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## Ingredients dominating Sections 73 and 74 of ICA, 1872 - How the study of Damages and Compensation is crucial for upholding the essence of a Contract?

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*The article deals with the relevant provisions and their subsequent analysis of Sections 73 and 74 of the Indian Contract Act 1872<sup>1</sup>. Section 73<sup>2</sup> states A party who suffers from a breach of a contract is entitled to compensation from the party responsible for the breach for any loss or damage that results from the breach that naturally occurred in the normal course of events or that the parties knew would likely occur when they entered the contract. — When a contract is broken, the party who suffers as a result of the breach is entitled to compensation from the party who committed the breach for any loss or damage that resulted to him as a result and that naturally resulted from the breach or that the parties were aware of at the time the contract was made. A "stipulation using punishment" is referred to in Section 74 of the Contract Act<sup>3</sup>. Therefore, it does not apply when an amount is listed as a fine to be paid later in the case of a violation; rather, it only applies when a sum has already been paid and is susceptible to forfeiture as a result of a contract clause. As unliquidated losses, actual damages resulting from contract violations and the harm they cause are covered under Section 73<sup>4</sup>. Before granting these damages, the courts*

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<sup>1</sup> Indian Contract Act 1872, s 73-74

<sup>2</sup> Indian Contract Act 1872, s 73

<sup>3</sup> Indian Contract Act 1872, s 74

<sup>4</sup> Indian Contract Act 1872, s 73

*determine the loss or harm that was done to the person against whom the breach occurred. Section 74<sup>5</sup> of the agreement covers liquidated losses and damages that are specified. Therefore, a breach of the contract must have occurred to claim damages, excluding situations in which the contract was validly terminated without any violations of its terms.*

**Keywords:** *liquidated damages, reasonable compensation, penalty, service, obligation.*

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## INTRODUCTION

Section 73 and 74 of the Indian Contract Act, of 1872 contains provisions for the parties involved in a valid contract and how, if any damage takes place, by any sort of breach, the parties are likely to receive compensation. Usually in contractual terms, section 73<sup>6</sup> should be read with the provisions of section 74<sup>7</sup>. Thus, the aggrieved party doesn't need to prove actual damage suffered by that party before resorting to a decree. The contractual sections 73 and 74<sup>8</sup> usually offer provisions for reasonable compensation of damages not exceeding the amount mentioned in the contract on proof of damages. To award damages, their respective measures should also be taken to assess the level of impact and the stipulations in nature of the penalty.

Compensation is not to be given for any remote or indirect loss. In estimating the loss or damage arising from a breach of contract, the means existing for solving any intricate complication amounts to some remedial steps which should not be ignored. The underlying essence of both of these sections is that they highlight the consequences of the breach of a contract. Failure to discharge obligations resembling those created by contract enhances the importance of these particular sections to a great extent. In the case of *K. Narayan Kurup v Sankaranarayanan*<sup>9</sup>, when a contract is breached, the aggravated party who has suffered such breach deserves to receive compensation for any loss or damage arising from that particular breach.

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<sup>5</sup> Indian Contract Act 1872, s 74

<sup>6</sup> Indian Contract Act 1872, s 73

<sup>7</sup> Indian Contract Act 1872, s 74

<sup>8</sup> *Ibid*

<sup>9</sup> *K. Narayan Kurup v Sankaranarayanan* (2000) Ker 296

This is the essence the fundamental essence glorifying the significance of all sorts of justice prevailing in the social arena of this particular contract. The party at default should take advantage of the benefit resulting in the breach of contract. Sometimes the aspects of *sections 73 and 74 of the Indian Contract Act, of 1872* target the aspect of special damage, the failure to perform can bring about contemplation of compensation.

### **ESSENTIALS AND IMPORTANCE OF PROVISIONS OF SEC 74 AND 75 CHAMPIONING THEIR INCLUSION IN THE INDIAN CONTRACT ACT OF 1872 VIA OBSERVATIONS AND CASE LAWS**

Sections 73 and 74 of the ICA, 1872 comprise the highlight of the aspect “damages” in the entire bare act and more importantly, act as the lifeline of the aggravated party. The probable result of damages is denoted by the reasonable proximity to the cause of the breach which in turn aids the aggrieved parties to resort to legal recourse. Legal scholars hail these two sections of the ICA as the primary justified sources of justice and that too in a proper way. The grand case of *Fateh Chand v Balkishann Das*<sup>10</sup> talks about the important meritorious aspect of reasonable damages where one can also foresee a justified stipulation not exceeding the amount specified in that particular clause. For instance, S, who owes money to Q, a money lender, decides to repay him by providing him with 20,000 tons of wheat on a particular date and specifies that, in the event of his default in delivering those particular amounts of wheat, he shall be liable to deliver the double the amount of wheat stipulated in the contract. By the theory of reasonable consideration, the stipulation takes the form of a penalty.

