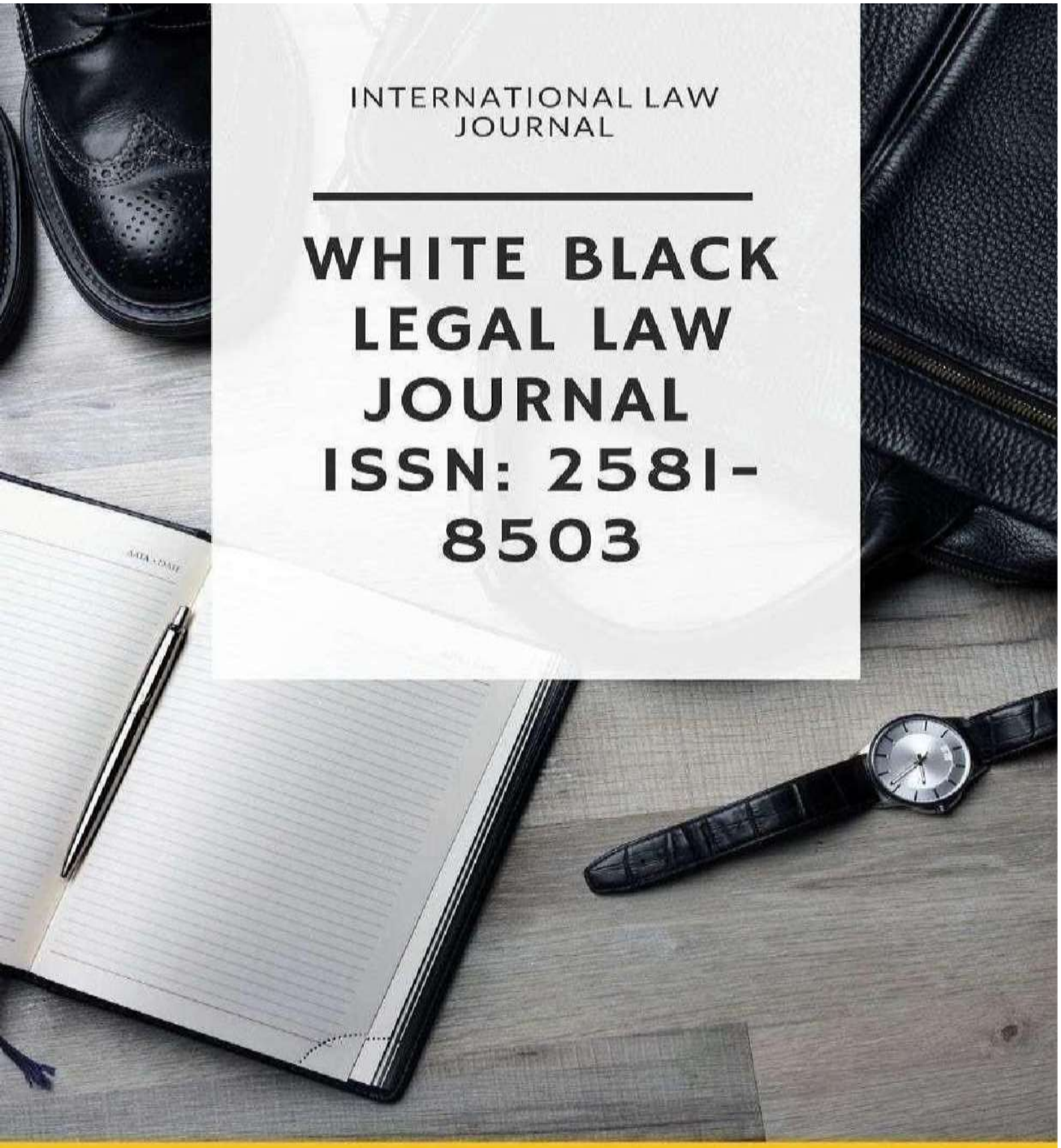

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REMEDIES FOR BREACH OF CONTRACT IN INDIA – AN ANALYSIS

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INTRODUCTION:

Damages for breach of contract is an unique and peculiar subject which deals with compensation awarded in case of breach of contract. In India breach of contract is governed by the Indian contract act, 1872. Every individual, in one way or the other way will come across as a party to a contract, in this sophisticated modern life. As a party, one must know what he must do and what he must not do. As a party to the contract, he is obliged to perform his side of the contract and in case of failure of his performance the other party will suffer some loss or injury for which he party must be compensated. This is known as the damages for breach of contract. It simply means compensation for the party who had offered from the breach of contract by the other party. In this paper, let us discuss in detail about the damages for breach of contract

'CONTRACT' ACCORDING TO INDIAN CONTRACT ACT

We will see how the Indian Contract Act, 1872 defines a contract. We will also define the terms as per the Act and see what that means. In these topics, we will decipher all the vivid aspects of the Contract Act. Let us begin by understanding the concept of a contract.

