MAULA BUX

v.

UNION OF INDIA

August 19, 1969

[J. C. SHAH, ACTING C.J., V. RAMASWAMI AND A. N. GROVER, JJ.]

Indian Contract Act (9 *of* 1872), *s.* 74—*Deposit of money as guarantee for due performance of contract for supply of goods—Breach of contract—Forfeiture of deposit—Proof of loss suffered when necessary—Scope of section—"Whether or not actual damage or loss is proved to have been caused thereby", meaning of—Earnest money, what is.*

The appellant entered into a contract with the respondent to supply some goods and deposited a certain amount as security for due performance of the contract. It was stipulated that the amounts were to stand forfeited in case the appellant neglected to perform his part of the contract. When the appellant made defaults in the supply, the respondent rescinded the contract and forfeited the amount deposited. The appellant filed a suit for recovery of the amount with interest. The trial court decreed the suit, holding that the respondent was justified in rescinding the contracts, but could not forfeit the deposit, for, it had not suffered any loss in consequence of the default committed by the appellant. The High Court modified the decree and awarded the respondent a major portion of the amount deposited as damages. The High Court took the view that the forfeiture of a sum deposited by way of security for due performance of a contract, where the amount forfeited was not unreasonable s. 74 of the Contract Act had no application and that the deposits so made could be regarded as earnest money.

HELD : The High Court was in error in disallowing the appellant's claim.

(i) Earnest money is a deposit made by a purchaser to be applied towards part payment of the price when the contract is completed and till then as evidencing an intention on the part of the purchaser to buy property or goods. Forfeiture of earnest money under a contract for sale of property, if the amount is reasonable, does not fall within s. 74 of the Contract Act. [933 D].

Kunwar Chiranjit Singh v. *Har Swarup*, A.I.R. 1926 P.C. 1, relied on.

(ii) Where under the terms of the contract the party in breach has undertaken to pay a sum of money or to forfeit a sum of money which he has already paid to the party complaining of a breach of contract, the undertaking is in the nature of a penalty and, s. 74 applied thereto. [933 E-F]

Fateh Chand v. *Balkishan Dass*, [1964] 1 S.C.R. 515, relied on.

Contrary view in *Natesa Aiyar* v. *Appavu Padayachi*, (1913) I.L.R. 38 Mad. 178, *Singer Manufacturing Co.* v. *Raja Prosad*, (1909) I.L.R. 36 Cal. 960 and *Manian Patter* v. *Madras Railway Company*, (1906) I.L.R. 29 Mad. 188, disapproved.

The expression "whether or not actual damage or loss is proved to have been caused thereby" in s. 74 is intended to cover different classes of contracts which come before the courts. In case of breach of some contracts it may be impossible for the court to assess compensation arising from breach, while in other cases, compensation can be calculated in

A accordance with established rules. 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. [934 A-C]

In the present case it was possible for the respondent-Government to B lead evidence to prove the loss suffered but it did not attempt to do so.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 851 of 1966.

Appeal by special leave from the judgment and order dated December 20, 1963 of the Allahabad High Court, Lucknow Bench in First Civil Appeal No. 28 of 1954.

C *Jagdish Swarup, Solicitor-General, Yogeshwar Prasad, C. M. Kohli* and *G. R. Chopra,* for the appellant.

L. M. Singhvi and *S. P. Nayar,* for the respondent.

The Judgment of the Court was delivered by

Shah, Ag. C.J. Maula Bux—hereinafter called 'the plaintiff D —entered into a contract No. C/74 with the Government of India on February 20, 1947, to supply potatoes at the Military Headquarters, U. P. Area, and deposited an amount of Rs. 10,000 as security for due performance of the contract. He entered into another contract with Government of India on March 4, 1947 No. C/120 to supply at the same place poultry, eggs and fish for E one year and deposited an amount of Rs. 8,500/- for due performance of the contract. Clause 8 of the contract ran as follows :

"The officer sanctioning the contract may rescind his contract by notice to me/us in writing :—

(i) . . . . . .

F (ii) . . . . . .

(iii) . . . . . .

