ANALYSIS OF DAMAGES FOR BREACH OF CONTRACTS IN INDIA

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ABSTRACT:

A contract is considered to be a correlative set of rights and obligations for the parties would be of no value, if there were no remedies to enforce the rights arising there under. The Latin maxim 'Ubi jus, ibi remedium' denotes where there is a right, there is a remedy. If theoretically seen, one finds that there is a distinction between a right and a remedy in law.[1] A right (in the sense of a cause of action) is considered to be a precondition to a remedy. This is the reason, it has been said that there is a remedy for every right. Moreover it can be said that the remedies are viewed as the "ends" and procedure, the "means", for achieving those ends.[2] When a breach of contract takes place, instantly the remedy that comes into the mind of the parties is 'damages' as the consequence of breach. The aggrieved party may seek compensation from the party who breaches the contract. All law courts are also guided with the same principle of Ubi Jus Ibi Remedium. This article is aimed at making an analysis of "Damages for Breach of Contracts in India".

Keywords: Contract, Rights, Obligations, Breach, Damages

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[1] Covell & Lupton, "Principles of Remedies", (2008), Lexis Nexis, at.p.3.

[2] *Ibid,* at.p.6.

Introduction:

A contract is considered to be a correlative set of rights and obligations for the parties would be of no value, if there were no remedies to enforce the rights arising there under. The Latin maxim *'Ubi jus, ibi remedium'* denotes where there is a right, there is a remedy. If theoretically seen, one finds that there is a distinction between a right and a remedy in law.[3] A right (in the sense of a cause of action) is considered to be a precondition to a remedy. This is the reason, it has been said that there is a remedy for every right. Moreover it can be said that the remedies are viewed as the "ends" and procedure, the "means", for achieving those ends.[4] When a breach of contract takes place, instantly the remedy that comes into the mind of the parties is 'damages' as the consequence of breach. The aggrieved party may seek compensation from the party who breaches the contract. All law courts are also guided with the same principle of Ubi Jus Ibi Remedium. This article is aimed at making an analysis of "Damages for Breach of Contracts in India". Basically, Sections 73 and 74 of Indian Contract Act, 1872, deals with damages for breach of contracts. Although anyone can get an idea as to what is the meaning of damages and penalty under the above mentioned sections only by a mere reading of the said sections. But the fact is - what exactly these sections means and includes and what are the interpretation of said sections is a matter of understanding and moreover the interpretation of said sections may differ in different cases. So, in this article an effort has been made to analyse all the perspectives and all the ways in which the term "Damages" can be construed so that one can easily conclude the real meaning and sense of these sections.

REMEDIES AVAILABLE FOR BREACH OF CONTRACTS:

The manner, in which a right is enforced or satisfied by a court when some harm or injury is inflicted upon an individual, recognized by society as a wrongful act, it is called remedy. According to the purpose of remedy, the four basic types of judicial remedies are:-

(1) Damages;

(2) Restitution;

(3) Coercive remedies; and

(4) Declaratory remedies.

[3] Covell & Lupton, "Principles of Remedies", (2008), Lexis Nexis, at.p.3.
[4] *Ibid*,at.p.6.

The fundamental basis of contractual damages was to compensate 'for pecuniary loss naturally flowing from the breach'.[5] The fundamental rule governing the award of damages at common law is that they are compensatory in nature.[6] The most common rule governing the assessment of compensatory damages in both contract and tort is that the plaintiff should receive the monetary sum which, so far as money can, represents fair and adequate compensation for the loss or injury sustained by reason of the wrongful conduct of the defendant.[7] The main focus of this paper is in relation to the enforcement of contracts. The remedies for the enforcement of contracts are generally by way of action in the court. The form of these actions depends upon the nature of breach committed.

Breach of contracts:

A breach of contract is: where a party to a contract fails to perform, precisely and exactly, his obligations under the contract. A contract being a correlative set of rights and obligations for the parties would be of no value, if there would be no remedies to enforce the rights arising there under. Thus, when an aggrieved party claims damages as a consequence of breach, the court is duty bound to take into account the provisions of law and the circumstances attached to the contract, in this regard. Moreover, the amount of damages depends upon the type of loss caused to the aggrieved party by the breach. In that case, the court would first make out the losses caused and then assess their monetary value. The discussion of the measure of damages in contract has been given more importance as the law of contract is always considered as the heart of commercial affairs. Thus basically, the following elements must be established in order to recover damages for breach of contract:-

- A breach of contract has occurred;
- Causation i.e., breach committed by the defendant has caused a loss to the plaintiff;
- The loss suffered by the plaintiff is the direct result of the breach and is not too remote; and
- The plaintiff has acted reasonably in mitigating his or her loss.

