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# CAN CONSEQUENTIAL LOSSES BE CLAIMED UNDER INDIAN LAW?

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**Abstract**

The concept of damages is an imperative aspect of Contract law. It is interesting to note that there are two types of damages: direct losses and consequential losses. Likewise, section 73 of the Indian Contract Act expressly prohibits the recovery of consequential losses. However, if both parties involved in the contract had actual or imputed knowledge and any future scheme could be contemplated by both parties to the standard of a reasonable man, such consequential loss can be awarded in damages. The rule of Hadley v Baxendale clarifies the circumstances under which consequential loss can be claimed.[2] The rule highlights that losses are not considered too remote if they naturally arise from the breach. Secondly, losses are not considered too remote if they have been in the contemplation of both parties at the contract date as a foreseeable result of the breach. Damages under section 73 are confused with the law of indemnity under section 124 as the measure of the two remedies often coincide. However, a contract of indemnity is not subject to the provisions under section 73 and does not prohibit the indemnity holder from being indemnified for consequential losses. Consequential losses can be awarded to the indemnified party provided the party faces any evidenced loss, *among other things*, if stipulated in the contract of indemnity. The article reviews and evaluates the legal nuances of damages and indemnity concerning consequential losses to identify whether significant losses can be claimed under Indian law.

## Consequential losses under Section 73

Section 73 of the Indian Contract Act 1872, *among other things*, stipulates as follows:

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[2]Hadley & Anor v Baxendale & Ors, (1854) 156 ER 145

"*Compensation for loss or damage caused by a breach of contract. — When a contract has been broken, the party who suffers the breach is entitled to receive, from the party which had 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 will not be given for any remote and indirect loss or damage sustained by the breach.*

The section above contemplates two kinds of damages viz. (i) damages arising out of direct losses, i.e., damages "which naturally arose in the usual course of things from such breach"; and (ii) damages arising out of consequential losses, i.e., damages which "result from the breach." The section further stipulates that "*compensation is not to be given for any remote and indirect loss or damage sustained because of the breach."*While the term consequential damage has not been used or defined in the section, the term 'consequential', if used in its ordinary English sense, would mean a 'happening as a result or an effect of something.'[3] Therefore, damage that "results from the breach," or is "remote," or pertains to an "indirect loss," or "sustained because of the breach" *would all fall within the ambit of 'consequential loss.'* Direct loss is the loss caused by a breach of a contract in the usual course of things and can be contemplated by both parties to the standard of a reasonable man. On the other hand, consequential loss is the result of direct loss, i.e., such losses arise from exceptional circumstances, not in the usual course of things.[4] Consequential losses refer to pecuniary losses consequent to physical damage.[5]

It may be interesting to note that the first paragraph of section 73 allows damages to be claimed only when they arise out of direct losses; an exception allows consequential damages to be claimed if the parties had actual or imputed knowledge of the possibility of such consequential loss when they entered into the contract.[6] However, the second paragraph of the said section ostensibly invalidates any damage arising from a significant loss. Such an interpretation renders

[3] Dictionary OL, 'Consequential' (*consequential adjective - Definition, pictures, pronunciation and usage notes | Oxford Advanced Learner's Dictionary at OxfordLearnersDictionaries.com*, 2015) accessed 19 July 2023
[4] Regional Power Corporation v Pacific Hydro Group Two Pty Ltd [No 2] [2013] WASC 356
[5]Ibid, 2013
[6]Ghaziabad Development Authority v UOI, AIR 2000 SC 2003 at 2006: (2000) 6 SCC 113

a particular aspect of the section void, which transgresses the doctrine of harmonious construction of statutes.

As per the doctrine of harmonious construction, a statute should be read as a whole, and the provisions within the statute should be read in a way that contributes to the lyrical interpretation of the said statute. In the case of Commissioner of Income Tax v M/S Hindustan Bulk Carrier, the apex court established certain principles of balanced construction. The court held that the flat construction of a statute must be such that it does not invalidate any other provision.[7] Further, the Supreme Court observed that courts must avoid circumstances of *"head-on clash"* between the requirements.[8] Concerning section 73, the question of whether such loss can be recovered must be interpreted harmoniously so that the entire statute can be lawfully applied. No singular aspect of the statute should invalidate a differing element, as such an interpretation would contravene the principle of harmonious construction. Moreover, some of the illustrations within the section recognize the consequential loss when the parties to the contract have actual or imputed knowledge of the course of things. For instance, illustration (j) states as follows:

> *"A, having contracted with B to supply B with 1,000 tons of iron at 100 rupees a ton, to be delivered at a stated time, contracts with C for the purchase of 1,000 tons of iron at 80 rupees a ton, telling C that he does so to perform his contract with B. C fails to perform his contract with A, who cannot procure other iron, and B, in consequence, rescinds the contract. C must pay A 20,000 rupees, the profit which A would have made by the performance of his contract with B."*

In this illustration, A can lawfully claim indirect damage sustained from C's breach as both parties had actual knowledge of A's future schemes. Likewise, C breached his contract, knowing it would harm A's agreement with B.

