(2011) 11 DEL CK 0261

In the Delhi High Court

Case No : Regular First Appeal No. 576 of 2002

Airports Authority of India APPELLANT

Vs

Shri R.K. Singhal RESPONDENT

Date of Decision : 16-11-2011

Acts Referred:

Civil Procedure Code, 1908 (CPC) — Section 96
Contract Act, 1872 — Section 74

Citation : (2011) 10 AD 339 : AIR 2012 Delhi 51 : (2011) 185 DLT 648

Hon'ble Judges : Valmiki J Mehta, J

Bench : Single Bench

Advocate : Sunil Ahuja, for the Appellant; S.K. Sharma with Mr. Aashish Gambhir, for the Respondent

Final Decision : Dismissed

Judgement

Valmiki J Mehta, J.—The challenge by means of this Regular First Appeal u/s 96 of the Code of the Civil Procedure (CPC), 1908 is to the impugned judgment of the Trial court dated 30.5.2002. By the impugned judgment and decree, the Trial Court decreed the suit of the respondent/plaintiff for recovery of the advance price paid of Rs.1,35,000/- which was given pursuant to an auction held by the appellant/defendant on 19.12.1998 for a Konica Nice Print System. The Trial Court held that the advance price paid cannot be forfeited even though the respondent/plaintiff was guilty of breach of contract because mere breach of contract does not entitle the aggrieved person viz. appellant/defendant for damages, unless losses have been pleaded and proved and which admittedly was not done.

2. The facts of the case are that the respondent/plaintiff participated in an auction held on 19.12.1998 conducted by the appellant/defendant. The respondent/plaintiff gave a bid for Rs.4,00,000/- for a Konica Nice Print System Machine and deposited an amount of Rs.1,35,000/- on the same day. Since the balance amount was not deposited by the respondent/plaintiff, the transaction

fell through and the appellant forfeited the amount of Rs.1,35,000/- on the ground that this payment which was made was an earnest money deposit, and by its very nature, earnest money deposited can be forfeited once breach of contract is established.

3. The only issue therefore which is required for determination by this Court is whether taking as correct that the respondent/plaintiff was guilty of breach of contract can the amount paid of Rs.1,35,000/- be forfeited by the appellant/ defendant on the ground that the same was an earnest money deposit without pleading and proving that any loss was caused to the appellant/defendant.

4. The law in this regard is well settled and three premier judgments of the Hon''ble Supreme Court are the judgments in the cases of Fateh Chand Vs. Balkishan Das, , Maula Bux Vs. Union of India (UOI), and Union of India (UOI) Vs. Raman Iron Foundry, . It has been held in these judgments that clauses of forfeiture of liquidated damages by their very nature are hit by Section 74 of the Contract Act, 1872 inasmuch as such clauses are in the nature of penalty and at best only provide for the upper limit for claim of damages, and which if capable of being proved, have to be proved before the amount paid as earnest money can be forfeited. It is the ratio of these Supreme Court judgments that mere breach of contract eo instanti does not entitle the aggrieved party to forfeit the amount. The Constitution Bench in the case of Fateh Chand (supra) has specifically referred to the fact that the fine distinctions drawn in English law have been obliterated by Section 74 of the Contract Act, and as per which all clauses of liquidated damages are to be treated as bad, once losses otherwise can be established, and only on establishing of which forfeiture can take place. The relevant observations of the Supreme Court in the aforesaid judgment of Fateh Chand (supra) are as under:-

8. The claim made by the plaintiff to forfeit the amount of Rs 24,000 may be adjusted in the light of Section 74 of the Indian Contract Act, which in its material part provides:-

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.

The section is clearly an attempt to eliminate the sometime 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.

10. 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. We are in the present case not concerned to decide whether a contract containing a covenant of forfeiture of deposit for due performance of a contract falls within the first class. 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 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.

15. Section 74 declares the law as to liability upon breach of contract where compensation is by agreement of the parties pre-determined, or where there is a stipulation by way of penalty. But the application of the enactment is not restricted to cases where the aggrieved party claims relief as a plaintiff. The section does not confer a special benefit upon any party; it merely declares the law that notwithstanding any term in the contract predetermining damages or providing for forfeiture of any property by way of penalty, the court will award to the party aggrieved only reasonable compensation not exceeding the amount named or penalty stipulated. The jurisdiction of the court is not determined by the accidental circumstance of the party in default being a plaintiff or a defendant in a suit. Use of the expression "to receive from the party who has broken the contract" does not predicate that the jurisdiction of the court to adjust amounts which have been paid by the party in default cannot be exercised in dealing with the claim of the party complaining of breach of contract. The court has to adjudge in every case reasonable compensation to which the plaintiff is entitled from the defendant on breach of the contract. Such compensation has to be ascertained having regard to the conditions existing on

the date of the breach.

