(2013) 01 KAR CK 0094

In the Karnataka High Court

Case No : Writ Petition No''s. 27436-437 of 2012 (GM-RES)

Shri K. Babjan and K. Sulaiman APPELLANT

Vs

Shimoga Urban Development Authority and The State of Karnataka RESPONDENT

Date of Decision : 02-01-2013

Acts Referred:

Contract Act, 1872 — Section 74, 74
Karnataka Urban Development Authority (Disposal of Corner sites and commercial sites) Rules, 1991 — Rule 6(3), 6(3)(d)

Citation : AIR 2013 Kar 99 : (2013) 2 AKR 457 : (2013) ILR (Kar) 3765 : (2013) 4 KarLJ 423 : (2013) 2 KCCR 1325

Hon'ble Judges : Dilip B. Bhosale, J

Bench : Single Bench

Advocate : S. Siddappa and Sri. S. Sunil Dutt Nitin, for the Appellant; M. Keshava Reddy, AGA for R2, for the Respondent

Final Decision : Dismissed

Judgement

Dilip B. Bhosale, J.—Heard learned counsel for the petitioners. In these writ petitions, the petitioners seek declaration that Rule 6(3)(d) of the Karnataka Urban Development Authority (Disposal of Corner sites and commercial sites) Rules 1991 (for short "the Rules") is ultra virus the Constitution and is in conflict with Section 74 of the Indian Contract Act. The petitioners have also prayed for a writ of mandamus directing respondent No. 1 to refund an amount of Rs. 1,86,250/- and Rs. 1,56,500/- with interest at the rate of 18% p.a. till the date of payment.

2. The petitioners had participated in an auction of site/s by making a payment of Rs. 10,000/- by way of deposit, as contemplated by clause (a) of sub-rule (3) of Rule 6 of the Rules, in response to the advertisement dated 18.7.2008. They, being the highest bidders, their bid was accepted. They, accordingly, deposited 25% of the bid amount on the spot as contemplated by Clause (b) Sub-rule 3 of Rule 6 of the Rules. They were supposed to pay the balance 75% of the bid

amount within 45 days from the date of receipt of an intimation letter. The first petitioner being the highest bidder in respect of site No. F-87, had paid 25% of the bid value i.e., Rs. 1,86,250/-. Similarly, the 2nd petitioner was the highest bidder in respect of site No. F-88 and he had paid 25% of the bid value i.e., Rs. 1,56,500/-. They did not pay the balance amount within the stipulated time and in view thereof the respondents forfeited the amount paid by the petitioners as provided for under Clause (b) of Sub-rule 3 of Rule 6 thereof.

3. Based on the judgments of the Supreme Court, learned counsel for the petitioners submitted that if the forfeiture is in the nature of penalty, Section 74 of the Indian Contract Act applies. It was submitted that where there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of contract which expressly provides for forfeiture, the Court has jurisdiction to award such sum only as it considers reasonable but not exceeding the amount specified in the contract as liable to forfeiture. It was further submitted that unless the actual loss or damage is proved, it is not open to the respondents to forfeit the amount deposited by the petitioners namely 25% of the bid value on the date of auction. He submitted that in the present case 25% of the amount deposited by the petitioner on the date of auction will have to be regarded as deposit for due performance of the contract and therefore, in any case the entire amount cannot be forfeited. In support of his contentions he placed reliance upon the Judgments of the Supreme Court in Maula Bux Vs. Union of India (UOI), and Fateh Chand Vs. Balkishan Das, It was submitted that forfeiture of the amount deposited by the petitioner is in the nature of penalty, and therefore, Section 74 applies. He did not urge any other contention.

4. Before I proceed further it would be advantageous to reproduce the provisions contained in sub-rule (3) of Rule 6 of the Rules which read thus:

(3) (a) All the persons intending to take part in auction sale shall before the commencement of auction deposit an amount not less than Rupees Five thousand with the Commissioner or such other Officer authorized by the authority to conduct the auction sale. The amount so deposited shall be refunded to the unsuccessful bidders, on the spot;

(b) The auction purchaser whose bid is accepted shall pay twenty-five per cent of the amount of his bid at once on the spot, in default of which the deposit made under clause (a) shall be forfeited and the site shall be reauctioned amongst the remaining bidders. The bidder who has so defaulted shall not take part in the re-auction of such site;

