
(1980) 03 MAD CK 0047
In the Madras High Court
Case No : App. No. 232 of 1976

S. Natesa Mudaliar (died) and others	Vs	APPELLANT
T. Sulochana Ammal		RESPONDENT

Date of Decision : 21-03-1980

Acts Referred:

Contract Act, 1872 — Section 74

Citation : (1980) 03 MAD CK 0047

Hon'ble Judges : Padmanabhan, J;Natarajan, J

Bench : Division Bench

Advocate : D.C. Krishnamurthi and D. Kuppuraja, for the Appellant; D. Srinivasagopalan, for the Respondent

Judgement

Padmanabhan, J.—The defendants in Original Suit No. 59 of 1971 on the file of the Court of the Subordinate Judge of Vellore, are the appellants. Pending the appeal the first appellant (first defendant) died. The second appellant (second defendant) and appellants 3 and 4 have been brought on record as legal representatives. The facts of the case may be briefly set out as follows : The second defendant is the son of the first defendant. The suit property is a house property in Vellore town. On 7th December, 1969 defendants 1 and 2 entered into Ex. A1 agreement with the plaintiff by which they promised to sell the suit property to the plaintiff for a sum of Rs. 1,60,000. On the date of the agreement a sum of Rs. 27,500 was paid by the plaintiff to defendants 1 and 2 as advance. It was agreed that on or before 6th March, 1970 the plaintiff should pay the balance of Rs. 1,32,500 and get the sale deed executed and registered. If the plaintiff failed to do so the advance amount of Rs. 27,500 would be forfeited. If, on the other hand, defendants 1 and 2 committed default in the execution of the sale deed within the fixed period, defendants 1 and 2 should refund the advance amount of Rs. 27,500 and further will be bound by the proceedings that might be taken by the plaintiff for specific performance. According to the plaintiff, since defendants 1 and 2 committed breach of Ex. A1 agreement she filed the suit for the recovery of the advance amount of Rs. 27,500 together with interest. The

total sum claimed in the plaint is Rs. 29,649.50. It is the plaintiff's case that at the time of Ex.A1 agreement the defendants undertook to show the title deeds before the execution of the sale deed, but failed to do so. They assured the plaintiff that there were no encumbrances over the property agreed to be sold. However, the plaintiff obtained an encumbrance certificate and found that the property was subject to a prior encumbrance of Rs. 50,000 to one Vijayaranga Mudaliar. There was another mortgage, dt. 6th January, 1964 to the extent of Rs. 29,000 subsisting in favour of Chagganlal Kalidoss and Company, yet another mortgage for Rs. 40,000 in favour of one, Kuppuswami Naicker of Madras. The plaintiff also came to know that the property agreed to be sold was subject to orders of attachment obtained in execution of a decree in O.S. No. 6818 of 1965 and O.S No. 82 of 1968, on the file of the City Civil Court, Bombay, for a total sum of Rs. 30,000. The heirs of one of the mortgagees, Kuppuswami Naicker had obtained a mortgage decree and were taking steps to bring the hypotheca to sale. The defendants were said to be in arrears of income tax to the extent of Rs. 10,000 and municipal tax to the extent of Rs. 7,000. On 5th March 1970 the plaintiff issued a notice, Ex.B35, calling upon the defendants to discharge the encumbrances and tax liabilities to enable the sale transaction to be pushed through or in default to return the advance sum of Rs. 27,500. The defendants sent a reply Ex. B16 on 8th March, 1970 wherein they have stated that the plaintiff has committed breach of the contract and that consequently the sum of Rs. 27,500 was liable to be forfeited. Consequently, the plaintiff has filed the suit for the recovery of the advance amount of Rs. 27,500 with interest at 6% per annum from 7th December, 1969 till the date of realisation. The plaintiff has further pleaded that even if the Court were to find that she has committed breach of the contract, the defendants could not forfeit the entire sum of Rs. 27,5000 under S.74 of the Contract Act.

2. The first defendant in his written statement admitted the execution of the agreement for sale. According to the first defendant, he was once in affluent circumstances, but unfortunately he went into financial difficulties later on. Therefore, the defendants were considering the disposal of their residential house in Vellore for the purpose of liquidating their debts. While so, the plaintiff approached them through one broker Kasiviswanathan. The plaintiff inspected the property agreed to be sold and also made enquiries about the title of the defendants to the said property. The first defendant then explained in detail the circumstances in which he wanted to sell the property and demanded a sum of Rs. 1,75,000. Finally, the sale consideration was settled at Rs. 1,60,000. At that time the two mortgagees had filed suits in the Vellore Sub-Court and three other creditors had attached the property. In fact, the plaintiff's counsel, Mr. N.S. Ramanathan was appearing for two of the creditors. The defendants agreed to sell the property for Rs. 1,60,000 but at the time of execution of the agreement for sale the plaintiff insisted upon the price being reduced to Rs. 1,55,000 and on account of their financial embarrassment, the defendants agreed to reduce the price by Rs. 2,500. But by that time the scribe had started to write the

