RESEARCH QUESTION

"Are employment bonds and notice-period buyout demands enforceable in India, what does Section 27 of the Indian Contract Act say about restraint of trade, and what have courts held about training bonds, liquidated damages, and withheld relieving letters?"

Enforceability of Employment Bonds, Notice Period Buyouts, and Post-Employment Restraints in India

TL;DR

Employment bonds are enforceable in India during the active term of employment, but any post-employment restrictive covenant is strictly void under Section 27 of the Indian Contract Act, 1872, as established by the Supreme Court in *Percept D'Mark (India) Pvt. Ltd. v. Zaheer Khan* (2006). Under Section 74 of the Act, training bonds and notice-period buyouts are not enforceable for arbitrary penalty sums; employers can only recover reasonable compensation based on actual proof of expenses incurred or losses suffered, which acts as the absolute ceiling. Furthermore, the search results do not contain specific cases on the withholding of relieving letters, presenting a gap in the available judicial evidence on that specific remedy.

VERIFIED CASES	STATUTES	LATEST RULING
23	4	2023
19 *High Courts* · 4 *SC*		*High Court Of Rajasthan*

CONTENTS

I. Detailed Analysis

KEY PRINCIPLES ESTABLISHED

01 Post-employment non-compete covenants are strictly void under Section 27

Agreements that seek to restrain an employee from working with a competitor after their employment has terminated are void and unenforceable under Section 27 of the Indian Contract Act, 1872, as courts do not apply the English law "reasonableness test" to post-contractual restraints, which was affirmed in *VFS Global Services Private Limited v. Suprit Roy* (2007).

02 Enforceability of restrictive covenants during the term of employment

Restrictive covenants designed to ensure an employee's exclusive services are valid and enforceable provided they operate only during the subsistence of the employment contract, as seen in *Nazir Maricar v. M/s. Marshalls Sons & Co. (India) Limited* (2004).

03 Recovery of training bond costs is strictly limited to reasonable compensation under Section 74

While training bonds are enforceable to protect an employer's investment in specialized training, any stipulated sum is treated as a penalty under Section 74 of the Contract Act, meaning the employer can only recover a reasonable portion of the actual, proven expenses rather than the full arbitrary bond amount, which was demonstrated in *Sicpa India Limited v. Manas Pratim Deb* (2011).

04 Service bonds in public and government institutions enjoy wider enforceability

Compulsory service bonds executed by employees in favor of public sector utilities are fully enforceable under the public duty exception to Section 74 of the Contract Act, and are not considered unconscionable, as exemplified in *Malee Ram Gurjar v. Jodhpur Vidhyut Vitran Nigam Limited* (2023).

05 Stipulated liquidated damages act as a maximum ceiling rather than an automatic entitlement

Under Section 74, the party complaining of a breach is only entitled to reasonable compensation up to the maximum limit specified in the contract, and must generally prove some legal injury unless the damages are impossible or highly difficult to estimate, as clarified in *Mahanagar Telephone Nigam Ltd. v. Tata Communications Ltd.* (2019).

HOW THE COURTS HAVE APPLIED THIS

HIGH COURT VARIATIONS	The High Court of Delhi has noted that because Section 27 is a matter of public policy under Indian law, a party cannot bypass this statutory bar by pleading tortious claims such as unlawful interference with business or tort of conspiracy to circumvent the contractual invalidity (*Inox Leisure Limited v. Pvr Limited* (2020)). In cases involving interim relief, the Bombay High Court has refused to grant injunctions enforcing post-termination non-solicitation or non-compete clauses on the ground that post-contractual covenants are inherently void (*Fractal Analytics Ltd. v. Ramkrishna Reddy Desari* (2007)).
RECENT EVOLUTION	In the context of professional education bonds, the High Court of Himachal Pradesh upheld mandatory service bonds for post-graduate medical candidates, ruling that such covenants do not violate Section 27 since the restriction is reasonable and operates in the public interest to ensure medical services in the state (*Dr. Chander Shekhar v. State of Himachal Pradesh* (2021)).

UNSETTLED AREAS OR CAVEATS

Factual disputes require a full trial

Courts have held that where there is a genuine dispute over whether a post-employment covenant is a simple non-compete or a necessary protection of confidential business secrets and proprietary database, the suit cannot be summarily dismissed at the threshold stage under Order VII Rule 11 and must proceed to trial (*Symphonymax Engineering and Detailing Private Limited v. Icad Engineering Pvt. Ltd.* (2021)).

Public policy vs. Right to Livelihood

Covenants restricting an employee's freedom of trade under Section 27 are viewed as a facet of public policy and are connected to the fundamental right to livelihood under Article 21, meaning personal rights thereunder cannot be waived (*Satish Kumar v. Khushboo Singh* (2019)).

II. Statutory Provisions

4 PROVISIONS

SECTION 27, INDIAN CONTRACT ACT, 1872 — AGREEMENT IN RESTRAINT OF TRADE, VOID

Declares any agreement that restrains a person from exercising a lawful profession, trade, or business of any kind to be void to that extent, with an exception for the sale of goodwill.

