A

SHREE HANUMAN COTTON MILLS & ORS.

v.

TATA AIR-CRAFT LTD.

October 28, 1969

B

[J. M. SHELAT, C. A. VAIDIALINGAM AND I. D. DUA, JJ.]

Contract—Money deposited as earnest money—Breach committed by buyer—Right of seller to forfeit—Principles.

Contract Act (9 *of* 1872), *ss.* 64 *and* 74—*Scope of.*

C

The respondent agreed to sell and the appellant agreed to buy some aero-scrap for Rs. 10,00,000. The appellant paid Rs. 2,50,000 on the date of the contract and it was agreed between the parties that the balance should be paid in two instalments. It was also agreed that the respondent's terms of business were made part of the terms and conditions governing the contract. According to cl. 9 of the respondent's terms of business the buyer has to deposit with the respondent 25% of the total value and that deposit is to remain with the respondent *as earnest money to be adjusted in the final bills* and no interest shall be payable to buyer on the amount. Under cl. 10 of the terms and conditions, if the buyer makes default in making payment according to the contract, the respondent has a right to cancel the contract and *forfeit unconditionally the earnest money* without prejudice to any other rights of the respondent in law. The appellant committed breach of the contract by refusing to pay the rest of the money and to take delivery of the aero-serap. The respondent thereupon cancelled the contract and forfeited the deposit of Rs. 2,50,000.

D

E

A suit by the appellant for recovery of the amount was dismissed.

In appeal to this Court,

HELD : (1) For a deposit by a purchaser to be treated as earnest money the following conditions must be satisfied : (i) it must be given at the moment at which the contract is concluded; (ii) it represents a guarantee that the contract will be fulfilled or, in other words, 'earnest' is given to bind the contract; (iii) it is part of the purchase price when the transaction is carried out; (iv) it is forfeited when the transaction falls through by reason of the default or failure of the purchaser; and (v) 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. [139 D-F]

F

G

In the present case, the payment of Rs. 2,50,000 could not be treated merely as part-payment towards the total price, because, the terms of business of the respondent applied to the contract, and under those terms, since the conditions regarding earnest money are satisfied, the amount deposited by the appellant was earnest money and the respondent was entitled to forfeit if. [140; 141 F]

H

Howe v. *Smith* L.R. (1884) Ch. 89, *Soper* v. *Arnold,* I.R. (1889) 14 A.C. 429, *Farr, Smith & Co.* v. *Messers, Ltd.* L.R. [1928] 1 K.B.D. 397, *Sumner and Leivesley* v. *John Brown & Co.* 25 T.L.R. 745 and *Chiranjit Singh* v. *Har Swarup,* A.I.R. 1926 P.C. 1, applied.

Roland Burrows, *Words and Phrases* Vol. II, *Benjamin on Sale, Halsbury's Laws of England* (III Edition) Vol. 34, p. 118, para. 189 and Jowitt's *Dictionary of English Law*, referred to. A

(2) In *Fateh Chand* v. *Balkishan Das*, [1964] 1 S.C.R. 515, this Court recognised the principle that earnest money could be forfeited, and that s. 74 of the Contract Act applied only to the amount paid by the buyer which was not earnest money. In the present case, since the entire amount paid by the appellant was earnest money under the contract, this decision has no application. [145 H; 146 A] B

(3) As the plea of misrepresentation was abandoned by the appellant and the breach of contract was admittedly committed by the appellant, s. 64 of the Contract Act could not be invoked by the appellant. [146 D]

Murlidhar Chatterjee v. *International Film Co.* L.R. 70 I.A. 35, not applicable. C

[The question as to whether the element of unreasonableness can ever be taken into account when considering the forfeiture of an amount deposited by way of earnest, and if so what factors should be taken into account left open.] [142 F-G]

Maula Bux v. *Union of India*, [1970] 1 S.C.R. 928, explained. D

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1122 of 1966.

Appeal from the judgment and decree dated January 29, 1964 of the Calcutta High Court in Appeal from original order No. 28 of 1960. E

B. P. Maheshwari and *Sobhag Mal Jain*, for the appellant.

Niren De, Attorney-General, N. S. Bindra and *S. P. Nayar*, for the respondent.

