAN A. GARNER, *BLACK'S LAW DICTIONARY*, 653 (Thomas Reuters 2009).

² H. K. SAHARAY, *DUTT ON CONTRACT*, 37 (Eastern Law House 2018).

³ *Atlantic Shipping and Trading Co. v. Louis Dreyfus & Co.*, [1992] 2 A.C. 250 (House of Lords).

⁴ *M/s. Texco Marketing Pvt. Ltd. v. TATA AIG General Insurance Company Ltd. And Ors*, (2022) 9 SCR 1031.

2. Key factors behind the widespread use of exclusion clauses: -

The notion of restricting or eliminating the liability of either party involved in a contract for breaching any contractual obligations contradicts the fundamental principles of damages and liability established by the Indian Contract Act, 1872. There are several reasons for the rise and common use of exclusion clauses.

- A. Excluding liability for a breach lessens the financial burdens and risks associated with a contractual agreement. The purpose of including an exclusionary clause in a contract is not to impose any unwarranted difficulties on the parties that can be anticipated or foreseen prior to entering into the agreement. Accordingly, implementing the principle of business efficacy, which emphasizes that 'transactions are unequivocally intended by businesspersons', as established in *Nabha Power Ltd vs. Punjab State Power Corporation Ltd & Another*, 2018⁵. When forming a contract, parties are mutually reliant on each other and operate under conditions of imperfect information. Consequently, exclusion clauses serve as an essential safeguard and a method for reducing risk in anticipation of potential liabilities.
- B. Furthermore, they help in minimizing the risks associated with any contractual dealings. Since the principle of foreseeability, as established in *Hadley v. Baxendale*⁶, and the ruling of the Hon'ble Supreme Court of India in *Maula Bux v. Union of India*⁷, which affirmed that courts have the authority to award reasonable compensation for a breach even in the absence of proven actual damages, have guided judicial decisions, the courts have progressively adopted a liberal approach to safeguard the interests of the aggrieved party. This has resulted in an expansion of the scope for awarding damages. Consequently, exclusion clauses serve to limit liability, preventing undue hardship and facilitating the smooth execution of agreements. Additionally, the reasonableness of such clauses is based on the presumption that both contractual parties mutually agreed to incorporate the specific exclusionary clause within the contract.
- C. Furthermore, exclusion clauses contribute to certainty in post-breach scenarios, enabling the parties to accurately anticipate potential damages arising from a breach. They function as a legal defence against claims for contractual breaches, offering predictability and stability in commercial transactions.

⁵ *Nabha Power Ltd. v. Punjab State Power Corporation Ltd & Another*, AIR 2018 SCC 508.

⁶ *Hadley v. Baxendale*, [1854] 156 ER 145 (House of Lords).

⁷ *Maula Bux v. Union of India*, AIR 1969 SCC 554.

- D. The Indian Contract Act, 1872 acknowledges exclusion clauses as an inherent part of contractual arrangements, as its framework is centered on the principle of freedom of contract. This allows parties to negotiate and define the extent of their liability during contractual discussions, reinforcing the validity and enforceability of exclusion clauses within the legal framework.

3. Exclusion clauses and their impact on contractual agreements: -

Exclusion clauses function similarly to any other contractual provision, carrying a binding nature that is enforceable in a court of law. The mere presence of hardship is not sufficient grounds to challenge their enforceability. However, the widespread acceptance of such clauses has led to their misuse, as entities began drafting them with excessively broad exclusions. This issue is particularly concerning in situations where there is a significant imbalance in bargaining power between contracting parties, leaving one party with little to no choice but to accept the terms presented especially in standard form contracts.

3.1 Standard form of contract: -

Standard form contracts are commonly used for essential services such as insurance, banking, travel, employment, and e-commerce. However, the classical theory of contract law fails to effectively address the exploitation of bargaining power by service providers. This is because such exploitation does not fit within the recognized vitiating elements of a contract namely, coercion, undue influence, fraud, misrepresentation, or mistake which primarily focus on procedural fairness⁸. Indian contract law, in both its written provisions and judicial interpretations, has followed a similar approach, emphasizing party autonomy. Section 10 of the Act states that: ‘All agreements are contracts if they are made by the free consent of parties’⁹ under Section 10 of the Indian Contract Act, 1872, a legally binding contract is formed when an agreement is made with the free consent of the parties. And section 14 further defines free consent as the one that is not caused by coercion, undue influence, fraud, misrepresentation or mistake¹⁰. Notably, the Act does not explicitly address unfair contracts or substantive unconscionability. Except for the public policy exception, the Act remains centered on procedural fairness rather than protecting parties from substantively unfair terms. The Supreme Court of India has reinforced this interpretation, particularly in commercial contracts. For

⁸ The Indian Contract Act, 1872, § 15-22, No. 9, Acts of Parliament, 1872 (India).

