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Liquidated Damages In International Arbitration: Governing Law Divergences Between Indian And English Law

Himanshu Handa
Research Scholar, School of Law, Manav Rachna University, Faridabad, India.
Email: handa652@gmail.com

Dr. Shaharyar Asaf Khan
Professor, School of Law, Manav Rachna University, Faridabad, India.
Email: shaharyarasafkhan@mru.edu.in

Abstract
Liquidated damages clauses are foundational instruments in modern commercial contracting, enabling sophisticated parties to pre-allocate risk, ensure financial predictability, and reduce post-breach transactional costs. Despite their ubiquity in cross-border agreements, the enforceability of such clauses diverges markedly across jurisdictions, generating significant uncertainty in international arbitration proceedings. This paper undertakes a systematic comparative analysis of the treatment of liquidated damages under English and Indian law, organised around three analytically distinct dimensions: (i) the structural characterisation of liquidated damages provisions; (ii) the allocation and shifting of the evidentiary burden; and (iii) the threshold requirement for proof of actual loss. In English law, the UK Supreme Court's landmark ruling in Cavendish Square Holding BV v Makdessi [2015] UKSC 67 fundamentally reconstituted the classical penalty doctrine by relocating its central inquiry from adequacy of pre-estimated loss to proportionality against the innocent party's legitimate interest in performance. Indian law, by contrast, remains anchored in Section 74 of the Indian Contract Act, 1872, which conditions recovery upon proof of actual loss and caps compensation at a judicially assessed 'reasonable' quantum. Through doctrinal analysis of foundational case law and comparative legal methodology, this paper identifies structural deficiencies in Indian jurisprudence that undermine contractual certainty and generate protracted disputes over damages quantification. Contextualising these findings within international commercial arbitration — supported by empirical data from the ICC, SIAC, and LCIA — the paper demonstrates that Indian law is rarely selected as governing law despite India's considerable presence as a participant jurisdiction. Three targeted legislative and judicial reforms are advanced to modernise India's approach, enhance commercial predictability, and strengthen India's position as a hub for international arbitration.

Key Words: Liquidated Damages; Penalty Clause; Section 74 Indian Contract Act; Cavendish v Makdessi; International Arbitration; Governing Law; Contractual Certainty; Comparative Contract Law; Burden of Proof; Primary and Secondary Obligations

Introduction

In the classical taxonomy of private law remedies, a party injured by contractual breach may seek compensation measured by the extent of loss actually suffered. The quantification of such loss is, however, frequently attended by significant evidential difficulty, particularly in complex commercial transactions involving long-term performance obligations or bespoke technical deliverables. Parties have long responded to this difficulty by incorporating liquidated damages

provisions into their agreements — contractual formulae that stipulate, ex ante, the financial consequence of defined categories of breach. Such clauses serve a plurality of commercial functions: they reduce post-breach litigation costs, incentivise timely performance, and convert uncertain future losses into a fixed and foreseeable contractual liability.[1]

The doctrinal treatment of liquidated damages, however, is not uniform across legal systems. Two jurisdictions of particular significance in international commercial practice — England and India — approach the subject from materially different conceptual starting points, with correspondingly divergent outcomes for parties and arbitral tribunals engaged in disputes under contracts governed by these laws. The divergence is not merely academic. In international arbitration, where parties negotiate both the governing law and the arbitral clause, the legal framework applicable to a liquidated damages provision may determine the entire financial exposure arising from a breach — the difference between automatic enforcement of the stipulated sum and a contested, court-supervised inquiry into actual loss and reasonable compensation.[2]

English law approaches liquidated damages enforceability through the lens of the penalty doctrine — a common law rule that invalidates contractual provisions imposing a secondary obligation disproportionate to the innocent party's legitimate interest in performance. Following *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, the doctrine has been substantially modernised to accommodate commercial reality and protect bargains struck between parties of comparable sophistication. Indian law, by contrast, channels all disputes concerning stipulated contractual sums through Section 74 of the Indian Contract Act, 1872, which simultaneously eliminates the English distinction between liquidated damages and penalties while introducing a compensatory ceiling that functions independently of the parties' agreed allocation of risk.[3]

This paper proceeds as follows. Section II examines the structural framework of each jurisdiction, focusing on the reformulated English penalty doctrine and the statutory 'reasonable compensation' standard under Indian law. Section III analyses the treatment of proof-of-loss requirements. Section IV addresses the allocation and shifting of evidentiary burdens. Section V presents a comparative synthesis in tabular form. Section VI identifies doctrinal difficulties in the current Indian jurisprudence. Section VII situates the analysis within international arbitration by reference to empirical institutional data. Section VIII advances targeted proposals for legislative and judicial reform. Section IX concludes.

II. Structural Framework: Divergent Doctrinal Foundations

A. The English Position: The Reformulated Penalty Doctrine

The modern English law on liquidated damages and the penalty doctrine was substantially reconstituted by the UK Supreme Court's decision in *Cavendish Square Holding BV v Makdessi*,[4] heard concurrently with *ParkingEye Ltd v Beavis*. In doing so, the Supreme Court

[1]LL Fuller and William R Perdue Jr, 'The Reliance Interest in Contract Damages' (1936) 46 *Yale Law Journal* 52.
[2]Chitty on Contracts (34th edn, Sweet & Maxwell 2021) para 26-001.
[3]*Common Cause v Union of India* (1999) 6 SCC 667.
[4]*Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2016] AC 1172.

