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# APPLICABILITY OF PRINCIPLE OF MITIGATION OF DAMAGE ON SECTION 73 AND 74 OF THE INDIAN CONTRACT ACT, 1872

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## ABSTRACT

*Contracts are the backbone of trade and commerce, necessitating robust laws to adjudicate disputes. A critical question arises in the realm of damages under the Indian Contract Act, 1872: Does the principle of mitigation of damages apply equally to liquidated and unliquidated damages? While Section 73 explicitly mandates mitigation for unliquidated damages, Section 74, governing liquidated damages, is silent on this duty. Judicial interpretations have nuanced this distinction, emphasizing reasonableness in assessing compensation under both sections. Courts have considered mitigation as a factor in determining the fairness of liquidated damages, despite the absence of statutory obligation. International jurisprudence underscores the universal relevance of the mitigation principle in all damages scenarios. This article explores the interplay between Sections 73 and 74, arguing for a consistent application of the mitigation principle to ensure fairness and equity in awarding damages.*

## I. INTRODUCTION

Contracts are the lifelines of trade and commerce in any economic system. So does the requirement of comprehensive and robust set of laws becomes indispensable to adjudicate the disputes arising therein. However, legal commercial disputes often stem from the ambiguities and gaps inherently present in the statutes. Imagine a commercial contract between A and B that obligates A to supply raw material to B. If A breaches this contract, can B claim damages even if reasonable steps could have mitigated the damage? At first glance, the answer might seem affirmative, but a nuanced legal analysis raises questions: What kind of damages? Are they liquidated or unliquidated? This

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question forms the crux of this article: Does the principle of mitigation of damage apply equally to liquidated and unliquidated damages under the Indian Contract Act, 1872<sup>3</sup> (hereinafter referred to as 'the Act')?

When a contract specifies a pre-estimate of potential loss due to breach, such damages are termed 'Liquidated Damages' and are addressed under Section 74<sup>4</sup> of the Act. Conversely, when no such pre-estimate is mentioned and damages are assessed post-breach, they are termed 'Unliquidated Damages' and are governed by Section 73<sup>5</sup> of the Act. The explanation to Section 73 imposes a duty to mitigate losses before claiming unliquidated damages, but Section 74 lacks such an explicit mandate. This raises a fundamental legal question: Is the principle of mitigation inapplicable to liquidated damages?

## II. UNLIQUIDATED DAMAGES

It is well established position of law that the duty to mitigate damages is imposed upon claimants before claiming unliquidated damages. This obligation arises not only from explanation to Section 73 but has also been reinforced time and again by the Hon'ble Courts. In *Murlidhar Chiranjilal*<sup>6</sup>, the Hon'ble Supreme Court held that there is a duty on claimant of taking all reasonable steps to mitigate the loss consequent on the breach and debars him from claiming any part of the damage which is due to his own neglect to take such steps. Following this precedent, the Hon'ble Delhi High Court in *Highway Engineering Pvt. Ltd.*<sup>7</sup>, emphasized that the non-defaulting party was required to show that it not only suffered loss due to the failure on the part of defaulting party to perform its mandated duties as per the contract, but it had also to establish that it had undertaken every possible action to mitigate the loss or damages consequent on the breach of the contract under question. Similarly, in *M. Lachia Setty & Sons Ltd.*<sup>8</sup>, the Hon'ble Supreme Court noted that principle of mitigation of loss does not give any right to the defaulting party, but the concept has to be considered by the court while awarding damages to the non-defaulting party. Therefore, in the event the non-defaulting party is unable to prove invocation of all reasonable steps to mitigate

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<sup>3</sup> Indian Contract Act, 1872, No. 9 Acts of Parliament 1872 (India)

<sup>4</sup> Section 74, Indian Contract Act, 1872

<sup>5</sup> Section 73, Indian Contract Act, 1872

<sup>6</sup> Murlidhar Chiranjilal, AIR 1962 SC 366

<sup>7</sup> Highway Engineering Pvt. Ltd. v. Union of India and Anr., 1997 (1) ARBLR 128 (Delhi)

<sup>8</sup> M. Lachia Setty & Sons Ltd. v. The Coffee Board, Bangalore, AIR 1981 SC 162

the damages caused by the breach of contractual obligations, the non-defaulting party is barred from claiming the unliquidated damages.

