

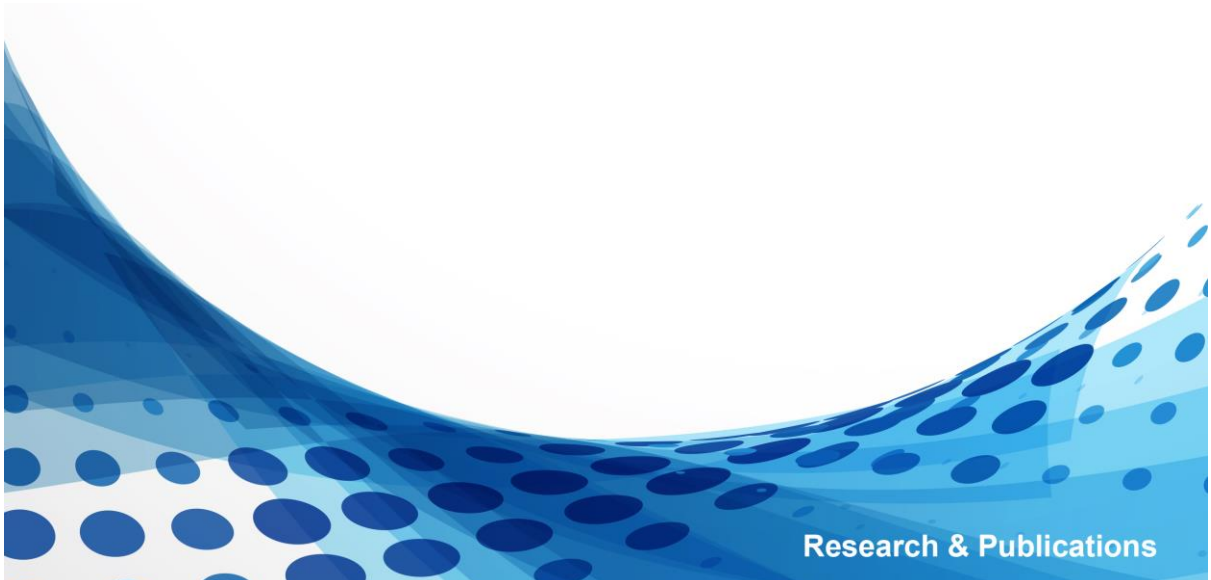


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Liquidated Damages in India: Concepts, Enforceability, and Drafting Considerations

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Liquidated Damages in India: Concepts, Enforceability, and Drafting Considerations

M P Ram Mohan*, Gaurav Ray**, Promode Murugavelu[#] and Jeeri Sanjana Reddy^{##}

ABSTRACT

Damages in contract law play a crucial role in compensating parties for losses resulting from breaches of contractual obligations. Liquidated damages clauses promote commercial certainty and party autonomy. Section 74 of the Indian Contract Act, 1872 codifies the law on liquidated damages. Over the years, courts have employed several evaluative criteria and interpretative tools when deciding upon the validity, scope and essential aspects of liquidated damages clauses. This paper analyses the principles governing liquidated damages and attempts to use this analysis to provide a guide in drafting a valid and legally enforceable liquidated damages clause.

Keywords – Liquidated Damages, Consequences of Breach, Remedy for Breach, Contracts, Reasonable Compensation, Penalty

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INTRODUCTION

In contract law, damages constitute a central concept, serving as a financial remedy aimed at compensating parties for losses resulting from a breach of contractual obligations. Damages are a “*means of restoring the injured party to a position they would have been in, had the contract been duly fulfilled*”.¹ Damages are the monetary loss that results inevitably due to non-fulfilment of contractual obligations.² Based on the manner of determination of the amount payable for breach of contract, damages can be classified as liquidated and unliquidated damages. Unliquidated damages arise when a claim for compensation arises for a sum which has not been pre-determined by the parties.³ On the contrary, a liquidated damages clause designates a fixed sum that shall be assessed as compensation for injury caused by a breach of contract.⁴ Liquidated damages are different from general damages, which are the “*compensation for losses which naturally arise in the usual course of things from a breach.*”⁵ This paper deals with the law on liquidated damages. At the time of contract drafting, the parties may agree that, in the event of a breach, the party breaching the contract shall be liable to pay an amount specified.⁶

Liquidated damages clauses are commonly found in a wide array of commercial contracts such as construction and engineering contracts, equipment supply contracts, purchase agreements and service agreements. Many such contracts have strict timelines for execution of the projects, and supply of goods and services, and this makes it easier for the parties to estimate the damages payable in the event of breach of these timelines. Liquidated Damages clauses serve the purpose of promoting commercial certainty, because by pre-determining the compensation payable beforehand, parties undertake a ‘defined risk’.⁷ Pre-determining the amount of compensation and the events which would entail such payment mitigates potential legal costs which could be incurred by contracting parties in determining the same at a later stage.⁸ Furthermore, a liquidated damages clause provides some certainty of the potential liability that

¹ *Halsbury’s Laws of India: Contract, Vol 9* (2nd edn Lexis Nexis India 2015).

² *ibid.*

³ Jack Beatson, Andrew Burrows and John Cartwright, *Anson’s Law of Contract* (29th edn, Oxford University Press 2010).

⁴ Stephen Smith, *Atiyah’s Introduction to the Law of Contract* (6th edn, Clarendon Law Series 2006).

⁵ R Yashod Vardhan and Chitra Narayan, *Pollock & Mulla: The Indian Contract Act* (16th edn, LexisNexis 2021).

⁶ *ibid.*

⁷ *Bharat Sanchar Nigam Limited v Reliance Communications Ltd* (2011) 1 SCC 394; *MSK Projects India (JV) Limited v State of Rajasthan and Another* (2011) 10 SCC 573; *Valence Operating Co. v Dorsett* (2005) 164 S.W.3d 656, 664 (Tex).

⁸ Kevin T Jacobs and Cynthia A Castillo, ‘Liquidated Damages Clauses: Preparing for a Breach in Today’s Oil and Gas Market’ (2017) 12 *Tex J Oil Gas & Energy L.*

would otherwise be unpredictable, while simultaneously offering the party suffering loss with a certain degree of surety regarding the amount of compensation it is entitled to receive.⁹ This could help the suffering party to effectively manage the contractual schedule and mitigate the negative effects of breach. A liquidated damages clause typically takes into account all material aspects, including a reasonable pre-estimate of costs. These costs are what the party who suffered would incur in arranging for an alternate source of supplier or service provider. Typically, such clauses also consider the escalation in cost due to shorter execution timelines and inflation. Therefore, the parties to a contract are better prepared to handle the possibility of a violation or delay in the execution of such a contract. Additionally, a liquidated damages clause helps in saving time for parties involved, as opposed to determining the amount payable through time-consuming litigation.¹⁰

Enforcing a liquidated damages clause though involves much more than merely specifying the amount of compensation in case of breach of contract. This paper explores all relevant aspects which are to be considered while formulating a liquidated damages clause and the consequences of non-adherence to such requirements.

