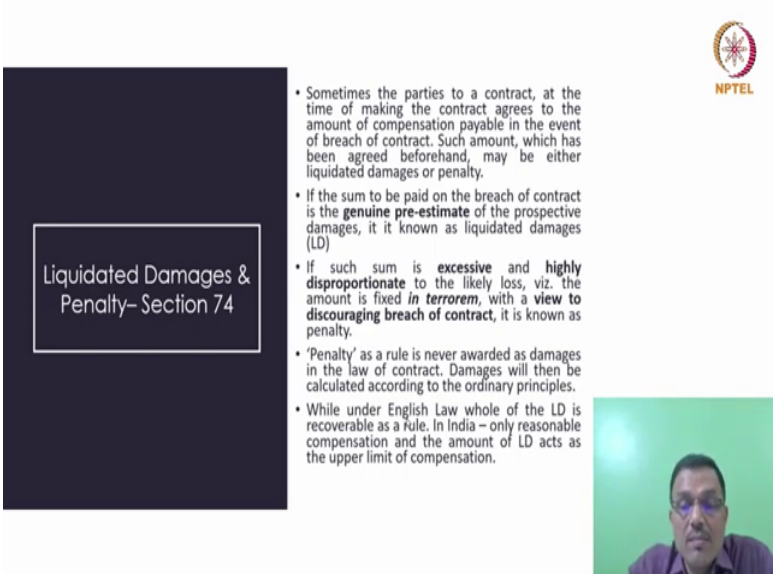
Advanced Contracts, Tendering and Public Procurement
Prof. (Dr.) Sairam Bhat
Professor of Law
National Law School of India University
Breach of Contracts Part 03

(Refer Slide Time 00:16)

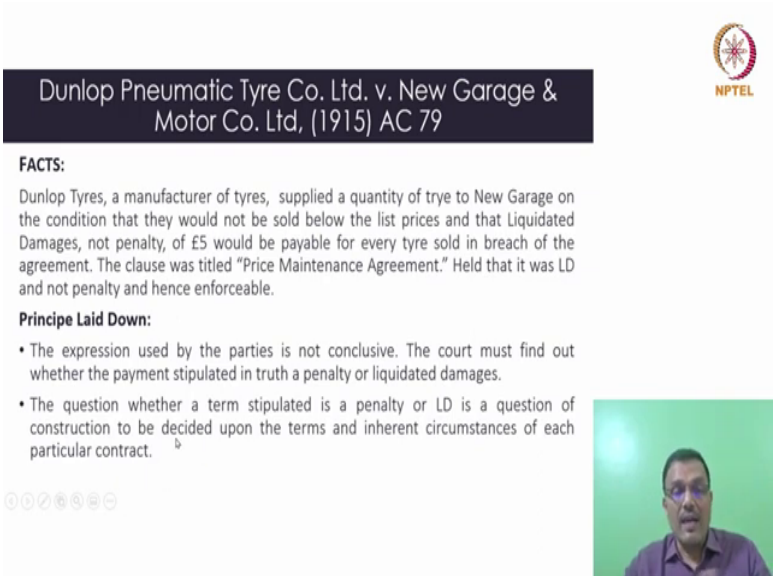


Today, we talk about damages under Section 74 and to conclude the law on damages per se, you will notice that a genuine pre-estimate of the prospective damages is known as liquidated damages. Please note, it must be a genuine pre-estimate. If it is not, it could not amount to damages, it could amount to something excess of the same which probably would be considered as a penalty.

Generally, a mention of a genuine pre-estimate is made just to discourage a breach of contract and that is something that you want to mention in the contract outrightly which is why sometimes, this is permitted by law and Section 74 also states that any interest on damages can be treated as a penalty. This is something we will see through some of the case laws entirely.

In English law and some other jurisdictions, you will notice that damages have their position of law. However, in India, only reasonable compensation or what is mentioned in liquidated damages, subject to their genuineness and reasonability is the kind of upper limit of compensation that you can gain under the contract.