Section 74 of the Indian Contract Act, of 1872 includes a very important recovery right relating to liquidated damages. As per The Indian Contract Act, of 1872, There is no dispute on the validity of the right to seek liquidated damages. Case law of **Chunilal Mehta & Sons Ltd v Century Spinning & Mfg. Co. Ltd.**, whenever a stipulation is added with certain costs and penalties that mean a certain party has failed to pay a stipulated amount of money within

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<sup>10</sup> *Fateh Chand v Balkishann Das* (1963) SCR (1) 515

a given period as per the time given in the Contract Act of 1872. However, if only half of the money is paid within the allotted period, the other party waives his claim to the remaining balance. Damages may only be recovered from the party or person who committed the breach when it has been established, according to section 73 of the ICA 1872. Section 73 of the ICA 1872 provide for damages for breach of contract of service. However, under section 74 of the ICA 1872, there may be circumstances in which the courts can't determine the amount of compensation resulting from the breach. In these circumstances, the amount named by the parties may be taken into account as the standard for reasonable compensation if it is believed to be a genuine pre-estimate.

### **THE ASPECT OF TIME AND OTHER PROVISIONS**

Time is a very important essence of this particular provision of Section 74 of the ICA 1872. A delay is followed by severe complications and consequences of the Indian Contract Act 1872 which can make it challenging for the defaulting party to breach a contract shortly. It's the deep philosophy in these acts that matter a lot. Without any loss, the contractual stipulation of a penalty makes no sense. The Indian Contract of 1872 mentions the aspect of taking advantage of benefits resulting from a breach of contract. The bare act mentions "Where a vendee is in default and the vendor subsequently sells at a higher price than the market price on the date of delivery, the fact that because of the loss of the contract which the vendee had failed to perform, the vendor obtained the benefit of another contract which was of value to him did not entitle the vendee to the benefit of the later contract."

### **CONCEPT OF DAMAGES AND THEIR CHARACTERISTICS**

Sections 73 and 74 are closely interlinked to give the concept of 'damages' a very broad spectrum to elaborately discuss the nitty-gritty of essential contractual obligations. Thus, in the supremely famous case law of *Kailas Nath Associates v DDA*<sup>11</sup>, the Court held that "damage or loss is a sine quanon for applicability of Section 74." The possibility to prove loss remains an important ingredient to fulfill the pre-requisites of Section 74 of The Indian

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<sup>11</sup> *Kailas Nath Associates v DDA* (2015) 4 SCC 136

Contract Act 1872.

Section 74 upholds the contractual entitlement of reasonable compensation and thus champions the concept of restoration of monetary loss to the aggrieved party. The contractual claim to the same should not be questioned because it is impossible to demonstrate the real loss incurred as a result of the breach, according to Karun Mehta of Khaitan & Co LLP. According to legal scholar B.V.R Sharma, “Every breach of contract upsets many settled expectations of the injured party. He may feel the consequences for a long time and in a variety of ways.” Thus, if we look at it, the consequences of the breach arising out of the contract can be of varied terms and principles, but that gets diluted to a fixed liability. If the damage is too remote, then it becomes irrevocable for the party to acquire that. B.V.R. Sharma further clarifies that “the elements of damage recognized by law are divisible into two main groups: - pecuniary and non-pecuniary.” However, if we talk about it categorically, there are two types of damages: - General Damages and Special Damages. General Damages arise in the natural course of things; the breach follows from the consequential events which lead to an actual loss to the aggrieved party or the suffering party. The concept of Liquidated Damages is very important under the ambit of both Sections 73 and 74 of the Indian Contract Act, of 1872.

So, what are liquidated damages? According to certain legal academics, in the event of a breach, the party complaining of the breach is entitled to collect compensation not to exceed the sum thus indicated, whether or not real harm or loss is proven to have been caused by the breach. Once liquidated damages are allowed to be claimed, no claims of damages by way of loss or profits can be claimed.