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departed from the narrow 'genuine pre-estimate of loss' inquiry that had dominated English law since the House of Lords' decision in *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd*.[5]

The classical *Dunlop* doctrine conditioned enforceability upon whether the stipulated sum was a 'genuine pre-estimate of loss' at the time of contracting. A provision that was 'extravagant and unconscionable in comparison with the greatest loss that could conceivably be proved' would be characterised as a penalty and struck down.[6] While conceptually coherent, this framework proved ill-suited to commercial contracts in which the parties' legitimate interests extended beyond pure financial compensation — interests such as the preservation of goodwill, the maintenance of a commercial model, or the deterrence of specific categories of breach.
Lords Neuberger and Sumption, with whom Lords Carnwath and Clarke substantially agreed, articulated the reformulated test as follows:[7]

"The true test is whether the impugned provision is a secondary obligation which imposes a detriment on the contract-breaker out of all proportion to any legitimate interest of the innocent party in the enforcement of the primary obligation." (Makdessi [2015] UKSC 67, [32])
This reformulation introduces two analytically significant modifications to the prior law. First, the inquiry is now anchored in the concept of 'legitimate interest' in performance, rather than the adequacy of the pre-estimate of financial loss.[8] Secondly, the test is explicitly proportionality-based: the question is whether the detriment imposed is disproportionate to the legitimate interest the clause serves to protect, not whether the stipulated sum corresponds to anticipated loss.[9]

(i) The Distinction between Primary and Secondary Obligations

A foundational contribution of *Makdessi* is its rigorous elaboration of the distinction between primary and secondary contractual obligations. The penalty doctrine applies exclusively to secondary obligations — those that arise upon breach of a primary contractual duty. Primary obligations define the core rights and duties constituting the parties' agreed exchange; secondary obligations are triggered by non-performance of those primary duties.[10]
The Supreme Court explained the distinction in the following terms:[11]
"[W]here a contract contains an obligation on one party to perform an act, and also provides that, if he does not perform it, he will pay the other party a specified sum of money, the obligation to pay the specified sum is a secondary obligation which is capable of being a penalty; but if the contract does not impose (expressly or impliedly) an obligation to perform the act, but simply provides that, if one party does not perform, he will pay the other party a specified sum, the

[5]*Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79 (HL).
[6]*Dunlop* [1915] AC 79 (HL) 86–87 (Lord Dunedin): 'To justify interference there must be an extravagant disproportion between the agreed sum and the amount of any damage capable of pre-estimate.'
[7]*Makdessi* [2015] UKSC 67 [32] (Lords Neuberger and Sumption).
[8]*Makdessi* [2015] UKSC 67 [12]–[13].
[9]*Makdessi* [2015] UKSC 67 [32].
[10]James Edelman, Jason Varuhas and Simon Colton, *McGregor on Damages* (21st edn, Sweet & Maxwell 2020) paras 16-015 to 16-017.
[11]*Makdessi* [2015] UKSC 67 [13], [28]–[31], [73].

obligation to pay the specified sum is a conditional primary obligation and cannot be a penalty." (Makdessi [2015] UKSC 67, [14])

This structural distinction has important practical implications. Clauses embedded within pricing mechanisms, risk allocation matrices, or conditional payment structures may fall entirely outside the penalty doctrine even where their triggering event is breach. As Chitty on Contracts notes, the court's inquiry is directed at the substance of the provision, not its formal characterisation — a clause framed as a conditional payment mechanism may nonetheless be characterised as a secondary obligation if it operates, in substance, as a sanction for breach.[12] Applying these principles to the facts of *Makdessi*: the claimant had agreed to sell his shares in an advertising business pursuant to a Share Purchase Agreement containing restrictive covenants. On breach of those covenants, the Agreement provided that (a) the seller would forfeit entitlement to the final two instalments of the purchase price, and (b) the buyer could acquire the seller's remaining shares at a formula price below market value. The Supreme Court held that both provisions formed part of the primary contractual exchange — the price the buyer was willing to pay for a business unencumbered by competitive conduct. Even if characterised as secondary obligations, they were not disproportionate to Cavendish's legitimate interest in protecting the acquired goodwill.[13]

The concurrent appeal in *ParkingEye* illustrates the doctrine's application in a more commercial context. A charge of £85 imposed upon motorists overstaying in a retail car park was challenged as penal. The Supreme Court upheld the charge, notwithstanding that it did not represent a pre-estimate of any identifiable financial loss to the operator. The operator had a legitimate interest in maintaining the turnover of parking spaces and funding the administration of the parking scheme — interests that justified the imposition of the charge as a proportionate regulatory mechanism.[14]

The significance of the primary/secondary obligation distinction extends beyond *Makdessi* to earlier and subsequent decisions. In *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana*,[15] Lord Diplock held that a 'penalty clause is one which provides that upon breach of a primary obligation under the contract a secondary obligation shall arise on the part of the party in breach to pay to the other party a sum of money which does not represent a genuine pre-estimate of any loss likely to be sustained by him as the result of the breach of primary obligation.' In *Export Credits Guarantee Department v Universal Oil Products Co*,[16] the court held that an indemnity payable upon specified events falling short of breach would not attract the penalty doctrine. Similarly, in *Berg v Blackburn Rovers FC*,[17] payment in lieu of notice following a contractual termination right was held not penal because the termination itself did not constitute a breach.