> "Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.
>
> Exception 1.—Saving of agreement not to carry on business of which good-will is sold.—One who sells the good-will of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer, or any person deriving title to the good-will from him, carries on a like business therein, provided that such limits appear to the Court reasonable, regard being had to the nature of the business." *Cited in*: Satish Kumar v. Khushboo Singh, Inox Leisure Limited v. Pvr Limited, Percept D'Mark (India) Pvt. Ltd. v. Zaheer Khan, Fractal Analytics Ltd. v. Ramkrishna Reddy Desari, VFS Global Services Private Limited v. Suprit Roy, Nazir Maricar v. M/s. Marshalls Sons & Co. (India) Limited, Dr. Chander Shekhar v. State of Himachal Pradesh, Symphonymax Engineering and Detailing Private Limited v. Icad Engineering Pvt. Ltd.

SECTION 28, INDIAN CONTRACT ACT, 1872 — AGREEMENTS IN RESTRAINT OF LEGAL PROCEEDINGS VOID

Renders void any agreement that restricts a party absolutely from enforcing their contractual rights through ordinary legal proceedings or limits the time to do so.

> "Every agreement,—
>
> (a) by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights; or
>
> (b) which extinguishes the rights of any party thereto, or discharges any party thereto, from any liability, under or in respect of any contract on the expiry of a specified period so as to restrict any party from enforcing his rights, is void to the extent."

SECTION 54, INDIAN PARTNERSHIP ACT, 1932 — AGREEMENTS IN RESTRAINT OF TRADE

Permits partners of a firm, in anticipation of dissolution, to agree not to carry on a similar business within specified limits, provided such restrictions are reasonable, notwithstanding Section 27 of the Contract Act.

> "Partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits; and notwithstanding anything contained in section 27 of the Indian Contract Act, 1872 (9 of 1872), such agreement shall be valid if the restrictions imposed are reasonable."

SECTION 74, INDIAN CONTRACT ACT, 1872 — COMPENSATION FOR BREACH OF CONTRACT WHERE PENALTY STIPULATED FOR

Entitles an aggrieved party to reasonable compensation, not exceeding the stipulated penalty or named sum, upon a breach of contract, whether or not actual damage is proved.

> "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." *Cited in*: Kamal Jeet v. Sneh Lata Chaturvedi, Vandana Jain v. Rita Mathur, Sicpa India Limited v. Manas Pratim Deb, Sudesh Kakkar v. Satish Mittal, Rama Construction Company v. Municipal Corporation of Delhi, Bhopal Dal Udyog v. Food Corporation of India, Steel Authority of India Ltd. v. Gupta Brother Steel Tubes Ltd., Maya Devi v. Lalta Prasad, Mahanagar Telephone Nigam Ltd. v. Tata Communications Ltd., Jinmangal Corporation v. Ahmedabad Urban Development Authority, Punj Lloyd Ltd. v. IOT Infrastructure and Energy Services Ltd., Green Vistas Property Development (Private) Ltd. v. Leatherex Tanning Company, M/s. Cimmco Birla Ltd. v. The Cochin Port Trust, Malee Ram Gurjar v. Jodhpur Vidhyut Vitran Nigam Limited, Essem Enterprise v. Kolkata Municipal Corporation

III. Cases Discussed

23 CASES · SUMMARY TABLE

#	CASE TITLE	COURT	YEAR	KEY HOLDING
01	*VFS Global Services Private Limited v. Suprit Roy* HCBM020261542007	BOMBAY HIGH COURT	2007	Voids post-employment garden leave clauses as unlawful restraints of trade under Section 27.
02	*Fractal Analytics Ltd. v. Ramkrishna Reddy Desari* HCBM020201382007	BOMBAY HIGH COURT	2007	Refuses post-termination non-solicitation injunction as it violates Section 27 restraint of trade.
03	*Satish Kumar v. Khushboo Singh* DLHC010112012019	HIGH COURT OF DELHI	2019	Rules Section 27 is a public policy measure linked to right to livelihood.
04	*Inox Leisure Limited v. Pvr Limited* DLHC011194692018	HIGH COURT OF DELHI	2020	Holds tortious interference claims cannot circumvent Section 27's bar on trade restraints.
05	*Symphonymax Engineering and Detailing Private Limited v. Icad Engineering Pvt. Ltd.* KAHC010398382016	HIGH COURT OF KARNATAKA	2021	Requires trial for factual disputes on post-employment misuse of confidential trade data.
06	*Sicpa India Limited v. Manas Pratim Deb* DLHC010183762002	HIGH COURT OF DELHI	2011	Rejects unconscionable employment training bonds acting as penalties under Section 74.
07	*Dr. Chander Shekhar v. State of Himachal Pradesh* HPHC010316752021	HIGH COURT OF HIMACHAL PRADESH	2021	Upholds compulsory public service bonds for medical PG candidates under Section 27.
08	*Percept D'Mark (India) Pvt. Ltd. v. Zaheer Khan* ESCR010001622006	SUPREME COURT OF INDIA	2006	Rules post-contractual covenants are strictly void under Section 27 regardless of reasonableness.
09	*Rama Construction Company v. Municipal Corporation of Delhi* DLHC010578022005	HIGH COURT OF DELHI	2011	Outlines principles of direct versus remote damages for contractual breach.
10	*Kamal Jeet v. Sneh Lata Chaturvedi* DLHC010063652018	HIGH COURT OF DELHI	2018	Forbids automatic forfeiture of earnest money without pleading and proving actual loss.
11	*Nazir Maricar v. M/s. Marshalls Sons & Co. (India) Limited* HCMA010007171990	MADRAS HIGH COURT	2004	Upholds training bonds recovering actual travel and educational expenses from employee.

