

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 25.05.2012
Pronounced on: 02.07.2012

+ **RFA (OS) 107/2006**

INDIAN OIL CORPORATION LTD. Appellant
Through: Sh. Rajesh Sawhney with Sh. Sumit
Singh, Advocate.

Versus

M/S. INTERNATIONAL BUILDING & FURNISHING COMPANY
(CAL) PVT. LTD Respondent
Through: Sh. Raman Kapoor, Advocate.

MR. JUSTICE S. RAVINDRA BHAT
MR. JUSTICE S.P. GARG

MR. JUSTICE S.RAVINDRA BHAT

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1. The Appellant, which was arrayed as defendant in the suit (hereafter called IOC) is aggrieved by the judgment and decree of a learned single judge of this Court dated 23-08-2003 in CS (OS) 2/1995. The plaintiff-arrayed as respondent in this appeal, had claimed a decree for the sum of ₹ 21,75,233/- along with pendent lite interest and future interest @ 24% per annum from IOC.

2. The facts briefly are that the IOC, in a letter dated 31-3-1993 to the plaintiff (Ex.PW-2/2 and also exhibited as Ex.DW-1/P-1) accepted the latter's offer to execute the works listed in the tender documents. These were mainly towards manufacture and supply of various furniture items. The

terms of the agreement were that the total cost of the works or the consideration for the supplies, were ₹ 77,71,667/-. The entire supplies were to be completed within 5 months of letter of award. Clause 2 of Ex.PW-2/2 required parties to execute a formal contract which was done, on 22.7.1993. In terms of the contract, the price quoted was to remain constant, till completion of the job (Clause 6 of letter of acceptance).

3. The plaintiff/ respondent was required to deposit ₹ 1,94,300/-, being 2.5% of the contract price, as security deposit for due performance of the contract. In the alternative, a bank guarantee for that amount, could be furnished. The plaintiff chose the latter option, and furnished the guarantee, issued by Indian Overseas Bank, on 15.4.1993.

4. After the contract was entered into, supplies could not be given to the IOC, barring some samples delivered to it. The plaintiff, on the other hand, alleged that those were part delivery of items of furniture to be supplied under the contract. The plaintiff eventually rescinded the contract, and blamed the IOC, alleging that the five month's period under the contract was consumed by the IOC, which did not give clear approval to the samples offered for inspection and acceptance. This, alleged the plaintiff, resulted in a price rise. The plaintiff's request for increase in price beyond contract stipulated period of five months was made, and according to its allegations, justified in the circumstances of the case; IOC refused the price increase. Therefore, the plaintiff terminated the contract in February, 1994.

5. IOC, in its written statement, alleged that there was no delay in approving the samples. That plaintiff was allegedly not manufacturing the

furniture items as per specifications. IOC alluded to several defaults which, according to its averments, were notified time and again to the plaintiff. IOC also denied that any price rise took place.

6. After cancelling or rescinding the contract, the plaintiff claimed various amounts, including the price for the samples supplied, and loss of profit. The IOC had, in the meanwhile, invoked the bank guarantee towards 2.5% security deposit, for due performance of the contract. The plaintiff's initial attempt to have the matter referred to arbitration proved unsuccessful. In this background, parties went to trial. During pendency of the suit, the IOC sought leave to amend its written statement, and lodge a counter claim. This court, by a separate judgment, rejected that application.

7. The learned single judge, in the impugned judgment, held that the plaintiff had not proved its entitlement to damages, and that the claim for loss of profit was unjustified, as it did not perform its part of the contract. The relevant findings in that regard are as follows:

“37. In my opinion, site inspection book would be the best evidence, for in the site inspection book record of inspections would be maintained. I hold that by not producing the same, an adverse inference has to be drawn against the plaintiff, being that, defendant notified defects in the samples and thus it cannot be said that plaintiff was prevented from finalizing the samples. Defects in the samples would mean that the plaintiff did not even finalize all samples within a reasonable time. From Ex.PW-2/D-4, I hold that the plaintiff was being intimated the various defects by writing the same in the site inspection book, a fact admitted by the plaintiff in its letter Ex. PW-2/D-4. I conclude and hold that defendant promptly carried out inspections of the samples submitted for approval by the plaintiff on 17.5.1993 and that by 31.5.1993 as many as 3 visits

were made. I also conclude that conditional approval to the samples was granted. Since plaintiff has led no other evidence to show that the defects notified in the samples were removed in its entirety, I hold that there is no delay on the part of the defendant in granting approval to the samples.