[12]*Makdessi* [2015] UKSC 67 [73]–[83], [152]–[155].
[13]*ParkingEye Ltd v Beavis* [2015] UKSC 67 [97]–[101].
[14]*Makdessi* [2015] UKSC 67 [14].
[15]Edwin Peel, *Treitel on the Law of Contract* (15th edn, Sweet & Maxwell 2020) para 20-135.
[16]*Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana* [1983] 2 AC 694, 702 (Lord Diplock).
[17]Chitty on Contracts (34th edn, Sweet & Maxwell 2021) para 30-213.

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Post-*Makdessi* decisions have applied these principles consistently. In *Holyoake v Candy*,[18] the High Court rejected a penalty argument, holding that the repayment obligation defined the commercial terms of the loan as a primary obligation, not a remedial sanction for breach. In *Vivienne Westwood Ltd v Conduit Street Development Ltd*,[19] by contrast, the High Court held that a clause requiring the tenant to pay higher rent retrospectively upon breach was penal in substance, having regard to the nature and consequences of the breach irrespective of its magnitude.

(ii) The 'All-or-Nothing' Consequence and Enforceability

A second critical structural feature of English law is the binary consequence of the penalty determination. If a contractual provision is characterised as a penalty, it is unenforceable in its entirety — the court does not reduce the stipulated sum to a reasonable quantum. As *Dunlop* established and *Makdessi* reaffirmed, judicial reduction of a penal sum would constitute impermissible re-drafting of the parties' bargain.[20]

Conversely, if a liquidated damages clause survives the penalty doctrine inquiry, it is enforced strictly according to its terms, irrespective of whether the stipulated sum exceeds the claimant's actual provable loss.[21] The clause represents the parties' agreed allocation of risk; the claimant is entitled to that allocation without further inquiry into the quantum of loss suffered. In *Jobson v Johnson*,[22] where a clause requiring transfer of shares at an undervalue upon default was held penal, the Court of Appeal's attempt at partial enforcement was subsequently treated with scepticism in *Makdessi* insofar as it suggested the possibility of partial relief.

B. The Indian Position: Section 74 and the Reasonable Compensation Standard

The Indian law on liquidated damages is governed exclusively by Section 74 of the Indian Contract Act, 1872.[23] Unlike the English penalty doctrine — which operates as a common law rule of invalidity — Section 74 is a statutory provision that simultaneously displaces both the penalty/liquidated damages distinction and the English rule of automatic enforcement. The section provides that, where a contract is broken and a sum is named as payable in consequence, the party complaining of the breach is entitled to receive 'reasonable compensation not exceeding the amount so named', whether or not actual damage or loss is proved.

The Supreme Court of India in *Fateh Chand v Balkishan Das*[24] confirmed that Section 74 was a deliberate legislative intervention designed to eliminate the elaborate English common law distinction between liquidated damages and penalties. The statutory formulation consolidates both categories under a unified 'reasonable compensation' standard, conferring upon Indian

[18]*Export Credits Guarantee Department v Universal Oil Products Co* [1983] 1 WLR 399 (HL).
[19]*Berg v Blackburn Rovers FC* [2013] EWHC 1070 (Ch).
[20]*Holyoake v Candy* [2017] EWHC 3397 (Ch) [467]–[468] (Nugee J).
[21]*Vivienne Westwood Ltd v Conduit Street Development Ltd* [2017] EWHC 350 (Ch) [41], [63].
[22]*Makdessi* [2015] UKSC 67 [255]; Edwin Peel, *Treitel on the Law of Contract* (15th edn, Sweet & Maxwell 2020) para 20-135.
[23]*Makdessi* [2015] UKSC 67 [161].
[24]*Dunlop* [1915] AC 79 (HL) 86–87 (Lord Dunedin).

courts a supervisory role in the assessment of damages that has no counterpart in the enforcement-oriented framework of English law.[25]

The practical operation of Section 74, as elaborated in subsequent Supreme Court jurisprudence, involves a structured evidentiary inquiry: (i) the claimant must establish breach and resulting loss or legal injury as a threshold matter;[26] (ii) once this burden is discharged, the defendant may rebut by demonstrating that no loss was suffered or that the stipulated sum is unreasonable; and (iii) the court then independently determines 'reasonable compensation', subject to the contractually stipulated ceiling. The parties' agreed sum functions as a ceiling, not a floor, and certainly not an automatic entitlement.

