Advanced Contracts, Tendering and Public Procurement
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Breach of Contracts – Part 1

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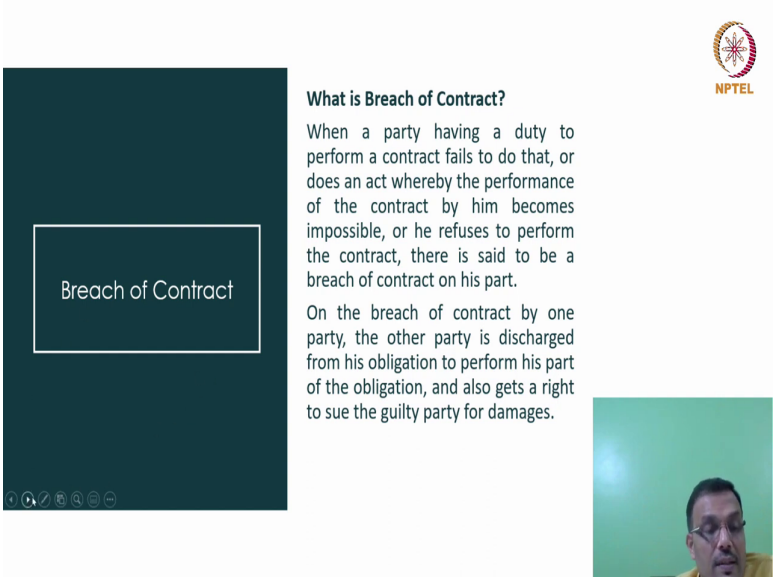

The topic for discussion today is going to be Breach of Contracts. When a contract is made it is often trusted that the contract will be performed by the parties to the expectations of the other. Obviously, obligations between the parties must be fulfilled and completed, which is termed as the discharge of a contract and one of the mechanisms of discharge is discharge by performance.

Substantial performance is also a mode of discharge of contract but if performance does not happen then a breach occurs. Interestingly, when a breach of contract occurs you will notice that it is one party who either fails to perform his duty under the contract or where it becomes impossible for him to perform but that impossibility is probably beyond Section 56 (doctrine of frustration), or he has very clearly communicated that he has no intention to perform.

So, the contract is made but he has communicated that he does not intend to perform. This is when we say that there has been a breach of contract. When a contract has been broken by one party, the other party is often called the aggrieved party. What must be discussed now is what happens when a party is aggrieved due to breach and what kind of remedies can he seek from the court of law.

The basic remedy that comes to anyone's mind is the remedy for damages. Damages is considered as one of the key remedies for breach of contract apart from other remedies that

we can always seek and you will notice that the law on damages is specifically mentioned in the Indian Contract Act 1872.

Sections 73 and 74 speak on the law of damages, whereas the Specific Relief Act talks about other kinds of reliefs that can be sought in case there is a breach of obligation. The Indian Contract Act seems to be quite a complete legislation. It talks about the rules for the formation of a contract, the rules at the time of performance, when performance can be excused, and the defenses available. Finally, it also specifies the remedies in case a breach occurs.

Interestingly while the Indian Contract law spoke on damages, it was concluded later that damages are not necessarily the only remedies that should be given in case of a breach. There can be other remedies that should also be applicable and hence a law called the Specific Relief Act was enacted and later it became a 1963 law as amended in 2018 currently as we speak today.

So, there are other remedies that are defined under the Specific Relief Act in addition to the remedies that are provided by the Indian Contract Act. You will notice that there is something called a specific performance of a contract. Here, you can claim specific performance because you do not want damages.

Specific performance of a contract is available when you think money in damages is not something that will compensate for your injury due to the breach. And as an aggrieved party, you do not want damages, you want the specific performance of the duty or the obligation that is agreed to in that particular contract. So, specific performance is a special plea under Section 20 of the Specific Relief Act as amended in 2018.

