
(1968) 10 GUJ CK 0010
In the Gujarat High Court

Narendrasingh Motilal Johary

APPELLANT

Vs

Karamchand Premchand (P.) Ltd.

RESPONDENT

Date of Decision : 04-10-1968

Acts Referred:

Contract Act, 1872 — Section 73, 74, 74

Citation : (1969) 10 GLR 584

Hon'ble Judges : M.U. Shah, J

Bench : Single Bench

Judgement

M.U. Shah, J.—This is original defendant's appeal against the decree passed in Civil Appeal No. 263 of 1959, by the learned District Judge, Baroda, awarding compensation to the plaintiff-respondent to the extent of Rs. 3, 9451-for an alleged breach by the defendant of a contract of service. The learned District Judge has thereby reversed the decree of dismissal of the plaintiff's suit that was passed by the learned Joint Civil Judge (Junior Division), Baroda, in Civil Suit No. 10 of 1957, holding that the amount of damages stipulated in the relevant Clause 18 of the service agreement Ex. 52 was fixed in terrorem, and was unconscionable, unfair, one sided and unilateral and the plaintiff was not entitled to any compensation in the matter.

2. The relevant facts may first be briefly stated. The appellant-defendant named one Narendrasingh Motilal Johary, Ph. D. (Lon.), D.I.C., was appointed by the respondent Company named M/s. Karamchand Premchand (Private) Ltd., Proprietors of the concern named Sarabhai Chemicals, as an Administrative Assistant of the Company with effect from Febuary 28, 1956. He was appointed on a salary of Rs. 460/- per month and dearness allowance of Rs. 100/- per month. He was appointed on probation for the first six months of his service during which period his services were liable to be terminated by the plaintiff Company without notice and it was provided that at the end of the period of probation, unless his services were confirmed by the plaintiff Company by a separate letter his services were deemed to have been automatically terminated

at the end of the period, although his employment was for a period of five years involving an initial period of about a year covering specialized training, A "Training Tentative Programme" from the date of the defendant's joining service, namely, February 28, 1956 to September 30, 1956, was drawn up by the plaintiff Company. The programme upto May 20, 1966, was for training in quality control, Pharmaceuticals, fine chemicals and research, production control, inventory, stores, accounts, costing, miscellaneous office work, such as labour and secretarial. The training programme from May 21, 1956, to September 30, 1956, included training in sales service and administration; promotion, a dream, a training in the branch where training class takes place for a week, a training in a field with a representative for two weeks; travelling etc. for a week; training in a branch at Madras; training at Bombay in purchases, printing, customs, etc; and training in Ahmedabad office, especially regarding insurance, letters of credit and miscellaneous. Further training to be provided was to depend upon the progress of the defendant. The defendant left the plaintiffs service after undergoing a training for two months and eleven days. He tendered resignation of his office by letter Ex. 52, dated May 12, 1956. The resignation was not accepted. However, the defendant took a unilateral decision and left the service on May 12, 1956. His salary at the time was Rs. 460/- per month. In addition, he was receiving dearness allowance of Rs. 100/- per month. On this scale, he had received the salary and dearness allowance for a period of two months. He does not appear to have received the salary for eleven days of the third month that he was in service. The plaintiff Company then filed the Civil Suit, out of which this Second Appeal arises, for recovery of a sum of Rs. 5,040/- as compensation for the breach of service contract, allegedly committed by the defendant. The damages were claimed on the allegation that the defendant had gone through the specialized training through most of the important Departments, viz., quality control, manufacturing and production and inventory control etc. and that the defendant having committed the breach of the agreement by leaving his "service before the expiry of the five years" period of his service, had made himself liable to pay to the plaintiff Company a sum equal to nine times the monthly salary of Rs. 560/- which the defendant drew from the plaintiff Company on the date of his deserting the employment, as liquidated damages according to Clause 18 of the agreement. It is significant that the plaintiff Company has invoked only a part of Clause 18 of the agreement of service, Ex. 52, and has not relied upon the part relating to the cost incurred by the Company in respect of defendant's training as will appear from paragraphs 5 and 6 of the plaint, which read as under:

(5) As the defendant committed the breach of the agreement and left off his employment, he made himself liable to pay to the plaintiffs a sum equal to nine times the monthly salary of Rs. 560/- which the defendant drew from the plaintiffs on the date of his deserting the employment, as liquidated damages according to Clause 18 of the agreement. "

(6) The defendant was, therefore, sent a notice through a pleader...After waiting

for a sufficient period, the plaintiffs have filed the present suit for recovery of the sum of Rs. 5,0401/- from the defendant.

