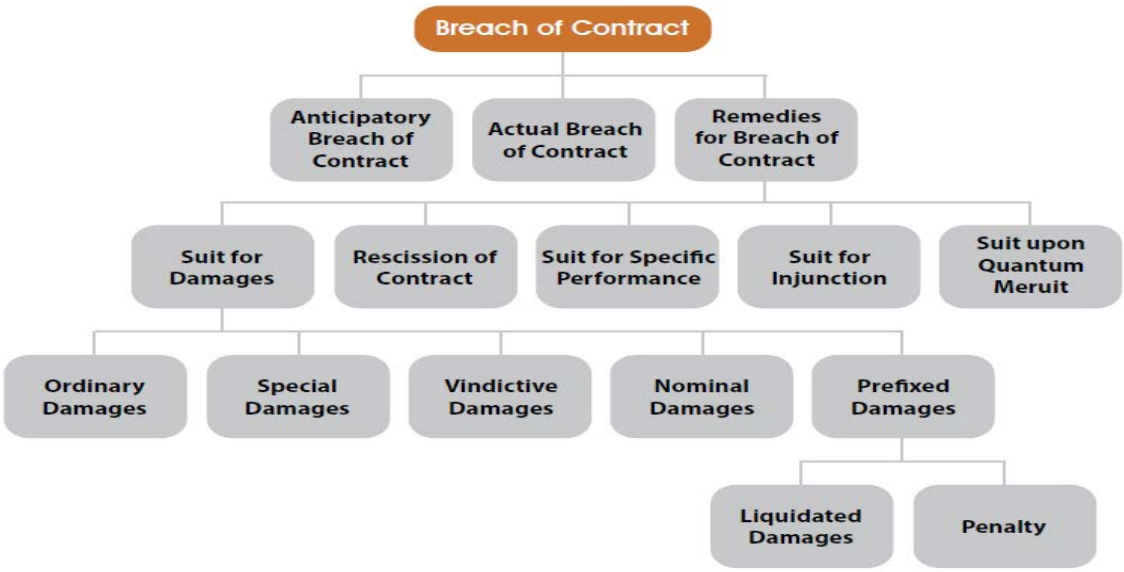
UNIT – 5: BREACH OF CONTRACT AND ITS REMEDIES

LEARNING OUTCOMES

After studying this unit, you would be able to understand-

- Understand the concept of breach of contract and various modes thereof.
- Be clear about how the damages are to be measured.

UNIT OVERVIEW



We have so far seen how a contract is made, the essential of a valid contract and also how a contract is to be performed as well as how a contract may be put an end. We shall now discuss about the breach of contract and also the mode in which compensation for breach of contract is estimated.

Breach means failure of a party to perform his or her obligation under a contract. Breach of contract may arise in two ways:

(1) Actual breach of contract

(2) Anticipatory breach of contract

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5.1 ANTICIPATORY BREACH OF CONTRACT

An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. When the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived, it is called Anticipatory Breach.

Anticipatory breach of a contract may take either of the following two ways:

(a) Expressly by words spoken or written, and

(b) Impliedly by the conduct of one of the parties.

Example 1: Where A contracts with B on 15th July, 2020 to supply 10 bales of cotton for a specified sum on 14th August, 2020 and on 30th July informs B, that he will not be able to supply the said cotton on 14th August, 2020, there is an express rejection of the contract.

Example 2: Where A agrees to sell his white horse to B for ₹ 50,000/- on 10th of August, 2020, but he sells this horse to C on 1st of August, 2020, the anticipatory breach has occurred by the conduct of the promisor.

Section 39 of the Indian Contract Act deals with anticipatory breach of contract and provides as follows: "When a party to a contract has refused to perform or disable himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, but words or conduct, his acquiescence in its continuance."