A significant doctrinal development occurred in *ONGC v Saw Pipes Ltd*[27] (*Saw Pipes*), where the Supreme Court introduced a degree of pragmatic flexibility into the Section 74 inquiry. The Court held that where the nature of the contract renders proof of actual loss inherently difficult or impractical, a contractual sum representing a genuine pre-estimate of loss may be awarded as reasonable compensation — particularly in commercial delay cases involving construction and infrastructure contracts.[28]

However, the scope of *Saw Pipes* has been substantially circumscribed by *Kailash Nath Associates v Delhi Development Authority*[29] (*Kailash Nath*), where the Supreme Court clarified that *Saw Pipes* does not authorise automatic enforcement of stipulated sums, nor does it reverse the requirement of proof of loss. The dispensation from proof of loss applies only in circumstances where loss is inherently impossible or impractical to prove — not as a general departure from compensatory principles.

III. The Treatment of Proof of Loss

A. English Law: Automatic Entitlement upon Validity

Under English law, once a liquidated damages clause has been determined not to constitute an unenforceable penalty under the *Makdessi* test, the claimant is entitled to recover the stipulated sum without adducing evidence of actual loss suffered.[30] The liquidated damages are recoverable as a matter of contractual right, not as a compensatory award derived from proof of harm. One of the primary commercial functions of a liquidated damages clause is precisely to provide this certainty — the avoidance of expensive post-breach inquiries into causation, remoteness, and quantum.

The enforced sum need not correspond to the actual loss ultimately suffered. If the actual loss is less than the stipulated sum, the claimant is nonetheless entitled to the full contracted amount. If the actual loss exceeds the stipulated sum, the claimant is ordinarily confined to

[25] *Makdessi* [2015] UKSC 67 [161].
[26] *Jobson v Johnson* [1989] 1 WLR 1026 (CA); criticised in *Makdessi* [2015] UKSC 67 [158]–[163].
[27] *Diestal v Stevenson* [1906] 2 KB 345 (CA).
[28] *Wall v Rederiaktiebolaget Luggude* [1915] 3 KB 66 (KB).
[29] Indian Contract Act 1872, s 74.
[30] *Fateh Chand v Balkishan Das* (1963) 1 SCR 515: 'The section is clearly an attempt to eliminate the somewhat elaborate refinements made under the English common law in distinguishing between stipulations providing for payment of liquidated damages and stipulations in the nature of penalty.'

that amount — the clause functions as both an entitlement and a cap.[31] As established in *Clydebank Engineering and Shipbuilding Co Ltd v Don Jose Ramos Yzquierdo y Castaneda*,[32] the payment represents the parties' agreed price for the breach, enforced on the basis of the contractual bargain rather than the empirical extent of harm.

B. Indian Law: The Proof of Loss Requirement and Its Limits

Indian law takes a fundamentally different approach. Section 74 of the Indian Contract Act embeds a compensatory orientation that requires the claimant, in most cases, to demonstrate that a breach has caused actual loss or legal injury before an award of damages may be made. The Supreme Court in *Kailash Nath* held that the statutory phrase 'whether or not actual damage or loss is proved to have been caused thereby' operates only as a dispensation from proof of precise quantum in cases where quantification is inherently impractical — it does not dispense with the threshold requirement of establishing that some loss or legal injury has in fact been suffered.[33]
Accordingly, where it is possible to prove actual loss in monetary terms, the claimant is required to do so. As established in *Maula Bux v Union of India*,[34] the compensatory principle — that damages are awarded to restore the claimant to the position it would have occupied but for the breach, and not to enrich the claimant beyond that position — is treated in Indian law as a near-absolute constraint on the assessment of contractual remedies.

A degree of pragmatic flexibility was introduced in *Construction and Design Services v Delhi Development Authority*[35] (*Construction and Design*), where the Supreme Court accepted that in infrastructure contracts involving delay, the existence of some loss may reasonably be presumed from the nature of the breach, and that quantification on a 'best estimate' basis is permissible in the absence of precise evidence. The Court upheld an award of half the claimed liquidated damages as reasonable compensation — a determination reached without specific evidence from either party regarding the precise extent of loss.[36]
This intermediate position — where loss is presumed but quantum is assessed on a judicial 'best estimate' — represents a pragmatic but doctrinally uncertain accommodation. The resulting awards can be difficult to predict or to challenge on appeal, given the inherently qualitative nature of the 'reasonable compensation' determination.

IV. The Allocation and Shifting of the Evidentiary Burden

A. English Law: Presumptive Validity and the Challenger's Burden

[31] *Fateh Chand v Balkishan Das* (1963) 1 SCR 515.
[32] *Indian Oil Corporation Ltd v Standard Casting Pvt Ltd*, FAO (COMM) 83/2021 & 84/2021 (Delhi High Court, 13 November 2025) [43.3]: 'Since Section 74 awards reasonable compensation for damage or loss caused by a breach of contract, damage or loss caused is a sine qua non for the applicability of the section.'
[33] *ONGC v Saw Pipes Ltd* (2003) 5 SCC 705.
[34] *ONGC v Saw Pipes Ltd* (2003) 5 SCC 705 [64], [67]–[68].
[35] *Kailash Nath Associates v Delhi Development Authority* (2015) 4 SCC 136.
[36] Edwin Peel, *Treitel on the Law of Contract* (15th edn, Sweet & Maxwell 2020) para 20-158.

