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# THE EFFECT OF BREACH OF CONTRACT ON ONGOING COMMERCIAL RELATIONSHIP

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## 1. INTRODUCTION

Converting informal conversations to a formal legally binding agreement, Contracts have been playing a significant as well as a critical role in commercial relationships, commanding over business's commercial, financial and legal matters. Thus, “ **Commercial contracts are those legally binding agreements commanding business transactions, timelines, obligations and repercussions in case of the party fails to keep up with the terms and agreements of the contract reducing the levels of risk to a business ensuring minimum disputes amongst the parties.**”<sup>1</sup>

Nevertheless, if one of the agreed parties fails to keep up with the agreed terms , then it results in negative ramification to the party, and therefore such breaches and issues and breaches are governed by Indian Contract Act,1872<sup>2</sup>. “**A breach of contract occurs when a party thereto renounces his liability under it, or by his own act makes it impossible that he should perform his obligations under it or totally or partially fails to perform such obligations.**”<sup>3</sup>

There are types of contracts:

- i. **Actual Breach-** When one of the agreed parties fails to perform the obligations according to the contractual terms and agreements. It can be due to non performance or delay in performance from either side. Therefore, the injured party can claim for remedy.
- ii. **Anticipatory Breach-** When a party declares or informs the other party its failure and incapacity to comply its actions with the contractual terms prior to its performance date.

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<sup>1</sup> AVTAR SINGH, LAW OF CONTRACTS AND SPECIFIC RELIEF 453 (12<sup>th</sup> ed. 2017).

<sup>2</sup> The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).

<sup>3</sup> AVTAR SINGH, LAW OF CONTRACTS AND SPECIFIC RELIEF (12<sup>th</sup> ed. 2017).

- iii. **Minor breach-** When a party fails to perform a very small or insignificant part of the contract that does not affect the party and the contract at large and hence, the injured party cannot terminate the contract but still demand for the estimated compensation which are usually settled without intervention of court.
- iv. **Material Breach-** When a party fails to perform a very significant obligatory part of the contract which affects the other party at large that it dissolves the whole purpose of the contract and refrains the other party to benefit from the same. Therefore, the injured party can terminate the contract.
- v. **Mutual Breach-** Where all the parties mutually fails to perform the terms and agreements of the contract. However, a sole party is not at fault and hence, the contract can be declared void and the parties can enter into a different new contract altogether.

## 2. RESEARCH QUESTIONS

- 1. To what extent does the Breach of Contract affect the commercial relations?
- 2. What legal remedies and resolution mechanisms are available to the parties in the contract when in commercial relationships.

## 3. RESEARCH OBJECTIVES

- i. To examine the Breach of Contract affect commercial relations.
- ii. To analyze legal remedies and resolution mechanisms are available to the parties in the contract when in commercial relationships.

## 4. RESEARCH CONTENT

### 4.1 CONCEPT ANALYSIS

Breach of Contracts in commercial relationships may unequivocally damage and negatively impact the parties causing financial losses, mistrust, reputational damage, legal repercussions, triggering overall growth of commercial entity when party fails to keep up with the contractual terms and agreements.. In order to attain financial stability, recover the damage caused to the goodwill and reputation of the business, delays in the operation and a multidimensional growth,

it is necessary for both the parties to honor their contractual obligations.

## 4.2 LEGAL ANALYSIS

To avoid serious repercussions that might result in the dissolution of the commercial entity, there is The Indian Contract Act, 1872<sup>4</sup>, that governs and provides a resilient legal framework such as Section 37 which provides a provision stating the obligation of parties to perform the obligations as per the contract and Section 73- 75, <sup>5</sup>which deals in the consequences of the breach of contract and the compensation arising for the losses. The contracts may have pre estimated damages clause, termination clause , and arbitration clause, where the aggrieved party is entitled to compensation such as monetary compensation, specific performance and injunctions. In addition to the breaches, parties also resort to Alternative Dispute Redressal (ADR) Mechanisms governed under **The Arbitration and Conciliation Act, 1996**, which serves as a preferred route of resolving contractual disputes through **Negotiation, Mediation, Conciliation and Arbitration** without the intervention of courts.<sup>6</sup>