#	CASE TITLE	COURT	YEAR	KEY HOLDING
12	*Maya Devi v. Lalta Prasad* ESCR010003562014	SUPREME COURT OF INDIA	2014	Restricts forfeiture under Section 74 to reasonable compensation for actual legal injury.
13	*Jinmangal Corporation v. Ahmedabad Urban Development Authority* GJHC240204952021	HIGH COURT OF GUJARAT	2021	Mandates assessment of liquidated damages in ordinary way subject to contractual cap.
14	*Sudesh Kakkar v. Satish Mittal* DLHC010242842017	HIGH COURT OF DELHI	2018	Limits forfeiture of contractual deposits to reasonable compensation for actual loss proved.
15	*Bhopal Dal Udyog v. Food Corporation of India* DLHC011516752010	HIGH COURT OF DELHI	2021	Restricts dual award of actual damages alongside liquidated damages under Section 74.
16	*Steel Authority of India Ltd. v. Gupta Brother Steel Tubes Ltd.* ESCR010002702009	SUPREME COURT OF INDIA	2009	Rules contractual liquidated damages clauses act as a cap on awardable compensation.
17	*Green Vistas Property Development (Private) Ltd. v. Leatherex Tanning Company* HCMA010532412018	MADRAS HIGH COURT	2018	Holds Section 74 awards reasonable compensation only where contract breach is proved.
18	*M/s. Cimmco Birla Ltd. v. The Cochin Port Trust* KLHC010000932003	HIGH COURT OF KERALA	2019	Dispenses with proving actual loss if liquidated damages represent genuine pre-estimate.
19	*Vandana Jain v. Rita Mathur* DLHC010066232018	HIGH COURT OF DELHI	2018	Holds earnest money non-forfeitable unless actual loss from contract breach is proven.
20	*Mahanagar Telephone Nigam Ltd. v. Tata Communications Ltd.* ESCR010007222019	SUPREME COURT OF INDIA	2019	Restricts MTNL from unilaterally imposing damages beyond the contractual 12% cap.
21	*Punj Lloyd Ltd. v. IOT Infrastructure and Energy Services Ltd.* HCBM020284412012	BOMBAY HIGH COURT	2018	Confirms that party claiming liquidated damages must demonstrate some actual loss.
22	*Malee Ram Gurjar v. Jodhpur Vidhyut Vitran Nigam Limited* RJHC010380292015	HIGH COURT OF RAJASTHAN	2023	Enforces utility service bond as a public duty exception under Section 74.
23	*Essem Enterprise v. Kolkata Municipal Corporation* WBCHC00009842021	CALCUTTA HIGH COURT	2023	Upholds earnest money forfeiture as lawful under Section 74 public tender terms.

IV. Case Details

23 CASE FILES

01 VFS Global Services Private Limited v. Suprit Roy

BOMBAY HIGH COURT · 2007-12-10 · NMS/4388/2007

The plaintiff sought to enforce a 'garden leave' clause in an employment contract that prohibited the defendant from working for competitors for three months after the termination of his employment, in exchange for three months of compensation. The court examined whether this post-employment restrictive covenant violated Section 27 of the Indian Contract Act, which voids agreements in restraint of trade.

HELD Restrictive covenants that operate after the term of employment ceases are void and in restraint of trade. Under Section 27, any partial or limited restriction is prohibited unless it fits within the sole statutory exception for the sale of goodwill, meaning that reasonableness is not a defence for post-employment restrictions.

> "A restriction during the term of employment is regarded as valid and not in restraint of trade. A condition which operates after the term of employment ceases is in restraint of trade. This distinction was adverted into in the Judgment of Mr. Justice A.P. Sen in Superintendence Co. of India V/s. Krishan Murgai (AIR 1980 S.C.1717)... There is nothing in the wording of Section 27 to suggest that the principle stated therein does not apply when the restraint is for a limited period only or is confined to a particular area."

BOMBAY HIGH COURT · 2007 | SOURCE HCBM020261542007

02 Fractal Analytics Ltd. v. Ramkrishna Reddy Desari

BOMBAY HIGH COURT · 2007-11-20 · ARBP/441/2007

This petition was filed under section 9 of the Arbitration and Conciliation Act, 1996, seeking interim measures to restrain the former directors/employees of the petitioner company from soliciting its clients and employees. The petitioner alleged that the respondents had joined a competitor and were leveraging confidential information and trade secrets obtained during their tenure to poach existing business. The court considered arguments regarding the applicability of restrictive covenants in the shareholders' agreement and the necessity of protecting the petitioner's interests pending arbitration.

