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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal providededicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

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# **LIQUIDATED AND UNLIQUIDATED DAMAGES UNDER SECTION 73 AND 74 OF INDIAN CONTRACT ACT**

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## **ABSTRACT**

This law provides guidelines that help in the formation and compliance of Contracts in a regulated and organized manner. These rules and regulations provide the framework for the course of Action to be followed in case of any disputes arising from the Contracts. The Act has 266 sections and applies to the entire country except for Jammu and Kashmir. The Indian Contract Act, of 1872 provides the guidelines for forming a valid Contract. This paper gives a detailed explanation of liquidated and unliquidated damages in the Indian Contract Act. At the time of breach of contract, damage or legal remedy is provided to the party.

The evolution of how the contract act came into force in India from ancient times to medieval to Roman to English law and then the enactment of the Indian Contract Act, 1872. The concept of liquidated and unliquidated damages serves as important mechanisms to address the breaches and provide remedies for aggrieved parties. Section 73 of the Contract Act pertains specifically to liquidated damages, which are predetermined amounts agreed upon by the party at the time of the contract. Section 74 deals with unliquidated damages, addressing situations where the parties have not predetermined the compensation in the event of a breach.

The remedies provided for the breach of contract are compensatory damages, liquidated damages, rescission, specific performance, injunction, and nominal damages. Section 10 of the Contract Act defines what agreements are contract which gives a clear view about in what cases the breach of contract can be found. If the contract is breached then the affected party can claim the damage from the court, and the court order is binding upon the other party. This is how section 73 of contract act defines liquidated damages and section 74 of contract act defines unliquidated damages.

## INTRODUCTION

The Indian Contract Act is based on the principles of English Common Law. It applies everywhere i.e. to all the states of India. The act deals with the matters concerned with breach of any agreement made between two or more parties. It determines the circumstances in which promises made by the parties to a contract shall be legally binding. The Indian Contract Act defines a contract as an agreement enforceable by Law is a contract under section 2(h). A contract is an agreement between parties, creating mutual obligations that are enforceable by law. The basic elements required for the agreement to be a legally enforceable contract are: mutual assent, expressed by a valid offer and acceptance; adequate consideration; capacity; and legality.

The criteria for any contract to be binding may vary according to the state. In some states, elements of consideration can be satisfied by a valid substitute. Certain possible remedies for breach of contract include general damages, consequential damages, reliance damages, and specific performance. Contract law is generally governed by state common law, and while general overall contract law is common throughout the country, some specific court interpretations of a particular element of the contract may vary between the states. Contracts arise when a duty comes into existence, because of a promise made by one of the parties. To be legally binding as a contract, a promise must be exchanged for adequate consideration.

There are two different theories or definitions of consideration: The bargain Theory of Consideration and the Benefit-Detriment theory of Consideration. Bargain Theory means when two individuals make a promise to each other and that promise made is in exchange for another promise. This bargain theory then makes it legally binding in eyes of law. Benefit-Detriment theory of consideration means when a promise is made to the benefit of the promisor or to the detriment of the promise then a consideration exists.

For the breach of contract, liquidated and unliquidated damages are provided to the concerned party. Liquidated damages are a fixed amount to be paid to the non-breaching party whereas unliquidated damages are the amount that is decided at the time of any future consequences. The liquidated damages are fixed at the time of the contract and are binding upon the parties in the contract.



## HISTORICAL BACKGROUND

In the era of historical records, contract is a term that has been used in society as a common term in one or the other language. The early history of contracts in India can be found in the sacred texts of Hinduism, such as the Vedas and the Manusmriti. Before the act was enacted, the contract in early times was governed by the personal laws of different religious communities. To understand the process of enactment of the Indian Contract Act, we need to look at different stages.

### **Vedia and Medeival period:**

In the earlier ancient and medieval periods there was no specific code for contracts. Rules were derived from different sources of law like Vedas, Smritis, the Dhramshatras, and the Shrutis. All the contract rules were a part of Vyavaharmayukha. The Vedic period gave birth to the concept of liability in contract law. Manusmriti, the first and foremost requirement for a contract process to start is the competence of the persons who are willing to enter into a contract. By the end of the medieval age, the law of contract was governed by two factors; the moral factor and the economic factor. The Arthashastra by Kautilya is considered to be the only existing secular treatise on politics and governments.

