
(2000) 11 MAD CK 0156
In the Madras High Court
Case No : Civil Suit No. 160 of 1997

A. Murali and Co.

APPELLANT

Vs

State Trading Corporation of India Ltd.

RESPONDENT

Date of Decision : 30-11-2000

Acts Referred:

Contract Act, 1872 — Section 74

Citation : AIR 2001 Mad 271

Hon'ble Judges : Prabha Sridevan, J

Bench : Single Bench

Advocate : K.M.K. Doss, for the Appellant; N. Sridharan, for the Respondent

Judgement

Prabha Sridevan, J.—The suit is for refund of Rs. 6,85,000/- together with interest at 21%.

2. The plaintiff, an importer, responded to the tender floated by the defendant-corporation for sale of dunpeas. The tender was issued by a fax message dated 8-2-1994. It was a high seas sale. The fax message contained the tender conditions. One of the conditions is payment of 5% of the sale value as earnest money deposit ("EMD" in short) within 48 hours from the date of conclusion of sale. The plaintiff agreed to purchase 5000 MT of dunpeas by reply telex message dated 16-2-1994. It was indicated by the plaintiff that the 5000 MT would be purchased in the name of the plaintiff and their associates. The break up details were also given in the said message. The defendant accepted the offer on 17-2-1994 subject to the condition of immediate payment of 5% of the sale value of 5000 MT as EMD on or before 21-2-1994. On 19-2-1994, the EMD was paid by cash into the bank account of the defendant in the name of the four tenderers (plaintiff and the three associates). The details were also intimated to the defendant with an assurance that internal Letter of Credit ("LC" in short) will be opened. The plaintiff also simultaneously presented applications to its bankers to open the LC for 100% value of 5000MT. The plaintiff was informed by the bank that as a portion of the credit limit has already been utilized by the plaintiff the

balance credit available could only be extended to a sum of Rs. 180 lakhs. The sale being a high seas sale was urgent in nature. The plaintiff not having the time to arrange for higher credit limits, brought his difficulty to the notice of the defendant on 22-2-1994 and requested them to treat the offer for only 3000MT instead of the original 5000MT and for refund of EMD for the unlifted 2000MT. Letter of Credits were immediately opened for a value 2500MT and cash payment was made for the balance 500MT. This payment was made well in advance before the ship arrived at Tuticorin port. The defendant accepting the documents for the revised value cleared 3000MT of dunpeas. No delivery order was issued for the balance 2000MT. The plaintiff was directed to supply the HDPE bags to clear the cargo for the balance 2000MT and also certain unsold cargo of the defendant (not covered by the suit transaction) and to arrange for the service of a surveyor. Full assistance was given by the plaintiff free of charge. Immediately after the 2000 MT were cleared from the ship, the defendant sold the goods and realized a profit of Rs. 2 Crores. In spite of this the defendant informed the plaintiff by a fax message dated 22-4-1994 that the sum of Rs. 6,85,000/- of the EMD proportionate to 2000MT which was not lifted was forfeited, because the plaintiff had failed to honour the contractual obligation. In view of the urgency in high sea sale, the fax message constituted the contract and therefore the arbitration clause, which is normally found in similar contracts was not included. Therefore, the plaintiff was denied the benefit of arbitration clause. The forfeiture of Rs. 6,85,000/- by an unilateral act was unreasonable. Even if the fax dated 25-4-1994, is the sole document which contains all the terms and conditions of the contract, the defendant is not entitled to forfeit the EMD, since no loss was sustained by the defendant. The EMD amount proportionate to the 3000MT for which full sale value was paid and goods cleared was refunded after a delay of three months. The plaintiff is entitled to commercial rate of interest and therefore, seeks recovery of Rs. 6,85,000/- together with interest at 21% per annum. The suit notice dated 28-10-1996 was replied by the defendant on 28-11-1996 which contained no valid reason for forfeiture of the EMD. Therefore the plaintiff filed the suit.