38. Since no meaningful work was done and the entire dispute centers around whether defendant delayed execution of the work by not granting approval to the samples, peripheral issues pertaining to non germane grievances which have been highlighted in the various other letters proved are not being discussed by me.

39. I accordingly proceed to decide issues No.2 to 9.

40. Issue No. 2 and 6 are interconnected. Dispute between the parties is whether furnishing of a few rooms was towards supply of items under the contract as pleaded by the plaintiff or whether, items offered were free samples as pleaded by the defendant.

41. That certain items were received by the defendant is not in dispute. It is not in dispute that 46 items were so supplied. DW-2 admitted that since the Chairman-cum-Managing Director was visiting the site at Gurgaon, 4 ? 5 model rooms were furnished. However, the witness stated that these were free samples.

42. Items of furniture supplied are detailed in Ex.PW-2/40, being plaintiff's letter dated 26.6.1993 duly acknowledged by the defendant. Acknowledgment records that 46 pieces of furniture were supplied. Ex. DW-1/1 is the only piece of evidence to show which samples were taken back. It shows that on 1.9.1993, 16 pieces were taken back.

43. Unfortunately, plaintiff has led no evidence, much less proved a bill submitted for the said items. The first bill proved is a bill dated 29.10.1993, Ex.PW-2/7. The said bill pertains to finished as well as unfinished pieces of furniture. However, since there is no evidence from the side of the defendant that

the prices charged for in the bill, Ex.PW-2/7, do not conform to the schedule of rates as per which plaintiff was to complete the work, I would be analyzing the claim for these 46 items of work in light of Ex.PW-2/7.

44. The amount claimed is Rs. 1,13,019/-. However, PW-2 said that price was Rs. 96,767/-. I, thus treat the price of 46 items to be Rs. 96,767/-. PW-2 admitted that some samples were taken back but stated that he did not remember how many samples were taken back. He stated that the samples which were taken back from the defendant were to form part of supply and were required for production of the articles in bulk. However, I find that vide Ex. DW-1/1, 16 items of sample were taken back on 1.9.1993. There is no proof that these 16 items were resupplied.

45. I do not agree with the stand of the defendant that items supplied were free samples for the reason contract does not envisage supply of samples free of cost.

46. Onus of issue No.2 is on the plaintiff. plaintiff had to establish the items supplied and their value. Having established that 46 items were supplied vide Ex.PW-2/40, having thereafter admitted to have received back some of all items, which I find are the one listed in Ex. DW-1/1, I have a problem at hand in deciding the price of the 30 items not received back by the plaintiff and appropriated by the defendant as no bill is proved for the 46 items and the bill Ex PW-2/7 is for items supplied (46 pieces) and unfinished goods. Applying the thumb rule i.e. dividing Rs. 96,767/- (price of 46 items admitted by DW-2) by 46 and multiplying by 30, I hold that the price of 30 items is Rs. 63,120 (Approximately).

47. I accordingly decide issue No. 2 by holding that plaintiff supplied 30 items of furniture to the defendant valued at Rs. 63,120/-.

48. I decide issue No. 6 by holding that plaintiff was not required to supply any samples free of cost and that the 30 items of furniture supplied by plaintiff to the defendant had to be paid for by the defendant.

49. Issue No.3, 4 and 5 are interlinked. The basic issue to be decided is whether the plaintiff was justified in rescinding the contract.

50. Justification of the plaintiff to rescind the contract is delay by the defendant in approving the samples and as a result prevented the plaintiff from completing the works in time. As per the plaintiff, there was a price rise in the interregnum and since defendant was at fault, plaintiff was justified in seeking price revision and since defendant refused to increase the prices it was justified in rescinding the contract. According to the plaintiff, for the raw products used in partial manufacture of the furniture it was entitled to be recompensed and was also entitled to be recompensed towards loss of profit.

