IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

CWP No. 13285 of 2012 (O&M)
Date of Decision :09.10.2012

SECL Industries Limited (Formerly known as Singla Engineers and Contractors Pvt. Ltd.)

...Petitioner

Versus

The State of Haryana and others

...Respondents

CORAM: HON'BLE MR. JUSTICE A.K. SIKRI, CHIEF JUSTICE
HON'BLE MR. JUSTICE RAKESH KUMAR JAIN

Present: Mr. Puneet Bali, Senior Advocate,
with Mr. Ajay Pal Singh, Advocate,
for the petitioner.

Mr. B.S. Rana, Additional Advocate General, Haryana.

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A.K. SIKRI, C.J. (ORAL)

The scope of the controversy raised in this writ petition is very narrow and has arisen in the following circumstances:-

In the year 2009, the respondent No. 2, namely, Superintending Engineer, Jind Circle, Department of Public Works (B&R) Branch in the State of Haryana had issued notice inviting tenders for the execution of the works of two road projects viz, "Construction of bye-pass road from Jind-Hansi road to Jind-Assandh road via Jind-Gohana road and Jind-Safidon road in Jind District" and "Special Repair to Jind-Safidon road and Panipat-Assandh road in Jind District" in the State of Haryana.

2. The petitioner also submitted its tender pursuant to the

aforesaid tender inquiry which was evaluated alongwith others and the respondent No. 2 decided to accept the bid of the petitioner. Allotment letters dated 02.03.2009 were accordingly issued. On 16.03.2009, the petitioner submitted the performance security in the form of bank guarantees in respect of each of the said projects. These bank guarantees were in the sum of Rs. 33,73,959/- and Rs. 76,23,609/- respectively. The respondent No. 2 instructed the petitioner on 19.03.2009 to proceed with the execution of the work. However, in May 2009, all mining operations and quarries were closed in the State of Haryana because of which work was held up and the petitioner communicated this fact to the respondent No. 3 – Executive Engineer, Provincial Division, Department of Public Works (B&R) Branch, Jind on 11.05.2009. The respondent No. 3, however, asked the petitioner to complete the work within stipulated period. It was followed by various communications threatening the petitioner that the petitioner would be liable for the liquidated damages in case the work is not completed. Ultimately, the respondents rescinded the contracts on 19.12.2011 and 30.12.2011 respectively, alleging breach/non-performance on the part of the petitioner. The petitioner filed writ petitions challenging the termination. However, these were directed to be withdrawn with liberty to the petitioner to invoke alternative remedy of arbitration, which is available under the contracts. In the present writ petition, the petitioner has challenged order dated 11.06.2012, which is addressed to the respondents No. 04 to 42. The respondents No. 04 to 42 are the Superintending Engineers working in various provincial divisions in the State of Haryana. In this communication, it is stated that on account of

termination of the aforesaid contracts, damages/penalty in the sum of Rs. 5,42,90,686/- is imposed upon the petitioner company and the respondents No. 04 to 42 are asked to recover the said amount from any credits of the petitioner company, which may be at the disposal of those officers. The petitioner has challenged the validity of this order. Primary contention is that no liability on account of damages/penalty has been crystalized so far as there is no judicial/quasi-judicial termination thereof either by any Court or by the Arbitrator. Another contention is that this amount cannot be recovered from the other contracts of the petitioner.

3. In the counter-affidavit filed by the respondent No. 3 on behalf of the respondents, namely, respondents No. 01 to 42, it is alleged that since the petitioner has violated Clause 52.2(a) and 52.2(f) of Part 1 of the General Condition of Contract in both the works, the respondent has imposed the liquidated damages in question and is entitled to recover the same. These amounts are stated to be Rs. 5,42,90,686/- in respect of both the works and after adjusting the securities of the petitioner balance net recoverable amount, as per the respondents is Rs. 5,20,77,352/-. The respondents have tried to justify the imposition of the aforesaid penalty and liquidated damages alleging defaults on the part of the petitioner. It is, however, also stated that in Clause 24 of Part 1 of the General Condition of the Contract there is a provision of dispute redressal system and specific averment is made that the same is not availed before approaching this Court.