agreement. Therefore, instead of rewriting the agreement it was stated that the advance amount paid was Rs. 27,500 instead of Rs. 25,000 and the balance amount payable as Rs. 1,32,500. But, actually only a sum of Rs. 25,000 was paid. The sum of Rs. 25,000 was paid an earnest money and not as advance of sale consideration as stated in the plaint. Since the original title deeds were with the mortgagees, the defendants handed over copies of the mortgage documents to the plaintiff. All the encumbrances were disclosed at the time of negotiations for sale. As a matter of fact, the defendants had explained to the plaintiff that they were constrained to sell the property only for the purpose of liquidating the debts. After the agreement for sale, the defendants negotiated with the creditors for scaling down the debts. The Bombay decree-holder who had attached the property agreed to receive Rs. 12,000 in full satisfaction of the two claims and the negotiation was concluded by Mr. Ramanathan, the standing counsel for the plaintiff. The mortgagee agreed to receive Rs. 50,000 and Rs. 30,000 as against the decree amount. There was no problem on account of the income tax arrears as the tax had only to be adjusted against the rent payable by the income tax department which is housed in the suit property. There was no impediment on the side of the defendants in completing the sale transaction within the specified time. Subsequently, the plaintiff and her brother had second thoughts in the matter of the completion of the sale transaction. On 3rd March, 1970 the plaintiff's brother and the broker Kasiviswanathan in the company of Margabandhu, the scribe and Thorapadi Jagadeesan met the defendants and requested for more time. The defendants expressed their difficulty to extend the time as they had in turn promised their creditors to make payments by the middle of March. The defendants therefore, suggested that the document might be written and executed. Though the plaintiff's brother agreed and promised to call again with the requisite non-judicial stamp paper, neither the plaintiff nor her brother turned up. The arrangement according to the defendants was that the plaintiff should pay the creditors of the defendants the amounts agreed to be received by them and the balance to the defendants. However, the plaintiff committed default and failed to pay the balance of sale consideration and get the documents executed and registered. In the circumstances, the defendants are entitled to forfeit the sum of Rs. 25,000 and the said amount is not refundable. On account of the conduct of the plaintiff the property itself depreciated in value and consequently the defendants have suffered loss on that account also. Therefore, the defendants have prayed that the suit should be dismissed.

3. An additional written statement has been filed by the first defendant. In the additional written statement it is stated that the case of the plaintiff that the clause relating to forfeiture of the advance amount amounts to a penalty is not sustainable. According to the defendants they have suffered greater loss than the plaintiff. A valuable property of the defendants had to be sold in Court sale, because of the breach committed by the plaintiff and the defendants had to suffer a loss of Rs. 30,000. Further, the defendants have suffered loss by way of accumulation of interest on the debts unpaid by them. They have also lost the

advantage of the discount which their creditors had agreed to give them provided the amounts were paid on the agreed date.

4. The second defendant has also filed a separate written statement. He has taken the plea that the defendants have suffered damages to the extent of more than Rs. 44,000 and that consequently the plaintiff was liable to forfeit the sum of Rs. 25,000 paid by her.

5. The plaintiff has filed a reply statement traversing the averments in the written statement filed by defendants 1 and 2. According to her the sale consideration was only Rs. 1,60,000 and not Rs. 1,57,500 as stated in the written statement. A sum of Rs. 27,500 was actually paid and not Rs. 25,000 as stated by the defendants. The said sum was paid as advance and not as earnest money. The averments that the plaintiff was aware of the details of the encumbrances over the property have been denied. The plaintiff has also denied that Mr. Ramanathan had anything to do with the execution of Ex. A1 agreement for sale. She has also denied the fact that on 3rd March, 1970 her brother called on the defendants and pleaded for more time. On the other hand, according to the plaintiff the defendants were never ready to give a clear and good title of the property free from encumbrances.

6. On the above pleadings, the following issues were raised for trial--

1. Whether a sum of Rs. 25,000 only had been paid under the suit agreement?
2. Whether the amount paid under suit agreement was an advance or on earnest money?
3. Whether the defendants have committed breach of the suit agreement and is the plaintiff entitled to get return of the amount paid under the suit agreement?
4. Whether the plaintiff is entitled to recover any damages by way of interest on the amount paid under the suit agreement?
5. To what relief, is plaintiff entitled?

Additional issue framed on 1st August, 1973.

1. Whether the forfeiture claim in the suit agreement amounts to penalty and has to be relieved against?

7. The trial Court found that a sum of Rs. 25,000 only was paid. The trial Court further found that the defendants did not commit breach of the contract, and that the sum of Rs. 25,000 was paid as earnest money and that the clause relating to forfeiture did not amount to a penalty. However, the trial Court found that the plaintiff was entitled to get a refund of the amount. In the circumstances, the trial Court granted a decree in favour of the plaintiff for the recovery of Rs. 25,000 by its judgment and decree, dated 9th October, 1975. Aggrieved by the judgment and decree of the trial Court the defendants have preferred this appeal.

8. The respondent-plaintiff has filed a memorandum of cross-objections. According to her the advance paid by her was Rs. 27,500 and not Rs. 25,000. She has further stated that she should have been awarded interest on the amount decreed. A specific ground has been taken in the memorandum of cross-objections that costs should have been awarded.