(iv) If I/we decline, neglect or delay to comply with any demand or requisition or in any other way fail to perform or observe any condition of the G contract.

(v) . . . . . .

(vi) . . . . . .

In case of such rescission, my/our security deposit (or such portion thereof as the officer sanctioning the contract shall consider fit or adequate) shall stand forfeited and be absolutely at the disposal of Government, without prejudice to any other remedy or action that the Government may have to take . . . .

> In the case of such rescission, the Government shall be entitled to recover from me/us on demand any extra expense the Government may be put to in obtaining supplies/services hereby agreed to be supplied, from elsewhere in any manner mentioned in clause 7(ii) hereof, for the remainder of the period for which this contract was entered into, without prejudice to any other remedy the Government may have."

The plaintiff having made persistent default in making "regular and full supplies" of the commodities agreed to be supplied, the Government of India rescinded the contracts—the first on November 23, 1947, and the second on December 2, 1947, and forfeited the amounts deposited by the plaintiff.

The plaintiff commenced an action against the Union of India in the Court of the Civil Judge, Lucknow, for a decree for Rs. 20,000/- being the amounts deposited with the Government of India for due performance of the contracts and interest thereon at the rate of 6 per cent. per annum. The Trial Court decreed the suit. The Court held that the Government of India was justified in rescinding the contracts, but they could not forfeit the amounts of deposit, for they had not suffered any loss in consequence of the default committed by the plaintiff. The High Court of Allahabad in appeal modified the decree, and awarded Rs. 416.25 only with interest at the rate of 3 per cent from the date of the suit. The plaintiff has appealed to this Court with special leave.

The Trial Court found in decreeing the plaintiff's suit that there was no evidence at all to prove that loss, if any, was suffered by the Government of India in consequence of the plaintiff's default, and on that account amounts deposited as security were not liable to be forfeited. In the view of the High Court, to forfeiture of a sum deposited by way of security for due performance of a contract, where the amount forfeited is not unreasonable, s. 74 of the Contract Act has no application. The Court observed that the decision of this Court in *Fateh Chand* v. *Balkishan Dass*(1) did not purport to overrule the previous "trend of authorities" to the effect that earnest money deposited by way of security for the due performance of a contract does not constitute penalty contemplated under s. 74 of the Indian Contract Act, that even if it be held that the security deposited in the case was a stipulation by way of penalty, the Government was entitled to receive from the plaintiff reasonable compensation not exceeding that amount, whether or not actual damage or loss was proved to have been caused, and that even in the absence of evidence to prove the actual damage or loss caused to the Govern-

(1) [1964] 1 S.C.R. 515.

A ment "there were circumstances in the case with indicated that the amount of Rs. 10,000 in the case of potato contract and Rs. 8,500/- in the case of poultry contract may be taken as not exceeding the reasonable compensation for the breach of contract by the plaintiff." The High Court further observed that the contract was for supply of large quantities of potatoes, B poultry and fish, which would not ordinarily be available in the market, and "had to be procured in case of breach of contract everyday with great inconvenience," and in the circumstances the Court "could take judicial notice of the fact that 1947-48 was the period when the prices were rising and it would not have been easy to procure the supplies at the rates contracted for". The High Court concluded :

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> ". . . . . taking into consideration the amount of inconvenience and the difficulties and the rising rate of prices, it would not be unfair if in case of such breach for the supply of such huge amounts of potatoes and poultry, we consider an amount of Rs. 18,500/- by way of damages as being not unreasonable."

D

Under the terms of the agreements the amounts deposited by the plaintiff as security for due performance of the contracts were to stand forfeited in case the plaintiff neglected to perform his part of the contract. The High Court observed that the deposits so made may be regarded as earnest money. But that view cannot be accepted. According to Earl Jowitt in "The Dic- E tionary of English Law" at p. 689 : "Giving an earnest or earnest-money is a mode of signifying assent to a contract of sale or the like, by giving to the vendor a nominal sum (*e.g.* a shilling) as a token that the parties are in earnest or have made up their minds." As observed by the Judicial Committee in *Kunwar Chiranjit Singh* v. *Har Swarup*(1) :

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> "Earnest money is part of the purchase price when the transaction goes forward : it is forfeited when the transaction falls through, by reason of the fault or failure of the vendee."

