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ANALYSIS OF DIFFERENCE BETWEEN LIQUIDATED AND UNLIQUIDATED DAMAGES UNDER INDIAN LAW

A Damages-Layman Language

- 1 Damages mean money claimed by, or ordered to be paid to a person as compensation for loss or injury.
- 2 The word 'damages' is understood as compensation under a contract paid by the defaulting party to the non-defaulting party, for actionable wrongs of the former.
- 3 There are two types of damages statutorily recognized under the Indian law, namely liquidated and unliquidated damages.
- 4 Liquidated damages is a pre-determined amount agreed by and between the parties, at the time of entering into contract as payable on the default of one of them.
- 5 Unliquidated damages is the compensation for the actual loss suffered arising out of the breach. The Court quantifies/assesses the damages, whether pecuniary or non-pecuniary.

B Emergence of the Law of Damages from English Law

- 1 India follows the common law system, though codified. Judicial decisions of the courts of the UK (or other common law jurisdictions) are not binding on courts in India.
- 2 However, such precedents have persuasive value and may be turned to for guidance in situations where the courts in India may have not established the jurisprudence on a particular question of law.
- 3 The law of damages has emerged from the leading case law of *Hadley vs. Baxendale* (1854)9 Ex 341. The following para quoted from the judgment explains both the meaning of liquidated and unliquidated damages only in a few words. Judge Alderson held the following:

“Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably considered either arising naturally i.e. according to the usual course of things, from such breach of contract itself or

such as may be reasonably supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of breach of it.”

- 4 The Judgment of *Hadley vs. Baxendale* has explained the concept of both liquidated and unliquidated damages.
- 5 The first part of the above judgment **“should be such as may fairly and reasonably considered either arising naturally i.e. according to the usual course of things, from such breach of contract itself”** explains unliquidated damages, which arise fairly and reasonably occur in the usual course of the things i.e. actual damages incurred as a result of breach of contract.
- 6 The second part of the above judgment **“such as may be reasonably supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of breach of it”** explains liquidated damages, which both the parties had contemplated while entering into contract and would be paid as a result of breach.

C The Law of Damages under Indian Contract Act, 1872(for short “the Contract Act”)

a Unliquidated Damages

- 1 Section 73 of the Contract Act deals with actual damages suffered on account of breach of contract and the injury resulting in the breach which is in the nature of unliquidated damages.
- 2 The essentials of unliquidated damages are as follows:
 - i **Breach of Contract**
 - Breach of contract constitutes the pre-condition for a claim of damages, be it liquidated, unliquidated or otherwise.
 - Thus, irrespective of the extent to which the defendant profits from the contractual arrangement, there can be no claim for damages unless there is a breach of the contract.
 - To establish a breach, it has to be adjudicated upon and be proved, and not merely decided by the parties.
 - ii **Causation**
 - An important aspect to be determined is whether the



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breach caused the loss.

- This is apparent from Section 73 itself according to which the plaintiff suffering a breach is entitled to compensation 'for any loss or damage caused to him thereby'. There has to be a clear nexus between the breach of contract and the loss or damage to be compensated.
- It is noteworthy that the nexus of the breach to the loss to the plaintiff is required to be proximate or *causa proxima*, and not remote if damages have to be awarded as a remedy for the breach.

iii Onus of Proof

- The onus of proof of the breach, and the loss suffered is on the plaintiff. The quantum of damages must be proved with reasonable certainty.

iii Remote or Indirect Loss

- Under Unliquidated Damages, Compensation is not to be given for any remote or indirect loss or damage sustained by reason of breach.
- Once the extent of recoverable loss is determined, it has to be evaluated in terms of money.

3 The determination of damages is determined on various factors such as market rate theory, damages are compensatory not penal, duty to mitigate.

i Market rate theory

- The damages are based on fair market or current price on the date of breach.
- What is necessary is that the plaintiff should establish what the contractual rate of purchase was and what the rate of article was on the date on which it was supplied.
- The difference between the two is a loss to the purchaser, if it is not supplied by the seller to the purchaser.

ii Damages are compensatory not penal

- The object of damages is to put the suffering party in the same position as if the contract had been performed.
- Damages are given by way of compensation for the loss suffered by the plaintiff and not for the purpose of punishing the defendant.

iii Duty to mitigate

- The injured party has to make reasonable efforts to avoid the losses resulting from the breach so that his as well as other party's losses are kept minimum.
- The duty to mitigate in essence means the court can take into account the conduct of the injured party so as to see what he ought to have done, whereby his loss would be diminished.

