BLOGS

Learn in a Minute: Liquidated and Unliquidated Damages

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Liquidated and Unliquidated Damages are damages awarded to parties in a contract in case of a breach. Read more about it here!

Introduction to Damages

A breach of contract occurs when one party fails to fulfill their obligations as specified under a contract. An aggrieved party is entitled to seek compensation from the breaching party for any losses incurred due to the breach.

In some contracts, a predetermined compensation amount is specified in case of a breach. Section 73 of the Indian Contract Act governs such compensation, stating that the breaching party must compensate the other for losses that naturally arise or were reasonably foreseeable at the time of the contract.

Damages refer to the monetary compensation awarded by a court to a party who has suffered loss or injury due to the wrongful act of another party. Damages can be categorized into two primary types: liquidated damages and unliquidated damages.

Definition of Liquidated and Unliquidated Damages

(A) Liquidated Damages

Liquidated damages are pre-determined sums agreed upon by the parties to a contract, which become payable in the event of a breach. These are stipulated in the contract itself to avoid disputes regarding the quantum of compensation. Section 74 of the Indian Contract Act, 1872, governs liquidated damages in India.

Example: A construction contract may specify that the contractor will pay ₹50,000 per day for any delay in completion beyond the agreed deadline.

The Supreme Court has held that even if liquidated damages are mentioned in a contract, they should not exceed the actual loss suffered.

(B) Unliquidated Damages

Unliquidated damages are not pre-determined and are assessed by the court based on the extent of loss suffered by the claimant. They apply when the contract does not specify a fixed sum in case of a breach. The court examines evidence and circumstances to determine fair compensation.

Example: If a person is injured in an accident due to another's negligence, the court assesses the extent of injury and grants compensation accordingly.

Difference Between Liquidated and Unliquidated Damages

Edit **BasisLiquidated DamagesUnliquidated Damages Pre-determinedYes, specified in the contractNo, determined by the court PurposeTo fix compensation in advanceTo compensate based on actual loss Court's RoleEnforces agreed-upon damages, subject to reasonabilityAssesses damages based on evidence**

Principles Governing Award of Damages

(A) Principle of Compensation

The primary objective of awarding damages is to compensate the injured party and restore them to the position they would have been in if the breach had not occurred.

Hadley v Baxendale (1854) established the principle of remoteness of damages in contract law. Hadley & Co.'s flour mill shut down due to a broken crankshaft, which Baxendale, a carrier, delayed delivering for repairs. Hadley sued for lost profits, but the court ruled that such damages were too remote since Baxendale was unaware that the mill's operation depended on timely delivery. The case set the rule that damages are recoverable only if they naturally arise from the breach or were reasonably foreseeable at the time of the contract.

(B) Mitigation of Loss

The aggrieved party has a duty to mitigate losses and cannot recover damages for losses that could have been reasonably avoided.

British Westinghouse Electric & Manufacturing Co. Ltd. v. Underground Electric Railways Co. established the duty to mitigate losses in contract law. Underground Electric Railways purchased turbines from British Westinghouse, which were defective and inefficient. To minimize losses, they replaced the faulty turbines with more efficient ones, ultimately saving more in operating costs than the damages claimed.

The court ruled that compensation should consider benefits gained from reasonable mitigating actions. Since the new turbines improved efficiency, the plaintiff's claim was reduced. This case reinforces that a party suffering a breach must take reasonable steps to reduce losses, and any resulting benefits may offset the damages.

(C) Remoteness of Damages

Damages must not be too remote; they should be a direct consequence of the breach.

In Victoria Laundry (Windsor) Ltd v Newman Industries Ltd, Victoria Laundry purchased a boiler from Newman Industries, expecting delivery on a specific date to expand their business. However, the delivery was delayed due to the defendant's negligence. As a result, Victoria Laundry lost regular profits and a lucrative government contract. They sued for both losses.

The court, applying the Hadley v. Baxendale principle, held that ordinary profits from business expansion were foreseeable and recoverable. However, the special government contract losses were too remote since Newman Industries was unaware of them at the time of contracting.

This case reinforced the rule that only foreseeable losses can be claimed unless special circumstances were communicated.

Conclusion

An aggrieved party is entitled to seek compensation from the breaching party for any losses incurred due to the breach. While liquidated damages provide certainty, unliquidated damages offer flexibility in compensation. Courts play a significant role in ensuring that damages awarded are fair and just.