This paper is structured as follows. Part 1 briefly examines the evolution of liquidated damages clauses in common law and civil law countries. Part 2 analyses the principles governing liquidated damages in India. Part 3 explores factors influencing the enforcement of liquidated damages clauses, including the tests for proof of actual damage, burden of proof of loss, interpretation of liquidated damages clauses, exclusions or waiver of liquidated damages, and the applicability of the principles of prevention and mitigation. Part 4 of this paper explains how a contract with a liquidated damages clause must be drafted with precision, and after careful consideration of the applicable legal standards which would make it valid and enforceable.

1. EVOLUTION OF LIQUIDATED DAMAGES – COMMON LAW & CIVIL LAW

During the fifteenth century, it was common for courts of equity to grant relief to the suffering party in cases of fraud involving common money bonds,¹¹ if the default on payments was

⁹ P C Markanda, *Building & Engineering Contracts* (4th edn, LexisNexis India 2013).

¹⁰ Larry A DiMatteo, 'An Examination of Judicial Reasoning – When a Penalty is Not a Penalty' (2017) 85(6) *Geo Wash L Rev* 1846.

¹¹ A common money bond intended to guarantee the payment of a specific amount of money with interest. Initially, they were restitutionary in nature and was executed with an agreement to pay an additional amount of money if the specified deadline for repayment was not met. Courts' intervention was subsequently broadened to encompass

justifiable.¹² The courts' role was later expanded by courts of equity to encompass situations where bonds were issued not only to guarantee the payment of a specific amount on a set date, but also to deter or ensure the performance of an action.¹³ There was no distinction between penal and liquidated damages clauses.

This 'equitable rule against penalties' as a concept is known to have emerged in 1721, in the case of *Sir Harry Peachy v Duke of Somerset*.¹⁴ The Plaintiff, Sir Harry, inherited a copyhold estate,¹⁵ and after his marriage, he surrendered some land to the Duke of Somerset. When the plaintiff sublet a portion of the estate without a licence, the Duke initiated an eviction action against the entirety of the Plaintiff's copyhold, which was challenged in court. Lord Macclesfield of the England and Wales Court of Chancery ruled:

“the true ground of relief against penalties is from the original intent of the case where the penalty is designed only to secure money and the court gives him all that he expected or desired.”

Lord Macclesfield's interpretation allowed the party liable to pay damages to sidestep the harsh consequences of penalty, as long as he repaid the determined actual damages, including interest.¹⁶ While the penalty in *Peachy* was not a financial penalty, it is a leading case which shows the origins of relief against penalties provided by equity courts.¹⁷

Similar practices of granting relief were adopted by common law courts, when they obtained the jurisdiction to deal with penalties (which were earlier dealt by the courts of equity) through the Administration of Justice Acts of 1696 and 1705.¹⁸ Until the seventeenth century there was no differentiation between penalties and liquidated damages under common law.¹⁹ The result of the aforementioned statutes was that even though the courts of equity retained jurisdiction

situations where bonds were issued not just to guarantee payment of money on a specified date, but also to ensure or restrict the performance of a specific act (punitive in nature) - in Peter Benjamin, 'Penalties, Liquidated Damages and Penal Clauses in Commercial Contracts: A Comparative Study of English and Continental Law' (1960) 9(4) *International & Comparative Law Quarterly* 600-627.

¹² F H Lawson, *The Rational Strength of English Law* (Steven & Sons Limited 1951).

¹³ David J Ibbetson, *A Historical Introduction to the Law of Obligations* (Oxford University Press 2001).

¹⁴ *Sir Harry Peachy v Duke of Somerset* (1721) 1 Strange 447.

¹⁵ Copyhold was a common form of customary land ownership in England dating back to the late Middle Ages. It is characterized by the practice of providing the tenant with a copy of the land's title deed that is documented in the manorial court roll, instead of the land deed itself.

¹⁶ James Allsop, 'The Doctrine of Penalties in Modern Contract Law' (2018) 30 *SaCLJ* 1.

¹⁷ William H Loyd, 'Penalties and Forfeitures: Before *Peachy v. Duke of Somerset*' (1915) 29(2) *Harvard L Rev*, 117.

¹⁸ The Administration of Justice Act 1696; The Administration of Justice Act 1705.

¹⁹ Benjamin (n 11) 605.

over penalties until 1878, common law courts now had to intervene and evaluate whether the amount stipulated as pre-determined damages was penal.²⁰ In cases where the monetary amount was considered penal, the claimant was only able to obtain compensation for the actual loss incurred. When the compensation in question was not deemed penal, courts were required to award the plaintiff the pre-determined amount in its entirety. Even until the mid-eighteenth century, courts of equity declined to intervene in situations involving contractual clauses that impose penalties.²¹ However, in the late eighteenth century, equity courts imposed limitations on penalties that they deemed “unconscionable”.²²

In the United States of America, courts adhere to the equitable rule against penalty.²³ The Uniform Commercial Code²⁴ and the Restatement (Second) of Contracts²⁵ formally embody the rule against penalty. Other common law nations, including Canada, UK, Australia, and Ireland have similar laws against penalties - allowing only reasonable damages to be stipulated in contracts.

The approach taken by civil law countries towards contractual penalties diverges significantly from that of common law countries. Historically, civil law nations have not differentiated between penalty clauses and liquidated damages clauses in terms of their enforceability.²⁶ It is common for civil law countries such as Portugal²⁷ and Spain²⁸ to enforce penalty clauses. In France, Articles 1226 to 1233 of the French Civil Code regulate penalty clauses,²⁹ and Article 1152 of the French Civil Code regulates clauses on liquidated damages,³⁰ which categorically argues against judicial intervention in enforcing penal clauses.

²⁰ Benjamin B Reed, ‘Liquidated Damages Provisions: Strategic Drafting and Enforcement Issues’ (2018) 37 Franchise LJ 523; *Bramwell B in Belli v Burch* (1859) 4 H. 4 N. 606.

²¹ *Roy v Duke of Beaufort* (1741) 2 Atk 190.

²² *Sloman v Walter* (1783) 1 Bro C C 418.

²³ Charles Calleros, ‘Punitive Damages, Liquidated Damages, and Clauses Penales in Contract Actions: A Comparative Analysis of the American Common Law and the French Civil Code’ (2006) 32(1) Brooklyn J of Intl L <<https://brooklynworks.brooklaw.edu/bjil/vol32/iss1/2>> accessed 2 October 2023.

²⁴ The Uniform Commercial Code, s 2-718(1).

²⁵ The Restatement (Second) of Contracts, s 356.

²⁶ Antonio P Monteiro, ‘Clause Penale/Penalty Clause/ Verstragsstrafe’ (2001) 1 Eur Rev Pvt L 149.