The Indian Contract Act, 1872 defines the term "Contract" under its section 2 (h) as "An agreement enforceable by law". In other words, we can say that a contract is anything that is an agreement and enforceable by the law of the land. This definition has two major elements in it viz "agreement" and "enforceable by law". So in order to understand a contract in the light of The Indian Contract Act, 1872 we need to define and explain these two pivots in the definition of a contract.

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Agreement

In section 2 (e), the Act defines the term agreement as "every promise and every set of promises, forming the consideration for each other". Now that we know how the Act defines the term "agreement", there may be some ambiguity in the definition of the term promise.

Promise

The Act in its section 2(b) defines the term "promise" here as: "when the person to whom the proposal is made signifies his assent thereto, the proposal becomes an accepted proposal. A proposal when accepted, becomes a promise". In other words, an agreement is an accepted promise, accepted by all the parties involved in the agreement or affected by it. This definition says that in order to establish or draft a contract, we need to initiate some steps:

A. The definition requires a person to whom a certain proposal is made.
B. The person (parties) in step one has to be in a position to fully understand all the aspects of a proposal.
C. "signifies his assent thereto" – means that the person in point one accepts or agrees with the proposal after having fully understood it.
D. Once the "person" accepts the proposal, the status of the "proposal" changes to "accepted proposal".
E. "accepted proposal" becomes a promise. Note that the proposal is not a promise. For the proposal to become a promise, it has to be an accepted proposal.

To sum up, we can represent the above information below:

Agreement = Offer + Acceptance.

Enforceable by Law

Now let us try to understand this aspect of the definition as is present in the Act. Suppose you agree to sell a bike for 30,000 bucks with a friend. Can you have a contract for this? Well if you follow the steps in the previous section, you will argue that once you and your friend agree on the promise, it becomes an agreement. But in order to be a contract as per the definition of the Act, the agreement has to be legally enforceable. Thus we can say that for an agreement to change into a Contract as per the Act, it must give rise to or lead to legal obligations. In other words, must be within the scope of the law. Thus we can summarize it as

Contract = Accepted Proposal (Agreement) + Enforceable by law (defined within the law)

Now we can define a contract and more importantly, understand what "Not" a contract is. A

contract is an accepted proposal (agreement) that is fully understood by the law and is legally defined or enforceable by the law. So a contract is a legal document that bestows upon the party's special rights (defined by the contract itself) and also obligations that are introduced, defined, and agreed upon by all the parties of the contract.

Essentials of a Valid Contract

What makes a valid contract? A valid contract is enforceable by law and if a contract is not valid it may lead to obstruction of businesses and unlawful and insincere dealings. Let us learn about the essential features of a valid contract. A contract that is not a valid contract will have many problems for the parties involved. For this reason, we must be fully aware of the various elements of a valid contract. In other words, here we shall ponder on all the ramifications of the definition of the contract as provided by The Indian Contract Act, 1872. The Indian Contract Act, 1872 itself defines and lists the Essentials of a Contract either directly or through interpretation through various judgments of the Indian judiciary. Section 10 of the contract enumerates certain points that are essential for valid contracts like free consent, Competency Of the parties, Lawful consideration, etc. Other than these there are some we can interpret from the context of the contract which is also essential.

A] Two Parties

So you decide to sell your car to yourself! Let us say to avoid tax or some other sinister purpose. Will that be possible? Can you have a contract with yourself? The answer is no, unfortunately. You can't get into a contract with yourself. A Valid Contract must involve at least two parties identified by the contact. One of these parties will make the proposal and the other is the party that shall eventually accept it. Both the parties must have either what is known as a legal existence e.g. companies, schools, organizations, etc. or must be natural persons.