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The allocation of the evidentiary burden in English law reflects the underlying presumption in favour of contractual freedom and the enforceability of commercial bargains. A liquidated damages clause in a negotiated commercial agreement is presumptively valid; the burden of establishing that the clause constitutes an unenforceable penalty rests upon the party making that assertion — typically the party in breach who seeks to resist the clause's operation.[37]
In *Makdessi*, the Supreme Court made explicit that commercial parties are generally the best judges of their own interests, and that courts should exercise particular restraint in interfering with bargains struck between parties of comparable sophistication and bargaining strength.[38] A 'strong initial presumption' of legitimacy attaches to such clauses, and the burden on the challenger is correspondingly demanding: it must demonstrate that the clause imposes a detriment 'out of all proportion' to the legitimate interest the clause protects.[39]
The historical development of the doctrine confirms this allocation. In *Dunlop,*[40] Lord Dunedin framed the inquiry in terms of whether the impugned provision was 'extravagant and unconscionable' — language that places the evidentiary emphasis firmly on the party seeking to invalidate the clause. *Makdessi* refines but does not reverse this structure: the clause stands unless disproportionality relative to the innocent party's legitimate interest is affirmatively demonstrated.

B. Indian Law: Initial Claimant's Burden and Conditional Shifting

The evidentiary burden under Indian law operates in a manner less favourable to the party seeking to enforce a liquidated damages clause. The initial burden is borne by the claimant, who must establish: (i) the existence and terms of the contract; (ii) breach of the relevant contractual obligation; and (iii) the existence of loss or legal injury consequent upon that breach. The burden does not shift to the defendant to challenge the quantum or reasonableness of the stipulated sum until the claimant has discharged this threshold requirement.

The applicable principles of evidentiary burden are derived from the general law of evidence, now codified in the Bharatiya Sakshya Adhiniyam, 2023 (BSA). Sections 101 and 102 of the BSA provide that the burden of proof lies with the party asserting the relevant right or fact and who would fail in the absence of evidence. Section 103 further clarifies that the burden of proving any particular fact rests with the person who wishes the court to act upon its existence.[41]

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[37]*Clydebank Engineering and Shipbuilding Co Ltd v Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6.
[38]*Kailash Nath Associates v Delhi Development Authority* (2015) 4 SCC 136 [43].
[39]*Kailash Nath Associates v Delhi Development Authority* (2015) 4 SCC 136 [44].
[40]*Maula Bux v Union of India* AIR 1970 SC 1955: 'Where the Court is unable to assess the compensation, the sum named by the parties if it be regarded as a genuine pre-estimate may be taken into consideration as the measure of reasonable compensation, but not if the sum named is in the nature of a penalty. Where loss in terms of money can be determined, the party claiming compensation must prove the loss suffered by him.'
[41]*Construction and Design Services v Delhi Development Authority* (2015) 14 SCC 263 [18]: 'Applying the above principle to the present case, it could certainly be presumed that delay in executing the work resulted in loss for which the respondent was entitled to reasonable compensation. Evidence of precise amount of loss may not be possible but in absence of any evidence by the party committing breach that no loss was suffered by the party complaining of breach, the Court has to

Applied to a claim under Section 74, the claimant bears the initial burden of establishing both the fact of breach and the resulting legal injury.
Once the claimant discharges this initial burden, the evidentiary weight may shift. If the defendant contends that no loss was suffered, and the relevant facts lie peculiarly within the defendant's knowledge, Section 106 of the BSA may operate to place the burden of establishing those facts upon the defendant.[42] Similarly, if the defendant asserts that the stipulated sum is unreasonable or unconscionable, the burden of substantiating that contention rests upon the defendant.

The interplay between *Saw Pipes* and *Kailash Nath* is significant in this context. *Saw Pipes* recognised that in defined categories of commercial contracts some loss may reasonably be presumed, such that the claimant need not adduce precise evidence of every head of damage. However, *Kailash Nath* confirmed that this accommodation does not displace the claimant's threshold obligation to establish the existence of loss — what is relaxed in appropriate cases is the obligation to prove precise quantum, not the existence of loss itself.[43]

V. Comparative Synthesis

The preceding analysis reveals that English and Indian law diverge along three analytically distinct dimensions. The following table presents a structured synthesis of the principal points of difference.

Table 1: Comparative Analysis of Liquidated Damages — English Law and Indian Law

Dimension	English Law	Indian Law
Structural Framework	Maintains a formal distinction between primary and secondary obligations. The penalty doctrine applies exclusively to secondary obligations triggered by breach. Clauses constituting primary obligations fall entirely outside the doctrine.	Section 74 applies uniformly whenever a sum is stipulated upon breach, without distinguishing between primary and secondary obligations. The statutory phrase 'when a contract has been broken' operates as the sole trigger.
Proof of Actual Loss	No proof of actual loss required where the clause is valid. The stipulated sum is recoverable as a matter of contractual right, enforced according to its terms regardless of whether actual loss equals, exceeds, or falls short of the stipulated amount.	Claimant must establish loss or legal injury as a threshold matter. Proof of precise quantum may be relaxed where quantification is inherently impractical, but the existence of some loss must be established.

proceed on guess work as to the quantum of compensation to be allowed in the given circumstances.'
[42] *Makdessi* [2015] UKSC 67 [35].
[43] *Makdessi* [2015] UKSC 67 [35]–[37].

