



Damages Claims in Construction Contract Disputes

Krrishan Singhania & Srishti Singhania analyze the Indian law governing damages, the limitations relating to the same and the recourse available to the contracting parties.

Damages in simple terms means the financial harm suffered by one party due to the breach of the contract by the other party. In construction projects, the contractor or the owner of the project usually claims for damages in the following circumstances: change in scope of work, project delays, acceleration related costs, disruption or termination of the project. In all these cases, the damages are awarded as per the contractual terms and the law governing the contracting parties.

The novel pandemic, has created havoc in the

construction sector, with projects being stalled, non-availability of labour, financial crunch and damages claims likely to be invoked. The Ministry of Road Transport & Highways (MoRTH) issued an order dated 25th March 2020 declaring the lockdown to be treated as 'force majeure' event. Similarly, the Ministry of New & Renewal Energy, vide office memorandum dated 20th March 2020, declared the prevailing conditions to be a 'force majeure' event and granted time extensions for its projects. Even though government notifications may declare the pandemic to be a 'force majeure' event in



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certain cases, it will be interesting to analyze if the parties can still claim for damages due to disruption of the project.

Indian Law Governing Damages

Section 73 and Section 74 of the Indian Contracts Act, 1872 (Indian Contract Act) lay down the legal principles governing damages. Section 73 is compensatory in nature and provides for actual damages for the loss suffered by one of the parties, due to the breach of the contract, arising naturally in the usual course of things from such breach, or which the parties had foreseen at the time of entering into the contract. Section 73 does not compensate any remote or indirect losses suffered due to the breach. On the other hand, Section 74 deals with liquidated damages where the contract stipulates the quantum of damages in case of a breach of the contract. However, in order to claim damages, the parties need to establish the following pre-requisites:

- (i) Existence of a valid and concluded contract which means that parties cannot claim damages when there is a proposal and counter proposal, and thus, no concluded contract
- (ii) Breach of contract which needs to be adjudicated upon and proved, and cannot be decided by the parties themselves
- (iii) Actual loss or injury suffered by the aggrieved party. In a case where the Delhi Development Authority (DDA) cancelled the allotment of land to the Appellant and forfeited the earnest money, the Apex Court held that damages could not be awarded as DDA did not suffer any loss and in spite made a profit from the re-auction of the land. The Court also clarified that the expression “whether or not actual damage or loss is proved to have been caused thereby”, under Section 74 of the

Indian Contract Act, does not mean that one can do away with proving actual loss. It only means that in cases where the loss is difficult or impossible to prove then the stipulated amount, named in the contract, if a genuine pre-estimate of the damage, can be awarded.

Causation and Foresee Ability of Loss

For claiming damages there has to be a direct causal link between the breach committed and the injury suffered. The Apex Court has applied the ‘but for’ test in order to determine if the breach of contract is the dominant cause in relation to the injury suffered. In this case, it was held that even though the government issued an ordinance in relation to compensating damaged insured goods subsequent to entering into a contract, there was a direct casual connection between the negligence of the plaintiff in insuring the goods and the loss suffered by the defendant. In another case, the Apex Court did not award loss of anticipated profits as the loss was caused by other multiple factors and the termination of the contract was not the dominant cause.

In relation to consequential damages, parties can only claim those damages that they could reasonably foresee at the time of entering into the contract. The test of ‘reasonable foresee ability’ means that a normally prudent person when entering into a contract should have foreseen the probable consequences due to the future breach. Thus, when claiming damages due to the loss caused due to the pandemic, parties will have to prove the direct causation or reasonable foresee ability.

Liquidated Damages not to be a Penalty

Most standard construction contracts have a liquidated damages clause for delay in the project



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timeline. However, it is important to note that the stipulated liquidated damages need to be a 'reasonable compensation' and a genuine pre-estimate of the loss likely to be suffered due to the breach. Liquidated damages cannot be in the nature of a penalty, i.e., higher or disproportionate to the loss likely to be suffered. In case the liquidated damages is by way of penalty, then the Courts have jurisdiction to only grant reasonable compensation. Thus, it is important to draft these clauses with clarity and keeping in mind the purpose of such a clause.

Mitigation of Losses and Waiver

It is also important to note that the party claiming damages should take all reasonable steps to mitigate the loss suffered due to the breach, and, if he fails to do so, he cannot claim damages. Thus, for parties that are going to claim damages arising out of the pandemic, they will have to prove that they took reasonable steps to mitigate the loss before making any claims.

It is also important to keep in mind that in case the plaintiff waives off his right to claim liquidated damages it cannot claim the same. In a case, where the owner of the project did not claim liquidated damages at the time of extending the timeline, the owner could not claim liquidated damages retrospectively during the arbitration proceedings. Thus, it is important for owners of the project that are extending project timelines due to the pandemic to consider the clauses of their contract and claim liquidated damages in accordance with the contractual terms.

Damages in Midst of a 'Force Majeure' Event

Recently, in the matter of M/s Halliburton Offshore Services Inc v. Vedanta Limited, the Delhi High Court clearly laid down that every breach or non-performance couldn't be justified or excused merely on the invocation of Covid-19 as a force

majeure condition; and the Court would have to assess whether the party was taking any steps to comply with its contractual obligations and was genuinely prevented from performing due to the pandemic. In this case, as the contractor was in breach since September 2019, and was defaulting much before the imposition of the lockdown, the Court did not allow the contractor to take the excuse of the pandemic. Thus, in cases where the defaulting party has been non-performing much before the lockdown, the other party may be able to seek for damages. In the English case of *Classic Maritime Inc v. Limbungan Makmur SDN BHD*, the Court of Appeal held that it was not enough for parties to show that they were prevented due to the force majeure event, but also had to show that there was a direct causation between the non-performance and the force majeure event. It will be interesting to see if this principle of direct causation is applied in the Indian scenario as well.

Conclusion

The pandemic has disrupted construction projects and parties have been grappling with issues of liquidated damages and force majeure. It is important for parties to analyze their contractual terms to understand if the pandemic will be construed as 'force majeure' and if there is a causal link between the pandemic and their non-performance. In cases where the non-performance is not linked to the pandemic, parties may claim damages. However, before claiming damages parties will have to take steps to mitigate the loss, prove the actual loss and establish the causal connection. Parties should also ensure that they are adhering to the notice requirements as provided under their contracts. It will be interesting to see if during these unprecedented times, the Courts apply the principles of equity to excuse parties from non-performance even when the pandemic may not be the direct cause.

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