In the present case the deposit was made not of a sum of money by the purchaser to be applied towards part payment of the price G when the contract was completed and till then as evidencing an intention on the part of the purchaser to buy property or goods. Here the plaintiff had deposited the amounts claimed as security for guaranteeing due performance of the contracts. Such deposits cannot be regarded as earnest money.

Section 74 of the Contract Act provides :

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> "When a contract has been broken, if a sum is named in the contract as the amount to be paid in case

(1) A.I.R. 1926 P.C. 1 .

> of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for.
>
> . . . . . ."

There is authority, no doubt coloured by the view which was taken in English cases, that s. 74 of the Contract Act has no application to cases of deposit for due performance of a contract which is stipulated to be forfeited for breach : *Natesa Aiyar* v. *Appavu Padayachi*(1); *Singer Manufacturing Company* v. *Raja Prosad*(2); *Manian Patter* v. *The Madras Railway Company*(3). But this view is no longer good law in view of the judgment of this Court in *Fateh Chand's* case(4). This Court observed at p. 526 :

> "Section 74 of the Indian Contract Act deals with the measure of damages in two classes of cases (i) where the contract names a sum to be paid in case of breach, and (ii) where the contract contains any other stipulation by way of penalty.... The measure of damages in the case of breach of a stipulation by way of penalty is by s. 74 reasonable compensation not exceeding the penalty stipulated for."

The Court also observed :

> "It was urged that the section deals in terms with the right to receive from the party who has broken the contract reasonable compensation and not the right to forfeit what has already been received by the party aggrieved. There is however no warrant for the assumption made by some of the High Courts in India, that s. 74 applies only to cases where the aggrieved party is seeking to receive some amount on breach of contract and not to cases whereupon breach of contract an amount received under the contract is sought to be forfeited. In our judgment the expression "the contract contains any other stipulation by way of penalty" comprehensively applies to every covenant involving a penalty whether it is for payment on breach of contract of money or delivery of property in future, or for forfeiture of right to money or other property already delivered. Duty not to enforce the penalty clause but

(1) [1913] I.L.R. 38 Mad. 178.
(2) [1909] I.L.R. 36 Cal. 960.
(3) [1906] I.L.R. 19 Mad. 188.
(4) [1964] 1 S.C.R. 515.

A only to award reasonable compensation is statutorily imposed upon courts by s. 74. In all cases, therefore, where there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of contract which expressly provides for forfeiture, the court has jurisdiction to award such sum only as it con-
B siders reasonable but not exceeding the amount specified in the contract as liable to forfeiture.", and that,

> "There is no ground for holding that the expression "contract contains any other stipulation by way of penalty" is limited to cases of stipulation in the nature of an agreement to pay money or deliver property on
C breach and does not comprehend covenants under which amounts paid or property delivered under the contract, which by the terms of the contract expressly or by clear implication are liable to be forfeited."

Forfeiture of earnest money under a contract for sale of property—movable or immovable—if the amount is reasonable,
D does not fall within s. 74. That has been decided in several cases : *Kunwar Chiranjit Singh* v. *Har Swarup*(1); *Roshan Lal* v. *The Delhi Cloth and General Mills Company Ltd., Delhi*(2); *Muhammad Habibullah* v. *Muhammad Shafi*(3); *Bishan Chand* v. *Radha Kishan Das*(4); These cases are easily explained, for forfeiture of a reasonable amount paid as earnest money does not
E amount to imposing a penalty. But if forfeiture is of the nature of penalty, s. 74 applies. Where under the terms of the contract the party in breach has undertaken to pay a sum of money or to forfeit a sum of money which he has already paid to the party complaining of a breach of contract, the undertaking is of the nature of a penalty.