²⁷ ‘Recent Case Law – Section 4.1: The Portuguese Supremo Tribunal de Justicia in judgment dated 3 July 2003’ (2004) (4) Eur Rev of Pvt L 552.

²⁸ *Sentencia del Tribunal Supremo RJ No 7307* dated 17 October 2007 (Supreme Court of Spain); *Sentencia del Tribunal Supremo RJ No 8441* dated 29 November 1997 (Supreme Court of Spain); Ignacio Marín García, ‘Enforcement of Penalty Clauses in Civil and Common Law: A Puzzle to be Solved by the Contracting Parties’ (2021) (5)1 Eur J of L Studies 92.

²⁹ French Civil Code 1804, arts 1226-1233.

³⁰ French Civil Code 1804, art 1152.

Be that as it may, while penalty clauses were once generally enforceable in countries with civil law, in the majority of jurisdictions today they can be modified by the judiciary. The ‘Resolution on Penalty Clauses’ promulgated by the Council of Europe in 1971³¹ permits the inclusion of penalty clauses; however, civil law courts have begun exercising the authority to reduce the penalty amount if it is exorbitant.³²

What constitutes “exorbitant”, “disproportionate” or “manifestly excessive” will be determined in accordance with the principles outlined in the Council of Europe’s 1971 ‘Resolution on Penalty Clauses’. Regardless, both, liquidated damages clauses and penalty clauses remain enforceable under civil law as opposed to common law’s strict rule against enforcement of penalties.

In India, the law on liquidated damages is enshrined in Section 74 of the Contract Act (‘Contract Act’). Section 74 prescribes that at the time of drafting the contract, parties may pre-estimate and stipulate the compensation payable in the event of a breach of contract. If the sum is a “genuine pre-estimate of damages likely to flow from the breach,” it is considered to be liquidated damages.³³ Section 74 of the Contract Act represents a legislative effort to depart from the intricate methodology and presumptions prevalent in English common law when differentiating between penalty clauses and liquidated damages clauses.³⁴ The provision in its initial form, was suggested by the Third Law Commission of British India in the Contract Bill.³⁵ It stipulated that:

“When a contract has been broken, if a sum is named in the contract itself as the amount to be paid in case of such breach, the amount so named shall be paid accordingly.”

In its present form, Section 74 of the Contract Act reads as follows:

“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

³¹ Committee of Ministers of the Council of Europe, Resolution 78(3) Relating to Penal Clauses in Civil Law 1971.

³² Reed Smith LLP, ‘Liquidated Damages and Penalty Clauses: A Civil Law versus Common Law Comparison’ (2008) The Critical Path 1,3-6. ; *Decision 74/2018* dated 14 February 2018 (Supreme Court of Spain); *Decision No. U.2004.4200H* dated 15 June 2004 (The Danish Hojesteret); *Decision No C.00.0176N* dated 16 December 2002 (The Belgian Hof van Cassatie/Cour de Cassation); *Decision No. No. 8188* dated 29 May 2003 (The Italian Corte di Cassazione, Sez. II).

³³ Halsbury (n 1).

³⁴ Vardhan and Narayan (n 5); *Fateh Chand v Balkishan Dass* (1963) AIR SC 1405.

³⁵ Draft Contract Bill 1866 (3rd Law Com, 28 July 1866).

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.

... ..”

(Emphasis Supplied)

The scope of Section 74 was expanded with the addition of the phrase “*or if the contract contains any other stipulation by way of penalty*” by the Indian Contract (Amendment) Act, 1899, to cater to situations stipulated under Illustrations (d) to (g) to Section 74 of the Contract Act. Although the provision uses the term “penalty” to refer to the sum payable, the provision itself does not refer to a penalty clause; rather it refers to a clause providing for the payment of liquidated damages.³⁶

Professor Shivprasad Swaminathan points out that the drafter’s original intention was to “*block any avenues for slipping back into the old penal-compensatory distinction that had troubled the English common law*”³⁷ However, as he points out, courts in India have “*insisted that reasonable compensation in section 74 is limited to compensation for loss or damage alone*”³⁸

In India, over the years, courts have employed number of evaluative criteria and interpretative tools when deciding upon the validity of liquidated damages clauses. These are discussed below.

2. PRINCIPLES GOVERNING LIQUIDATED DAMAGES – INDIA

Indian Courts have over the years consistently upheld the validity of liquidated damages clauses when they meet certain criteria. A clear understanding of the principles governing liquidated damages would help parties formulate liquidated damages clauses which are enforceable, thereby mitigating potential disputes. In India, like the United Kingdom (‘UK’), a clause mandating the payment of liquidated damages is enforceable only if it does not possess the characteristics of a penal clause and is otherwise reasonable. Furthermore, liquidated damages must pre-estimate a ‘reasonable’ amount as compensation payable for breach of

³⁶ *Bharat Sanchar Nigam Limited v Reliance Communications Ltd* (2011) 1 SCC 394.

³⁷ Shivprasad Swaminathan, ‘De-inventing the Wheel: Liquidated Damages, Penalties and the Indian Contract Act, 1872’ (2018) 6(1) *The Chinese of Comp L* 109.

³⁸ *ibid* 111.

contract. There are three principles which have consistently surfaced across common law countries during any analysis of the differences between a penalty (which are generally unenforceable) and liquidated damages clauses:

First, liquidated damages constitute a pre-estimate of the losses suffered while penalties are punitive in nature and go beyond losses suffered by the suffering party,

Second, the pre-estimated sum so stipulated must be reasonable, and

Third, the sum fixed in the liquidated damages clause is the “upper limit” on the damages payable.³⁹

2.1 Rule against Penalty

The Supreme Court of India has distinguished between the common law and Indian approaches to the rule against penalties in *Fateh Chand v Balkishan Dass*.⁴⁰ It was held by the Supreme Court that:

*“[Section 74] is clearly an attempt to eliminate the somewhat elaborate refinements made under the English common law in distinguishing between stipulations providing for payment of liquidated damages and penalty... Under the common law, a stipulation in a contract in terrorem is a penalty and the Court refuses to enforce it... The Indian Legislature has sought to cut across the web of rules and presumptions.”*⁴¹

The manner in which the rule against penalty operates in India, as against UK and the USA, was analysed by the Supreme Court of India in *Maya Devi v Lalta Prasad*.⁴² Placing emphasis on *Fateh Chand v Balkishan Dass*,⁴³ the Court held that Section 74 of the Contract Act, imposes on courts the statutory obligation not to enforce penalty clauses, but to award only reasonable compensation whether the clause is a liquidated damages clause or any other clause stipulating an amount payable. In this case, the Supreme Court did not allow for the enforcement of a Deed

³⁹ William S Harwood, ‘Liquidated Damages: A Comparison of the Common Law and Uniform Commercial Code’ (1977) 45(7) Fordham L Rev 1349-81; *Kailash Nath Associates v Delhi Development Authority and Anr* (2015) 4 SCC 136.

⁴⁰ *Fateh Chand v Balkishan Dass* (1963) AIR SC 1405.