16. There is no evidence that any loss was suffered by the plaintiff in consequence of the default by the defendant, save as to the loss suffered by him by being kept out of possession of the property. There is no evidence that the property had depreciated in value since the date of the contract provided; nor was there evidence that any other special damage had resulted. The contact provided for forfeiture of Rs 25,000 consisting of Rs, 1039 paid as earnest money and Rs 24,000 paid as part of the purchase price. The defendant has conceded that the plaintiff was entitled to forfeit the amount of Rs 1000 which was paid as earnest money. We cannot however agree with the High Court that 13 percent of the price may be regarded as reasonable compensation in relation to the value of the contract as a whole, as that in our opinion is assessed on an arbitrary assumption. The plaintiff failed to prove the loss suffered by him in consequence of the breach of the contract committed by the defendant and we are unable to find any principle on which compensation equal to ten percent of the agreed price could be awarded to the plaintiff. The plaintiff has been allowed Rs 1000 which was the earnest money as part of the damages. Besides he had use of the remaining sum of Rs 24,000, and we can rightly presume that he must have been deriving advantage from that amount throughout this period. In the absence therefore of any proof of damage arising from the breach of the contract, we are of opinion that the amount of Rs 1000 (earnest money) which has been forfeited, and the advantage that the plaintiff must have derived from the possession of the remaining sum of Rs 24,000 during all this period would be sufficient compensation to him. It may be added that the plaintiff has separately claimed mesne profits for being kept out possession for which he has got a decree and therefore the fact that the plaintiff was out of possession cannot be taken, into account in determining damages for this purpose. The decree passed by the High Court awarding Rs.11,250 as damages to the plaintiff must therefore be set aside.

(Underlining added)

5. To the same effect are the observations in Maula Bux Vs. Union of India (UOI), and para 4 of which reads as under:-

4. 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 Dictionary 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 AIR 1926 P.C. 1

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 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.

5. Section 74 of the Contract Act provides :

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.

There is authority, no doubt coloured by the view which was taken in English cases, that Section 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 ILR [1913] Mad. 178, Singer Manufacturing Company v. Raja Prosad ILR [1909] Cal. 960, Manian Patter v. The Madras Railway Company ILR 1906 Mad.188 But this view is no longer good law in view of the judgment of this Court in Fateh Chand Vs. Balkishan Das, . 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 Section 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 Section 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 only to award reasonable compensation is statutorily imposed upon courts by Section 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 considers 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 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.

(Underlining added)

6. In Union of India (UOI) Vs. Raman Iron Foundry, there are similar conclusions. Para 11 of this judgment reads as under:-

11. Having discussed the proper interpretation of Clause 18, we may now turn to consider what is the real nature of the claim for recovery of which the appellant is seeking to appropriate the sums due to the respondent under other contracts. The claim is admittedly one for damages for breach of the contract between the parties. Now, it is true that the damages which are claimed are liquidated damages under Clause 14, but so far as the law in India is concerned, there is no qualitative difference in the nature of the claim whether it be for liquidated damages or for unliquidated damages. Section 74 of the Indian Contract Act eliminates 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 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, and according to this principle, even if there is a stipulation by way of liquidated damages, a party complaining of breach of contract can recover only reasonable compensation for the injury sustained by him, the stipulated amount being merely the outside limit. It, therefore makes no difference in the present case that the claim of the appellant is for liquidated damages. It stands on the same footing as a claim for unliquidated damages. Now the law is well settled that a claim for unliquidated damages does not give rise to a debt until

the liability is adjudicated and damages assessed by a decree or order of a Court or other adjudicatory authority. When there is a breach of contract, the party who commits the breach does not eo instanti incur any pecuniary obligation, nor does the party complaining of the breach becomes entitled to a debt due From the other party. The only right which the party aggrieved by the breach of the contract has is the right to sue for damages................The Court in the first place must decide that the defendant is liable and then it proceeds to assess what that liability is. But till that determination there is no liability at all upon the defendant.