Clause 18 of the agreement made a provision for recovery of a sum as liquidated damages on the basis of a set theory, namely, "a sum equal to nine times the monthly salary at the date of termination of service or cessation of employment as the case may be plus the cost incurred by the Company in respect of your training."

3. The defendant had resisted the suit and contended that the agreement of service was unilateral, unconscionable, unfair, one-sided and against law and, therefore, it was not binding to him. He denied his liability to pay any compensation amount by way of liquidated damages. In the alternative, he pleaded that as he had served the plaintiff's concern only for two months and eleven days and had received the salary for two months, in aggregate a sum of Rs. 920/-, the plaintiffs could claim that much amount and no more.

4. The learned trial Judge took the view that Clause 18 of the service agreement Ex. 52 was in terrorem, unconscionable and extravagant. He held that the sum fixed was absolutely out of proportion to the injury caused and the burden did not fall evenly and equitably on both the sides, but it fell heavily and overwhelmingly on the defendant. The learned Judge found that the service agreement was unilateral and unfair. The learned Judge further found that the defendant had not committed breach of the terms of the agreement. In this view of the matter, the learned Judge dismissed the suit.

5. In appeal that was filed by the plaintiffs, the learned District Judge has taken the view that the defendant had committed a breach of the terms of the service agreement by voluntarily leaving the service of the plaintiff Company and was liable to pay reasonable compensation, not exceeding the sum stipulated under Clause 18 of the service agreement, Ex. 52. As regards the quantum of damages, the learned Judge has found that the defendant would be liable to refund the amount of salary including dearness allowance that he had actually drawn for a period of two months from the plaintiff Company and this would come to a sum of Rs. 1,120/-. He has found that the defendant was further liable to pay a salary of a month's notice, which came to Rs. 460/- as, according to the learned Judge, for a person to leave off any service, one would expect a month's notice to the other side, so that the Company may be able to make suitable arrangement. For this purpose, the learned Judge took into account the basic salary and did not consider it proper to include the dearness allowance. The learned Judge has further found that by way of training cost incurred by the plaintiff Company, it was entitled to receive a sum of Rs. 2,365/- calculated on the basis of the services of several highly placed and important officers having been utilized for the training purposes. For the purpose, the learned Judge has taken the full-time services of one officer as a whole for a period of two months and eleven days, calculated at Rs. 1,000/- per month as a basis on the assumption that several important officers of the different departments had

given training to the defendant for the period. Thus, in aggregate, the learned Judge has awarded a sum of Rs. 3,945/- as damages to the plaintiff Company.

6. Mr. M. H. Chhatrapati, learned Advocate appearing on behalf of the appellant-defendant, has contended that the sum stipulated to be paid as liquidated damages for breach of service contract was, in substance, in terrorem of the defendant and as such, by way of penalty. He has contended that the formula fixing the sum as liquidated damages did not constitute a genuine pre-estimate of damages. In Mr. Chhatrapati's submission, there was no kind of nexus or correlation between the sum equal to nine times the monthly salary at the date of termination or cessation of employment, as the case may be, plus the cost incurred by the Company in respect of the training and the period of specialized training undergone or to be undergone by the defendant. Mr. Chhatrapati has further contended that the decision of the learned District Judge fixing a sum of Rs. 2,365/- as loss to the plaintiff Company on account of the services of a higher officer being utilized for training of the defendant and calculating the damages in this behalf in that manner was arbitrary and not based on any evidence on record, but on mere surmises and, therefore, liable to be set aside. Mr. I. M. Nanavati, learned advocate appearing on behalf of the respondent-plaintiff, has supported the judgment of the learned District Judge and has further contended that the defendant was liable to pay the sum named in Clause 18 of the service agreement Ex. 52, payable as liquidated damages and as being a genuine pre-estimate of the damages.

7. Before appreciating the aforesaid rival contentions raised by the learned advocates of the parties, I may conveniently set out hereinbelow the relevant clauses (conditions of employment) of the agreement Ex. 52, including Clause 18, a part of which has been invoked by the plaintiff Company. Clause 18 reads:

Your employment here involves an initial period of about a year covering specialised training. In consideration for this, if during the period of term of employment for 5 years, you will cease to work for the Company or if your services are terminated by the Company under Clause 15 hereof, you shall pay to the Company without prejudice to any other rights of the Company under the same terms hereof or otherwise a sum equal to nine times the monthly salary at the date of termination or cessation of employment as the case may be plus the cost incurred by the Company in respect of your training as liquidated damages without any further proof of loss or damage by the Company.

Clause 2 of the agreement which provides for the period of probation reads:

You will be on probation for the first six months of your service during which period your services are liable to be terminated by us without notice, and which will automatically terminate at the end of the period unless confirmed by us by a separate letter.