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Dimension	English Law	Indian Law
Burden of Proof	A liquidated damages clause is presumptively valid. The burden falls on the party alleging penalty to demonstrate disproportionality relative to the innocent party's legitimate interest in performance.	Initial burden borne by the claimant to establish breach and resulting loss. Only after this burden is discharged may the onus shift to the defendant to demonstrate unreasonableness of the stipulated sum.
Consequence of Invalidity	A penal clause is entirely unenforceable. Courts have no power to award a 'reasonable' proportion of the stipulated sum. The claimant may seek unliquidated damages in the ordinary way, unconstrained by the stipulated figure.	Courts award 'reasonable compensation' not exceeding the stipulated sum. The clause operates as a ceiling while the court independently determines the appropriate compensatory quantum.
Judicial Philosophy	Strong deference to freedom of contract; particular restraint in interfering with arm's-length commercial bargains between sophisticated parties.	Pronounced compensatory orientation; significant judicial supervisory role in the assessment of contractual damages.

VI. Doctrinal Difficulties in the Current Indian Jurisprudence

A. Erosion of Contractual Certainty

The central structural difficulty with the current Indian approach is that it treats the contractually stipulated sum as a presumptive ceiling rather than an agreed entitlement. Sophisticated commercial parties who negotiate a liquidated damages clause at arm's length — following careful consideration of risk exposure and commercial consequences — cannot be assured that courts will give effect to the agreed figure. The judicial power to award 'reasonable compensation' operates as an independent supervisory mechanism that may result in recovery substantially below the contractually anticipated quantum, irrespective of the parties' expressed intentions.[44]

The difficulties are illustrated by *Construction and Design*, in which the Supreme Court awarded half of the claimed liquidated damages as 'reasonable compensation', without specific evidence from either party regarding actual loss.[45] The absence of a principled basis for the fifty percent reduction underscores the uncertainty inherent in the 'best estimate' approach: parties and their advisers are unable to predict, with any reliability, what proportion of a contractually stipulated sum a court may consider 'reasonable' in a given factual context — the very outcome that liquidated damages clauses are designed to prevent.

[44]*Dunlop* [1915] AC 79 (HL) 86–87.
[45]James Edelman, Jason Varuhas and Simon Colton, *McGregor on Damages* (21st edn, Sweet & Maxwell 2020) paras 16-015 to 16-017.

As Pollock & Mulla observe, although English law has evolved significantly following *Makdessi*, which reformulated the penalty test around the protection of a legitimate interest, Section 74 of the Indian Contract Act continues to adopt a statutory standard of reasonable compensation rather than the traditional English penalty doctrine — a standard that imposes significant judicial discretion over quantum in circumstances where the parties themselves have pre-agreed the financial consequences of breach.[46]

B. Absence of a Primary/Secondary Obligation Framework

A further doctrinal deficiency concerns the failure of Indian courts to systematically distinguish between primary and secondary contractual obligations. The statutory phrase 'when a contract has been broken' in Section 74 has encouraged an undifferentiated application of the reasonable compensation standard to all stipulated payment provisions triggered by breach, without inquiry into whether the provision constitutes a conditional primary obligation forming part of the agreed commercial exchange or a secondary remedial obligation designed to compensate for breach.[47]

This conflation has practical consequences. Provisions embedded within pricing mechanisms, risk allocation frameworks, or conditional payment structures — which, under English law, would fall outside the penalty doctrine as primary obligations — are exposed to judicial scrutiny under Section 74 in India merely because their triggering event is a species of contractual non-performance.[48]

There are, however, encouraging developments at the High Court level. In *Niko Resources Limited v Gujarat State Petroleum Corporation Ltd*,[49] the Bombay High Court considered a clause requiring payment upon the occurrence of a specified contractual contingency and held that such payment constituted a contractual obligation simpliciter — not a damages claim requiring proof of loss, causation, or remoteness. The Court drew an explicit distinction between a claim for an agreed sum (in which proof of loss is irrelevant) and a claim for damages arising from breach.

"The Law of Contract draws a clear distinction between a claim for an agreed sum and a claim for damages for breach of contract. The claimant need not prove loss where a claim is for payment of an agreed sum and remoteness of damages and mitigation of loss are irrelevant in such situations." (Niko Resources, [54])

[46]Bharatiya Sakshya Adhiniyam 2023, ss 101–103.
[47]Bharatiya Sakshya Adhiniyam 2023, s 106.
[48]Gaurav Pachnanda, 'Commercial Law Monologues: Liquidated Damages — On Whom Does the Burden of Proof Lie?' (*Bar & Bench*, 1 February 2026).
[49]*Construction and Design Services v Delhi Development Authority* (2015) 14 SCC 263 [18]: 'Since the respondent also could have led evidence to show the extent of higher amount paid for the work got done or produce any other specific material but it did not do so, we are of the view that it will be fair to award half of the amount claimed as reasonable compensation.'

