

Section 37: “The parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of this Act, or of any other law”.

Section 55: “When a party to a contract promises to do a certain thing at or before a specified time, or certain things at or before specified times, and fails to do any such thing at or before the specified time, the contract, or so much of it as has not been performed, becomes voidable at the option of the promisee, if the intention of the parties was that time should be of the essence of the contract.”.

Section 51: “When a contract consists of reciprocal promises to be simultaneously performed, no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.”.

Section 52: “Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they shall be performed in that order; and where the order is not expressly fixed by the contract; they shall be performed in that order which the nature of the transaction requires.”.

Section 53: “When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise, the contract becomes voidable at the option of the party so prevented; and he is entitled to compensation from the other party for any loss which he may sustain in consequence of the non-performance of the contract.”.

Section 54: “When a contract consists of reciprocal promises, such that one of them cannot be performed, or that its performance cannot be claimed till the other has been performed, and the promisor of the promise last mentioned fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party to the contract for any loss which such other party may sustain by the non-performance of the contract.”.

Section 73: “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. Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.”.

Section 74 : “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, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or 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 or, as the case may be, the penalty stipulated for.”

Liquidated Damages in EPC Contracts: Legal Principles, Commercial Reality, and Judicial Control

At the outset, it is important to understand that **time is a fundamental obligation in EPC contracts**. Most standard forms of engineering, procurement and construction contracts

expressly require the contractor to complete the works either **by a specified date** or **within a defined period** calculated from the commencement of the contract.

Where the contract does not expressly specify a completion timeline, the law implies a term requiring completion **within a reasonable period of time**. This implication is critical because EPC contracts are inherently time-sensitive, and failure to complete within the agreed or implied timeline constitutes a **breach of contract**, exposing the contractor to liability in damages.

However, in large and complex EPC projects, the losses arising from delay are often **difficult to quantify with precision**. It is in this commercial context that parties incorporate **liquidated damages clauses** as “previously set” remedies, enabling compensation to be paid upon default without requiring prolonged disputes on quantum.

Nature and Purpose of Liquidated Damages

Liquidated damages are damages whose amount is **designated by the parties at the time of drafting the contract**, to be payable upon the occurrence of a specified breach, most commonly delay in completion or failure to meet performance guarantees.

As defined in **Black’s Law Dictionary**, a liquidated damages clause is a contractual provision that determines in advance the measure of damages payable upon breach. In EPC contracts, parties commonly agree that a **fixed and pre-determined sum** shall be payable for failure to complete works within the stipulated time.

These damages are usually calculated:

- on a **daily or weekly basis**, and
- as a **percentage of the contract price**, subject to an overall cap.

The underlying legal requirement is that such damages must constitute a **genuine pre-estimate of the employer’s loss**, assessed **at the time the contract is entered into**, and not retrospectively with the benefit of hindsight.

Penalty versus Liquidated Damages

Across most legal systems, including India, a liquidated damages clause will **not be enforced if its dominant purpose is to punish the breaching party**, rather than to compensate the injured party. Such clauses are treated as **penalty clauses** and are unenforceable.

Courts are particularly cautious because enforcing a punitive clause would effectively result in **unjust enrichment** and may amount to compelling performance through financial coercion. Accordingly, while contractual autonomy is respected, courts intervene where enforcement would lead to inequitable outcomes.

This introduces a recurring tension in EPC contracts—while liquidated damages promote certainty, they must not disproportionately burden one party or operate as a windfall for the other.

Delay Liquidated Damages

Most EPC contracts stipulate a **guaranteed completion date**, either as a fixed date or as a fixed duration from commencement. If this date is not met, the contractor becomes liable for **delay liquidated damages**.

Delay liquidated damages are designed to compensate the employer for losses arising from late completion, including:

- extended supervision and administrative costs,
- additional insurance and financing charges, and
- loss of anticipated revenue.

These damages are typically expressed as a **rate per day of delay**, subject to an overall cap—commonly around **10% of the contract price**. For enforceability, the rate must represent a **genuine pre-estimate of foreseeable loss**, determined at the time of contract formation.

Performance Liquidated Damages

Performance liquidated damages address a different risk. In EPC projects, the employer's revenue is derived from **operating the completed facility**, making performance in terms of output, efficiency, and reliability crucial.

Accordingly, EPC contracts contain **performance guarantees**, backed by liquidated damages payable if the facility fails to meet contractual benchmarks. These damages are intended to compensate the employer for **long-term operational losses** over the life of the project.

As with delay liquidated damages, performance liquidated damages must also be a **genuine pre-estimate of loss**, assessed at the time of contract execution, and are usually subject to a contractual cap.

Statutory Framework under Indian Law

In India, the enforceability of liquidated damages is governed primarily by **Sections 37, 55, 73, and 74 of the Indian Contract Act, 1872**.