Clause 5 which provides for termination of the agreement by the Company reads:

This agreement shall remain in force till 1st March 1961 provided always the Company shall be entitled to terminate this agreement by 30 days' notice in writing terminating on any day of the month without assigning any reason.

Clause 15 which provides for termination of service of the defendant before the period of five years reads:

This arrangement is liable to be terminated immediately if in the opinion of the Company you are found guilty of breach of any of the above clauses, insubordination, insolence, gross negligence of duty, dishonesty or embezzlement or accepting any commission or discounts, etc, from any merchant or outsiders or placing personal consideration of any nature above the Company's interest in such cases.

Clause 15 has relevance to Clause 18 as Clause 18 provides that the defendant shall be liable to pay on termination of the service by the Company under Clause 15 of the agreement by way of liquidated damages a sum equal to nine times the monthly salary at the date of termination plus the costs incurred by the Company in respect of the defendant's training.

8. Clause 19 of the agreement which provides for the cost of special training of the defendant outside Baroda and to any place in India or abroad is not material for the present purpose and has not been relied upon by the learned advocates, although Mr. Chhatrapati had, at first, passingly referred to the provision relating to the recovery of the cost of training to be found in Clause 19. However, I will set out Clause 19 hereinbelow:

If you are sent for special training outside BARODA to any place in India or abroad, any money spent by the Company over and above your monthly salary or any stipends or allowance paid to you over and above your monthly salary shall be treated as part of the cost of your training, for purposes of this clause The amount recoverable from you as cost of your training shall be certified by the Company's Auditors and such amount shall be conclusive and binding on both the parties.

Ex. 52 which has been also referred to as an arrangement was confirmed by the defendant.

9. Now, it is not in dispute that the plaintiff was a Ph. D of the London University and held the D.I.C. Immediately before he was appointed on the staff of the plaintiff Company as an Administrative Assistant on terms and conditions to be found in the agreement Ex. 52, dated February 28, 1956, he was serving in the Government of Madhya Bharat. It is not known how long he served with the Madhya Bharat Government and on what salary and on what terms and conditions. But, it is clear that on his appointment as an Administrative Assistant by the plaintiff Company, he was on probation with the plaintiff Company as provided in Clause 2 of the service agreement. At the time when he took a unilateral decision and left the employment, he was drawing a salary of Rs 460/-

per month and the usual dearness allowance of Rs 100/- per month. He had drawn the salary and the dearness allowance for a period of two months. His employment was for a term of five years expiring on March 1, 1961. His employment involved an initial period of about a year covering specialized training. An initial training tentative programme Ex 77 was drawn up and this covered the period between February 28, 1956, and September 30, 1956, during which period he was required to undergo training on the technical side as well as on the administrative side. At the time when he took the unilateral decision and left the service, he had undergone a technical training from February 28, 1956, to May 12, 1956, and this training included training regarding quality control, Pharmaceuticals, fine chemicals and research, production control, inventory and stores, accounts, costing, and miscellaneous-office, labour, secretarial. Still he had to undergo the training in (i) sales service and administration; (ii) promotion, adrema, (iii) in the branch where the training class takes place for one week; (iv) field training with a representative for two weeks; (v) travelling etc. for one week; (vi) training in a branch at Madras; (vii) training at Bombay-purchases, printing, customs, etc; and (viii) training in Ahmedabad Office-especially insurance, letters of credit and miscellaneous, as stated in the programme Ex. 77. Thereafter also, some further training was to be provided for. Thus, during the short period of two months and eleven days during which the defendant was in the employment of the plaintiff Company, he had received specialized training in some technical matters aforesaid. He had still to receive administrative and other specialized training as may be required by the plaintiff Company. Because of his unilateral decision to leave the services without the consent of the plaintiff Company, the latter has filed the suit for damages for breach of service contract and has for the purpose invoked a part of Clause 18 of the agreement set out earlier. These are the indisputable facts found on the record and are not in challenge before me.

10. The main question that falls for my consideration in this appeal is as to whether the formula set out in Clause 18 of the agreement Ex. 52 by which the sum payable by the defendant by way of liquidated damages for breach of service agreement is to be worked out is a genuine pre-estimate of damages or is in terrorem of the offending party, viz. the defendant. Now, Clause 18 set out earlier, makes a provision for payment of damages by the defendant in the event of the defendant ceasing to work for the Company during the term of employment for five years. It also provides for payment of damages in the event of the services of the defendant being terminated by the plaintiff Company under Clause 15 of the agreement. Clause 15 of the agreement provides for the defendant's services to be terminated in the event of His being found guilty of the breach of any of the relevant clause or clauses of the service agreement, and also for insubordination, insolence, gross negligence of duty, dishonesty or embezzlement or acceptance of any commission or discounts, etc. from any merchant or outsiders or for placing personal consideration of any nature above the Company's interest. For all these eventualities, the damages which are

termed as liquidated damages provided are to be calculated on the same set formula:

A sum equal to nine times the monthly salary at the date of termination or cessation of employment as the case may be plus the cost incurred by the Company in respect of your training as liquidated damages without any further proof of loss or damage by the Company.