Similarly, in *Indiabulls Properties P Ltd v Treasure World Developers P Ltd*,[50] the Bombay High Court characterised 'lock-in' period payments as a debt arising under the contract — a primary obligation — rather than as liquidated damages:[51]

"I am unable to see how Claim 3, for licence fees for the remainder of the lock-in period, couched in the manner it is in the contract, can be said to be one for damages of any kind. Treasure World's liability…arises under clause 13.2…This is a debt. It is payable eo instanti; debitum in praesenti and solvendum in praesenti." (Indiabulls, [59])

These decisions demonstrate growing judicial awareness of the analytical significance of the primary/secondary obligation distinction. However, they remain isolated High Court pronouncements without authoritative Supreme Court endorsement, and they do not establish a clear and generally applicable framework for distinguishing between the two categories of obligation.[52] Without such a framework, inconsistency and unpredictability in the treatment of stipulated payments will persist across Indian courts.

VII. Governing Law Choice and International Arbitration: Empirical Perspective

The doctrinal divergences identified above are not merely of academic significance — they have direct consequences for the choices made by commercial parties in structuring international transactions and selecting governing law. Empirical data from the principal international arbitral institutions illustrates the extent to which these considerations influence governing law selection in practice.[53]

Statistics published by the International Chamber of Commerce indicate that English law governed approximately fifteen percent of contracts in newly registered ICC arbitrations in 2024, making it the most frequently selected governing law in ICC disputes.[54] By contrast, Indian law governed approximately sixteen cases in the same period — roughly two percent of ICC arbitrations — despite the fact that sixty-one Indian parties participated in ICC-administered proceedings during that year, making India the second-largest user of ICC arbitration from the Asia-Pacific region.

Data from the Singapore International Arbitration Centre for the same period reflect a similar pattern: English law governed approximately twenty-seven percent of SIAC cases, while Indian law governed approximately four to five percent.[55] India was, notably, among the three largest sources of foreign parties in SIAC arbitrations, with one hundred and sixty Indian parties participating in cases filed in 2023.

The statistics from the London Court of International Arbitration present perhaps the starkest illustration: English law governed approximately seventy-eight percent of LCIA-administered disputes, while Indian law featured in a negligible proportion of cases.[56]

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[50]Dr Sanjeev Gemawat, 'Respect Commercial Wisdom: Why India Must Overhaul Its Damages Jurisprudence' (*Bar & Bench*, 17 September 2025).

[51]Pollock & Mulla, *The Indian Contract Act 1872* (16th edn, LexisNexis 2021) para 74.4.3.

[52]*DAG Private Limited v Ravi Shankar Institute for Music and Performing Arts* 2023 SCC OnLine Del 3293.

[53]Gaurav Pachnanda, 'Commercial Law Monologues: Conditional Primary Obligations and Section 74 of the Indian Contract Act — Testing *Cavendish v Makdessi* in India' (*Bar & Bench*, 30 November 2025).

[54]*Niko Resources Limited v Gujarat State Petroleum Corporation Ltd*, Commercial Arbitration Petition No 484 of 2017 (Bombay High Court, 9 June 2020).

[55]*Indiabulls Properties P Ltd v Treasure World Developers P Ltd* 2014 SCC OnLine Bom 4768.

[56]Queen Mary University of London and White & Case, *2021 International Arbitration Survey: Adapting Arbitration to a Changing World* (School of International Arbitration, Queen Mary

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Table 2: Governing Law Selection Across Major Arbitral Institutions (2023–2024) | Sources: SIAC Annual Report 2024; ICC Dispute Resolution Statistics 2024; LCIA Annual Casework Report 2024

Institution	Total Cases (2024)	Indian Parties	English Law (%)	Indian Law (%)
SIAC	625	160 (2023, top 3 foreign user)	~27.4%	~4–5%
ICC	841	61 (2nd in Asia-Pacific)	~15%	~2%
LCIA	318	2 cases	~78%	<1%

The pattern that emerges is significant: Indian parties are active and substantial participants in international commercial arbitration, yet Indian law is rarely selected as the governing law of contracts in proceedings administered by the world's leading arbitral institutions. The uncertainty associated with the enforcement of liquidated damages clauses under Indian law is consistently identified by practitioners and institutional commentators as a material contributing factor.[57]

The aspiration to position India as a leading hub for international commercial arbitration requires attention to the substantive law of contract as well as the procedural architecture of arbitration. Uncertainty in the enforcement of fundamental contractual risk-allocation mechanisms — including liquidated damages provisions — constitutes a material disincentive to choosing Indian law as governing law, and to selecting India as an arbitral seat.[58]

VIII. Proposed Reforms

The foregoing analysis supports the case for targeted reform of the Indian legal framework governing liquidated damages. Three specific proposals are advanced.