⁴¹ *Fateh Chand v Balkishan Dass* (1963) AIR SC 1405; *Naresh Chandra Sanyal v Calcutta Stock Exchange Association Ltd.* (1971) 1 SCC 50; *Kamal Kant Jain v Surinder Singh* (2019) 1 SCC 432.

⁴² *Maya Devi v Lalta Prasad* (2015) 5 SCC 588.

⁴³ *Fateh Chand v Balkishan Dass* (1963) AIR SC 1405.

of Agreement for Earnest Money which required the payment of an exorbitant amount of money, because the stipulated sum in the deed was in the nature of a penalty.

In an effort to streamline the complex “*web of rules and presumptions under English common law*”, the Contract Act established a single standard that applies to all stipulations that specify the amount to be paid in the event of a breach.⁴⁴ The standard is that when the fixed amount is in the nature of a penalty, only reasonable compensation, not surpassing the stated penalty, may be awarded.⁴⁵

Similarly, a clause that refers to “penalty” but is in fact a provision for liquidated damages maybe upheld by Courts as being valid, for the simple reason that the Courts consider substance over form. For example, in *Bharat Sanchar Nigam Limited v Reliance Communications Limited*,⁴⁶ the Supreme Court of India stated:

“*The fact that a sum of money is payable on breach of contract is described by the contract as ‘penalty’ or ‘liquidated damages’ is relevant but not decisive as to categorization.*”

A detailed exercise in distinguishing penalty and liquidated damages was undertaken by the Supreme Court of India in *Oil and Natural Gas Corporation Ltd v Saw Pipes*,⁴⁷ which emphasised the importance of analysing the terms and language of the contract. The Court held that:

First: when determining the nature of the clause, it is necessary to examine the terms of the contract, and

Second: when the parties explicitly consented to a genuine pre-estimated liquidated damages amount as compensation for the contractor’s breach of contract, and the amount is not in the nature of penalty, the court ought to grant the compensation.

⁴⁴ *Naresh Chandra Sanyal v Calcutta Stock Exchange Association Ltd* (1971) 1 SCC 50.

⁴⁵ *Maula Bux v Union of India* (1970) AIR SC 1955; The Indian Contract Act 1872, s 74.

⁴⁶ *Bharat Sanchar Nigam Limited v Reliance Communications Ltd* (2011) 1 SCC 394; extracted portion was reiterated in *MSK Projects (I) (JV) Ltd v State of Rajasthan and Ors* (2011) 10 SCC 573; *M/s Pawan Hans Helicopters Ltd v M/s Maritime Energy Heli Air Services Pvt Ltd* (2017) SCC OnLine Del 8773; *GAIL (India) Limited v Punj Lloyd Limited* (2017) 240 DLT 610.

⁴⁷ *Oil and Natural Gas Corporation Limited v Saw Pipes Limited* (2003) 5 SCC 705.

2.2 Compensation must be Reasonable and “Genuine Pre-Estimate”

Under common law, the “unconscionable and extravagant” standard was traditionally used to determine reasonableness of the compensation.⁴⁸ The origin of this standard can be identified in the *Clydebank case*.⁴⁹ Before a court intervenes in the enforcement of a specific clause in a contract, Lord Halsbury cautioned that an exceptionally high standard should be set, i.e., the clause must be “*unconscionable and extravagant, and one which no Court ought to allow to be enforced.*”⁵⁰ In *Dunlop Pneumatic Tyre Co v New Garage and Motor Co*,⁵¹ this standard was expanded further, and Lord Dunedin prescribed four approaches to triggering the “unconscionable-extravagant standard”: (i) when the pre-determined sum exceeds foreseeable loss from the breach, (ii) when the breach involves non-payment of money, and the stipulated penalty exceeds the amount owed, reflecting principles rooted in common law and equity, (iii) when the same stipulated amount applies to various types of non-performance, which could result in it being a penalty in some instances, and (iv) Even if the consequences of a breach are too uncertain for precise estimation of the sum, the pre-determined sum may still represent a genuine pre-estimate of damages, because such scenarios often align with the parties’ intended agreement.

However, the UK Supreme Court (‘UKSC’) in *Cavendish-ParkingEye*⁵² has suggested looking at the intention of the liquidated damages clause to ascertain its reasonableness as against using the “unconscionable and extravagant” standard. It opined that Lord Dunedin’s ‘four tests’ applied to “simple” clauses, and not complex clauses in which needed courts to determine unconscionability. The UKSC emphasized on a ‘compensatory motive’ and ‘not deterrence’ as the purpose behind the clause “*because it serves to protect a legitimate interest and is neither unconscionable nor extravagant*”.

In India, a party alleging breach of contract is limited to recovering “reasonable compensation” for the loss suffered when seeking liquidated damages. Such a pre-determined sum must be a “genuine pre-estimate” so as to be reasonable.⁵³ This methodology equalises the

⁴⁸ DiMatteo (n 10).

⁴⁹ *Clydebank Eng’g & Shipbldg Co v Yzquierdo y Castaneda* (1905) AC 6 (HL).

⁵⁰ *Clydebank Eng’g & Shipbldg Co v Yzquierdo y Castaneda* (1905) AC 6 (HL).

⁵¹ *Dunlop Pneumatic Tyre Co v New Garage and Motor Co* (1915) AC 79 (HL); DiMatteo (n 10) 1852.

⁵² *Cavendish Square Holdings BV v Makdessi and ParkingEye Ltd v Beavis (Consumers’ Association intervening)* (2015) UKSC 67.

⁵³ *Maula Bux v Union of India* (1970) AIR SC 1955; *Mahanagar Telephone Nigam Ltd v TATA Communications Ltd* (2019) 5 SCC 341; *Construction and Design Services v Delhi Development Authority* (2015) 14 SCC 263.

compensation sought for liquidated damages and unliquidated damages; in both situations, courts tend to award damages which are not excessive.⁵⁴ In India, the doctrine of unconscionability was briefly discussed in *Phulchand Exports Ltd v OOO Patriot*,⁵⁵ but not in the context of whether it can be a test to determine the reasonableness of the amount stipulated. On what constitutes reasonable compensation, courts have stated that it can be fixed on “well-known principles that are applicable to the law of contract.”⁵⁶ This can be understood to include general principles of contract law on damages, which can be found in Section 73 of the Contract Act.⁵⁷

2.3 Time Period for the calculation of Liquidated Damages

Liquidated damages begin accruing upon the occurrence of an event specified in the clause of the contract. In the *Triple Point* case⁵⁸ the UKSC ruled that if a contract is terminated before work is completed, liquidated damages apply only up to the termination date. In *Triple Point*, relying on *Photo Production Ltd v Securicor Transport Ltd*,⁵⁹ the UKSC reasoned that there will be no further responsibility on the part of a contractor to pay the liquidated damages if the contractor is released from its obligation due to termination.