For Example: In the case State of Gujarat vs Ramanlal S & Co. – A business partnership was dissolved and assets were distributed among the partners as per the settlement. However, all transactions that fall under a contract are liable for taxation by the office of the State Sales Tax Officer. However, the court held that this transaction was not a sale because the parties involved were business partners and thus joint owners. For a sale, we need a buyer (party one) and a seller (party two) which must be different people.

B] Intent of Legal Obligations

The parties that are subject to a contract must have clear intentions of creating a legal relationship between them. What this means is those agreements that are not enforceable by the law e.g. social or domestic agreements between relatives or neighbours are not enforceable in a court of law and thus any such agreement can't become a valid contract.

C] Case Specific Contracts

Some contracts have special conditions that if not observed would render them invalid or void. For example, the Contract of Insurance is not a valid contract unless it is in the written form. Similarly, in the case of contracts like contracts for immovable properties, registration of contract is necessary under the law for these to be valid.

D] Certainty of Meaning

Consider this statement "I agree to pay Mr X a desirable amount for his house at so and so location". Is this a valid contract even if all the parties agree to this term? Of course, it can't be as "desirable amount" is not well defined and has no certainty of meaning. Thus we say that a valid contract must have certainty of Meaning.

E] Possibility of Performance of an Agreement

Suppose two people decide to get into an agreement where a person A agrees to bring back the person B's dead relative back to life. Even when all the parties agree and all other conditions of a contract are satisfied, this is not valid because bringing someone back from the dead is an impossible task. Thus the agreement is not possible to be enforced and the contract is not valid.

F] Free Consent

Consent is crucial for an agreement and thus for a valid contract. If two people reach a similar agreement in the same sense, they are said to consent to the promise. However, for a valid contract, we must have free consent which means that the two parties must have reached consent without either of them being influenced, coerced, misrepresented or tricked into it. In other words, we say that if the consent of either of the parties is vitiated knowingly or by mistake, the contract between the parties is no longer valid.

G] Competency of the Parties

Section 11 of the Indian Contract Act, 1872 is:

"Who are competent to contract — Every person is competent to contract who is (1) of the age of majority according to the law to which he is subject, and who is (2) of sound mind and is (3) not disqualified from contracting by any law to which he is subject."

Let us see these qualifications in detail:

A. refers to the fact that the person must be at least 18 years old or more.
B. means that the party or the person should be able to fully understand the terms or promises of the contract at the time of the formulation of the contract.
C. states that the party should not be disqualified by any other legal ramifications. For example, if the person is a convict, a foreign sovereign, or an alien enemy, etc., they may not enter into a contract.

H] Consideration

Quid Pro Quo means 'something in return' which means that the parties must accrue in the form of some profit, rights, interest, etc. or seem to have some form of valuable "consideration".

For example, if you decide to sell your watch for Rs. 500 to your friend, then your promise to give the rights to the watch to your friend is a consideration for your friend. Also, your friend's promise to pay Rs. 500 is a consideration for you.

I] Lawful Consideration

In Section 23 of the Act, the unlawful considerations are defined as all those which:

A. it is forbidden by law.
B. is of such a nature that, if permitted, it would defeat the provisions of any law, or is fraudulent.
C. involves or implies, injury to the person or property of another
D. the Court regards it as immoral or opposed to public policyThese conditions will render the agreement illegal.

PERFORMANCE OF A CONTRACT

The basis of a contract is that both the parties have to fulfil their part of the contract in order to give effect to it according to the stipulated terms. Performance of a contract is the fulfilment of the contractual obligations by the parties. It is one of the methods to discharge a contract.

The parties have no further rights and liabilities once the contract is discharged. The obligation

of parties to contract—The parties to a contract must either perform, or offer to perform, their respective promises unless such performance is dispensed with or excused under the provisions of this Act, or of any other law. Promises bind the representatives of the promisors in case of the death of such promisors before the performance, unless a contrary intention appears from the contract.

A contract being an agreement enforceable by law comprises of reciprocal promises. In order that a party can enforce the promises made to him, he should perform his promise or offer to perform his promise and it is after he has so performed, or offered to perform, his promise that he could ask the other party to carry out his promise. Either performance or readiness and willingness to perform the contract is the basic requirement

BREACH OF CONTRACT

A breach of contract is a violation of any of the agreed-upon terms and conditions of a binding contract. The breach can be anything from a late payment to a more serious violation such as the failure to deliver a promised asset.

