

News

Commercial Law Monologues: Section 74 of the Indian Contract Act and Conditional Primary Obligations: Evaluating Cavendish v. Makdessi in India



The article compares Section 74 of the Indian Contract Act, which governs Conditional Primary Obligations in India, with the penalty rule under English law as explained in Cavendish v. Makdessi.

In *Photo Production Ltd. v. Securicor Transport Ltd.*, reported at [1980] 2 WLR 283, Lord Diplock clarified that "every failure to perform a primary obligation is a breach of contract." By

implication of common law, the contract violator's secondary obligation is to compensate the other party financially for the loss he suffered as a result of the breach.

In English law, the legality of a financial obligation resulting from a contract violation has typically been evaluated based on whether the specified amount is a penalty or liquidated damages. **[See pages 86 and 87 of *Dunlop Pneumatic Tyre Co Ltd v. New Garage and Motor Co Ltd*, reported at [1915] AC 79].**

For instance, Lord Diplock held in *Scandinavian Trading Tanker Co Ab v. Flota Petrolera Ecuatoriana*, reported at [1983] 2 AC 694, at page 702, 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 he is significantly greater than that amount.

In *Cavendish Square Holdings BV v. Talal El Makdessi*, reported at [2015] UKSC 67 ("Cavendish"), the fundamentals of the penalty rule under English law were reexamined. The Supreme Court of the United Kingdom ("UKSC") ruled in Cavendish that "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" is the standard for judging whether a contractual provision is a penalty.

More significantly, the UK Supreme Court ruled in Cavendish that a contractual provision may not impose an obligation to carry out a certain conduct, but it may stipulate that the contracting party will be required to pay a certain amount of money if the performance is not carried out. Such a payment would be considered a "conditional primary obligation." It was also decided that when a primary commitment is broken, a conditional primary obligation may occasionally be triggered as well.

Based on the rules established in a number of English cases, some of which are mirrored in Cavendish, the question of whether a contractual commitment to pay a certain amount of money is a conditional primary obligation or a secondary obligation would depend on how the contract is construed. For instance, if there is a strong business case for establishing such a conditional primary obligation, its main goal is not to punish the contract-breaker but rather to compensate the innocent party for the harm caused by the breach. One such provision would be a price adjustment clause that is activated in the event of a contract violation. In general, a

secondary duty will resemble a claim for damages, but a conditional primary obligation will resemble a contractual debt.

Additionally, Cavendish acknowledges that a contractual commitment to pay a certain amount of money cannot be subject to the penalty doctrine under English law if it is determined to be a conditional primary obligation (at least according to Lord Neuberger and Lord Sumption, with whom Lord Carnwath agreed).

Generally speaking, Indian law should follow the guidelines established by the UK Supreme Court in Cavendish with regard to conditional primary responsibilities. One could, however, hear a possible case that Section 74 of the Indian Contract Act, 1872, as amended (the "Indian Contract Act") should be used to thoroughly test such an obligation to pay a specific amount of money following the breach of a contract.

Indian law's conditional primary responsibilities

According to the prevailing opinion, Section 74 of the Indian Contract Act governs a sum specified in the contract or any other stipulation by way of penalty with the aim of compensating the innocent party for the loss it suffered due to a breach of an obligation to which that stipulation is tied. As a result, only secondary duties are covered by Section 74 of the Indian Contract Act; main responsibilities are not [see Ponnuswami Naicken v. Nadimuthu Chetty, reported at (1917) 6 LW 421, at page 425].

However, under Indian law, as it might also be under English law, the enforceability of an obligation to pay a certain amount of money that is triggered upon the breach of a primary obligation under a contract should need a more thorough analysis.

In order to determine whether a conditional primary obligation is enforceable under Indian law, three main scenarios must be evaluated: (i) when a conditional primary obligation is clearly predicated upon a non-breach event; (ii) when a conditional primary obligation is caused by the breach of a primary obligation; and (iii) when a conditional primary obligation is predicated upon the occurrence of multiple events, some of which may amount to a breach of a contract.

Situation I:

Sections 31 to 33 of the Indian Contract Act apply when a conditional primary obligation is based on a non-breach occurrence. As demonstrated in *Indiabulls Properties Private Ltd. v. Treasure World Developers Private Ltd.*, reported at 2014 SCC Online Bom 4768, at paragraphs 53, 58, and 59, such a conditional primary obligation is outside the scope of Section 74.

Situation II:

Indian courts are more inclined to interpret a duty caused by a primary obligation violation as a secondary obligation rather than a conditional primary obligation when a conditional primary obligation is based on that breach. In actuality, Section 74 of the Indian Contract Act's usage of the phrase "when a contract has been broken" makes it difficult to distinguish between a conditional primary obligation and a secondary obligation. Because the obligation is triggered upon the breach of a contract, courts frequently apply the principles of Section 74 of the Indian Contract Act without further investigation [see *DAG Private Limited v. Ravi Shankar Institute for Music and Performing Arts*, reported at 2023 SCC Online Del 3293, at paragraphs 117 to 120].

However, some Indian courts have begun to investigate the true nature of the obligation and have determined that the payment of a certain amount of money in the event of a contract breach is a conditional primary obligation that is essential to the contractual bargain. They have also enforced such stipulations [See *Indian Oil Corporation Ltd. v. Fiberfill Engineers*, reported at (2025) 316 DLT 172, at paragraphs 37, 38, 51]. However, the evolution of Indian law on this topic is still proceeding. In addition to the English law-recognized tests for determining whether a stipulation of this kind is a conditional primary obligation or a secondary obligation, Indian courts may adopt additional aspects of these tests that are unique to the Indian context.

Situation III:

Section 74 of the Indian Contract Act does not always apply to conditional primary obligations that are dependent on multiple circumstances, some of which could constitute a breach of contract. In this situation, the investigation would be to determine the actual nature of the obligation, even if it is the result of a violation. In the case of *Videocon Telecommunications Ltd. v. IBM India Private Ltd.*, reported at 2018 SCC Online Del 11606, at paragraphs 46, 47, it may be clear that a conditional primary obligation is part of the contractual consideration on the occurrence of several stipulated events, one or more of which may be a breach of the

contract, rather than being intended to remedy the loss caused by breach.

In conclusion

Nevertheless, Section 74 of the Indian Contract Act was passed under a situation that was exclusive to India. Therefore, it is essential that courts exercise caution when determining whether a clause requiring payment of a certain amount of money in the event of a contract breach is a conditional primary obligation or a secondary obligation. Under Indian law, courts should be able to examine a true secondary responsibility that is only cleverly constructed as a conditional primary obligation.

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