Effect of anticipatory breach: The promisee is excused from performance or from further performance. Further he gets an option:

(1) To either treat the contract as "rescinded and sue the other party for damages from breach of contract immediately without waiting until the due date of performance;

or

(2) He may elect not to rescind but to treat the contract as still operative, and wait for the time of performance and then hold the other party responsible for the consequences of non-performance. But in this case, he will keep the contract alive for the benefit of the other party as well as his own, and the guilty party, if he so decides on re-consideration, may still perform his part of the contract and can also take advantage of any supervening impossibility which may have the effect of discharging the contract.

5.2 ACTUAL BREACH OF CONTRACT

In contrast to anticipatory breach, it is a case of refusal to perform the promise on the scheduled date. The parties to a lawful contract are bound to perform their respective promises. But when one of the parties breaks the contract by refusing to perform his promise, he is said to have committed a breach. In that case, the other party to the contract obtains a right of action against the one who has refused to perform his promise.

Actual breach of contract may be committed-

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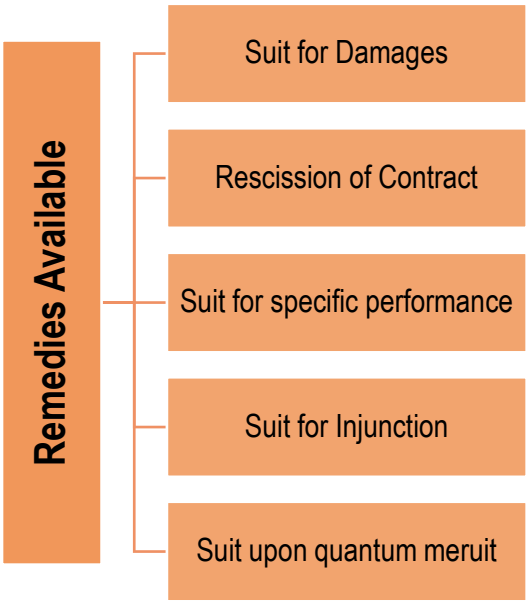
(a) At the time when the performance of the contract is due.

Example 3: A agrees to deliver 100 bags of sugar to B on 1st February 2020. On the said day, he failed to supply 100 bags of sugar to B. This is actual breach of contract. The breach has been committed by A at the time when the performance becomes due.

(b) During the performance of the contract: Actual breach of contract also occurs when during the performance of the contract, one party fails or refuses to perform his obligation under it by express or implied act.

Remedies for Breach of Contract



5.3 SUIT FOR DAMAGES

Compensation for loss or damage caused by breach of contract (Section 73)

When a contract has been broken, the party who suffers by such a breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

Compensation for failure to discharge obligation resembling those created by contract: When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract.

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Explanation to Section 73

In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

Analysis of Section 73

The Act, in Section 73, has laid down the rules as to how the amount of compensation is to be determined. On the breach of the contract, the party who suffers from such a breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him by breach.

Compensation can be claimed for any loss or damage which naturally arises in the usual course of events.

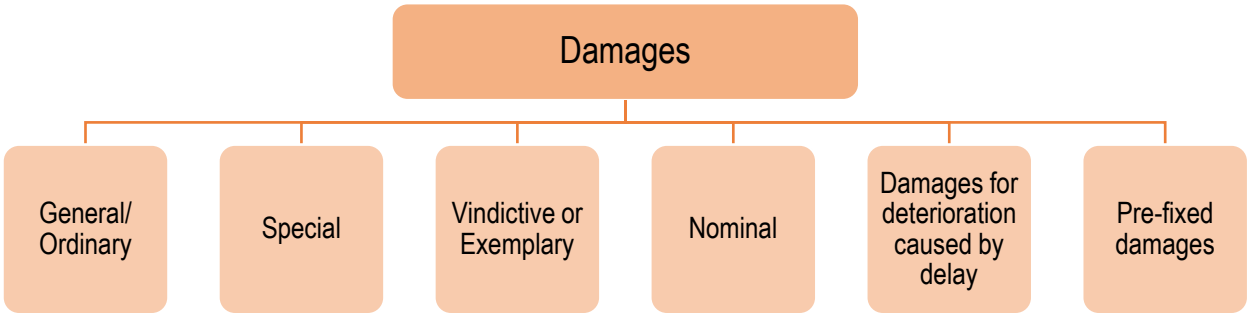
A compensation can also be claimed for any loss or damage which the party knew when they entered into the contract, as likely to result from the breach.

