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Liquidated Damages Across Jurisdictions: Evolving Standards Of Proof And Proportionality

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INTRODUCTION

In construction contracts, delay and non-performance are frequent grounds for disputes. Contracting parties tend to pre-determine a sum payable upon breach, to avoid complex post-breach quantifications vide a Liquidated Damages (LD) clause. While these clauses are ubiquitous, their enforceability and treatment vary significantly between common law jurisdictions (such as India, the United Kingdom, and Singapore) and civil law jurisdictions (such as United Arab Emirates and France).

This article examines the evolution of the common law position towards such LD clauses and compares it with the treatment under the civil law jurisdictions. It further analyses the conceptual divergence between LD and penalties, and how each system approaches the burden of proof and judicial discretion in the assessment of LDs.

THE SCOPE OF LIQUIDATED DAMAGES

Liquidated damages are a pre-estimated sum agreed by the parties at the time of contracting to avoid disputes over loss quantification upon breach. As stated in Dunlop Pneumatic Tyre Co. Ltd. v. New Garage and Motor Co. Ltd, the essence lies in whether the sum represents a "genuine pre-estimate of damages" or operates "in terrorem" of the defaulting party. LD clauses shall be interpreted while ensuring that:

a) It simplifies proof, substituting a predetermined sum for uncertain post-breach assessment; and
b) It promotes performance and provides predictable financial consequences for breach.

However, despite this apparent certainty, judicial approaches have varied over time, balancing respect for contractual freedom with the need to guard against clauses that function as oppressive penalties.

INDIAN POSITION UNDER THE CONTRACT ACT

Statutory Framework

Section 74 of the Indian Contract Act, 1872 statutorily unifies the concepts of "*penalty*" and "*liquidated damages*", providing 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 the breach is entitled … to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named, whether or not actual damage or loss is proved to have been caused thereby…"

Section 74 was enacted to delineate the distinction between liquidated damages and penalties, and to regulate only the quantum of damages recoverable, without addressing the validity of any contractual clause that excludes or limits a party's liability. Although the text of Section 74 indicates that proof of actual loss is not an indispensable requirement, Indian courts have, over time, introduced nuanced qualifications to this principle.

Early Judicial Approach

In Fateh Chand v. Balkishan Dass, the Supreme Court held that S.74 declares the law that the aggrieved party is entitled to reasonable compensation not exceeding the stipulated amount, but such compensation must relate to the loss "actually sustained". This introduced the need for some evidence of loss, even where the clause was labelled as "liquidated damages." Similarly, in Maula Bux v. Union of India, the Court reiterated that where actual loss is capable of proof, it must be proved; where it is inherently impossible to quantify, the court may award reasonable compensation up to the named sum.

Evolution of the Indian approach

The landmark judgment in Kailash Nath Associates v. DDA reaffirmed the centrality of reasonableness. The Supreme Court held that Section 74 does not dispense with proof of loss in all cases, as it only relieves the party from proving exact loss when the same is difficult or impossible to assess. The apex court held that the expression 'whether or not actual damage or loss is proved to have been caused thereby' means that where it is impossible to prove the exact loss, the court can award reasonable compensation not exceeding the amount stipulated/pre-determined with the LD clause.

Thus, while Section 74 aims to mitigate the burden of proof, the party invoking LD clause must still establish occurrence of loss or the difficulty of proving it. This has introduced an evidentiary burden contrary to the LD clause's commercial intent.

Post-Kailash Nath Developments
Subsequent cases such as ONGC v. Saw Pipes Ltd and Construction and Design Services v. Delhi Development Authority have nuanced the interpretation. In Saw Pipes (supra), the Court permitted recovery of the full LD amount where the clause represented a genuine pre-estimate and there was actual delay, holding that proof of specific loss was unnecessary. However, Kailash Nath (Supra) reintroduced a stricter threshold, emphasizing the need for the claimant to at least demonstrate that some loss occurred. This ambivalence remains unresolved, creating tension between contractual certainty and judicial oversight.

BURDEN OF PROOF TO PROVE LOSS INCURRED

The question of who bears the burden of proving loss under Section 74 has significant practical implications in construction arbitration. Although the provision seems to relieve the non-breaching party from proving actual damage, Indian tribunals and courts have interpreted this relaxation narrowly. Following Kailash Nath (Supra), Following the decision in Kailash Nath (supra), it is now well-established that the claimant must demonstrate that loss has indeed occurred, or at the very least, that the nature of the contractual undertaking is such that quantification of loss is inherently difficult or impossible. This distinction often becomes decisive in delay claims, where the employer seeks to recover liquidated damages for late completion.