Section 74 is particularly significant. Where a contract stipulates a sum payable upon breach, the court may award **reasonable compensation not exceeding the amount stipulated**. This means that the liquidated damages figure operates as a **ceiling**, not an automatic entitlement.

Even where a liquidated damages clause exists, the claimant must still establish that **loss has been suffered**, although proof of exact quantum may not be required.

Judicial Approach to Loss of Profit and Overheads

Given the scale of EPC contracts, courts have recognised that contractors cannot realistically prove every item of loss. Consequently, courts have accepted **formula-based methods** for computing claims for loss of profit and overheads.

In the **AT Brij case**, the Supreme Court observed that while adjudicating claims for loss of profit, it is not necessary to enter into minute details of execution, and a **broad and reasonable assessment** would suffice. The Court relied on Hudson's Building and Engineering Contracts, noting that overheads and profits in major contracts generally fall between **3% to 7%**.

This approach was further developed in **McDermott International Inc. v. Burn Standard Co. Ltd.**, where the Supreme Court recognised the **Hudson and Emden formulae** as acceptable tools for computation, provided the foundational facts are established.

However, **recent Supreme Court judgments have significantly refined this position**, cautioning against mechanical application of such formulae.

Batliboi Environmental Engineers Ltd. v. HPCL

In **Batliboi**, the Supreme Court clarified that claims for loss of overheads and profits must be computed **only on the value of unexecuted works**, and must exclude payments received or receivable for work already executed.

The Court further held that such claims may be raised even where the contractor does not immediately repudiate the contract, **provided the employer's breach is fundamental**. This recognises the commercial reality that contractors often continue performance to mitigate losses.

Crucially, the Court explained that loss of profit and overheads is compensable only where:

- there is an **increase in on-site or off-site overheads**, or
- the contractor's **profit-earning capacity is affected**,

due to **employer-caused delay beyond the contractual period**, without any corresponding increase in monetary benefit.

Strict Evidentiary Threshold

The Supreme Court emphasised that **loss cannot be presumed**. For successful claims relating to loss of profit or overheads, the contractor must produce **credible documentary evidence**, such as:

- declined invitations to tender,
- books of accounts showing a drop in turnover, and
- financial records establishing a causal link between delay and loss.

The Court cautioned that while Hudson, Emden, and Eichleay formulae have judicial acceptance, they are **theoretical models based on assumptions**. Blind application can lead to arbitrary or inflated results.

Relying on **Property and Land Contractors Ltd. v. Alfred McAlpine Homes**, the Court held that these formulae are useful only where their underlying assumptions are satisfied. It further warned that the **Hudson formula may even result in double recovery** if applied casually, and noted that the **Eichleay formula**, though more rigorous, demands a higher evidentiary threshold.

Ultimately, Batliboi's claim failed because it did not meet these evidentiary requirements.

Unibros v. All India Radio

The Supreme Court reaffirmed this approach in **Unibros v. All India Radio**, where it rejected a claim for loss of profit due to absence of substantiating evidence.

The Court held that to sustain a claim for loss of profit due to delay, the contractor must establish the presence of a **viable alternate opportunity**, supported by compelling evidence.

Relying on **Bharat Coking Coal Ltd. v. L.K. Ahuja**, the Court reiterated that the contractor must show that had the contract payments been received on time, they could have been deployed elsewhere to earn profit.

The Court clarified that formulae do not prove loss by themselves; they merely **assist in quantification once loss is independently established**.

Determination of Fault and Extension of Time

Before liquidated damages can be imposed, it is essential to determine **who is responsible for the delay**. Delays may arise due to employer actions, contractor defaults, or neutral events.

EPC contracts therefore include **Extension of Time clauses**, identifying "relevant events" such as:

- client variations,
- additional scope,
- latent conditions, and
- extreme weather.

These clauses protect contractors from unfair exposure and preserve the enforceability of liquidated damages by maintaining a **defined completion date**.

Partial Possession, Sectional Completion, and Early Use

Clauses permitting partial possession, sectional completion, and early use allow the employer to derive benefit from completed portions of the project before final completion.

From a liquidated damages perspective, these mechanisms can **reduce the employer's actual loss**, thereby proportionately reducing the contractor's liability and ensuring equitable adjustment.

Conclusion

In conclusion, liquidated damages in EPC contracts serve as a critical risk-allocation mechanism. Indian courts have consistently upheld such clauses where they are **reasonable, compensatory, and evidence-backed**, while cautioning against their mechanical or punitive application.

The Supreme Court's recent jurisprudence reinforces that:

- damages must restore, not enrich;
- quantum must reflect proven loss;
- computation must be rational and evidence-based; and
- formulae are tools, not entitlements.

This balanced approach reflects judicial sensitivity to both **commercial reality and legal fairness**.