9. It will be convenient to dispose of the memorandum of cross-objections first. Mr. D.K. Srinivasa Gopalan, the learned counsel for the respondent took exception to the finding of the trial Court that the plaintiff committed breach of Ex.A1 agreement. The learned counsel submitted that at the time the parties entered into the agreement for sale the defendants undertook to furnish the title deeds for inspection and also disclose the encumbrances. He referred to paragraph 4 of the written statement and submitted that the defendants themselves had admitted, in their written statement that they were in financial difficulties and that consequently they were constrained to enter into Ex.A1 agreement for sale with the plaintiff. The learned counsel further submitted that subsequently it came to light that the encumbrances over the property were much more than the sale consideration recited in Ex.A1 agreement for sale. On the other hand, it is the case of the defendants that even at the time of the execution of the agreement for sale the plaintiff was fully made aware of the encumbrances subsisting over the property and the necessity for the defendants to dispose of the property in order to liquidate the debts. The question for consideration is which of the two versions can be accepted. Exs.A22 and A23 are the encumbrance certificates. Ex. A22 is dated 9th February, 1970. No encumbrance is shown in Ex.A22. Ex.A23 is dated 18th February, 1970. Ex.A23 shows a mortgage, dt. 25th June, 1960 for Rs. 50,000 in favour of one Vijayaranga Mudaliar, another mortgage, dt. 21st June, 1963 for Rs. 40,000 in favour of Kuppusamy Naicker and a further charge dt. 6th January, 1964 to the extent of Rs. 29,000 in favour of Chhaganlal Kalidoss and Company. Exs.A24 to A27 are documents to prove that one of the creditors of the defendants in Bombay had obtained decree in the Bombay Court and had got the decree transferred for execution to the Vellore Court.

10. P.W.1, the plaintiff's brother has given evidence that the plaintiff came to know about the encumbrance only after she obtained Exs. A22 and A23 encumbrance certificate and copies of Exs. A24 to A27. He has further deposed that the defendants are in arrears of income tax to the extent of Rs. 10,000 and Municipal tax to the extent of Rs. 7,000. P.W.1 has further stated that one, Veera Raghava Mudaliar told him that the defendants owed him Rs. 50,000. Further, P.W.1 has also stated that the defendants owed moneys to various other parties. Consequently, the plaintiff did not conclude the contract.

11. On the other hand, the first defendant has given evidence as D.W.1. He was engaged on Mandi business in fruits and was very well-off. Unfortunately, he went into bad times, with the result he incurred heavy liabilities. For liquidating his debts he had to sell all his other properties and execute a mortgage in favour

of Vijayaranga Mudaliar for Rs. 50,000. He admitted having borrowed Rs. 40,000 under a mortgage from Kuppuswamy Naicker, but according to him with the mortgage money and another sum of Rs. 10,000 he discharged the debts due to Vijayaranga Mudaliar. In 1968 the mortgagee Kuppuswamy Naicker's heirs filed a suit for the recovery of the mortgage debt in which the charge holder Chhaganlal Kalidoss was also impleaded as a party. The Bombay decree-holder had also attached the property for about Rs. 10,000. He has leased the Ex. A1 house to the income tax department. The department was paying a monthly rent of Rs. 900 and towards the income tax arrears they were adjusting a sum of Rs. 400 every month, and on the date of Ex.A1 agreement the amount due to the income tax department was only about Rs. 5,000. He has further deposed that it was on account of the financial crisis in which he and his son found themselves he decided to sell the Ex. A1 house. P.W.1 approached him through D.W. 3 Kasiviswanathan and after bargaining on the part of P.W.1 he agreed to sell the property for Rs. 1,60,000. It was made clear even at the time of negotiations that Ex. A1 property was proposed to be sold only for the purpose of discharging the mortgage debts and other decree debts. The copies of the mortgage deeds were handed over to P.W.1. Further, P.W.1 was informed that the mortgagee's heirs had agreed to receive an amount of Rs. 50,000 in full satisfaction of their claim and that another mortgagee had also agreed to receive Rs. 30,000 and that the Bombay decree-holders have agreed to receive Rs. 12,000 in full satisfaction if the amounts were paid in the second week of March, 1970. P.W.1 had undertaken to meet the heirs of Kuppuswamy, the mortgagee at Madras and pay the amount agreed upon. However, he failed to do so. According to D.W.1, P.W.1 met him in the company of D.W.3 on 3rd March, 1970, and requested for further time to pay the balance of the sale consideration and complete the transaction. However, D.W.1 informed P.W.1 that his creditors were not willing to extend the time. However, he would extend the time for registration by four months provided the document was executed. P.W.1 never returned thereafter. D.W.3 is Kasiviswanathan, the broker. He has stated that he had known P.W.1 for nearly 25 years and that he had requested him to negotiate for the purchase of Ex. A1 property from the defendants. At that time, the sale consideration was originally fixed at Rs. 1,60,000. However, at the time of the execution of the agreement P.W.1 insisted upon the amount being reduced to Rs. 1,55,000 and finally at the instance of D.W. 3 the parties agreed to fix the sale price at Rs. 1,57,500. Rs. 25,000 was paid as advance, and since the sale consideration had been entered in the agreement as Rs. 1,60,000 the advance amount was shown as Rs. 27,500. He has further stated that the first defendant told him that he owed Rs. 40,000 to Kuppuswamy, Rs. 15,000 to one Sait Rs. 6,000 to Rs. 7,000 to the income tax department and that the property was being sold for the discharge of these debts. He has further given evidence that P.W.1 and he met the first defendant about the expiry of the period fixed in Ex.A1 and requested for three months extension of time. The first defendant then told them that they should get the document prepared and executed and that the same could be registered within four months. P.W.1 stated that he would consider the same and

give a reply the next day. When subsequently D.W. 3 enquired of P.W. 1 about the same he is said to have told D.W.3 that he had obtained a site beside the C.M.C. Hospital, Vellore, and that money was required for that purpose and that the finalisation of Ex.A1 agreement could be kept pending. The witness has also stated that subsequently the plaintiff had put up a construction on the said site and that the said construction would yield Rs. 5,000 to Rs. 6,000 towards rent per month. D.W.3's evidence has not been shaken in any manner in cross-examination. D.W. 4 is the second defendant. He has also corroborated the evidence of D.W.1. D.W.2 is one of the attestors to Ex.A1 agreement for sale. He has spoken to the fact that originally the sale price was fixed at Rs. 1,60,000 and that when the document was being written the amount was reduced to Rs. 1,57,000, Though a sum of Rs. 25,000 was only paid as advance it was shown in the document that a sum of Rs. 27,500 was paid. He has also deposed that the first defendant stated that there were encumbrances over the property and decrees against him and that he was selling the property for discharging those debts. His evidence has not been shaken in cross-examination. The trial Court has accepted the evidence of D.Ws. 1 to 4. Mr. Srinivasa Gopalan has not been able to convince us that the trial Court was not justified in accepting the evidence of D.Ws. 1 to 4.

