

News

[Commercial Law Monologues] Liquidated damages: Who bears the burden of proof?



An outline of India's developing legal precedence concerning the burden of proof in liquidated damages claims.

According to Indian law, the party seeking liquidated damages under Section 74 of the Indian Contract Act, 1872, as amended (the "Indian Contract Act") is typically responsible for demonstrating (a) loss or damage or legal injury, as well as (b) the amount, magnitude, and measure of such loss or damage. This is identical to a claim for unliquidated damages under Section 73 [See *Maya Devi v. Lalta Prasad*, reported at (2015) 5 SCC 588, at paragraph 19, and Section 105 of the Bharatiya Sakshya Adhiniyam, 2023, as amended ("Bharatiya Sakshya Adhiniyam").

As a result, during the trial, the innocent party should fulfill this initial burden. The initial burden of proving that the innocent party has not been harmed by the breach, that the amount specified in the contract is not a true pre-estimate of damages, that it is unreasonable, or that it is a penalty is typically not placed on the party in breach.

However, there appears to be some dispute over the burden of proof under Section 74 of the Indian Contract Act. This is due to a common misinterpretation of the theoretical underpinnings of the Supreme Court of India's ruling in Oil & Natural Gas Corporation Ltd. v. Saw Pipes Ltd., reported at (2003) 5 SCC 705 ("Saw Pipes Case").

shifting of the burden of proof with respect to (a) the incidence of a loss or a legal damage and (b) the amount stated being a true pre-estimate rather than a penalty

In some circumstances, the burden of proof may move to the party in violation, regardless of who has the original burden, as will be discussed below. In those situations, the party in violation must demonstrate that there has been no legal harm caused by the violation or, in the event that there has been, that the amount specified in the contract is either not a true pre-estimate, is unreasonable, or is a punishment.

Paragraph 67 of the Supreme Court's ruling in the Saw Pipes Case makes it clear that the Court was acting on the premise that in some contracts, the incidence of a loss or legal injury is so evident that no more proof is needed. It may be assumed. [See Bharatiya Sakshya Adhinyam, Section 119]

Additionally, the Saw Pipes Case contract's liquidated damages language made it clear that the amount specified was ***"an agreed, genuine pre-estimate of damages duly agreed by the parties" and that "agreed liquidated damages are not by way of penalty."***

Given the nature of the agreement and this specific clause, the Court determined that the burden of proof had shifted to the party in breach to demonstrate that: (a) the innocent party had not suffered any loss or legal harm; and (b) the amount specified in the contract is not a true pre-estimate (and is unreasonable or a penalty). [See Bharat Sanchar Nigam Limited v. Haryana Telecom Limited, reported at 2010 (116) DRJ 157, at paragraphs 20, 21, and Saw Pipes Case, at paragraphs 38, 40, 41, 63, 67, 68].

In the Saw Pipes Case, for instance, if the party in breach had contested the contract that the innocent party was relying upon, the innocent party would have had to prove the contract to show that there was a sum that the parties had agreed upon as a

genuine pre-estimate and that the parties even agreed that this sum was not in the nature of a penalty. The party in violation would then have the burden of proving otherwise.

Therefore, the burden of proof may only shift to the party in breach to demonstrate that (a) no loss or legal injury had been suffered by the innocent party and (b) the sum named in the contract is not a genuine pre-estimate and is unreasonable or a penalty, depending on the particular facts of each case (such as the nature of the contract, the terms of the contract, the nature of obligations, and the state of evidence led during trial). In every case, the process of shifting the burden of proof throughout a trial is ongoing. [See paragraph 12 of *A. Raghavamma v. A. Chenchamma*, reported at AIR 1964 SC 136].

The burden of demonstrating that determining damages is difficult or impossible
The Supreme Court ruled in paragraphs 6 and 7 of *Maula Bux v. Union of India*, reported at 1969 (2) SCC 554 ("*Maula Bux Case*"), that Section 74 of the Indian Contract Act only eliminates the need for proof of extent, quantum, and measure of loss or damage in situations where the court is unable to determine loss or damage in accordance with "established rules" of quantification of the extent of loss or damage. Additionally, it was decided that "[w]here loss in terms of money can be determined, the party claiming compensation must prove the loss suffered." This idea seems to be extended to proof of legal injury in the *Saw Pipes Case*.