F Counsel for the Union, however, urged that in the present case Rs. 10,000/- in respect of the potato contract and Rs. 8,500 in respect of the poultry contract were genuine pre-estimates of damages which the Union was likely to suffer as a result of breach of contract, and the plaintiff was not entitled to any relief against forfeiture. Reliance in support of this contention was
G placed upon the expression (used in s. 74 of the Contract Act), "the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation". It is true that in every case of breach of contract the person aggrieved by the breach is not required to prove actual
H loss or damage suffered by him before he can claim a decree, and the Court is competent to award reasonable compensation in

(1) A.I.R. 1926 P.C. 1.
(2) I.L.R. 33 All. 166.
(3) I.L.R. 41 All. 324.
(4) I.D. 19 All. 490.

case of breach even if no actual damage is proved to have been suffered in consequence of the breach of contract. But the expression "whether or not actual damage or loss is proved to have been caused thereby" is intended to cover different classes of contracts which come before the Courts. In case of breach of some contracts it may be impossible for the Court to assess compensation arising from breach, while in other cases compensation can be calculated in accordance with established rules. 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.

In the present case, it was possible for the Government of India to lead evidence to prove the rates at which potatoes, poultry, eggs and fish were purchased by them when the plaintiff failed to deliver "regularly and fully" the quantities stipulated under the terms of the contracts and after the contracts were terminated. They could have proved the rates at which they had to be purchased and also the other incidental charges incurred by them in procuring the goods contracted for. But no such attempt was made.

Counsel for the Union, however, contended that in the Trial Court the true position in law was not appreciated and the parties proceeded to trial on the question whether the Government was entitled in the circumstances of the case to forfeit under cl. 8 of the terms of the contracts the deposits made for securing due performance of the contracts. Since there was no pleading and no issue on the question of reasonable compensation, an opportunity should be given to the parties to lead evidence on this point. But with the suit out of which this appeal arises was tried another suit filed by the plaintiff Maula Bux against the Union for a decree for Rs. 53,000 odd being the price of goods supplied under the terms of another contract with the Government of India. In that suit the Union claimed that it had set off the amount due to the plaintiff, amounts which the plaintiff was liable to pay as compensation to the Union for loss suffered because of the plaintiff's failure to carry out the terms of the contracts C/74 and C/120. The Trial Court held in that case that the Union failed to prove that any loss was suffered by it in consequence of the default by Maula Bux to supply potatoes, poultry, eggs and fish as stipulated by him. Against the judgment of that Court Appeal No. 2001 of 1966 is filed in this Court and is decided today. The High Court of Allahabad having confirmed the decree passed by the Trial Court, no useful purpose will be served by directing a fresh enquiry into the question whether the Union

A of India is entitled to recover from the plaintiff any reasonable compensation for breach of contracts and whether that compensation is equal to or exceeds the amounts deposited. Evidence on that question has already been led and findings have been recorded. In dealing with the Appeal No. 2001 of 1966 we have held that the Union has failed to establish by evidence that any B damage or loss was suffered by them which arose out of the default committed by the plaintiff. We decline therefore to afford another opportunity for leading the evidence as to the loss suffered by the Union on account of the failure on the part of the plaintiff to carry out the contracts.

C On the view taken by us it must be held that the High Court was in error in disallowing the plaintiff's case.

The High Court has held that the plaintiff is not entitled to any interest prior to the date of the suit. No argument has been advanced before us challenging that view. Since interest was not recoverable under any contract or usage or under the provisions D of the Interest Act, 1838 the High Court allowed interest at the rate of 3% per annum on Rs. 416.25 from the date of the suit, the rate of interest allowed on the claim decreed also should not exceed 3 per cent per annum.

We set aside the decree passed by the High Court and substitute the following decree :

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> "The Union of India do pay to the plaintiff Rs. 18,500/- with interest at the rate of 3% per annum from the date of the suit till payment."

The plaintiff was guilty of breach of the contracts. Considerable inconvenience was caused to the Military authorities because of F the failure on the part of the plaintiff to supply the food-stuff contracted to be supplied. Even though there is no evidence of the rates at which the goods were purchased, we are of the view, having regard to the circumstances of the case, that the fairest order is that each party do bear its own costs throughout.

Y.P. *Appeal allowed.*