⁹ The Indian Contract Act, 1872, § 10, No. 9, Acts of Parliament, 1872 (India).

¹⁰ The Indian Contract Act, 1872, § 14, No. 9, Acts of Parliament, 1872 (India).

example, in *S.K. Jain v. State of Haryana*¹¹, the parties had included an additional clause in their contract, which the appellant later challenged as unconscionable. However, the Court ruled against applying the doctrine of unequal bargaining power, reasoning that if parties knowingly and willingly enter into unfavourable contracts, they cannot later seek legal protection from such terms.

This reasoning raises an important counterargument: does the mere act of signing a standard contract truly reflect an individual's voluntary consent? A key question to consider is whether the individual had any real opportunity to negotiate the removal of an unreasonable exclusion clause. The Law Commission of India, in its 103rd Report¹², examined such concerns in depth. The Commission critically analysed cases involving transport carriers that used exclusion clauses to limit or entirely exclude liability. Many High Courts ruled in favour of these carriers, reasoning that since the terms and conditions were presented to consumers in printed form, they were deemed to have accepted them regardless of whether they had actually read them. However, the Law Commission challenged this logic by asking: 'Even assuming that the consumer was aware of the conditions, could they have negotiated a change in those terms? If not, then how does it matter whether they knew them or not? How can the courts intervene in such situations?' This lack of genuine negotiating power is one of the strongest limitations to the principle of true contractual freedom.

Recognizing this issue, India has enacted the Consumer Protection Act, 2019, which provides remedies against unfair consumer contracts. Moving forward, it is essential to ensure that statutory safeguards are structured to prevent the exploitation of unequal bargaining power. Unreasonable exclusion clauses should not be allowed to undermine one of the fundamental principles of contract law: that parties must honour the promises they make¹³.

4. Developing remedies under the Indian Contract Act, 1872: -

The remedies against exclusion clauses can be categorized into four broad heads:

- A. Addressing non-compliance notice procedure
- B. Interpretative mechanism as a remedy

¹¹ *S. K. Jain v. State of Haryana* AIR 2009 SCC 357.

¹² Law Commission of India, 103rd report, *Unfair Terms in Contract*, 4 (1984), available at <https://lawcommissionofindia.nic.in>, (last visited Mar. 9, 2024).

¹³ The Indian Contract Act, 1872, § 37, No. 9, Acts of Parliament, 1872 (India).

- C. Ensuring compliance with statutory requirements and
- D. Challenging unconscionable contract terms

A. Addressing non-compliance notice procedure - The law requires that an exclusion clause must be properly communicated to the other party through a legally recognized medium that imposes an obligation to take cognizance of it. The exclusion clause must be included in a contractual document in such a way that a reasonable person can clearly understand that specific terms and conditions are being conveyed, preventing any subsequent unilateral exclusions. Once it is established that the exclusion clause was communicated and that the principle of freedom of contract has been upheld, courts are bound to enforce it. However, if the party incorporating the exclusion clause fails to explicitly disclose it as part of the contract's terms, the clause is deemed foreign to the contract and thus rendered unenforceable.

A relevant case illustrating this principle is *Modern Insulators v. Oriental Insurance Co. Ltd*¹⁴, where the insurer failed to inform the insured about certain terms and conditions, including an exclusion clause, while issuing the schedule of the insurance policy. The exclusion clause sought to exempt the insurer from liability if second-hand property was used in a specific mechanical test. When the insured structure collapsed due to the use of second-hand property, the Supreme Court ruled against the insurer, reasoning that the exclusion clause was neither disclosed nor an explicit part of the insurance contract. As a result, the insurer was held liable for the damages.

B. Interpretative mechanism as a remedy - A fundamental rule of contract interpretation is that a contract must be read as a whole, with its meaning derived from the intended language and purpose of the parties. No additional terms can be inferred beyond what is explicitly stated. Similarly, when interpreting an exclusion clause, its language must be understood in the broader context of the entire contract while maintaining fidelity to its intended purpose. If the exclusion clause is not given its plain and natural meaning within the context of the agreement, its very existence would become redundant. Courts, therefore, ensure that exclusion clauses are interpreted strictly in alignment with the contractual intent, preventing any misapplication or distortion of their original purpose.