4. Clause 24, which contains the disputes redressal system, reads as under:-

> *"24.1 If any dispute or difference of any kind whatsoever arises in connection with or arising out of this contract or the execution of works*

thereunder, whether before its commencement or during the progress of works or after the completion of works or after termination, abandonment or breach of the contract, it shall, in the first instance, be referred for settlement to the competent authority, described alongwith their powers in the contract data. The competent authority shall within a period of forty-five days after being requested in writing by the contractor to do so, convey his decision to the contractor. Such decision in respect of every matter so referred shall, subject to the review as hereinafter provided, be final and binding upon the Contractor. In case, the work is already in progress, the contractor shall proceed with the execution of works, thereof pending receipt of the decision of the competent authority as aforesaid, with all due diligence.

24.2 Either party will have the right of appeal, the decision of the competent authority, to the Standing Empowered Committee if the amount appealed against exceeds rupees one lakh.

24.3 The composition of the Empowered Standing Committee will be:-

(i) One official member, Chairman of the Standing Empowered Committee, not below the rank of Additional Secretary to State Government.

(ii) One official member not below the rank of Chief Engineer ; and

(iii)One non-official member who will be technical expert of Chief Engineer's level selected by the contractor from a panel of three given to him by the employer.

24.4 The contractor and the employer will be entitled to present their case in writing duly supported by documents. If so requested, the Standing Empowered Committee may allow one opportunity to the contractor and the employer for oral arguments for a specified period. The Empowered Committee shall give its decision within a period of ninety days from the date of appeal, failing which the contractor can approach the appropriate Court for the resolution of the dispute.

24.5 The decision of the Standing Empowered

> *Committee will be binding on the employer for payment of claims upto five percent of the Initial Contract Price. The contractor can accept and receive payment after signing as "in full and final settlement of all claims". If he does not accept the decision, he is not barred from approaching the Courts. Similarly, if the employer does not accept the decision of the Standing Empowered Committee above the limit of five percent of the initial contract price, he will be free to approach the Courts applicable under the law."*

5. There is no dispute that, as per the aforesaid clause, the disputes between the parties have to be redressed on the basis of mechanism provided thereunder. It is for this reason, Civil Writ Petition Nos. 342 of 2012 and 975 of 2012 were allowed to be withdrawn by the petitioner, relegating the petitioner to the aforesaid dispute redressal mechanism. The question available in the present case is totally different, namely, whether the respondents can recover the amount of penalty and liquidated damages without adjudication thereupon by the Arbitral Tribunal/Court, when the imposition of the penalty/liquidated damages is challenged by the petitioner? Our answer has to be in the negative.

6. Consequences for breach of the contract are provided in Chapter VI of the Contract Act which contains three sections, namely, Section 73 to Section 75. As per Section 73 of the Contract Act, the party who suffers by the breach of contract is entitled to receive from the defaulting party, compensation for any loss or damage caused to him by such breach, which naturally arose in usual course of things from such breach, or which the two parties knew when they make the contract to be likely the result of the breach of contract. This provision makes it clear that such compensation is not

to be given for any remote or indirect loss or damage sustained by reason of the breach. The underlying principle enshrined in this Section is that a mere breach of contract by a defaulting party would not entitle other side to claim damages unless the said party has in fact suffered damages because of such breach. Loss or damage which is actually suffered as a result of breach has to be proved and the plaintiff is to be compensated to the extent of actual loss or damage suffered. When there is a breach of contract, the party who commits the breach does not eo instant i.e. at the instant incur any pecuniary obligation, nor does the party complaining of the breach becomes entitled to a debt due from the other party. The only right which the party aggrieved by the breach of the contract has is the right to sue for damages. No pecuniary liability thus arises till the Court has determined that the party complaining of the breach is entitled to damages. The Court in the first place must decide that the defendant is liable and then it should proceed to assess what the liability is. But, till that determination, there is no liability at all upon the defendant. Courts will give damages for breach of contract only by way of compensation for loss suffered and not by way of punishment. The rule applicable for determining the amount of damages for the breach of contract to perform a specified work is that the damages are to be 'assessed at the pecuniary amount of difference between the state of the plaintiff upon the breach of the contract and what it would have been if the contract had been performed and not the sum which it would cost to perform the

contract, though in particular cases the result of either mode of calculation may be the same. The measure of compensation depends upon the circumstances of the case. The complained loss or claimed damage must be fairly attributed to the breach as a natural result or consequence of the same. The loss must be a real loss or actual damage and not merely a probable or a possible one. When it is not possible to calculate accurately or in a reasonable manner, the actual amount of loss incurred or when the plaintiff has not been able to prove the actual loss suffered, he will be, all the same, entitled to recover nominal damages for breach of contract. Where nominal damages only are to be awarded, the extent of the same should be estimated with reference to the facts and circumstances involved. The general principle to be borne in mind is that the injured party may be put in the same position as that he would have been if he had not sustained the wrong.