12. As rightly pointed out by the trial Court the plaintiff has not examined any other witness, excepting P.W.1, her brother who was connected with the execution of Ex.A1, like the attesor or the scribe. Further it is impossible to believe P.W.1 when he says that without making any enquiries regarding the encumbrances over the property he paid a large sum of money, viz., Rs. 25,000 at the time of the execution of the agreement for sale towards advance and further agreed to forfeit the amount in the event of the failure to complete the sale transaction. P.W.1 has admitted that he had gone to Madras with money sometime in January, 1970 to meet Balakrishnan, son of mortgagee Kuppuswamy. This probablises the version of D.W.1 that he had asked P.W.1 to pay the amount to Balakrishnan who had agreed to scale down the debt. Ex.B1 is the income tax clearance certificate, obtained by the defendants. Ex.B4 is a letter sent by the second defendant to the first defendant from Bombay which shows that the Bombay decree-holders finally agreed to receive Rs. 12,000 in full satisfaction of the two decree debts as against Rs. 18,000. Therefore, the version of the plaintiff that she was not made aware of the encumbrances over the property and that therefore, when she came to know that there were large encumbrances over the property, she decided to back out from the transaction, cannot be believed. The learned Subordinate Judge has also referred to the evidence of D.W. 5 who is an assistant employed in the municipality. His evidence shows that the plaintiff started the construction of a building opposite to C.M.C. Hospital in Vellore and notice was issued by the Municipality to the plaintiff under Ex.B7, dated 2nd June, 1970. Thereafter, the plaintiff obtained necessary licence for the construction as evidenced by Exs. B8 to B15. It is not disputed that a large construction which would fetch a monthly rent of Rs. 5,000 to Rs. 6,000

has been erected on the said site. As rightly pointed out by the trial Court this probabalises the version of D.W. 3 that the plaintiff was not interested in finalising the sale transaction as the plaintiff then was interested in putting up the construction on the site opposite to C.M.C. Hospital. We therefore, confirm the finding of the trial Court that the plaintiff committed breach of contract and not the defendants.

13. The next question for consideration is whether Rs. 27,500 was paid or Rs. 25,000. We have already accepted the evidence of D. Ws. 1 to 4 as against the evidence of P.W.1. D.Ws.1 to 4 have clearly stated that only a sum of Rs. 25,000 was paid by the plaintiff to the defendants at the time of the execution of Ex.A1 agreement. They have explained the circumstances in which the amount was shown as Rs. 27,500. In view of the fact that we have agreed with the trial Court that the evidence of D.Ws. 1 to 4 should be accepted, we confirm the finding of the trial, Court that only a sum of Rs. 25,000 was paid by the plaintiff to the defendants at the time of execution of Ex.A1 agreement.

14. It will be convenient at this stage to consider the main contention of Mr. D.C. Krishnamurthi in the appeal that once the trial Court had found that it was the plaintiff who committed the breach of contract and further that the sum of Rs. 25,000 was paid as earnest money, the trial Court ought not to have granted a decree for the refund of the said amount. On the other hand Mr. Srinivasa Gopalan contended that the sum of Rs. 25,000 was not paid as earnest money but only as advance and that the clause relating to forfeiture of the said amount was in the nature of a penalty and could not be enforced. The learned counsel further argued that even assuming that the said amount was paid as earnest money, the defendants could not forfeit the entire amount and that they could claim to retain only such reasonable amount which they would have sustained as loss because of the breach of the contract by the plaintiff by way of damages and that in the instant case the defendants had not proved that they had suffered any loss and that consequently, the entire amount was refundable.

15. It was not disputed by Mr. D.C. Krishnamurthi that it would be open to Mr. Srinivasa Gopalan to challenge the finding of the trial Court that the sum of Rs. 25,000 was not paid as advance but as earnest money. Even though he had not filed a cross-objection against the said finding it would be open to a party to support the decree of the court below on any of the grounds decided against him under O.41, R.22, C.P.C. Therefore, the question that falls to be considered is whether the sum of Rs. 25,000 was paid as earnest money or as advance.

16. In Meenakshinada Deikshitar Vs. Murugesu Nadar and Another, , Ramaprasada Rao, J. (as he then was), on a consideration of the earlier precedents on the subject has explained the word "deposit" or "earnest money" thus:

Deposit or earnest money is not part of the price bargained for but it is unambiguously paid for the due performance of the contract. Any money paid

contemporaneously with the execution of a contract cannot be treated as "deposit".