Breach of contract" is a legal term that describes the violation of an agreement or a contract that occurs when one party fails to fulfil its promises as per the provisions given in the agreement. The fundamental of Breach of contract also involves interfering with the ability of another party to fulfil his/her duties. A contract can be breached in whole or in a part.

Most of the contract end when both the parties fulfil their contractual obligations, but when one of them violates it, breach of contract happens. Breach of contract is one of the common reasons why contract disputes are brought to the court for resolution.

DAMAGES FOR BREACH OF CONTACT

The term “damages” has not been defined under the Indian Contract Act, 1872. However, it can be said that it is an award of money to be paid by the party at fault to the injured party as compensation for loss or injury caused on account of the breach of the terms and conditions of the contract by the defaulting party. Although, there is no proper definition of the term “damages”, still some jurists and judges in their judgements have tried to define this term.

"Damages" are the pecuniary compensation, obtainable by success in an action, for a wrong which is either a tort or a breach of contract.The compensation can be either in the form of a lump sum or can be calculated on the basis of set rules.

Although the words, "damages", "damage" and "injury", are sometimes used as synonyms, yet there is a material difference between them. The difference between these words can be discussed as: - "Injury is the illegal invasion of illegal right." While "damage" is the loss, hurt, or harm which results from the injury. The word "damages" means the recompense for compensation awarded for the damage suffered.

Generally, the word "damage" means depreciation caused by a wrongful or a lawful act; but in statutes or other legal instruments giving compensation for "damages", the word refers to some actionable loss, injury, or harm which results from the unlawful act, omission, or negligence of another. But when it is used to signify the money which a plaintiff court to recover from the defendant, the word "damage" or "damages" is never in any sense synonymous with or collateral to, the terms "example", "fine", "penalty", "punishment", "revenge" etc.

Damages can be divided into Unliquidated and Liquidated Damages

A.UNLIQUIDATED DAMAGES

A contract is not a property. It is only a promise supported by some consideration upon which either the remedy of specific performance or that of damages is available. The party who is injured by the breach of a contract may bring an action for damages. "Damages" means compensation in terms of money for the loss suffered by the injured party. Burden lies on the injured party to prove his loss. Every action for damages raises two problems.

1. **Remoteness of damage**
2. **Measure of damages**

1. Remoteness of Damage

Every breach of contract upsets many a settled expectation of the injured party. He may feel the consequences for a long time and in a variety of ways. A person contracts to supply to a shopkeeper pure mustard oil, but he sends impure stuff, which is a breach. The oil is seized by an inspector and destroyed. The shopkeeper is arrested, prosecuted and convicted. He suffers the loss of oil, the loss of profits to be gained on selling it, the loss of social prestige and of

business reputation, not to speak of the time and money and energy wasted on defence and the mental agony and torture of the prosecution. Thus, theoretically the consequences of a breach may be endless, but there must be an end to liability. The defendant cannot be held liable for all that follows from his breach. There must be a limit to liability and beyond that limit the damage is said to be too remote and, therefore, irrecoverable. The problem is where to draw the line.

The rule in "Hadley v Baxendale[3]"

A very noble attempt was made as early as (1854) in the well-known case of Hadley v Baxendale to solve the problem by laying down certain rules. The plaintiffs carried on an extensive business as miller. Their mill was stopped by a breakage of the crankshaft by which the mill was worked. The defendants, a firm of carriers, were engaged to carry the shaft to the manufacturers as a pattern for a new one. The plaintiffs' servant told the defendants that the mill was stopped, and that the shaft must be sent immediately. But the defendants delayed the delivery by some neglect, and the consequence was that the plaintiffs did not receive the new shaft for several days after they would otherwise have done. The action was brought for the loss of profits which would have been made during the period of the delay.

Alderson B laid down the following rule that the appropriate rule in a situation like this is as follows: When two parties enter into a contract that one of them breaches, the damages that the other party should be entitled to for that breach should be those that can be fairly and reasonably interpreted as either arising naturally that is, in accordance with the normal course of events from the breach of the contract itself, or as being reasonably guessed to have been in both parties' minds at the time the contract was made as the likely consequence of the breach.