(Refer Slide Time: 1:41)

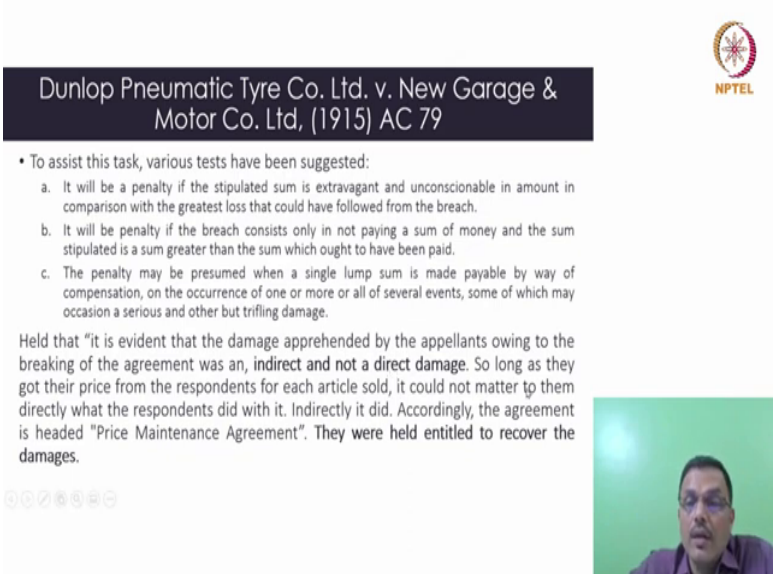


If you look at the case laws that have come into place you will notice one case, Dunlop Tyre company was a New Garage. This was a case of a resale price maintenance agreement. Today, resale price maintenance agreements can be covered under competition law as well and in this case, Dunlop Tyres had told its suppliers not to sell goods or tyres below the listed price and in case they did so they would be imposed with a five-pound penalty.

This is called resale price maintenance. Now, when you mention something in the contract that if you do or if you do not do, we will impose this kind of five-pound penalty, then you will notice that this becomes a genuine pre-estimate of the kind of loss that may occur due to the breach that is anticipated by the contract.

The court in this case had to decide whether the five pounds that has been mentioned amounts to a penalty or liquidated damages because a penalty is usually like a fine or as interest on damages. The court had to decide these terms and conditions and that is why you will notice what the court has laid down as the test here becomes very relevant.

(Refer Slide Time: 3:00)



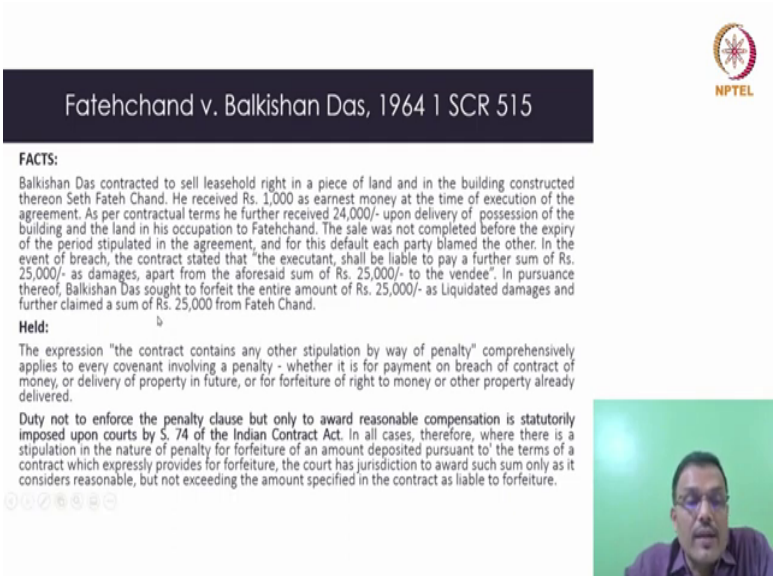
It will be a penalty if the stipulated sum is extravagant and unconscionable in amount in comparison to the greatest loss that would have followed the breach. Therefore, anything that is over and above the kind of anticipated loss that you may put in a contract will be considered a penalty. It would be a penalty if the breach consists not only of paying the sum of money but the sum stipulated is greater than the sum which ought to have been paid.

