

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

+ **RFA No.702/2017**

% **4th August, 2017**

NAR SINGH PRASAD Appellant

Through: Mr. Siddharth, Advocate.

versus

SHAILENDER KUMAR MISHRA Respondent

CORAM:

HON'BLE MR. JUSTICE VALMIKI J. MEHTA

To be referred to the Reporter or not?

VALMIKI J. MEHTA, J (ORAL)

C.M. No.27916/2017 (exemption)

1. Exemption allowed subject to just exceptions.

C.M. stands disposed of.

RFA No.702/2017 and C.M. No.27917/2017 (stay)

2. This Regular First Appeal under Section 96 of Code of Civil Procedure, 1908 (CPC) is filed by the defendant in the suit impugning the judgment of the Trial Court dated 19.5.2017 decreeing the suit for recovery of earnest money filed by the respondent/plaintiff. The suit has been decreed for the amount of Rs.3 lacs along with interest at 8% per annum, and it is noted that the trial

court has not granted the relief of Rs.6 lacs prayed in the suit of double the amount of earnest money of Rs.3 lacs.

3. It is settled law from the Constitution Bench judgment of the Supreme Court in the case of ***Fateh Chand Vs. Balkishan Dass AIR 1963 SC 1405*** and ratio of which has been recently reiterated by the Supreme Court in the case of ***Kailash Nath Associates Vs. Delhi Development Authority and Another, (2015) 4 SCC 136*** that in the type of contracts which are in the nature of an agreement to sell, there cannot be forfeiture of the huge amount of earnest money unless and until loss is pleaded and proved to be caused to the affected/non-guilty party. The relevant paras of the judgment of the Supreme Court in the case of ***Kailash Nath Associates (supra)*** reads as under:-

“30. We now come to the reasoning which involves Section 74 of the Contract Act. The Division Bench held: (*Kailash Nath & Associates case*)

“38. The learned Single Judge has held that the property was ultimately auctioned in the year 1994 at a price which fetched DDA a handsome return of Rupees 11.78 crores and there being no damages suffered by DDA, it could not forfeit the earnest money.

39. The said view runs in the teeth of the decision of the Supreme Court in *Shree Hanuman Cotton Mills Vs. Tata Aircraft Ltd.*, which holds that as against an amount tendered by way of security, amount tendered as earnest money could be forfeited as per terms of the contract.

40. We may additionally observe that original time to pay the balance bid consideration, as per Ex. P-1 was May 18, 1982 and as extended by Ex. P-8 was October 28, 1982. That DDA could auction the plot in the year 1994 in the sum of Rupees 11.78 crores was immaterial and not relevant evidence for the reason damages with respect to the price of property have to be computed with reference to the date of the breach of the contract”.

31. Section 74 as it originally stood read thus:

“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, 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.”

32. By an amendment made in 1899, the Section was amended to read:

“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.

Explanation.--A stipulation for increased interest from the date of default may be a stipulation by way of penalty.

Exception.--When any person enters into any bail-bond, recognizance or other instrument of the same nature, or, under the provisions of any law, or under the orders of the Central Government or of any State Government, gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable, upon breach of any condition of any such instrument, to pay the whole sum mentioned therein.

Explanation.--A person who enters into a contract with Government does not necessarily thereby undertake any public duty, or promise to do an act in which the public are interested.”

33. Section 74 occurs in Chapter 6 of the Indian Contract Act, 1872 which reads "Of the consequences of breach of contract". It is in fact sandwiched between Sections 73 and 75 which deal with compensation for loss or damage caused by breach of contract and compensation for damage which a party may sustain through non-fulfillment of a contract after such party rightfully rescinds such contract. **It is important to note that like Sections 73 and 75, compensation is payable for breach of contract Under Section 74 only where damage or loss is caused by such breach.**

34. In *Fateh Chand Vs. Balkishan Dass (supra)*, this Court held:

“The section is clearly an attempt to eliminate the somewhat elaborate refinements made under the English common law in distinguishing between stipulations providing for payment of liquidated damages and stipulations in the nature of penalty. Under the common law a genuine pre-estimate of damages by mutual agreement is regarded as a stipulation naming liquidated damages and binding between the parties: a stipulation in a contract in terrorem is a penalty and the Court refuses to enforce it, awarding to the aggrieved party only reasonable compensation. The Indian Legislature has sought to cut across the web of rules and

presumptions under the English common law, by enacting a uniform principle applicable to all stipulations naming amounts to be paid in case of breach, and stipulations by way of penalty.....”

* * *

Section 74 of the Indian Contract Act deals with the measure of damages in two classes of cases (i) where the contract names a sum to be paid in case of breach and (ii) where the contract contains any other stipulation by way of penalty. We are in the present case not concerned to decide whether a covenant of forfeiture of deposit for due performance of a contract falls within the first class. The measure of damages in the case of breach of a stipulation by way of penalty is by Section 74 reasonable compensation not exceeding the penalty stipulated for. In assessing damages the Court has, subject to the limit of the penalty stipulated, jurisdiction to award such compensation as it deems reasonable having regard to all the circumstances of the case. Jurisdiction of the Court to award compensation in case of breach of contract is unqualified except as to the maximum stipulated; but compensation has to be reasonable, and that imposes upon the Court duty to award compensation according to settled principles. The section undoubtedly says that the aggrieved party is entitled to receive compensation from the party who has broken the contract, whether or not actual damage or loss is proved to have been caused by the breach. Thereby it merely dispenses with proof of "actual loss or damages"; it does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted, because compensation for breach of contract can be awarded to make good loss or damage which naturally arose in the usual course of things, or which the parties knew when they made the contract, to be likely to result from the breach.