Arbitral tribunals typically require the employer to demonstrate that the delay was attributable to the contractor, that the stipulated rate of LDs was based on a genuine pre-estimate of potential loss, and that no concurrent delays or employer defaults caused delay. Merely pointing to a contractual clause specifying an LD rate is insufficient; the claimant must correlate the breach with evidence, such as quantification of damages, delayed revenue generation, prolonged overhead costs, or extended financing exposure.

In practical terms, therefore, the evidentiary standard in India seated arbitrations remains demanding. Tribunals consistently emphasize the importance of contemporaneous records including but not limited to progress reports, critical path analyses, daily site records, and correspondence establishing delay causation. The Saw Pipes (Supra) continues to provide a limited window for claiming LDs without detailed loss quantification, but it is applied only where the contract expressly stipulates a genuine pre-estimate and where the loss cannot reasonably be measured, such as in public infrastructure projects with complex financial implications.

The modern arbitral approach reflects a balance between contractual autonomy and evidentiary discipline. While LD clauses may obviate the need for precise loss calculation, they do not absolve the claimant from demonstrating a causal nexus between the breach and loss. This doctrinal nuance has made the burden of proof in India's construction arbitration both procedural and substantive a hybrid of contractual presumption and factual substantiation.

COMMON LAW VS. CIVIL LAW JURISDICTIONS

Common Law Approach

United Kingdom

In common law jurisdictions, particularly the United Kingdom, Singapore, and Australia, the enforcement of liquidated damages clauses is guided by the "genuine pre-estimate of loss" principle and, more recently, by the "legitimate commercial interest" test established in Cavendish Square Holding BV v. Talal El Makdessi. Under this evolved doctrine, the validity of an LD clause does not depend solely on whether the sum accurately predicts loss but on whether it protects a legitimate commercial interest of the innocent party.

This test broadened the traditional understanding, allowing courts to uphold LD clauses even when the sum stipulated exceeds a strict pre-estimate of loss, provided it is not "out of all proportion" to the legitimate interest being protected. For instance, in ParkingEye Ltd v. Beavis, the Supreme Court upheld a parking overstay charge, reasoning that it served the landowner's commercial interest in regulating parking, not merely to compensate for financial loss.

Singapore

In Denka Advantech Pte Ltd v. Seraya Energy Pte Ltd, the Singaporean Court reaffirmed the same position, holding that an LD clause will be unenforceable only if it is "extravagant, exorbitant, or unconscionable."

This modern approach places greater emphasis on freedom of contract, presuming that sophisticated commercial parties are best placed to allocate risk at the time of contracting.

Moreover, common law jurisdictions do not require proof of actual loss when invoking an LD clause; the stipulated amount is recoverable as a debt upon breach. However, courts continue to scrutinize clauses that appear punitive or that bear no rational relationship to the anticipated harm.

Civil Law Approach

Civil law jurisdictions such as France, Germany, and the United Arab Emirates adopt a markedly different philosophy rooted in judicial control and proportionality rather than strict contractual freedom. Under the Article 1231-5 of the French Code Civil and Article 390 of the UAE Civil Code, parties are permitted to stipulate a pre-agreed compensation for breach of contract, but courts retain an overriding power to increase or reduce the stipulated amount to ensure that it reflects the actual loss suffered. The underlying rationale is that contractual autonomy must yield to fairness and equity.

UAE

Article 390(2) explicitly states that "the judge may increase or reduce the compensation so that it corresponds to the loss," and any agreement excluding such judicial power is void. Consequently, the enforceability of LD clauses in civil law systems is inherently qualified by

mandatory judicial discretion. In practice, UAE courts have frequently reduced LDs where the claimant failed to substantiate actual loss, or conversely, increased the amount where the pre-agreed sum was manifestly inadequate.

This approach stems from the civil law's compensatory ethos, which views damages primarily as a tool for restoring equilibrium between the parties rather than enforcing bargains. The emphasis lies on actual loss, not deterrence. Thus, even if the parties intended the LD amount as a final settlement, the court may disregard the same finding it disproportionate to the damage suffered. In construction disputes, this means that contractors can successfully challenge LD deductions if they can demonstrate either that the delay was excusable or that the employer suffered little to no actual loss. The civil law approach, therefore, imposes a mandatory safeguard against unjust enrichment while promoting substantive fairness. For practitioners, this necessitates careful evidence of actual loss, contemporaneous financial impacts, and transparent estimation methods as arbitral tribunals applying UAE or French law may regularly exercise their discretion to recalibrate the pre-agreed sum to align with proven damages.