On the basis of this principle the defendants were held not liable for the loss of profits, because in the great multitude of cases of millers sending off broken shafts for repair, it does not follow in the ordinary circumstances that the mill is stopped. Even though it was pointed out that the mill was stopped there could have existed several reasons for the stopping of the mill.

The fact that the mill was out of action for want of the shaft was a special circumstance affecting the plaintiff's mill and the same should have been pointed out to the defendants in clear terms.

[3] (1854) 9 Exch 341

It should also have been communicated that the plaintiffs would have suffered unreasonable loss by way of delay.

This decision has always been taken as laying down two rules.

(i) General damages

General damages are those which arise naturally in the usual course of things from the breach itself. Another mode of putting this is that the defendant is liable for all that which naturally happens in the usual course of things after the breach.

(ii) Special damages

Special damages are those which arise on account of the unusual circumstances affecting the plaintiff. They are not recoverable unless the special circumstances were brought to the knowledge of the defendant so that the possibility of the special loss was in the contemplation of the parties.

Section 73 of the Contract Act

The same principles are applicable in India. The Privy Council, for example, observed in A.K.A.S. Jamal v Moolla Dawood Sons &Co[4] that Section 73 is declaratory of the common law as to damages.

Similarly, Patanjali Sastri J (afterwards CJ) of the Supreme Court observed in Pannalal Jankidas v Mohanlal[5] that the party who violated the agreement must compensate for the immediate effects of the violation, not for any loss or harm that was produced indirectly or remotely.

S. 73. Compensation for Loss Or Damage Caused By Breach Of Contract.-

When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss or damage sustained by

[4] (1915-16) 43 IA 6
[5] AIR 1951 SC 144

reason of the breach.

Compensation for failure to discharge obligation resembling those created by contract.- When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract.

Explanation.-In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

Section 73 incorporates two rules of "Hadley v Baxendale"

The section declares that compensation is not to be given for any remote or indirect loss or damage sustained by reason of the breach. The section also provides that the same principles will apply where there has been a breach of a quasi-contractual obligation.

The section thus clearly lays down two rules. Compensation is recoverable for any loss or damage

(i) arising naturally in the usual course of things from the breach, or

(ii) which the parties knew at the time of the contract as likely to result from the breach.

The first rule is "objective" as it makes the liability to depend upon a reasonable man's foresight of the loss that will naturally result in the breach of the contract. The second rule is "subjective" as, according to it, the extent of liability depends upon the knowledge of the parties at the time of the contract about the probable result of the breach. The burden of proof lies on the plaintiff to show that damage has been sustained and what shall be the measure of converting the loss into money. A claim for damages becomes liable to be rejected where this burden is not discharged.

Liability in ordinary cases

The extent of liability in ordinary cases is what may be foreseen by "the hypothetical reasonable man", as arising naturally in the usual course of things. One illustration is the decision of the Madras High Court in Madras Railway Co v Govinda Rau[6]. The plaintiff, who was a tailor,

[6] ILR (1898) 21 Mad 172

delivered a sewing machine and some cloth to the defendant railway company to be sent to a place where he expected to carry on his business with special profit by reason of a forthcoming festival. Through the fault of the company's servants the goods were delayed in transmission and were not delivered until some days after the conclusion of the festival. The plaintiff had given no notice to the company of his special purpose. He claimed as damages the expenses of travelling up to the place of festival and of staying there and the loss of profits which he would have earned.

The court held that the damages claimed were too remote. All of these were due to the frustration of the special purpose and that was not known to the company.

Fazal Ilahi v East Indian Rly Co[7] is another illustration of the same kind. The plaintiff delivered to the defendant office railway company's parcel at Cawnpore four boxes of Chinese crackers for consignment to Allahabad where he needed them for a festival on 5th June, but he did not disclose the purpose. The company's servants considering it unsafe to send crackers by parcel train, actually sent them by goods train and they reached only after the conclusion of the festival. The company required him to take delivery on payment of additional freight, which he refused to pay and, therefore, the company sold the goods at a nominal price. He sued the railway company. The court disallowed the claim for profits which would have been made, as the plaintiff's special purpose was not within the knowledge of the company. But the the plaintiff succeeded in recovering cost price of his goods sold by the company in breach of the contract and Rs 100 as damages and other incidental expenses. Even whcre the goods are altogether lost in transit, the carrier is not liable for the loss of profits which would have been made by selling the goods at their destination.