7. In **Murlidhar Chiranjilal** Vs **Harishchandra Dwarkadas and Another,** AIR 1962 SC 366, the Supreme Court highlighted two principles which follow from the reading of Section 73 of the Contract Act. The first principle on which damages in cases of breach of contract are calculated is that, as far as possible, he who has proved a breach of a bargain to supply what he contracted to get is to be placed, as far as money can do it, in as good a situation as if the contract had been performed; but this principle is qualified by a second, which imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach and

debars him from claiming any part of the damages which is due to his neglect to take such steps.

8. Thus, while on one hand, damages as a result of breach are to be proved to claim the same from the person who has broken the contract and actual loss suffered can be claimed, on the other hand, Section 74 of the Act entitles a party to claim reasonable compensation from the party who has broken the contract which compensation can be pre-determined compensation stipulated at the time of entering into the contract itself. Thus, this section provides for pre-estimate of the damage or loss which a party is likely to suffer if the other party breaks the contract entered into between the two of them. If the sum named in the contract is found to be reasonable compensation, the party is entitled to receive that sum from the party who has broken the contract. Interpreting this provision, the Courts have held that such liquidated damages must be the result of a "genuine pre-estimate of damages". If they are penal in nature, then a penal stipulation cannot be enforced, that is, it should not be a sum fixed in **terrarium** or **interrarium**. This action, therefore, merely dispenses with proof of "actual loss or damage". However, it does not justify the award of compensation when in consequence of breach, no legal injury at all has resulted, because compensation for breach of contract can be awarded to make good loss or damage which naturally arose in the usual course of things, or which the parties knew when they made the contract, to be likely to result from the breach.

9. The Supreme Court in the case of **Union of India** Vs **Raman Iron Foundry,** AIR 1974 SC 1265*, expounded this very principle in the following words:*

> *"9. Having discussed the proper interpretation of Clause 18, we may now turn to consider what is the real nature of the claim for recovery of which the appellant is seeking to appropriate the sums due to the respondent under other contracts. The claim is admittedly one for damages for breach of the contract between the parties. Now, it is true that the damages which are claimed are liquidated damages under Clause 14, but so far as the law in India is concerned, there is no qualitative difference in the nature of the claim whether it be for liquidated damages or for unliquidated damages. Section 74 of the Indian Contract Act eliminates the somewhat elaborate refinements made under the English common law in distinguishing between stipulations providing for payment of liquidated damages and stipulations in the nature of penalty. Under the common law a genuine pre-estimate of damages by mutual agreement is regarded as a stipulation naming liquidated damages and binding between the parties : a stipulation in a contract in terrorem is a penalty and the Court refuses to enforce it, awarding to aggrieved party only reasonable compensation. The Indian Legislature has sought to cut across the web of rules and presumptions under the English common law, by enacting a uniform principle applicable to all stipulations naming amounts to be paid in case of breach, and stipulations by way of penalty, and according to this principle, even if there is a stipulation by way of liquidated damages, a party complaining of breach of contract can recover only reasonable compensation for the injury sustained by him, the stipulated amount being merely the outside limit. It, therefore makes no difference in the present case that the claim of the appellant is for liquidated damages. It stands on the same*