(c) The balance amount after deducting the amount deposited or paid under clause (a) and (b) shall be paid within forty five days from the date of receipt of intimation letter in Form I regarding the confirmation of sale, in default of which the amount paid by such auction purchaser under clause (b) shall be liable to be forfeited to the authority and the authority shall be entitled to resell in public auction the site and in such an event of resale the defaulting auction purchaser shall be liable to make good any loss suffered by the authority on account of such resale;

(d) The Commissioner may extend the period specified in clause (c) for payment for a period not exceeding ninety days and auction purchaser shall pay in additional, interest at the rate of eighteen percent per annum on the balance amount for the extended period. The authority may extend the time for payment for a further period not exceeding thirty days and the auction purchaser shall in addition pay to the authority interest at the rate of Twenty-one per cent per annum on the said amount for the next period of thirty days of the extended period. If the auction purchaser fails to pay the balance amount with interest before the expiry of the extended period the authority shall be entitled to forfeit the amount paid by the auction purchaser under clause (b) and resale in public auction the site and in such an event of resale the defaulting auction purchaser shall be liable to make good any loss supposed by the authority on account of such resale.

(emphasis supplied)

5. From bare perusal of the provisions contained in Sub-rule 3, it is clear that this Rule not only prescribe the procedure to be followed and adopted while conducting the auction, but it is also in the nature of terms and conditions of the contract that the highest bidder and the Tender Inviting Authority are expected to follow. As per this provision, all the persons who participate in the auction are required to deposit an amount with the Commissioner as indicated in Clause (a) of Sub-rule (3). The auction purchaser, whose bid is accepted, as stipulated in Clause (d) of Sub-rule (3), requires to pay 25% of the amount of his bid at once on the spot, and as provided in Clause (c) the remaining amount, after deducting the amount deposited or paid under Clause (a) and (b), within 45 days from the date of receipt of intimation letter in Form No. 1 regarding the confirmation of sale. The Commissioner is empowered to extend the period specified in Clause (c) for payment not exceeding 90 days and in that event the auction purchaser requires to pay, in addition, interest at the rate of 18% p.a. on the balance amount for the extended period. All these clauses also provide for the consequences for non-compliance of the conditions mentioned in Sub-rule 3. If the auction purchaser, whose bid is accepted and who has paid 25% of the amount of his bid, fails to pay the balance amount with interest before the expiry of the extended period, the authority is empowered to forfeit the amount paid by the auction purchaser under Clause (b) i.e., 25% of the amount of his bid. All the persons who intend to take part in auction sale are made aware of Sub-rule (3) of Rule 6 of the Rules and/or are supposed to have a knowledge of the terms and conditions mentioned in Sub-rule (3). It is in this backdrop, I would like to consider the judgments of the Supreme Court relied upon in support of the submissions advanced by learned counsel for the petitioners.

6. The Supreme Court in Fateh Chand (supra) while dealing with the provisions

contained in Section 74 of the Contract Act in paragraph 11, on which a heavy reliance was placed by learned counsel for the petitioners, held thus:

(11) 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, where there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of contract which expressly provides for forfeiture, the Court has jurisdiction to award such sum only as it considers reasonable, but not exceeding the amount specified in the contract as liable to forfeiture.

(emphasis supplied)

7. The Supreme Court in Maula Bux vs. Union of India (supra) was considering a case where the plaintiff had entered into a contract with the Government of India to supply potatoes at the Military Headquarters and deposited an amount of Rs. 10,000/- as security for due performance of the contract. He, then entered into another contract with Government of India to supply at the same place poultry, eggs and fish for one year and deposited Rs. 8,500/- for due performance of the contract. Clause 8 of the contract, in that case, provided that if the plaintiffs decline, neglect or delay to comply with any other way fail to perform or observe any condition of the contract, the security deposit shall stand forfeited and be absolutely at the disposal of Government, without prejudice to any other remedy or action that the Government may have to take. It is, in this context, after considering the provisions of Section 74 of the Indian Contract Act, the Supreme Court, in paragraph 7 of the Judgment held thus:

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, Section 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.