In *Manju Bagai*<sup>9</sup>, the Hon'ble Delhi High Court laid down “*A person, therefore, must take reasonable steps to minimize the loss and refrain from taking unreasonable steps which would increase the loss. Defense cannot be held liable to pay a loss which the claimant could have avoided or which arises due to the neglect and failure of the claimant to take such reasonable steps. Damages is compensation for the wrong suffered by the claimant and the loss incurred by him but this is subject to the rule that the claimant must take reasonable steps to avoid their avoidable accumulation.*”

Thus, it is undisputed that claimants seeking unliquidated damages must prove they took all reasonable steps to mitigate losses. In the international jurisprudence also, principle of avoidable circumstances is applicable universally. For instance, in *Burns v. MAN Automotive (Aust) Pty Ltd.*<sup>10</sup>, the Hon'ble High Court of Australia affirmed that the principle of mitigation is a universal tenet of contract law. Similarly, in *British Westinghouse Electric Co. Ltd. v. Underground Electric Rlys. Co. of London Ltd.*<sup>11</sup>, the Hon'ble court emphasized that mitigation is intrinsic to the doctrine of damages, irrespective of whether the damages are pre-agreed or assessed after breach. The doctrine of avoidable consequences or mitigation of damages is mandatory under Section 73 of the Act.

### III. LIQUIDATED DAMAGES

Unlike Section 73, Section 74, which governs liquidated damages, does not explicitly impose a duty to mitigate losses. This statutory silence creates scope for judicial interpretation. Applying the Mischief Rule of statutory interpretation, which aims to address the "mischief" the statute intends to remedy, one could argue that the absence of an explicit mitigation requirement under Section 74 reflects the legislative intent to prioritize contractual certainty over equitable mitigation principles. However, this leaves courts with the discretion to interpret the provision broadly to ensure fairness. It also underscores the often-misunderstood distinction between mitigation and

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<sup>9</sup> Manju Bagai v. M/s Magpie Retail Ltd., 2010 SCC OnLine Del 3842

<sup>10</sup> Burns v. MAN Automotive (Aust) Pty Ltd. (1986) 161 CLR 653

<sup>11</sup> British Westinghouse Electric Co. Ltd. v. Underground Electric Rlys. Co. of London Ltd, (1912) AC 673

reasonableness. While mitigation focuses on the claimant's duty to minimize losses, reasonableness pertains to the quantum of compensation that courts deem fair. Courts sometimes blur these lines, applying principles of mitigation to assess reasonableness, particularly in cases of liquidated damages.

In *Tower Vision India Pvt. Ltd.*<sup>12</sup>, the Hon'ble Delhi High Court held that the duty to mitigate damages is not mandatory under Section 74 but may be considered at the court's discretion. The Court observed: "29. *What follows from the above is that even if there is 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 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...*"

While Section 74 does not mandate mitigation, courts consider it when assessing the reasonableness of liquidated damages. Liquidated damages serve as an upper limit on compensation, and courts ensure the awarded amount is reasonable and proportional to the actual harm caused. The actual quantum has to be reasonable and in consonance with the nature of the damage caused to the non – defaulting party. This adjudication of reasonableness has to be done by the courts, and this includes doctrine of avoidable circumstances as well. The Hon'ble Madras High Court in *Green Vistas Property Development (Private) Ltd*<sup>13</sup>, reiterated that mitigation, though not mandatory, is relevant in determining reasonableness and held as - "14. *...A liquidated damage would arise when there is a valid agreement, breach and a loss proved. As these factors are very much satisfied, the contention raised by the petitioner cannot be countenanced. Though there is no mandatory duty imposed on a person claiming liquidated damages, to avoid certain consequences arising for the default, it is a factor to be taken note of in the measurement of damages. What is to be seen is the element of 'Reasonableness'. In the action, a party seeking*

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<sup>12</sup> Tower Vision India Pvt. Ltd. v. Procall Private Limited, 2012 SCC OnLine Del 4396

<sup>13</sup> Green Vistas Property Development (Private) Ltd. v. Leatherex Tanning Company, 2018 SCC OnLine Mad 14049

*damages. This is for the reason that for such a failure, the non-defaulting party cannot be sued. Therefore, at best, it is a question of adjustment in analyzing and assessing damages. What constitutes a reasonable action is a question of fact to be seen from case to case.”*

In *ONGC Ltd*<sup>14</sup>, the Hon’ble Supreme Court held that non-breaching parties are entitled only to ‘reasonable compensation’ even if the contract specifies liquidated damages. The named sum serves as an upper limit, not a binding obligation. Therefore the emphasis has always been on reasonable compensation. Similarly, in *SECL Industries Ltd.*<sup>15</sup>, the Hon’ble Punjab and Haryana High Court emphasized that mitigation actions are essential in determining the reasonableness of liquidated damage claims. Thus doctrine of avoidable circumstances or principle of mitigation of damages serves as a tool of such measurement. The courts have to be conscious of mitigating actions taken by the non-breaching party in consonance with doctrine of avoidable circumstances in determining the reasonability of the claim.

