LIQUIDATED DAMAGES IN INDIA: SECTION 74'S SILENT STRUGGLE FOR JUSTICE

Ananya Shukla* Astik Pal*

ABSTRACT

Section 74 of the Indian Contract Act, 1872, governs the working of liquidated damages and penalties in case of a contractual breach. This article unifies the legal position by focusing on "reasonable compensation." Section 74 has sparked considerable debate due to its interpretational ambiguities and evolving judicial stance. It also explores the historical roots of this provision, its branching from English common law, and the conflicting judicial interpretations in landmark cases such as Fateh Chand v. Balkishan Das, ONGC v. Saw Pipes, and Kailash Nath v. DDA. Special emphasis is laid on the Delhi High Court's recent judgment in J&K Economic Reconstruction Agency v. Simplex Projects Ltd., which again brings up the controversy by seemingly departing from stricter precedents. The article argues that while Section 74 merges the concepts of penalties and liquidated damages under a common rule of fairness, its flexible nature often leads to judicial unpredictability, which may lead to controversy. Despite its flaws, Section 74 remains a vital provision that attempts to strike a balance between contractual freedom in the Indian legal landscape.

Keywords: Section 74, Liquidated Damages, Reasonable Compensation, Freedom of Contract, Pre-Estimated Loss.

INTRODUCTION

This article delves into the pivotal Section 74[1] of the Indian Contract Act, 1872, a crucial provision that deals with Liquidated Damages in India by providing for measures to calculate

*BA LLB, SECOND YEAR, DR. RAM MANOHAR LOHIYA NATIONAL LAW UNIVERSITY, LUCKNOW.

*BA LLB, SECOND YEAR, DR. RAM MANOHAR LOHIYA NATIONAL LAW UNIVERSITY, LUCKNOW.

[1] The Indian Contract Act 1872, s 74

damages for breach of contract where a penalty is stipulated. This section asserts that in the event of a contract breach with a specified penalty, the aggrieved party is entitled to reasonable compensation, not exceeding the agreed amount. By capping liability at the amount fixed, while keeping it open to parties to prove actual damages, this provision necessitates a genuine pre-estimate of the likely loss from the breach, thus ensuring that the provision for penalty in a contract is not used as a punitive measure.

However, the said provision has many interpretational challenges which have time and again been addressed by the Courts. For one, while Section 74 of the Indian Contract Act,1872, covers both liquidated damages and penalties, unlike English Law, it does not give a clear distinction between liquidated damages and penalties. Secondly, while deciding on the quantum of liquidated damages to be awarded, the focus is on the "reasonableness of compensation", a term that is open to wide interpretation. Accordingly, we can see that Indian courts usually use a very broad discretion in this section, which leads to unpredictable and uncertain outcomes. Even after decades of this provision being in effect, the law is being interpreted dynamically, considering the changing needs of the time.

There has been a steady evolution of law in regards Section 74, which can be broadly covered by three judgments. In Fateh Chand v. Balkishan Das,[2] the court held that even if an amount is mentioned, only reasonable compensation can be awarded. But in the case of ONGC v. Saw Pipes,[3] it was held that liquidated damages can be granted if the amount is a genuine pre-estimate, even if actual loss is difficult to prove. Here, they allowed liquidated damages in good faith if it was pre-estimated. However, the final position was laid down in Kailash Nath Associates v. DDA,[4] wherein it was held that if no loss is proved, then liquidated damages cannot be claimed arbitrarily. The present article attempts to summarise the law on liquidated damages as of the date by shedding light on the principles laid down in the landmark judgment of Kailash Nath Associates v. DDA, which has been followed and further clarified in a recent judgment of the Delhi High Court in the matter of Jammu & Kashmir Economic Reconstruction Agency vs. M/s Simplex Projects Limited.[5] The article also covers how the aforesaid judgment of the Delhi High Court has departed from the rationale of Kailash Nath and has followed the

[2] Fateh Chand v Balkishan Das (1964) 1 SCR 515, AIR 1963 SC 1405.
[3] Oil & Natural Gas Corporation Ltd v Saw Pipes Ltd (2003) 5 SCC 705, AIR 2003 SC 2629
[4] M/S Kailash Nath Associates v Delhi Development Authority (2015) 4 SCC 136, AIR 2015 SC 1174.
[5] Jammu & Kashmir Economic Reconstruction Agency v Simplex Projects Ltd [2025] DHC 4076

earlier judgment of ONGC v. Saw Pipes, by holding that proof of loss isn't essential if compensation is reasonable.