## 4.3 EXCEPTIONS

- i. **Force Majeure-** Non- performance is excused in the event that may become impossible to perform that are beyond human control, may be disasters, pandemics, war, or government prohibition. This may ensure that business entities are not punished unfairly.
- ii. **Minor Breach-** The previous breach may become ineffective where both parties agree to change, alter the terms and cease the initial breach. Commercial dealings tends to be negotiated, comprises instead of flexibility rather than enforcing the breach.
- iii. **Novation or Substitution-** In the case where a new contract is formed, substituting the initial contract, the breach in the old contract does not have a force of law.
- iv. **Waiver by Aggrieved Party-** The breach may be expressly or impliedly waived by the party or person who suffers the legal injury, as a form of acceptance or either defective or

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<sup>4</sup> The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).

<sup>5</sup> The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).

<sup>6</sup> The Arbitration and Conciliation Act, 1996, Acts of Parliament, 1996 (India).

timely performance. When this happens, the party at fault is released and the commercial reality is that parties typically value continued over rigorous compliance

#### 4.4 CASE LAWS

Hon'ble Supreme Court reinforced the importance of right to claim liquidated damages when compensation is concerned, In a landmark judgement of *Construction and Design Services v. Delhi Development Authority (2015)*<sup>7</sup>, where the contractor (Construction and Design Services) fails to construct the sewerage pumping stations on time, whereas the contract clearly stated that if there are delays in the work , CDS has to pay 1 percent of the contract value per day. Invoking the liquidated damage clause filed against DDA, while CDS argued that there is no proven actual loss to the party. The court ruled in favour of Delhi Development Authority underlining the significance of the liquidated damages clause, even if no actual loss has been incurred highlighting the importance of timelines and professionalism in commercial relationships to prevent it from actual losses.

Another important case, *Kailash Nath Associates v. Delhi Development Authority ,2015*,<sup>8</sup>shedding light on key aspects of effects of breach of contract. The petitioner ( Kailash Nath Associates) had one the bid for the plot in the auction arranged by Delhi Development Authority. The contract demanded to pay the earnest amount at the time of bid and rest after the proceedings of the contract, therefore, Kailash Nath Associates deposited the earnest amount and due to the delays from the end of DDA for the demand letters and acceptances, KNA could not deposit the final amount, hence, the party filed a lawsuit against KNA forfeiting the earnest amount as well, stating it to be called as a breach of contract. The Supreme court of India ruled against DDA, that mere contractual clauses are not sufficient for the party until there is actual loss or harm caused stressing over the balanced form of contract that is lawful, justified in the eyes of law, that does not overshadow the weaker party due to mere unjust contractual terms maintaining standard forms of commercial contracts highlighting fair functioning.

A case which appointed an arbitrator, understanding the statutes of commercial contracts with termination clauses, arbitration clause and distributorship agreements *Indian Oil Corporation*

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<sup>7</sup> Construction & Design Services v. Delhi Development Authority, (2015)14 S.C.C. 263 (India).

<sup>8</sup> Kailash Nath Associates v. Delhi Dev. Auth., (2015) 4 S.C.C. OnLine SC 445 (India).

*Ltd. v. Bhagawan Balasai Enterprises & Anr.*,<sup>9</sup> IOC entered into a distributorship agreement, but the contract held a termination clause stating that the contract can be terminated by notice. While, IOC terminated the contract with a notice, however, BBE filed against IOC marking the termination as unlawful and stating it be causing financial damages to the party. The arbitration highlighted that termination by IOC was lawful, since the contract consists of clause as such underlining the legal complexities of clear contractual terms. And establishing a clear understanding of termination clauses, arbitration.