### **IMPORTANCE OF PENALTY**

The importance of a penalty is the payment of financial compensation of money stipulated to the aggrieved party. The principles underlying the essence of compensation are that the injured party should return to its original position before the execution of the contract. This

principle arose in the famous case law of TATA Iron & Steel Co Ltd v Ramanlal Kandoi<sup>12</sup>, the knowledge of the circumstances leading to the loss of profits to the plaintiff is necessary. Understanding damages is crucial for the innocent party. The form of economic gain should also be measured by the aspects of sections 73 and 74 of the ICA 1872. The nature of penalties and damages should be critically examined. The mere usage of language like “loss” or “damage” doesn’t put the liability on the defaulting party. There should be a chain of events that should be coherent enough to justice for the loss arising due to the breach of the contract. The fairly complex distinctions made under the English Common Law between clauses allowing for the payment of liquidated damages and clauses in the form of penalties are eliminated by Section 74 of the Indian Contract Act.

### RELEVANT EXAMPLES AND CASE LAWS WITH SUBSTANTIATIONS

For instance, A might contract with C to buy 6000 tonnes of iron at 120 rupees per tonne to fulfill his agreement with B to supply B with the iron at 250 rupees per tonne to be delivered at a specific time. A might also explain to C that he is doing this to fulfill his obligation to B. Because A is unable to get alternative iron due to C's breach of contract, B rescinds the agreement. C is required to pay A 20,000 rupees, which represents the profit A would have earned through the fulfillment of his contract with B. The Supreme Court Judgment of *Oil & Natural Gas Corporation Ltd. v Saw Pipes Ltd.*<sup>13</sup> addressed the issue of determining compensation for loss and damage brought on by contract violation, which is covered under Sections 73 and 74 of the Indian Contract Act 1872.<sup>14</sup>

There needs to be considered proof of the breach on the behalf of the defaulting party as mentioned earlier a lot of times. For example, in the case of *Thakral and Sons v Indian Petro Chemicals Corporation Ltd*<sup>15</sup>, there was no knowledge that the price of goods have risen to a threshold of Rs 3000. And the alleged defaulting party forbids delivering the alleged goods

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<sup>12</sup> TATA Iron & Steel Co Ltd v Ramanlal Kandoi (1971) 2 Cal. Rep. 493, 528

<sup>13</sup> Oil & Natural Gas Corporation Ltd. v Saw Pipes Ltd. (2003) 5 SCC 705

<sup>14</sup> Rishabh Tyagi, Oil & Natural Gas Corporation Ltd. v Saw Pipes – A Case Study’ (Jus Corpus, 6 July 2022) <<https://www.juscorpus.com/oil-and-natural-gas-commission-v-saw-pipes-a-case-study/>> accessed 12 December 2022

<sup>15</sup> Thakral and Sons v Indian Petro Chemicals Corporation Ltd (1994) Del 226

based on the new information. The plaintiff has not demonstrated this, hence he is not entitled to any damages.

According to Section 74 of the Indian Contract Act of 1872, a party who enters into a contract with the government does not fundamentally and compulsorily undertake or perform any public duty or promise to perform an act in which the general mass is interested. This is an extremely interesting observation. Another intriguing finding is that a clause that calls for higher interest rates starting from the date of default might constitute a punishment clause. These insightful findings demonstrate to a large extent the applicability of Sections 73 and 74 of the Indian Contract Act of 1872.

Section 73 is so comprehensive that it makes use of the provision for damages for service contract breaches. The Indian Contract Act of 1872's Sections 73 and 74 highlight the fundamental elements of public utility contracts. For instance, a service agreement signed by a parent on behalf of, let's say, a child is invalid since it was not for consideration.<sup>15</sup> As per the London School of Economics in the Indian Contract Law, 'The difficulty of proving actual damage or loss is felt more acutely in certain classes of Contracts, such as public utility contracts, specifically where the state is the aggrieved party. The adequate performance of public utility contracts entails benefits for the public at large so that, as a corollary, any breach of performance of such contracts is, therefore, likely to cause public harm, a harm that is not easy to quantify or even prove for that matter.'

The renowned institution also mentions the case law of *Construction and Design Services v Delhi Development Authority*<sup>16</sup> where the doctrine of section 74 is also discussed thoroughly through a microscopic point of view. The case dealt with the non-establishment of a sewage pumping station in Delhi, a contract that was formulated between the contractor and the Delhi Development Authority. The contractor did not efficiently complete the pumping station within the stipulated amount of time. DDA terminated the agreement and sought payment from the contractor. The Delhi High Court was served with

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<sup>16</sup> *Construction and Design Services v Delhi Development Authority* (2015) 14 SSC 263

a recovery lawsuit. The Supreme Court heard the matter. DDA received just half of the sum allowed under the definition of "fair recompense." The court further determined that a violation of such long-standing public utility contracts would cause serious harm to society as a whole, for whose benefit the contract was created.