CONCLUSION

The law on liquidated damages continues to navigate the tension between contractual autonomy and judicial control. In India, while Section 74 permits recovery without strict proof of loss, courts particularly after Kailash Nath (Supra) have required claimants to establish either actual loss or the difficulty of quantifying it, tempering contractual certainty with evidentiary discipline. In contrast, modern common law jurisdictions like the UK and Singapore uphold LD clauses that serve a legitimate commercial interest, reinforcing party autonomy, whereas civil law systems such as France and the UAE empower courts to adjust LDs to reflect actual loss, prioritizing fairness over finality. For construction arbitration, this divergence underscores the importance of careful drafting, contemporaneous documentation, and alignment with governing law. Ultimately, the effectiveness of liquidated damages clauses lies in balancing commercial predictability with legal reasonableness, ensuring they compensate genuine loss without operating as punitive deterrents.

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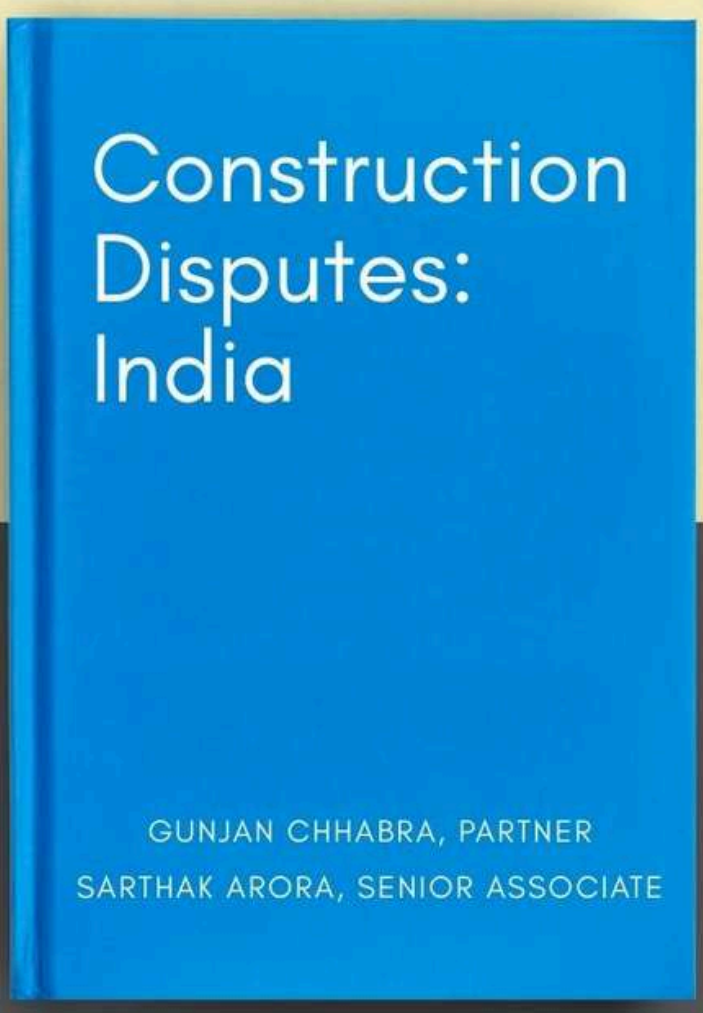
THE SPOTLIGHT

We are delighted to share that our Partner, Gunjan Chhabra, and Senior Associate, Sarthak, have authored an insightful article featured in Lexology Index, focusing on key aspects of construction disputes in India.

The article offers a nuanced analysis grounded in practical experience and evolving dispute resolution trends in the construction and infrastructure sector. We congratulate Gunjan and Sarthak on this well-deserved recognition.



READ THE ARTICLE HERE:

HTTPS://WWW.LEXOLOGY.COM/INDEPTH/CONSTRUCTION-DISPUTES/INDIA

VIRTUAL SPOTLIGHT

MRP Advisory hosted an expert-led webinar on **'Variations, Disruption & Prolongation: What are Tribunals Actually Awarding in 2025?'** featuring distinguished practitioners and institutional perspectives, discussing emerging trends, practical insights, and recent approaches adopted by tribunals in 2025. 👉 Watch the full recording here: 📺https://youtu.be/ytex0zb1N7c

MRP Advisory hosted an insightful webinar on **'Construction Law in Transition: Regulatory Trends, Sustainability, and Technology in 2025–26'** bringing together global perspectives from leading legal and industry professionals to discuss what lies ahead for construction law and project delivery in 2025–26. 🔗 Watch here: https://youtu.be/9AnCcRkEA_E

AWARDS & ACCOLADES

Ms. Roopa Somasundaran, AVP, MRP Advisory was elected to the International Board of IWIRC. Incepted in USA, for more than 30 years, IWIRC has been connecting women worldwide. Across the board room, courtroom and the continents, fostering diverse relationships make IWIRC the premier organization for women in the legal profession.

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