footing as a claim for unliquidated damages. Now the law is well settled that a claim for unliquidated damages does not give rise to a debt until the liability is adjudicated and damages assessed by a decree or order of a Court or other adjudicatory authority. When there is a breach of contract, the party who commits the breach does not eo instanti incur any pecuniary obligation, nor does the party complaining of the breach becomes entitled to a debt due From the other party. The only right which the party aggrieved by the breach of the contract has is the right to sue for damages. That is not an actionable claim and this position is made amply clear by the amendment in Section 6(e) of the Transfer of Property Act, which provides that a mere right to sue for damages cannot be transferred. This has always been the law in England and as far back as 1858 we find it stated by Wightman, J., in Jones v. Thompson [1858] 27 L.J.Q.B. 234 "Exparte Charles and several other cases decide that the amount of a verdict in an action for unliquidated damages is not a debt till judgment has been signed". It was held in this case that a claim for damages does not become a debt even after the jury has returned a verdict in favour of the plaintiff till the judgment is actually delivered. So also in O'Driscoll v. Manchester Insurance Committee [1915] 3 K. B. 499, Swinfen Eady, L.J., said in reference to cases where the claim was for unliquidated damages : "... in such cases there is no debt at all until the verdict of the jury is pronounced assessing the damages and judgment is given". The same view has also been taken consistently by different High Courts in India. We may mention only a few of the decisions, namely, Jabed Sheikh v. Taher Mallik 45 Cal. Weekly Notes, 519, S. Malkha Singh v. N.K. Gopala Krishna Mudaliar 1956 A.I.R. Pun. 174 and Iron & Hardware (India) Co. v. Firm Shamlal & Bros. 1954 A.I.R. Bom. 423. Chagla, C.J. in the last mentioned case, stated the law in these terms:

In my opinion it would not be true to say

that a person who commits a breach of the contract incurs any pecuniary liability, nor would it be true to say that the other party to the contract who complains of the breach has any amount due to him from the other party.

As already stated, the only right which he has is the right to go to a Court of law and recover damages. Now, damages are the compensation which a Court of law gives to a party for the injury which he has sustained. But, and this is most important to note, he does not get damages or compensation by reason of any existing obligation on the part of the person who has committed the breach. He gets compensation as a result of the fiat of the Court. Therefore, no pecuniary liability arises till the Court has determined that the party complaining of the breach is entitled to damages. Therefore, when damages are assessed, it would not be true to say that what the Court is doing is ascertaining a pecuniary liability which already existed. The Court in the first place must decide that the defendant is liable and then it proceeds to assess what that liability is. But till that determination there is no liability at all upon the defendant.

This statement in our view represents the correct legal position and has our full concurrence. A claim for damages for breach of contract is, therefore, not a claim for a sum presently due and payable and the purchaser is not entitled, in exercise of the right conferred upon it under Clause 18, to recover the amount of such claim by appropriating other sums due to the contractor. On this view, it is not necessary for us to consider the other contention raised on behalf of the respondent, namely, that on a proper construction of Clause 18, the purchaser is entitled to exercise the right conferred under that clause only where the claim for payment of a sum of money is either admitted by the contractor, or in case of dispute, adjudicated upon by a court or

> *other adjudicatory authority. We must, therefore, hold that the appellant had no right or authority under Clause 18 to appropriate the amount of other pending bills of the respondent in or towards satisfaction of its claim for damages against the respondent and the learned Judge was justified in issuing an interim injunction restraining the appellant from doing so.*

10. In that case, Clause 18 of the contract entered into between the parties provide that whenever any claim for the payment of a sum of money arises out of or under the contract against the contractor, the purchaser shall be entitled to recover such sum by appropriating in whole or in part, the security, if any, deposited by the contractor. The purchaser/Union of India, invoking this clause, wanted to recover and adjust liquidated damages in terms of clause 14 of the contract. As is seen from the aforesaid extracted portion, the Court held that a claim for liquidated damages does not give rise to a debt until the liability is adjudicated and damages assessed by a decree or order of a Court or other adjudicatory authority. When there is such a clause, the only right which the plaintiff has is the right to go to Court and recover damages.

11. The Supreme Court also explained that damages are the compensation which a Court of Law gives to a party for the injury which he has sustained and the plaintiff does not get damages or compensation by reason of any existing obligation on the part of the person who has committed the breach. He gets compensation as a result of fiat of the Court. Therefore, it has to be decided by the

Court, in the first instance, that the defendant is liable and then it proceeds to assess what liability is. Till that determination, there is no liability at all upon the defendant. The Court further went to the extent of holding that there would not be any debt payable unless the Court determines the liability. In this process, the Court also explained the concept of 'debt' in the following manner:

> *"6. The first thing that strikes one on looking at Clause 18 is its heading which reads: "Recovery of Sums Due". It is true that a heading cannot control the interpretation of a clause if its meaning is otherwise plain and unambiguous, but it can certainly be referred to as indicating the general drift of the clauses and affording a key to a better understanding of its meaning. The heading of Clause 18 clearly suggests that this clause is intended to deal with the subject of recovery of sum due. Now a sum would be due to the purchaser when there is an existing obligation to pay it in praesenti. It would be profitable in this connection to refer to the concept of a 'debt', for a sum due is the same thing as a debt due. The classical definition of 'debt' is to be found in Webb v. Stenton [1883] 11 Q.B.D. 518 where Lindley, L.J., said :"... a debt is a sum of money which is now payable or will become payable in the future by reason of a present obligation". There must be debitum in praesenti; solvendum may be in praesenti or in future- that is immaterial. There must be an existing obligation to pay a sum of money now or in future. The following passage from the judgment of the Supreme Court of California in People v. Arguello [1869] 37 Calif. 524 which was approved by this Court in Kesoram Industries v. Commissioner of Wealth Tax : [1966] 59 ITR 767 (SC) clearly brings out the essential characteristics of a debt:*
>
> *Standing alone, the word 'debt' is as applicable to a sum of money which has*

> *been promised at a future day as to a sum now due and payable. If we wish to distinguish between the two, we say of the former that it is a debt owing, and of the latter that it is debt due."*

12. The Supreme Court in the matter of **ONGC Ltd.** Vs **Saw Pipes Ltd.,** AIR 2003 SC 2629, in para 65 has discussed provisions of Section 73 and 74 of the Indian Contract Act and held as under:

> *"Under Section 73, when a contract has been broken, the party who suffers by such breach is entitled to receive compensation for any loss caused to him which the parties knew when they made the contract to be likely to result from the breach of it. This Section is to be read with Section 74, which deals with penalty stipulated in the contract, inter alia [relevant for the present case] provides that when a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, the party complaining of breach is entitled, whether or not actual loss is proved to have been caused, thereby to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named. Section 74 emphasizes that in case of breach of contract, the party complaining of the breach is entitled to receive reasonable compensation whether or not actual loss is proved to have been caused by such breach. therefore, the emphasis is on reasonable compensation. If the compensation named in the contract is by way of penalty, consideration would be different and the party is only entitled to reasonable compensation for the loss suffered. But if the compensation named in the contract for such breach is genuine pre-estimate of loss which the parties knew when they made the contract to be likely to result from the breach of it, there is no question of proving such loss or such party is not required to lead evidence to prove actual loss suffered by him. Burden is on the other party to lead*

> *evidence for proving that no loss is likely to occur by such breach…"*

13. In the matter of **Keshoram Industries & Cotton Mills Ltd.** Vs **Commissioner of Wealth Tax (Central), Calcutta, 1966 (2) SCR 688**, the Supreme Court considered the meaning of expression "debt owed". What does the word „debt" mean was also considered with reference to various English decisions and held as under:

> *"a debt is a sum of money which is now payable or will become payable in further by reason of a present obligation : debitum in presenti, solvendum in future."*
>
> *The said decisions also accept the legal position that a liability depending upon a contingency is not a debt in presenti or in future till the contingency happened. But if there is a debt the fact that the amount is to be ascertained does not make it any the less a debt if the liability is certain and what remains is only the quantification of the amount."*

14. What follows from the above is that even if there is a clause of liquidated damages, in a given case, it is for the Court to determine as to whether it represents genuine pre-estimate of damages. In that eventuality, this provision only dispenses with the proof of "actual loss or damage". However, the person claiming the liquidated damages is still to prove that the legal injury resulted because of breach and he suffered some loss. In the process, he may also be called upon to show that he took all reasonable steps to mitigate the loss. It is only after proper enquiry into these aspects that the Court in a given case would rule as to whether liquidated

damages as prescribed in the contract are to be awarded or not. Even if there is a stipulation by way of liquidated damages, a party complaining of breach of contract can recover only reasonable compensation for the injury sustained by him and what is stipulated in the contract is the outer limit beyond which he cannot claim. Unless this kind of determination is done by the Court, it does not result into "debt".

15. What follows from the aforesaid is, merely by imposing penalty/liquidated damages, the respondents cannot be allowed to recover the same from other contracts being executed. Matter would have been different, if adjustment of this amount was made from the same contract. Impugned communication dated 11.06.2012 addressed to the respondents No. 04 to 42, therefore, does not stand the judicial scrutiny. This writ petition is accordingly allowed. Rule made absolute. The communication dated 11.06.2012 is hereby quashed.

(A.K. SIKRI)
CHIEF JUSTICE

(RAKESH KUMAR JAIN)
JUDGE

09.10.2012

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