The damages are payable on the aforesaid basis by the defendant if his services are terminated under Clause 15 or if he ceases to work for the Company at any time during the five years" period of his employment. In the instant case, the defendant has served the plaintiff Company only for a period of two months and eleven days and all along he was on probation and liable to have his services terminated at the end of the six months" period of probation. This is a uniform formula to be invoked even if the services of the defendant are terminated under Clause 15 and at any point of time and the formula is also sought to be applied to the case of a defendant ceasing to work for the Company at any point of time, may be during the period of probation or before the initial period of specialized training is over or at any time thereafter. A system of graduated sums which increase in proportions to the seriousness of the breach is not provided for. The damage caused by each and every one of the events constituting a breach of service or cessation of service, however varying in importance, is thus sought to be assessed on the set formula. Even if the defendant had left the service after one or two weeks of specialized training instead of after two months and eleven days, the plaintiff Company could have, under the clause, claimed damages under the said formula. The same would be the case in the event of the defendant completing the specialized training of a period of one year or so and continuing in service for a longer period thereafter, say two years or three years. Even in the event of no specialized training programme having been fixed and no training having been given, and if the defendant had left the service, the plaintiff Company could have well resorted to the said formula. Thus, clearly, there is no rationale provided to determine the sum payable as liquidated damages by the defendant either on his leaving the service, may be during the period of probation, or on his services being terminated under Clause 15. In the instant case, the defendant was a Ph. D. and a qualified man. He was appointed as an Administrative Assistant of the Company. He was earlier serving with the Madhya Bharat Government. He had undergone a part of the technical training during the period of his employment, but he is not shown to have undergone substantial training on the administrative side as would appear from the training programme Ex. 77, when considered in the context of the fact that the training for the administrative side was to start some time in the middle of May 1956, the defendant having left the service earlier on May 12, 1956. The aforesaid formula provided to work out the sum of liquidated damages payable by the defendant on the occurrence of one or more of several events aforesaid, some of which may occasion serious and others but trifling damage, cannot be considered as providing a genuine, admitted and agreed estimate of real damage. The sum

stipulated as payable according to the formula is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach. It does not attempt to assess the loss, but appears to have been imposed as security for the due performance of the contract. Having regard to the terms and inherent circumstances of the service contract Ex. 52, judged of at the time of the making of the contract, the sum to be worked out according to the formula as stipulated is, in my opinion, by way of a penalty and not liquidated damages.

11. It is true that the parties to the contract have used the words "liquidated damages" in Clause 18 and this may prima facie be supposed to mean what they say, yet the expression used is not conclusive. A Court has, in such a case, to find out whether stipulation is penalty in truth or liquidated damages and, in my opinion, as aforesaid, the amount stipulated being out of proportion to the event for which the provision is made and having no rational basis, is, in truth, a penalty. The stipulation works in terrorem of the offending party. In any event, it is not a genuine pre-estimate of damages. In this view of the matter, the plaintiff Company will not be entitled to the stipulated amount, but will be entitled only to a reasonable compensation not exceeding the stipulated sum to be worked out by the part of the set formula invoked by the plaintiff Company as indisputably the defendant has committed breach of the contract of service by his unilateral decision to cease working for the plaintiff Company.

12. It may here be remembered that the learned trial Judge has found that the amount of damages stipulated was in terrorem and was unconscionable, extravagant and absolutely out of proportion to the injury caused. Although the learned District Judge does not appear to have given a definite finding as regards the nature of the stipulation, viz., as to whether it is by way of penalty or liquidated damages, the learned District Judge has considered what is the reasonable compensation that can be awarded to the plaintiff Company in the matter. The learned District Judge has, in this connection, in paragraph 14 of his judgment observed that the plaintiff Company had not attempted to show by way of evidence as to how the damages mentioned in the agreement were estimated and that when one was left without any such material on record, the Court has to find out what reasonable compensation can be awarded to the plaintiff. Thus, very probably, the learned District Judge did not consider that the stipulated amount was a genuine pre-estimate of damages arrived at by the parties. In any case, in my opinion, as aforesaid, the stipulated amount is not a genuine pre-estimate of damages and apart from the fact whether it is in terrorem of the offending party, viz., the defendant, or not, the plaintiff Company would be entitled only to reasonable compensation not exceeding the sum stipulated in Clause 18. Here, it may be remembered that the plaintiff Company has not invoked the second part of the Clause 18 which provides that the cost incurred by the Company in respect of the defendant's specialized training was to be added to the sum equal to nine months-the monthly salary of the defendant at the material time. As such, it is not necessary for me to consider the effect of

Clause 19 of the agreement.