#### IV. INTERNATIONAL APPROACH

In contrast to India’s approach, several international jurisdictions mandate the application of the mitigation principle even in cases involving liquidated damages. For instance, in *Burns v. MAN Automotive (Aust) Pty Ltd.*<sup>16</sup>, the High Court of Australia confirmed that the principle of mitigation applies universally in contract law. Similarly, in *British Westinghouse Electric Co. Ltd. v. Underground Electric Rlys. Co. of London Ltd.*<sup>17</sup>, the court held that mitigation is an inherent principle in damages, regardless of whether the amount is pre-agreed or not. These cases demonstrate a global tendency to prioritize fairness by ensuring that claimants act reasonably to minimize losses, even in liquidated damages scenarios.

#### V. CONCLUSION

There is a nuanced interplay between Sections 73 and 74 of the Act. While Section 73 imposes a mandatory duty to mitigate losses, Section 74 leaves room for judicial discretion. This disparity can be traced to the historical and doctrinal development of contract law in India. Section 73

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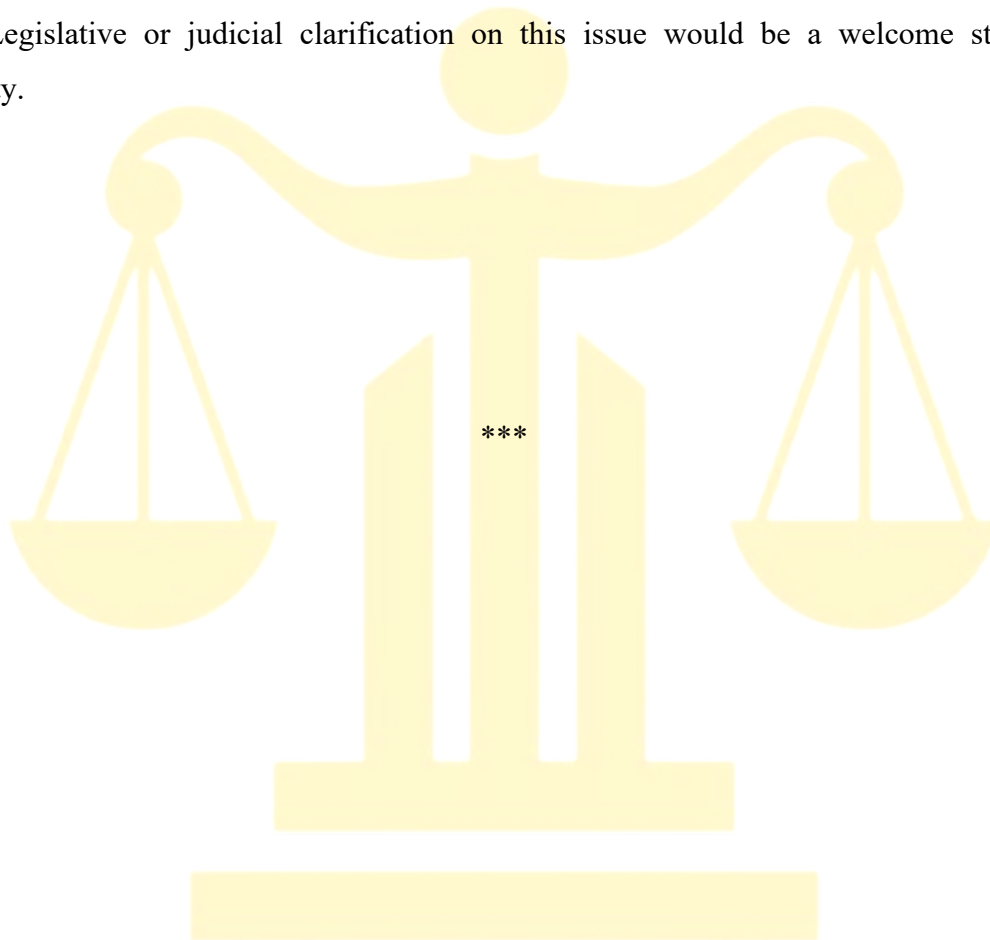
<sup>14</sup> *ONGC Ltd. v. Saw Pipes Ltd.*, AIR 2003 SC 2629

<sup>15</sup> *SECL Industries Ltd. v. The State of Haryana and Others*, CWP No. 13285 of 2012

<sup>16</sup> *Supra* Note 10

<sup>17</sup> *Supra* Note 11

reflects the influence of common law principles that emphasize fairness and the claimant's duty to avoid exacerbating losses. However, Section 74, introduced to simplify the process of awarding damages in cases of pre-agreed sums, prioritizes contractual freedom over strict mitigation requirements. This divergence underscores a broader tension between equitable principles and the enforcement of contractual terms, often leaving courts to navigate this gray area through interpretive judgments. In essence, there is no qualitative difference between claims for liquidated and unliquidated damages.<sup>18</sup> Both must adhere to the principle of reasonableness. Strictly applying the mitigation doctrine to Section 74 would align it with Section 73, ensuring consistency and equity. Legislative or judicial clarification on this issue would be a welcome step toward uniformity.



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<sup>18</sup> Union of India v. Raman Iron Foundry, AIR 1974 SC 1265