The Judgment of the Court was delivered by F

Vaidialingam, J.—This appeal, by the plaintiffs-appellants, on certificate granted by the Calcutta High Court, is directed against the judgment and decree of the Division Bench of that Court, dated January 29, 1964 in Appeal from Original Order No. 28 of 1960, affirming the judgment and decree, dated July 16, 1959 of the learned Single Judge in Suit No. 2745 of 1947. The circumstances leading up to the institution of the said suit may be stated. G

The appellants, who were dealing also in the purchase of new and second hand machinery, on coming to know from an advertisement in a Daily that the defendant-respondent was offering for sale aero-scrap, addressed a letter, dated November 6, 1946 to the respondent intimating their desire to purchase the materials advertised for sale, and stating that one of their representatives H

A would be contacting them shortly. Obviously the parties must have met and decided about the purchase, as is seen from the letter, dated November 18, 1946 addressed by the General Manager of the respondent, to the appellants. That letter refers to a discussion that the parties had on that day and the respondents confirmed having sold to the appellants the entire lot of aero-scrap B lying at Panagarh, on the terms and conditions mentioned in the letter. The material was stated to be in Dump No. 1 near the flight line at Panagarh and the approximate quantity was 4000 tons of aero-scrap, more or less. The letter refers to the appellants having agreed to pay Rs. 10 lakhs as price of the materials in the said Dump No. 1, against which the receipt, by cheque, of C a sum of Rs. 2,50,000 was acknowledged by the respondent. There is a further reference to the fact that the appellants had agreed to pay the balance of Rs. 7,50,000 that day itself. The letter also refers to the fact that the price mentioned does not include sales-tax to be paid by the appellants and to certain other matters, which are not relevant for the purpose of the appeal. The letter further says: "The company's terms of business apply to this D contract and a copy of this is enclosed herewith". We shall refer to the relevant clauses in the company's terms of business, referred to in this letter, a little later. It is enough to note, at this stage that those terms of business have been made part of the terms and conditions governing the contract.

E On the same day, the appellants sent a reply to the respondent, acknowledging the letter. The appellants said that they noted that the respondent wants to sell the aero-scrap as it is and that it wanted the appellants to pay the full value, *viz.*, the balance of Rs. 7,50,000 at once. The appellants confirmed the arrangement contained in the respondent's letter; but regarding payment, the appellants said that they agree to pay the balance amount in two F instalments *viz.*, Rs. 2,50,000 on or before November 22, 1946 and the balance of Rs. 5,00,000 on or before December 14, 1946. They also further stated that they shall commence taking delivery after making full payment. The respondent by its letter dated November 20, 1946 acknowledged the receipt of the appellants' letter dated November 18, 1946 together with the modifications G contained therein. But the respondent emphasised that the other terms and conditions will be as mentioned in its letter of November 18, 1946.

On November 22, 1946, the appellants sent a communication, purporting to be in continuation of their letter dated November 18, 1946. In this letter they state that the transaction has been H closed without inspecting the materials, merely on the assurance of the respondent that the quantity of aero-scrap was about 4,100 tons. The appellants further state that they have since obtained

information that the quantity stated to be available is not on the spot and therefore they cannot do the business. Under the circumstances, they request the respondent to treat their letter, dated November 18, 1946 as cancelled and to return the sum of Rs. 2,50,000 already paid by them. A

The respondent sent several letters to the appellants asking them to pay the balance amount and take delivery of the goods; but the appellants refused to pay any further amount to the respondent. The respondent ultimately forfeited the entire sum of Rs. 2,50,000 which, according to it, was earnest money and then cancelled the contract. B

Now that we have referred to the material correspondence that took place between the parties as well as the final action of the defendant of forfeiting the amount, it is now necessary to advert to certain clauses in the Company's terms of business which, as mentioned earlier, have been made by the defendant's letter dated November 18, 1946 as part of the terms and conditions of the contract. We have also referred to the fact that the appellants in their reply dated November 18, 1946 have accepted the same. C D

The respondent's terms of business contain various clauses, of which clauses 9 and 10 are relevant for our purpose. They are :

"9. *Deposits*

The buyer shall deposit with the Company 25% of the total value of the stores at the time of placing the order. The deposit shall remain with the Company as earnest money and shall be adjusted in the final bills, no interest shall be payable to the buyer by the Company on such amounts held as earnest money. E F

10. *Time and method of payment.*

(a) The buyer shall, before actual delivery is taken or the stores despatched under conditions, pay the full value of the stores for which his offer has been accepted less the deposit as hereinbefore contained after which a Shipping Ticket will be issued by the Company in the name of the buyer. The buyer shall sign his copy of the Shipping Ticket before the same is presented to the Depot concerned for taking delivery of the stores concerned. G

(b) If the buyer shall make default in making payment for the stores in accordance with the provisions of this contract the Company may without prejudice to its rights under Clause II thereof or other remedies in law H

A forfeit unconditionally the earnest money paid by the buyer and cancel the contract by notice in writing to the buyer and resell the stores at such time and in such manner as the Company thinks best and recover from the buyer any loss incurred on such resale. The Company shall, in addition be entitled to recover from
B the buyer any cost of storage, warehousing or removal of the stores from one place to another and any expenses in connection with such a resale or attempted resale thereof. Profit, if any, on resale as aforesaid, shall belong to the Company."

C From the above clauses, it will be seen that a buyer has to deposit with the company 25% of the total value and that deposit is to remain with the company as earnest money to be adjusted in the final bills. The buyer is bound to pay the full value less the deposit, before taking delivery of the stores. In case of default by the buyer, the company is entitled to forefeit unconditionally the
D earnest money paid by a buyer and cancel the contract.