The learned Judge has referred to the observations of Cotton, and Fry, L.J., in *Rowe v. Smith* (1884) 27 Ch. D. 89 and the Privy Council in *Chiranjit Singh v. Har Swarup* 50 M.L.J. 629=23 L.W. 172=A.I.R. 1926 P.C.1. Then, the learned Judge has observed as follows:

Incidentally in some contracts the word "advance" is used. Mere misdescriptive nomenclature will not conclude matters. What may be called "advance" may be "deposit" and what may be termed "deposit" may ultimately be proved to be advance. In either case it is the intention of the parties that governs. The cardinal rule of interpretation of contract, whether mercantile or otherwise, is to find out the intention of the parties. Such an intention could be gathered by the express terms of the contract or from the contract and by the surrounding circumstances incidental to such a contract. The expression adopted may be a guide to find out such an intention. But it is not always the sole guide.

17. In *Shri Hanuman Cotton Mills and Others Vs. Tata Air Craft Limited*, the following tests have been laid down by Vaidialingam, J. to find out whether the payment is a deposit or earnest money :

(1) it must be given at the moment at which the contract is concluded ; (2) It represents a guarantee that the contract will be fulfilled or in other words, "earnest" is given to bind the contract ; (3) It is part of the purchase price when the transaction is carried out ; (4) it is forfeited when the transaction falls through by reason of the default or failure of the purchaser, and (5) unless there is anything to the contrary in the terms of the contract, on default committed by the buyer the seller is entitled to forfeit the earnest.

18. In *Fateh Chand Vs. Balkishan Das*, a covenant in a contract for sale of certain land and building standing thereon provided that if for any reason the vendee failed to get the sale deed registered by the date stipulated, the amount of Rs. 25,000 (Rs. 1,000 paid as earnest money and Rs. 24,000 paid out of the sale price on delivery of possession) shall stand forfeited and the agreement shall be deemed cancelled. Dealing with the contention whether the sum of Rs. 24,000 should be deemed to be a deposit or earnest money for due performance of the contract, the Supreme Court observed as follows:

If the amount of Rs. 24,000 to be paid when vacant possession of the land and building was delivered expressly referred to in the agreement as "out of the sale price" the amount of Rs. 24,000 cannot be regarded as earnest money or a deposit for due performance of the contract. It cannot be assumed that because there is stipulation for forfeiture, the amount paid must bear the character of a deposit for due performance of the contract.

19. In the light of the above principles, we have to consider whether the sum of Rs. 25,000 paid in this case was by way of advance or earnest money. On a

perusal of Ex. A1, agreement for sale we have no hesitation to arrive at the conclusion that the sum of Rs. 25,000 was paid only by way of advance and not as earnest money. The very first statement that is found in Ex. A1 is :

Therefore, the sum of Rs. 25,000 as per our finding for Rs. 27,500 as stated in the document, has been described as advance amount. Secondly, it is made clear in Ex. A1 that within a period of three months from that date, i.e. before 6th March, 1970 the balance sale consideration of Rs. 1,32,500 should be paid and the document registered. It is further stated that if the plaintiff failed to pay the balance amount before 6th March, 1970 and get the document registered, the defendants will be entitled to forfeit the advance amount paid. It is again mentioned that if defendants 1 and 2 committed default in registering the document they will be liable to return the advance amount and will be subject to the proceedings that might be initiated by the plaintiff for specific performance of the agreement for sale. No doubt, there is the clause that in the event of default on the part of the plaintiff the amount paid as advance would be forfeited. Merely because there is such a stipulation for forfeiture, it cannot be said that the amount paid bears the character of earnest money for the due performance of the contract. There is nothing in the terms of Ex. A1 to show that the amount was paid as a guarantee on the part of the plaintiff that she would fulfil the contract. On a reading of the terms of Ex. A1 agreement for sale we are convinced, that the intention of the parties was not that the sum of Rs. 25,000 which according to us is the amount paid at the time Ex. A1 was entered into should be treated as deposit or earnest money and not as advance or part of the sale consideration. This conclusion of ours is further strengthened by the fact that the sum of Rs. 25,000 paid at the time of Ex. A1 agreement for sale represents an appreciable percentage of the sale consideration. It works out roughly at 15.6% of the total consideration. Normally, the earnest money will form a small percentage of the total sale consideration to be passed on by one to the other under a contract for sale. In view of the fact that in this particular case the amount that was originally paid forms an appreciable percentage of the sale consideration, it is but proper to conclude that parties must have intended to treat the amount as advance and not as earnest money.

20. In this context, it is relevant to refer to a Bench decision of this Court rendered by Ramaprasada Rao, C.J., and Ramanujam, J. in *Marimuthu Gounder Vs. Ramaswamy Gounder and Others*, There the plaintiff entered into an agreement for sale with the defendants and paid a sum of Rs. 10,000 as advance. The agreement for sale having fallen through the plaintiff sued the defendants for the refund of the advance paid on the ground that the defendants had committed breach of contract. It was contended on behalf of the defendants that it was the plaintiff who had committed default and that the sum of Rs. 10,000 had to be forfeited. On the question whether the amount paid was to be treated as advance of sale consideration or as earnest money or deposit, Ramaprasada Rao, C.J., speaking for the Bench observed as follows:

It is reasonable to characterise the amount concerned as advance since it bore a very great proportion to the totality of the consideration as well. Generally, earnest money forms a small proportion or ratio to the consideration to be passed by one to the other under a contract of sale.

21. We therefore, find differing from the trial Court that the sum of Rs. 25,000 was paid as advance and not as deposit or earnest money.

22. The next aspect that has to be considered is whether the plaintiff is entitled to the refund of the sum of Rs. 25,000 or the defendants are entitled to forfeit the same as provided for in the agreement for sale. It is, common ground that in such a case the situation is governed by the provisions of S.74 of the Contract Act. S.74 of the Contract Act reads as follows:

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.

