

IN THE HIGH COURT OF HIMACHAL PRADESH, SHIMLA

RSA No. 167 of 2008

Reserved on: 27.8.2026

Date of Decision: 09.9.2026

H.P. General Industries Corporation Ltd. & anr. ...Appellants

Versus

M/s Batra Traders

...Respondent

Coram

Hon'ble Mr Justice Rakesh Kainthla, Judge.

Whether approved for reporting?¹ Yes.

For the Appellants : M/s B.B. Vaid and Hemant Vaid,
Advocates.

For the Respondent : Mr Arhant Mahajan, Advocate,
vice Mr Rahul Mahajan,
Advocate.

Rakesh Kainthla, Judge

The present appeal is directed against the judgment and decree dated 03.01.2008, passed by the learned District Judge, Shimla (learned Appellate Court), vide which the judgment and decree dated 28.09.2005, passed by the learned Civil Judge (Senior Division), Shimla (learned Trial Court), were set aside. *(The parties shall hereinafter be referred to in the same*

¹ Whether reporters of Local Papers may be allowed to see the judgment? Yes.

manner as they were arrayed before the learned Trial Court for convenience).

2. Briefly stated, the facts giving rise to the present appeal are that the plaintiff filed a civil suit for recovery of ₹2,15,600/- along with interest @ 18% per annum, and for a permanent prohibitory injunction restraining the defendants from forfeiting the property and appropriating the security. It was asserted that the plaintiff is a proprietorship concern dealing with the supply of empty bottles, gunny bags, corrugated boxes, and all kinds of scraps. The defendants placed an order with the plaintiff on 09.07.1991 for supply of 25,00,000 bottles of 750 ml each, 2,00,000 bottles of 375 ml each, and 2,00,000 bottles of 180 ml each. The defendants started purchasing empty bottles from the open market. The plaintiff objected to it, and the dispute was resolved on 31.01.1992. The defendants extended the time for supply of the order and placed an additional order for supply of 6,00,000 bottles of 750 ml each at the rate of ₹25.90 per dozen.

3. The defendants floated another tender for supply of empty liquor bottles for the year 1992. The plaintiff's bid was

accepted, and the plaintiff was ordered to supply the empty bottles at the rate of ₹28.25 per dozen. The plaintiff applied for the refund of the security for the previous year's order. The defendants raised an additional demand instead of refunding the security. The plaintiff sent a reply to the demand. The defendants decreased the order by 20% for the year 1992–1993. The plaintiff complied with the order but also served a notice upon the defendants. There was no dispute regarding the refund of the security for the year 1991–1992. However, the defendants did not refund the security of ₹60,000/- and ₹5,000/-.

4. The defendants again floated a tender in the year 1993, and the plaintiff's was accepted. Security of ₹60,000/- and ₹15,000/- was deposited. The plaintiff supplied the bottles. The defendants purchased the bottles from the open market. A dispute arose between the parties, which was resolved with the intervention of the Chief Secretary to the Government of Himachal Pradesh. The plaintiff completed the supply, but the defendants failed to refund the security.

5. A fresh tender was floated for the year 1994–1995, and security was deposited. The dispute is pending before the

Arbitrator. The plaintiff requested the defendants for the refund of the security, but the defendants failed to refund it. The defendants served a legal notice upon the plaintiff on 03.07.1997 threatening to forfeit the security in case of non-supply of the bottles. The defendants are not entitled to retain the security; hence, the suit was filed seeking the reliefs mentioned above.

6. The suit was opposed by filing a written statement taking preliminary objections regarding lack of cause of action and maintainability, the plaintiff being estopped by his act and conduct and acquiescence to file the suit, the suit having not been properly instituted by a competent person, the suit being barred by limitation, the suit not being properly valued for the purpose of court fees and jurisdiction, and the suit being bad for misjoinder of causes of action. The contents of the plaint were admitted to the extent that the defendants had invited tenders for supply of empty bottles and the plaintiff's bid was accepted. It was asserted that the plaintiff failed to supply the bottles as per the demand, and letters were sent to the plaintiff from time to time. An audit objection was raised regarding the new order at a higher rate when the old rate was prevailing. The plaintiff repeated the violation of the terms and conditions of the tender.