The appellants instituted suit No. 2745 of 1947 in the Original Side of the Calcutta High Court against the respondents for recovery of the sum of Rs. 2,50,000 together with interest. The plaintiffs pleaded that there had been no concluded agreement
E entered into between the parties and even when the matter was in the stage of proposal and counter-proposal, the plaintiffs had withdrawn from the negotiations. They alleged that even if there was a concluded contract, the same was vitiated by the false and untrue representations made by the respondents regarding the quantity of scrap material available and the plaintiffs had been induced to enter into the agreement on such false representations.
F Hence the plaintiffs were entitled to avoid the contract and they have avoided the same. They pleaded that the respondents were never ready and willing to perform their part of the contract. Even on the assumption that the plaintiffs had wrongfully repudiated the contract, such repudiation was accepted by the defendant by putting an end to the contract. The respondents were not entitled
G to forfeit the sum of Rs. 2,50,000 as the latter cannot take advantage of their own wrongful conduct. In any event, the sum of Rs. 2,50,000 represents money had and received by the defendants to and for the use of the plaintiffs. The plaintiffs, in consequence, prayed for a decree directing the defendants to refund the sum of Rs. 2,50,000 together with interest at 6% from November 18,
H 1946.

The defendants contested the claim of the plaintiffs. They pleaded that a concluded contract has been entered into between

the parties as per two letters dated November 18 and November 20, 1946. The appellants had agreed to buy the lot of scraps lying in Dump No. 1 for Rs. 10,00,000 of which Rs. 2,50,000 was paid as deposit. The defendants had agreed to the balance amount being paid in instalments as asked for by the plaintiffs in their letter of November 18, 1946. The defendants further pleaded that there has been no misrepresentation made by them but the plaintiffs, without any justification, repudiated the contract by their letter dated November 22, 1946. As the plaintiffs wrongfully repudiated the contract, the defendants, as they are entitled to in law, forfeited the sum of Rs. 2,50,000 paid by the plaintiff as earnest money, under the terms of business of the Company which had become part of the contract entered into between the parties. The defendants further pleaded that they have always been ready and willing to perform their part of the contract and that they, in fact, even after the plaintiff repudiated the contract, called upon them to pay the balance amount and take delivery of the articles. But the plaintiffs persisted in their wilful refusal to perform their part and therefore the defendants had no alternative but to forfeit the earnest money and conduct a resale of the goods. The defendants further pleaded that the appellants had to pay them a sum of Rs. 42,499 for the loss and damage sustained by the defendants. They further urged that the plaintiffs were not entitled to claim the refund of the sum of Rs. 2,50,000 or any part thereof which had been paid as earnest money and forfeited according to law, and the terms of contract, by the defendants.

Though the plaintiffs have raised various contentions in the plaint, it is seen from the judgments of the learned Single Judge and the Division Bench, on appeal, that the appellants conceded that they committed breach of contract and that the defendants have been at all material times ready and willing to perform their part of the contract. The plea that the plaintiffs entered into the contract under a mistake of fact and that they were induced, to so enter into the contract due to the misrepresentation of the defendants regarding the quantity of scrap available, was also given up. The appellants have also accepted the position that there has been a concluded contract between the parties and the said contract was concluded by the correspondence between the parties consisting of the letters dated November 18, 1946 and November 20, 1946. The plaintiffs have further abandoned the plea that the defendants were not ready and willing to perform their part of the contract. Therefore the two questions that ultimately survived for consideration by the Court were: (1) as to whether the sum of Rs. 2,50,000 was paid by the plaintiffs as and by way of part payment or as earnest deposit; and (2) as to whether the defendants were entitled to forfeit the said amount.

A The learned Single Judge and, on appeal, the Division Bench, have held that the sum of Rs. 2,50,000 paid by the appellants was so paid as and by way of deposit or earnest money and that it is only when the plaintiffs pay the entire price of the goods and perform the conditions of the contract that the deposit of Rs. 2,50,000 will go towards the payment of the price. It is the B further view of the Courts that the amount representing earnest money is primarily a security for the performance of the contract and, in the absence of any provision to the contrary in the contract, the defendants are entitled to forfeit the deposit amount when the plaintiffs have committed a breach of contract. In this view the defendant's right to forfeit the sum of Rs. 2,50,000 was accepted C and it has been held that the plaintiffs are not entitled to claim refund of the said amount. The plaintiffs' suit, in the result, was dismissed by the learned Single Judge and, on appeal, the decree of dismissal has been confirmed.