Apart from this, the courts highlighted the importance of equitable remedies, *P.Ramasubbamma v. V. Vijayalakshmi & Ors.* (2022)<sup>10</sup>, where court enabled the specific performance of the sales deed mentioned in the contract in favour of Ramasubbama, apart from monetary compensation because not in every situation monetary compensation serves as an adequate restitution to the party. The continuation to the supply of raw materials to the aggrieved party highlights the need for continuation of business activities for the convenience. Specifically, in *the Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc. (BALCO)*, 2012<sup>11</sup>, where the court shed a light upon arbitration as a mode of restitution emphasizing on flexibility and functioning of commercial entities highlighting the role of Alternative Dispute Redressal (ADR) Mechanisms in India.

#### 4.5 COMPARATIVE ANALYSIS

In India, breach of contract is regulated by the Indian Contract Act of 1872<sup>11</sup> by which damages, specific performance and injunctions are offered as remedies. The compensatory damages are usually granted by the courts to put the aggrieved party in the scenario in which would have been in the absence of the breach. Where monetary relief will not adequately cover the aggrieved party, specific performance may also be obtained under special contracts such as subject-matter contracts<sup>12</sup>. Mediation or arbitration resolutions may be encouraged by courts and the arbitral tribunals as an alternative to resolving business related cases and continuing business as usual in the case of commercial partnerships, infrastructure development projects, joint venture and long-term supply partners<sup>14</sup>. In common law jurisdictions, such as the UK

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<sup>9</sup> Indian Oil Corporation Ltd. V. Bhagwan Balasai Enters. & Anr., (2017) S.C.C. OnLine SC 1325 (India). <sup>10</sup> P. Ramasubbamma v. V. Vijayalakshmi & Ors., (2022) S.C.C. OnLine SC 445 (India).

<sup>10</sup> Bharat Aluminium Co. v. Kaiser Aluminum Tech. Servs. Inc., (2012) 9 S.C.C. 552 (India).

<sup>11</sup> The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).

<sup>12</sup> Abhishek Tripathi, *Breach of Contract and Remedies under Indian Law*, 5 NALSAR L. REV. 214 (2019) <sup>14</sup> Shubhangi Singh, *Alternative Dispute Resolution in Commercial Contracts in India: Emerging Alternative Dispute Resolution in Commercial Contracts in India: Emerging Trends*, 12 NUJS L. REV. 133 (2020).

and the USA the main remedy is damages, specific performance being regarded as being exceptional. Business relationships may include a few breaches and may endure them but the actual serious ones may cause the contract to be finished, or reworked, and future contracts will take more measures to ensure misconduct: stricter conditions or clauses against misconduct. Otherwise, under civil law (such as in France and Germany), specific performance is the usual remedy and the courts might order the fulfilment of contracts. This can promote maintenance of commercial relations because there will be continuity in performance. In cross-border business, conciliating tribunals such as that of the ICC or the SIAC <sup>13</sup> promote settlement by agreement as a means of preserving amicability. Irrespective of jurisdiction, the breaches generally cause a negative impact on trust, shift the power balance of negotiations, and sustainable commercial relationships.

## 5. CONCLUSION

Contracts have been providing a lifeline to all the commercial relationships laying the foundation of trust, mutual understanding, professionalism and stability in the business dynamics. It is specified under Indian Contract Act, 1872 <sup>14</sup> provides a legal backing to the commercial transactions, emphasizing flexibility, foster growth and avoiding disputes with uninterrupted functioning keeping up the reputation and goodwill of businesses.

For a law student, it is important to have a clear understanding of breach of contracts and its consequences and the role of judiciary and other mediums such as arbitration, mediation, defining the role of Alternative Dispute Mechanisms in commercial relationships without the intervention of courts. While breach of contracts might result in financial loss, interrupted supply chains, delays in operational work, employee discouragement that causes serious repercussions to the commercial entities that is not only satisfied by monetary compensations but demands more than that estimated according to the situation at that particular time.

Through the landmark judgements as discussed in the project, the legal system has established and maintained a balance between the legal contractual considerations, the law governing it, the implications and most importantly making it fair and just so that no party suffers a loss

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<sup>13</sup> Ashok R. Patil, *Commercial Arbitration and Breach of Contract in India*, 10 INDIAN J. ARB. L. 77 (2021).

<sup>14</sup> The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).

which it is not obliged to, maintaining healthy commercial relationships for the betterment of either of the parties entered into the contract.

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