The defendants suffered a loss of ₹5,70,356/-; they forfeited the security of ₹1,70,000/-. and asked the plaintiff to deposit the remaining amount of ₹3,05,356/-. The suit was filed without any basis; hence, it was prayed that the suit be dismissed.

7. A replication denying the contents of the written statement and affirming those of the plaintiff was filed.

8. The learned Trial Court framed the following issues on 20.05.1999:

- (i) Whether the plaintiff has performed and complied with the terms and requirements of the contract regarding supply of bottles which was executed between him and defendants for the year 1991, 1992 and 1993 and is therefore entitled to refund the security amount as alleged? OPP.
- (ii) Whether the order of forfeiture of security amount is justified and defendants are entitled to some more amount besides the security amount on account of alleged non-performance/breach of the terms and conditions of the contract? OPD.
- (iii) Whether the suit is barred by time? OPD.
- (iv) Whether the plaintiff is estopped to sue by his acts, deeds and conduct? OPD.
- (v) Whether the suit has not been properly instituted? OPD.
- (vi) Whether the plaintiff has no enforceable cause of action? OPD.
- (vii) Whether the plaintiff is not properly verified, if so, its effect? OPD.

- (viii) Whether the suit is bad for mis-joinder of cause of action? OPD.
- (ix) Whether the suit has not been properly valued for the purpose of court fee and jurisdiction? OPD.
- (x) Relief.

9. The parties were called upon to produce the evidence. The plaintiff examined B.C. Bhardwaj (PW-1), Gopal Kishan (PW-2), Anant Ram (PW-3) and Ram Avtar (PW-4). The defendants examined Shri B.C. Gupta (DW-1).

10. The learned Trial Court held that the plea taken by the defendants that the plaintiff had failed to supply the bottles as per the demand was probable. The defendants issued repeated letters and telegrams to the plaintiff pointing out the shortfall. The plaintiff failed to adhere to the schedule of supply. The security amount was liable to be forfeited for breach of terms and conditions as per Clause 9 of the agreement. The plaintiff had completed the supply in the year 1993, and the suit was to be filed within three years. However, it was filed after the lapse of about five years and was barred by limitation. Hence, the learned Trial Court answered Issue Nos. 3, 4, 6, and 7 in the affirmative, Issue No. 2 partly in the affirmative, the rest of the issues in the negative, and dismissed the suit.

11. Being aggrieved by the judgment and decree passed by the learned Trial Court, the plaintiff filed an appeal, which was decided by the learned District Judge, Shimla (learned Appellate Court). The learned Appellate Court concurred with the findings recorded by the learned Trial Court that the agreement between the parties contained a penalty clause; however, the defendants were not justified in forfeiting the penalty without showing the extent of damages suffered by them. The defendants claimed that there was a short supply, but had not proved the damages suffered by them. The statement made by Shri B.C. Gupta (DW-1) that the defendants could not fulfill the obligation to the Excise Department was not corroborated by any material on record. Hence, the learned First Appellate Court allowed the appeal, set aside the judgment and decree passed by the learned Trial Court, and decreed the suit.

12. Being aggrieved by the judgment and decree passed by the learned First Appellate Court, the defendants have filed the present appeal, which was admitted on the following substantial questions of law:

- (i) Whether the learned First Appellate Court was justified in applying the provisions of Section 74 of

the Indian Contract Act when there was a breach of the terms of the supply order, which itself rendered the forfeiture of the security amount, moreover, when there is no such plea of the plaintiff and still the First Appellate Court can invoke the said provisions?

- (ii) Whether there is misreading, misappropriation and non-application of mind to the pleadings as well as oral and documentary evidence?
- (iii) Whether the suit of the plaintiff was within limitation and the First Appellate Court was justified in not giving any findings on limitation?

13. I have heard M/s B.B. Vaid and Mr Hemant Vaid, learned counsel for the appellants/defendants, and Mr Arhant Mahajan, learned vice counsel representing the respondent/plaintiff.

14. Mr B.B. Vaid, learned counsel for the appellants/defendants, submitted that the learned Trial Court had specifically held the suit to be barred by limitation. However, the learned Appellate Court failed to record any finding regarding the plea of limitation, and this issue was simply ignored. It was an admitted case of the plaintiff that the contract was fulfilled in the year 1993; therefore, the cause of action for filing the suit arose in the year 1993. The suit was to be filed within three years from the accrual of the cause of action, and the suit was hopelessly barred by limitation. Therefore, he

prayed that the present appeal be allowed, the judgment and decree passed by the learned Appellate Court be set aside, and the judgment and decree passed by the learned Trial Court be restored.