On behalf of the appellants Mr. Maheshwari, learned counsel, has raised two contentions : (1) That the amount of Rs. 2,50,000 D paid by the plaintiffs and sought to be recovered in the suit is not by way of a deposit or as earnest money and that, on the other hand, it is part of the purchase price and therefore the defendants are not entitled to forfeit the said amount. (2) In this case, it must be considered that the sum of Rs. 2,50,000 has been named in the contract as the amount to be paid in case of breach or in the E alternative the contract contains a stipulation by way of penalty regarding forfeiture of the said amount and therefore the defendants will be entitled, if at all, to receive only reasonable compensation under s. 74 of the Contract Act and the Courts erred in not considering this aspect. Under this head, the counsel also urged that even a forfeiture of earnest money can only be, if the amount is considered reasonable and in this case the amount which repre- F sents 25% of the total price cannot be considered to be reasonable and hence the appellants are entitled to relief in law.

The learned Attorney General, on behalf of the respondents, pointed out that the material correspondence between the parties, by which the contract was concluded read along with the terms of G business will clearly show that the sum of Rs. 2,50,000 paid by the appellants was as earnest. It was further pointed out that the position in law is that the earnest money is part of the purchase price when the transaction goes through and is performed and that on the other hand it is forfeited when the transaction falls through by reason of the fault or failure of the vendee. The learned Attor- H ney General invited us to certain decisions laying down the salient features of 'earnest deposit' and the right of the party to whom the amount has been paid to forfeit when the opposite party has committed a breach of contract. Regarding the second contention of

the appellant, the learned Attorney General pointed out that the appellants never raised any contention that the amount of Rs. 2,50,000 deposited by the appellants is to be treated as a sum named in the contract as the amount to be paid in case of breach or that the contract must be considered to contain any stipulation by way of penalty. He also pointed out that the question of reasonableness or otherwise of the earnest deposit forfeited in this case, was never raised by the appellant at any stage of the proceedings in the High Court. Therefore s. 74 of the Contract Act has no application.

The first question that arises for consideration is whether the payment of Rs. 2,50,000 by the appellants was by way of deposit or earnest money. Before we advert to the documents evidencing the contract in this case, it is necessary to find out what in law constitutes a deposit or payment by way of earnest money and what the rights and liabilities of the parties are, in respect of such deposit or earnest money.

Borrows, in Words & Phrases, Vol. II, gives the characteristics of "earnest". According to the author,

> "An earnest must be a tangible thing... That thing must be given at the moment at which the contract is concluded, because it is something given to bind the contract, and, therefore, it must come into existence at the making or conclusion of the contract. The thing given in that way must be given by the contracting party who gives it, as an earnest or token of good faith, and as a guarantee that he will fulfil his contract, and subject to the terms that if, owing to his default, the contract goes off, it will be forfeited. If, on the other hand, the contract is fulfilled, an earnest may still serve a further purpose and operate by way of part payment."

Benjamin, in his book on 'Sale', 8th Edition, after referring to clause 17 of the Statute of Frauds and s. 4(1) of the Sale of Goods Act, 1893 providing for giving "something in earnest to bind the contract, or in part payment", says, at p. 219 :

> "'give something in earnest' or 'in part payment,' are often treated as meaning the same thing, although the language clearly intimates that the earnest is 'something to bind the bargain,' or, 'the contract,' whereas it is manifest that there can be no part payment till after the bargain has been bound, or closed."

The author further states that there are two distinct alternatives, *viz.*, a buyer may give the seller money or a present as a token or evidence of the bargain quite apart from the price, *i.e.*, earnest, or

A he may give him part of the agreed price to be set off against the money to be finally paid, *i.e.*, part payment and that if the buyer fails to carry out the contract and it is rescinded, cannot recover the earnest, but he may recover the part payment. But this does not affect the seller's right to recover damages for breach of contract unless it was by way of deposit or guarantee in which case
B it is forfeited. It is further stated that an earnest does not lose its character because the same thing might also avail as a part payment.

Regarding "deposit", the author states at p. 946, that a deposit is not recoverable by the buyer, for a deposit is a guarantee that the buyer shall perform his contract and is forfeited on his failure
C to do so and if a contract distinguishes between the deposit and instalments of price and the buyer is in default, the deposit is forfeited.

Halsbury, in "Laws of England", Vol. 34, III Edition, in paragraph 189 at p. 118, dealing with deposit, states :

D "Part of the price may be payable as a deposit. A part payment is to be distinguished from a deposit or earnest.

A deposit is paid primarily as security that the buyer will duly accept and pay for the goods, but, subject thereto, forms part of the price. Accordingly, if the
E buyer is unable or unwilling to accept and pay for the goods, the seller may repudiate the contract and retain the deposit."

Earl Jowitt, in his Dictionary of English Law, says :

"Giving an earnest or earnest-money is a mode of
F signifying assent to a contract of sale or the like, by giving to the vendor a nominal sum (*e.g.*, a shilling) as a token that the parties are in earnest or have made up their minds."