### **ABSENCE OF SPECIFIC EVIDENCE - DOES IT MATTER?**

The harmed party may not be able to provide any particular proof of the "actual or precise amount of loss." The court may define some of the awards as fair compensation and the other portion as a penalty since the contract included a clause stating the maximum amount of compensation that may be awarded. The contractor was required to demonstrate that there had been no damage as a result of the delay. Many of India's high courts have upheld this ruling. Any person impacted by the failure to discharge an obligation similar to those generated by the contract is entitled to the same compensation from the party in default as if the such party had contracted to discharge it and had violated his contract. It is necessary to consider any past contract non-performance. The Kerala High Court declared in October that under sections 73 and 74 of the Indian Contract Act 1872, no compensation could be awarded in the event of contract violation. The damages were not correctly estimated, according to the P.B. Suresh Kumar and Justice C.S. Sudha division bench. It is important to properly and realistically analyse the damages. Both parties have considered the provisions for compensation. As was already indicated, exceptional circumstances may be used to collect extraordinary damages.

Special damages cannot be known when there is no plausibility of recovery. Damages may be claimed in case of anticipatory breach of contract. A prospective violation will have specific effects, and failure to fulfill commitments may result in contract cancellation. On proving that the plaintiff intended to perform the contract before it was rescinded, the plaintiff would be qualified to pursue damages claims. Regardless of the type of actual harm, these Damages relate to the sum that the parties have agreed to pay as compensation for losses under the terms of the contract. The contract's parties may decide at the time of signing that, in the event of a breach by one party, any money given to the other party will be forfeited.



Alternatively, they may decide that, in the event of a breach by one party, the defaulting party will pay the other party a specific sum of money. It is a true estimate of the damages that will most likely result from the breach. This reference was needed because the root of this contract act 1872 lies in the remedial provisions of liquidated damages. The position in English is a bit different. Following English Common Law, parties may specify a quantity to be paid in the event of a violation; however, if the court classifies the amount as liquidated damages instead of a penalty, the liquidated damages are recoverable. The Indian Law of Contracts, however, does not acknowledge any qualitative distinction like damages since Section 74 eliminates the very complex refinement under Common Law. After examining the numerous provisions of both systems, we might conclude that Indian law and English law share several similarities. But there is some connection between the section and the distinction between a penalty and liquidated damages. The first reason for its importance is that the amount that the parties are considering will only be reduced if it seems to be a punishment. If not, liquidated damages may be used to recoup the whole sum.

Second, the word "punishment" appears in the first sentence of this section's explanation. It says that a provision for higher interest rates starting from the date of default may be a provision for a penalty. The decision demonstrates another similarity between Indian law and English common law. A party to a contract who obtains a security deposit from the other party to ensure proper performance of the contract is not entitled to keep the deposit if no loss was incurred by him as a result of the default, according to the Supreme Court's ruling in *Union of India v Rampur Distillery and Chemical Co. Ltd.* Thus, it's very important to comprehend the judgments of 1970-the 80s to discuss the earlier deliberations based upon the remedial steps of this topic. In light of the aforementioned debate, the arbitral tribunal was undoubtedly incorrect to deny the claimant's request for the release of his or her security deposit of Rs. 3 lakhs. The Arbitral Tribunal's conclusion that Sections 73 to 75 of the Contract Act were unconstitutional went against the fundamental principles of Indian law as stated in Section 34(2)(b)(ii) of the Act.<sup>17</sup>

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<sup>17</sup> Arbitration and Conciliation Act 1996, s 34(2)(b)(ii)

## THE PRINCIPLE OF MITIGATION

The principle of Mitigation states that the complainant must go out of his/her way to do much more in the normal course of transaction. In the event of a contract breach, the steps he takes to withdraw himself if he feels embarrassed should not be weighed on a fancy scale. The complainant is not required to harm his property, himself, or his company's reputation to lower the damages that the defendant will have to pay. The Supreme Court ruled in *M Lachia Setty & Sons Ltd. v Coffee Board Bangalore*<sup>18</sup> that rather than giving a party in violation of the contract any rights, the mitigation principle is the only factor to be taken into account when determining damages. In this instance, it was found that the complainant was expected to take all practical measures to minimise the loss and that if he failed to do so, he was unable to pursue claims for avoidable losses.

