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LIQUIDATED DAMAGES AND PENALTY **IN INDIAN LAW AND ENGLISH LAW**

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ABSTRACT

"Ubi Jus Ibi Remedium" is a Latin legal adage that translates as "where there is a right, there is a remedy," implying that if a person's right is infringed, the victim will be entitled to an equitable solution under the law.

The purpose of this article is to examine the two most essential words in Sections 73 and 74 of the Indian Contract Act, of 1872, namely "Damages" and "Penalty." In this article, an attempt has been made to examine all of the viewpoints and ways in which these phrases might be interpreted so that the genuine meaning and sense of these portions can be easily deduced. These two words are not defined in the same way in terms of what they signify or include.

When a contract is broken, liquidated damages and/or a penalty are due. While the phrases penalty and liquidated damages may appear to be interchangeable, there is a substantial distinction between the two. In this post, we'll look at the regulations that regulate the amount of compensation that must be paid in the case of a contract violation.

KEYWORDS: Breach, Liquidated damages, penalty, Indian Contract Act.

INTRODUCTION

The Latin legal aphorism "Ubi Jus Ibi Remedium" means "where there is a wrong, there is a remedy." The maxim's underlying idea is that when a person's right is infringed, the victim will be entitled to an equitable remedy under the law.

"A contract is an agreement enforceable by law," according to Section 2(h) of the Indian Contract Act of 1872. It refers to any agreement created with free consent, lawful consideration, and a legitimate object, and signed and executed by a legally competent person.

In basic words, breach of contract implies breaching the terms of a contract by failing to fulfill a promise made under an agreement by either side. When a person or parties to a contract fail to perform their responsibilities, whether partially or totally, it is considered a civil wrong.

Even if the party(ies) acts in a way that indicates their intention to not execute their duties willingly shortly, this might result in a breach of contract.

The court or arbitrator should determine the type of breach of contract and its compensating value to grant relief to the aggrieved party after a thorough examination of the facts and scraps of evidence about the specific contract and the parties involved.

The Remedies allowed for the reimbursement of loss or damages caused by a violation of contract are dealt with in Chapter VI of the Indian Contract Act, 1872.

Any party to the contract that wilfully fails to fulfil its obligations or violates the conditions of a contract is obligated to pay the aggrieved, either via a penalty or through damages.

• **The concept of Damages in the Indian Contract Act:**

If the parties violate a contract, they will be obligated to pay the aggrieved party for the losses caused, which will be the sum known as liquidated damages/penalty. Damages, according to the black's law dictionary, are any monetary claim made by, or ordered to be paid to, a person as recompense for any loss or harm they have suffered¹. In contrast, civil law regimes generally enforce fixed sums, whether they are intended to approximate damages or deter breach.² The case of *Dunlop Pneumatic Tyre Co. Ltd v. New Garage & Motor Co. Ltd*³ (Dunlop's case) is regarded as authoritatively elucidating the common law stance on damages.

In that instance, the key concept was established that if contracting parties agree to a stipulated sum as damages in the event of a violation, the courts would only maintain such an amount provided it is a true pre-estimate. When there is a breach of contract, i.e. when one party fails to satisfy the conditions of the contract to which he is committed, that person is obligated to compensate the other party who has incurred a loss under the Indian Contract

Act. The basic purpose of compensation is to put the damaged or aggrieved party in the same financial position as if the contract had not been violated.

• **Interpretation of Damages by the judiciary/ Case laws: Justice Greenwood of the**

Utah Court of Appeals opined the following terms in *Sohm v. Dixie Eye*⁴: "damages" normally refers to money demanded by, or directed to be paid to, a person as recompense for loss or damages. "The term injury is sometimes used in the sense of damage, including the harm or loss for which compensation is sought, and has been defined as damage resulting from an unlawful act; however, there is, properly speaking, a material distinction between the two terms in that injury means something done against the party's right, causing damage, whereas damage is the harm, detriment, or loss sustained as a result of the injury."

• **Remedies for the damages/injury caused:**

A contract's parties are legally required to fulfil their respective commitments, hence any violation by any side is frowned upon by the law. As a result, once one party breaches a contract, the law provides the other party with three remedies. He could try to get:

1. Damages for the monetary loss.
2. A decree for specific performance.
3. An injunction.

¹ *Bryan A. Garner and Henry Campbell Black, Black Law dictionary (Thomson Reuters 11th edition, 2019)*

² *Edward Alan Farnsworth, Contracts (4th edn Aspen Treatise Series 2004)*

³ *Dunlop Pneumatic Tyre Co. Ltd v. New Garage & Motor Co. Ltd UKHL 1, AC 79*

⁴ *166 P.3d 614, 2007 UT App. 235 (Utah Ct. App. 2007)*

In this paper, the researcher will focus on the remedies for the breach of contract that is liquidated damages, and penalties, and the differences between Indian Law and English Law.