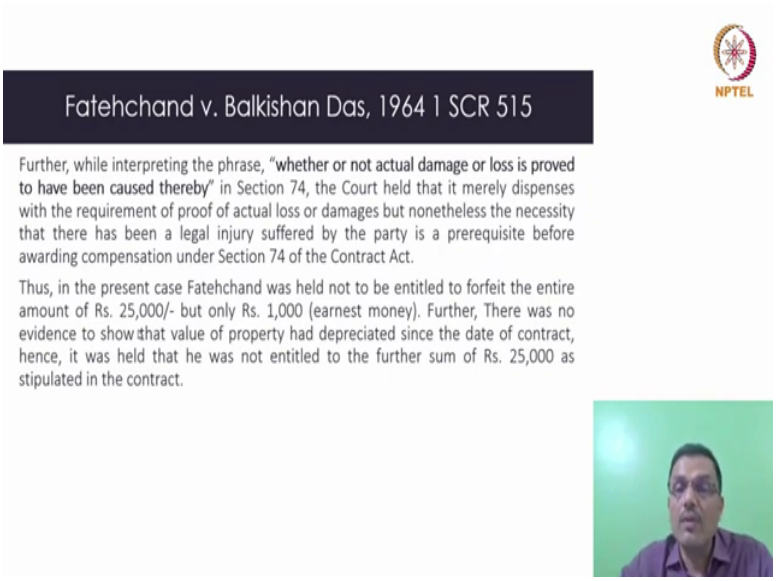
The penalty may be presumed when a single lump sum amount is payable by way of compensation on the occurrence of one or more several events, some of which may have serious or other trifling damage. So, anything that is over and above what is a genuine estimate of loss will amount to being called the penalty.

The court held that it is evident that the damage apprehended by the appellants owing to breaking of the agreement was indirect, not direct damage because if you decide to state that this is the price list and do not sell below it, you are controlling the price in the market; you are not allowing competitive pricing. So, are you going to suffer a loss if he sells it to you for less than that price?

You still mention it in the contract, but if you are not going to be able to substantiate that this is a five-pound loss for every tyre that is sold below a particular price if you can display the same, then it would be liquidated damages or else it could be held to be a penalty. Accordingly, the agreement is headed as a price maintenance agreement. They were held entitled to recover the same as damages.

(Refer Slide Time 04:52)





Now the Fatehchand versus Balkishan Das case is also important from an Indian perspective. This was about earnest money that was asked at the time of execution of an agreement. Balkishan Das contracted to sell a leasehold right in a piece of land and the building constructed thereon; so, he received 1000 rupees as earnest money deposit.

And as per the contractual terms he further received 24,000 upon their delivery of the possession of the building and the land in his occupation to Fatehchand. The sale was not completed before the expiry period stipulated in the agreement and for this default, each party blamed the other.

So, as per the term of the agreement, the contract stated that the executant shall be liable to pay a further sum of rupees 25,000 as damages apart from the aforesaid sum of 25,000 to the vendee. In pursuance thereof, Balkishan Das sought to forfeit the entire amount of 25,000 as liquidated damages and further made a claim of 25,000 from Fatehchand.

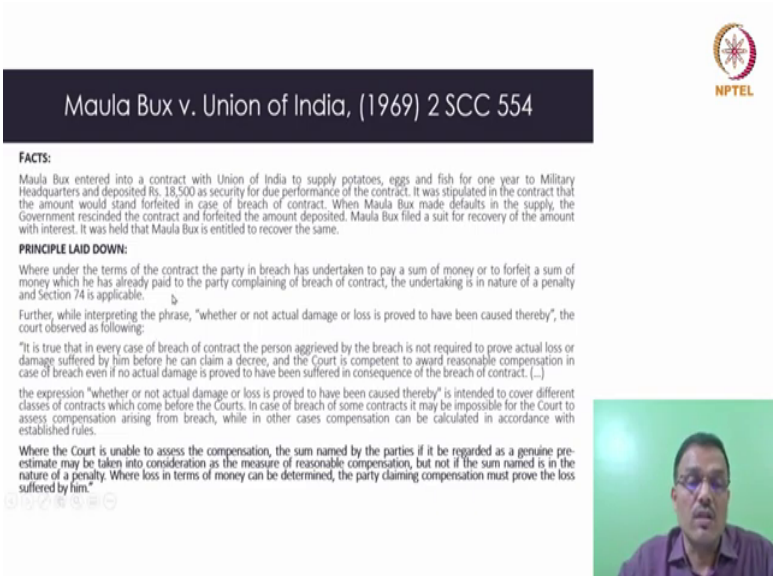
Now when we say that this is the initial amount, liquidated damages and when you want to claim another 25,000 because it is like the contract and it is kind of pre-estimated in the contract, will you be entitled to the same and can you forfeit if the contract is breached or if the contract has not been performed due to the fault of one of the parties or both the parties. That is one kind of element in *Fatehchand* that had to be decided.