The Supreme Court of India has not had the opportunity to adjudicate upon specific time period for calculating liquidated damages, and typically damages have been computed taking into account the terms of the contract between the parties. Consequently, liquidated damages have been calculated from the date of delay in performance (or breach) of contract, based on the parties’ choice of the time period for which liquidated damages are payable.⁶⁰

⁵⁴ *Union of India v Raman Iron Foundry* (1974) 2 SCC 231.

⁵⁵ *Phulchand Exports Ltd v OOO Patriot* (2011) 10 SCC 300.

⁵⁶ *Maharashtra State Electricity Distribution Company Ltd v Maharashtra State Electricity Regulatory Commission* (2022) 4 SCC 657; *Kailash Nath Associates v Delhi Development Authority and Anr* (2015) 4 SCC 136; *Naresh Chandra Sanyal v Calcutta Stock Exchange Association Ltd* (1971) 1 SCC 50.

⁵⁷ The Indian Contract Act 1872, s 73; *Oil and Natural Gas Corporation Limited v Saw Pipes Limited* (2003) 5 SCC 705, which held that Section 73 and Section 74 of the Indian Contract Act, 1872 should be read together.

⁵⁸ *Triple Point Technology, Inc v PTT Public Company Limited* (2021) UKSC 29.

⁵⁹ *Photo Production Ltd v Securicor Transport Ltd* (1980) AC 827, 844 and 849.

⁶⁰ *Commissioner of Income Tax, Gujarat v Saurashtra Cement Ltd* (2010) 11 SCC 84; *Oil and Natural Gas Corporation Limited v Saw Pipes Limited* (2003) 5 SCC 705, where the liquidated damages payable was a particular percentage of the contract price for each week (*Saurashtra*), or month (*ONGC*) of delay. This was the time period chosen by parties.

2.4 Compensation payable cannot exceed the Stipulated Amount

Under common law, the party claiming liquidated damages is obligated to accept the amount payable as per the liquidated damages clause, even if such amount is less than the loss incurred.⁶¹ Higher compensation cannot also be claimed as damages under common law when the amount has been fixed as liquidated damages.⁶² The basis for this lies in the reason for adopting a liquidated damages clause in the first place, i.e., pre-determining the compensation payable beforehand. In summary, a clause that specifies a monetary amount to be paid as liquidated damages precludes any claim of damages for an undetermined sum.

The Supreme Court of India has held when parties have consciously designated a particular amount as liquidated damages, it is not possible to infer that they intended to allow the recovery of more than what was pre-determined.⁶³ Therefore, the party affected by the breach cannot reject the specified sum and instead assert a monetary claim that was not pre-determined or ascertainable at the time the breach occurred. Therefore, there is an ‘upper limit’ on the amount payable when damages are pre-determined.⁶⁴

3. ENFORCEABILITY OF LIQUIDATED DAMAGES CLAUSES

Enforceability of liquidated damages clauses depends on certain important factors, and these are analysed below.

3.1 Test of Proof of Actual Damage or Loss

The “proof of actual damage or loss” is a significant factor in ascertaining the enforceability of a liquidated damages clause in India. Under Section 74 of the Contract Act, the occurrence of damage or loss is essential for the applicability of this provision to recover compensation⁶⁵.

The relevant portion of Section 74 of the Contract Act reads as follows:

“When a contract has been broken... the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive

⁶¹ Neil Andrews, *Contract Law* (Cambridge University Press 2011) 609.

⁶² *Cellulose Acetate Silk Co Ltd v Widnes Foundry Ltd* (1933) AC 20 HL; *Cellulose v Widnes* was recently referred in *Eco World – Ballymore Embassy Gardens Company Ltd v Dobler UK Ltd* (2021) EWHC 2207 (TCC).

⁶³ *Chunilal Mehta and Sons Ltd v Century Spg and Mfg Co Ltd* (1962) AIR SC 1314.

⁶⁴ *Kailash Nath Associates v Delhi Development Authority and Anr* (2015) 4 SCC 136.

⁶⁵ *Maharashtra State Electricity Distribution Company Ltd v Maharashtra State Electricity Regulatory Commission* (2022) 4 SCC 657.

from the party who has broken the contract, reasonable compensation not exceeding the amount so named...”

(Emphasis Supplied)

The expression “*whether or not actual damage or loss is proved to have been caused thereby*” means that such proof is mandatory in cases where it is possible for the claimant to prove actual damage or loss due to such breach.⁶⁶ Loss is a pre-requisite to award damages in such cases. Accordingly, failure to prove loss or damage would result in setting aside the award of liquidated damage⁶⁷ or denial of compensation.⁶⁸

It is only in cases where liquidated damages are a genuine pre-estimate of damages and actual damage or loss is impossible or even difficult to prove that the requirement to prove actual damage or loss can be waived.⁶⁹ For instance, in *GAIL (India) Limited v Punj Lloyd Limited*,⁷⁰ the contract provided for the payment of interim liquidated damages for delays in the completion of work. Punj Lloyd - the respondent, breached the contract. It argued that without GAIL providing proof of actual damages or loss due to delays caused by rainfall, the amount could not be recovered. The Delhi High Court observed that the respondent accepted the contract with knowledge of the likelihood for precipitation in areas where it was required to conduct business. Interestingly, the court remarked that despite these conditions, the respondent’s inability to strategize and ensure performance of contract depicted its ineptitude. Thus, the Court ruled that the liquidated damages contemplated in the contract between GAIL and Punj Lloyd would be payable even without proof of actual loss. An illustration of a situation where it can be impossible to prove loss or damage under a claim for liquidated damages was given by the Supreme Court of India in *Oil and Natural Gas Corporation Limited v Saw Pipes Limited* and re-iterated in *Construction and Design Services v DDA*:⁷¹

“Take for illustration construction of a road or a bridge. If there is delay in completing the construction of road or bridge within the stipulated time, then it would be difficult to prove how much loss is suffered by the society/State. ... in such a contract, it would

⁶⁶ *Mahanagar Telephone Nigam Ltd v TATA Communications Ltd* (2019) 5 SCC 341; *GAIL (India) Limited v Punj Lloyd Limited* (2017) 240 DLT 610.

⁶⁷ *Haryana Telecom Ltd v Union of India* (2006) AIR Del 339.

⁶⁸ *Union of India v Motor General Sales Ltd* (2016) MANU MH 1119.

⁶⁹ *Kailash Nath Associates v Delhi Development Authority and Anr* (2015) 4 SCC 136.

⁷⁰ *GAIL (India) Limited v Punj Lloyd Limited* (2017) 240 DLT 610.

⁷¹ *Oil and Natural Gas Corporation Limited v Saw Pipes Limited* (2003) 5 SCC 705; *Construction and Design Services v Delhi Development Authority* (2015) 14 SCC 263.

be difficult to prove exact loss or damage which the parties suffer because of the breach thereof.”