This position has been followed in a recent case of the Delhi High Court, Jammu & Kashmir Economic Reconstruction Agency vs. M/s Simplex Projects Limited, 2025. There was a commercial contract between the two companies which included a provision for liquidated damages in case of delays. Unfortunately, due to the delay, JKERA (Jammu & Kashmir Economic Reconstruction Agency) unilaterally started to adjust the LD and demanded additional compensation separately. M/s Simplex Projects Limited brought this case before the Arbitral Tribunal, where they ruled JKERA's move unlawful. Further, it stated that liquidated damages should be enforced judiciously with at least a rational basis for the loss that occurred. It further strengthened the judgment of Kailash Nath Associates v. DDA by stating that the party cannot unilaterally deduct the Liquidated Damages amount unless actual loss is proved. The mere presence of a provision for Liquidated damages in the contract is not a license to claim damages.

EVOLUTION OF LIQUIDATED DAMAGES

The concept of liquidated damages in India was taken from the English Common Law, with little modifications. We can say that English common law in general had a heavy influence on the making of the Indian Contract Act, 1872. The concept did originate from English Law, but it has undergone several modifications under the Indian legal framework. Indian law has always emphasised "reasonable compensation", rather than any strict classification. These ads often stirred a questionable doubt on the credibility of this section, because they often led to conflicting judgments.

One of the reasons why this section is controversial is that it does not have a strict distinction. Despite being derived from the English Law, where there is a clear distinction between liquidated damages and penalties, the Indian legal framework mostly focuses on reasonable compensation. This often leads to great confusion in international contracts as well. Due to this policy of "reasonable compensation" in Indian law, there has been a lot of disagreement with the courts' decisions sometimes. Even after the parties mention a fixed sum of money, courts sometimes may reduce the award to that money if they feel it is unreasonable. This leads to a loss of freedom to contract as the court interferes with the contract, leading to contractual uncertainty.

Apart from this, Section 74 states that there is no need to prove the actual loss, like in ONGC v. Saw Pipes, but there has always been a dilemma. In Kailash Nath v. DDA, the court asked the party to prove the loss, and if no loss is proved, the aggrieved party cannot claim damages. This judgement is a clear contradiction to what has been written in the section, which states that one need not prove actual loss. This leads to a lot of uncertainty in the section, often considered vague.

This inconsistent judgment has created judicial uncertainty as different judges or benches may interpret it differently. Fateh Chand v. Balkishan Dass followed the strict approach of reasonable compensation, whereas, in the case of ONGC v. Saw Pipes, the court allowed pre-estimated damages, if reasonable, even if the proof of loss is not proved. But in Kailash Nath v. DDA, the court said no damages can be claimed if the loss is not proved.

Almost all these landmark judgments, which have been very conflicting with each other, a new judgment of the Delhi HC has again created a stirring debate amongst the law professionals

and students. The case of J&K Economic Reconstruction Agency v. Simplex Projects Ltd. again opened the debate by holding that proof of loss isn't essential if compensation is reasonable and contractually agreed, relying on *ONGC v. Saw Pipes*, while seemingly disregarding stricter views. All this has led to great unpredictability, as it has granted the courts greater discretion.

LIQUIDATED DAMAGES VS. PENALTY

The concept of penalty and liquidated damages has always been complex and remains so today. However, when the select committee was formed in 1872 for drafting the Indian contract, lawmakers deliberately rejected the English law's rigid classification due to its intricacy because they aimed to balance contractual certainty rather than automatically allowing pre-agreed sums. This empowered Indian courts to intervene when the stipulated amount is found to be unreasonable or excessive to the actual harm suffered. The idea of liquidated damages vs penalty clauses originates from English contract law**,** especially from the case Dunlop Pneumatic Tyre Co. Ltd. v. New Garage & Motor Co. Ltd.,[6] where the House of Lords laid down tests to distinguish liquidated damages (valid) from penalties (unenforceable).