S.74 of the Contract Act has come up for interpretation before the Supreme Court in *Fatech Chand v. Balkishan Dass* (1954) 1 S.C.J. 187=1963 S.C. 1405. There, as already stated, a covenant in a contract for sale of certain land and building standing thereon provided that if for any reason the vendee failed to get the sale deed registered by the date stipulated, the amount of Rs. 25,000 (Rs. 1,000 paid as earnest money and Rs. 24,000 paid out of the price on delivery of possession) shall stand forfeited and the agreement shall be deemed cancelled. It was contended that the covenant for forfeiture of Rs. 24,000 was manifestly stipulation by way of penalty. The Supreme Court observed as follows :

S.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 S.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 a 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, of which the parties knew when they made the contract, to be likely to result from the breach. Before turning to the question about the compensation which may be awarded to the plaintiff, it is necessary to consider whether S.74 applies to stipulations for forfeiture of amounts deposited or paid under the contract. It was urged that the section deals in terms with the right to receive from the party who has broken the contract reasonable compensation and not the right to forfeit what has already been received by the party aggrieved. There is however, no warrant for the assumption made by some of the High Courts in India, that S. 74 applies only to cases where the aggrieved party is seeking to receive some amount on breach of contract and not to cases where upon 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 S.74. In all cases, therefore, whether there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of the 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.

Then again the Supreme Court observed as follows:--

S.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.

23. In the Bench decision already referred to in *Marimuthu Gounder v. Ramaswamy Gounder* 1979-1 M.L.J. 343=92 L.W. 3 = 1979 Mad 189 it has been observed thus:

Proof of actual damage was a sine qua non to seek damages. In the absence of any proof or, even an allegation in the pleading of such damage, it appeared that the conclusion of the single Judge of the High Court was right.

It is therefore, clear that the clause in Ex.A1 which provides for forfeiture of a sum of Rs. 25,000 is in the nature of a penalty and the defendants will be entitled only to reasonable compensation for the damage sustained by them subject to the maximum amount of Rs. 25,000 which has been fixed under the agreement for sale.

24. The law is not different even if it is assumed as contended for by Mr. D.C. Krishnamurthi and as found by the trial Court that the sum of Rs. 25,000 was paid as earnest money or deposit, if the amount stipulated is unreasonable and is in the nature of a penalty.

25. In *Maula Bux v. Union of India* 1970 2 M.L.J. (S.C.) 61 = 1970 S.C. 1955 the facts were these: The appellant entered into a contract with the respondent to supply some goods and deposited a certain amount as, security for the performance of the contract. It was stipulated that the amounts were to stand forfeited in case the appellant neglected to perform his part of the contract. When the appellant made defaults in the supply, the respondent rescinded the contract and forfeited the amount deposited. The appellant filed a suit for recovery of the amount with interest. The trial Court decreed the suit, holding, that the respondent was justified in rescinding the contracts, but could not forfeit the deposit, for, it had not suffered any loss in consequence of the default committed by the appellant. The High Court modified the decree and awarded the respondent a major portion of the forfeiture of a sum deposited by way of security for due performance of a contract ; where the amount forfeited was not unreasonable, S. 74 of the Contract Act had no application and that the deposits so made could be regarded as earnest money. Dealing with the question whether S. 74 of the Contract Act applies to a case of deposit for due performance of a contract which has stipulated for forfeiture for breach, the Supreme Court after extracting S. 74 observed as follows :

There is authority, no doubt, coloured by the view which was taken in English cases that S. 74 of the Contract Act has no application to cases of deposits for due performance of a contract which is stipulated to be forfeited for breach: *Natesa Aiyar v. Appavu Padayachi* 38 Mad. 278 *Singer Manufacturing Company v. Raja Prasad* 36 Cal. 960 *Manian Patter v. The Madras Railway Company* 19 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 page 526; "S. 74 of the Indian Contract Act deals with the measure of damages in two classes of cases

(i) where the contract names a sum to be paid in case of breach, and (ii) where the contract contains any other stipulation by way of penalty....The measure of damages in the case of breach of a stipulation by way of penalty is by S. 74 reasonable compensation not exceeding the penalty stipulated. It is further observed thus: "Forfeiture of earnest money under a contract for sale of property--movable or immovable--if the amount is reasonable, does not fall within S.74. That has been decided in several cases; Kunwar Chiranjit Singh v. Har Swarup 50 M.L.J. 629=A.I.R. 1926 P.C. 1; Roshan Lal v. The Delhi Cloth General Mills Company Limited Delhi 33 All. 166; Muhammad Habibullah v. Muhammad Shaft 41 All. 324 Bishan Chand v. Radha Kishan Das 19 All. 490. These cases are easily explained, for forfeiture of a reasonable amount paid as earnest money does not amount to imposing a penalty. But if forfeiture is of the nature of penalty S.74 applies. Where under the terms of the contract the party in breach has undertaken to pay a sum of money or to forfeit a sum of money which he has already paid to the party complaining of a breach of contract, the undertaking is of the nature of a penalty.

27. However, Mr. D.C. Krishnamurthi cited the decision of the Supreme Court in Shree Hanuman Cotton Mills and others v. Tata Air Craft Limited (1970) 3 S.C.R. 157=(1970) 2 S.C.J. 420, and contended that earnest money or deposit represents a guarantee that the contract will be fulfilled or in other words earnest is given to bind the contract. Unless there is anything to the contrary in the terms of the contract, on default committed by the buyer, the seller is entitled to forfeit the earnest. In such cases, the question of reasonableness or otherwise will not arise at all for consideration and the matter will not fall under S. 74 of the Contract Act.