That is to say, special damage can be claimed only on a previous notice. But the party suffering from the breach is bound to take reasonable steps to minimise the loss.

No compensation is payable for any remote or indirect loss.

Remedy by way of Damages or Kind of Damages

Remedy by way of damages is the most common remedy available to the injured party. This entitles the injured party to recover compensation for the loss suffered by it due to the breach of contract, from the party who causes the breach. Section 73 to 75 of the Contract Act incorporate the provisions in this regard. The damages which may be awarded to the injured party may be of the following kinds:



(i) **Ordinary damages:** When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage cause to him thereby, which naturally arose in the usual course of things from such breach, or which the parties know, when they made the contract, to be likely to result from the breach of it:

Such compensation is not to be given for any remote and indirect loss or damage sustained by reasons of the breach. ***(Section 73 of the Contract Act and the rule in Hadley vs. Baxendale).***

HADLEY vs. BAXENDALE- Facts

The crankshaft of P's flour mill had broken. He gives it to D, a common carrier who promised to deliver it to the foundry in 2 days where the new shaft was to be made. The mill stopped working, D delayed the delivery of the crankshaft so the mill remained idle for another 5 days. P received the repaired crankshaft 7 days later than he would have otherwise received. Consequently, P sued D for damages not only for

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the delay in the delivering the broken part but also for loss of profits suffered by the mill for not having been worked. The count held that P was entitled only to ordinary damages and D was not liable for the loss of profits because the only information given by P to D was that the article to be carried was the broken shaft of a mill and it was not made known to them that the delay would result in loss of profits.

Example 4: A agrees to sell to B bags of rice at ₹ 5,000 per bag, delivery to be given after two months. On the date of delivery, the price of rice goes up to ₹ 5,500 per bag. A refuse to deliver the bags to B. B can claim from A ₹ 500 as ordinary damages arising directly from the breach.

(ii) **Special damages:** Where a party to a contract receives a notice of special circumstances affecting the contract, he will be liable not only for damages arising naturally and directly from the breach but also for special damages.

Example 5: 'A' delivered a machine to 'B', a common carrier, to be conveyed to 'A's mill without delay. 'A' also informed 'B' that his mill was stopped for want of the machine. 'B' unreasonably delayed the delivery of the machine, and in consequence 'A' lost a profitable contract with the Government. In this case, 'A' is entitled to receive from 'B', by way of compensation, the average amount of profit, which would have been made by running the mill during the period of delay. But he cannot recover the loss sustained due to the loss of the Government contract, as 'A's contract with the Government was not brought to the notice of 'B'.

(iii) **Vindictive or Exemplary damages**

These damages may be awarded only in two cases -

(a) for breach of promise to marry because it causes injury to his or her feelings; and

(b) for wrongful dishonour by a banker of his customer's cheque because in this case the injury due to wrongful dishonour to the drawer of cheque is so heavy that it causes loss of credit and reputation to him. A business man whose credit has suffered will get exemplary damages even if he has sustained no pecuniary loss. But a non-trader cannot get heavy damages in the like circumstances, unless the damages are alleged and proved as special damages. ***(Gibbons v West Minister Bank)***

(iv) **Nominal damages:** Nominal damages are awarded where the plaintiff has proved that there has been a breach of contract but he has not in fact suffered any real damage. It is awarded just to establish the right to decree for the breach of contract. The amount may be a rupee or even 10 paise.

