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SERIES ON DAMAGES : ISSUE 2

DAMAGES : ISSUE 2 - CONCEPT OF LIQUIDATED DAMAGES

INTRODUCTION

Under the Indian Contract Act, 1872 (for short the Act) damages are not granted by way of punishment. They are only compensatory. The object is to compensate the injured party and bring him in the same position in which he would have been if there was no breach of contract.

Types of damages

Ordinary damages

Ordinary damages are those which naturally arise in the usual course of things from such breach. They are the natural and probable consequence of the breach, which the aggrieved party suffering can recover from the defaulting party.

In the case of *Modi Sugar Mills v. Union of India, AIR 1984 SC 1248*- The Supreme Court held that the buyer was liable to pay the price of containers or return the same, but since he did not do either, the seller was entitled to deduct the price of containers from the buyer's security.

Special damages

Special damages are those that resulted from a breach of contract under some special circumstances that are in the knowledge of the parties at the time of making the contract.

Remote or indirect damages

Damages which cannot be claimed for any remote or indirect loss alleged to arising out of the breach. The damages that are not reasonably foreseeable are remote.

Nominal Damages

Nominal Damages mean the damages of a very small amount say a rupee or a cent. Where the injured party has not suffered any loss because of the breach of a contract, the damages recoverable by him are nominal, i.e., very small and awarded in a symbolic manner.

Compensation for breach of contract where penalty stipulated for Section 74 (Liquidated Damages)

The rule contained under Section 74 of the Act

provides that when the parties have mentioned in the agreement the amount of compensation that is to be paid in the event of a breach, the aggrieved party is entitled to receive from the defaulted party a reasonable compensation not exceeding the amount mentioned in the contract.

In the case of *Roshan Lal v. Manohar Lal, AIR 2000 Delhi 31*- The Court stated that Section 74 of the Contract Act deals with the measure of damages in two classes of cases-

- (i) Where the contract mentions a sum to be paid in case of breach and
- (ii) The contract containing any other stipulation by way of penalty.

Jurisdiction of the Court to award compensation in case of breach of contract is unqualified except as to the maximum stipulated but the law imposes a duty upon the Court to award compensation only in cases where party has suffered loss on account of breach and the losses stands proved.

- a. The requirement to prove the actual loss by the party is not dispensed with but only in cases where such proof is impossible.
- b. To dispense with the proof of actual loss or damage was a deliberate departure made by the Indian legislature from the complicated principles of English common law.
- c. The emphasis of the Section is on awarding reasonable compensation.
- d. If an aggrieved party were to prove the loss it suffered in every case of breach of contract, then the very purpose of having a stipulated sum in the first place would fail.

In *Iron & Hardware (India) Co. v. Firm Shamlal & Bros AIR 1954 Bom 423*- The Court clarified that an automatic pecuniary liability does not arise in the case of a breach of a contract containing a clause for liquidated damages. The court must decide that the party complaining of the breach is entitled to damages. Aggrieved party shall not get compensation merely on the ground that



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there is a clause of liquidated damages in the contract.

Fateh Chand v. Balkishan Dass AIR 1963 SC 1405- Section 74 of the Act declares the law as to liability upon breach of contract where the contract predetermines the liabilities of parties or where there is a stipulation by way of penalty. It promotes certainty in commercial contracts.

ONGC v. Saw Pipes (2003) 5 SCC 705-The Apex Court framed guidelines to decide reasonable compensation under Section 74 of the Act. The Court laid down two kinds of damages i.e. firstly, where the contract specifically provides a sum of the contract that is to be paid in case of breach; secondly, where the contract contains any other stipulation by way of penalty. However, the same was done since the disputes related to construction of roads which being public utility the actual loss suffered could never be ascertained.

Let's discuss the issues about Section 74 of the Act:

1. Whether the plaintiff needs to show loss?

The philosophy behind the rule in breach of contract is that the aggrieved party should be compensated and restored to a position that it would have been in if the contract was performed.

If there is no loss caused to the party due to the breach of contract, then there is no question of restoration or compensation. Hence, the existence of sustenance of a loss or damage on account of the breach is necessary for a party to claim compensation.

In Dunlop Pneumatic Tyre Co. Ltd v. New Garage & Motor Co Ltd, [1914] UKHL- It was clarified that it is the nature of the Liquidated Damages clause that should be considered whether it is a genuine pre-estimate of loss occurred on breach of contract or the said clause is in the form of penalty and deterrent in nature.

In MaulaBux v. Union of India, (1969)2 SCC 554- It was specifically held that the court has the competency to award reasonable compensation in case of breach of a contract even if no actual damage is proved by the plaintiff due to the breach of contract.

In Haryana Telecom Ltd. v. Union of India, 2004 (76) DRJ 240-A contractor delayed in supplying cables and subsequently Government procured the same at cheaper rates. The proof of loss suffered thus seems indispensable and hence there was no loss. Loss is always a prerequisite for awarding damages.

2. Whether the plaintiff needs to prove loss?

As mentioned above in *Fateh Chand case (supra)*, the Apex Court had held that Section 74 of the Act allows an aggrieved party to receive compensation from the defaulted party, whether or not it was proved that the actual damage has been caused by such breach.

In Saw Pipe Line Judgment (Supra)-Section 74 should be read along with Section 73 and an aggrieved party need not prove the actual loss suffered before it could claim a decree for the award for compensation from the court. The party need not lead evidence to prove loss in a case where, at the time of making the contract, the parties were aware of a particular loss that would arise due to the breach.

In Indian Oil Corporation v. Messers Lloyds Steel Industries Limited, 2007 (144) DLT 659- It was held that the liquidated damages cannot be claimed if it is proved that no actual damages were caused by the breach of contract.

The Supreme Court in *Kailash Nath Associates v. DDA, 2015 4 SCC 136*- Observed that a party must prove the extent of the loss suffered by it. There may be an exception where it is difficult to prove the damage or it is impossible to prove the extent of the loss was dispensed with.

The Hon'ble Court further clarified that the damage or loss is sine qua non for payment of compensation for breach of the contract and the actual loss is required to be proved even under Section 74. Only when the damages are completely difficult to be proved, then the Court is entitled to award compensation as mentioned in the contract.

In Union of India v. Motor & General Sales Ltd., 2016 SCC Online Bom. 6787-The High Court refused to give reasonable compensation to the aggrieved party as they were unable to "prove" the loss suffered by them.

Conclusion

Section 74 of the Act awards reasonable compensation for damage or loss caused by a breach of contract. This provision is compensatory and liquidated damages are awarded by the court when actual loss/ damage are proved.

The expression 'whether or not actual damage or loss is proved to have been caused thereby' refers to the possibility of proving actual damage or loss, such proof is not dispensed with.

Only in the cases where damage or loss is impossible to prove, the liquidated amount can be awarded that is named in the contract, if it is a genuine pre-estimate of damage or loss.