It can become a mandatory duty of the court to grant specific performance of the contract. Earlier, before the 2018 amendment, the term used was ‘may’, and ‘may’ meant that the courts may grant, and in most cases in India, unfortunately, the courts refused to grant specific performance of the contract for multiple reasons and awarded damages instead.

The reason why damages were preferred is because it is easy to quantify the injury in terms of loss, in the sense if you can prove damage then the monetary value of that damage is termed as damages. So, you can prove damage to your business, damage to property, and damage regarding contract value. So, you can provide some proof of that damage and then

the equivalent monetary quantification of the same is the ‘damages’ that is generally awarded to you.

However, the Specific Relief Act also mentions that in certain kinds of contracts, money cannot be an adequate compensation in many cases and hence, what is agreed in the contract must be performed and that is when specific performance is ordinarily granted. For example, when you think that you want goods that have intellectual property, money cannot buy any other patented commodity.

In cases of intellectual property goods, I think the specific performance of the contract can be granted. Apart from that, the Specific Relief Act has other remedies that can be granted. Quickly mentioning two of them, one is injunction which courts grant in contracts and the second is what we call the rectification or cancellation of an instrument. These are possibilities that can be taken in case a breach of contract occurs.

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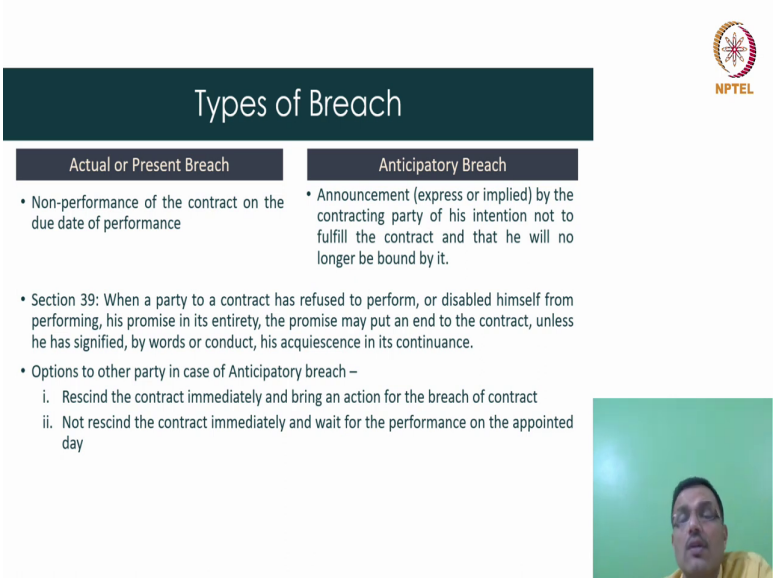

If you look at the types of breach of contract, essentially, I think it is very important to understand that there are two kinds of breach, one is called actual or present breach the other is called anticipatory breach. Now, an actual or present breach means that when the time to perform the contract has come, i.e., the due date of performance has come, and the performance is not done, that is when an actual breach of contract takes place. However, an anticipatory breach is a very interesting provision in law, which gives an aggrieved party the right to go to Court even before the due date of performance arrives. So, anticipating a breach is a breach that has not occurred yet.

It is not certain. But still, you are anticipating that a breach exists because there is a certain expression of an intention by the other party that he has no intention to complete or perform his contract on the due date. That is when you anticipate the breach. Now, the question is if you can anticipate a breach, can you go to the court and seek remedies even before the due date?

That is the real question. Can you file a suit of an anticipatory breach in court or can you only file suits of an actual breach? It is important to note that if you talk of anticipatory breach, most of the cases of anticipatory breach must be treated as actual breach and if they are treated as actual breach then the remedies are the same between Specific Relief Act and the Law of Damages.