Furthermore, the concept of consequential damages was elaborated in the English case of Hadley v Baxendale, 1854.[9] The case's central issue was whether Baxendale was liable to compensate Hadley for their loss of profits. The Exchequer court held that Baxendale was not responsible for the same as the shutting down of the mill was not contemplated as a consequence

[7]Commissioner of Income Tax vs. Hindustan Bulk Carriers (2002) SC: MANU/SC/1379/2002
[8]Ibid, 2002
[9]Hadley & Anor v Baxendale & Ors, (1854) 156 ER 145

of the contractual breach. Moreover, Baxendale did not know this potential consequence as the plaintiff had not informed the defendant that the mill would be non-operational until a new crankshaft had been installed. The court observed,

> *"Where two parties have made a contract, which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, with the probable result of the breach of it."*[10]

According to Hadley v. Baxendale, consequential damages can be claimed by the non-breaching party only if both parties to the contract were aware of the possibility of such losses arising from the breach of contract. The court held that the defendant will not be liable to compensate any consequential loss if he cannot be expected to contemplate the same to the standard of a reasonable man.[11] The court had observed two limbs of recoverable damages. The first limb established that losses are not considered too remote if they naturally arise from the breach. Moreover, the second limb elucidates that losses are not considered too remote if they have been in the contemplation of both parties at the date of the contract as a probable result of the breach of the contract.[12]

Furthermore, the rule of Hadley v Baxendale was applied in various cases, especially in onward contracts. If a third party is made to rely on the contract with the seller, the buyer can claim damages on the condition that such an onward contract was completed within the knowledge or contemplation of the parties.[13] In the case of *Thyssen Krupp Materials AG v Steel Authority of India*, the Hon'ble Delhi High Court held that the damages that the buyers can recover should not be limited solely to the difference between the contract price and the market price on the date of the breach.[14] The court maintained that the damages should also include the buyers' loss of profit and the resale value. Moreover, the damages should include the buyers' liability for

[10]Ibid, 1854
[11]Ibid, 1854
[12]Ibid, 1854
[13] Thyssen Krupp Materials AG v Steel Authority of India, 2017 SCC OnLine Del 7997
[14] Ibid, 2017

breaching the resale contract. The defendant was made aware of the resale, and the original contract expressly stipulated the nature of the resale.[15] Similarly, the plaintiff was entitled to recover damages sustained from consequential losses.

In contracts of sale of land, certain exceptional circumstances are prerequisites to impart knowledge to the vendor about the manner in which the buyer will use the land. Likewise, imparting such knowledge helps justify the recovery of profits lost if the vendor defaults, as held in Diamond v Campbell-Jones, 1960.[16] Similarly, if the vendor sells the property to a third party, the buyer will be entitled to claim damages. Such damages are not limited to the difference between the market price and contractual sale price but also the profit he would have made from the land provided the vendor knew about such a scheme.

Likewise, in the case of Ghaziabad Development Authority v Union of India, 2000, the apex court held that if a vendor breaches a contract and fails to convey the land to the buyer, he is liable for damages.[17] The Supreme Court held the plaintiff would be entitled to receive the property's market value at the fixed time for completion, less the contract price. In exceptional circumstances, wherein the seller had actual or imputed knowledge of the buyer's schemes for the land, the buyer would be entitled to recover the loss of profits. In cases of delay in performance, the standard nature of damages is the value of the use of the land for the period of delay, which is usually the rental value of the land. Moreover, the court held that compensation for mental agony cannot be awarded.[18]

Hence, concerning damages under section 73 of the Indian Contract Act of 1872, as evident from the judicial precedents mentioned hereinabove, no individual can claim losses unless the circumstances are aligned with either of the two limbs of principles laid down in Hadley v Baxendale, i.e. (i) The losses naturally arose from the breach, and (ii) The losses have been in the contemplation of both parties at the date of the contract.

**Consequential Losses under Section 124**

Section 124 of the Indian Contract Act of 1872, *among other things*, stipulates as follows:

[15] Ibid, 2017
[16] Diamond v Campbell-Jones, [1960] 1 All ER 583
[17] Ghaziabad Development Authority v UOI, AIR 2000 SC 2003 at 2006: (2000) 6 SCC 113
[18] Ibid, 2000

> *"A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person, is called a "contract of indemnity."*

In its broadest sense, indemnity means to recompense an individual for any loss or liability the said individual has incurred, such duty arising from an agreement or otherwise. A contract of indemnity is separate from the main contract.