(emphasis supplied)

8. Based on these judgments, learned counsel for the petitioners invited my attention to Clause (d) of Sub-rule 3 of Rule 6 to submit that under any circumstances the action of forfeiting 25% of the amount paid by the petitioners is arbitrary and is in conflict with Section 74 of the Indian Contract Act.

9. To appreciate the submissions advanced by learned counsel for the petitioners in the light of the judgments of the Supreme Court, it would be relevant to reproduce Section 74 of the Indian Contract Act, which reads thus:

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

10. Section 74 of the Contract Act provides that 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 contact 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 (See Maula Bux). Section 74 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. In the present case I am not concerned with a covenant of forfeiture of deposit for due performance of a contract, which apparently 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. It is true that 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 (See Fateh Chand). The section 74 undoubtedly says that the aggrieved party is entitled to receive compensation from the party who has broken the contract whether or not actual damage or loss is proved to have been caused by the breach. Thereby it merely dispenses with proof of "actual loss or damage"; it does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted because compensation for breach of contract can be awarded to make good loss or damage which naturally arose in the usual course of things, or which the parties knew when they made the contract, to be likely to result from the

breach.

11. In the present case, the petitioners paid Rs. 10,000/- as deposit as specified in Clause (a) of Sub-rule (3) of Rule 6 and 25% of the bid amount on the date of the auction, as specified in clause (b) thereof. As provided for in Clause (b) of Sub-rule 3, the amount of deposit had not been forfeited in view of the payment of 25% of the amount of their bid at once on the spot. As specified in Clause (c) of Sub-rule (3) the petitioners were liable to pay the balance amount, after deducting the amount paid towards the deposit and 25% of the bid amount. The petitioners, admittedly did not make payment of the balance amount within the stipulated or extended time. The payment of deposit and 25% of the bid amount, has been forfeited for non-performance of the contract. From the scheme of sub-rule 3 of rule 6 of the rules and the terms and conditions mentioned in the tender inviting notice clearly appears to me that the payment of 25% of the bid amount was in the nature of earnest money and it is reasonable amount paid as earnest money and forfeiture thereof does not amount to imposing a penalty. In other words, the payment of 25% of the bid amount deposited by the petitioners will have to be regarded as earnest money and in any case it cannot be equated either with deposit to ensure performance of the contract by the highest bidder or with the penalty contemplated by Section 74 of the Contract Act. In other words, payment of 25% of the bid amount cannot be regarded as pre-determining damages or an amount to be forfeited by way of penalty. The terms and conditions of the contract, in the present case, do not say so. I have no hesitation in holding that payment of 25%, being a part of the total consideration, made was an earnest money and it is reasonable amount paid as earnest money and forfeiture thereof does not amount to imposing a penalty. In the present case the 25% of the bid amount, under the terms of the agreement, deposited by the petitioners cannot be regarded as security for due performance of the contracts. Giving an earnest or earnest-money is a mode of signifying assent to a contract of sale or the like by giving to the vendor a nominal sum as a token that the parties are in earnest or have made up their minds (see Maula Bux). As observed by the Judicial Committee in 94 Ind. Cas. 782 (Privy Council) the earnest money is a part of the purchase price when the transaction goes forward: it is forfeited when the transaction falls through, by reason of fault or failure of the vendee. In the present case, the petitioner defaulted or failed to make payment of balance amount within the stipulated and/or extended time and in view thereof and by virtue of provisions contained in Sub-rule 3 of Rule 6 of the Rules, the concerned authority forfeited 25% of the amount of bid deposited by the petitioners on the date of auction. The 25% amount, in my opinion, is reasonable amount paid as earnest money and forfeiture thereof cannot be termed as penalty. The stipulation in sub-rule 3 of rule 6 of the forfeiture of amount cannot be regarded as penalty as contemplated by Section 74 of the Contract Act. The amount of 25% deposited on the date of auction also cannot be regarded as deposit for due performance of the contract. It was an earnest amount and which as per the terms and conditions of the contract was

liable to be forfeited on the failure on the part of the highest bidder to deposit the balance amount within the stipulated time. I may also observe that such stipulation is necessary in case of auctions of such nature. If such condition is not incorporated in the contract or not a part of the contract, there will be a possibility of bogus persons/dummies, taking part in auction and that would frustrate the objective of conducting the auction.

In these circumstances, I find no merit in the writ petitions and the writ petitions fail and dismissed as such.