The appellant in *Construction and Design Services v DDA*⁷² could not complete the sewage pumping station’s construction by the deadline. The Supreme Court observed that since the project was a public utility project, specific evidence of damage might not be available. In such a situation, when damages had been incurred as a result of delay, “*the delay itself could be taken to had resulted in loss in form of environmental degradation and loss of interest on capital, for which Respondent was entitled to reasonable compensation.*” Consequently, the Supreme Court ruled since the delay resulted in a loss, reasonable compensation ought to be awarded. Since only half of the amount claimed was ‘reasonable’ in the Court’s opinion, the same was awarded as liquidated damages.

Thus, proving actual damage or loss is an essential element, and such proof is mandatory in cases where it is possible for the claimant to establish actual damage or loss due to such breach. It is only in cases where it is impossible or even difficult to produce evidence of actual loss or damage that the Courts allow parties to claim liquidated damages (which is a genuine pre-estimate of damages) even without proving such actual damage or loss.

3.2 Onus of Proof

If a liquidated damages clause is clearly a genuine pre-estimate of damages or loss, the burden of proof of loss shifts from the claimant to the defendant.⁷³ A properly drafted liquidated damages clause saves judicial time and energy. The judgment in *Oil and Natural Gas Corporation Ltd v Saw Pipes*⁷⁴ highlights the importance of the language of the liquidated damages clause in shifting the onus of proof:

“64. ... Section 74 emphasises that in case of breach of contract, the party complaining of the breach is entitled to receive reasonable compensation whether or not actual loss is proved to have been caused by such breach. Therefore, the emphasis

⁷² *Construction and Design Services v Delhi Development Authority* (2015) 14 SCC 263.

⁷³ This point is specifically discussed in Gaurav Panchnanda and Kartikey Mahajan (eds), *Damages, Expert Evidence and Valuation in Commercial Disputes in India* (1st edn, Thomson Reuters 2023) 170. Here, reliance is placed on the common law principle that “*it is open for parties to agree, as a matter of contract, to place the onus of proof of any particular fact on either party*”. The authors have cited the judgment in *Levy v Assicuranzoni Generali* (1940) AC 791 for this proposition.

⁷⁴ *Oil and Natural Gas Corporation Limited v Saw Pipes Limited* (2003) 5 SCC 705.

*is on reasonable compensation. If the compensation named in the contract is by way of penalty, consideration would be different and the party is only entitled to reasonable compensation for the loss suffered. **But if the compensation named in the contract for such breach is genuine pre-estimate of loss which the parties knew when they made the contract to be likely to result from the breach of it, there is no question of proving such loss or such party is not required to lead evidence to prove actual loss suffered by him. Burden is on the other party to lead evidence for proving that no loss is likely to occur by such breach... ..***

... ..

67. *In our view, in such a contract, it would be difficult to prove exact loss or damage which the parties suffer because of the breach thereof. **In such a situation, if the parties have pre-estimated such loss after clear understanding, it would be totally unjustified to arrive at the conclusion that the party who has committed breach of the contract is not liable to pay compensation. It would be against the specific provisions of Sections 73 and 74 of the Indian Contract Act. There was nothing on record that compensation contemplated by the parties was in any way unreasonable. It has been specifically mentioned that it was an agreed genuine pre-estimate of damages duly agreed by the parties. It was also mentioned that the liquidated damages are not by way of penalty. It was also provided in the contract that such damages are to be recovered by the purchaser from the bills for payment of the cost of material submitted by the contractor. No evidence is led by the claimant to establish that the stipulated condition was by way of penalty or the compensation contemplated was, in any way, unreasonable... ..***

(Emphasis Supplied)

This judgment was relied upon by the Supreme Court of India in *Construction and Design Services v DDA*⁷⁵ to re-iterate the same proposition. Therefore, a liquidated damages clause that represents a genuine pre-estimate of loss shifts the onus of proving the absence of loss on the defendant. The Supreme Court has emphasized that such clauses uphold the principles of Sections 73 and 74 of the Indian Contract Act by focusing on ensuring reasonable compensation.

⁷⁵ *Construction and Design Services v Delhi Development Authority* (2015) 14 SCC 263.

3.3 Interpretation of contractual Clauses

In the *Triple Point* case, the UKSC has emphasized the importance of “*context and objective meaning*” in the interpretation of contractual terms.⁷⁶ It was further emphasized by UKSC that liquidated damages clauses must be interpreted keeping in mind “commercial reality.”⁷⁷ In *Triple Point*, the contract stipulated that liquidated damages would cease to accumulate upon completion of work or acceptance of the same by the respondents, PTT. The work stood incomplete due to contract termination. The Court of First Appeal concluded that PTT was not entitled to the liquidated damages on the grounds that it had not accepted or completed any work.⁷⁸ However, the UKSC noted that such a literal interpretation was “inconsistent with commercial reality” and the Appellate Court “*in effect threw out the baby with the bathwater*” by interpreting the clause literally and out of context.⁷⁹

Ultimately, the UKSC upheld that the liquidated damages would cease to accumulate upon termination of the contract. It reasoned that a contractor who fails to abide by the scheduled time for project completion would otherwise be motivated to abstain from finishing the work so as to evade the payment of liquidated damages under such an interpretation of waiting for ‘completion of the work’.

The Supreme Court of India has emphasized on the interpretation of liquidated damages clauses with importance being given to its (i) construction, and (ii) context: “*whether a clause is penal or pre-estimate of damages depends on its construction and on the surrounding circumstances at the time of entering into the contract.*”⁸⁰ Referring to Chitty on Contracts,⁸¹ the Supreme Court asserted the importance on the ‘predominant contractual function’ of the liquidated damages provision at the time the contract was entered:

“According to Chitty on Contracts “*whether a provision is to be treated as a penalty is a matter of construction to be resolved by asking whether at the time the contract was entered into the predominant contractual function of the provision was to deter a party*

⁷⁶ *Triple Point Technology, Inc v PTT Public Company Limited* (2021) UKSC 29.

⁷⁷ *Triple Point Technology, Inc v PTT Public Company Limited* (2021) UKSC 29.

⁷⁸ *Triple Point Technology, Inc v PTT Public Company Limited* (2021) EWCA Civ 230.

⁷⁹ *Triple Point Technology, Inc v PTT Public Company Limited* (2021) UKSC 29.

⁸⁰ *Bharat Sanchar Nigam Limited v Reliance Communications Ltd* (2011) 1 SCC 394; G H Treitel, *Law of Contract* (10th edn, Sweet & Maxwell 1999).

⁸¹ Joseph Chitty, *Chitty on Contracts* (Sweet & Maxwell 2004); extracted portion was re-iterated in *Rama Construction Company v Municipal Corporation of Delhi* (2011) SCC OnLine Del 5481; *General Manager and Another v Raisingh and Company* (2018) SCC OnLine MP 657.

from breaking the contract or to compensate the innocent party for breach. The question to be always asked is whether the alleged penalty clause can pass muster as a genuine pre-estimate of loss”. (See para 26-126 of Chitty on Contracts, 30th edition).”