It was held in *Esso Petroleum Co. Ltd. v Mardon*<sup>19</sup> that the court has the discretion to treat a forecast made by a party with special knowledge and expertise about the subject of a contract during the pre-negotiation stage as more than just an expression of opinion and as a continuing warranty. This is because the forecast was made to persuade the other party to enter into a contract.<sup>24</sup> If the estimate is later determined to be wholly negligent, the party that made the forecast may be held liable for breach of warranty. In *Murlidhar Chiranjilal v Harishchandra Dwarkadas*<sup>20</sup>, the Supreme Court declared that there are two factors on which damages are estimated in circumstances of contract violation for the sale of goods. To start, the party that can demonstrate that the other party failed to deliver what they had committed to receiving will be put in a position financially comparable to what would have been the case if the contract had been completed. Additionally, the plaintiff is under a responsibility to take reasonable measures to reduce the loss as a result of the breach and is not permitted to claim any of the harm that follows from failing to do so.

In *Union of India v Raman Iron Foundry*,<sup>21</sup> damages were determined to be the

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<sup>18</sup> *M Lachia Setty & Sons Ltd. v Coffee Board Bangalore* (1981) SCR (1) 884

<sup>19</sup> *Esso Petroleum v Mardon* [1976] QB 801

<sup>20</sup> *Murlidhar Chiranjilal v Harishchandra Dwarkadas* 1962 SCR (1) 653

<sup>21</sup> *Union of India v Raman Iron Foundry* (1974) SCR (3) 556

compensation that an injured party may be entitled to following a court-ordered adjudication; however, he does not receive them as the result of any present obligation on the part of the party in breach of contract who has no financial liability until the court has decided the issue of the breach and the amount of compensation as a result. If there was antecedent responsibility, the court will not rule on it. Furthermore, the right to damages is not actionable and cannot be transferred because the party who breached the contract did not acquire any new duties as a result of the violation. The Supreme Court ruled in *M Licha Setty & Sons Ltd. v Coffee Board Bangalore*<sup>22</sup> that instead of granting a party in violation of the contract any rights, the idea of mitigation must be taken into account when calculating damages. In this case, it was ruled that to be eligible for compensation for losses that may have been avoided, the plaintiff had to make every attempt to mitigate the loss. It is only necessary for the plaintiff to act morally; whether or not he has done so in each instance is a question of fact rather than one of law. He must consider the interests of the defendant in addition to his own and must take reasonable measures to lessen the damages.

When there has been a breach of contract, the plaintiff must go above and beyond the normal course of business, and in cases where he feels embarrassed; the steps he takes to remove himself from the situation shouldn't be measured on fancy scales at the request of the offending party. The plaintiff is under no responsibility to lose control of his assets, harm him, or damage his reputation in the marketplace. It's vital to remember that by expressly excluding the opportunity to sue for damages under the general law, compensation is expressly provided for.

## CONCLUSION

Thus, based on several significant findings and legal precedents, we may conclude the fundamental elements of Sections 73 and 74 of the Indian Contract Act of 1872. After careful consideration, we may conclude that since Section 74 is to be interpreted in light of Section 73, the person who suffered harm as a result of the breach need not demonstrate that he

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<sup>22</sup> *M Licha Setty & Sons Ltd. v Coffee Board Bangalore* (1981) SCR (1) 884

genuinely suffered loss or damage to get a decree. The court has the power to award just compensation even if it is impossible to show that the contract violation caused harm. In some contracts, it would be difficult for the court to evaluate the breach damages, but if the damages are not in the form of a penalty or are fair, the court can nevertheless award them provided they constitute a true estimate of the breach damages by the parties. Because contractual breach damages do not include the defendants' purpose or behaviour, it is clear why aggravated and exemplary damages are a more important aspect of commercial law. This is largely because the purpose of contractual remedies is to make up for the promise's breach rather than to compel the promisor to perform. However, in situations when elements of fraud, oppression, malice, etc. are established, exemplary damages may be granted. Exemplary damages differ from compensatory damages in that they are based on the real monetary losses the injured party experienced. But when it comes to granting punitive penalties for breach of contract, courts in the UK and India have been strict.

As the leading authority on the subject of punitive or exemplary damages, the House of Lords established three categories of cases in which such penalties may be granted in *Rookes v Barnard*.<sup>23</sup> Although fines are sometimes excessive compared to actual losses and more than potential losses from contract breaches, they are stipulated to enforce contract performance and prevent any potential breaches. On the other hand, liquidated damages are predefined estimations of losses and commensurate payments that are due in the event of a contract breach. The money that was paid by the contractual party as "earnest money" or "security" for the correct execution of the agreement must also be forfeited, hence the contract must have a forfeiture provision. The parties to a contract must agree to insert language establishing a right to forfeit since it is a punitive contractual right. Therefore, the party does not have the right to forfeit the money if the contract does not contain a forfeiture clause.

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<sup>23</sup> *Rookes v Barnard* [1964] AC 1129