In *Howe* v. *Smith*(1) Fry, L.J., discussed the history of "earnest", which is identical with a deposit. In that case, the
G plaintiff agreed to purchase a property for the price mentioned in the agreement and paid £500 on the signing of the agreement "as a deposit and in part payment of the purchase-money." There were other stipulations in the agreement regarding title to the property and the payment of the balance of the purchase money. The plaintiff, apprehending that the defendant-vendor would re-sell
H the property, brought an action against him for specific performance of the agreement; but the suit was dismissed on the ground

(1) L.R. [1884] Ch. D. 89.

that there had been inordinate delay on the plaintiff's part in insisting on the completion of the contract. The plaintiff appealed. Before the Court of Appeal a request was made on his behalf for leave to amend the plaint that if specific performance could not be decreed, he should get a return of the deposit of £500. Leave was granted by the Appellate Court and the question hence arose as to whether the plaintiff was entitled to get a refund of the said amount. In dealing with the deposit claimed back by the plaintiff, Cotton, L.J., at p. 95, observes :

> "What is the deposit ? The deposit, as I understand it, and using the words of Lord Justice James (in L. R. 10 Ch. 512), is a guarantee that the contract shall be performed. If the sale goes on, of course, not only in accordance with the words of the contract, but in accordance with the intention of the parties in making the contract, it goes in part, payment of the purchase-money for which it is deposited; but if on the default of the purchaser the contract goes off, that is to say, if he repudiates the contract, then, according to Lord Justice James, he can have no right to recover the deposit."

Bowen, L.J., at p. 98, states :

> "We have therefore to consider what in ordinary parlance, and as used in an ordinary contract of sale, is the meaning which business persons would attach to the term 'deposit'. Without going at length into the history, or accepting all that has been said or will be said by the other members of the Court on that point, it comes shortly to this, that a deposit, if nothing more is said about it, is, according to the ordinary interpretation of business men, a security for the completion of the purchase. But in what sense is it a security for the completion of the purchase ? It is quite certain that the purchaser cannot insist on abandoning his contract and yet recover the deposit, because that would be to enable him to take advantage of his own wrong."

Fry, L.J., at p. 101, observes :

> "Money paid as a deposit must, I conceive, be paid on some terms implied or expressed. In this case no terms are expressed, and we must therefore inquire what terms are to be implied. The terms most naturally to be implied appear to me in the case of money paid on the signing of a contract to be that in the event of the contract being performed it shall be brought into

A

> account, but if the contract is not performed by the payer it shall remain the property of the payee. It is not merely a part payment, but is then also an earnest to bind the bargain so entered into, and creates by the fear of its forfeiture a motive in the payer to perform the rest of the contract."

B

Ultimately, the Court of Appeal rejected the claim of the plaintiff for refund of the deposit.

In *Soper* v. *Arnold*(1) the House of Lords had to consider the right of the plaintiff therein to claim a refund of the deposit made by him. In that case the plaintiff had contracted to purchase a C piece of land and entered into an agreement with the vendee. The agreement provided that the purchaser *viz.*, the plaintiff, should make a deposit and it further provided that if the vendee failed to comply with the conditions, the deposit should be forfeited. The plaintiff, accordingly, paid the deposit but as he was not in a position to complete the contract by paying the D balance purchase money, the contract could not be fulfilled. When in another litigation it was subsequently found that the vendor's title to the property was defective, the plaintiff brought an action to recover his deposit on the ground of mistake and failure of consideration. The suit was dismissed and the Court of Appeal also confirmed the said decision. The House of Lords also finally rejected the plaintiff's claim. In discussing the nature E of the deposit made by the plaintiff under the agreement, Lord Macnaghten at p. 435 observes :

> "The deposit serves two purpose—if the purchase is carried out it goes against the purchase-money, but its primary purpose is this, it is a guarantee that the pur- F chaser means business; and if there is a case in which a deposit is rightly and properly forfeited it is, I think, when a man enters into a contract to buy real property without taking the trouble to consider whether he can pay for it or not."

In *Farr, Smith & Co.* v. *Messrs, Ltd.*(2) dealing with the G question as to whether the payment was by way of earnest given to bind the contract, or it was a part payment towards the price. Wright J., observes at p. 408 :

> "Certain characteristics, however, seem to be clear, An earnest must be a tangible thing, in which definition it may be that a deposit is included, but in the old cases H it was always some tangible thing. That thing must be given at the moment at which the contract is concluded,

(1) L.R. [1889] 14 A.C. 429.

(1) L.R. [1928] 1 K.B.D. 397.

> because it is something given to bind the contract, and, therefore, it must come into existence at the making or conclusion of the contract. The thing given in that way must be given by the contracting party who gives it, as an earnest or token of good faith, and as a guarantee that he will fulfil his contract, and subject to the terms that if, owing to his default, the contract goes off, it will be forfeited. If on the other hand, the contract is fulfilled, an earnest may still serve a further purpose and operate by way of part payment."