27. In Shree Hanuman Cotton Mills and others v. Tata Air Craft Limited (1970) 3 S.C.R. 157=(1970) 2 S.C.J. 420, it was urged on behalf of the contracting party in default (who were the appellants before the Supreme Court) that earnest money unless it was considered to be a reasonable amount could not be forfeited in law. Per contra, it was contended by the learned Attorney General for the opposite side that the question of the quantum of earnest deposit which was forfeited being unreasonable, or forfeiture being by way of penalty, was never raised by the appellants. It was further pleaded that unless the appellants had pleaded and established that there was unreasonableness attached to the amount required to be deposited under the contractor that the clause regarding forfeiture amounted to a stipulation by way of a penalty, the respondents had no opportunity to satisfy the Court that no question of unreasonableness or the stipulation being by way of penalty arises, The Supreme Court observed as follows :

In our opinion the learned Attorney-General is well-founded in his contention that the appellants raised no such contentions covered by the second point, noted above. It is therefore, unnecessary for us to go into the question as to whether the amount deposited by the appellants, in this case, by way of earnest and

forfeited as such, can be considered to be reasonable or not. We express no opinion on the question as to whether the element of unreasonableness can ever be considered regarding the forfeiture of an amount deposited by way of earnest and if so, what are the necessary factors to be taken into account in considering the reasonableness or otherwise of the amount deposited by way of earnest. If the appellants were contesting the claim on any such grounds, they should have laid the foundation for the same by raising appropriate pleas and also led proper evidence regarding the same, so that the respondents would have had an opportunity of meeting such a claim. In this view, it is unnecessary for us to consider the decision of this Court in *Maula Bux Vs. Union of India (UOI)*, relied on by the appellants and wherein there is an observation to the effect : (observation) omitted).

It is therefore clear that in *Shri Hanuman Cotton Mills and Others Vs. Tata Air Craft Limited*, the Supreme Court did not lay down a rule as contended by Mr. D.C. Krishnamurthi that in the case of a claim for forfeiture of deposit or earnest money, the question of reasonableness or otherwise will not arise at all for consideration and that the matter will not fall under S. 74 of the Contract Act.

28. In *Union of India (UOI) Vs. Rampur Distillery and Chemical Co., Ltd.*, the respondents before the Supreme Court, viz., Rampur Distillery and Chemical Co., Ltd., supplied to the appellants. Union of India, a large quantity of rum. The rum was found not to conform to the quality stipulated and was therefore, rejected by the appellants. The appellants then cancelled the contract and forfeited the entire security deposit of Rs. 18,332 which was kept by the respondents for due performance of the contract. On the respondents disputing the right of the appellants to forfeit the security deposit, the dispute was referred to an arbitrator who held that the appellants were entitled under S.74 of the Indian Contract Act to the award of reasonable compensation only which, the arbitrator fixed at Rs. 7,332. He directed the appellants to refund the balance viz., Rs. 11,000 to the respondents. The award was accepted by the trial Judge and a decree was passed in terms of the award which was confirmed by the High Court of Delhi. The Union of India thereupon took the matter in appeal before the Supreme Court on leave being granted by the Delhi High Court. It was contended on behalf of the Union of India that the security deposit was taken from the respondents in order to ensure the due performance of the contract and the respondents having defaulted the entire amount was liable to be forfeited. Dealing with this contention Chandrachud, J. (as he then was) observed as follows :

A similar contention was advanced before this Court but was rejected in *Maula Bux Vs. Union of India (UOI)*, The appellant therein had entered into a contract with the Government of India for the supply of certain goods and had deposited a certain amount of security for the due performance of the contract. As in the instant case, it was stipulated in the contract there that the amount of security deposit was to stand forfeited incase the appellant neglected to perform his part

of the contract. On the appellant committing default in the supply the Government rescinded the contract and forfeited the security deposit. It was held by this Court that forfeiture of earnest money under a contract for sale of property does not fall within S. 74 of the Contract Act, if the amount is reasonable, because the forfeiture of a reasonable sum paid as earnest money does not amount to the imposition of a penalty. But "where under the terms of the contract the party in breach has undertaken to pay a sum of money or to forfeit a sum of money which he has already paid to the party complaining of a breach of contract, the undertaking is of the nature of a penalty".

It is important that the breach of contract caused no loss to the appellants. The stipulated quantity of rum was subsequently supplied to the appellants by the respondents themselves at the same rate. The appellants, in fact, made no attempt to establish that they had suffered any loss or damage on account of the breach committed by the respondents.

In the result the Supreme Court, rejected the claim of the Union of India to forfeit the security deposit.

29. No doubt, *Maula Bux Vs. Union of India (UOI)*, and *Union of India (UOI) Vs. Rampur Distillery and Chemical Co., Ltd.*, are cases where the security deposit was taken for the due performance of a contract. However the principle is not in any way different from a case where there is a clause for forfeiture of earnest money paid under a contract of sale of property movable or in immovable. But in *Maula Bux Vs. Union of India (UOI)*, the Supreme Court has clearly stated that forfeiture of a reasonable amount paid as earnest money does not amount to imposing a penalty, but if the forfeiture is of the nature of penalty then S. 74 applies.