13. This will take me to the question of reasonable compensation awardable in the matter Section 74 of the Indian Contract Act, 1872 (Act IX of 1872) 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 section in 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.

As observed by the Supreme Court in *Fateh Chand Vs. Balkishan Das*, ;

The section 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.

As further observed by Shah, J., speaking for the Supreme Court, at page 527 In the said decision:

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 learned Judge has further observed that:

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 damages"; 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.

Thus, Section 74 of the Contract Act declares the law where the compensation is by agreement of the parties pre-determined or where there is a stipulation by way of penalty. It may not, therefore, matter much whether the instant case is one where the stipulation is by way of liquidated damages or by way of penalty. It is, however, significant that the measure of damages provided herein is not a sum named in the contract, but it is a particular formula which is set out, which would work out a particular sum. The formula as aforesaid is that the plaintiff Company would be entitled to a sum equal to nine times the monthly salary at the date of termination or cessation as the case may be plus the cost incurred by the Company in respect of defendant's training. The stipulation having been held by me to be by way of penalty, it would follow that the plaintiff company would be entitled to reasonable compensation not exceeding the amount stipulated for.

14. Now, in the instant case, although on behalf of the plaintiff Company, Executive Director Mr. Nadkarni was examined as a witness, his evidence is of too general a nature and he does not speak of the actual loss or the damage to which the plaintiff Company would be or was put as a result of the breach of service contract by the defendant. It does not, therefore, matter that the defendant did not give evidence. As observed by the learned District Judge in paragraph 14 of his judgment, the plaintiff has not attempted to show by any evidence as to how the damages mentioned in the agreement were estimated and when one was left without any such material on record, the Court has to find out what reasonable compensation can be awarded to the plaintiff Company for the breach of the contract of service, committed by the defendant. It appears that in absence of any data on the record to assess the reasonable compensation awardable, the learned District Judge has taken the view that the defendant having received the salary for a period of two months would primarily be liable to refund the amount of salary including dearness allowance that the defendant had actually drawn and in addition, to the amount calculated on the basis of one month's basic salary on the reasoning that in normal circumstances, one would expect a month's notice to be given to the other side before terminating the contract so as to enable it to make suitable alternative arrangement instead. Thus, the learned District Judge has considered the three months' salary amount as a reasonable compensation awardable to the plaintiff Company in the matter. The learned Judge has thus awarded a sum of Rs. 1, 120/- on the basis of two months' salary and dearness allowance received by the defendant and Rs. 460/-, the basic salary in lieu of one month's notice period. Here, Mr. Chhatapati has contended, and with substance, that the basic salary and not the dearness allowance can be taken into account for the purpose of considering reasonable compensation in the matter. Mr. Nanavati appearing for the plaintiff Company had nothing to say in the matter. The learned District Judge has himself in

paragraph 18 of his judgement observed that while claiming compensation, one has to take into account basic salary and he did not think that the dearness allowance could be taken into account. Moreover, Clause 18 of the service agreement which contains a covenant for the compensation to be awarded for breach speaks of the sum equal to nine times the monthly salary and is silent about dearness allowance. In any view of the matter, therefore, dearness allowance cannot be taken into consideration while awarding reasonable compensation to the plaintiff Company. The result is that the plaintiff Company be entitled to a sum of Rs. 920/- calculated on the basis of two months' salary actually drawn by the defendant plus Rs. 460/- one month's notice period salary as awarded by the learned District Judge, in all, Rs. 1,380/-.

15. Besides awarding the compensation on the basis of three months' salary as aforesaid, the learned District Judge has considered the question of compensation awardable to the plaintiff Company on account of the costs of specialized training incurred by the plaintiff Company. The learned Judge has, for the purpose, considered the loss to which the plaintiff Company was put on account of the services of several senior and important officers of the company having been utilized for giving specialized training to the defendant. In this connection, the learned Judge has observed as under:

It appears further admittedly clear by reason of his own reports made in respect of the training that he had received, that several important officers of the different department of the company had given him training for a period of two months and 11 days. Though to doubt, it would not be possible to make cut as to what those officers were getting by way of salary from the Company, one can reasonably think that they must be ordinarily getting far more than what the defendant was getting viz, Rs. 560/- per month and it would not be unreasonable to estimate on an average, salary of about Rs. 1,000/- inclusive of dearness allowance per month. Those who gave him training would ordinarily be expected to be persons well versed in that and capable of giving him training. If we were to take into account full time service for a period of two months and 11 days on the basis of one person as a whole, it would come to Rs. 2,365/-. By reason of their engaging themselves in training, the defendant for that much period, the plaintiff Company had to suffer a loss on account of their services being utilized otherwise than for the Company. This, adding Rs. 1,580/- to that sum of Rs. 2,365/-, the amount of compensation available to the plaintiff would be Rs. 3,945/-.