51. But, in view of the evidence and as discussed by me in paras 12 to 37 above, plaintiff has miserably failed to prove defaults by the defendant. On the contrary, defendant has established that it promptly went for inspecting the samples. Defects were notified in the samples. plaintiff has failed to establish that the defects which were notified were rectified and inspire thereof final approval was not accorded. I accordingly hold that the plaintiff was in breach of the agreement, in that, failed to get the samples approved and complete production as per samples within period of 5 months. I hold that plaintiff had no cause to rescind the contract. I hold that plaintiff is not entitled to any loss of profit. I hold that plaintiff is not entitled to any price or cost towards items of furniture allegedly finished and unfinished which were lying in the factory of the plaintiff. Issue No.3, 4 and 5 are accordingly decided in favor of the defendant and against the plaintiff. For the unfinished product, plaintiff is not entitled to any money. Plaintiff is not entitled to any loss of profit... ”

Thereafter, dealing with the question of the plaintiff's entitlement to return of the amount of security deposit, the learned single judge proceeded, *inter alia*, to hold that:

*“59. The sum covered by the bank guarantee is admittedly a **security deposit** for due performance of the obligations under the contract by the plaintiff.*

*60. As noted above, as per contract, plaintiff was to give a cash **deposit** equivalent to 2.5% of the contract value. Alternatively, bank guarantee in said sum could be offered. The amount is obviously a **security** for the completion of the supply. But in what sense is it a **security** for the completion of the supply?”*

Discussing the matter, and after citing various judgments, the impugned judgment held that IOC was not entitled to retain the amount. The relevant findings are as follows:

*“67. Learned counsel for the defendant urged that claim of defendant for **forfeiture** of **security deposit** was a claim for adjustment for the loss suffered due to breach of contract by the plaintiff. I do not agree for the reason the essence of a claim of adjustment, like a plea of payment, is that the plaintiff's claim has already been discharged.*

68. This is evident from the decision of the Supreme Court reported as [2003]3SCR691 O.N.G.C. v. Saw Pipes Ltd. In para 46, it was held as under: 46. From the aforesaid sections, it can be held that when a contract has been broken, the party who suffers by such breach is entitled to receive compensation for any loss which naturally arises in the usual course of things from such breach.

69. Thereafter in relation to Sections 73 and 74 of the Contract Act and the decisions reported as AIR 1962 SC1314 , Chunilal Mehta v. Century Spinning and Mfg. Co. [1964] 1 SCR 515 , Fateh Chand v. Balkishan Dass [1970] 1 SCR 928 , Maula Bux v. Union of India: 1973 SC 1098 U.O.I. v. Rampur Distilling and Chemical Co. Ltd. and [1974]3 SCR 556 , U.O.I. v. Raman Iron Foundry, in para 68, their Lordships held:

68. From the aforesaid discussions, it can be held that:

(1) Terms of the contract are required to be taken into consideration before arriving at the conclusion whether the party claiming damages is entitled to the same.

(2) If the terms are clear and unambiguous stipulating the liquidated damages in case of the breach of the contract unless it is held that such estimate of damages/compensation is unreasonable or is by way of penalty, party who has committed the breach is required to pay such compensation and that is what is provided in Section [73](#) of the Contract Act.

(3) Section [74](#) is to be read along with Section [73](#) and, Therefore, in every case of breach of contract, the person aggrieved by the breach is not required to prove actual loss or damage suffered by him before he can claim a decree. The court is competent to award reasonable compensation in case of breach even if no actual damage is proved to have been suffered in consequence of the breach of a contract.

(4) In some contracts, it would be impossible for the court to assess the compensation arising from breach and if the compensation contemplated is not by way of penalty or unreasonable, the court can award the same if it is genuine pre-estimate by the parties as the measure of reasonable compensation.

70. Admittedly, defendant has not awarded the works to be executed by the plaintiff in its entirety to M/s. Office Equipment and there is no material to establish that there was a price rise in cost of wood. Indeed, argument of learned Counsel for the defendant was that there was no increase in price of wood. The extra amount stated to be incurred by the defendant is on account of supervision charges which M/s. Office Equipment was to incur. It appears that the contract with M/s. Office Equipment has been tailor made to take a defense against the claim of the plaintiff for the reason under a supply contract the supplier has to receive payment after goods are supplied. The supplier has not to pay supervision charges to the purchaser. It may be noted that even qua the plaintiff, defendant was to supervise the manufacture of furniture evidenced by the fact

that defendant has led evidence to the effect that as and when inspection was carried out at the factory of the plaintiff, in the site inspection book, deficiencies were noted. In any case, it is obvious that contract with M/s. Office Equipment is on materially different terms vis-a-vis the contract with the plaintiff and hence cannot form the basis for comparative assessment of rates.