30. In *Meenakshinada Deikshtar Vs. Murugesu Nadar and Another*, which has already been referred to by us, *Ramaprasada Rao, J.* (as he then was) has observed as follows :

In a given contract if a sum is paid under the caption "deposit" or "earnest money" or has to be interpreted as such according to the intentions of parties, and is made forfeitable in case of breach, even then Courts have to adjudge the reasonable compensation to which a party would be entitled to, in such circumstances. Such determination of reasonable compensation can be made either in a suit filed by the depositor (purchaser) against the deposittee (vendor) or in a suit filed by the deposittee (vendor) complaining of such breach.

31. From the above discussion, the following principles emerge; Whether the amount paid at the time of the contract for sale is treated as advance or deposit or earnest money S. 74 will be attracted; notwithstanding the clause for forfeiture of the said amount, the party in breach will be entitled only to reasonable compensation subject to the maximum amount mentioned in the agreement for sale. We are satisfied that the clause for forfeiture of the advance of Rs. 25,000 is in the nature of a penalty and the defendants will therefore be entitled to only

a reasonable compensation. Therefore, whether the payment of Rs. 25,000 is treated as advance or as earnest money the defendants will be entitled only to reasonable compensation for loss sustained. However, we have in this case, definitely found that the payment of Rs. 25,000 was only made by way of advance and therefore, the case squarely falls under S.74 of the Contract Act. The defendants have pleaded in their written statement that on account of the breach of the contract committed by the plaintiff, they have suffered damages. Their creditors had agreed to scale down the amounts payable by them if the debts were discharged in the second week of March. Since the plaintiff committed default the defendants were not in a position to take advantage of the concession offered to them by their creditors. There is absolutely no evidence with regard to the quantum of loss or damage suffered by the defendants on account of the breach of the contract committed by the plaintiff except in the case of the money they owed to their Bombay creditors. Ex. B4 is a letter written by the second defendant from Bombay to the first defendant on 25th January, 1970. There, it is stated that the Bombay decree-holders agreed to accept Rs. 7,000 and Rs. 5,000 in respect of the two decrees they had obtained in O.S. No. 6818 of 1095 and O.S. No. 82 of 1968 on the file of the City Civil Court, Bombay, if the amount was paid forthwith, as against the settled figure of Rs. 18,000. We therefore, feel that the defendant are entitled to adjust a sum of Rs. 6,000 by way of compensation for loss sustained by them on account of the breach of contract committed by the plaintiff.

32. Mr. Srinivasa Gopalan contended that the defendants would not be entitled to any amount being deducted from the sum of Rs. 25,000 so long as there is neither a counter-claim nor a set-off. In this connection, he referred to the observation of Ramaprasada Rao, J. (as he then was) in *Meenakshinada Deikshitar Vs. Murugesu Nadar and Another*, to the following effect : The defendants (vendors) who interdict a claim for refund of deposit have to plead and prove the damage suffered by them upon which the Court will adjudicate as to what may be the reasonable compensation to which the defendants are entitled and deduct the same and award a decree in favour of the plaintiff only for the balance. The procedure which the defendants have to follow in such circumstances is that they are to allege and prove damage to themselves by either putting forward a plea of set-off or of counterclaim against the plaintiff for damages for breach of contract. An independent suit for the same purpose is also maintainable.

In that case, there was a total absence of pleading regarding the character of the amount paid and there was no iota of evidence that it was paid with the intention of treating it as earnest money for due performance of the contract and in any event there was no attempt made on the part of the defendants to prove any damage sustained by them by reason of the plaintiff's default. The observations made by the learned Judge were general in nature. Strictly speaking the principle of set-off or counter-claim will not apply in such a case. The doctrine of set off may be defined as the extinction of debts, of which two persons are reciprocally

debtors to one another by the credits of which they are reciprocally creditors to one another. In this case, it cannot be said that the plaintiff and defendants stand in the capacity of debtors to each other under the terms of the agreement for sale a sum of Rs. 25,000 is liable to be forfeited in the event of there being a breach of contract on the part of the plaintiff. However, by the operation of S.74 of the contract, the defendants are precluded from forfeiting the entire sum of Rs. 25,000 and will be entitled to forfeit that portion of the amount which represents the reasonable amount of damages suffered by them. Therefore, the sum of Rs. 6,000 which we have found as due to the defendants by way of penalty suffered by them on account of the breach of contract committed by the plaintiff has to go in diminution of the amount liable to be refunded by the defendants, to the plaintiff. Therefore, there is no necessity for the defendants to claim the amount by way of set-off or by way of counterclaim and pay court-fee thereon. We, therefore, overrule the contention of Mr. Srinivasa Gopalan. The net result is, the judgment and decree of the trial Court have to be modified and the defendants' appeal has to be accepted in part. We hold in modification of the decree of the trial Court that the defendants will be entitled to a sum of Rs. 6,000 towards compensation for the loss sustained by them on account of the breach of contract committed by the plaintiff. The defendants are bound to return the balance of Rs. 19,000. In the result, the appeal is partly allowed and the judgment and decree of the trial Court are set aside; in modification thereof there will be a decree in favour of the plaintiff for the recovery of a sum of Rs. 19,000. The parties will be entitled to their costs to the extent of their success in the appeal. The plaintiff will be entitled to interest at 6% per annum from the date of plaint till the date of payment.

The plaintiff in her memorandum of cross-objections claims costs which has been disallowed by the trial Court. The trial Court has given valid reasons for not awarding costs in favour of the plaintiff. We do not consider it just to interfere with the discretion exercised by the trial Court. In the result, the memorandum of cross-objections is dismissed. However, there will be no order as to costs.