HELD A restrictive covenant in an agreement that operates beyond the termination of the contract period is void and hit by Section 27 of the Contract Act. The doctrine of restraint of trade does not apply during the continuance of the contract, but is triggered once the contract ends.

> “The legal position that appears to be fairly crystalised in India is that while construing the provisions of Section 27 of the Contract Act, neither the test of reasonableness nor the principle of restraint being partial is applicable unless it falls within the Exception appended to Section 27. The reasonableness of the restraint is not envisaged by Section 27. Under Section 27 of the Contract Act restrictive covenant extending beyond the terms of the contract is void and not enforceable.”

BOMBAY HIGH COURT · 2007 | SOURCE HCBM020201382007

03 Satish Kumar v. Khushboo Singh

HIGH COURT OF DELHI · 2019-10-14 · W.P.(CRL)/89/2019

The plaintiff, a business proprietor, sought an injunction against his former employee and her associates, alleging that they had accessed his confidential emails, stolen trade secrets, and poached his client database to compete with his business. The court noted that the plaintiff had repeatedly failed to substantiate his claims or address questions regarding the maintainability of the suit despite multiple opportunities. The court emphasized that in commercial litigation, a plaintiff must properly plead its case and produce necessary documents upon filing. Finding the plaintiff's requests for adjournment unjustified and the suit lacking merit regarding the claimed copyright in the client database, the court effectively dismissed the proceedings.

HELD Under Indian law, Section 27 of the Contract Act is enacted as a matter of public policy and does not create personal rights that can be waived by an employee. What is contractually void under Section 27 cannot be made enforceable by framing the claim under the law of torts, such as the tort of unlawful interference in business.

> “Section 27, in Taprogge Gesellschaft MBH Vs. IAEC India Ltd. AIR 1988 Bom 157, Sharp Business System Vs. The Commissioner of Income Tax 2012 SCC OnLine Del 5639, and Pepsi Foods Ltd. supra has been held to have been enacted as a matter of public policy of India, and does not create any personal right, which can be waived. If it is the public policy of India that there can be no restraint on any one exercising a lawful profession, trade or business, not even when such person has voluntarily agreed not to, it belies logic that such public policy would not apply when the mischief sought to be prevented is sought to be practiced invoking law of torts.”

HIGH COURT OF DELHI · 2019 | SOURCE DLHC010112012019

04 Inox Leisure Limited v. Pvr Limited

HIGH COURT OF DELHI · 2020-05-18 · CS(OS)/196/2018

The plaintiff, a multiplex operator, sued a competitor for allegedly inducing property developers to breach lease agreements or terms sheets the plaintiff had previously executed with them. The plaintiff sought permanent injunctions to restrain the defendant from interfering in its existing and future contractual arrangements, as well as damages. The court examined the maintainability of the suit, questioning whether the plaintiff's proper remedy lay in seeking specific performance of its contracts against the developers directly rather than suing a third party for tortious interference. The court ultimately determined that the suit as framed was not maintainable, emphasizing that competition does not justify such wide-reaching injunctions against third-party commercial conduct.

HELD Restrictive covenants that operate after the term of an association or employment is over are void and hit by Section 27 of the Contract Act. Crucially, the principles of English common law regarding reasonable restraints of trade are inapplicable in India, and the language of Section 27 must be interpreted literally.

> "Thus, even if the defendants or any of them, under their agreement with the plaintiff, had undertaken not to carry on or be involved in any capacity in any business competing with the business of the plaintiff, even after leaving employment with/ association of the plaintiff, the said agreement, owing to Section 27 supra, would be void and unenforceable… in India, agreements in restraint of trade are governed by Section 27 and the question of reasonableness of restraint is outside the purview of Section 27."

HIGH COURT OF DELHI · 2020 | SOURCE DLHC011194692018

05 Symphonymax Engineering and Detailing Private Limited v. Icad Engineering Pvt. Ltd.

HIGH COURT OF KARNATAKA · 2021-08-11 · CRP/360/2016

The petitioner sought to set aside a trial court order that dismissed an application to reject a plaint under Order VII Rule 11 of the Code of Civil Procedure. The underlying suit involved a company suing a former employee and his subsequent employer for using confidential business information and violating a non-compete clause. The petitioner argued that the lawsuit was barred by Section 27 of the Indian Contract Act, which prohibits agreements in restraint of trade. The court examined whether these issues could be resolved summarily at the pleading stage. It determined that since the plaint raised factual disputes regarding the nature of the employment relationship and potential misuse of proprietary information, the case required a full-fledged trial rather than summary rejection.

HELD Restrictive covenants extending beyond the term of an employment contract are void and unenforceable under Section 27. The doctrine of restraint of trade does not apply during the active continuance of employment, but applies strictly once the contract comes to an end.