15. Mr Arhant Mahajan, learned vice counsel representing the respondent/plaintiff, submitted that time is not the essence of the contract. The notice of forfeiture was received on 03.07.1997, and the cause of action accrued on that day. The suit was filed on 18.04.1998, within the period of three years from the date of the accrual of the cause of action; hence, the same was within limitation. The learned Appellate Court had rightly held that the penalty clause is not sufficient to forfeit the security, and the defendants were required to prove the actual damage sustained by them. Since the defendants have not proved the damages sustained by them, the learned Appellate Court had rightly decreed the suit. There is no infirmity in the judgment and decree passed by the learned Appellate Court; hence, he prayed that the present appeal be dismissed. He relied upon the following judgments in support of his submission:-

- (i) *Gomathinayagam Pillai vs. Palaniswami Nadar* 1967 SC 868;

(ii) *Maula Bux v. Union of India (AIR 1970 SC 1955)*

(iii) *Union of India v. Rampur Distillery and Chemical Co. Ltd.*

16. I have given considerable thought to the submissions made at the bar and have gone through the record carefully.

Substantial Question of Law No.3:

17. The plaintiff asserted in Para 4 of the plaint that there was no dispute between the parties, but the security for the year 1991–1992 of ₹60,000/- and ₹5,000/- for the bottles of 180 ml. was not refunded. He stated in Para 5 of the plaint that the supply was completed for the year 1993, but the security of ₹60,000/- and ₹15,000/- was not refunded without any justifiable reason.

18. Shri Ram Avtar Batra (PW-4) stated that he had deposited money by way of security twice: the amount of one security was ₹65,000/-, and the amount of the other security was ₹75,000/-. He made the supplies to the defendants as per their demand, but the defendants failed to refund the security despite his performance of the agreement by him. He stated in his cross-examination that he had stopped making supplies to the defendants during the year 1991–1992 because the

defendants had started making purchases from other sources. He admitted that he had received telegraphic reminders from the defendants for supply of bottles, and volunteered to state that the defendants had not accepted the supply.

19. Therefore, as per the admitted version of the plaintiff, the plaintiff had completed the supply, but the defendants had failed to return the security deposited by him.

20. It was laid down by the High Court of Bombay in *Shankar Moreshwar Kulkarni Chinchwadkar v. State of Maharashtra*, 1968 SCC OnLine Bom 52: AIR 1970 Bom 8: 1969 Mah LJ 677 that the suit for the recovery of security has to be filed within three years from the completion of the contract. It was observed at page 9:

“9. Where money is deposited by way of security for the due performance of a contract or otherwise under the terms of a contract and is refundable after the completion of the contract, in our opinion, Article 62 is not applicable to the suit for refund as the money was not received by the defendant for the plaintiff's use. Such suit would be governed by the residuary Article 120 of the Indian Limitation Act, 1908.

11. Our attention was invited to the judgment of a Division Bench of this Court in the case of *Dhanraj Mills Ltd. v. Laxmi Cotton Traders, Bombay*, 60 Bom LR 1295 : (AIR 1960 Bom 404). In that case it was merely held that Article 145

was not applicable to the facts which were similar to the facts of this case, but it was not decided as to which of the articles in the first schedule of the Indian Limitation Act was applicable. In an earlier Bombay case, namely, *Lingangouda v. Lingangouda*, ILR (1953) Bom 214 : (AIR 1953 Bom 79) —Chagla C.J. had taken the view that Article 120 was applicable in a similar matter. The reason given in the judgment was that Article 62 should not apply to a case where the terms of the article were not literally complied with. It was observed that such a construction would result in plaintiffs losing a large number of cases on the ground of limitation, whereas if Article 120 was held to be applicable, the plaintiffs would be safe. The reasoning of this decision was not approved of by the Supreme Court in (1965) 2 SCR 577 (AIR 1965 SC 1773), referred to hereinabove. We are, however, bound by the judgment of the Supreme Court on the point that Article 62 was not applicable. The only article with which we are left is Article 120. In our opinion, Article 120 is applicable, being the residuary article.