*71. Looked at from both angles, no counter claim from the defendant and no proof of actual loss, amount towards **security deposit** has to be refunded by the defendant to the plaintiff.*

72. I accordingly decide issue No.7 by holding that the plaintiff is entitled to Rs. 63,120/- plus Rs. 1,94,300/- from the defendant i.e. Rs. 2,57,420/- “

8. It is argued on behalf of the IOC, the appellant that the impugned judgment has proceeded upon an erroneous understanding of the law. Counsel urged that once the Court found that the party seeking damages, and claiming to be aggrieved in the performance of a contract, was himself in breach, there was no further requirement of having to prove the loss suffered, since the security deposit amount itself constituted a genuine pre-estimate or parties' assessment of damages. Learned counsel relied on the judgment in *Maula Bux (supra)* and Section 74 of the Contract, and further urged that the pleadings in the written statement had clearly set out a case that the IOC had suffered losses on account of the plaintiff's default. It was also urged that the single judge overlooked a material aspect, viz that after the plaintiff rescinded the contract unjustifiably, the IOC had to resort to procurement through a third party, i.e M/s Office Equipment. Learned counsel submitted that the said contract was entered into on 3-05-1994, and was for a consideration of ₹ 70 lakhs. The document was exhibited as Ex.

D-13; counsel submitted that there was no cross examination of DW-1 or DW-2 on this aspect. Therefore, the learned single judge erred in law, in holding that the security deposit had to be returned.

9. Counsel for the plaintiff urged that the impugned judgment and decree does not disclose any error of law, or misappreciation of evidence. It was argued that an earnest money, or security deposit, cannot be forfeited in the manner urged by the IOC. Counsel submitted that the settled law, right from the decision in *Chunnilal Mehta, Fateh Chand, and Maula Bux* is that mere showing of breach of contract is not sufficient for a party seeking to forfeit any amount deposited with it. The general principle is that there should be some proof of damage, upon which the party complaining of it would be entitled to reasonable damages, not exceeding the amount specified.

10. Learned counsel argued that having attempted, unsuccessfully, to amend the written statement, during pendency of the suit, it was not open for the defendant IOC to stake a claim for alleged losses, since no set off had been pleaded or urged. It was also submitted that the defendant did not prove any loss, and the evidence placed on record by it, did not point to any loss which qualified for reasonable damage, entitling it to retain the security deposit.

11. Since the only question argued by the parties was whether the IOC is entitled to retain the security deposit amount, which was furnished through a bank guarantee, that was invoked, we will proceed to consider the same. IOC's submission is that once parties agreed through a stipulation that an amount is to be retained by it, towards due performance of the contract, and

there was an unjustified breach of that contract, there was no further need to prove actual damages, having regard to the text of Section 74 of the Contract Act. That provision 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.”

Fateh Chand involved a claim by the Plaintiff to forfeit the amount of ₹24,000 by adjustment; a similar argument, in the light of Section [74](#) of the Indian Contract Act was advanced. The Supreme Court held 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. The section undoubtedly says that the aggrieved party is entitled to receive compensation from the party who has broken the contract, whether or not actual damage or loss is proved to have been caused by the breach. Thereby it merely dispenses with proof of "actual loss or damage"; it does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted, because compensation for breach of contract can be awarded to make good loss or damage which naturally arose in the usual course of things, or which the parties knew when they made the contract, to be likely to result from the breach.

