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Supreme Court has indicated the evidence required for awarding claims for loss of profit and overheads

The Supreme Court of India (“**Supreme Court**”), in 2 (two) judgments i.e., *M/s Unibros v. All India Radio*¹ (“**Unibros Judgement**”) and *Batliboi Environmental Engineers Limited v. Hindustan Petroleum Corporation Limited*², (“**Batliboi Judgement**”) has indicated the evidence required to be proved by a contractor for being entitled to a claim for loss of profit and overheads (due to delayed completion of a contract). The Supreme Court further held that in the absence of such evidence, the arbitral awards that grant claims for loss of profit or overheads (based merely on a formula), would be liable to be set aside under Section 34³ of the Arbitration & Conciliation Act, 1996 (“**Arbitration Act**”).

Unibros Judgment

In this case, the completion of a construction contract was delayed due to reasons attributable to the employer (i.e. on account of delay in handing over site and drawings etc.). In the arbitration, the contractor raised claims for (a) compensation for increased prices/rates after the scheduled contract period; (b) compensation for extended stay of establishment, machinery, etc.; and (c) loss of profit.

The arbitral tribunal rejected the claims for increased prices and establishment and machinery cost, due to the lack of evidence on record. However, the tribunal awarded the claim for loss of profit on the basis that:

1. The party responsible for the breach of contract is liable for reasonably foreseeable losses.
2. It was reasonable to assume earning of expected profits elsewhere by the contractor.
3. The contractor was not required to establish the exact amount of gain or loss with absolute certainty and instead, presenting fairly persuasive and the best available evidence was sufficient.
4. The tribunal used the Hudson Formula⁴ to quantify the claim for loss of profit.

A single Judge of the Delhi High Court set aside the award under Section 34 of the Arbitration Act which was upheld by the Division Bench in an appeal under Section 37 of the Arbitration Act.

¹ 2023 INSC 931. Judgement dated October 19, 2023.

² 2023 INSC 850. Judgement dated September 21, 2023.

³ Applications for setting aside arbitral awards are made under Section 34 of the Arbitration Act.

⁴ Hudson’s formula has received legal acceptance and is generally used by courts and other judicial bodies in awarding overheads and profit. The Hudson’s formula works on the numbers and figures contemplated in the contract as envisaged by the parties at the time of signing of the contract rather than the actuals.

Finding in Unibros Judgment

In the Special Leave Petition filed against the judgment passed by the Division Bench, the Supreme Court held that:

1. To claim loss of profit, the contractor (claimant) will have to establish the following:
 - a) first, that there was a delay in the completion of the contract;
 - b) second, that such delay is not attributable to the claimant;
 - c) third, the claimant's status as an established contractor, handling substantial projects; and
 - d) fourth, credible evidence to substantiate the claim of loss of profitability.
2. Though the evidence required would depend on the facts and circumstances of each case, it may generally include independent contemporaneous evidence, such as:
 - a) other potential projects that the contractor had in the pipeline that could have been undertaken if not for the delays,
 - b) the total number of tendering opportunities that the contractor received and declined owing to the prolongation of the contract,
 - c) financial statements, or
 - d) any clauses in the contract related to delays, extensions of time, and compensation for loss of profit.
3. Formulae such as the Hudson Formula are well accepted but cannot apply in vacuum. These formulae can be useful to assess losses only if the contractor has shown, with evidence, the loss of profits and opportunities it suffered owing to the prolongation of the contract.

Batliboi Judgment

In this case there was a delay in completion of a turnkey contract for detailed engineering including civil and structural design, supply and erection, testing and commissioning of a Sewage Water Reclamation Plant. After completing 80% of the work, the contractor abandoned the contract and raised a claim, *inter alia*, for loss of profit and overheads due to the delay caused to the project.

The arbitral tribunal awarded 10% of the contract value each, towards loss of profit and overheads.

In a petition filed under Section 34 of the Arbitration Act, a Single Judge of the Bombay High Court upheld the award. However, the Division Bench allowed the appeal under Section 37 of the Arbitration Act and set aside the award.

Finding in Batliboi Judgment

In a Special Leave Petition filed against the judgment of the Division Bench, the Supreme Court held that:

1. When the completion of a contract is delayed and the contractor claims (a) that he has suffered a loss arising from depletion of his income from the job and hence turnover of his business, and (b) for the overheads in the form of workforce expenses which could have been deployed in other contracts, the contractor has to prove that:
 - i) There was other work available that he would have secured if not for the delay, by producing invitations to tender which were declined due to insufficient capacity to undertake other work.
 - ii) The same may also be proven from the books of accounts to demonstrate a drop in turnover and establish that this result is from the particular delay, rather than from extraneous causes.
 - iii) If loss of turnover resulting from the delay is not established, it is merely a delay in receipt of money, and as such, the builder/ contractor is only entitled to interest on the capital employed and not the profit.

2. Formulae for quantification of the claim, are only rough approximations of the cost impact of unabsorbed overhead and should therefore be applied with great care and caution to ensure fair and just computation. The court/tribunal should ensure that there is no double recovery, overlap with other claims or when payments are obtained by the contractor on account of variation(s), or any damages for breach.
3. Particularly, the court pointed out issues which may arise while using the Hudson formula and set out guidelines to be kept in mind if the said formula has to be applied as a last resort.

The Batliboi Judgment also re-visited in detail the scope and ambit of the court's power to review the awards under Section 34 of the Arbitration Act.

Conclusion

In the light of the Supreme Court judgments, contractors may now find it difficult to prove their claims for loss of profit and office overhead. In construction contracts, particularly executed through special purpose vehicles⁵ etc., it is difficult to prove lost opportunities and the books of accounts may not provide an accurate estimate of the loss sustained due to delay. Given the directions passed by the Supreme Court in these 2 (two) judgments, instead of awarding claims on the basis of broad estimates, arbitral tribunals would now be very conscious about the supporting evidence for the claims for loss of profit and head office overhead.

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⁵ Corporations incorporated to execute a single project.

This Prism has been prepared by:









Dhirendra Negi
Partner





Pragya Chauhan
Partner



Tanya Tiwari
Senior Associate

		
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