(v) **Damages for deterioration caused by delay:** In the case of deterioration caused to goods by delay, damages can be recovered from carrier even without notice. The word 'deterioration' not only implies physical damages to the goods but it may also mean loss of special opportunity for sale.

(vi) **Pre-fixed damages:** Sometimes, parties to a contract stipulate at the time of its formation that on a breach of contract by any of them, a certain amount will be payable as damage. It may amount to either liquidated damages (i.e., a reasonable estimate of the likely loss in case of breach) or a penalty (i.e., an amount arbitrarily fixed as the damages payable). Section 74 provides that if a sum is named in a contract as the amount to be paid in case of a breach, the aggrieved party is entitled to receive from the party at fault a reasonable compensation not exceeding the amount so named (Section 74).

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Example 6: If the penalty provided by the contract is ₹ 1,00,000 and the actual loss because of breach is ₹ 70,000, only ₹ 70,000 shall be available as damages, i.e., the amount of actual loss and not the amount stipulated. But if the loss is, say, ₹ 1,50,000, then only, ₹ 1,00,000 shall be recoverable.

Example 7: X promised Y, a priest, to pay ₹ 10,000 as charity. The priest on X's promise incurred certain liabilities towards the repairing of the temple to the extent of Rs. 7,500. Y, the priest, can recover from X ₹ 7,500.

5.4 PENALTY AND LIQUIDATED DAMAGES (SECTION 74)

The parties to a contract may provide before hand, the amount of compensation payable in case of failure to perform the contract. In such cases, the question arises whether the courts will accept this figure as the measure of damage.

English Law: According to English law, the sum so fixed in the contract may be interpreted either as liquidated damages or as a penalty.

If the sum fixed in the contract represents a genuine pre-estimate by the parties of the loss, which would be caused by a future breach of the contract it is liquidated damages. It is an assessment of the amount which in the opinion of the parties will compensate for the breach. Such a clause is effective and the amount is recoverable. But where the sum fixed in the contract is unreasonable and is used to force the other party to perform the contract; it is penalty. Such a clause of disregarded and the injured party cannot recover more than the actual loss.

Indian Law: Indian law makes no distinction between 'penalty 'and liquidated damages'. The Courts in India award only a reasonable compensation not exceeding the sum so mentioned in the contract. Section 74 of the Contract Act lays down if the parties have fixed what the damages will be, the courts will never allow more. But the court may allow less. A decree is to be passed only for reasonable compensation not exceeding the sum named by the parties. Thus, Section 74 entitles a person complaining of breach of contract to get reasonable compensation and does not entitle him to realise anything by way of penalty.

Exception: Where any person gives any bond to the Central or State government for the performance of any public duty or act in which the public are interested, on breach of the condition of any such instrument, he shall be liable to pay the whole sum mentioned therein.

Example 8: A contracts with B, that if A practices as a surgeon in Kolkata, he will pay B ₹ 50,000. A practice as a surgeon at Kolkata, B is entitled to such compensation not exceeding ₹ 50,000 as the court considers reasonable.

Example 9: A borrows ₹ 10,000 from B and gives him a bond for ₹ 20,000 payable by five yearly instalments of ₹ 4,000 with a stipulation that in default of payment, the whole shall become due. This is a stipulation by way of penalty.

Example 10: A undertakes to repay B, a loan of ₹ 10,000 by five equal monthly instalments with a stipulation that in default of payment of any instalment, the whole shall become due. This stipulation is not by way of penalty and the contract may be enforced according to its terms.

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Distinction between liquidated damages and penalty

Penalty and liquidated damages have one thing in common that both are payable on the occurrence of a breach of contract. It is very difficult to draw a clear line of distinction between the two but certain principles as laid down below may be helpful.

