

LAW RELATING TO LOSS OF PROFIT CLAIMS

Most of the construction and infrastructure arbitrations in which termination happens due to the lapses attributable to the employer, the major claim of the contractor shall be “Loss of Profit”. Because the employer enters into the contract for the execution of certain works and the contractor enters into the contract to earn certain profits by executing that work. Hence, the expectation of profit by the contractor in a contract is his right.

Ordinarily, when a contractor submits his tender in response to an invitation to tender for a works contract, a reasonable expectation of profit is implicit in it and its loss has to be compensated by way of damages if the party to the contract is guilty of breach of contract by rescinding the contract illegally. Hence the party entrusting the contract commits breach of contract by illegally terminating the same, the contractor would be entitled to claim damages for loss of profit which was expected to be earned by undertaking the contract. So, a Loss of profit claim, is a claim which is made by the contractor to get compensated for the loss of profit that was incurred due to an illegal termination. The basic assumption of this claim is that the contractor would have got a certain amount of profit if the contract was not terminated by the employer and since the contract was illegally rescinded the contractor lost that amount.

But if the contractor fails to prove that the rescission of contract was illegal, it would not be entitled to claim any loss of profit. The burden of proving that the termination is illegal is on the Contractor. However, a claim by a contractor for recovery of amount as damages as expected profit out of contract cannot be disallowed on the ground that there was no proof that he suffered actual loss to the extent of amount claimed on account of breach of contract¹. This is because

¹ MSK Projects India (JV) Limited Vs State of Rajasthan and Another (2011) 10 SCC 573.

loss of profit is a compensation given to the suffering for the party as a loss of the expected profit and not as a damage towards some expenses.

What would be the measure of profit, would however depend upon facts and circumstances of the case. While estimating the loss of profit for the breach of contract, it would be unnecessary to go into the minute details of the Work expected in relation to the value of the contract. A broad valuation would be sufficient². In this case it was held by Supreme Court that the appellate court was, therefore, not justified in disallowing the claim of appellant of Rs.20,000 on account of damages as expected profit out of the contract which was found to have been illegally rescinded. In Mohamad Salamathullah Vs Government of AP³ it was held that 15% of contract price can be reasonable in a works contract towards loss of profit. There is no specific formulae to estimate the profit because business to business profit margins differ. If a party is able to demonstrate that the profit margin in a similar work is certain percentage, then the arbitrator or the court can take it as a basis for the granting of the claim.

It is important to note that the loss of profit can be claimed only on the balance work that is to be executed and not on the total value of the contract work. This is because for the work completed a contractor should have raised the invoice which includes the profit portion also. If the contractor did not receive the payment for the completed works, the contractor should make a claim for the payment due and not loss of profit for the total amount of the project. In the case of Batliboi, the Hon'ble Supreme Court of India held *"We have briefly referred to the principle applicable for computing the claim for compensation/damages in case of prevention. i.e., where the breach by employer is not fundamental and does not entitle the builder/contractor to cease the work, or, being fundamental, is not treated as repudiation by the builder/contractor. Measure of compensation/damages in such cases is the loss of profit arising*

² M/S. A.T. Brij Paul Singh Vs State of Gujarat (1984) 4 SCC 59 Page 9,10 & 12)

³ Mohamad Salamathullah Vs Government of AP³ (1977) 3 SCC 590

from reduced profitability or added expense of the work carried out⁴. In a given case, where there is a fundamental breach by the employer, the builder/contractor does not elect to treat the contract repudiated, he may still be entitled to raise a claim for loss of profit on the uncompleted work”

The usage of formulae such as Hudson’s, or Eichery’s formulae to ascertain the loss of overheads and profits has been judicially approved in the English cases cases of Peak Construction⁵, Whittel Builders⁶ and JF Finnegan⁷. Among the Indian cases Mc Dermott⁸ . But unfortunately, [Supreme Court](#) in a recent Judgment in the matter of Unibros Vs All India Radio⁹ confused loss of profit and loss of opportunity and held that there should be clear evidence for “Loss of profit” instead of saying “loss of profit due to missed opportunities”. Barring these few exceptions, law is well settled relating to Loss of Profit that it does not require actual evidence of loss and the arbitrator can make guess work or apply formulae based on certain reasonable assumptions.

⁴ See Hudson’s Building Contracts (10th Edition) pp450,596

⁵ Peak Construction Vs McKinney Foundations Limited (1970) 1 BLR 114

⁶ Whittel Builders Vs Chesterie- Street District Council (1987) 40 BLR 82

⁷ JF Finnegan Ltd., Vs Sheffield City Council (1988) 43 BLR 124

⁸ Mc Dermott International (2006) 11 SCC 181

⁹ Unibro Vs All India Radio (2023) SCC Online SC 1366