Measure of Damages

Once it is determined whether general or special damages have to be recovered they have to be evaluated in terms of money. This is the problem of measure of damages and is governed by some fundamental principles.

[7] ILR (1921) 43 All 623

Claim for damages is not debt

A claim for damages arising out of breach of contract, whether for general or liquidated damages, remains only a claim till its adjudication by the court and becomes a debt only after the court awards it. Till then and on the basis of the claim alone, the claimant is not entitled to present a winding up petition of the defendant company on the ground of its inability to pay debts.

Damages are compensatory, not penal

In Victoria Laundry (Windsor) Ltd v Newnan Industries Ltd[8] the Judgeship Asquith J observed that it is widely accepted that the main goal of damages is to make the person whose rights have been infringed upon feel as though his rights have been upheld, to the extent that money may accomplish this." Placing the plaintiff in the same situation as he would have been in had the contract been fulfilled, or in the same position he would have been in had the breach of the contract not occurred, is the main goal or premise of the law of damages for a breach of contract. When this is achieved, the law of damages' main goal or tenet has been fulfilled. In a case involving the construction of a swimming-pool where the depth of the pool happened to be less than what was specified, the pool being otherwise useful, the court allowed the difference in value of the pool as provided and its value as it should have been provided. The court did not allow the cost of setting right the pool because that would have given the recipient windfall profits which are impermissible because the award of damages is to compensate the claimant and not to punish the payer.

Inconvenience caused by breach

But the inconvenience caused by the breach may be taken into account. Thus, for example, in Hobbs v London &South-Western Rly Co[9], where a train pulled its passengers to a wrong direction and consequently the plaintiff and his wife, finding no other conveyance, nor a place to stay, had to walk home at midnight, the jury allowed £ 8 as the damages for the inconvenience suffered by the plaintiffs in being obliged to walk and £ 20 in respect of the wife's illness caused by catching a cold.

On appeal, the court of Queen's Bench held that the £8 was properly awarded but not £20. The

[8] (1949) 2 KB 528 (CA)
[9] (1875) LR 10 QB 111

inconvenience of walking back must be taken to have been within the reasonable contemplation of the parties. But the wife's cold was not the necessary or even the probable consequence of the breach.

But in the subsequent case of McMahon v Fields[10] the above decision was criticised and damages were allowed when the plaintiff's horses were turned out of the defendant's stable in breach of contract and they caught a cold before an alternative accommodation could be found for them.

Duty to Mitigate

The explanation attached to Section 73 provides for the duty to mitigate damages. It says that The methods available for resolving the inconvenience brought on by the non-performance of the contract must be considered when calculating the loss or damage resulting from a breach of contract. To minimize his losses, the harmed party must take reasonable steps to prevent the losses brought on by the breach.

The most frequent application of this rule takes place in contracts for sale or purchase of goods. On the buyer's refusal to take delivery, the seller should resell the goods at the prevailing market price and he may then recover from the defaulting buyer as damages the difference between the price he realised and the price he would have received under the contract. If the seller does not resell the goods and his loss is aggravated by the falling market, he cannot recover the enhanced loss.

Contract of employment and duty of mitigation

The duty of mitigation also finds application in reference to premature termination of a contract of employment. Thus, where on account of the retirement of two out of four partners, a partnership firm was ended and with it the services of the manager but the remaining two partners reconstituted the firm and offered him employment on identical terms which he refused to accept and instead brought an action for damages, it was held that he should have accepted the employment in mitigation of his loss and that he was entitled to nominal damages only.

[10] (1881) LR 7 QBD 591

But where no alternative employment of equal standing is available to him, the ex-employer cannot ask that he should have mitigated his loss by accepting a lesser job. The Bombay High Court in K.G. Hiranandani v Bharat Barrel & Drum Mfg Co P Ltd[11] explained the real nature of the duty of mitigation. Vimad Lal J said that as our legislature has correctly stated, the position is simply that what the Explanation means is not in the nature of an independent rule or duty but rather is merely a factor to be taken into account in assessing the damages naturally arising from the breach, for the purposes of the main part of Section 73. This is true even though the rule the Explanation enacts is commonly referred to as the "rule in regard to mitigation of damages," and it has been so even in decided cases and standard works..