The section above specifies that the indemnified party must be saved from loss caused to him by the indemnifier or any other party as stipulated in a contractual agreement. The section defines the nature of a contract of indemnity. However, it is silent on the ingredients of such a contract. It may be appropriate to mention that the section above does not expressly prohibit the recovery of consequential damages, even without knowledge or reasonable contemplation of the indemnity holder and indemnifier, unlike section 73.

The Hon'ble Madras High Court has succinctly differentiated between damages under section 73 and indemnity under section 124 in the case of A. Krishnaswami Aiyar v Tatha Raghaviah Chetty And Anr. where it observed:

> *"In the case of contracts, the right to indemnity must be carefully distinguished from the right to damages. The original contract gives a right to indemnity, whereas a right to damages arises as a consequence of the breach of that contract. These two rights are confounded, and one reason for the confusion is that when a contract is broken, indemnity is often found to coincide with the measure of damages. In those cases, whether the right is called right to indemnity or right to damages, the same result follows, and it is forgotten that these two words express two fundamentally different legal ideas."*[19]

The High Court further stated that the right to damages only arises when a party breaches the terms of a contract. Likewise, the party suffering loss can claim damages sustained from such breach. On the contrary, a contract of indemnity is an independent contract derived from the original contract. The right to indemnity is specific about the recoverable damage, and the

[19] A. Krishnaswami Aiyar vs Tatha Raghaviah Chetty And Anr. on 4 October, (1927) 53 MLJ 679

indemnity holder can be indemnified from loss as stipulated in the contract of indemnity. *Prima facie*, the contract of indemnity is predominantly a code within itself, as both parties can name provisions, among other things, as they deem fit, provided such stipulations are lawful. Therefore, concerning consequential losses, contracts of indemnity do not exempt indirect losses as recoverable for the indemnity holder. It is not subject to the exclusion of the recovery of significant losses as per section 73 of the act.

A contract of indemnity is a code by itself; consequently, parties are free to choose the extent and nature of losses, which would be the subject matter of the contract. In the landmark case of Gajanan Moreshwar Parelkar v Moreshwar Madan Mantri,[20] Justice MC Chagla observed that sections 124 and 125 of the act do not entirely embody the principle of indemnity. Moreover, as it was considered a consolidating and amending act, it was not exhaustive of the law of contract to be applied by Indian courts. Justice Chagla held,

> *"I have already held that sections 124 and 125, Contract Act, are not exhaustive of the law of indemnity and that the Courts here would apply the same equitable principles that the Courts in England do. Therefore, if the indemnified had incurred absolute liability, he is entitled to call upon the indemnifier to save him from that liability and pay it off."*[21]

In the case of M/S Matrix Global Pvt Ltd. v Bank of Baroda and Anr, the Hon'ble High Court recognized that consequential loss could be indemnified when it observed as under:

> *"I say that the said release is subject to the execution of necessary indemnity by the mortgagor/property owner Sh. Prabhat Kumar is to keep the respondent Bank* ***indemnified for any consequential loss****, cost, or expenses incurred by the respondent Bank in case of any payments that the respondent Bank is compelled to make under the Bank Guarantee in question bearing no. 2562FGBID027813 valued at USD 2,55,805/-."*[22] **[emphasis applied]**

[20] Gajanan Moreshwar Parelkar v Moreshwar Madan Mantri, (1942) 44 BOMLR 703
[21] Gajanan Moreshwar Parelkar v Moreshwar Madan Mantri, (1942) 44 BOMLR 703
[22] M/S Matrix Global Private Limited ... vs Bank Of Baroda And Anr, 2021, W.P.(C) 1221/2021

Similarly, while dealing with the principle of consequential loss in a contract of indemnity (insurance), the Hon'ble Delhi High Court, in the case of Indo Rama Synthetics India Ltd. v IFFCO Tokio General Insurance Co. Ltd.,[23] observed

> *"The business interruption insurance contracts or fire loss of the profit policy like other contracts of insurance are no exception to the applicability of the principle of indemnity. The policies clearly aim to indemnify the insured and not allow the insured to earn more than the suffering of the loss. This is because the term* ***consequential loss of profit as a term itself suggests that there has to be an establishment of the loss of the profit on account of the business*** *interruption as a result of the damage. Thus, the establishment of the loss is a condition precedent. Several case laws indicate that business interruption insurance is a contract of indemnity."* **[emphasis applied]**

In conclusion, a consequential loss can be lawfully indemnified under the contract of indemnity under section 124, provided the same is appositely captured in the indemnity agreement. However, significant losses cannot be claimed as damages under section 73 unless the parties have actual or imputed knowledge of the substantial loss due to the breachwhen entering the contract.

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