[5] British Westinghouse Electric and Manufacturing Co. Ltd. v. Underground Electric Railways Co. of London Ltd. (1912) A.C. 673 at 689 per Viscount Haldane L.C. Similarly, see Farley v. Skinner (2001) UKHL 49; (2002) 2 A.C. 732 at para. 16 per Lord Steyn: the 'general principle is that compensation is only awarded for financial loss resulting from the breach of contract'. For recovery of non-pecuniary loss see Watts v. Morrow (1991) 1 W.L.R. 1421 and Farley v. Skinner (ibid.)

[6] Johnson v. Perez *(*1988) 166 CLR 351 at.p.355; as per Mason CJ.

[7] Commonwealth v. Amman Aviation Pty Ltd. (1991) 174 CLR 64 at.p.116; as per Deane J.

The fact is that both "damages and penalty" are a form of economic gain which are payable by the defaulter to the innocent party that has suffered a loss due to the breach. This can be observed by getting a clear understanding of the above terms under Ss. 73 and 74. Thus, for this reason, one should do intensive study of the meaning of these under law of contracts in India as well.

Meaning of Damages:

When a party fails to perform his part of obligation under the contract, there is a breach of contract, and every breach of a term of contract entitles the innocent party to claim for compensation. The party who is injured by the breach of a contract may bring an action for damages.[8]

The theory of damages is that they are a compensation and satisfaction for the injury sustained, i.e. the sum of money to be given for reparation of the damages suffered should as nearly as possible, be the sum which will put the injured party in the same position as he would have been if he had not sustained the wrong for which he is getting damages.

Damages, as a personal remedy:

The purpose behind filing a suit for damages for breach of contract is to seek personal redress against the defendant who stands in a certain relationship (whether contractual or otherwise) with the plaintiff. Thus, usually personal action or what one can say an action *in personam* is taken in case of breach of contract. The parties in such a suit are: one who has suffered the injury, and the other who has committed the wrongful act. In such a suit, the plaintiff claims for the recovery of the loss suffered by him for the breach of contract or for the violation of right from the defendant.

Definitions:

- Black's law dictionary: "Damages are the sum of money claimed by or ordered to be paid to a person as compensation for loss or injury."

[8] This is the only remedy which the contract act affords. Some other remedies are afforded by the Specific Relief Act 1963, e.g., an injunction to prevent breach or specific enforcement of the contract, i.e., an action for specific recovery of the thing promised to be sold, P.R. & Co. V. Bhagwandas, ILR (1909) 34 Bom 192.

- Acc. to Frank Graham: "Damages are the sum of money which a person wronged is entitled to receive from the wrong doer as compensation for the wrong."[9]

Thus, "Damages" can be termed as compensation in terms of money for the loss suffered by the injured party. Burden of proof lies on the injured party to prove his losses.[10]

JUDICIAL INTERPRETATION ON THE CONCEPT OF DAMAGES:

A contract is not a property.[11] It is only a promise supported by some consideration upon which either the remedy of specific performance or that of damages is available.[12] Parties come together in a contract for an equal exchange. Therefore, the monetary equivalent is usually adequate compensation for a breach. There are various remedies available to an innocent party where there has been a breach of contract, which are already discussed in the previous chapter under different headings. The main remedy is damages, which basically can be discussed under two main heads:-

A. Unliquidated Damages.

B. Liquidated Damages.

As far as the law related to breach of contract, law of damages and those circumstances in which damages can be awarded to the injured party and moreover, the quantum of damages is concerned, up to what extent the injured party can recover the damages from the defaulting party, is being cleared the famous case popularly known as Hadley v. Baxendale[13] by the court of England. In Sohm v. Dixie Eye[14], Justice Greenwood of the Court of Appeals of Utah adopted these words: "damages" generally refers to money claimed by, or ordered to be paid to, a person as compensation for loss or injury. "The term injury is sometimes used in the sense of damage, as including the harm or loss for which compensation is sought, and has been defined as damage resulting from an unlawful act; but in strict legal significance, there is, properly speaking, a material distinction between the two terms, in that injury means something done against the right of the party, producing damage, whereas damage is the harm, detriment, or loss sustained by reason of the injury."