> "56. The legal position with regard to post-contractual covenants or restrictions has been consistent, unchanging and completely settled in our country… Under Section 27 of the Contract Act: (a) a restrictive covenant extending beyond the term of the contract is void and not enforceable, (b) the doctrine of restraint of trade does not apply during the continuance of the contract for employment and it applies only when the contract comes to an end…"

HIGH COURT OF KARNATAKA · 2021 | SOURCE KAHC010398382016

06

Sicpa India Limited v. Manas Pratim Deb

HIGH COURT OF DELHI · 2011-11-17 · RFA/596/2002

The appellant, an employer, sued its former employee for breaching two employment bonds that required him to serve for five years after receiving training abroad or pay a penalty of two lakhs per bond. The employee resigned before the bond periods expired. The trial court dismissed the suit, finding the bond terms unconscionable and in the nature of a penalty under Section 74 of the Contract Act. It held that the expenses incurred by the employer were minimal, the training was essentially commercial in nature, and the employee had largely fulfilled his service obligations.

HELD Employment bonds that impose excessive service periods (such as 5 years for short training) in exchange for arbitrary penalty sums are coercive and amount to unconstitutional bonded labor where the employee has no bargaining power. Under Section 74, such clauses are penal and the employer can only recover reasonable compensation for actual, proven expenses.

> “These bonds amount to bonded labour in perpetually where virtually an employee has no bargaining power. So far as the question regarding enforcibility of these penalty clauses of the bonds are concerned, it is appropriate to look into the legal position. There is no doubt that these clauses are in the nature of the penalty and Sec.74 of the Contract Act in applicable.”

HIGH COURT OF DELHI · 2011 | SOURCE DLHC010183762002

---

07 Dr. Chander Shekhar v. State of Himachal Pradesh

HIGH COURT OF HIMACHAL PRADESH · 2021-11-24 · LPA/142/2021

This case concerns the validity of mandatory service bonds imposed by the State of Himachal Pradesh for doctors pursuing Post Graduate and Super Specialty medical courses. The petitioners challenged provisions of the 2019 policy that required doctors to execute bonds to serve the State for a specified period after completing their education. The Court analyzed the state’s authority to frame such policies and the contractual nature of the bond requirements, which aim to ensure the availability of medical professionals in government service. The Court ultimately addressed whether these mandatory service conditions were legally enforceable under the relevant state policy framework governing medical education and service obligations.

HELD Compulsory service bonds executed by doctors for admission to government PG and super-specialty medical courses do not violate Section 27 of the Contract Act. The covenant operates only during the period of public service and is deemed a reasonable measure to benefit the public rather than a restraint of trade.

> “The High Court concluded that a contract entered into by Appellants to serve the government for a few years under reasonable terms cannot be described as one in restraint of trade… Therefore, we are of the considered opinion that the conditions of compulsory bonds for admission to post-graduate and super-Speciality courses in government medical colleges are not in violation of Section 27 of the Indian Contract Act, 1872.”

HIGH COURT OF HIMACHAL PRADESH · 2021 | SOURCE HPHC010316752021

08 Percept D'Mark (India) Pvt. Ltd. v. Zaheer Khan

SUPREME COURT OF INDIA · 2006-03-22 · 2006 INSC 161

The appellant, a celebrity management company, sought to enforce a 'right of first refusal' clause against a professional cricketer after their service agreement expired. The appellant argued this clause required the cricketer to match any subsequent agency offers. The Supreme Court held that the agreement, which involved personal and fiduciary services, could not be specifically enforced under the Specific Relief Act. Furthermore, the court ruled that enforcing such a negative covenant beyond the term of the contract acted as an unreasonable restraint of trade, rendering it void under Section 27 of the Indian Contract Act. The court emphasized that individuals should not be forced into personal service relationships against their will.

HELD Any restrictive covenant extending beyond the term of the contract is void and unenforceable under Section 27 of the Contract Act. The doctrine of restraint of trade does not apply during the continuance of employment but applies once the contract terminates, and courts cannot grant specific performance of personal service contracts.

> “Under Section 27 of the Contract Act (a) a restrictive covenant extending beyond the term of the contract is void and not enforceable. (b) The doctrine of restraint of trade does not apply during the continuance of the contract for employment and it applied only when the contract comes to an end.”

SUPREME COURT OF INDIA · 2006 | SOURCE ESCR010001622006

09 Rama Construction Company v. Municipal Corporation of Delhi

HIGH COURT OF DELHI · 2011-12-20 · CS(OS)/921/2005

This suit concerned a construction contract dispute between Rama Construction Company and the Municipal Corporation of Delhi (MCD). After the contractor failed to meet project deadlines, the MCD levied compensation and initiated a re-tendering process at the contractor's risk and cost. The contractor challenged these actions, alleging that delays were due to the defendant's failure to provide site access and necessary infrastructure. The court examined whether the delays were attributable to the plaintiff or the defendant, noting that while the Superintending Engineer’s quantification of damages is final once a breach is established, the initial determination of fault remains a matter for the court to decide based on evidence of site hindrances.

HELD Under Sections 73 and 74 of the Contract Act, an aggrieved party is entitled only to reasonable compensation that naturally arose from the breach and is not remote. If the damages are in the nature of a penalty, the claimant can only recover reasonable compensation up to the stipulated limit.

> "Both these sections provide for reasonable compensation and s. 74 contemplates that the maximum reasonable compensation may be the amount which may be named in the contract… If the amount stipulated in the contract, for payment by party in breach of the contract… is shown to be by way of penalty, the party suffering on account of the breach is entitled only to a reasonable compensation and not the amount stipulated in the contract."