With respect, it is difficult to appreciate this reasoning. There is nothing on record to which my attention is invited which would go to justify such an inference. It is difficult to accept the learned Judge's assumption that one important Senior Officer's whole-time attention will have to be devoted to the defendant's training for a period of two months and 11 days. For aught we know, there may be more than one trainee in employment. The assumption is based on surmises not warranted by any facts on the record. The whole basis of

assessment involved appears to me to be arbitrary and, in my opinion, the award of damages on such a calculation as is involved in the aforesaid reasoning of the learned Judge is not the award of a reasonable compensation. Again, it is to be remembered that, in the plaints, the damages are not claimed on the basis of the second part of Clause 18. The cost incurred by the plaintiff Company does not form the basis of the claim of the plaintiff Company and has been, by necessary implication, given up in the plaint as observed earlier. In any view of the matter, therefore, this part of the decision of learned Judge cannot be upheld and I must hold that the plaintiff Company is not entitled to damages of a sum of Rs. 2,365/- to cover the cost of training, assumed to have been incurred by the plaintiff Company. The result is that the plaintiff would be entitled only to a sum of Rs. 1,380/- as reasonable compensation for the breach by the defendant of the service contract.

16. It was contended by Mr. Nanavati that when a sum is named in the contract as the amount to be paid in case of a breach of contract, that sum and nothing more or less than that sum is awardable. Mr. Nanavati has fairly conceded that this argument of his proceeds on the basis that the sum named is not by way of penalty, but is by way of liquidated damages. As aforesaid, I have taken the view that the formula set up for the purpose works out in terrorem of the offending party and is by way of penalty. Having regard to the facts and circumstances of the case, the plaintiff Company would be entitled only to a reasonable compensation. Reliance was, however, placed by Mr. Nanavati on the following observations of the Supreme Court made in *Sir Chunilal V. Mehta and Sons, Ltd. Vs. The Century Spinning and Manufacturing Co., Ltd.*, :

x x x when parties name a sum of money to be paid as liquidated damages, they must be deemed to exclude the right to claim an unascertained sum of money as damages, x x x x x Again the right to claim liquidated damages is enforceable u/s 74 of the Contract Act and where such a right is found to exist no question of ascertaining damages really arises. Where the parties have deliberately specified the amount of liquidated damages, there can be no presumption that they, at the same time, intended to allow the party who has suffered by the breach to give a go-by to the sum specified and claim instead a sum of money which was not ascertained or ascertainable at the date of the breach.

In that case, Their Lordships of the Supreme Court were concerned with the construction of Clause 14 of the agreement which showed that the parties had themselves provided for the precise amount of damages that would be payable by the Company to the Managing Agents if the Managing Agency Agreement was terminated before the expiry of the period for which it was made. The clause stated that the Managing Agents shall receive from the Company as compensation or liquidated damages for the loss of appointment a sum equal to the aggregate amount of the monthly salary of not less than Rs. 6,000/- for and during the whole of the then unexpired portion of the term of agency. The contention raised before Their Lordships of the Supreme Court was that the

words "not less than" appearing before "Rs. 6,000/- " in Clause 14 clearly brought in Clause 10 of the agreement, and therefore, entitled the appellant to claim 10% of the estimated profits for the unexpired period by way of damages. Clause 10 of the agreement provided that :

The Company shall pay to the Firm by way of remuneration for the services to be performed by the Firm as such agents of the Company under this Agreement a monthly sum of Rs. 6, 000/- provided that if at the close of any year "it shall be found that the total remuneration of the firm received in such year shall have been less than 10 per cent of the gross profits of the Company for such year, the Company shall pay to the Firm in respect of such year such additional sum by way of remuneration as will make the total sum received by the Firm in and in respect of such year equal to 10 per cent of the gross profits of the Company in that year.

The contention was repelled on the ground that if the interpretation was accepted, it would mean that the parties intended to confer on the Managing Agents what was, in fact, a right conferred by Section 73 of the Contract Act and the entire clause would be rendered otiose. In the opinion of their Lordships, the words "not less than" as rightly pointed out by the High Court, were intended only to emphasize the fact that compensation will be computable at an amount not less than Rs. 6, 000/- per month. It was further observed:

Apparently, they thought it desirable to emphasize the point that the amount of Rs. 6,000/- per month was regarded by them as reasonable and intended that it should not be reduced by the Court in its discretion.