• **Proof of Damage:**

For a claim of damages and the imposition of liability, there must be a causal relationship between the breach and the loss or injury incurred. If the defendant's breach of contract is the only "genuine and active" cause of the harm or damage for which damages are sought, this causal relationship is said to have been established; in the case of numerous causes, the "dominant and effective" cause is to be considered.

The proof of damage lies in the hands of the party claiming the damages of the breach of contract. For a claim of liquidated damages, the production of total proof is required. This stems from the concept that the fair recompense agreed upon as liquidated damages in the event of a contract breach is in respect of some loss or harm; consequently, the presence of such loss or injury is required for a claim of liquidated damages.

➤ **LIQUIDATED DAMAGES**

Section 74 of the Indian Contract Act talks about where a penalty is established for a breach of contract and compensation is provided in the liquidated or unliquidated form. To avail of the compensation, it has to be proved by the party claiming the compensation or revoking the contract. It can't be merely decided by the parties.

As per the black law dictionary liquidated damages means, "*an amount contractually stipulated as a reasonable estimation of actual damages to be recovered by one party if the other party breaches the contract*"⁵

Parties agree to a sum or an amount before entering into a contract that will be paid or compensated by the party which violates the guidelines or breaches the contract to the party at loss or who suffered the injury. This is known as Liquidated Damages.

IMPORTANCE:

1. A way of pre-determining the loss at the time of contracting aids in the recovery of damages. Simultaneously, the computation error is decreased.
2. It reduces the expense and inconvenience while highlighting genuine loss and harm.
3. It reduces the risk of under-compensation and, in cases when the consequences of the breach of contract are understood, it reduces the complexity of evaluating the situation to some extent.
4. As the uncertainty facing the contracting parties increases, so does their latitude in stipulating post-breach damages.⁶

CASE LAWS:

1. **Sir Chunilal V. Mehta and Sons**⁷: In this case, the agreement was terminated by the board of directors. The appellant then filed an action in the Bombay High Court on the original side, demanding damages of Rs. 50 lakhs for the improper termination of the agreement. It eventually changed the plaint with the Court's approval and sought Rs. 28,26,804/- instead as mentioned in clause 14 of the contract as the liquidated damages.

⁵ *Bryan A. Garner and Henry Campbell Black, Black Law dictionary (Thomson Reuters 11th edition, 2019)*

⁶ *Charles J. Goetz and Robert E. Scott, "Liquidated Damages, Penalties and the Just Compensation Principle" Columbia Law School Scholarship Archive, 1977*

⁷ *Sir Chunilal v. Mehta and sons, 1962 AIR 1314, 1962 SCR Supl. (3) 549*

The corporation conceded before the Court that the termination of the appellant's employment was improper, leaving the only question for the learned Judge to resolve was the number of damages the appellant was entitled to. The court determined that construing the provisions of the agreement to determine the amount of compensation owed is a serious matter of law.

2. Arbitration Petition No. 4 of 1986 vs Dilip Dharamsey Khatau on 12 April 2013:

It was opined by the bench of 5 judges who interpreted section 74 of the Indian Contract Act in this that the party committing a breach of contract shall pay the compensation and the upper limit of the compensation has the amount stated in the

contract as liquidated damages. Section 74 has linked a provision for payment of liquidated damages in the event of a contract violation with a stipulation for payment of a penalty.

3. **Balkishan Das v. Fateh Chand (AIR 1964) 1 SCR⁸**- The Hon'ble Supreme Court concluded in this case that the amount of compensation paid to the aggrieved party must be based on the real loss and cannot exceed the amount mentioned as damages or penalty prescribed.

➤ PENALTY

In the case of the penalty provided in section 74 of the Indian Contract Act 1872, however, this is not the case. Damages or a stipulated penalty are used to establish the amount. Furthermore, the amount indicated in the appropriate compensation for the breach and cannot be greater than the amount specified in the contract. As a result, section 74 only discusses liquidated losses and no other types of damages. Damages in liquidation: (not defined in the Indian Contract act, 1872) It is liquidated damages if the amount determined is a genuine estimate of the foreseeable losses that would come from the breach.

1. **T.K. Sundaram v Co-operative sugars ltd:⁹** opined that the compensation agreed upon by the parties is a genuine pre-estimate of the compensation. e it is not by way of penalty the court will enforce the penalty as such.
2. **Cellulose Acetate silk v. Widness Foundry:¹⁰** It was opined by the court that the parties were knowledge of the actual loss will be more than the loss calculated while drafting the actual contract, but the payable damages will be limited to the amount which was agreed by both the parties.

• Difference between liquidated damages and penalties

In accordance with Section 74 of the Indian Contract Act of 1872, "If a contract has been breached, whether the sum is specified as the amount to be paid in the contract in the event of such breach, or whether the contract includes some other clause as a punishment, the complaining party shall be entitled to claim fair compensation from the party who has breached the contract, whether or not the actual damage or loss is found to have been caused thereby."

