Damages under Indian Law

Thanks to globalisation, international contracts governed by Indian law are no longer a rarity. It is, therefore, important to understand the different types of damages available on breach of contract under the Indian Contract Act, 1872 (ICA).

Let us consider the following clauses.

1. "X shall perform its obligations hereunder in conformance with the terms of the Agreement and all other applicable Indian laws and statutes including all Indian employment and workmen's laws."

2. "X shall perform its obligations hereunder in conformance with the terms of the Agreement and all other applicable Indian laws and statutes including all Indian employment and workmen's laws. X agrees that if at any time during the term of this Agreement, except on account of Force Majeure, the Plant is unable to supply electricity at the Discharge Capacity resulting in Y being unable to operate its cement unit, then in that event and in every such case X will pay Y a sum to be calculated as per the formula specified below as and by way of liquidated damages for failure of X to supply electricity at the Discharge Capacity resulting in delay in the operations of the cement unit."

The difference between clauses 1 and 2 is that clause 2 provides for payment of liquidated damages should the Plant not be able to supply electricity to the cement unit. In contrast, under clause 1, Y will be entitled to seek only actual damages sustained on account of non-supply of electricity.

Liquidated Damages

When the terms of a contract are broken, if a sum is named in the contract as the amount to be paid in case of breach, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive compensation not exceeding the amount so named. If a stipulation to pay a certain amount by way of penalty has been provided in the contract, then reasonable compensation not exceeding that amount should be paid. (Section 74 of the ICA)

In the example, in clause 2, except on account of Force Majeure, Y is entitled to claim liquidated damages. This will be more beneficial to Y because Y will be entitled to a predetermined sum of money. Under clause 1, Y will have to prove all damages suffered by Y at the time of breach. However, once liquidated damages are awarded, no claim for damages by way of loss of profits or other incidental damages will lie. Thus, the events triggering liquidated damages should be clearly stated, so that the parties are free to claim actual damages in cases of breach of contract due to other reasons.

From a reading of section 74, it becomes clear that Indian law does not distinguish between liquidated damages and penalties, as is the case in the UK and the USA. In these countries, the question whether the sum stipulated in a contract is in the nature of a penalty or liquidated damages is a question of law. The essence of a penalty is a payment of money stipulated to terrorise the offending party. The essence of liquidated damages is a pre-estimate of damage. The question whether a sum is a penalty or liquidated damages is to be judged on a case to case basis at the time of entering into the contract, and not as at the time of the breach. If the sum stipulated for is excessive in amount in comparison with the greatest loss that can conceivably be proved, it will be held to be a penalty. Reference can be drawn to *Aswathnarayaniah v. Sanjeeviah* AIR 1965 AP 33, as cited in II Pollock & Mulla, Indian Contract and Specific Relief Acts (11th ed.) pp. 888-889)

Since Indian law does not make the foregoing distinction, the language of a liquidated damages clause need not specifically state that liquidated damages are not in the nature of a penalty.

Actual Damages

Section 73 of the ICA provides as follows: 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 such breach.

Compensation is not paid for any remote and indirect loss or damage sustained by reason of the breach. Besides, an explanation to this section adds that: 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.

The principle of award of compensation is that the injured party should as far as possible be placed in the same position in terms of money as if the contract had been performed by the party in default. Where the contract is one of sale, this principle calls for assessment of damages as at the date of breach. Under a contract for the sale of goods, the measure of damages upon a breach by the buyer is the difference between the contract price and the market price at the date of breach. On a breach of contract to supply goods by the seller, the buyer is entitled to recover all the expenses of procuring same or similar goods. This was held by the Calcutta High Court in the case of *Tata Iron & Steel Co Ltd v Ramanlal Kandoi* (1971) 2 Cal. Rep. 493, 528. In case of non-delivery of goods, the damages are fixed on the basis of the price prevailing on the date on which delivery is to be made, as was held by the Supreme Court in the case of *Union of India v. Jolly Steel Industries (Pvt) Ltd.* (AIR 1980 SC 1346). This tenet is also extended to instances of late delivery of goods.

Indirect Damages (Loss of Profits)

Let us consider the following example.

> "A delivers to B, a courier company, a machine to be delivered overnight to A's factory. B does not deliver the machine on time, and A, in consequence, loses a profitable contract with the Government. A is entitled to receive from B, by way of compensation, the average amount of profit which would have been made by the working of the factory during the time that delivery of it was delayed, but not the loss sustained through the loss of the Government contract."

The leading case on this subject is that of *Hadley v. Baxendale*, 9, Ex. 341: 96 R.R. 742. Section 73 and various cases clearly provide that knowledge of circumstances leading to loss of profits to the plaintiff imposes liability on the defendant. In *Victoria Laundry (Windsor Ltd.) v. Newman Industries Ltd.* (1949) 2 K.B. 528, 537, the plaintiffs agreed to buy a large boiler from the defendant by a fixed date but the seller delayed delivery. The plaintiffs sued for damages and for loss of profits on the grounds of (1) the large number of customers they could have taken had the boiler been installed and (2) the amount they could have earned under a special dying contract. The defendant knew that the plaintiffs were launderers who wanted the boiler for immediate use. The Court of Appeal held that under the circumstances the defendant as a reasonable man could have foreseen some loss of profit though not the loss under the special contract of dying of which he had no knowledge. In addition, it was also clarified that mere knowledge was not enough. It should have been brought to the knowledge of the defendant that he accepts the contract with that knowledge.

The House of Lords in England in *Kourfos v. C. Czarnikow Ltd.* (1969) 1 A.C. 350, has enunciated the following principles:

"(2) In case of breach of contract, the aggrieved party is only entitled to recover such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach…."

"(3) What was at that time reasonably so foreseeable depends on the knowledge then possessed by the parties or at all events, by the party who later commits the breach…."

"(4) For this purpose, knowledge 'possessed' is of two kinds: one imputed, the other actual. Everyone, as a reasonable person, is taken to know the 'ordinary course of things and consequently what loss is liable to result from a breach of contract in that ordinary course.' But to this knowledge which a contract breaker is assumed to possess whether he actually possesses it or not, there may have to be added in a particular case -knowledge which he actually possesses, of special circumstances outside the 'ordinary course of things' of such a kind that a breach in those special circumstances would be liable to cause more loss."

Mitigation of Damages

Section 73 imposes a duty on the party seeking damages to mitigate its loss. In *Murlidhar Chiranjilal v. Harish Chandra Dwarkadas* (1962) 1 SCR 653, the Supreme Court of India has set out two principles on which damages are calculated in case of breach of contract of sale of goods. The first is that the injured party has to be placed in as good a situation as if the contract has been performed. He who has proved a breach of a bargain to supply what he has contracted to get, is to be placed so far as money can do it in as good a situation as if the contract has been performed. This is qualified by a second principle - the injured party is debarred from claiming any part of damages arising out of his neglect. The onus is on him to mitigate losses consequent to the breach of contract.

The Supreme Court of India has decided that the principle of mitigation does not give any right to a party in breach of contract but it is a circumstance to be borne in mind in assessing damages. (*M. Lachia Setty & Sons Ltd v Coffee Board Bangalore* (AIR 1981 SC 162, 168) It must be added that in the latter case, the Supreme Court has not taken into consideration its previous judgement and the explanation to section 73. However, Supreme Court judgements are binding unless set aside or modified by other Supreme Court Benches.

In the circumstances, parties to the contract are required to mitigate their losses in case of breach.

Conclusion

Liquidated damages clauses eliminate the award of actual damages. Thus, care should be taken when drafting a contract to specify the type of damages sought.