The observations made in the case indicate that what is awardable in such a case is a reasonable amount not exceeding the maximum sum, named and do not go to support Mr. Nanavati's contention.

17. However, Mr. Nanavati had relied upon the following observations of Ameer Ali, J., made in Mahadeoprasad Vs. Siemens (India) Ltd., :

To my mind, the following is the intention of the Legislature: (1) The plaintiff must prove his damage in a general sense: (2) the contract made by the parties estimating their damages is in itself evidence; (3) if there is no other evidence of damage, I can conceive of certain cases where this evidence alone will be considered sufficient, nor do I think that the Judicial Committee intended by anything said in *Parma Singh v. Firm Bhai Arjan Singh* AIR 1929 P.C. 179 to exclude such a possibility; (4) the sum named however is not conclusive evidence, that is to say, if there is other evidence or circumstances showing that it was excessive, the Court will not consider itself bound by it; (5) if, on the other hand, the other evidence and circumstances indicate that the damage equals or may equal, or is likely to exceed the amount named, the Court will abide by it, and lastly, (6) in case (4), that is to say, where the other evidence shows that it is unresasonable, the plaintiff will have to prove his damage irrespective of the figure.

The learned Judge has earlier observed that:

In Indian law, it remains an upper limit or maximum. The other point to be noticed is: "whether or not" actual damage or loss is proved. "Now., what is the sense of that, if you have to disregard the figure named entirely ? If it is simply maximum, what is the sense of it ? It may have little sense upon any reading, but one at all if one has to disregard the sum named entirely, i.e. for all purposes except as a maximum.

Relying upon these observations, Mr. Nanavati has contended that, in the instant case, no evidence is led on behalf of the appellant in order to show that the sum named was unconscionable, excessive or unfair. But here, it must be remembered that in Clause 18 of the covenant, a particular formula on which the compensation is to be assessed is set out and on the very face of it, it does not provide for a reasonable compensation and does not appear to be a genuine pre-estimate of damages. In these circumstances, in any view of the matter, the Court has to consider what is reasonable compensation awardable to the plaintiff Company from the defendant in the matter. The effect of Section 74 of the Indian Contract Act is to disentitle the plaintiff to recover simpliciter the sum fixed in the contract, whether as penalty or liquidated damages. It is for the plaintiff to show that the sum named in the agreement is a genuine pre-estimate of damages or is otherwise a reasonable compensation for the breach.

18. The true effect of Section 74 of the Indian Contract Act was considered by a Division Bench of the Rajasthan High Court, consisting of Wanchoo, C.J. (as he then was), and Modi, J., in *Badhdva Singh and another v. Charon Singh and Anr.* AIR 1955 Raj 87, wherein the learned Judges have considered the relevant decisions on the point including the decisions of the Privy Council in *Bhai Panna Singh and others v. Bhai Arjun Singh and Ors.* AIR 1929 P.C. 179, *Michel Habib Raji Ayoub and Ors. v. Sheikh Suleiman El Taji El Farouqui* AIR 1941 P.C. 101 , and *Mahadeoprasad Vs. Siemens (India) Ltd.,* , and has summarized the true effect of Section 74 at page 90 of the report as follows:

"On a review of the authorities cited above, we are of opinion that the true effect of Section 74 may be summarized somewhat as follows:

(1) Where a sum is named in the agreement as payable on breach thereof, the plaintiff cannot be entitled to the entire sum so named "simpliciter", that is, merely because such a sum may be mentioned in the agreement to be so payable.

(2) All that the plaintiff would be entitled to is a "reasonable compensation" subject to the amount named therein being the maximum.

(3) What is "reasonable compensation" would depend upon and must be determined by the circumstances of each case.

(4) The aforesaid result must hold good regardless of the consideration that the sum named in the agreement is what under the English law is termed as

"liquidated damages" or is in the nature of a "penalty". The effect of the Indian law as embodied in Section 74 is to do away with the distinction between "penalty" and "unliquidated damages" under the English law which has been a prolific source of case law and which has sometimes given rise to not a little confusion.

(5) It must be for the plaintiff to prove the damage suffered by him, but such proof may be direct or circumstantial, and need not possess the quality of arithmetical exactitude.

(6) If the plaintiff succeeds in establishing that the sum named in the agreement is a genuine pre-estimate of damages, or would otherwise be a reasonable compensation for the breach, the Court may grant the entire sum named in the breach as such compensation. If on the other hand, the Court comes to the conclusion that the amount as fixed was "in terrorem" or unconscionable and extravagant, it would be open to it to award such sum as may appear to be reasonable.