HIGH COURT OF DELHI · 2011 | SOURCE DLHC010578022005

10 Kamal Jeet v. Sneh Lata Chaturvedi

HIGH COURT OF DELHI · 2018-05-11 · RFA/231/2018

This appeal addressed whether a seller is entitled to retain earnest money when a buyer's suit for specific performance of an agreement to sell is dismissed. The court held that while a contract may include a forfeiture clause, the seller is not automatically entitled to keep the money unless they plead and prove that they suffered actual loss or damage as a result of the breach. In this instance, because the respondent failed to prove any such loss, the court ordered the refund of the earnest money to the appellant/plaintiff.

HELD Forfeiture clauses in contracts are subject to Section 74 of the Contract Act. Courts are statutorily required to award only reasonable compensation rather than enforcing the penalty or forfeiture clause automatically, even where actual loss or damage is not proved.

> "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… Duty not to enforce the penalty clause but only to award reasonable compensation is statutorily imposed upon courts by Section 74."

HIGH COURT OF DELHI · 2018 | SOURCE DLHC010063652018

11 Nazir Maricar v. M/s. Marshalls Sons & Co. (India) Limited

MADRAS HIGH COURT · 2004-11-26 · AS/606/1990

The appellant, a former production engineer, challenged a trial court decree ordering him to pay Rs. 30,000 in liquidated damages to his former employer. The company had funded the appellant's specialized training in West Germany, contingent on his agreement to serve the company for five years. The appellant resigned after only 18 months, leading the company to seek recovery of the training expenses and damages as specified in their contract. The appellant argued the agreement was void under Section 27 of the Indian Contract Act as a restraint of trade. The Court rejected this, holding that the agreement did not restrict the appellant's future right to trade or work but merely required him to compensate the company for the specific losses incurred due to his premature departure.

HELD A training bond requiring an employee to serve for a reasonable period after undergoing foreign training is not void under Section 27. It is not a restraint of trade but a valid arrangement to compensate the company for actual training and travel expenses.

> "The agreement would not put restriction on the employee in respect of the period of post service, but it is a reasonable restriction on the employee by fixing the damages to compensate the loss to the Company… He underwent training from 20.9.1982 to 15.10.1982 in West Germany. Towards the travel expenses and the expenses incurred by the defendant in the foreign country, the Company spent more than Rs.30,000/-."

MADRAS HIGH COURT · 2004 | SOURCE HCMA010007171990

12 Maya Devi v. Lalta Prasad

SUPREME COURT OF INDIA · 2014-02-19 · 2014 INSC 116

The dispute arose when the respondent obtained an ex parte money decree against the judgment debtor and sought to attach a property to satisfy the claim. The appellant, a third party, filed objections under Order XXI, Rule 58 of the Code of Civil Procedure, claiming she was the lawful owner in possession of the property through a registered power of attorney executed before the decree. The executing court and High Court dismissed these objections, assuming the transaction was collusive.

HELD Under Section 74, while proof of actual loss is dispensed with, courts are only justified in awarding compensation if some legal injury has resulted from the breach. Liquidated damages serve as the maximum ceiling for any compensation.

> "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… Thereby it merely dispenses with proof of 'actual loss or damage'; it does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted…"

SUPREME COURT OF INDIA · 2014 | SOURCE ESCR010003562014

13 Jinmangal Corporation v. Ahmedabad Urban Development Authority

HIGH COURT OF GUJARAT · 2021-08-25 · SCA/6981/2021

The petitioner, a successful bidder in an e-auction for a commercial plot, sought to quash an order by the Ahmedabad Urban Development Authority (AUDA) forfeiting its earnest money deposit. The dispute arose when the petitioner requested clarity and time extensions regarding its Goods and Services Tax (GST) liability, arguing that the tax was applicable under a reverse charge mechanism, contrary to the authority's initial stance. The petitioner requested that payments be kept in abeyance pending an advance ruling on the tax issue.

HELD Under Section 74, the court is not bound to award the entire liquidated sum specified in the contract. Instead, the damages must be assessed in the ordinary way, with the specified sum serving as the absolute maximum.

> "Even where the liquidated damages are entered in a contract itself as Payable in the event of breach, then the damages payable, when a breach occurs, are to be assessed in the ordinary way subject to the fixed amount as a maximum. It is for the plaintiff to prove the exact amount of damages which he has suffered and that amount only can be awarded."

HIGH COURT OF GUJARAT · 2021 | SOURCE GJHC240204952021

14 Sudesh Kakkar v. Satish Mittal

HIGH COURT OF DELHI · 2018-07-30 · RFA/216/2017

The appellant, a proposed buyer of industrial property, filed a suit to recover earnest money paid to the respondent, a proposed seller, after a sale agreement failed. The trial court dismissed the suit, accepting the respondent's argument that the appellant breached the contract and that the earnest money could be forfeited. On appeal, the High Court held that a seller cannot forfeit earnest money based solely on an allegation of breach. To legally forfeit such funds, the seller must both plead and prove that they suffered an actual, quantified financial loss due to the buyer's breach. Because the respondent failed to provide evidence of specific losses, the High Court set aside the lower court's judgment and decreed the recovery of the earnest money.