C. Ensuring compliance with statutory requirements – While parties are generally free to negotiate contractual terms, this freedom is not absolute and cannot be exercised in

¹⁴ *Modern insulators v. Oriental insurance Co. Ltd* AIR 2000 SCC 734.

a way that circumvents statutory provisions applicable to a given dispute. Exclusion clauses cannot be used to override mandatory legal obligations imposed by legislation. For example, in *Guru Govekar v. Filomena F. Lobo*¹⁵, the petitioner had given his vehicle for repairs, and during a test drive, the mechanic caused an accident. When the petitioner filed an insurance claim, the insurer denied liability, citing an exclusion clause that exempted it from responsibility for accidents occurring when the vehicle was being used for hire or testing. However, the court rejected this argument, holding that the insurer was obligated to pay compensation under Sections 94 and 95 of the Motor Vehicles Act, 1939¹⁶, which mandate that all motor insurance policies must cover third-party liability for injuries arising from the use of a vehicle in a public place. This case exemplifies how statutory provisions can override contractual exclusions, ensuring that legal protections for the affected party remain intact.

D. Challenging unconscionable contract terms - The Indian Contract Act does not expressly contain provisions addressing the concept of unconscionability. However, Indian courts have inferred remedies for unconscionable contract terms from Section 16, which defines undue influence, and Section 19A¹⁷, which allows contracts vitiated by undue influence to be rendered voidable at the affected party's discretion. Additionally, Section 23 of the Act states that a contract is void if its consideration or object is contrary to public policy¹⁸. These provisions provide a legal foundation for challenging contractual terms that result in an unfair advantage to one party at the expense of another. A notable case illustrating this principle is *Lilly White v. Manuswami*¹⁹, where the Madras High Court was asked to determine whether a dry cleaner could enforce a contractual clause limiting a customer's compensation to only 50% of the market price in the event of lost or damaged articles. The court held that such a clause was against public policy, as it incentivized dry cleaners to misappropriate customer belongings without accountability. The judgment emphasized that merely printing an exclusion clause on the reverse side of a bill, without any real negotiation or meaningful consent from the customer, could not make it enforceable. The court ruled that a contractual term which contradicts fundamental principles of contract law and public policy cannot be upheld simply because the consumer tacitly accepted it.

¹⁵ *Guru Govekar v. Filomena F. Lobo* AIR 1988 SCC 1.

¹⁶ The Motor Vehicles Act, 1939, § 94-94, No. 4, Acts of Parliament, 1939 (India).

¹⁷ *Supra* note 8.

¹⁸ The Indian Contract Act, 1872, § 23, No. 9, Acts of Parliament, 1872 (India).

¹⁹ *Lilly White v. Manuswami* AIR 1966 MAD 13.

The Law Commission of India²⁰ has also stressed the importance of protecting public interest through statutory safeguards. It has asserted that Section 23 of the Indian Contract Act is designed to ensure that contractual freedom does not lead to the exploitation of weaker parties, particularly in cases where the principle of free consent is undermined. The Commission has pointed out that contractual dealings must be regulated to prevent unjust outcomes that harm the broader public welfare.

5. The path ahead: -

Exclusion clauses exemplify a stark manifestation of how unequal bargaining power in contractual relationships, particularly in employment contracts, can result in agreements that are disproportionately skewed in favour of the employer. These clauses limit or entirely exempt liability, often leaving the weaker party with no real choice but to accept the terms as dictated. While contractual freedom is a cornerstone of contract law, unchecked discretion in drafting exclusion clauses has led to widespread concerns regarding fairness and justice. In the Indian legal framework, the Consumer Protection Act, 2019, for the first time, statutorily addresses unfair contracts²¹ and provides the judiciary with discretionary power to assess and invalidate exclusionary clauses that are deemed unfair.

This legislative development signals a shift towards greater judicial scrutiny over contractual terms in consumer agreements. However, despite this progress in consumer protection law, the broader legal framework governing contracts remains inadequate in addressing substantive unconscionability a concept that recognizes contractual terms as unfair not merely due to procedural defects like coercion or undue influence, but because they create an overwhelmingly one-sided bargain.

5.1 The case for reform –

Given the limitations of the current legal framework, we argue that Indian contract law should undergo reform to comprehensively address the issue of unfair exclusion clauses. The following mechanisms could serve as potential pathways for such reform:

A. An amendment be made in the Indian Contract Act to Incorporate Substantive Unconscionability:

²⁰ *Supra* note 12.

²¹ Consumer Protection Act, 2019, § 2(46), No. 35, Acts of Parliament, 2019 (India).