The learned Judge, quoting the observations of Hamilton, J., in *Sumner and Leivesley* v. *John Brown & Co.*(1), observes at p. 409:

> "'Earnest'....meant something given for the purpose of binding a contract, something to be used to put pressure on the defaulter if he failed to carry out his part. If the contract went through, the thing given in earnest was returned to the giver, or, if money, was deducted from the price. If the contract went off through the giver's fault the thing given in earnest was forfeited."

The Judicial Committee had to consider in *Chiranjit Singh* v. *Har Swarup*(2) the question as to whether a payment made by way of earnest money by a buyer could be recovered when the buyer had committed breach of contract. In that case the plaintiff had entered into a contract with the defendant for purchase of a property. One of the terms of the contract of sale was:

> "Willing on old terms namely earnest twenty thousand balance in two moieties, first payable on executing conveyance, last within six months net cash we receive 4 lakhs 76,000."

The plaintiff did not pay the earnest money *eo nomine* but sent two cheques amounting to Rs. 1,65,000 and obtained a receipt that this amount was paid towards the sale price of the estate in question out of the total consideration of Rs. 4,76,000. Later the plaintiff informed the defendant that he was not in a position to complete the purchase and gave opportunity to the latter to sell the property to any other party. Therefore it was clear that the plaintiff-purchaser was unable or unwilling to complete the contract of purchase. The plaintiff, notwithstanding his default, sued to recover the entire sum of Rs. 1,65,000 paid by him. The High Court held that as the plaintiff had broken the contract, he must lose the earnest money of Rs. 20,000 but was entitled to a refund of the balance amount of Rs. 1,45,000 from and out of the amounts paid by him on that account. The plaintiff, dissatis-

(1) 25 Times L. R. 745. (2) A.I.R. 1926 P.C. 1.

A fied with the decision of the High Court, carried the matter in appeal to the Judicial Committee for obtaining relief of repayment of earnest money also. The Judicial Committee agreed with the High Court that from and out of the amounts paid by the plainitff, a sum of Rs. 20,000 was earnest money and there was nothing in the contract to suggest that the seller had agreed to B sacrifice the stipulated earnest. Regarding the legal incidents of earnest money, the Judicial Committee stated :

> "Earnest money is part of the purchase price when the transaction goes forward; it is forfeited when the transaction falls through, by reasons of the fault or failure of the vendee."

C Holding that the above principle applied squarely to the contract before them, they dismissed the paintiff's appeal for refund of earnest.

From a review of the decisions cited above, the following principles emerge regarding "earnest":

D (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 hte transction E is carried out.

(4) It is forfeited when the transaction falls through by reason of the default or failure of the purchaser.

(5) Unless there is anything to the contrary in the terms of the contract, on default committed by F the buyer, the seller is entitled to forfeit the earnest.

Having due regard to the principles enunciated above, we shall now consider, the relevant claims in the contract between the parties in the case before us, to ascertain whether the amount G of Rs. 2,50,000 paid by the appellant constitutes earnest money and if so whether the respondents were justified in law in forfeiting the same.

We have already referred to the letter, dated November 18, 1946 written by the respondents to the appellants confirming the sale of scrap lying in Dump No. 1. That letter states that the H total price for which the appellants agreed to purchase the scrap material is Rs. 10,00,000 against which a sum of Rs. 2,50,000 had been paid and the balance amount was to be paid that day itself. In the reply sent by the appellant on the same day, they

confirmed the arrangement referred to by the respondents but, regarding the payment of the balance amount, they agreed to pay the same in two instalments. The letter of November 18, 1946 to the appellants clearly refers to the fact that the Company's Terms of Business applied to the contract and a copy of the said terms was also sent to the respondents. The respondents, by confirming the arrangement, by their letter of November 18, 1946 were fully aware that the terms of business of the respondent company formed part of the contract entered into between the parties. We have also referred, earlier, to clauses 9 and 10 of the Terms of Business of the respondents. Clause 9 requires the buyer to deposit 25% of the total value of the goods at the time of placing the order. That clause also further provides that the deposit shall remain with the company "as earnest money", to be adjusted in the final bills. It further provides that no interest is payable to the buyer by the company "on such amounts held as earnest money". There is no controversy in this case that the appellants deposited the sum of Rs. 2,50,000 under this clause nine, representing 25% of the purchase price of Rs. 10,00,000. It is therefore clear that this amount deposited by the appellant is a deposit "as earnest money".

Mr. Maheshwari drew our attention to the letter, dated November 18, 1946 sent by the respondents to the appellants wherein the respondents have stated that the appellants have agreed to pay Rs. 10,00,000 for all the materials in Dump No. 1 against which a cheque for Rs. 2,50,000 has been paid and that the appellants further agreed to pay the balance of Rs. 7,50,000 that day itself. This statement, according to the learned counsel, will clearly show that the sum of Rs. 2,50,000 has been paid as part payment towards the total price, pure and simple, and there is no question of any payment by way of earnest money. But this contention ignores the last recital in the said letter wherein it has been specifically stated that the terms of business of the respondent company applied to the contract. This condition has also been accepted by the appellants in their reply, dated November 18, 1946. Therefore the position is this, that the terms of business of the respondent company have been incorporated as part of the letter and has been embodied in the terms of contract between the parties. Clause 9, to which we have already referred, clearly shows that 25% of the total value is to be deposited and that amount is to remain with the respondents as earnest money. It is again emphasized in clause 9 that the amount so deposited as earnest will not bear any interest, but will be only adjusted in the final bills. Therefore the amount of Rs. 2,50,000 deposited by the appellants, representing 25% of the total of Rs. 10,00,000, is "earnest money" under clause 9 of the Terms of Business.