1. If the sum payable is so large as to be far in excess of the probable damage on breach, it is certainly a penalty.
2. Where a sum is expressed to be payable on a certain date and a further sum in the event of default being made, the latter sum is a penalty because mere delay in payment is unlikely to cause damage.
3. The expression used by the parties is not final. The court must find out whether the sum fixed in the contract is in truth a penalty or liquidated damages. If the sum fixed is extravagant or exorbitant, the court will regard it is as a penalty even if, it is termed as liquidated damages in the contract.
4. The essence of a penalty is payment of money stipulated as a terrorem of the offending party. The essence of liquidated damages is a genuine pre-estimate of the damage.
5. English law makes a distinction between liquidated damages and penalty, but no such distinction is followed in India. The courts in India must ascertain the actual loss and award the same which amount must not, however exceed the sum so fixed in the contract. The courts have not to bother about the distinction but to award reasonable compensation not exceeding the sum so fixed.

Besides claiming damages as a remedy for the breach of contract, the following remedies are also available:

(i) **Rescission of contract:** When a contract is broken by one party, the other party may treat the contract as rescinded. In such a case he is absolved of all his obligations under the contract and is entitled to compensation for any damages that he might have suffered.

Example 11: A promises B to deliver 50 bags of cement on a certain day. B agrees to pay the amount on receipt of the goods. A failed to deliver the cement on the appointed day. B is discharged from his liability to pay the price.

(ii) **Quantum Meruit:** Where one person has rendered service to another in circumstances which indicate an understanding between them that it is to be paid for although no particular remuneration has been fixed, the law will infer a promise to pay. *Quantum Meruit* i.e. as much as the party doing the service has deserved. It covers a case where the party injured by the breach had at time of breach done part but not all of the work which he is bound to do under the contract and seeks to be compensated for the value of the work done. For the application of this doctrine, two conditions must be fulfilled:

(1) It is only available if the original contract has been discharged.

(2) The claim must be brought by a party not in default.

The object of allowing a claim on quantum meruit is to recompensate the party or person for value of work which he has done. Damages are compensatory in nature while quantum merit is restitutory. It is but reasonable compensation awarded on implication of a contract to remunerate. Where a person orders only 12 bottles of a whiskey from a wine merchant but also receives 2 bottles of brandy, and the purchaser accepts them, the purchaser must pay a reasonable price for the brandy.

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The claim for quantum meruit arises in the following cases:

(a) When an agreement is discovered to be void or when a contract becomes void.

(b) When something is done without any intention to do so gratuitously.

(c) Where there is an express or implied contract to render services but there is no agreement as to remuneration.

(d) When one party abandons or refuses to perform the contract.

(e) Where a contract is divisible and the party not in default has enjoyed the benefit of part performance.

(f) When an indivisible contract for a lump sum is completely performed but badly the person who has performed the contract can claim the lump sum, but the other party can make a deduction for bad work.

Example 12: X wrongfully revoked Y's (his agent) authority before Y could complete his duties. Held, Y could recover, as a quantum meruit, for the work he had done and the expenses he had incurred in the course of his duties as an agent.

Example 13: A agrees to deliver 100 bales of cottons to B at a price of ₹1000 per bale. The cotton bales were to be delivered in two instalments of 50 each. A delivered the first instalment but failed to supply the second. B must pay for 50 bags.

(iii) Suit for specific performance: Where damages are not an adequate remedy in the case of breach of contract, the court may in its discretion on a suit for specific performance direct party in breach, to carry out his promise according to the terms of the contract.

(iv) Suit for injunction: Where a party to a contract is negating the terms of a contract, the court may by issuing an 'injunction orders', restrain him from doing what he promised not to do.

Example 14: N, a film star, agreed to act exclusively for a particular producer, for one year. During the year she contracted to act for some other producer. Held, she could be restrained by an injunction.

Example 15: A, a singer, agreed with B to perform at his theatre for two months, on a condition that during that period, he would not perform anywhere. In this case, B could move to the Court for grant of injunction restraining A from performing in other places.