One effective measure would be to amend the Indian Contract Act in accordance with the recommendations of the Law Commission of India to grant courts the discretion to invalidate contracts or specific clauses on the grounds of substantive unconscionability. The 103rd Report of the Law Commission²² had earlier proposed the inclusion of Section 67A into the Contract Act²³, which would read as follows:

- a. If, upon examining the terms of the contract or the evidence presented by the parties, the court determines that the contract or any of its specific provisions is unconscionable, it may refuse to enforce the contract or those specific provisions.
- b. Without limiting the general scope of this section, a contract (or part thereof) shall be deemed unconscionable if it:
 - Exempts a party from liability arising from wilful breach of the contract, or
 - Excludes liability for consequences of negligence.

If this provision were enacted, courts would gain independent authority to assess and strike down unconscionable contractual clauses, separate from the traditional arguments based on freedom of contract or undue influence. This would mark a significant departure from the current approach, which primarily focuses on procedural fairness rather than addressing grossly unfair substantive terms.

B. Enactment of a Law Similar to the Unfair Contract Terms Act, 1977 (UK):

A second approach to reform would be the enactment of a dedicated statute modelled on the Unfair Contract Terms Act, 1977 (UCTA), which governs the enforceability of exclusion clauses in the United Kingdom. One of the key provisions of UCTA Section 2(3) acknowledges that an individual's mere signature on a contractual document does not necessarily indicate true consent or voluntary acceptance of an exclusion clause²⁴. This provision is crucial as it allows courts to go beyond the formalistic approach of treating signatures as conclusive evidence of consent, thereby prioritizing substantive fairness over rigid contract enforcement.

The UCTA framework introduces three key statutory safeguards to regulate exclusion clauses:

- a. Absolute Restrictions on Exclusion of Liability for Death or Personal Injury (Section 2) - Under Section 2, any contractual term that seeks to exclude liability for death or personal injury is automatically void. For liability related to loss or

²² *Supra* note 12.

²³ The Indian Contract Act, 1872, § 67A, No. 9, Acts of Parliament, 1872 (India).

²⁴ Unfair Contract Terms Act, 1977. c, § 2(3).

damage caused by negligence, parties can only exclude such liability if they provide adequate notice of the exclusion, and such notice satisfies the requirement of reasonableness.

b. Regulation of exclusion clauses in standard form of contracts (Section 3) –

This provision applies to standard form contracts, which are widely used in consumer agreements and employment contracts. It restricts a party's ability to exclude liability for contractual breach unless such exclusion meets the test of reasonableness. This prevents powerful entities from drafting excessively broad exclusion clauses that unfairly disadvantage the weaker party²⁵.

c. Introduction of the reasonableness test (Section 11) –

Section 11 introduces the reasonableness test, which mandates that an exclusion clause will only be valid if it was fair and reasonable in the circumstances prevailing at the time the contract was formed²⁶. The test ensures that courts assess whether the weaker party had a genuine opportunity to negotiate terms and whether the clause was justifiable under the given contractual context.

The Law Commission of India, in its 199th Report²⁷, had already recognized the significance of such safeguards and proposed a modified version of UCTA under the Unfair (Procedural and Substantive) Terms in Contract Bill, 2006. The objective of this Bill was to empower courts with the jurisdiction to provide relief against unfair contractual terms, thereby reinforcing the principles of equity and justice within Indian contract law.

6. Conclusion: -

One of the defining characteristics of a modern state is the principle of free contracting, wherein the industry itself determines the manner in which contractual relationships are structured. Indian contract law follows this principle by permitting the inclusion of exclusion clauses, provided that they are clearly drafted, incorporated into the contract with proper notice to the other party, and are not vitiated by procedural unconscionability. However, the fundamental notion of freedom of contract is directly challenged by the issue of unfair and unconscionable contractual terms, which disproportionately benefit the more powerful party at the expense of

²⁵ Unfair Contract Terms Act, 1977, c. 2, § 2.

²⁶ Unfair Contract Terms Act, 1977, c. 2, § 11.

²⁷ Law Commission of India, 199th Report, Report on Unfair (Procedural and Substantive) Terms in Contract, 228-240 (2006), available at <https://lawcommissionofindia.nic.in>, (last visited Mar 10, 2024).

the weaker ones. At present, the general principles of Indian contract law remain insufficient to effectively address the issue of substantive unconscionability. The existing framework allows parties with greater bargaining power to introduce unreasonable exclusion clauses into contracts, provided they meet certain procedural requirements. This enables entities with a dominant market position to exploit the circumstantial powerlessness of the weaker party, often leaving them with no meaningful ability to negotiate fairer terms. The law, as it currently stands, maintains an artificial distinction between procedural and substantive fairness, treating them as separate legal considerations despite their inherent interdependence.