4 Unliquidated damages can be explained through this illustration:

A sells certain merchandise to B, warranting it to be of a particular quality, and B, in reliance upon this warranty, sells it to C with a similar warranty. The goods prove to be not according to the warranty, and B becomes liable to pay C a sum of money by way of compensation. B is entitled to be reimbursed this sum by A.

5 The above illustration explains the elements of unliquidated damages as follows:

- There has to be breach of contract, one of the parties fails to perform their part of the contract.
- The breach should cause actual loss or damage to the other party.
- The court assesses the damage suffered and grants compensation to the injured party.

b Liquidated Damages

1 Sometimes the parties to a contract, at the time of making the contract agree to a reasonable amount of compensation payable in the event of breach of contract. Such amount which has been agreed beforehand, may be either liquidated damages or penalty.

2 Section 74 of the Contract Act deals with liquidated damages, i.e., damages that are stipulated for.

3 If the sum to be paid on the breach of contract is the genuine pre-estimate of the prospective damages, it is known as liquidated damages.

4 If such amount is excessive and highly disproportionate to the likely loss the amount is fixed with a view to discourage the breach of contract it is known as penalty

5 Under Liquidated damages the pertinent question is whether the party suffering breach must prove actual loss or damage in order to get the liquidated sum mentioned in the contract.

6 Take for instance the following illustration:

X contracts with Y for construction of a dining table within a period of one week failing which liquidated damages of 1000 are leviable on Y. Y delays the delivery by 100 days. X claims liquidated damages against Y to which Y states that X has not suffered any loss due to the delay in delivery, since X already had in his possession a functional (although old) dining table which is serving the exact intended purpose of the new dining table.

7 Parties find themselves in situations similar to the one stated above will have to persuade the adjudicator(s) on the legal requirement of proving loss in order to enforce or defend their clause on liquidated damages.

8 In doing so, the first point of reference is Section 74 itself, which reads as follows:

“Section 74. Compensation for breach of contract where penalty stipulated for — When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, **whether or not actual damage or loss is proved to have been caused** thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.”

9 The phrase ‘whether or not actual damage or loss is proved to have been caused thereby’ has important implications.

10 First, by using the word caused, the requirement to connect the act of breach with the resulting damage or loss is dispensed with. In other words, the breach of contract need not result in an actual damage or loss in order for a party to claim under this section.

11 Second, the use of word “proved” connotes that there is no requirement to prove actual damage or loss by leading evidence. However, the above expansive reading of the emphasized phrase becomes narrower as we compare it with another phrase in the section which states that only “reasonable compensation not exceeding the amount so named” should be awarded. This phrase reflects that, notwithstanding the sum stipulated in the contract, the resultant award of damages will always be reasonable and court is under no compulsion to award the entire sum stipulated by the contract merely because the parties agreed on such payment.

12 This position in law is aptly explained by the Constitutional Bench of the Supreme Court in the case of *Fateh Chand v. Balkishan Dass* AIR 1963 SC 1405 as follows:

- In assessing damages the Court has, subject to the limit of the penalty stipulated, jurisdiction to award such compensation as it deems reasonable having regard to all the circumstances of the case.

- Jurisdiction of the Court to award compensation in case of breach of contract is unqualified except as to the maximum stipulated.

- But compensation has to be reasonable, and that imposes upon Court duty to award compensation according to settled principles.

13 Pertinently, only a few years after the decision in *Fateh Chand*, the Supreme Court passed its judgment in *Maula Bux v. Union of India*

1969 (2) SCC 554, wherein the Court, discussed the scenario where it is not possible for a party suffering breach, to prove loss or injury caused.