3. The defendant filed a written statement denying the averments in the plaint. According to the defendant the contract between the parties was spelt out in the tender dated 22-2-1994. The defendant also was willing to extend credit up to a maximum of 60 days from the date of sale as per clause 5 of Ex-P1. The plaintiff accepted the offer and agreed to purchase 5000MT of dunpeas. As regards the inability of the plaintiff to obtain LC for the full value of 5000MT, the defendant stated that the plaintiff should not have agreed to purchase without getting clearance from the Bankers. In any event the plaintiff could have availed the credit facility extended by the defendant. The excuse given by the plaintiff for not lifting the entire quantity was not valid. Because of the plaintiff's default in lifting the balance of 2000 MT, the defendant had to sell it elsewhere but they did not make a profit of a sum of Rs. 2 Crores. The delay in refunding the EMD for 3000MT was procedural. By virtue of Clause 6 of the tender the EMD had to be

forfeited. The terms of the tender did not provide for arbitration. The reason given by the plaintiff was something that he ought to have known with reasonable diligence. The defendant was always ready and willing to perform their side of the contract. The plaintiff had committed breach. Therefore, the defendant was justified in forfeiting the EMD by way of compensation for the breach. There is no question of interest being paid since the terms of the tender categorically stipulated that the EMD would be interest free. Therefore, the plaintiff is neither entitled to refund of EMD much less with interest, The suit should be dismissed. The following issues were framed for trial.

- (1) Whether the defendant had committed breach of contract ?
- (2) Whether the contract is capable of being performed ?
- (3) whether the plaintiff is entitled to refund of Rs. 6,85,000/- ?
- (4) Whether the defendant is liable to pay interest ? and
- (5) to what relief, if any, the plaintiff is entitled ?

4. Issue No.3 :

El is admitted by both the parties that the suit sale was a high seas Sale, which is an urgent transaction and that the plaintiff was sole tenderer.

Ex-Pi is the contract. The terms and conditions inter alia are that sale price of dunpeas is Rs. 6860 per MT, the minimum quantity to be lifted is 500MT. 5% of the sale value has to be paid as EMD. Clause 6 of this exhibit is the relevant clause and it states that,

"the EMD will be interest free and subject to forfeiture in case the buyer fails to honour his contractual obligations, including payment of vessel demurrage, if any".

Ex-P 14 was marked to show the language of the usual contract entered into by the defendant when it is local sale as opposed to high seas sale. Clause 10 of this exhibit relates to the forfeiture clause.

"In respect of any stock remaining unlifted by the party at the end of each one of the 4 periods indicated under item (4) above STC will be free to sell such stocks remaining unlifted. In such circumstances, the PBG given by the party at 5% sale value for entire stock will be forfeited which will be appropriated towards interest and carrying charges from 16-9-1996 till disposal of stocks and shortfall in sale price below Rs. 11,080/-PMT. In case, the PBG forfeited is not sufficient to cover above losses, the party should remit to STC the blance amount on its first demand."

It is true that the original contract between the plaintiff and the defendant was for a sale of 5000 MT of dunpeas. Ex- P2 is the plaintiff offer. Ex-P3 is the defendant's acceptance. Ex-P4 is the plaintiffs message giving the names of its associates who will be lifiting the stocks along with the plaintiff, By Ex-P6 dated

22-2-1994, the plaintiff wrote to the defendant that since the financial limit available to them with their bankers was only for 3000MT, they revised their offer to 3000 MT and asked for refund of the EMD in respect of 2000MT. The plaintiff also opened an internal LC for 3000MT and the defendant released the 3000MT. It is not denied by the defendant that this variation of the original contract was made by the plaintiff before the vessel arrived at Tuticorin. The defendant while releasing the cargo of 3000MT forfeited the balance EMD and intimated the same to the plaintiff. The plaintiff protested to this action by Ex-P7 dated 25-2-1994. To this, the defendant wrote a letter dated 18-4-1994, Ex-P9 stating that the request for refunding the proportionate EMD was not acceded to. Several representations were sent by the plaintiff, thereafter, Exs-P9, P10, P11 etc. But the defendant did not change from their original stand. The request of the plaintiff to refer the matter to arbitration was refused on the ground that there was no formal agreement between the parties, by the defendant's letter dated 21-6-1996, Ex-P12. Though under Ex-P12, the defendant took the stand that there was no formal agreement they issued the letter dated 9-7-96, Ex-P13 stating that Ex-Pi is the agreement, and it sets down the forfeiture clause and there was no arbitration clause in the said agreement. Ex-P15 is another reminder from the plaintiff to which Ex-P 16 is the reply. Ex-P 17 is the legal notice and Ex-P 18 is reply of the defendant. The partner of plaintiff was examined as P.W.I and he had stated in his chief examination that when the plaintiff restricted the quantity to be lifted to 3000 MT, the defendant had received the money and released the cargo to that extent. At that juncture the defendant had not informed the plaintiff that the balance EMD would be forfeited. D.W. 1, in his cross-examination, would say,