Advantage out of one's own wrong not allowed

The rule that a person cannot be permitted to take advantage of his own wrong is a rule of construction rather than a principle of law and therefore it can be excluded by express terms of the contract. Accordingly, damages for loss of share option cannot be claimed by an employee who is wrongfully dismissed shortly before becoming entitled to exercise the option if the option scheme expressly stated that the option was to lapse if the employee ceased to be employed by the employer. The option-holder is not entitled to any compensation for loss of the option if the option-holder ceased to be employed by the company for any reason whatsoever. Furthermore, the court said that the termination of a contract of employment destroys the status or relationship between the employer and employee, although certain aspects of the contract may continue to exist, and since the option to purchase the employer company's shares depended upon the status or relationship of the employer to the employee it no longer continued in existence when the employee was dismissed.

B. LIQUIDATED DAMAGES AND PENALTY

The parties to a contract may determine beforehand the amount of compensation payable in the event of breach. According to English law a sum so fixed may fall in any of the following two categories:

(1) Liquidated damages, or

(2) Penalty.

If the sum fixed represents a genuine pre-estimate of the probable damage that is likely to result from the breach, it is liquidated damages. A sum less than the amount of probable damage is

[11] AIR 1969 Bom 373

also regarded as liquidated damages. The whole of such sum is recoverable.

A well-known illustration is Dunlop Pneumatic Tyre Co Ltd v New Garage &Motor Co Ltd[12]. A manufacturer of tyres supplied a quantity of tyres to a dealer on the condition that they would not be sold below the list prices and that dated damages, liqui not penalty, of #5 would be payable for every tyre sold in breach of the agreement. The dealer committed breach. The question was whether the above sum was intended as a genuine compensation for the loss suffered.

The House of Lords held it to be liquidated damages. Lord DUNEDIN stated the effect of cases in the following propositions

(1) The expression used by the parties is not conclusive. The court must find out whether the payment stipulated is in truth a penalty or liquid dated damages.

(2) The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage.

(3) The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract.

(4) To assist this task, various tests have been suggested:

(a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach,

(b) It will be a penalty if the breach consists only in not paying a sum of money and the sum stipulated is a sum greater than the sum which ought to have been paid.

(c) There is a presumption (but no more) that it is penalty, when "a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion a serious and others but trifling damage"

S. 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

[12] 1915 AC 79 (HL)

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.

Rule stated in Section 74

The rule is that where a sum is named in a contract as the amount to be paid in case of breach, regardless whether it is a penalty or not, the party suffering from breach is entitled to receive reasonable compensation not exceeding the amount so named. The named sum constitutes the maximum limit of liability. The court cannot order damages beyond that. The distinction between liquidated damages and penalty has been abolished in India. The courts award reasonable compensation not exceeding the stipulation. The courts knock down agreements which are unconscionable and extravagant. The court has the latitude to reduce the amount to what appears to be reasonable in the circumstances. Whether or not the party has proved to have suffered actual loss, is immaterial.

This has certain advantages over the English system. The section dispenses with the necessity of laying down rules for distinguishing liquidated damages from penalty. Further, according to English law, the court must either accept the amount in whole or reject it in whole. In India, the court need not reject the amount. It may either accept the amount or reduce it to what appears reasonable.

In the Fateh Chand v Balkishan Dass[13] the Supreme Court observed that the relatively complex adjustments established under the English Common Law to distinguish between stipulations in the nature of penalties and stipulations providing for the payment of liquidated damages are obviously being attempted to be eliminated by Section 74. By establishing a consistent concept that applies to all stipulations and specifies the amount to be paid in the event of a breach and stipulations by way of penalty, the Indian Legislature aimed to cut through the complex web of laws and presumptions under the English Common Law.

The amount stipulated in the contract is not decisive but it is a good attempt to avoid litigation. It is well know that assessment of compensation with precision is somewhat difficult task. The figure work provided by the parties gives a good start to overcome the difficulty of proof. In

[13] AIR 1963 SC 1405

this case the court had to reduce the amount stipulated because neither that much loss was proved nor it was in the neighbourhood of probable loss.

One party not to be adjudicating authority

In a case before the Supreme Court a clause in a contract was to the effect that for any breach of the conditions of the contract the first party shall be liable to pay damages to the second party as may be assessed by the second party. This clause was held to be void because it had the effect of making a party also a judge to decide breach and assess damages.