A. Statutory Presumption of Enforceability in Arm's-Length Commercial Contracts

The most fundamental reform required is an amendment to Section 74 of the Indian Contract Act to introduce a structured presumption of enforceability for liquidated damages clauses negotiated between commercially sophisticated parties acting at arm's length. Under such a reformed provision, where a liquidated damages clause has been freely negotiated between parties of comparable bargaining strength, courts should be required to enforce the clause according to its terms, without conducting an independent assessment of 'reasonable compensation'. The presumption should be rebuttable upon demonstration that the clause is unconscionable, the product of significantly unequal bargaining power, or imposes a detriment so grossly disproportionate to any legitimate commercial interest that it cannot rationally represent a genuine allocation of risk.

This formulation draws upon the *Makdessi* framework's emphasis on legitimate interest proportionality, while adapting it to India's statutory context. The reform would preserve

University of London 2021).

[57]International Chamber of Commerce, *ICC Dispute Resolution Statistics 2024* (ICC, June 2025).

[58]Singapore International Arbitration Centre, *SIAC Annual Report 2024* (SIAC, March 2025).

judicial protection against oppressive provisions in contracts involving weaker parties while eliminating unnecessary supervisory intervention in negotiated commercial arrangements.

B. Reallocation of the Evidentiary Burden

A second reform concerns the allocation of the evidentiary burden in Section 74 proceedings. Under the current framework, the claimant bears the initial burden of proving both breach and resulting loss, before the burden shifts to the defendant. This allocation is inconsistent with the commercial reality that a liquidated damages clause represents a pre-agreed allocation of risk that should be presumptively enforceable, and that it is the party resisting enforcement who should bear the obligation of demonstrating grounds for departure from the parties' agreement.

The Bharatiya Sakshya Adhiniyam, 2023, or Section 74 itself, should be amended to provide that, once a claimant has established breach of a contract containing a liquidated damages clause, the burden of proving that the clause is unreasonable, unconscionable, or disproportionate shifts to the party in breach. This reform would bring the allocation of the evidentiary burden into alignment with the commercial presumption of enforceability and reduce the burden on innocent parties seeking to enforce a pre-agreed remedy.[59]

C. Judicial Recognition of the Primary/Secondary Obligation Distinction

The third reform is directed at the development of a principled framework for distinguishing between primary and secondary contractual obligations in the context of Section 74. The Supreme Court of India should recognise, in an appropriate case, the analytical distinction between a conditional primary obligation — one that defines the commercial terms of the parties' agreed exchange — and a secondary remedial obligation that is imposed as a consequence of breach. Clauses properly characterised as primary obligations should not be subject to the Section 74 supervisory assessment; they should be enforced as ordinary contractual debts.

The *Makdessi* framework provides a principled doctrinal foundation that Indian courts could adapt, with appropriate modifications to accommodate the statutory context of Section 74. Authoritative Supreme Court guidance would provide the certainty currently lacking in this area and would reduce the inconsistency and unpredictability observed in decisions of the High Courts.[60]

IX. Conclusion

English and Indian law both trace their origins to the common law tradition and historically shared a common hostility to contractual provisions that functioned as penalties. The evolutionary trajectory of the two systems has, however, diverged substantially in the contemporary period.

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[59]London Court of International Arbitration, *LCIA Annual Casework Report 2024* (LCIA 2024).
[60]Herbert Smith Freehills, 'Inside Arbitration: Choosing Wisely — Selecting a Seat for India-Related Arbitrations' (2023).

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English law, as reconstituted by the UK Supreme Court in *Makdessi*, has embraced a commercial philosophy that affords considerable weight to freedom of contract, recognises the plurality of legitimate interests that sophisticated parties may seek to protect through liquidated damages provisions, and confines judicial intervention to cases of genuine disproportionality. The result is a framework that provides commercial parties with a high degree of certainty that their pre-agreed risk allocations will be respected by the courts and by arbitral tribunals applying English law.
Indian law, as shaped by Section 74 and the Supreme Court's decisions in *Fateh Chand*, *Saw Pipes*, *Kailash Nath*, and *Construction and Design*, retains a pronounced compensatory orientation that subjects all stipulated payment provisions to independent judicial assessment of 'reasonable compensation'. While this framework was designed to protect against oppressive provisions in contracts involving unequal bargaining power, its undifferentiated application to sophisticated commercial agreements undermines the contractual certainty that liquidated damages clauses are specifically designed to generate.

The empirical data from international arbitral institutions demonstrates that the doctrinal characteristics of a jurisdiction's substantive contract law are a material factor in governing law selection by international commercial parties. India's ambition to establish itself as a leading hub for international commercial arbitration will require not only procedural reform of its arbitration framework but substantive reform of the legal principles governing the enforcement of commercial contracts. The three reforms proposed in this paper — a presumption of enforceability in arm's-length commercial agreements, a reallocation of the evidentiary burden, and judicial recognition of the primary/secondary obligation distinction — offer a coherent and targeted pathway towards aligning Indian law with the commercial expectations of international contracting parties, without sacrificing the protective function of the law in contexts where that protection remains warranted.