"As per Ex-P6, the plaintiff has requested to reduce the quantity from 5000 MT to 3000 MT. We accepted the plaintiffs request for 3000 MT. The plaintiff paid through LC for 3000MT. After accepting the payment, we had released the document only for that 3000 MT. We did not issue any notice to lift the remaining 2000 MT, the sale is completed after receiving the payment and receiving the documents".

From this we may conclude that the defendant had accepted the plaintiffs revision of the original contract for 5000 MT with a new contract for 3000 MT. There is also no pleading on the side of the defendant as to whether they rejected or accepted the revised offer of the plaintiff. We have to draw our conclusion only from the conduct of the parties. The evidence of P.W. 1 is that when 3000MT of cargo was released after receiving the internal LC for the prepaid value the defendant did not indicate that if the balance cargo is not lifted the EMD will be forfeited. This is not rebutted by the defendant. When the plaintiff expressed his inability to lift the balance 2000MT, the defendant had not cancelled the contract on account of breach but had tacitly accepted the modified offer to purchase 3000MT. According to the learned counsel for the plaintiff the very fact that they had allowed the plaintiff to lift the 3000MT showed that they had accepted his offer to purchase that quantity alone. The learned counsel for

the defendant on the other hand would submit that the right to forfeit the EMD arises from Clause 6 of the tender, Ex-P1 and once it is shown that the plaintiff did not perform the contract, forfeiture will follow. The counsel for the defendant would submit that the reason given by the plaintiff for not lifting the balance 2000MT is not at all acceptable because Clause 5 of Ex-P1 makes it clear that the defendant would extend credit to the buyer in case the buyer wants to avail of the same. Therefore, if financial incapacity was their only problem the plaintiff had only to ask the defendant and the defendant would have extended credit. To this the counsel for the plaintiff submitted that without sufficient bank facility the defendant would not extend any financial credit and when the plaintiffs bankers had categorically informed the plaintiff that their facility had already been fully utilized there was no question of the plaintiff approaching the defendant for credit. If the plaintiffs account had sufficient limit to cover the purchase price of 5000MT he would not have had looked anywhere else and the contract would have been performed as set down in Ex-P1. This contention of the learned counsel for the plaintiff finds support in the evidence of D.W. 1, who state that

The credit terms include a 17% interest to be paid in advance and a LC should be opened for 60 days credit. The plaintiff approached for the 3000MT because he did not have the facilities to open the LC with the bank. Only for want of cash credit in the bank the LC could not be opened for the remaining 2000 MT. Even to avail the credit facility for such credit bank facility is required to open the LC."

It is clear from this that the defendant would also demand the furnishing of bank facility for opening credit, when the plaintiffs inability to clear the entire 5000MT is because he did not have sufficient limit, this argument of the learned counsel for the defendant that the plaintiff should have called in aid Clause 5 is not of any use.

The learned counsel for the plaintiff referred to Section 73 of the Contract Act, which reads as follows :

Compensation for loss or damage caused by breach of contract-- When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

He submitted that unless the defendant is able to establish loss or damage by the non-lifting of 2000 MT he is not entitled to forfeit the EMD at all. The learned counsel for the defendant on the other hand would refer to Section 74 of the Contract Act, which reads as follows :

"Compensation for breach of contract where penalty stipulated for -- When a

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

According to the learned counsel for the defendant when a fixed amount has been stipulated in the contract; then whether or not actual damage or loss is proved to have been caused the party who has breached the contract must pay compensation to the other. The only restriction is that, this compensation should not exceed the amount set down in the contract itself. Since the defendant had only retained the EMD, which was stipulated in the contract itself, the plaintiff cannot ask for refund.