The Supreme Court used the phrase "**difficult or impossible to prove**" in paragraph 43.6 of *Kailash Nath Associates v. Delhi Development Authority*, reported at (2015) 4 SCC 136 ("*Kailash Nath Case*"). In my opinion, the term "difficult" refers to something that is nearly impossible rather than simply being inconvenient, costly, or burdensome to prove damages. Otherwise, it would be unnecessary to use the word "impossible" in conjunction with the word "difficult" in the *Kailash Nath Case*.

In Construction and Design Services v. Delhi Development Authority, reported at (2015) 14 SCC 263 ("Construction Design Case"), the Supreme Court once more held in paragraphs 14, 15, 17, and 18 that in contracts involving a claim for liquidated damages for delay in construction of public utility projects, it can be assumed that (a) the innocent property has suffered some loss or legal injury, and (b) the sum named in the contract is a genuine pre-estimate (rather than a penalty) in the absence of actual proof.

Nonetheless, there are three difficulties with the Construction Design Case study.

First, assuming that it is impossible to prove the degree, amount, and measure of loss or damage does not always imply that it is impossible to prove legal injury. For instance, even in public utility projects, it might occasionally be possible to show that the employer or state has suffered legal harm as a result of having to spend money on additional resources (or wasting paid time of its resources), even though it is impossible to prove the extent, quantity, and measure. These two elements of (a) legal injury and (b) the degree, amount, and measure of loss or damage may not always be related.

This exception is not mentioned in the Construction Design Case, possibly because it was not brought up in the case's facts or was not discussed during the hearing.

Second, it is unclear why only half of the requested amount—or even half of the sum specified in the contract as the maximum amount of liquidated damages—would be awarded. In contrast to the observations in paragraph 43.2 of the previous ruling in the Kailash Nath Case that ***"[r]easonable compensation will be fixed on well-known principles..." which are to be found inter alia in Section 73 of the Contract Act,"*** the Court seems to have acted intuitively. [See Construction Design Case, paragraph 17].

It seems that the Court in the Construction Design Case was not made aware of the ruling in the Kailash Nath Case.

Third, the decision proceeds on the basis that a uniform treatment would follow in such a situation regardless of whether the sum named in the contract is liquidated damages or a penalty, having made both assumptions—that a loss, damage, or legal injury would have occurred and that the precise extent, quantum, and measure of loss or damage is impossible to prove.

In contrast to the Saw Pipes Case, the Construction Design Case's contract did not explicitly state that the amount specified was a true pre-estimate and not a penalty. Conversely, under the circumstances of the case, the specified amount had been expressly imposed as a penalty rather than liquidated damages. [See Construction Design Case, paragraphs 4 and 15].

The Supreme Court's ruling in the Maula Bux Case, which stated in paragraph 6 that "where a court is unable to assess the compensation, the sum named by the parties if

it be regarded as a genuine pre-estimate may be taken into consideration as the measure of reasonable compensation, but not if the sum named is in the nature of a penalty," seems to be at odds with this aspect of the Construction Design Case's methodology.

Once more, it seems that the Court in the Construction Design Case was neither informed of or presented with arguments about these factors. It is hoped that the Supreme Court would provide more specific clarification on these points in a suitable case.

In conclusion

According to Indian law, an innocent party seeking liquidated damages from a party in violation must meet three requirements. First, there has been a loss or harm to an innocent party. Second, the scope, magnitude, and measure of the loss or harm cannot be proven. Third, that the amount specified in the contract is not a penalty but rather a true pre-estimate.

Based on the nature of the contract, the terms of the contract, the nature of the obligations, and the status of the evidence shown during the trial, Indian courts have the authority to make assumptions and draw negative conclusions regarding all three elements, as evidenced by the country's developing judicial precedence. But this is due to the ongoing practice of shifting the burden of proof during the trial. When a claim for liquidated damages is made, the innocent party always has the initial burden.

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