

IN BRIEF

CONCEPT OF DAMAGES IN CONTRACT LAW: IF YOU DELAY YOU PAY



Introduction

The concept of damages is a significant component of contract law in India, allowing parties to be compensated monetarily for losses arising due to a breach of contractual obligations. Damages are classified into two – liquidated and unliquidated – depending on the nature of their quantification. Unliquidated damages are claimed in the absence of a pre-determined compensatory sum in the contract. In contrast, liquidated damages involve pre-determined contractual stipulations payable by the defaulting party in the event of a breach.

The prevalent standard of liquidated damages clauses is to stipulate damages accruing on a daily, weekly, or monthly basis, subject to a threshold of 10% of the contract value. Incorporation of a liquidated damages clause in a contract, however, does not guarantee the grant of compensation to the extent of the amount mentioned. Judicial decisions have put forth requirements such as the need to prove loss suffered as a consequence of the breach.

Law of Liquidated Damages in India

Section 74 of the Indian Contract Act, 1872 (Act) establishes the framework governing contractual stipulations that provide for a pre-agreed sum of money

payable upon breach. Such stipulations may either be in the nature of liquidated damages or penalty. Irrespective of the nature of the clause, and whether or not actual damage or loss is proved, the party complaining of breach is entitled only to reasonable compensation, subject to the upper limit of the amount stipulated in the contract.

Proof of Loss and Liquidated Damages

A significant issue which arises in the case of liquidated damages clauses is whether the aggrieved party must prove the entire extent of loss suffered, particularly in cases where the loss is difficult to quantify. A related issue concerns the allocation of the burden of proof – whether it rests on the innocent party to establish that loss was in fact incurred, or on the defaulting party to demonstrate that no loss was likely to result from the breach.

Cases on Liquidated Damages in India

A series of judgements have delineated the contours of liquidated damages under Section 74 of the Act:

Fateh Chand v. Balkishan Dass¹:

- English law distinguishes between genuine pre-estimated stipulations (fully recoverable) and penalties (extravagant and unconscionable stipulations which are unenforceable and where the court awards only reasonable compensation)². In contrast, Indian law adopts a uniform standard. Irrespective of the nature of the pre-determined damages clause, the courts consider the stipulated amount to be a maximum ceiling, and independently assess reasonable compensation based on the actual loss suffered (*ex post* approach).³
- The phrase “*whether or not actual damage or loss is proved to have been caused thereby*” in Section 74 of the Act merely dispenses with the proof of “*actual damage or loss*” and does not justify compensation when no legal injury has been suffered as a result of the breach.⁴

Maula Bux v. Union of India⁵:

- The phrase “*whether or not actual damage or loss is proved to have been caused thereby*” under Section 74 of the Act deals with two classes of contracts⁶. In

¹ 1963 SCC Online SC 49

² Fateh Chand v. Balkishan Dass, 1963 SCC Online SC 49, para 8.

³ “Liquidated Damages and Penalties Ex Ante or Ex Post Methodology”, (2013) 1 SCC J-1, p.31

⁴ Maula Bux v. Union of India, (1969) 2 SCC 554, para 10.

⁵ 1969 2 SCC 554

⁶ Maula Bux v. Union of India, (1969) 2 SCC 554, para 6.

contracts where loss is determinable *ex post*, the party claiming compensation must prove actual loss suffered by him, notwithstanding the pre-estimated amount agreed between the parties⁷. In other cases where the loss is unascertainable or impossible to prove, the Court may grant the agreed amount, if it is regarded as a genuine pre-estimate and is not penal in nature.⁸

ONGC v. Saw Pipes⁹:

- Where the contractual figure reflects a genuine pre-estimate and the nature of the transaction makes quantification difficult; the innocent party need not prove actual loss. For instance, in cases where goods are purchased as stock-in-trade, economic loss through delayed delivery can be proved through fluctuations in market price. If, however, the same were to be purchased for manufacturing processes, the consequences of delay would depend upon factors such as lost business opportunities. Such losses cannot be precisely reduced to a monetary figure.¹⁰
- Similarly, in cases of delay in public utility and infrastructure contracts, it is difficult to quantify losses to the society/ State.¹¹
- In such cases where it is difficult to quantify the loss and parties have agreed to a genuine pre-estimate through a clear understanding, then the burden of proof shifts on the party in breach to prove that no loss is likely to occur because of the breach.¹²

