

Union of India

Vs

Rampur Distillery and Chemical Co. Ltd.

Civil Appeals Nos. 1346-1348 of 1967

(J.M. Shelat, Y. V. Chandrachud JJ)

20.02.1973

JUDGMENT

CHANDRACHUD, J. -

1. The respondents - Rampur Distillery & Chemical Co. Ltd. supplied to the appellants - Union of India - a large quantity of rum (presumably, for the use of Defence personnel). The rum was found not to conform to the quality stipulated and was therefore rejected by the appellants. The appellants then cancelled the contract and forfeited the entire security deposit of Rs. 18,332/- which was kept by the respondents for the due performance of the contract. On the respondents disputing the right of the appellants to forfeit the security deposit, the dispute was referred to an arbitrator who held that the appellants were entitled under Section 74 of the Indian Contract Act to the award of reasonable compensation only, which the arbitrator fixed at Rs. 7,332/-. He directed the appellants to refund the balance viz. Rs. 11,000/- to the respondents.

2. The respondents filed a petition under the Arbitration Act, 1940 for making the award a rule of the court. The appellants filed their objections thereto contending that there was an error of law apparent on the face of the award as they were entitled to forfeit the entire amount of the security deposit. This contention was rejected by the learned Judge and he passed a decree in terms of the award. The appeal against that judgment having been dismissed in limine by the High Court of Delhi, the appellants have filed this appeal by special leave.

3. Only one contention was urged on behalf of the appellants before us : that the security deposit was taken from the respondents in order to ensure the due performance of the contract and respondents having defaulted, the entire amount was liable to be forfeited. A similar contention was advanced before this Court but was rejected in *Maula Bux v. Union of India*. ((1970) 1 SCR 928 : (1969) 2 SCC 554) The appellant therein 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. As in the instant case, it was stipulated in the contract there that the amount of security deposit was to stand forfeited in case the appellant neglected to perform his part of the contract. On the appellant committing default in the supply, the Government rescinded the contract and forfeited the security deposit. It was held by this Court that forfeiture of earnest money under a contract for sale of property does not fall within Section 70 of the Contract Act, if the amount is reasonable, because the forfeiture of a reasonable sum paid as earnest money does not amount to the imposition of a penalty. 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 a penalty". It was further held that the amount deposited by way of security for guaranteeing the due

performance of the contract cannot be regarded as earnest money.

4. It is important that the breach of contract caused no loss to the appellants. The stipulated quantity of rum was subsequently supplied to the appellants by the respondents themselves at the same rates. The appellants, in fact, made no attempt to establish that they had suffered any loss or damage on account of the breach committed by the respondents.

5. Following the decision in Maula Bux's case (*supra*), we hold that the High Court was right in rejecting the appellants' claim that they are entitled to forfeit the security deposit. Civil Appeal 1346 of 1967 is accordingly dismissed with costs.

6. This judgment will govern the other two appeals except that there will be no order as to costs in these appeals.

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