[6] Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd [1915] AC 79.

Section 74 treats the amount specified in the contract, that is, the pre-estimated sum, as the base for the reasonable compensation that the aggrieved party may receive. The actual compensation is subject to the court's discretion and on the reasonableness of the amount of the harm suffered.

Section 74 was formed in such a way as to eliminate the technical and confusing distinction coming under English common law between liquidated damages and penalties. In Fateh Chand v. Balkishan Das, the court held that Section 74 of the Indian Contract Act creates a single rule for all breaches of contract that specify a sum to be paid on breach, whether as liquidated damages or penalty. The aggrieved party is only entitled to reasonable compensation not exceeding the amount specified, and if the actual loss is not proved, there must be some form of legal injury.

In ONGC v. Saw Pipes Ltd., the Arbitral Tribunal had denied ONGC's claim for liquidated damages due to the absence of proof of actual loss. However, the Supreme Court overruled this decision, marking a significant departure from earlier interpretations. The Court upheld the enforceability of a liquidated damages clause even in the absence of proved loss, provided the sum was a genuine pre-estimate of anticipated harm. This judgment expanded the scope

of Section 74, reinforcing the principle of party autonomy and recognising the commercial wisdom of the contracting parties. Despite all the controversies, this section serves as a safeguard in a world of contracts. Though it has been criticised, it is still not only relevant, but also necessary. Section 74 deals with compensation for breach of contract, particularly when the contract itself contains a clause specifying an amount to be paid in case of such a breach; this is what we refer to as liquidated damages. Unlike in English law, which makes a sharp distinction between enforceable liquidated damages and unenforceable penalties, Indian law merges both concepts and says that the aggrieved party is entitled to reasonable compensation not exceeding the amount named in the contract.

Section 74 may be controversial, but it is far from redundant. It serves as a crucial tool for achieving fairness in contractual relationships. It balances the need for contractual certainty along with ensuring justice. In a country as diverse and dynamic as India, where contracts are entered into daily between individuals, businesses, and governments, Section 74 continues to play a silent yet significant role in upholding the spirit of fair dealing.

People often argue that this goes against the idea of freedom of contract. But freedom without fairness can quickly become exploitation. If we blindly enforce every penalty clause just because both sides have agreed upon it, we will be allowing imbalance and bullying, not justice. Section 74 doesn't throw out the agreed damages; it simply puts a check on abuse.

Its fairness and flexibility, and the idea to protect people on the grounds of "reasonable compensation", show that though it might be controversial, but also has great relevance in today's world. While Section 74 may be imperfect and debated, it remains a vital safeguard in Indian contract law, ensuring that justice, not just rigid terms, guides the outcome of a broken agreement.

CONCLUSION

Liquidated damages in India represent a balanced legal approach, allowing parties to pre-estimate losses while empowering courts to ensure fairness through reasonable compensation. Though influenced by English law, the Indian framework under Section 74 focuses not just on enforcement, but on equity. This makes it relevant in a diverse and dynamic contractual landscape, where protecting both commercial certainty and individual fairness is essential, despite all the controversies.

The final take from what we got after reading all the cases with different judgments is that Section 74 of the Indian Contract Act, though controversial and often inconsistently interpreted, remains a vital safeguard in Indian contract law. It aims to ensure fairness over rigidity by awarding only *reasonable compensation* for breach of contract, regardless of whether a fixed penalty was agreed upon. While it blends the concepts of liquidated damages and penalties, unlike English law's strict classification, it continues to evolve through landmark judgments. Despite judicial ambiguities and differences, the section plays a crucial balancing role between freedom of contract and protection from exploitation, ensuring justice is upheld in contractual relationships across India. In conclusion, while Section 74 invites debate and controversy, due to the wavering judgments passed, its continued relevance lies in its commitment to equitable relief, ensuring that compensation for breach is just, and not merely punitive, in the eyes of the law in India.