A legal framework that prioritizes procedural fairness while disregarding substantive fairness fails to uphold the core principles of justice and equity. It is therefore unsurprising that Indian courts, recognizing this gap, have attempted to develop ad-hoc remedies to counteract unconscionable contractual provisions. However, such case-specific interventions lack consistency and predictability, leading to uncertainty in contract enforcement. In light of these challenges, and drawing inspiration from the Consumer Protection Act, 2019, we advocate for comprehensive reforms to the Indian Contract Act, 1872. These reforms should empower the judiciary with discretionary authority to examine the fairness of contractual terms holistically, ensuring that both procedural and substantive fairness are given equal weight. By granting courts the power to invalidate unreasonable and unfair contractual provisions, India can move towards a more equitable contractual regime, one that upholds the true essence of freedom of contract—a system where consent is genuinely voluntary, and contractual obligations are fairly distributed between the parties.

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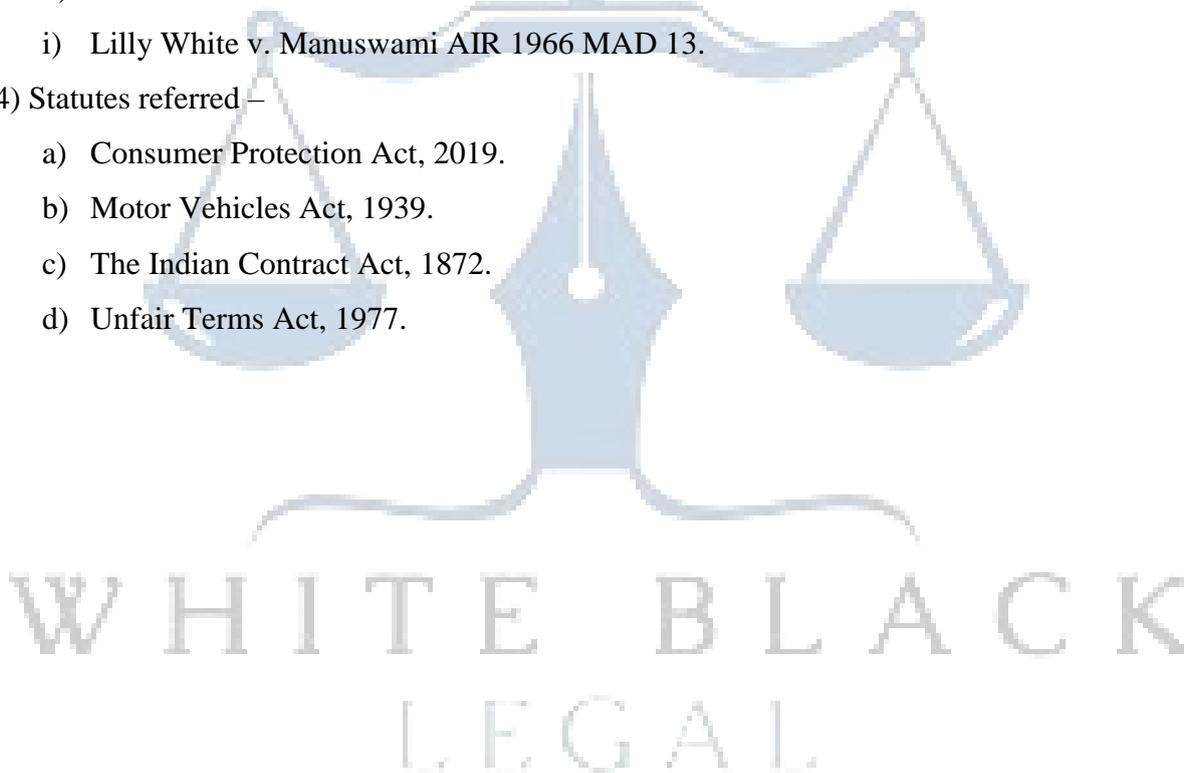
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- h) Guru Govekar v. Filomena F. Lobo AIR 1988 SCC 1.
- i) Lilly White v. Manuswami AIR 1966 MAD 13.

4) Statutes referred –

- a) Consumer Protection Act, 2019.
- b) Motor Vehicles Act, 1939.
- c) The Indian Contract Act, 1872.
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