(7) In deciding whether the amount fixed is a genuine pre-estimate or reasonable compensation or not, it would be a factor for consideration whether the sum named in the agreement is not disproportionate to the injury caused and whether the burden evenly and equitably falls on both parties to the contract.

I am in respectful agreement with the aforesaid observations of the Division Bench of the Rajasthan High Court. Simply because a sum is stipulated in the agreement as payable on the breach thereof, the plaintiff cannot be entitled to the entire sum so named simpliciter. In the instant case, the plaintiff Company has not proved damages even in a general sense. It is not shown from the evidence on record that the sum stipulated is either a genuine pre-estimate of damages or is otherwise a reasonable compensation for the breach. On the contrary, it appears to be wholly unreasonable and out of proportion to the injury suffered by the plaintiff Company.

19. As observed by a Division Bench of the Calcutta High Court in *The Brahmaputra Tea Co. Ltd v. E. Scarth*. (I.L.R.) 11 Cal 545:

The effect of Section 74 of the Contract Act was to do away with the distinction between liquidated damages and a penalty, and to leave it to the Court in all cases in which a sum is named in the contract as the amount to be paid, to award against the party who has broken the contract reasonable compensation not exceeding sum named.

It was observed:

It is clear that the Court might have awarded the full sum stipulated without any proof of damages or loss. The plaintiff gave no proof of actual damage or loss, and the Court assessed the damages with reference wholly to the increased emoluments which the defendant had drawn subsequent to the time when the agreement came into operation.

It was further observed at page 551:

No doubt the Court has a discretion to fix what it considers reasonable compensation; but when the parties have already agreed among themselves as to what the penalty should be, we think the Court should not in fixing the compensation, wholly ignore the amount agreed on, unless this is, on its face, wholly unreasonable with reference to the position of the parties and the breach provided against.

In the instant case, there is no sum named, but a particular formula has been adopted. The formula when worked out would result in naming a sum which would be highly unreasonable having regard to the injury caused.

20. In Satyanarayan Amolakchand Bhut Vs. Vithal Narayan Jamdar, Mudholkar, J. (as he then was), had an occasion to consider the question and has observed at p. 1072 of the report that: The learned Judge has further observed:

If the sum mentioned in the contract as damages payable by the defendant to the plaintiff is a pre-estimate by the parties, Section 74 of the Contract Act would apply and would entitle the plaintiff to reasonable damages not exceeding the amount so named in case there was a breach of the contract by the defendant.

If, however, this amount has been mentioned in terrorem, it would be by way of penalty and the plaintiff would not be entitled to claim this amount or any reasonable amount unless it is shown that he has actually sustained damages.

Thus, the learned Judge has made a distinction between the case where the sum stipulated is by way of a genuine pre-estimate and the case where it is by way of penalty. Even in the former case, in the view of the learned Judge, what is awardable for breach of contract is reasonable damages, not exceeding the amount so named. Thus, even assuming that the instant case is one where there is a sum named as payable by way of damages and that such a sum is a pre-estimate by the parties, even then, the plaintiff would be entitled only to reasonable damages not exceeding the amount so named. In this view of the matter also, the plaintiff Company would not be entitled to a sum higher than Rs. 1, 380/- as compensation as observed by me earlier.

21. As aforesaid, I am of the view that, having regard to the terms of Clause 18 of the service agreement which does not provide for graduated damages, but which provides for compensation to be paid on the [basis of a set formula and this is irrespective of the length of service or the period of specialized training and the nature of the breach, the formula set up would work out a sum payable by way of compensation, which would be out of all proportion to the legal injury sustained by the Company for breach of the service contract by the defendant. Thus, the stipulation in the covenant is one in terrorem of the defendant and is in the nature of a penalty and the plaintiff Company would be entitled to a reasonable compensation. Assuming that it is in the nature of liquidated damages, even then, taking an integrated view of all the facts and circumstances

of the case including the nature and length of the service and the terms of the contract, in my opinion, the plaintiff Company would not be entitled to anything more than the reasonable compensation not exceeding the maximum amount to be worked out with the aid of the set formula. In either event, therefore, the plaintiff would be entitled to a sum of Rs. 1,380/- only instead of Rs. 3, 945/- as reasonable compensation.

22. Accordingly, I order and decree that the plaintiff Company do recover from the defendant a sum of Rs. 1, 380/- as compensation with future interest at the rate of 4% per annum from the date of the suit till realization. The plaintiff Company will receive from the defendant proportionate costs all throughout to the extent it has succeeded and will pay the proportionate costs of the defendant to the extent it has lost The decree to be substituted for the one passed by the lower Court. Decree accordingly.