The learned counsel for the defendant relied on *State of Gujarat Vs. Dahyabhai Zaverbhai*, where the Supreme Court held that in a works contract when the contract was abandoned, forfeiture on security deposit is not illegal. The learned counsel for the plaintiff on the other hand would refer to the decision reported in *Messrs. Sudhakar and Co, by Propr. M. Sivagnanambal v. The City Municipal Corporation of Madras, by its Chief Executive Authority, the Commissioner* 1976 (89) MLW 559 where in addition to forfeiting the security deposit, actual loss was also recovered. This Court held that while calculating the compensation for the loss suffered, the amount paid as security deposit should be given credit to and only the balance can be recovered and that no party can make a profit out of the breach out of the other. The learned counsel drew the conclusion from this to show that even when actual loss was suffered the security deposit forfeited should be adjusted towards the actual loss and only the balance can be recovered. In this case, according to the learned counsel for the plaintiff the defendant had not suffered any loss and therefore, was not entitled to forfeit the EMD.

We have already seen that the defendant had released the cargo to an extent of 3000MT, on receiving the full value therefore by internal LC and cash, unconditionally. This itself would amount to acceptance of the plaintiffs revised offer. Even if it did not, will the defendant be still entitled to retain the EMD for 2000 MT. In none of the exhibits filed by the defendant have they stated that, they had suffered a loss because of the plaintiffs refusal to lift the 2000 MT. It is the case of the plaintiff that when the plaintiff had indicated to the defendant that they could not lift more than 3000 MT, the defendant directed the plaintiff to supply HDPE bags to clear the bulk cargo from the ship and also to arrange for the service of a surveyor to supervise the discharge operation, which the plaintiff arranged promptly. According to the plaintiff they had also extended all services to the defendant free of cost to clear the cargo from the vessel in time without any demurrage or loss. It was also the plaintiffs case that the defendant had realised huge profit from the sale of the cargo. In the written statement it is

admitted that the defendant had requested one of the plaintiffs sister concerns to supply the balance but denied that they had asked plaintiffs to arrange for the surveyor and that the plaintiffs had extended their service free of cost for clearing the cargo. They also denied that they had made a profit of a sum of Rs. 2 crores out of the sale as alleged by the plaintiff.

Let us see the oral evidence D.W. 1 had stated,

"In the written statement the reason given for forfeiture of EMD as compensation. Therefore, I cannot substantiate for what the compensation was appropriated, by forfeiting the EMD."

Though he would not categorically say how much profit they made from the sale of the 2000 MT he had stated that,

"the remaining 2000 MT was sold higher than the high sea sale price. Thus we made some profit out of this sale. 1 cannot say how much profit we made from the sale."

Therefore, while the defendant has not given any acceptable evidence as regards the quantum of profit, it has been admitted that they made profit. It is the defendant's case that as per Clause 6 in Ex P1 they are entitled to forfeit the EMD in the event of any default committed by the plaintiff including vessel demurrage. The defendant did not suffer any loss on account of the resale, did they pay vessel demurrage ?

The evidence of D.W. 1 is as follows :

"The vessel did not incur any demurrage, but earned despatch money. Under Ex. P1, Clause 6, the EMD will be forfeited in case the buyer fails to honour the contractual obligation including the payment of vessel demurrage, if any."

Therefore, recovery of demurrage does not arise. When the counsel for the plaintiff was asked what was despatch money he explained that if the cargo is lifted within the period that is allowed to the ship to clear the cargo then the importer earns despatch money. For instance if the time allowed for discharging the cargo is 16 days and the time actually utilised is 14 days then the two days is earned despatch. On the other hand if more time taken then the liability to pay demurrage arises. For this purpose, the plaintiff filed Exs. P19, P20, which are the laytime statement for the vessel MV Great Prize, on which the suit cargo was shipped, and the details to datewise discharge of cargo respectively. The counsel for the defendant objected to placing any reliance on these two documents since they are not authenticated by any proper authority. But in view D. W. 1's statement that instead of incurring demurrage they actually earned despatch money, the plaintiff does not need the support of Exs. P19 to P20. The oral and documentary evidence shows that after the plaintiff intimated they were not able to lift 2000 MT, the defendant had resold the same in open market and earned profit and there is also no expenditure incurred by the defendant on account of demurrage.

There are several decisions of our Court and other Courts which deals with the right of the party who has broken the contract to have the EMD or security deposit refunded.

In the State of Tamil Nadu Vs. K.R. Selvamoorthy, , and extract from the decision of the Supreme Court in Union of India (UOI) Vs. Rampur Distillery and Chemical Co., Ltd., is quoted.