⁸ *Balkishan Das v. Fateh Chand (AIR 1964) 1 SCR*

⁹ *T.K. Sundaram v Co-operative sugars ltd A.I.R 1988 Mad. 167.*

¹⁰ *Cellulose Acetate silk v. Widness Foundry (1933) A.C. 20*

The claimant does not need to provide proof to demonstrate his real loss, as is the case under English law if the parties have agreed that the amount represents a true preliminary assumption of the damage or harm that will be experienced. However, the petitioner must establish a civil injury, and it is legitimate for the defendant to assert that the amount sought by the plaintiff may be less than the amount to which he or she is entitled because it is difficult to show that the plaintiff suffered a forfeiture.

If the parties break a contract, they are accountable for repaying the aggrieved party for the losses they have incurred, which are calculated as liquidated damages/penalties.

These damages or penalties are the same as they are under Indian law, but they are not the same as they are under English law.

The simple test for evaluating whether a "liquidated damages" clause is an unenforceable penalty clause is whether the agreed sum of liquidated damages was a legitimate covenanted pre-estimate of the loss that may be caused by a breach of the relevant main duty. This concept was established a century ago in the case of *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co*¹¹, which held that if the sum payable was "extravagant, excessive, or unreasonable," the clause would be invalid. As a result, LDs provisions have been challenged because they are penalties.

Lopes, J. in *Law v. Redditch*¹² Local Board clarified the difference between a penalty and liquidated damages. The difference between penalties and liquidated damages is determined by the parties desire to be obtained from the whole contract. The sum mentioned is the penalty if the purpose is to secure contract performance by the imposition of a fine or penalty; nevertheless, it is liquidated damages if the intention is to assess damages for contract violation.

➤ **English Law**

The sum indicated in the contract might be either a penalty or liquidated damages, according to English law.

Liquidated damages are when the parties to a contract jointly agree and pre-fix an amount as compensation, and the amount pre-fixed is fair. This is a sum set aside before or at the time of the contract to cover any future breaches. The Court cannot compel the party to compensate the aggrieved party an amount greater than this predetermined sum for losses suffered.

Penalty: If the sum specified by the party(ies) is not fair and is not adequately estimated but is set forth in the contract to instil dread in the minds of the contracting parties to follow through on their commitments and not violate any terms/obligations as stated in the contract. It is frequently a larger sum than the average loss that any party may suffer as a result of the breach. In such a circumstance, the parties are only given the amount equal to the real loss, not the entire penalty.

Under English Common Law, parties may specify a payment to be paid in the event of a breach. If the money is categorized as a penalty by the court, it is irrecoverable; but, if it is classified as liquidated damages, it is recoverable.

¹¹ *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor, Co* 1915 AC 79.

¹² *Lopes, J. in Law v. Redditch*(1892) 1 C.B. 127, at 132

➤ Indian Law

According to Indian law, there is no distinction between a penalty and liquidated damages. According to Section 74 of the Indian Contract Act, 1872, if a party breaks or breaches a contract, the amount to be paid in such breach is by way of penalty/damages or any other form stipulated, and the party claiming for such breach is entitled, whether the actual damage or loss is proven, to receive from the party committing such breach a reasonable compensation not exceeding the amount so mentioned, which is usually decided by the Court.

Exception — In the event of contracts with the government for the general public, a breach is compensated by the Authority returning the whole contract amount.

According to the Indian Contracts Act, of 1872, the theory of fair compensation governs the liquidated damages and penalties due by a party that breaches a contract. The amount of appropriate compensation must be determined by the court.

The Law of Contracts in India does not recognize any qualitative differences in the nature of damages, as section 74 abolishes the relatively complicated refinement that existed under Common Law. The elimination of this distinction avoids a morass of complicated categories, requiring the court to give just "fair compensation" that does not exceed the contract's damages.

CONCLUSION

When it comes to liquidated damages and penalties, courts have the propensity to decide that liquidated damages must be adequate recompense, whereas penalties must be shown. If no loss is expected to arise as a result of the violation, the court might decline to award compensation.

If the damages are in the character of a penalty, the court has the authority to award fair compensation up to the amount specified in the contract upon proof of damages. In the event of a contract violation, the courts have unrestricted power to award damages, but the damages must be fair.

While Indian law regards both to be synonymous, English law distinguishes between the two. To prevent the parties from defaulting, the penalty is overstated. Liquidated damages are a more accurate representation of the loss.

In terms of liquidated damages and penalties, the court appears to have reached the judgment that liquidated damages should be considered appropriate recompense, whilst penalties should not.

When compared to penalties, liquidated damages are simple to apply. Penalties can also be levied for specific occurrences such as late completion of work or supply delays. In addition, there is no distinction between liquidated damages and penalties in the Indian Contract Act.

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