Similar reasoning has been re-iterated by Indian High Courts.⁸²

3.4 When are parties not entitled to claim Liquidated Damages?

In India, the Supreme Court has laid down the principle that once parties have “unconditionally accepted the terms of a contract,” the liability to pay liquidated damages cannot be waived.⁸³ In *Shyam Telelink Ltd v Union of India*,⁸⁴ Shyam Telelink was granted a licence by the government of India to provide basic telecom services. The company gave an unconditional acceptance to pay liquidated damages under a Migration Package offered by the government. However, at a later stage, Shyam Telelink sought waiver of liquidated damages. When this request for waiver was rejected, Shyam Telelink proceeded to pay the liquidated damages. Two years later, the government raised a demand for payment of an additional amount of money as liquidated damages. At this juncture, the company questioned the terms of Migration Package and refused to pay to the government. The Supreme Court asserted that by paying the liquidated damages after its request for waiver was rejected, Shyam Telelink effectively accepted the obligation to pay liquidated damages under the Package – which cannot be challenged later before the Court. The Court stated the rationale behind this decision lies in the doctrine of estoppel and the maxim *qui approbat non reprobat* (“one who approbates cannot reprobate”).

However, in certain situations, parties may not be entitled to receive liquidated damages. Some of these are:

- (i) a party cannot be entitled to recover liquidated damages if its own acts contributed to the breach of contract;
- (ii) a party claiming liquidated damages must demonstrate that he attempted to mitigate the loss and was unable to do so to the extent specified in the clause.⁸⁵

⁸² *Gateway Impex Pvt Ltd v Tata AIG Life Insurance Co. Ltd* (2019) SCC OnLine Del 10291; *General Manager v Raisingh* (2018) SCC OnLine MP 657.

⁸³ *Shyam Telelink Ltd v Union of India* (2010) 10 SCC 165.

⁸⁴ *Shyam Telelink Ltd v Union of India* (2010) 10 SCC 165.

⁸⁵ *Manju Bagai v Magpie Retail Ltd* (2010) 175 DLT 212; *Tower Vision India Pvt Ltd v Procall Pvt Ltd* (2014) 183 COMP CASES 364; Vardhan and Narayan (n 5).

The *first* situation refers to the prevention principle laid down in *Holme v Guppy*.⁸⁶ In the USA, it is generally accepted that a party claiming liquidated damages cannot recover them if it contributed towards the breach of contract.⁸⁷ Applying the principle as laid down in *Holme*, the Supreme Court of India held where the party claiming liquidated damages is responsible for the delays in works, its ‘acts of prevention’ left “time at large” (i.e., time is no longer the essence of the contract).⁸⁸ As a result, the liquidated damages provision would be rendered unenforceable.

The *second* situation refers to the doctrine of mitigation.⁸⁹ The Massachusetts Supreme Judicial Court in the USA ruled that parties claiming liquidated damages are not required to mitigate damages.⁹⁰ Similarly, the Maryland Court of Appeals held that in cases where a contract has a valid liquidated damages clause, no legal obligation to mitigate damage exists.⁹¹ A valid liquidated damages clause, in the Court’s opinion, eliminated the necessity for mitigation in the absence of a statutory mandate.⁹² In contrast, the Contract Act considers mitigation be an important consideration when determining the loss sustained by the party claiming damages.⁹³ The rule of “mitigation of losses” is considered relevant in contracts with liquidated damages clauses, and it is essential for courts to apply the mitigation of loss principle when determining ‘reasonable compensation’.⁹⁴

3.5 Granularity

A liquidated damages clause should contain the exact events or breaches which would entail the levy of liquidated damages. The scope of a liquidated damages clause is too broad when it

⁸⁶ *Holme v Guppy* (1838) 150 ER 1195; The prevention principle established that, “if the party be prevented by the refusal of the other contracting party from completing the contract within the time limited, he is not liable in law for the default.”

⁸⁷ *Glassman Const Co v Md City Plaza, Inc* (1974) 371 F. Supp. 1154; *Gen Ins Co v Commerce Hyatt House* (1970) 5 Cal. App. 3d 460, 85 Cal. Rptr. 317.

⁸⁸ *Welspun Speciality Solutions Limited v Oil and Natural Gas Corporation Limited* (2022) 2 SCC 382.

⁸⁹ The rule of mitigation refers to the principle that compels courts to presume (when determining the amount of recoverable damages) that the innocent party took reasonable steps to minimise losses that arising from the breach of contract by the other party – in Kwangkyy Park and Ben Holland, ‘English Law of Liquidated Damages and Penalty’ (*Squire Patton Boggs*, April 2016).

⁹⁰ *NPS, LLC v Minihane* (2008) 886 N.E.2d 670, 675 (Mass.).

⁹¹ *Barrie School v Patch* (2007) 401 Md. 497, 933 A.2d 382.

⁹² George Perry, ‘Recent Developments: Barrie School v. Patch: There Is No Duty for a Non-Breaching Party to Mitigate Damages When the Contract Contains a Valid Liquidated Damages Clause’ (2008) 38(2) University of Baltimore L Forum.

⁹³ P C Markanda, *Building & Engineering Contracts* (6th edn, LexisNexis India 2023).

⁹⁴ *Oil and Natural Gas Corporation Limited, New Delhi v Oil Country Tubular Limited, Hyderabad* (2011) 113 (3) LR 141.

applies to various types of breaches regardless of the severity or nature of the breach. In such a situation, a court is likely to conclude that the purpose of the provision is punitive, even in spite of declarations to the contrary.⁹⁵ Parties also often fail to allocate the kinds of damages they seek to liquidate.⁹⁶

A single amount being pre-determined for all types of breaches shows a lack of “granularity”.⁹⁷ Granularity ensures clarity and certainty on the sum payable at the time of breach. A lack of granularity in a liquidated damages clause may render it unenforceable, as was the case in *Lordsvale Finance Plc v Bank of Zambia*.⁹⁸ Liquidated damages clauses that award a single sum irrespective of the nature or gravity of the breach are particularly discouraged by courts.⁹⁹

“When a contract specifies a single sum in damages for any and all breaches even though it is apparent that all are not of the same gravity, the specification is not the reasonable effort to estimate damages; and when in addition the fixed sum greatly exceeds the actual damages likely to be inflicted by a minor breach, its character as a penalty becomes unmistakable.”

The Supreme Court of India has observed that where a liquidated damages clause does not apply to all breaches, parties should clearly specify the damages payable for specific breaches.¹⁰⁰ When Steel Authority of India Limited (‘SAIL’) contracted with Gupta Brother Steel Tubes Limited to arrange for the import of certain materials, the liquidated damages clause was under ‘Clause 7.2’ of the contract. It was held by the Supreme Court that the Company’s claim for damages due to SAIL’s infractions was not a breach within the scope of Clause 7.2: *“Section 74 of the Contract Act has no application as the contract does not determine damages for the breaches in question.”* Finally, the types of breaches covered by liquidated damages clause should be drafted keeping in mind commercial reality.¹⁰¹

Ensuring granularity and accurately quantifying the precise amount of damages may prove challenging or impossible in certain circumstances. These variations should be accounted for

⁹⁵ *Wilt v Waterfield* (1954) 273 S.W.2d 290, 1954 Mo. LEXIS 810 (Mo.).