Kailash Nath Associates v. DDA¹³:

- The requirement of legal injury is a precondition for claiming compensation. This case involved an earnest money clause which provided for the forfeiture of the earnest money upon breach of the terms of the auction. The auction terms stipulated that 75% of the bid amount must be paid to the Delhi Development Authority (Respondent) within 3 months by the successful bidder (in this case, Kailash Nath Associates, the Appellant). The failure of the appellant to pay the balance 75% amount within the stipulated time led the Respondent to claim a right over the earnest money. The Court however ruled against the Respondent, holding that no loss had been shown, and the land had been re-auctioned for a higher consideration subsequently.¹⁴

Important Principles on Liquidated Damages

From the above decisions, it can be gleaned that:

1. Irrespective of the nature of the contractual clause stipulating a pre-determined amount (whether by way of penalty or liquidated damages), the innocent party is entitled only to *reasonable compensation*.¹⁵
2. In all cases, the party claiming compensation must establish legal injury and

“*actual loss or damage*” suffered. Where the actual loss or damage can be quantified or otherwise ascertained in monetary terms, proof of such loss is not dispensed with.¹⁶ The precise monetary value, however, need not be established with exactness.¹⁷ In such cases, the court may award reasonable compensation, irrespective of whether the exact amount of loss has been proven.¹⁸

3. The proof of loss is dispensed with in cases where it is difficult or impossible to ascertain the compensation. In such cases, the court relies upon the pre-estimated figure as decided between the parties, provided that is a genuine pre-estimate¹⁹ and is not penal in nature. Burden of proof shifts to the party in breach to prove that no loss was likely to occur because of the breach.

Conclusion

Liquidated damages clauses ensure that the need for complex calculations is avoided in cases where it is difficult to prove loss. They also ensure risk mitigation by guaranteeing the innocent party a pre-determined amount of compensation in the event of breach. Such clauses therefore serve a dual purpose: of ensuring efficiency and promoting predictability in contractual performance. It is, therefore, imperative that parties entering into a contract ensure that there is no ambiguity in this regard.

In contracts where it would be impossible or extremely difficult to quantify loss, such as in those involving public utility services, parties may consider incorporating an acknowledgement that the loss is difficult to quantify and therefore the stipulated amount may be regarded as a genuine pre-estimate. This would ensure that where loss on account of contractual breach is difficult to ascertain *ex post*, the liquidated damages clause is regarded as a viable risk allocation rather than a contestable approximation which can be exploited after the breach.²⁰

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⁷ Maula Bux v. Union of India, (1969) 2 SCC 554, para 6.

⁸ Maula Bux v. Union of India, (1969) 2 SCC 554, para 6.

⁹ 2003, 5 SCC 705

¹⁰ ONGC v. Saw Pipes, (2003) 5 SCC 705, para 64.

¹¹ ONGC v. Saw Pipes, (2003) 5 SCC 705, para 67.

¹² ONGC v. Saw Pipes, (2003) 5 SCC 705, para 64.

¹³ 2015 4 SCC 136

¹⁴ Kailash Nath Associates v. DDA, (2015) 4 SCC 136, para 42.

¹⁵ “Liquidated Damages Misconceptions and Misconstructions”, (2023) 9 SCC J-1, p. 19.

¹⁶ “Legal Requirement of Proving Actual Loss or Damage Under Section 74 of the Contract Act,

1872”, (2018) PL March 84, p. 7.

¹⁷ Vivek Khanna v. OYO Apartments Investments LLP, 2023 SCC OnLine Del 5792, para 21.

¹⁸ “Liquidated Damages and Penalties: Ex Ante or Ex Post Methodology”, (2013) 1 SCC J-1, p. 38.

¹⁹ Jeevan Ballav Panda and Satish Padhi, “Liquidated Damages Saga: What does Fateh Chand, Maula Bux and Saw Pipes lead to?”, Bar and Bench, 20 December 2018, available at: <https://www.barandbench.com/columns/liquidated-damages-fateh-chand-maula-bux-saw-pipes>

²⁰ Annol Jain, “Psychology Of Breach: How Misreading Liquidated Damages Skews Contractual Behavior”, Live Law, 01 August 2025, available at:

<https://www.livelaw.in/articles/psychology-breach-misreading-liquidated-damages-skews-contractual-behavior-299552>

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