A We have also earlier referred to clause 10 of the Terms of Business, which relates to the time and method of payment. Under clause 10(b) a right is given to the respondents when the buyer makes default in making payment according to the contract, to forfeit unconditionally the earnest money paid by the buyer. That clause further provides that this forfeiture of earnB est money is without prejudice to the other rights of the respondents in law. We have referred to the fact that though the appellants raised pleas that they have not committed any breach of contract and that on the other hand the respondents were the parties in breach, these contentions were not pursued and had been abandoned before the High Court. Further, as noted by the High Court, C the appellants conceded that they had committed a breach of the contract. If so, as rightly held by the High Court, under clause 10(b) the respondents were entitled to forfeit the earnest money of Rs. 2,50,000.

Before closing the discussion on this aspect, it is necessary to note that in the case before the Privy Council, in *Chiranjit Singh's* D Case, though the contract stipulated that a sum of Rs. 20,000 should be paid as earnest, the buyer did not pay any amount by way of earnest, as such, but he paid by two cheques the sum of Rs. 1,65,000 against the purchase price of Rs. 4,76,000. The receipt of the sum of Rs. 1,65,000, granted by the seller was also stated to be only towards the sale price. But, nevertheless, the High Court, as well as the Judicial Committee, treated a sum of E Rs. 20,000 out of the sum of Rs. 1,65,000, as earnest money paid under the terms of the agreement, and a claim to recover that amount of earnest money was negatived. In the case before us, the contract read with the Terms of Business of the company, clearly refers to the earnest money being paid and to the fact of Rs. 2,50,000 having been paid as earnest. Therefore, there is no F ambiguity regarding the nature of the above payment and the right of the respondents to forfeit the same, under the terms of the contract, when the appellants admittedly had committed breach of the contract, cannot be assailed. The first contention for the appellants therefore fails.

The second contention of Mr. Maheshwari, noted earlier, is G really based upon ss. 73 and 74 of the Contract Act. According to the learned counsel, under s. 73, the respondents will be entitled only to compensation for any loss or damage caused to them by the breach of the contract, committed by the appellants. Counsel very strongly relied upon s. 74 of the Contract Act. According to him, the sum of Rs. 2,50,000, referred to in the contract, must be treated as the amount to be paid in case of a breach. In the H alternative, counsel also urged that the provision in the contract regarding the forfeiture of the said amount, should be treated as a term containing a stipulation by way of a penalty. Under any of

these circumstances, the remedy of the aggrieved party would be to get compensation which is adjudged reasonable by the Court. Counsel also urged that "earnest money", unless it is considered to be a reasonable amount, could not be forfeited in law. A

The learned Attorney General very strongly urged that the pleas covered by the second contention of the appellant had never been raised in the pleadings nor in the contentions urged before the High Court. The question of the quantum of earnest deposit which was forfeited being unreasonable or the forfeiture being by way of penalty, were never raised by the appellants. The Attorney General also pointed out that as noted by the High Court the appellants led no evidence at all and, after abandoning the various pleas taken in the plaint, the only question pressed before the High Court was that the deposit was not by way of earnest and hence the amount could not be forfeited. Unless the appellants had pleaded and established that there was unreasonableness attached to the amount required to be deposited under the contract or 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. He further urged that the question of unreasonableness or otherwise regarding earnest money does not at all arise when it is forfeited according to the terms of the contract. B C D

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. E F G

In this view, it is unnecessary for us to consider the decision of this Court in *Maula Bux* v. *Union of India*(1) relied on by the appellants and wherein there is an observation to the effect : H

"Forfeiture of earnest money under a contract for sale of property—movable or immovable—if the

(1) [1970] 1 S. C. R. 928.

A amount is reasonable, does not fall within s. 74 (of the Indian Contract Act). That has been decided in several cases. *Kunwar Chiranjit Singh* v. *Har Swarup* (AIR 1926 P.C. 1); *Roshan Lal* v. *The Delhi Cloth and General Mills Co. Ltd. Delhi* (ILR 33 All. 166); *Muhammad Habibullah* v. *Muhammad Shafi* (ILR 41 B All. 324); *Bishan Chand* v. *Radha Kishan Das* (ILR 19 All. 489). These cases are easily explained, for forfeiture of 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 C 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."

