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**LIQUIDATED DAMAGES –
Applicability and Enforceability**

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“LIQUIDATED DAMAGES – APPLICABILITY AND ENFORCEABILITY”

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In all contracts, whether commercial or construction contracts, breach often occurs due to failure of one contracting party to fulfill its contractual obligations. In law the party, which commits breach of contract, is required to pay damages to the other party. Such damages are calculated on the basis of legal principles enacted in the statute or the party are also at liberty to provide in their contract that in case of non performance or delayed performance the party in default shall pay a fixed sum called liquidated damages the amount of which may be calculated either as a lump-sum or on a scale varying with the length of default.

The term “Construction Contract” include both building contract and engineering contract. It is quite common in construction industry to use model contracts form such as FIDIC, JCT standard building contract, ICE form for civil engineering works dealing with erection of works and installations etc. Damages for delay and disruption, failure to build or delay, defective work etc. are determined either under the broad principle behind any award of damages for breach of contract i.e.- “ Where a party sustains a loss by reason of breach of contract he is, as far as money can do it, to be placed in the same situation with respect to the damages as if the contract had been performed” or on the basis of liquidated damages stipulated in the contract.

In India, the mode of assessing damages due to a party upon breach of a contract are laid down in Section 73 and 74 of the Indian Contract Act, 1872. Relevant part of Sections 73 and 74 of Contract Act are as under:

“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 reason of the breach.

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.**

Explanation:- A stipulation for increased interest from the date of default may be a stipulation by way of penalty.

Section 74 of the Indian Contract Act is an attempt to eliminate the somewhat elaborate refinements made under the English Common Law in distinguishing between stipulations providing for payment of liquidated damages and stipulations in the nature of penalty. Under the common law a genuine pre-estimate of damages by mutual agreement is

regarded as a stipulation naming liquidated damages and binding between the parties; a stipulation in a contract in *terrorem* is a penalty and court refuses to enforce it, awarding the aggrieved party only reasonable compensation. The Indian Legislature has sought to cut across the web of rules and presumptions under the English common law by enacting a uniform principle applicable to all stipulations naming amounts to be paid in case of breach, and stipulations 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 compensation has to be reasonable, and that imposes upon the court a duty to award compensation according to settled principles. Section 74 does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted. Section 74 applies not only to cases where the aggrieved party is seeking to receive some amount on breach of contract but also to cases whereupon breach of contract an amount received under the contract is sought to be forfeited.

The Hon'ble Supreme Court recently in the case *ONGC Vs SAW PIPES LTD.* (JT 2003 (4) SC 171, after considering the judgements of *Maula Bux (1970 (1) SCR 929)*, *Fateh Chand vs Balkishan Das (1964 (1) SCR 515)* laid down the following propositions of law with regard to liquidated damages..

- (1) Terms of the contract are required to be taken into consideration before arriving at the conclusion whether the party claiming damages is entitled to the same.
- (2) If the terms are clear and unambiguous stipulating the liquidated damages in case of the breach of the contract unless it is held that such estimate of damages/compensation is

unreasonable or is by way of penalty, partly who has committed the breach is required to pay such compensation and that is what is provided in Section 73 of the Contract Act.

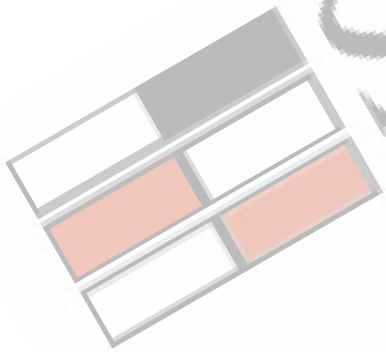
(3) Section 74 is to be read along with Section 73 and, therefore, in every case of breach of contract, the person aggrieved by the breach is not required to prove actual loss or damage suffered by him before he can claim a decree. The Court is competent to award reasonable compensation in case of breach even if no actual damage is proved to have been suffered in consequences of the breach of a contract.

(4) In some contracts, it would be impossible for the court to assess the compensation arising from breach and if the compensation contemplated is not by way of penalty or unreasonable, court can award the same if it is genuine pre-estimate by the parties as the measure of reasonable compensation.

This judgement of the Hon'ble Supreme Court has summarized the law relating to liquidated damages in a very concise manner.

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