So, Section 39 provides an idea about what can be anticipated in terms of performance of a contract in cases where someone who tenders performance is good, i.e., he has the intention to perform. But if he tenders non-performance or expresses his intention or doubt that he no longer will be bound by the contractual obligation then a case of anticipatory breach can be easily made out from his words or conduct.

And that would give the aggrieved party an immediate right to terminate the contract and claim remedies instead of postponing his remedies at the time when the actual breach takes place. What are the options for the parties in case of anticipatory breach; one is to rescind the contract immediately and bring an action or one need not rescind the contract but they can wait for the actual date of performance to occur because maybe there might be a change of mind. So, this is an option parties can exercise in case of anticipatory breach.

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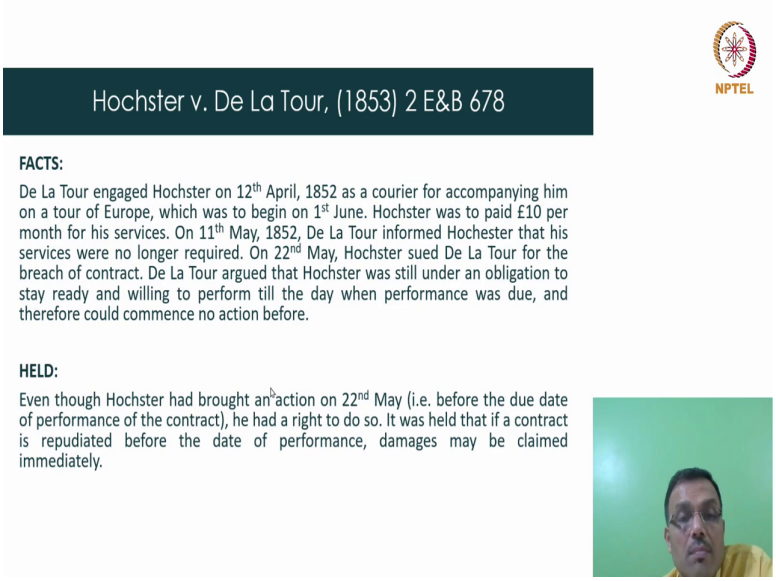

Now, to understand anticipatory breach, the De La Tour case is an interesting one, a very old case of 1852, even before the Indian Contract Act was enacted in 1872. Here, a person was supposed to accompany the tour on a ship to Europe and he was supposed to be paid 10 pounds for his services.

He had promised to join the same. However, before the tour could even commence, on 11th May, this person informed the tour that he was no longer going to join them. So, the tour was supposed to start only on the 22nd. So, can someone bring an action before 22nd May, which is the due date of performance of the contract?

So, he was supposed to join only on the 22nd, but on the 11th of May, he communicates that he is no longer interested and the issue here was whether someone can institute a suit before the 22nd of May. In today's time, a suit instituted in Court probably takes a couple of months before it can even be listed or heard for the first time or the court accepts your petition. But this case occurred in 1852 and hence, the question was could that be done?

The court said, “Yes, it could be done.” This depends upon the option of whether one wants to treat it as an actual breach. Actual breach means after 22 May, and anticipatory breach means 11th May, when the communication that he would not be interested to perform the contract or come to the tour, would be the date when a case of anticipatory breach can be made.