⁹⁶ Eric Fishman and Anne Lefever, ‘4 Tips for a Better Liquidated Damages Clause’ (*Corporate Counsel* 2013) <<https://www.pillsburylaw.com/images/content/4/3/v2/4314/ARTICLE-TheSanityClause-06-25-13.pdf>> accessed 29 February 2024.

⁹⁷ DiMatteo (n 10) 1853.

⁹⁸ *Lordsvale Finance Plc v Bank of Zambia* (1996) QB 752.

⁹⁹ *Lake River Corp v Carborundum Co* (1985) 769 F.2d 1284.

¹⁰⁰ *Steel Authority of India v Gupta Brother Steel Tubes Ltd* (2009) 10 SCC 63.

¹⁰¹ *Triple Point Technology, Inc v PTT Public Company Limited* (2021) UKSC 29.

in the liquidated damages clause.¹⁰² One approach is to express the amount payable as a formula based on the nature of the breach, as opposed to a fixed sum. Calculating damages as a percentage of the contract price is another common approach in liquidated damages clauses.¹⁰³ Formulae guarantee that the amount will be customised in accordance with the relative severity of the breach. Therefore, they indicate that the amount payable as liquidated damages are proportional to a reasonable estimate of the anticipated damages, and such a clause is more likely to be enforced:¹⁰⁴

“A provision for] liquidated damages [is] viable if it is established that at formative stages of contract ... the amount or formula stipulated by the parties represent[s] a reasonable endeavour to ascertain.”

3.6 Exclusions within the Liquidated Damages Clause

An exclusion clause is an arrangement between contracting parties to account for possible future circumstances that may impede or preclude the performance of the contract.¹⁰⁵ It is common for parties to a contract to exclude liability for payment of damages – such as restricting the amount¹⁰⁶ and time-period¹⁰⁷ to claim damages on breach of contract. Similarly, a contract stipulating liquidated damages can include an “exclusion clause” under which the liability to pay compensation may be capped for any reason so stipulated.

The need to use clear language while drafting exclusionary clauses is a well-established principle.¹⁰⁸ This rationale can be found in *Stocznia Gdynia SA v Gearbulk Holdings Ltd*,¹⁰⁹ where it was held:

“The court is unlikely to be satisfied that a party to a contract has abandoned valuable rights arising by operation of law unless the terms of the contract make it sufficiently

¹⁰² Henry F Luepke III, ‘How to Draft and Enforce a Liquidated Damages Clause’ (2005) 61 J. Mo. B. 324.

¹⁰³ Larry A DiMatteo, ‘A Theory Of Efficient Penalty: Eliminating The Law Of Liquidated Damages’ (2001) 38 Am Bus LJ 633.

¹⁰⁴ *Vrgora v Los Angeles Unified School District* (1984) 200 Cal. Rptr. 130 (Cal. Ct. App).

¹⁰⁵ Beatson, Burrows and Cartwright (n 3) 193; J W Carter, *Carter’s Breach of Contract* (Hart Publishing 2018) 48.

¹⁰⁶ *Scruttons Ltd v Midland Silicones Ltd* (1962) AC 446 (HL); *Atlantic Shipping and Trading Co v Louis Dreyfus & Co* (1922) 2 AC 250 (HL).

¹⁰⁷ *Kenyon, Son & Craven v Baxter Hoare & Co* (1971) 2 All ER 708; *Photo Production v Securicor Transport* (1980) 1 All ER 556 (HL).

¹⁰⁸ *Seadrill Management Services Ltd v OAO Gazprom* (2011) 1 All ER (Comm) 1077; *Federal Republic of Nigeria v JP Morgan Chase Bank NA* (2019) EWHC 347 (Comm).

¹⁰⁹ *Stocznia Gdynia SA v Gearbulk Holdings Ltd* (2010) QB 27.

clear that that was intended. The more valuable the right, the clearer the language will need to be.”

4. DRAFTING CONSIDERATIONS FOR LIQUIDATED DAMAGES CLAUSES

A careful analysis of principles and precedents shows certain factors the drafter ought to consider while drafting liquidated damages clauses to ensure their validity and enforceability.

We have framed the following guiding principles keeping in mind the above:

- (i) *Genuine Pre-Estimate & Not Penal*: The liquidated damages clause should be drafted in a manner which ensures that at the time of contracting, the liquidated amount is a genuine pre-estimate intended only to fully compensate the non-defaulting party and not to punish the defaulting party for a breach of contract. This delicate balancing act can be achieved by taking into account all relevant facts pertaining to the relevant matter and applying the principle of reasonableness.
- (ii) *Specific Performance; Time Period*: The parties must carry out the following two vital exercises: (a) ascertain that damages are a sufficient remedy for a breach of the contract. If not, the liquidated damages clause should make it clear that it is in addition to the innocent party's right to seek specific performance in addition to damages; and (b) if damages are an adequate remedy, analyse and estimate the losses that would be suffered in case of a potential breach of contract in various scenarios along with the basis of the estimation. Choice of time period for which liquidated damages is payable should be clearly demarcated and specified.
- (iii) *Granularity*: The liquidated damages clause should contain the exact events or breaches which would entail the levy of liquidated damages. The parties must ensure granularity. Where possible, the liquidated damages amount payable can be expressed through a formula based on the nature of the breach or as a percentage of the contract price, as opposed to a fixed sum.
- (iv) *Timelines*: Breach / delay timelines can also be a factor in calculating the liquidated damages amount and the contract should clearly indicate the rationale for interplay between the variation in amount and timeline of breach / delay.

- (v) *Exclusion Clause*: The exclusion clause should be drafted carefully to account for possible future circumstances that may impede or preclude the performance of the contract, and restrict the amount and time-period to claim damages on breach of contract. The exclusion clause should also not conflict with the main purpose of the contract.¹¹⁰

- (vi) *Basis of Estimation*: In addition, the liquidated damages clause should specifically state:
 - (a) the basis for the estimation of damages must be incorporated in the liquidated damages; and
 - (b) while open to contest later, still the drafting can emphasize that at the time of contracting the parties have agreed and acknowledged that the liquidated damages amount is a reasonable pre-estimate of the damages that would be suffered in case of the breach it is meant to cover.

¹¹⁰ *Skandia Insurance Co. Ltd. v Kokilaben Chandravadan* (1987) 2 SCC 654 as quoted in KV Krishnaprasad and others (eds), *Foundations of Indian Contract Law* (Oxford University Press 2024) 372-373.