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

16. There is no evidence that any loss was suffered by the Plaintiff in consequence of the default by the Defendant, save as to the loss suffered by him by being kept out of possession of the property. There is no evidence that the property had depreciated in value since the date of the contract provided; nor was there evidence that any other special damage had resulted. The contract provided for **forfeiture** of Rs. 25,000 consisting of Rs. 1039 paid as earnest money and Rs. 24,000 paid as part of the purchase price. The Defendant has conceded that the Plaintiff was entitled to forfeit the amount of Rs 1000 which was paid as earnest money. We cannot however agree with the High Court that 13 percent of the price may be regarded as reasonable compensation in relation to the value of the contract as a whole, as that in our opinion is assessed on an arbitrary assumption. The Plaintiff failed to prove the loss suffered by him in consequence of the breach of the contract

committed by the Defendant and we are unable to find any principle on which compensation equal to ten percent of the agreed price could be awarded to the Plaintiff. The Plaintiff has been allowed Rs 1000 which was the earnest money as part of the damages. Besides he had use of the remaining sum of Rs. 24,000, and we can rightly presume that he must have been deriving advantage from that amount throughout this period. In the absence therefore of any proof of damage arising from the breach of the contract, we are of opinion that the amount of Rs 1000 (earnest money) which has been forfeited, and the advantage that the Plaintiff must have derived from the possession of the remaining sum of Rs. 24,000 during all this period would be sufficient compensation to him. It may be added that the Plaintiff has separately claimed mesne profits for being kept out possession for which he has got a decree and therefore the fact that the Plaintiff was out of possession cannot be taken, into account in determining damages for this purpose. The decree passed by the High Court awarding Rs. 11,250 as damages to the Plaintiff must therefore be set aside.”

The principle enunciated in *Fateh Chand* was restated in *Maula Bux*, and later, in *Union of India v Raman Iron Foundry* 1974 (3) SCR 556, in the following words:

“The Indian Legislature has sought to cut across the web of rules and presumptions under the English common law, by enacting a uniform principle applicable to all stipulations naming amounts to be paid in case of breach, and stipulations by way of penalty, and according to this principle, even if there is a stipulation by way of liquidated damages, a party complaining of breach of contract can recover only reasonable compensation for the injury sustained by him, the stipulated amount being merely the outside limit. It, therefore makes no difference in the present case that the claim of the Appellant is for liquidated damages. It stands on the same footing as a claim for un liquidated damages. Now the law is well settled that a claim for un-liquidated damages does not give rise to a debt until the liability is adjudicated and damages assessed by a

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

12. This Court is of opinion that the IOC is correct in contending that the plaintiff was unable to establish its entitlement for damages; the impugned judgment also held the plaintiff disentitled to any compensation for breach of contract. However, this court cannot be oblivious of the circumstance that the defendant IOC had the obligation to both plead and prove entitlement to the amounts it claims towards security deposit forfeiture. From a lay perspective, it might appear incongruous that a party aggrieved by the breach of contract of another, where a certain stipulation or amount exists in the contract, would nevertheless have to prove its claim. Nevertheless, the law on the subject is clear. It is not mere breach, which entitles a party aggrieved by another party's conduct, to damages; it is the proof of such damages which results in such conclusion. In this case, even if the defendant's pleadings were to be construed as adjustment, amounting to a claim, yet the requirement, so pithily spelt out in *Raman Iron* (in the following words) have not been fulfilled:

“When there is a breach of contract, the party who commits the breach does not constant incur any pecuniary obligation, nor does the party complaining of the breach becomes entitled to a debt due from the other party. The only right which the party aggrieved by the breach of the contract has is the right to sue

for damages.... The Court in the first place must decide that the Defendant is liable and then it proceeds to assess what that liability is.”

13. This court has also considered the original records. Ex. D-13, which concededly is the subsequent contract entered into for supply of furniture to IOC, was for a total consideration of ₹ 70,89,350/-; the said supplier was paid ₹ 70,35,876/31 finally for the entire contract. The documents filed in court by IOC also indicate that the entire security deposit amount, including the 2.5% margin, was directed to be released to the subsequent contractor, i.e M/s Office Equipment, on 18th October, 1995, since completion certificate was on the file, and the retention period had elapsed. The defendant IOC brought the documents on record, and the Court is within its rights to consider them.

14. In the light of the above discussion, it is held that there is no infirmity in the findings of the learned single judge, directing the IOC to release the security deposit, issued to it, by the plaintiff. Since no other point was urged, the Court is of opinion that the appeal is bereft of merit; it is consequently dismissed, without any order as to costs.

S. RAVINDRA BHAT
(JUDGE)

S.P.GARG
(JUDGE)

JULY 02, 2012