The party to a contract taking security deposit from the other party to ensure due performance of the contract is not entitled to forfeit the deposit on ground of default when no loss is caused to him in consequence of such default."

And our Court held that, since no loss was either pleaded or proved the EMD was held not liable to be forfeited.

In the decision reported in The Vijaya Foundry, Pappanaicken Palayam, Coimbatore by its Proprietor A. Ramaswami Naidu v. Gordon Woodroffe & Co., Madras Private Ltd., 1963 (2) MLJ 153 , the difference between an earnest money or deposit and an advance was discussed. The decision reported in Sabina D'Costa Vs. Joseph Antony Noronha, deals with the legal position on the subject and how the Court should deal-with the question of forfeiture of earnest money. In the said decision the following passage from Fateh Chand Vs. Balkishan Das, was quoted :

"Section 74 of the Indian Contract Act is clearly an attempt to eliminate the somewhat elaborate refinements made under the English common law in distinguishing between stipulations providing for payment of liquidated damages and stipulations in the nature of penalty. Under the common law a genuine pre-estimate of damages by mutual agreement is regarded as a stipulation naming liquidated damages and binding between the parties, a stipulation in a contract in terrorem is a penalty and the Court refuses to enforce, it awarding to the aggrieved party only reasonable compensation. The Indian Legislature has sought to cut across the web of rules and presumptions under the English common law, by enacting a uniform principle applicable to all stipulations, naming amounts to be paid in case of breach, and stipulations by way of penalty."

Again in para 10 of the judgment, the Supreme Court has observed :

"..... The measure of damages in the case of breach of a stipulation by way of penalty is by Section 74 reasonable compensation not exceeding the penalty stipulated for. In assessing the damages the Court has, subject to the limit of the penalty stipulated, jurisdiction to award such compensation as it deems reasonable having regard to all the circumstances of the case. Jurisdiction of the Court to award compensation in case of breach of contract is unqualified except as to the maximum stipulated, but compensation has to be reasonable, and that imposes upon the Court duty to award compensation according to settled principles. The section undoubtedly says that the aggrieved party is entitled to receive compensation from the party who has broken the contract whether or not

actual damage or loss is proved to have been caused by the breach. Thereby it merely dispenses with proof of actual loss or damage" it does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted because compensation for breach of contract can be awarded to make good loss or damage which naturally arose in the usual course of things or which the parties knew when they made the contract, to be likely to result from the breach."

In this case, is the earnest money a genuine preestimate of damages or is it a stipulation in terrorem. It is plain that it is more in the nature of the penalty than a genuine estimate of damages since as per Clause 6, the EMD is subject to forfeiture even if demurrage, is not paid. Therefore, it cannot be based on the loss that is likely to be suffered by the defendant. To the argument of the learned counsel for the defendant that they are entitled to forfeit the EMD and they do not have to prove loss as per Section 74 of the Contract Act, the aforesaid decision of the Karnataka High Court provides an answer. Section 74 of the Contract Act only means that proof of actual loss or damages is not necessary. The tenor of Ex. P4 also shows that the deposit is taken only to cover possible losses. But when neither legal injury nor actual loss has been suffered then an award of compensation is not at all justified. For the aforesaid reasons," 1 hold issue No. 3 in favour of the plaintiff.

5. Issue No. 4 :

The plaintiff has prayed for interest at the rate of 21% from 1-3-1994 till date of payment. In the evidence of D.W. 1 it is stated that they are earning interest on the EMD made by the plaintiff. But whether the plaintiff is entitled to 21% interest has to be decided. There is no contract between the parties for payment at 21% interest per annum and the EMD as per the contract is retained by them interest free. The refund of the proportionate EMD for 3000MT, which is the cargo that was lifted though made with delay was not repaid with interest. Therefore, the plaintiff will not be justified in claiming interest at 21% per annum from 1-3-1995 till date. But in the circumstances, the plaintiff will be entitled to claim the refund with interest at 12% per annum from the date of the suit till realization.

6. Issues :

In view of my findings on Issue Nos. 3 and 4, there is no need to deal with the other issues.

7. In the result, the plaintiff will be entitled to refund of Rs. 6,85,000/- with interest at 12% per annum from the date of suit till date of realization and the suit is decreed accordingly with costs.