Party rightfully rescinding contract, entitled to compensation (Section 75)

A person who rightfully rescinds a contract is entitled to compensation for any damage which he has sustained through non-fulfilment of the contract.

Example 16: A, a singer, contracts with B, the manager of a theatre, to sing at his theatre for two nights in every week during the next two months, and B engages to pay her ₹ 100 for each night's performance. On the sixth night, A wilfully absents herself from the theatre, and B, in consequence, rescinds the contract. B is entitled to claim compensation for the damage which he has sustained through the non-fulfilment of the contract.

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SUMMARY

1. In case of breach of contract by one party, the other party need not perform his part of the contract and is entitled to compensation for the loss occurred to him.
2. Damages for breach of contract must be such loss or damage as naturally arise, in the usual course of things or which had been reasonably supposed to have been in contemplation of the parties when they made the contract, as the probable result of the breach.
3. Any other damages are said to be remote or indirect damages, hence, cannot be claimed.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. When prior to the due date of performance, the promisor absolutely refuses to perform the contract, it is known as

   (a) abandonment of contract (b) remission of contract

   (c) actual breach of contract (d) anticipatory breach of contract

2. In case of anticipatory breach, the aggrieved party may treat the contract

   (a) as discharged and bring an immediate action for damages

   (b) as operative and wait till the time for performance arrives

   (c) exercise option either (a) or (b)

   (d) only option (a) is available

3. In case of breach of contract, which of the following remedy is available to the aggrieved party?

   (a) Suit for rescission (b) Suit for damages

   (c) Suit for specific performance (d) All of these

4. Sometimes, a party is entitled to claim compensation in proportion to the work done by him. It is possible by a suit for

   (a) damage (b) injunction

   (c) quantum meruit (d) none of these

5. Generally, the following damages are not recoverable?

   (a) Ordinary damages (b) Special damages

   (c) Remote damages (d) Nominal damages

6. Damages which arise naturally in usual course of things from breach itself are called:

   (a) Special damages (b) Liquidated damages

   (c) Nominal damages (d) General damages

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7. A contracted to supply 200 bags of rice to B on 30th December, 2019. After supplying 20 bags of rice. A informed B that he will not supply remaining bags of rice to B. In this case,

(a) There is anticipatory breach of contract (b) There is actual breach of contract

(c) Both of the above (d) None of the above

8. Where the Court orders the defaulting party to carry out the promise according to the terms of the contract, it is called

(a) Quantum Meruit (b) Rescission

(c) Injunction (d) Specific Performance

9. Quantum Meruit means

(a) a non-gratuitous promise (b) as gratuitous promise

(c) as much as is earned (d) as much as is paid

10. Wrongful dishonour of cheque by a banker having sufficient funds in the account of customer, the court may award:

(a) Mitigation of damages (b) contemptuous damages

(c) Quantum Meruit (d) exemplary damages

Answers to MCQs

1.	**(d)**	2.	**(c)**	3.	**(d)**	4.	**(c)**	5.	**(c)**
6.	**(d)**	7.	**(b)**	8.	**(d)**	9.	**(c)**	10.	**(d)**

Descriptive Questions

1. "An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived". Discuss stating also the effect of anticipatory breach on contracts.

2. "Liquidated damage is a genuine pre-estimate of compensation of damages for certain anticipated breach of contract whereas Penalty on the other hand is an extravagant amount stipulated and is clearly unconscionable and has no comparison to the loss suffered by the parties". Explain.

3. 'X' entered into a contract with 'Y' to supply him 1,000 water bottles @ ₹ 5.00 per water bottle, to be delivered at a specified time. Thereafter, 'X' contracts with 'Z' for the purchase of 1,000 water bottles @ ₹ 4.50 per water bottle, and at the same time told 'Z' that he did so for the purpose of performing his contract entered into with 'Y'. 'Z' failed to perform his contract in due course and market price of each water bottle on that day was ₹ 5.25 per water bottle. Consequently, 'X' could not procure any water bottle and 'Y' rescinded the contract. Calculate the amount of damages which 'X' could claim from 'Z' in the circumstances? What would be your answer if 'Z' had not informed about the 'Y's contract? Explain with reference to the provisions of the Indian Contract Act, 1872.