[9] Arnold, "Law of Damages", ed.2nd, (1958), at.p.4.
[10] Sudesh Prabhakar Volvoikar v. Gopal Babu Savolkar, (1996) 5 Bom CR 1; ONGC Ltd. v. Saw Pipes Ltd., (2003) 5 SCC 705: A.I.R 2003 SC 2629.
[11] Dr. Avtar Singh, "Law of Contract and Specific Relief", ed.11th, (2013), at.p.449.
[12] Sunrise Associates v. Govt. Of NCT of Delhi, (2006) 5 SCC 603: A.I.R 2006 SC 1908.
[13] Hadley v. Baxendale, (1854) 9 Ex. 341.
[14] (2007) UT App 255, p.166.

CONCEPT OF DAMAGES UNDER INDIAN CONTRACT ACT, 1872:

Chapter VI of the Indian contract act deals with the consequences of breach of contract. Section 73 of Indian contract act, 1872 deals with the concept of remoteness, which is basically founded upon the principles formulated in the Hadley v. Baxendale case. The principle laid down under section 73 is the general principle, which governs all the cases of breach of contract, resulting in loss of damages to one of the contracting parties (who is considered as an innocent party), whereas section 161 (responsibility of bailee when goods are not duly returned) deals with only specific kind of breach of contract. In brief, it can be said that section 73 basically deals with the genus while section 161 deals with a species.

The Indian Contract Act, 1872 uses the words loss or damage under section 73 as: "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, form 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 of damage sustained by reason of the breach."[15]

It simply means that a claim for unliquidated damages does not give rise to a debt until the liability is adjudicated and damages assessed by a decree or order of a court or other adjudicatory authority. When there is a breach of contract, the party who commits the breach does not *eoinstanti* incur any pecuniary obligation nor does the party complaining of the breach becomes entitled to a debt due from the other party. The only right which the party aggrieved by the breach of the contract is the right to sue for damages. That is not an actionable claim[16].

In case of State of Rajasthan v. Nathu Lal,[17] it was held by the court that this section declares that compensation is not to be given for any remote or indirect loss or damages sustained by reason of the breach. It means that the right of action depends upon the proof of breach. There

[15] Section 73 of The Indian Contract Act, 1872.
[16] Union of India v. Raman Iron Foundry, A.I.R 1974 S.C. 1265 at p. 1273.
[17] AIR 2006 Raj.19, the recovery of amount for breach of contract without taking decision on the fact of breach is not proper.

are certain other cases[18] in which it was held that this section provides that the same principle will be applicable where there has been a breach of *quasi*-contractual obligation. The plaintiff has to prove his losses and where loss is not provable, reasonable compensation is awarded on the basis of the material before the court.[19]

APPRAISAL OF LAW OF DAMAGES IN INDIA:

Section 73 and 74 of the Indian Contract Act, 1872 cannot be discussed in isolation, as they walk to their destination together. The right to claim liquidated damages is enforceable under Sec.74 of the Contract Act and where such a right is found to exist, no question of ascertaining damages really arises. Where the parties have deliberately specified the amount of liquidated damages there can be no presumption that they at the same time intended to allow the party who has suffered by the breach to give a go-by to the sum specified and claim instead a sum of money which was not ascertained or ascertainable at the date of the breach. In some cases, this amount will apply to all breaches, in others only to particular breaches. In some cases, it will apply to breach by either party, in others only to breach by one particular party. And sometimes different sums may be stipulated for different breaches, whether by one or by both parties. "Liquidated damages means that it shall be taken as the sum which the parties have by contract assessed as that change to be paid, whatever maybe the actual damages."[20] The purpose of law in framing section 74 was to do away with the distinction between penalty and liquidated damages.Here arises a question i.e. why, the courts allow a plaintiff to recover liquidated damages, thereby ousting the judicial assessment and awarding damages? In the answer to this question, it can be said that liquidated damages have a number of advantages such as:

- Liquidated damages make it less likely that there will be serious dispute between the parties;
- Liquidated damages help the defendant to know in advance what exactly his liability will be in case of breach of contract;

[18] State of Karnataka v. Shree Rameshwara Rice Mills, (1987) 2 SCC 160: AIR 1987 SC 1359, the contract provided that damages would be assessed by the government and it was held that the government was not the proper party to determine whether a breach had taken place or not. To the same effect, Vairappa Thevar v. Tehsildar, (1989) 1 MLJ 387; P.C. Rajput v. State of M.P., AIR 1993 MP 107: (1994) 1 MPLJ 387.

[19] English Electric Co. of India Ltd. v. Cement Corpn. Of India Ltd., 1996 AIHC 1875 (Del).

[20] Wallis v. Smith, (1882) 21 Ch D 243, 267, as per Cotten L.J.

- In view of administration of justice, liquidated damages save judicial time and expenses in deciding what damages should be granted to the plaintiff;
- From the plaintiff's point of view, liquidated damages avoid the costs of litigation and the risk of inaccurate assessment by the courts. And moreover, if liquidated damages are the in the agreement, the party need not to prove his loss according to the judicially imposed standard, and probably restrictions such as remoteness and the known recoverability of certain types of losses.
- In addition to the above-mentioned advantages, the courts are not hostile to liquidated damages because they reflect the compensatory aim of judicially assessed damages i.e. they are a genuine pre-estimate of the sum needed to put the plaintiff into as good a position as if the contract had been performed.

The above discussion makes it very clear that the concept of liquidated damages has emerged due to its advantages to both the parties as well as to the judicial agencies also.

Penalty under law of contract does not mean punishment to the wrong doer. It is used in quite different sense. It is totally different from punitive damages. As punitive damages means monetary compensation awarded to an injured party that goes beyond which is necessary to compensate the individual for losses and that is intended to punish the wrongdoer. The purposes of punitive damages are to punish the defendant for outrageous misconduct and to deter the defendant and others from similar misbehaviour in the future. Whereas, under sec. 74 of Indian Contract Act 1872, it is not so in case of penalty stipulated for.

The Indian Contract Act, 1872 uses the words penalty under section 74 as: "Compensation of breach of contract where penalty stipulated for :-When a contract has been broken, if a sum is named in the contract as the amount 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 or 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." In section 74 the words that have to be emphasized upon are sum is named, penalty. The term 'sum is named' gives out the clear meaning that the amount that becomes payable in the event of any breach is pre- estimated and is provided for in the contract. It is determined in the form of either damages or a stipulated penalty. Further, they

sum that is so specified is the reasonable compensation for the breach and in no case the amount can be exceeded from what has been specified in the contract. Thus, in short section 74 talks about liquidated damages and not other kind of damages.

Judicial Interpretation of Damages and Penalty:

The leading authority of Fateh Chand is worth mentioning here. It was observed by the Supreme Court in this case as follows:[21] "Section 74 is clearly an attempt to eliminate the somewhat elaborate refinement made under the English common law in distinguishing between stipulations providing for payment of liquidated damages and the stipulations in the nature of penalty. The Indian legislature sought to cut across the web of the rules and presumptions under the English common law by enacting a uniform principle applicable to all the stipulations naming the amount to be paid in case of breach and stipulation is by way of penalty."

A perusal of this section makes it very clear that even though the parties may, by an agreement, settle a fixed sum as damages for the breach of contract; the court is not incapable to grant relief to the party committing default, if it is held that the amount of damages fixed by the parties is unconscionable or penal. Once it is decided by the court, it is open to it, to grant such reasonable compensation as the court may deem fit in those circumstances.

In Oil and Natural Gas Corporation Ltd v. Saw Pipes Ltd.[22] the Supreme court laid down the following guidelines:-

- Terms of the contract are required to be taken into consideration before arriving at the conclusion whether the party claiming is entitled to the same.
- If the terms are clear and unambiguous stipulating 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, the party who has committed the breach is required to pay such compensation and that is what is provided in section 73 of the Contract Act.
- Section 74 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

[21] Fateh Chand v. Balkishan Dass, AIR 1963 SC 1405: (1964) 1 SCR 515.
[22] AIR 2003 SC 2629

compensation in case of breach even if no actual damage is proved to have been suffered in consequences of the breach of the contract.