21. Similarly, the Rajasthan High Court also held in *State of Rajasthan v. Anand Construction Co.*, 1971 SCC OnLine Raj 7: AIR 1972 Raj 101 that in case of refund of the security deposit, the obligation to refund the security arises on the completion of the contract, and a period of three years would apply. It was observed at page 102: -

10. In *Nasiruddin v. Abdullah Mian*, 1959 Raj LW 317 where a tenant had deposited money with the landlord as a security for the due fulfilment of the stipulation to do all repairs which may be necessary at the termination of the lease, and that if the tenant did not do so, the landlord would be entitled to do it and deduct the cost out of the

said deposit, the suit was filed for the refund of the deposit and it was held that as there was no specific article applicable to the case of this nature, Article 120 of the Limitation Act of 1908 would apply. Reliance was placed on *Upendra Lal Mukhopadhyaya v. The Collector of Rajshaye*, (1886) ILR 12 Cal 113.

11. In *Harij Gram Panchayat v. Thakkar Lakhiram Ramji*, AIR 1962 Guj 14, it was held that in a suit brought for the refund of deposit by way of security for the due performance of the contract, neither Art. 62 nor Art. 60 nor Article 97 of the Act of 1908 applies, and in the absence of any specific Article application to the suit, Article 120 applies.

12. The same view was taken by the Bombay High Court in *Shankar v. State*, AIR 1970 Bom 8. It was held there that:

“Where money is deposited by way of security for the due performance of a contract or otherwise under the terms of a contract and is refundable after the completion of the contract, Article 62 is not applicable to the suit for refund as the money was not received by the defendant for the plaintiff's use. The right to refund did not arise immediately on receipt by the defendant. The suit not being a suit against a depository or pawnee to recover movable property deposited or pawned, Article 145 also would not be applicable. Such suit would be governed by the residuary Article 120.”

13. The Calcutta High Court in *G.D. and Co. v. W.I. Theatres*, (1961) 65 Cal WN 504 came to the decision that to such suits Article 146 of the Indian Limitation Act of 1908 would be applicable and if for any reason, this article is not applicable, there is no doubt that Article 120 is applicable. This was also a case for the refund of the deposit made by the contractor. Bose J. in that case observed that:

“A deposit made as security for due performance of a contract is refundable whether it is coupled with a promise or agreement to repay it or not. Even if nothing is agreed as to its repayment at the time the deposit is made, the obligation to repay arises upon the proper performance of the engagement by reason of the very nature of the transaction of deposit. If an express agreement is entered into for repayment of the deposit, the transaction remains a deposit, and its nature is not thereby altered. The essence of the causes of action for a suit for refund of a deposit is not the breach of the contract to repay it, but the fact that the transaction is a deposit which by its very nature is refundable.

14. The person who holds the deposit and the person on whose behalf or for whose benefit the deposit is held as security are liable to refund it because it is a deposit. They are both in the position of depositories. Accordingly, the article applicable is Article 145 of the Indian Limitation Act, and if for any reason this article is not applicable, there is no doubt that Article 120 is applicable to the present case.”

15. Thus there is sufficient authority for the view I have taken in the matter. The contracts in this case were completed on 27-1-1958, and the suit has been filed within six years of that date. Although, on behalf of the defendant, the Engineer-in-charge has deposed that the amount of security deposit was refundable six months after the completion of the contract, but no such period is fixed in the agreement and in its absence the time will begin to run from the date of the completion of the contract. But in any case, the suit was instituted within six years of the completion of the contract

22. A similar view was taken by the High Court of Allahabad in *State of U.P. v. Chandra Gupta & Co.*, 1976 SCC OnLine All 159: 1976 All LJ 426 wherein it was observed at page 434