(Underlining added)

7. In view of the ratio of the decisions of the Supreme Court in the aforesaid judgments, it is trite that if losses can be proved, then, a clause of liquidated damages is void. I may hasten to add that there are two types of contracts. One set of contracts are those contracts where it is not possible to estimate and prove the losses. One of such contracts was the contract which was the subject matter of a Constitution Bench decision of the Supreme Court in the case of Sir Chunilal V. Mehta and Sons, Ltd. Vs. The Century Spinning and Manufacturing Co., Ltd., wherein the Supreme Court allowed liquidated damages where the contract was as managing agents with a return of percentage of profits of 21 years and on which managing agency agreement having been wrongly terminated it would not have been known that how much would have been earned as share of profits over 21 years once the contract was found to be illegally terminated. Therefore claim of liquidated damages was allowed. Other set of contracts are those contracts which were the subject matter of the decision of the Supreme Court in the case of Oil and Natural Gas Corporation Ltd. Vs. SAW Pipes Ltd., wherein with respect to contract for construction of an oil rig, the Supreme Court said that liquidated damages can be claimed because it cannot be estimated and proved that what would be the loss on account of the delayed construction of an oil rig because what would have been the losses were dependent on factors such as amount of production (including prices of crude oil at different times) of oil which could not be exactly estimated. In the case of O.N.G.C. Vs. Saw Pipes Ltd. (supra) the Supreme Court has also referred to a case of delay in construction of a toll road and said that in such contracts again there is an entitlement to liquidated damages because what would have been the loss caused by number of days of delay in construction of toll roads cannot be estimated as how many vehicles which would have passed cannot be exactly arrived at and hence therefore the clause with respect to liquidated damages is not in the nature of penalty.

8. In the present case, surely losses which were caused to the appellant/ defendant, with respect to the sale of machine in question could very well have been proved because if the appellant/defendant was forced to sell the machine for an amount lesser than Rs.4,00,000/- (the price at which the respondent/ plaintiff agreed to buy the same) then, by difference of receipt of lesser price

such loss could have been pleaded and proved and hence, subject to the upper limit of the earnest money deposited, such loss could well have been claimed by the appellant/defendant. Admittedly, the appellant/defendant in the facts of the present case has neither pleaded nor proved any loss having been caused to it on account of breach of contract by the respondent/plaintiff.

9. The Trial Court has therefore rightly held that since such loss has not been pleaded and proved, the appellant/plaintiff was bound to refund the earnest money/advance price which was received by the appellant in the auction conducted on 19.12.1998. The relevant observations of the Trial Court in this regard are contained in para 13, and the same reads as under:-

13. The question that arises next is whether the defendant could have legally forfeited the earnest money. Needless to say that the clause providing for forfeiture of earnest money was a penal clause. A clause in the nature of penalty could not have been enforced in its entirety by reason of Section 74 of the Indian Contract Act. There is nothing to suggest that the amount of penalty was a genuine pre-estimate of damages likely to be suffered by the defendant in the event of breach of contract on the part of bidder. Section 74 lays down that the party complaining of breach is entitled, whether or not actual damages or loss is proved to have been caused thereby, to receive from the defaulting party a reasonable compensation not exceeding the amount of penalty stipulated for. The words "whether or not actual damages or loss is proved to have been caused thereby" have been considered in several case and it has been held that these words merely exempt the complaining party from proving the actual loss or damage. These words do not at all covey that compensation is to be awarded in all cases whether some loss or damage has been occasioned or not. Thus, a compensation can be awarded only when the complaining party has suffered some loss or damage as a result of breach of contract by the other party. It is another matter that it is not obligatory to adduce positive evidence of such damage or loss. If there has been no damage or loss in consequence of breach of contract, the question of awarding or claiming compensation does not arise. In the present case, the defendant has nowhere alleged in the Written Statement that it suffered any loss as a result of plaintiff''s failure to deposit the balance auction money. Therefore, the forfeiture of earnest money cannot be justified.

10. In view of the above, there is no illegality or perversity in the impugned judgment which calls for interference by this Court. The appeal being devoid of merit is accordingly dismissed, leaving the parties to bear their own costs.

11. The appellant has deposited the decretal amount in this Court. The amount deposited in this Court along with accrued interest, if any, be released to the respondent/plaintiff in full and final satisfaction of the claim of the respondent/plaintiff under the subject money decree. Trial Court record be sent back.