The following contracts were made void during the time of Chandragupta's region:

- Contracts formed during the night or made in the forest.
- Contracts entered into the interior compartment of the house.
- Contracts made in any other secret place.
- Contracts made to ward off violence, attack, and affray.
- Contracts made in celebration of marriage.
- Contracts made under orders of government
- Contracts made by traders, hunters, spies and others who would roam in the forest frequently.

Another form where a contract was made void is that women could not make contracts binding on their husbands or against family properties. There was no 'limitation' for bringing a suit for money lent. This was the evolution of contract law in the times of ancient and medieval era.

## **EARLY LAW OF CONTRACT: ROME**

The law of contracts developed with the recognition of several categories of promises to be enforced rather than the creation of any general criteria for enforcing promises. A promise might be morally binding but it was not legally enforceable until it fell within the specified categories of “stipulation”, “real” contracts, and “consensual” contracts. A fourth category was added i.e. “innominate” contract. All these categories met the Roman needs through the classical period. The Roman notion in Indian law of contract was not directly included but helped in the development of English law.

## **ENGLISH LAW IN INDIA**

The English common law was in force at the time came into India by the Charter of the eighteenth century which established the Courts of Justice in three presidency towns of Calcutta, Madras, and Bombay. The statute of 1781 empowered the Supreme Court at Calcutta and the statute of 1797 empowered the Courts of Madras and Bombay, to determine all actions and suits of a contractual nature against the natives of the said towns. The year 1862 saw the introduction of High Courts in the presidential towns of Calcutta, Madras, and Bombay. The courts established under the statutes of 1781 and 1797 were abolished. The expression ‘justice, equity, and good conscience’ was interpreted to mean the rules of English law so far as applicable to the Indian society and circumstances. It has been observed that in practice, the application of English law did not raise difficulty because on many points there were no differences between the English and the personal law, and there was no rule of personal law in many cases, moreover because many Indian businessmen acquired experience from their relations with Britons. The law of England, so far as consistent with the principles of equity and good conscience, generally prevailed in the country unless it came in conflict with Hindu or Mahomedan law.

Therefore, the Indian Contract Act, of 1872 was enacted on 25<sup>th</sup> April 1872, and came into force on the first day of September 1872. Further amendments were made as time passed according to the requirements of society.

## **BREACH OF CONTRACT**

A breach of contract is a violation of any of the agreed-upon terms and conditions of a binding contract. A breach of contract is when one party breaks the terms of an agreement between two or more parties. This includes when an obligation that is stated in the contract is not completed on time—for example, you are late with a rent payment—or when it is not fulfilled at all, such as a tenant vacating their apartment owing six months' back rent.

The breach can be of two types i.e. Minor and Material breach or actual and anticipatory breach. Breach of contract can be avoided with clarity, legality, and expectations. Any contract comes into force to fulfill the agreement, if any contract is breached then comes the damages and legal remedies that can be provided to the parties.

## **DAMAGES IN CONTRACT LAW**

### **LIQUIDATED DAMAGES**

These damages are pre-agreed damages that must be paid by the non-breaching party. These are decided at the time of entering the contract and are mentioned in the contract agreement. The amount in the liquidated damages are fixed, and it is not modified once the contract is signed.

Section 73 governs the regulation of liquidated damages in the Indian Contract Act 1872. Section 74 defines 'Compensation for breach of contract where penalty stipulated for'. It states that, '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.'

For example:

1. A contracts with B to pay B Rs. 1,000, if he fails to pay B Rs. 500 on a given day. A fails to pay B Rs. 500 on that day. B is entitled to recover from A such compensation, not exceeding Rs. 1,000, as the Court considers reasonable.

2. A borrows Rs. 100 from B and gives him a bond for Rs. 200 payable by five yearly installments of Rs. 40, with a stipulation that, in default of payment of any installment, the whole shall become due. This is a stipulation by way of penalty.

CASE: Oil & Natural Gas Corporation Ltd vs Saw Pipes Ltd

Judgment: The Hon'ble Court first extensively discussed the court's jurisdiction to set aside an award under Section 34 of the Arbitration and Conciliation Act 1996 and the various grounds on which interference was permissible. Passing over to the question of damages, the Hon'ble Court opined that when the words of the contracts are clear, there is nothing that the court can do about it. If the parties had agreed upon a sum as being pre-estimated genuine liquidated damages there was no reason for the tribunal to ask the purchaser to prove his loss.