In terms of the right of forfeiture, especially when advances are given in an agreement to sell or whenever contracts stipulate that the initial amount can be forfeited in case the contract does not get concluded. Now if you look at the phrases or wordings of Section 74 it says ‘whether or not actual damage or loss is proved to have been caused thereby’, liquidated damages may be recoverable.

The court held that if that merely dispenses with the requirement of proof of actual loss or damage but the necessity that there is a legal injury of the other party is a prerequisite in awarding the compensation under Section 74. Therefore, unless you can prove legal injury, whatever has been mentioned in the contract is not going to be recovered.

You will not be entitled to forfeit the entire amount; you will be entitled to forfeit only 1000 rupees as earnest money because that is the very purpose of earnest money. Or, if you can prove that your injury amounts to 25,000 and that is something that I should have a right to, then you can always claim the same, is what the court had to say in that case.

(Refer Slide Time 07:48)

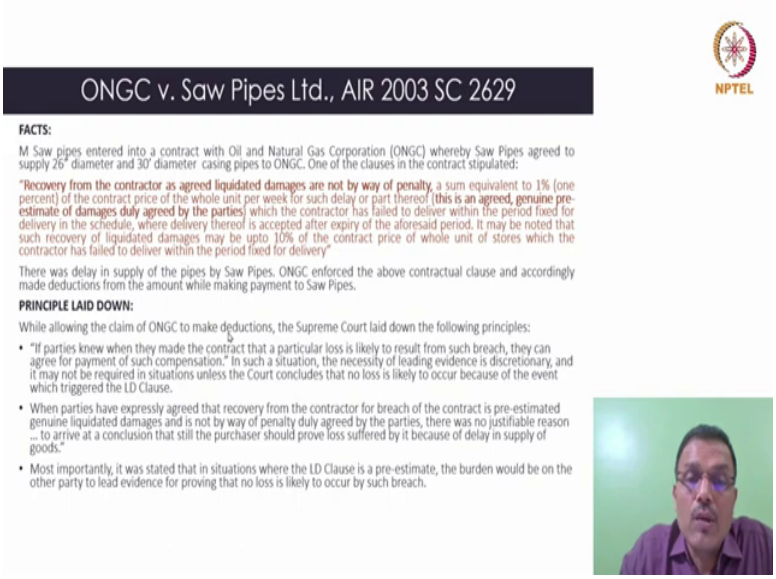


There are other cases which are also very relevant and important. The Maula Bux case is another very important case and the principle in this case also reiterates the question of whether actual damage or proof of loss is required under Section 74 or not. So, the courts have been very sure of what they intend to do, when they say that unless you expect the word ‘reasonable’ to be interpreted there, you cannot enforce liquidated damages.

So liquidated damages cannot be anything that is written unless you can prove the reason for forfeiture of liquidated damages or exceeding liquidated damages, and if you fail to do so, your right to the same cannot be established. So liquidated damages in India is also compensatory, it is based on your reasonable right to claim that kind of money for the injury or the loss that occurred to you and the party claiming compensation must prove the loss suffered by him.

So, this has been laid down by the Supreme Court from time to time saying that under Section 74 for liquidated damages proof of loss or proof of injury to claim compensation is essential and unless that justification is made, a mere mention in the contract will not entitle the party to recover the kind of damages that is there.

(Refer Slide Time 09:21)



Finally, the ONGC versus Saw Pipes case is a landmark case in many aspects including arbitration and public policy. The courts have said that you need to make a distinction between penalties and liquidated damages because Section 74 does try to make that kind of distinction. Anything that is stipulated for time as the essence of a contract.

Now, in this case, you will notice I explained earlier how liquidated damages are going to be awarded; it is one per cent of the contract value for the whole unit per week for delay thereof. This was agreed as a genuine pre-estimate of damages and the contract also stated that such may be up to 10 per cent of the contract and it was fixed for that day.