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Answer of Descriptive Questions

1. An anticipatory breach of contract is a breach of contract occurring before the time fixed for performance has arrived. When the promisor refuses altogether to perform his promise and signifies his unwillingness even before the time for performance has arrived, it is called Anticipatory Breach. The law in this regard has very well summed up in ***Frost v. Knight and Hochster v. DelaTour:***

Section 39 of the Indian Contract Act deals with anticipatory breach of contract and provides as follows: "When a party to a contract has refused to perform or disable himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, but words or conduct, his acquiescence in its continuance."

Effect of anticipatory breach: The promisee is excused from performance or from further performance. Further he gets an option:

(1) To either treat the contract as "rescinded and sue the other party for damages from breach of contract immediately without waiting until the due date of performance; or

(2) He may elect not to rescind but to treat the contract as still operative, and wait for the time of performance and then hold the other party responsible for the consequences of non-performance. But in this case, he will keep the contract alive for the benefit of the other party as well as his own, and the guilty party, if he so decides on re-consideration, may still perform his part of the, contract and can also take advantage of any supervening impossibility which may have the effect of discharging the contract.

2. **Liquidated damage** is a genuine pre-estimate of compensation of damages for certain anticipated breach of contract. This estimate is agreed to between parties to avoid at a later date detailed calculation and the necessity to convince outside parties.

Penalty on the other hand is an extravagant amount stipulated and is clearly unconscionable and has no comparison to the loss suffered by the parties.

In terms of Section 74 of the Act "where a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damages or loss is proved to have been caused thereby, to receive from the other party who has broken the contract, a reasonable compensation not exceeding the amount so named, or as the case may be the penalty stipulated for.

Explanation to Section 74

A stipulation for increased interest from the date of default may be a stipulation by way of penalty.

In terms of Section 74, courts are empowered to reduce the sum payable on breach whether it is 'penalty' or "liquidated damages" provided the sum appears to be unreasonably high.

Sri ChunniLal vs. Mehta & Sons Ltd (Supreme Court)

Supreme Court laid down the ratio that the aggrieved party should not be allowed to claim a sum greater than what is specific in the written agreement. But even then, the court has powers to reduce the amount if it considers it reasonable to reduce.

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3. **Breach of Contract-Damages:** Section 73 of the Indian Contract Act, 1872 lays down that when a contract has been broken, the party who suffers by such breach is entitled to receive from the party who has broken the contract compensation for any loss or damage caused to him thereby which naturally arose in the usual course of things from such breach or which the parties knew when they made the contract to be likely to result from the breach of it.

The leading case on this point is "Hadley v. Baxendale" in which it was decided by the Court that the special circumstances under which the contract was actually made were communicated by the plaintiff to the defendant, and thus known to both the parties to the contract, the damages resulting from the breach of such contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from the breach of contract under these special circumstances so known and communicated.

The problem asked in this question is based on the provisions of Section 73 of the Indian Contract Act, 1872. In the instant case 'X' had intimated to 'Z' that he was purchasing water bottles from him for the purpose of performing his contract with 'Y'. Thus, 'Z' had the knowledge of the special circumstances. Therefore, 'X' is entitled to claim from 'Z' ₹ 500/- at the rate of 0.50 paise i.e. 1000 water bottles x 0.50 paise (difference between the procuring price of water bottles and contracted selling price to 'Y') being the amount of profit 'X' would have made by the performance of his contract with 'Y'.

If 'X' had not informed 'Z' of 'Y's contract, then the amount of damages would have been the difference between the contract price and the market price on the day of default. In other words, the amount of damages would be ₹ 750/- (i.e. 1000 water bottles x 0.75 paise).

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