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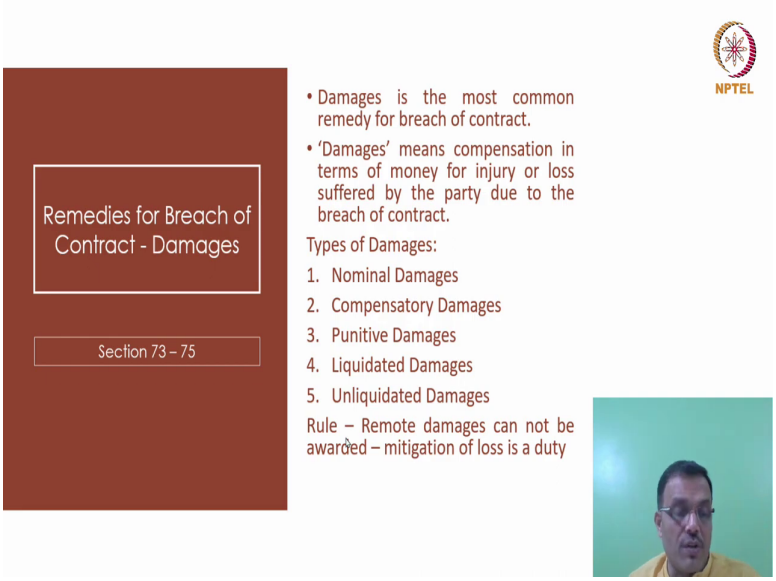

Coming to the remedies for breach of contract, be it in an anticipatory breach or actual breach, the most common remedy is damages. Damages is a kind of compensation in terms of money or its value for the injury or loss suffered by the parties in a contract. This means the purpose of the contract law is to make promises as binding promises, as enforceable promises and to impose a penalty if someone does not fulfill his commercial promise.

Imposing a responsibility or liability on the parties is something that the law on damages tries to do. In India, there are different kinds of damages that we have seen in different statutes or different kinds of obligations and further looking at the jurisprudence comparatively, the types of damages are divided into the following.

First is nominal damage. This is the first type of damage and it is the most common damages that are awarded in Indian contractual scenarios. Second is compensatory damage which is a kind of over and above nominal damages as it tries to seek all kinds of proof about your injury. It tries to compensate you, which means it gives you a kind of satisfactory monetary value. Nominal damage is just basic money value, whereas compensation is satisfactory money value.

The third most important type of damages is called punitive damages, sometimes it is called also exemplary damage, and this is over and above nominal damage.

The word punitive clearly clarifies that it is damages in the form of a penalty or in the nature of something that is imposing a fine in the name of damages. Here, it may be that the breach is intentional, or the breach is deliberate, or the breach is mischievous, and if he is allowed to

get away just by giving nominal or compensatory damage there will be a tendency to repeat the same.

Hence the court in those circumstances would want to impose a fine or a penalty in the form of damages and say, “Please do not repeat it again and that is the reason we are imposing such punitive damages against you, and your actions are so grave and serious that the other party has suffered irreparable damage and hence you have to pay this as punitive damages.”

Interestingly, punitive damages are very common in the United States of America. They are common in some other jurisdictions, but very rare in terms of common law jurisdictions that punitive damages are ordered, including in India because this kind of damage is not provided for or not allowed vis-a-vis Sections 73 and 74.

Because you will notice that when you read these two sections, which are the law on damages for breach of contract, these two sections use the word ‘reasonable’ and that clearly rules out punitive damage. So, the concept of punitive damages is not statutorily backed in India.

What is statutorily provided is only nominal damage and not punitive damage. Unless the damages are reasonable, they cannot be claimed is what the law clearly states.

The other type of damages that we will have to note is what is known as liquidated damages and this is provided in Section 74. The distinction between Sections 73 and 74 is that 73 is about unliquidated damages and 74 is about liquidated damages.

Liquidated means pre-estimated damages, liquidated means something that has been pre-agreed, it is something that is written in the contract at the time the contract is made. So, a liquidated damages clause is very common in government contracts and you will notice that in every government contract LD clause or the Liquidated Damage clause does not cover ordinary breach, it covers breach in terms of delay of performance.

That is how government contracts have been designed. So, whenever there is a delay in performance, government contractual clauses on LD state something like this, ‘in case there is a one-week delay then it is half percent of the contract value that will be imposed as LD. If it is a second week it is 1 percent.’ So, every week half percent is what you will have to suffer as LD, and the contract price will be directed to that half percent or 1 percent. Here, time is made as the essence of performance of a contract and in case the contractor does not complete it on time, the LD starts coming into effect.