Breach and right to compensation must be established

The injured party has to prove that there has been a breach of contract on the part of the other party and, therefore, the remedial system provided in the contract has become exercisable. The claim in this case was for refund of amount retained by the other party as liquidated damages for breach. A decree for refund of the amount was passed without going into the question whether delay in completion of the work was caused due to lapses on the part of one party or the other or whether the guarantee had become inviolable. The case breach was sent back to the trial court for fact finding as to and its consequences. The plaintiff, a Government undertaking, was dealing in export of marine products. It provided financial assistance to the defendant who was engaged in the business of sea food. A clause in the agreement provided that he would be liable to compensate the plaintiff if his goods were rejected by the foreign buyer. It was found that the goods were rejected not because of any inherent defect but because of the malfunctioning of the containers in which the goods were shipped. The plaintiff had filed a suit against the shipping agent but did not pursue it. An action against the defendant was not allowed. The plaintiff could not take shelter of the clause when there was no breach on the part of the defendant.

The court has to make its own assessment of the amount of loss caused by the breach. It cannot blindly follow the contract clause in awarding damages without any adjudication.

Unilateral deduction from final bill not permissible

It has been held that unilateral deductions towards liquidated damages from the contractor's final bill are not permissible. Even if there is a breach, the aggrieved party cannot of its own work out liquidated damages and deduct the amount from the final bill. The party carrying out deduction is not free from the responsibility of showing evidence in justification of deductions.

In this case, there were various facts which were denied by the contractor that was clear from the pleadings and materials and documents on record. There was also the finding by the arbitrator that deductions were carried out on the basis of disputed facts and by attributing the delay to the contractor and this was contrary to the record.

The contract carried a stipulation as to the amount of liquidated damages. There was delay in execution of work by the contractor. The aggrieved party became entitled to reasonable compensation but gave no evidence of the amount of loss caused. The contractor also did not show any precise amount of possible loss. The court awarded half of the amount claimed by way of reasonable compensation.

Withholding of payment under bills

There was e-tender for extraction of coal. The equipment capacity of the bidder was less than the required capacity. The bidder could not achieve the target. The result was huge shortage in extraction and transportation of coal. The tender requirement of deployment of requisite equipment was not fulfilled. It was held that withholding of his bills and imposition ot shortfall penalty was proper.

Whether actual loss necessary

Another question which the court considered was whether actual proof of loss is necessary to recover anything under Section 74. In the earlier case of Chunilal V. Mebta and Sons Ltd v Century Spg Mfg Co Ltd[14] Mudholkar J suggested that where the right to recover liquidated damages under Section 74 is found to exist no question of ascertaining damage really arises. The section also says that the named sum is recoverable whether or not actual damage or loss is proved to have been caused thereby.

Stipulation for refund of double amount of earnest and interest

The stipulation in the contract was that if the party failed to perform from his side, he would refund the amount of earnest doubling it up and also with interest at 12 per cent p.a. It was held that the Civil Judge rightly decreed the suit of the plaintiff to receive the double amount by way of compensation. It must be presumed that the parties at the time of entering into the agreement knew very well the amount of loss which the plaintiff was likely to sustain in the

[14] AIR 1962 SC 1314

event of breach. Where the parties were supposed to know that breach would cause loss in any case, it would not be necessary for the aggrieved party to show any actual loss. The court has the ample power to grant compensation for loss caused by breach of contract.

CONCLUSION

It can be seen that not all the contracts that have been made end up in discharge of contract by performance. Some of the contracts will not get completed due to impossibility of performance or non-performance of the contract by one party. In the latter scenario, the non-defaulting party must work towards obtaining damages for breach of contract or direction for specific performance under Specific Relief Act, 1963. But from the analysis of the judicial trend of Indian courts, it is easier and advantages for the non-defaulting party to go with the damages for breach of contract under Indian Contract Act, 1872. Indian Contract Act has provisions for Liquidated as well as Unliquidated damages which makes it comfortable to the contracting parties to be prepared for the unfortunate outcomes from a contract as well. Thus a contracting party can choose to include liquidated damages clause as per section 74 of the Indian Contract act or he may approach the court once a breach has been made where the court will assess the damage and award damages for breach of contract.

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