¹⁴ The court also classifies what may constitute a reasonable compensation, where judicial intervention for its determination, may not be required. The court, holds in paragraph 6 of the judgment as follows:

- It is true that in every case of breach of contract the person aggrieved by the breach is not required to prove actual loss or damage suffered by him before he can claim a decree, and the Court is competent to award reasonable compensation in case of breach even if no actual damage is proved to have been suffered in consequence of the breach of contract.
- But the expression “whether or not actual damage or loss is proved to have been caused thereby” is intended to cover different classes of contracts which come before the Courts.
- In case of breach of some contracts it may be impossible for the Court to assess compensation arising from breach, while in other cases compensation can be calculated in accordance with established rules.
- Where the Court is unable to assess the compensation, the sum named by the parties if it be regarded as a genuine pre-estimate may be taken into consideration as the measure of reasonable compensation, but not if the sum named is in the nature of penalty.

¹⁵ Where loss in terms of money can be determined, the party claiming compensation must prove the loss suffered by him.

¹⁶ The most significant amongst those is the case of *Oil & Natural Gas Corporation Limited v. Saw Pipes Limited* (2003) 5 SCC 705 the issue for consideration was whether ONGC was required under Section 74 to prove loss in a scenario where it is impossible to prove it. In this background, the Court reviewed the various decisions on this subject, including the above mentioned decisions of *Fateh Chand and Maula Bux*, and held as follows:

- The Court held in construction contracts it is difficult to assess the damage caused.
- Take for illustration construction of a road or a bridge. If there is delay in completing the construction of a road or bridge within the stipulated time, then it would be difficult to prove how much loss is suffered by the society/State.
- In such a situation [where it is impossible to prove exact loss or damage which the parties suffer because of the breach], if the parties have pre-estimate such loss after clear understanding, it would be totally unjustified to arrive at the conclusion that the party who has committed breach of contract is not liable to pay compensation.
- If the compensation named in the contract for such breach is genuine pre-estimate of loss which the parties knew when they made the contract to be likely to result from the breach of it, there is no question of proving such loss or such party is not required to lead evidence to prove actual loss suffered by him.
- Burden is on the other party to lead evidence for proving that no loss is likely to occur by such breach.

¹⁷ Pursuant to the decision in *Saw Pipes* there has been debate whether the decision of the Court in the said judgment was altered in the case of *Kailash Nath v. Delhi Development Authority and Another* (2015) 4 SCC 136.

¹⁸ In the said case, the Court held that, “damage or loss caused is a sine qua non for the application of the section”.

¹⁹ Further, Kailash Nath judgment itself acknowledges that, “in cases where damage or loss is difficult or impossible to prove then the liquidated amount named in the contract, if a genuine pre-estimate of damage or loss, can be awarded.”

²⁰ Recently in the case of *MTNL vs. Tata Communications Limited*, (2019)5SCC 341, the Supreme Court held the following:

- Where a sum is named in a contract as a liquidated amount payable by way of damages, the party complaining of a breach can receive as reasonable compensation such liquidated amount only if it is a genuine pre-estimate of damages fixed by both parties and found to be such by the court.
- Reasonable compensation will be fixed on well-known principles that are applicable to the law of contract, which are to be found inter alia in Section 73 of the Contract Act.
- Since Section 74 awards reasonable compensation for damage or loss caused by a breach of contract, damage or loss caused is a sine qua non for the applicability of the section.
- The expression “whether or not actual damage or loss is proved to have been caused thereby” means that where it is possible to prove actual damage or loss, such proof is not dispensed with.
- It is only in cases where damage or loss is difficult or impossible to prove that the liquidated amount named in the contract, if a genuine pre-estimate of damage or loss, can be awarded

D Conclusion

The following conditions are essential for liquidated and unliquidated damages:

Unliquidated damages

- Contract entered between the parties.
- Breach of contract by one of the parties
- Loss or damage from such breach
- The loss or damage should be:
 - That arose in the usual course of things
 - Parties knew that such loss or damage could subsequently arise
- Compensation for such loss or damage by the party causing breach

Liquidated Damages

- Contract entered between the parties.
- Contract has a certain sum stipulated as compensation or penalty which would be effectuated on breach of contract
- Breach of contract
- Compensation by party causing breach.
- That compensation shall be reasonable and not more than the sum determined in the contract as liquidated damages.