“22. Article 56, quoted above, will show that it prescribes a period of three years for a suit for the price of work done by the plaintiff for the defendant at his request, where no time has been fixed for payment. In this eventuality, the period of limitation starts running from the date when the work is done. In the instant case, however, we find that Clause 7 of the Conditions of Contract provides for payment on intermediate certificate to be regarded as advances. Under this limitation clause, a contractor is entitled to receive a monthly payment proportionate to the part thereof that is approved for such purpose by the Engineer-in-Charge. Similarly, a provision for final payment has also been made in Clause 6. Accordingly, as the contract provides for the time when the payment is to be made, Art. 56 of the old Limitation Act would not be applicable to the claim for the extra work. The other Articles which were relied upon by the plaintiff were Arts. 120 and 115 of the said Act. Art. 115 will apply to a claim of compensation for breach of any contract, express or implied. The period of limitation in such cases is three years, and it commences to run when the contract is broken. Although it was vehemently urged by Sri Radha Krishna that the correct Article applicable to the claim for the extra work was Art. 120, we find that even applying Art. 115, the suit of the plaintiff is within time; we do not think it necessary to examine the question as to whether Art. 120 applies. The facts of the case, stated above, would show that the claim of the plaintiff was rejected by the State of U.P. on 15-3-1959, whereas the suit was filed by the plaintiff on 16-5-1962. The plaintiff, having given two months' notice to the State of U.P., was entitled to the exclusion of this period of two months, and as 15th of May, 1962, was a public holiday, the plaintiff could,

therefore, file the suit on 16-5-1962. Accordingly, the suit filed by the plaintiff on the aforesaid date was within time. This view of ours is supported by a decision of a Division Bench of this Court in *State of U.P. v. Suraj Prasad Gupta* [F.A. No. 351 of 1968, decided on 3-2-1976]. In this case also it was held that to a claim like the present, the applicable provision is that provided by Art. 115 of the old Limitation Act.

23. There remains to be considered the question as to whether the claim made by the plaintiff for the refund of the security deposit forfeited by the State was within time. The real question in this case is about the character of the deposit made by the plaintiff as a contractor. The amount was deposited as security for the performance of the contract. The question of limitation as to the refund of the security amount came up for consideration before a Division Bench of the Punjab and Haryana High Court in (*Zila Parishad, Ambala v. Banarsi Dass [A.I.R. 1973 Pun. and Har. 276.]*). The Bench observed that a suit for return of security deposit is not for compensation for the breach of any contract; the deposit remains a deposit whether the depositor has a right to deduct anything therefrom or not. Thus, the suit would be governed either by Art. 145 or 120 of the Limitation Act. In *Datt Singh v. Srihar Singh [1955 N.U.C. 3551]*, a learned Single Judge was also required to consider a similar controversy. The commentator has digested the observations made by the learned Judge in the following terms:

“The claim for a return of the deposit money cannot by any stretch of the language of Art. 115 be considered as a suit for compensation for breach of any contract. When an employee makes a deposit for due performance of the duties, the deposit is in the nature of a trust, and the proper Article in such a case is Art. 145, which provides for a greater period of limitation than Art. 120. Even if Art. 145 is not applied, there is no escape from the conclusion that the other Article applicable to a case of this type is Art. 120.”

24. For the reasons given above, we find that a suit relating to a deposit would fall under the residuary Art. 120 of the Act. The period provided under this Article is six years. Applying this period, we find that the suit is within time and, therefore, the claim of the plaintiff for the refund of the security deposit cannot be defeated on the ground of limitation.”

23. These judgments were followed by this Court in *M/s Kumar & Company v. State of H.P., Civil Suit No. 33 of 1990, decided on 03.06.2000.*

24. In the present case also, the agreement for the year 1991–1992 came to an end in the year 1992, and the agreement for the year 1993 came to an end in the year 1993. This is also evident from the fact that, as per the plaint, a fresh tender was floated in the year 1994–1995 and there was a dispute regarding the same, which is the subject matter of the arbitration. Hence, the learned Trial Court had rightly held that the suit was to be filed within three years, and the learned Appellate Court erred in ignoring these findings.

25. Mr Arhant Mahajan, learned counsel for the plaintiff, referred to the performance report (Ext. PB) and stated that orders were being placed in the year 1994–1995, and the contract had not come to an end. This submission cannot help the plaintiff. It is undisputed that different tenders were floated

for different years, and merely because orders were placed in different years cannot mean that those were referable to the tenders for the years 1991–1992 and 1993–1994, for which the security is being claimed. Therefore, not much advantage can be derived from the performance report.

26. It was submitted that a notice (Ext. PA) was issued to the plaintiff for forfeiting the security amount, which would furnish a cause of action. This submission can also not help the plaintiff, because the plaintiff has not challenged the order of forfeiture but has claimed the refund of the security deposited by him, and any order of forfeiture will not have the effect of extending the period of limitation in the present case.