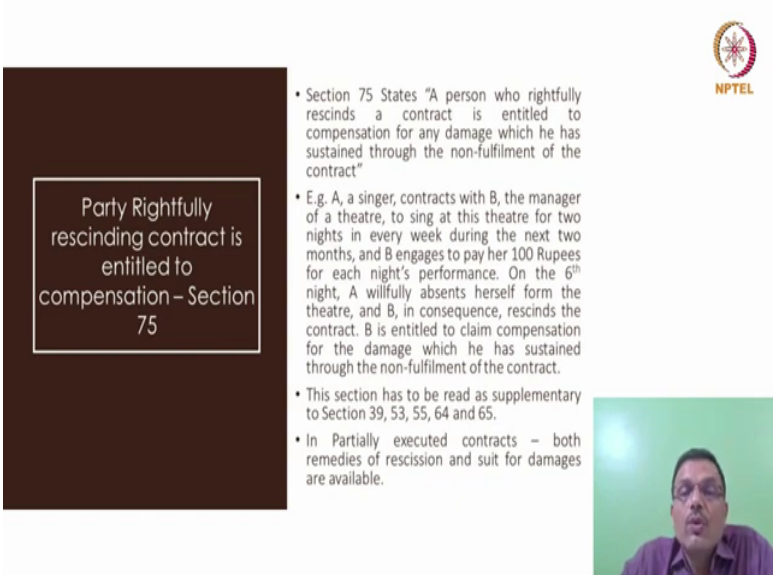
Now, enforcing such a liquidated damages clause in the ONGC case was very important that was challenged in this case. The Supreme Court laid down the following principle which I think is very important for us to understand. Now, the Supreme Court said if the parties knew that when they made the contract, a particular loss is likely to result from such a breach, they can agree to payment of such compensation.

In such a situation, the necessity of leading evidence is discretionary, and it may not be required in situations unless the court concludes that no loss is likely to occur because of the event which triggered the liquidated damage clause. So, the point is that even if you mention any kind of liquidated damages, the courts are not entirely dispensing off the fact that they need evidence or proof that this is the likely cause that is going to be affected through the delay.

The delay itself is, if you prove saying that look this was the time and this was the delay, that itself is a kind of a loss that you can probably claim in the court of law to claim any kind of reasonable amount of liquidated damages. The court went on to further hold that when parties have expressly agreed that recovery from the contractor for the breach of contract is pre-estimated genuine liquidated damages and is not by way of penalty, it has been duly agreed that it is not a penalty, it is just a genuine pre-estimate and that we are not imposing any fine on you, then to that extent proving any further loss may not be required. So, it is most importantly stated in situations where LD clauses are a pre-estimate, the burden would be on the other party to lead evidence for proving that no loss is likely to occur by such a breach.

So, if there is an LD clause and I have already informed you about the time; if you do not supply within the time, the proof is on the other party to justify why he caused the delay and why you think his delay has not contributed to a loss to the other party. So, shift the burden on the contract breaker or the one who has delayed the contract and in case he can justify that the other party has not suffered any kind of loss then an LD will not be imposed. But the burden is on the other party to show that even though he had agreed to a particular time of delivery and he does not stick to that kind of delivery, the loss should be made recoverable from the other party.

(Refer Slide Time 12:24)



Finally, you will notice that in Section 75, the parties have the right to compensation, so any person who has rightfully rescinded a contract is entitled to compensation. So, if you have suffered any kind of injury to yourself or your property then you should be entitled to

compensation. One who has done equity can always do equity or claim equity under Section 75 for the non-fulfilment of the obligation by the other party.

This is something that is always a matter of right, and damages is a right to a party rescinding the contract rightfully and this is finally concluded under Section 75 of the Indian Contract Law. So, with this, we conclude the discussion on the law of damages, where we try and understand the importance of the law of damages as a remedy, we have discussed the rule of reasonableness, the rule of remoteness and the rule between direct and consequential losses.

We have looked at how liquidated damages can be awarded if it is liquidated damages and not a penalty. We have also looked at whether proof is required where we have concluded that it is quite discretionary for the court to decide on the proof or lead the evidence and the ONGC case puts a burden on the other party who has broken the contract due to delay that he has factored in because he knew that despite the Liquidated Damage Clause, he delays the delivery or goes beyond the schedule of the delivery.

So, the burden is on him to rather say that there was no loss occurred and if he could prove that, then LD may be on a prorated basis, and if not, whatever has been stipulated can be recovered under the contract law. That is one thing that is very clear from the discussions that we have had so far and the ONGC case rightfully decides the parameters of liquidated damages.

And finally, I think a very broad provision is the person who rescinds a contract is entitled to compensation for the non-fulfilment of the contractual obligation. This is a matter of right that you can always claim. You can be compensated and the term compensation here is quite wide in the sense that there is a loss or injury to you or your property and you should be entitled to the same as damages under the law of contract.

So, if you make a claim, I think it is for the courts to use the discretionary power to grant you any kind of nominal damage that may amount to compensation from the other party breaking the contract.