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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.”

35. Similarly, in *Maula Bux v. Union of India (UOI)*, it was held:

“Forfeiture of earnest money under a contract for sale of property-movable or immovable-if the amount is reasonable, does not fall within Section 74. That has been decided in several cases: *Chiranjit Singh Vs. Har Swarup*; *Roshan Lal Vs. Delhi Cloth and General Mills Co. Ltd.*; *Mohd. Habibullah Vs. Mohd. Shafi*; *Bishan Chand Vs. Radha Kishan Das*. 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, 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.

Counsel for the Union, however, urged that in the present case Rs. 10,000/- in respect of the potato contract and Rs. 8,500 in respect of the poultry contract were genuine pre-estimates of damages which the Union was likely to suffer as a result of breach of contract, and the Plaintiff was not entitled to any relief against forfeiture. Reliance in support of this contention was placed upon the expression (used in Section 74 of the Contract Act), "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". It is true that 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, and 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 contract. But the expression "whether or not actual damage or loss is proved to have been caused thereby" is intended to cover different classes of contracts which come before the Courts. In case of breach of some contracts it may be impossible for the Court to assess compensation arising from breach, while in other cases compensation can be calculated in accordance with established rules. Where the Court is unable to assess the compensation, the sum named by the parties if it be regarded as a genuine pre-estimate may be taken into consideration as the measure of reasonable compensation, but not if the sum named is in the nature of a penalty. Where loss in terms of money can be determined, the party claiming compensation must prove the loss suffered by him.

In the present case, it was possible for the Government of India to lead evidence to prove the rates at which potatoes, poultry, eggs and fish were purchased by them when the Plaintiff failed to deliver "regularly and fully" the quantities stipulated under the terms of the contracts and after

the contracts were terminated. They could have proved the rates at which they had to be purchased and also the other incidental charges incurred by them in procuring the goods contracted for. But no such attempt was made.”

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40. From the above, it is clear that this Court held that *Maula Bux's* case (*supra*) was not, on facts, a case that related to earnest money. Consequently, the observation in *Maula Bux* (*supra*) that forfeiture of earnest money under a contract if reasonable does not fall within Section 74, and would fall within Section 74 only if earnest money is considered a penalty is not on a matter that directly arose for decision in that case. The law laid down by a Bench of 5 Judges in *Fateh Chand's* case (*supra*) is that all stipulations naming amounts to be paid in case of breach would be covered by Section 74. This is because Section 74 cuts across the rules of the English Common Law by enacting a uniform principle that would apply to all amounts to be paid in case of breach, whether they are in the nature of penalty or otherwise. It must not be forgotten that as has been stated above, forfeiture of earnest money on the facts in *Fateh Chand's* case (*supra*) was conceded. In the circumstances, it would therefore be correct to say that as earnest money is an amount to be paid in case of breach of contract and named in the contract as such, it would necessarily be covered by Section 74.

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43. On a conspectus of the above authorities, the law on compensation for breach of contract Under Section 74 can be stated to be as follows:

43.1. Where a sum is named in a contract as a liquidated amount payable by way of damages, the party complaining of a breach can receive as reasonable compensation such liquidated amount only if it is a genuine pre-estimate of damages fixed by both parties and found to be such by the Court. In other cases, where a sum is named in a contract as a liquidated amount payable by way of damages, only reasonable compensation can be awarded not exceeding the amount so stated. Similarly, in cases where the amount fixed is in the nature of penalty, only reasonable compensation can be awarded not exceeding the penalty so stated. In both cases, the liquidated amount or penalty is the upper limit beyond which the Court cannot grant reasonable compensation.

43.2. Reasonable compensation will be fixed on well known principles that are applicable to the law of contract, which are to be found *inter alia* in Section 73 of the Contract Act.

43.3. Since Section 74 awards reasonable compensation for damage or loss caused by a breach of contract, damage or loss caused is a *sine qua non* for the applicability of the Section.

43.4. The Section applies whether a person is a Plaintiff or a Defendant in a suit.

43.5. The sum spoken of may already be paid or be payable in future.

43.6. The expression "whether or not actual damage or loss is proved to have been caused thereby" means that where it is possible to prove actual damage or loss, such proof is not dispensed with. It is only in cases where damage or loss is difficult or impossible to prove that the liquidated amount named in the contract, if a genuine pre-estimate of damage or loss, can be awarded.

43.7. Section 74 will apply to cases of forfeiture of earnest money under a contract. Where, however, forfeiture takes place under the terms and conditions of a public auction before agreement is reached, Section 74 would have no application.” (emphasis is mine)

4. It is seen that there is no pleading in the written statement filed by the appellant/defendant that the earnest money has to be forfeited on account of the losses caused by the respondent/plaintiff to the appellant/defendant on account of breach of contract. Also no evidence is led on any losses caused to the appellant/defendant on account of breach of the agreement to sell by the respondent/plaintiff. Therefore even taking that the respondent/plaintiff was guilty of breach of contract yet the amount of earnest money received of Rs.3 lacs by the appellant/defendant cannot be forfeited by the appellant/defendant unless the appellant/defendant had pleaded and proved that loss was caused to him on account of the breach of the agreement to sell by the respondent/plaintiff, and which is however not the case.

5. There is no merit in the appeal. Dismissed.

AUGUST 04, 2017/ Ne

VALMIKI J. MEHTA, J