27. It was further submitted that time is not the essence of the contract and the suit cannot be said to be barred by limitation. This submission is only stated to be rejected. This principle cannot apply to the refund of security, which becomes due after the completion of the contract.

28. It is an admitted version that different tenders were being floated for different years; therefore, the tender came to an end once a new tender was floated, and the plaintiff cannot

claim that time was not the essence of the contract when the period of limitation started running from the expiry of the previous tender.

29. The judgment in *Gomathinayagam Pillai (supra)* and *Hind Construction (supra)* related to the performance of the contract and not the refund of the security, and will not help the plaintiff.

30. A reference was made to the letter dated 01.06.1992 (Ext. P-9), vide which the plaintiff had demanded the refund of the security. This letter will not help the plaintiff because it would show that the demand for the refund was made on 01.06.1992, and a cause of action arose from that date. The plaintiff was required to file the suit within three years, but failed to do so.

31. Thus, the learned Trial Court had rightly held that the suit was barred by limitation, and the learned First Appellate Court erred in not recording any finding regarding this issue. Hence, this substantial question of law is answered accordingly.

Substantial Question of Law No. 1:

32. The learned First Appellate Court had rightly held that the security amount could not be forfeited simply because of default, and Section 74 of the Indian Contract Act will apply to the refund of the security deposit. It was laid down by the Hon'ble Supreme Court in *Maula Bux v. Union of India*, (1969) 2 SCC 554: 1969 SCC OnLine SC 291 that the security could not be forfeited simply because of breach of the contract unless the damages are shown. It was observed at page 557:-

4. Under the terms of the agreements the amounts deposited by the plaintiff as security for due performance of the contracts were to stand forfeited in case the plaintiff neglected to perform his part of the contract. The High Court observed that the deposits so made may be regarded as earnest money. But that view cannot be accepted. According to Earl Jowitt in *Dictionary of English Law* at p. 689: "Giving an earnest or earnest-money is a mode of signifying assent to a contract of sale or the like, by giving to the vendor a nominal sum (e.g. a shilling) as a token that the parties are in earnest or have made up their minds". As observed by the Judicial Committee in *Chiranjit Singh v. Har Swarup*: [1925 SCC OnLine PC 63: AIR 1926 PC 1]

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

In the present case, the deposit was made not as a sum of money by the purchaser to be applied towards part

payment of the price when the contract was completed and till then as evidencing an intention on the part of the purchaser to buy property or goods. Here the plaintiff had deposited the amounts claimed as security for guaranteeing due performance of the contracts. Such deposits cannot be regarded as earnest money.

Section 74 of the Contract Act provides;

“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.

1. ***”

2. There is authority, no doubt coloured by the view which was taken in English cases, that Section 74 of the Contract Act has no application to cases of deposit for due performance of a contract which is stipulated to be forfeited for breach, *Natesa Aiyar v. Appayu Padayachi* [1913 SCC OnLine Mad 208: ILR (1915) 38 Mad 178]; *Singer Manufacturing Company v. Raja Prosad* [ILR (1909) 36 Cal 960]; *Manian Pattar v. Madras Railway Company*. [1905 SCC OnLine Mad 88: ILR (1906) 29 Mad 118] But this view is no longer good law in view of the judgment of this Court in *Fateh Chand case* (supra). This Court 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...,’ ‘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.’”

The Court also observed:

“It was urged that the section deals in terms with the right to receive from the party who has broken the contract reasonable compensation and not the right to forfeit what has already been received by the party aggrieved. There is, however, no warrant for the assumption made by some of the High Courts in India that Section 74 applies only to cases where the aggrieved party is seeking to receive some amount on breach of contract and not to cases whereupon breach of contract an amount received under the contract is sought to be forfeited. In our judgment, the expression “the contract contains any other stipulation by way of penalty” comprehensively applies to every covenant involving a penalty whether it is for payment on breach of contract of money or delivery of property in future, or for forfeiture of right to money or other property already delivered. Duty not to enforce the penalty clause but only to award reasonable compensation is statutorily imposed upon courts by Section 74. In all cases, therefore, where there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of contract which expressly provides for forfeiture, the court has jurisdiction to award such sum only as it considers reasonable, but not exceeding the amount specified in the contract as liable to forfeiture, and that,

“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 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.”