- 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, the court can award the same if it is a genuine pre-estimate by the parties as the measure of reasonable compensation.

In Steel Authority of India v. Gupta Brothers Steel Tubes Ltd.[23] it was held by the Apex court that there is no impediment or any obstacle for the parties to a contract to make provisions of liquidated damages for specific breaches only, leaving other types of breaches to be dealt with as unliquidated damages. There is no principle which requires that once the provision of liquidated damages has been made in the contract, in the event of breach of one of the parties, such clause has to be read covering all types of breaches although parties may not have intended and provided for compensation in express terms of all types of breaches.

In Bhuley Singh v. Khazan Singh and Ors[24] the Supreme Court held that Section 74 declares the law as to liability upon breach of contract where compensation is by agreement of the parties pre-determined, or where there is a stipulation by way of penalty. But the application of the enactment is not restricted to cases where the aggrieved party claims relief as a plaintiff. The section does not confer a special benefit upon any party; it merely declares the law that notwithstanding any term in the contract predetermining damages or providing for forfeiture of any property by way of penalty, the court will award to the party aggrieved only reasonable compensation not exceeding the amount named or penalty stipulated. The jurisdiction of the court is not determined by the accidental circumstance of the party in default being a plaintiff or a defendant in a suit. Use of the expression "to receive from the party who has broken the contract" does not predicate that the jurisdiction of the court to adjust amounts which have been paid by the party in default cannot be exercised in dealing with the claim of the party complaining of breach of contract. The court has to adjudge in every case reasonable compensation to which the plaintiff is entitled from the defendant on breach of the contract. Such

[23] (2009) 10 SCC 63
[24] RFA No.422 of 2011

compensation has to be ascertained having regard to the conditions existing on the date of the breach. High amounts called earnest money will be in the nature of penalty and thus hit by Section 74 of the Indian Contract Act, 1872 in view of Fateh Chand's case[25]. The principles laid down in Fateh Chand's case[26]; that forfeiture of a reasonable amount is not penalty but if forfeiture is of a large amount the same is in the nature of penalty attracting the applicability of Section 74; have been recently reiterated by the Supreme Court in the case of V. K. Ashokan v. CCE[27] . Therefore, with regard to liquidated damages and penalties, the primary conclusions of the court appear to be that liquidated damages should be regarded as reasonable compensation, while penalties should not.

CONCLUSION

As far as the Indian law is concerned, it has developed its law of damages merely on the English Law but now the courts in India have to interpret provisions of Section 73 of the Indian Contract Act which are discussed and analyzed in brief in this paper. The measure of damages is based on either liquidated or unliquidated damages. To conclude this, it can be stated that the purpose of setting liquidated damages clause in contracts is actually to ascertain a fixed and reasonable compensation at the time of drafting of the contract and reduce the burden and expense of assessment of actual damages. It also gives an assurance to the parties to the contract that the obligations under the contract will be complied with. There are many landmark judgments which are discussed above lay down rules and guidelines for providing a reasonable compensation under Sections 73 and 74 of the Indian Contract Act, 1872. Both the sections should be read together while awarding damages under a contract. It should also be noted that as far as possible the aggrieved party should be placed in the same position as it would have enjoyed if the contract had been performed and reasonable steps should be taken to mitigate the losses. There is an aggressive growth in the field of technology, due to which the parties entering into commercial transactions are more cautious than ever, thus making the parties deliberate even on the minute details or specifications so as they can best secure their interest. Therefore, contents of a contract have become highly detailed and elaborate. Particularly, as a measure of safeguarding, securing and protecting their respective interests in an event of breach of the terms of the contract, parties

[25] *Supra* note 19.
[26] *Ibid.*
[27] 2009 (14) SCC 85.

generally negotiate and agree upon the various remedies that the injured party can invoke to mitigate and compensate for the losses it may suffer on account of such breach. All possible flaws with regard to damages and penalty have already been discussed above. The courts in India should interpret the above mentioned sections i.e. sec.73 and 74 very carefully, so that the ordinary man can be benefited by these principles, because the law is made to facilitate the people, not to harass them. So, these principles should be used, not misused.

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