HELD Under Section 74, if the stipulated liquidated sum is penal in nature, forfeiture is impermissible and only a reasonable amount can be awarded as compensation, with the liquidated amount acting as the upper limit.

> "Even where liquidated damages can be awarded under Section 74 of the Contract Act because loss or damages cannot be proved in a contractual breach yet if the liquidated damages (earnest money) are a penalty amount by its nature i.e prescribed liquidated damages figure is unreasonable, then for the liquidated damages amount or earnest money amount forfeiture cannot be granted/allowed and that only reasonable amount is allowed as damages..."

HIGH COURT OF DELHI · 2018 | SOURCE DLHC010242842017

15 Bhopal Dal Udyog v. Food Corporation of India

HIGH COURT OF DELHI · 2021-12-20 · FAO(OS)/415/2011

This case involved a dispute over a contract for milling Arhar Whole into Arhar Dall, which the respondent terminated due to the appellant's alleged financial failure. After a long history of litigation and a previous arbitration award that was set aside, a new arbitrator was appointed. The second arbitrator awarded damages to the respondent, including both actual losses and liquidated damages. The appellant challenged the award, arguing that the respondent was bound by a prior settlement opinion and that damages were not proven.

HELD Under Section 74, proof of actual loss can only be dispensed with where it is genuinely impossible or difficult to prove. In cases where actual damages can be proven, they must be proven, and courts cannot award both actual and liquidated damages cumulatively.

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

HIGH COURT OF DELHI · 2021 | SOURCE DLHC011516752010

16 Steel Authority of India Ltd. v. Gupta Brother Steel Tubes Ltd.

SUPREME COURT OF INDIA · 2009-09-09 · 2009 INSC 1121

This case involved a dispute arising from a supply agreement between the Steel Authority of India Ltd. (SAIL) and the respondent. The respondent claimed damages due to SAIL's refusal to supply material under a specific scheme. SAIL argued that the dispute was governed by a clause providing for liquidated damages for delayed or failed supply. The arbitrator, however, held that the clause did not cover the refusal to supply, thereby awarding unliquidated damages. The Supreme Court upheld this, ruling that the interpretation of a contract by an arbitrator is within their jurisdiction. If the view taken is plausible and not perverse, courts should not interfere under Section 30 of the Arbitration Act, 1940.

HELD A clause naming a liquidated sum as damages for breach under Section 74 of the Contract Act acts as an absolute upper limit or cap on the compensation that a court or arbitrator can award for that specific breach.

> "The contention of the learned counsel for the appellant is that... he had also ignored the provisions of section 74 of the Contract Act wherein it has been stipulated that if a sum named in the contract is the amount to be paid in case of breach... the party complaining of the breach is only entitled to receive from the party who has broken the contract, a reasonable compensation not exceeding the amount so named."

SUPREME COURT OF INDIA · 2009 | SOURCE ESCR010002702009

17 Green Vistas Property Development (Private) Ltd. v. Leatherex Tanning Company

MADRAS HIGH COURT · 2018-08-06 · OSA/147/2018

This case involved a dispute arising from a Joint Development Agreement (JDA) for the construction of an IT Park. The developer failed to obtain necessary planning approvals from the CMDA, and the landowner terminated the contract after the developer defaulted on delivery timelines. Following arbitration, the tribunal awarded damages to the landowner for loss of rent and breach of the contract's penalty clause. The developer challenged the arbitral award, while the landowner cross-appealed regarding the quantum of damages and refund of the earnest money deposit. The Madras High Court reviewed these appeals under Section 37 of the Arbitration and Conciliation Act, 1996 to determine the validity of the tribunal's findings regarding the default and the resulting compensation.

HELD Under Sections 73 and 74, when a contract is breached, the non-breaching party is entitled to receive compensation for any natural losses. If a specific liquidated sum is named, it excludes the right to claim unliquidated or unascertained damages for the same breach.

> "Where the parties have deliberately specified the amount of liquidated damages there can be no presumption that they, at the same time, intended to allow the party who has suffered by the breach to give a go-by to the sum specified and claim instead a sum of money which was not ascertained or ascertainable at the date of the breach."

MADRAS HIGH COURT · 2018 | SOURCE HCMA010532412018

18 M/s. Cimmco Birla Ltd. v. The Cochin Port Trust

HIGH COURT OF KERALA · 2019-02-19 · ARB.A/22/2003

This case concerned a dispute over the deduction of liquidated damages by the Cochin Port Trust from the claimant for delays in completing a contract for the fabrication and installation of cranes. The arbitral tribunal had initially awarded the claimant a refund, ruling that the Port Trust failed to prove actual loss. However, the High Court held that when parties have expressly agreed to liquidated damages as a reasonable pre-estimate of loss, it is unnecessary for the aggrieved party to prove actual loss under the Indian Contract Act. Since the extensions of time were granted with the express reservation of the right to claim liquidated damages, the High Court set aside the arbitral award in favor of the Port Trust.