5. 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 v. Har Swarup*; *Roshan Lal v. Delhi Cloth and General Mills Company Ltd. Delhi* [1910 SCC OnLine All 98: ILR (1911) 33 All 166]; *Mohd Habibullah v. Mohd Shafi* [1919 SCC OnLine All 87: ILR 41 All 324]; *Bishan Chand v. Radhakishan Das.* [1897 SCC OnLine All 52: ILR (1897) 19 All 490] These cases are easily explained, for forfeiture of a reasonable amount paid as earnest money does not amount to imposing a penalty. But if forfeiture is of the nature of a 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.

33. The High Court of Allahabad followed this judgment in *Chandra Gupta & Company* (supra) and observed:-

20. A similar question regarding the right of the Union of India to forfeit the security came up for consideration before the Supreme Court in *Maula Bux v. Union of India* [(1969) 2 SCC 554: A.I.R. 1970, S.C. 1955]. In that case, Maula Bux had entered into a contract with the Government of India for the supply of certain goods and had deposited a certain amount of security for the due performance of the contract. It was stipulated in the contract that the amount of security was to stand forfeited in case the appellant neglected to perform his part of the contract. On Maula Bux committing default in the supply, the government did not only rescind the contract but also forfeit the security deposit. Holding that

a case of forfeiture of earnest money was different from forfeiture of security deposit for due performance of the contract, the Supreme Court held that under Sec. 74, only a reasonable amount can be forfeited if a contract is not performed. But, where under the terms of the contract the party in breach has undertaken to pay a sum of money or to forfeit a sum of money which he has already paid to the party complaining of a breach of contract, the undertaking is of the nature of penalty. It further held that the amount deposited by way of security for guaranteeing the due performance of the contract could not be regarded as earnest money. Applying the law to the facts of the present case, we find that as the defendant, admittedly, did not suffer any damage, it was not entitled to forfeit the security deposit, in as much as forfeiture of security would amount to imposition of penalty. This case was followed by the Supreme Court in *Union of India v. Rampur Distillery and Chemicals Limited* [(1973) 1 SCC 649; A.I.R. 1973 S.C. 1098]. It was held in this case that the party to a contract taking security deposit from the other party to ensure due performance of the contract is not entitled to forfeit the security deposit on the ground of default, when no loss is caused to him in consequence of such default. We, accordingly, find that the learned Civil Judge was not right in holding that the forfeiture of security by the defendant in the instant case was justified. We, therefore, hold that the plaintiff is entitled to get a decree for the sum of Rs. 6,650/- under this head.

34. The defendants claimed in the written statement that they had suffered a loss of ₹5,70,356/-; however, there was no evidence of this fact. Shri B.C. Gupta (DW-1) stated that the bottles were not supplied despite repeated letters and telegrams, and the defendants could not fulfil their obligation to the Excise

Department for supply of liquor bottles to various liquor licenses. The learned First Appellate Court had rightly pointed out that this statement does not give the details of the loss suffered by the defendants. The cost of the liquor bottles purchased from the market and the difference in price vis-à-vis the tender were not outlined to calculate the loss suffered by the defendants. Hence, his statement was not sufficient to infer that the defendants had sustained the loss of ₹5,70,356/-.

35. It was submitted that no party had pleaded the applicability of Section 74 of the Indian Contract Act, and the learned First Appellate Court erred in invoking this provision. This submission cannot be accepted. The Court is bound to apply the law and cannot refuse to apply the law simply because no person has brought the law to the attention of the Court in its pleadings. Therefore, this substantial question of law is answered accordingly.

Substantial Question of Law No. 2:

36. The learned First Appellate Court failed to appreciate the plea regarding limitation and record any findings. However, it had rightly held that the security amount could not be

forfeited simply because of default. Therefore, this substantial question of law is answered partly in the affirmative.

Final Order:

37. In view of the above, the present appeal is allowed. The judgment and decree passed by the learned First Appellate Court are ordered to be set aside, while those passed by the learned Trial Court are ordered to be restored.

38. Pending application(s), if any, also stand(s) disposed of.

39. Records of the learned Courts below be sent down forthwith.

(Rakesh Kainthla)
Judge

9th September, 2026
(Chander)