Here the use of the words penalty or Liquidated Damages does not necessary mean that a clause is either a penalty or a Liquidated Damages clause. The court will review the clause in light of the circumstances at the time of entering into a contract. However, even in English law, a liquidated damages clause will result in the plaintiff recovering the stipulated sum without being requested to prove damages and irrespective of any actual damage, even when actual damage is demonstrably smaller than the stipulated sum. It is stated in the Chitty that the purpose of fixing a sum is to facilitate recovery of damage without difficulty and expense of proving actual damage or to avoid the risk under compensation where the rules on the remoteness of damage might not cover consequential, indirect or idiosyncratic loss or to assure the promisee that he may safely rely on the fulfillment of the promise. A distinction is drawn between contracts which accelerate an existing liability to pay and those that create or increase a liability to pay. The latter are penal, the former are not. In this context it's also relevant to consider contracts that provide for forfeiture of amounts already paid. If the sum paid is penal and is unconscionable for the payee to retain the money, equitable relief may be available. However, the genuine pre-establishment of damages test does not apply in these cases. Nonetheless courts will take into account whether the sum to be forfeited is much greater than the damage caused by the breach.

## UNLIQUIDATED DAMAGES

These damages are not pre-agreed and are assessed by the court or an arbitrator after the breach of contract has occurred. These damages are calculated based on the actual loss or damage suffered by the aggrieved party.

In India, unliquidated damages are governed by Section 73 of the Indian Contract Act, 1872. This section states that if a contract is breached, then the non-breaching party is entitled to receive compensation for any loss or damage suffered by them that was a natural consequence of the breach. It defines that 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.

For example, A contracts to sell and deliver 50 maunds of saltpeter to B, at a certain price to be paid on delivery. A break his promise. B is entitled to receive from A, by way of compensation, the sum, if any, by which the contract price falls short of the price for which B might have obtained 50 maunds of saltpeter of like quality at the time when the saltpeter ought to have been delivered.

A contracts to buy B's ship for 60,000 rupees, but breaks his promise. A must pay to B, by way of compensation, the excess, if any, of the contract price over the price that B can obtain for the ship at the time of the breach of promise.

CASE: Ram Lal Jain vs Central Bank of India Ltd, Bombay

The petitioner appealed to this Court and the learned Single Judge held that Ram Lal was a debtor of the bank at the tune of the partition and not its creditor, and that, therefore, he could not file an application under Section 13 of the Act. The court ordered, The appeal was dismissed but the parties are left to their own costs in this Court.

With regards to this, liquidated and unliquidated damages are basically the depending upon amount being fixed or not in the contractual obligation.

## CONCLUSION

The Contract Act is a pivotal legislation in India, governing the formation, performance, and breach of contracts. Enacted in 1872, it defines the legal framework for agreements and ensures their enforceability. The law outlines essential elements such as offer, acceptance, consideration, and intention to create legal relations. Sections like 73 and 74 address damages for breaches, distinguishing between liquidated and unliquidated damages. The Contract Act plays a vital role in facilitating fair and transparent transactions, providing a robust foundation for business and personal agreements while promoting legal remedies for contractual disputes. Sections 73 and 74 of the Indian Contract Act, 1872, play a crucial role in addressing the aftermath of a contractual breach, offering a structured approach to the assessment and award of damages.

The interplay between Sections 73 and 74 underscores the importance of contractual precision. Parties are encouraged to delineate their expectations and remedies clearly to mitigate potential disputes. A well-crafted contract serves as a roadmap, steering the parties through the labyrinth of legal intricacies.

Section 73 and Section 74 are linked to damages in contract by providing avenues for the recovery of losses arising from a breach. While Section 73 focuses on predetermined, liquidated damages, Section 74 addresses situations where damages are unliquidated, leaving it to the court to determine a fair and reasonable compensation based on the actual harm suffered. Together, these sections offer a comprehensive framework for addressing damages in contractual relationships.

In conclusion, Sections 73 and 74 together create a nuanced framework for dealing with contractual breaches, balancing the need for predictability through liquidated damages with the flexibility of unliquidated damages when the former is absent. The provisions underscore the principle of compensating the aggrieved party without unduly punishing the defaulting party, promoting a just and equitable resolution of contractual disputes in the Indian legal landscape.

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