The learned Attorney General has pointed out that the decisions D referred to in the above quotation do not lay down that the test of reasonableness applies to an earnest deposit and its forfeiture. He has also pointed out that this Court, in the above decision, did not agree with the view of the High Court that the deposit, the recovery of which was sued for by the plaintiff therein, was earnest money. The learned Attorney General also referred us to various decisions, wherein, according to him, though the E amounts deposited by way of earnest were fairly large in proportion to the total price fixed under the contract, nevertheless the forfeiture of those amounts were not interfered with by the Courts. But, as we have already mentioned, we do not propose to go into those aspects in the case on hand. As mentioned earlier, the appellants never raised any contention that the forfeiture of the F amount amounted to a penalty or that the amount forfeited is so large that the forfeiture is bad in law. Nor have they raised any contention that the amount of deposit is so unreasonable and therefore forfeiture of the entire amount is not justified. The decision in *Maula Bux's* Case(1) had no occasion to consider the question of reasonableness or otherwise of the earnest deposit G being forfeited. Because, from the said judgment it is clear that this Court did not agree with the view of the High Court that the deposits made, and which were under consideration, were paid as earnest money. It is under those circumstances that this Court proceeded to consider the applicability of s. 74 of the Contract Act.

H Mr. Maheshwari has relied upon the decision of this Court in *Fateh Chand* v. *Balkishan Das*(1) wherein, according to him, this

(1) [1970] 1 S.C.R. 928. (2) [1964] 1 S.C.R. 515.

Court has held, under similar circumstances, that the stipulation under the conrtact regarding forfeiture of the amount deposited is a stipulation by way of penalty attracting s. 74 of the Contract Act. On this assumption, counsel urged that there is a duty, statutorily imposed upon Courts by s. 74 of the Contract Act not to enforce the penalty clause but only to award reasonable compensation. This aspect, he urges, has been totally missed by the High Court.

We are inclined to accept this contention of the learned counsel. This Court had to consider, in the said decision, two questions : (i) whether the plaintiff therein was entitled to forfeit a sum of Rs. 1,000 paid as earnest money on default committed by the buyer; and (ii) whether the plaintiff was further entitled to forfeit the entire sum of Rs. 24,000 paid by the buyer under the contract which recognised such right. This Court held that the plaintiff was entitled to forfeit the sum of Rs. 1,000 paid as earnest money, when default was committed by the buyer. But, regarding the second item of Rs. 24,000 this Court held that the same cannot be treated as earnest and therefore the rights of the parties would have to be adjudged under s. 74 of the Contract Act. In view of this conclusion the Court further had to consider the relief that the plaintiff had to get when breach of contract was committed by the buyer and, in dealing with this question. it observed at p. 526 :

> "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 conrtact 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."

Again, at p. 528 it observed :

> "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 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."

B The Court further observed at p. 529 :

"There is no ground for holding that the expression contract contains any other stipulation by way of penalty' is limited to cases of stipulation in the nature of an agreement to pay money or deliver property on C breach and does not comprehend covenants under which amounts paid or property delivered under the contract, which by the terms of the contract expressly or by clear implication are liable to be forfeited.

Section 74 declares the law as to liability upon breach of contract where compensation is by agreement D 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 E 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. F 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."

G This Court applied s. 74 of the Contract Act, and ultimately fixed a particular amount which the plaintiff would be entitled to as reasonable compensation in the circumstances.

Mr. Maheshwari placed considerable reliance on the above extracts in support of his contention and urged that the recitals H regarding forfeiture of the amount of Rs. 2,50,000 shows that the contract contains a stipulation by way of penalty and therefore s.74 is attracted. It is not possible to accept this contention. As we have already pointed out, this Court, in the above decision,

recognised the principle that earnest money can be forfeited, but in dealing with the rest of the amount which was not, admittedly, earnest money, s.74 was applied. In the case before us the entire amount, as evidenced by the contract and as held by us earlier, is earnest money and therefore the above decision does not apply.

Mr. Maheshwari finally urged that s.64 of the Contract Act may apply and he also relied on the decision of the Judicial Committee in *Murlidhar Chatterjee* v. *International Film Co.*(1). On the basis of that ruling he urged that the respondents are bound to restore the benefit that they have obtained under the contract. In our opinion there is no scope for applying s.64 of the Contract Act and it follows that the decision of the Judicial Committee, referred to above, and dealing with s.64 has no relevance.

We have already pointed out that the appellants raised a contention that they had been induced to enter into the agreement on a misrepresentation made by the respondents regarding the quantity of material available. If the appellants had proceeded on that basis, then the contract would have been voidable at their instance under s.19 of the Contract Act. But they have abandoned that plea and have admitted that the breach of contract was committed by them. Hence s. 64 cannot be invoked by the appellants.

In this view, the second contention also fails.

In the result, the appeal fails and is dismissed with costs.

V.P.S. *Appeal dismissed.*

(1) L. R. 70 I.A. 35.