The clause also caps liquidated damages to 5 percent of the contract value which is the maximum that is taken as a fine, penalty, or what is termed as LD, to ensure that there is delivery on time, there is performance on time, and the 5 percent may be forfeited from his final payment as an LD in case he delays the performance of the contract.

So, that is how liquidated damages are anticipated and pre-estimated to factor in time as the essence of the contract in government tendering and public procurement purposes. Keeping government processes aside, if you look at liquidated damages broadly under Section 74, you will notice that liquidated damages can be anything that is pre-estimated or pre-anticipated.

In the past when employment bond was discussed, I told you that in case you breach the bond you will have to give 3 lakh rupees as damages. Please note, something that has been pre-estimated or written in the contract. Something that the other party says, "Look, if you commit breach this is what you have to pay me."

All the pre-estimated kind of damages that is written on the contract even before the breach occurs are considered liquidated damages. Liquidated is pre-estimated, pre-calculated, pre-determined damages.

The other form of damages is unliquidated, generally which is claimed before the courts of law, before the arbitrator, etc. when the damage occurs.

And those are punitive, compensatory damage. An interesting facet in this aspect is that if you talk about liquidated damages, should it be based on proof of damage? That is one interesting factor that should be considered at this point in time and we will discuss the case regarding the same as we go forward.

Now, the rule on damages is very important, because if you look at the rule on damages, Section 74 is a type of damage, whereas Section 73 is the rule on damages. Section 73 very clearly says that in India as we speak under the Indian Contract Act, please note, the law on damages in India, if you look at it from a contractual perspective is defined into two legislations, one is called the Sale of Goods Act, the other is called the Indian Contract Act.

In cases of the sale of goods, under the Sale of Goods Act, 1930, please note, which is also a very comprehensive law, this Act talks about various remedies for the breach of sale of goods contract, but there is something called a special damages that are different and hence, under the Sale of Goods Act there is a possibility of granting special damages which I think is beyond damages that are reasonable under Section 73.

And one can claim what we call anticipated damage, communicated damage, or damages that are known to the other party; that is something that the Sale of Goods Act, 1930, provides for. Section 73 very clearly brings in the rule of 'remoteness of damage'. It very clearly states that damages that are not direct or what is called a consequential loss cannot be granted under Section 73.

So, what is damage that is direct from the breach? Direct from what has happened in the contract is something that you can claim. So, a direct loss can be claimed. Anything that is indirect, anything that is remote, anything that is far-fetched, or anything that cannot be foreseen is always remote damages. Remote damages cannot be awarded; that is something that Section 73 as a rule clearly states.

So, we always say that in case you expect consequential losses to be covered you must mention it in the contract. You must write it in the contract, you must define what the consequential losses are, and unless they can fit within what is called the 'special damage rule' under the Sale of Goods Act you cannot recover the same.

Finally, it is very important to understand that as per the rules of law on damages it is important that you have a claim as an aggrieved party, but then when you have the right to claim damages, the law immediately imposes a duty or an obligation. So, that is the design of the contract law. Wherever it has stated rights, it has always communicated its duties.

Now, one of the duties of anyone who claims damages for breach of contract is that he has a duty to mitigate the loss. This is a duty that is clearly visible in Section 73. Mitigation of loss is a rule wherein you may have a claim, but you do not aggravate the claim unnecessarily.

You have a duty to mitigate the loss to the maximum extent possible. You must take steps and measures to see that your loss is curtailed which means just because you have a right to claim breach or the right to claim damages does not mean you can probably gain anything out of it. So, one of the defenses for the contract breacher or breaker is that the other party unnecessarily aggravated the losses and that he did not do his duty to mitigate the same.

And hence he should not be entitled to the claim is something that they can always come up and do with. So, there are counter defenses on the other side and that is that the claim is without the duty of mitigation of loss and that is a counter claim that can always be done in case of breach of contract.