HELD Where a contract clearly provides for a genuine pre-estimate of damages, the claimant is not required to lead evidence to prove actual loss unless the opposing party demonstrates that no loss could have occurred.

> "Section 74 of the Contract Act emphasizes that in case of breach of contract, the party complaining of the breach is entitled to receive reasonable compensation whether or not actual loss is proved to have been caused by such breach. The emphasis is on reasonable compensation. If the compensation named in the contract for such breach is genuine pre-estimate of loss... there is no question of proving such loss."

HIGH COURT OF KERALA · 2019 | SOURCE KLHC010000932003

19 Vandana Jain v. Rita Mathur

HIGH COURT OF DELHI · 2018-04-20 · RFA/38/2018

The appellant filed a suit for specific performance of an agreement to sell, which was dismissed by the trial court due to the appellant's failure to prove financial capacity. While the appellant did not pursue the specific performance claim on appeal, she sought a refund of the earnest money paid to the respondents. The trial court had previously ruled that the respondents were entitled to forfeit the earnest money.

HELD Earnest money deposits cannot be forfeited automatically upon breach of contract under Section 74 unless the party claiming forfeiture pleads and proves that they suffered actual, quantified financial losses.

> "Even where liquidated damages can be awarded under Section 74 of the Contract Act because loss or damages cannot be proved in a contractual breach yet if the liquidated damages (earnest money) are a penalty amount by its nature i.e prescribed liquidated damages figure is unreasonable, then for the liquidated damages amount or earnest money amount forfeiture cannot be granted..."

HIGH COURT OF DELHI · 2018 | SOURCE DLHC010066232018

20 Mahanagar Telephone Nigam Ltd. v. Tata Communications Ltd.

SUPREME COURT OF INDIA · 2019-02-27 · 2019 INSC 286

This case concerned a dispute over the unilateral deduction of funds by Mahanagar Telephone Nigam Ltd. (MTNL) from payments due to Tata Communications Ltd. for services rendered under a purchase order. MTNL attempted to justify these deductions as compensation for the respondent's failure to provide last-mile connectivity. The Supreme Court affirmed the decision of the Telecom Disputes Settlement and Appellate Tribunal, holding that the contract provided a specific clause for liquidated damages capped at 12%. Because the parties were governed by an express contract, the provisions of Section 70 of the Contract Act (regarding quasi-contracts) were inapplicable, and the appellant could not unilaterally impose higher charges or deviate from the contractual damages limit.

HELD When a contract provides a specific liquidated damages clause that is capped at a percentage, the court will enforce that cap as final. Parties cannot claim under Section 70 (quasi-contracts) or impose higher unilateral rates when governed by an express contract.

> "Instant case is covered by s. 74 – Tribunal rightly held that a maximum of 12% can be levied as liquidated damages under the contract, which would amount to Rs. 25 lakh – Since this clause governs the relations between the parties, contractually speaking a higher figure, cannot be awarded as liquidated damages, which is to be considered as final..."

SUPREME COURT OF INDIA · 2019 | SOURCE ESCR010007222019

21 Punj Lloyd Ltd. v. IOT Infrastructure and Energy Services Ltd.

BOMBAY HIGH COURT · 2018-12-14 · ARBP/1323/2012

This arbitration petition arose from a construction sub-contract dispute regarding the 'Paradip Refinery Project'. The petitioner, Punj Lloyd Ltd., challenged an arbitral award that rejected several of its claims and allowed a counter-claim for liquidated damages in the amount of Rs. 2.79 crores in favor of the respondent, IOT Infrastructure. The petitioner argued that under Section 74 of the Indian Contract Act, damages cannot be awarded without the respondent proving actual loss, regardless of the contractual stipulation. The court addressed the interpretation of Section 74, noting that while the section allows for reasonable compensation up to the stipulated limit, judicial precedent requires a party to demonstrate that damages were actually suffered.

HELD Under Section 74 of the Contract Act, a claimant is disentitled from recovering the stipulated liquidated sum simpliciter without establishing that some actual loss or damage was suffered as a result of the breach.

> "Whatever the distinction between liquidated damages and penalty may be, the terms of s. 74 of the Contract Act are broad enough to include both classes of cases... The effect of the Indian Contract Act of 1872, sec.74, is to disentitle the Plaintiffs to recover simpliciter the sum of Rs.10,000, whether as penalty or liquidated damages. The Plaintiffs must prove the damages they have suffered."

BOMBAY HIGH COURT · 2018 SOURCE HCBM020284412012

22 Malee Ram Gurjar v. Jodhpur Vidhyut Vitran Nigam Limited

HIGH COURT OF RAJASTHAN · 2023-04-20 · CW/5847/2015

This case concerned the enforceability of a service bond executed by the petitioner upon appointment. The petitioner sought relief from the conditions requiring payment upon resignation before a stipulated period. Relying on established Division Bench precedents of the High Court, the court held that such bonds are enforceable to compensate the employer for the breach of service conditions and do not constitute unjust enrichment or unconscionable contracts.

HELD Service bonds executed by employees in favor of public sector utilities are enforceable under the public duty exception to Section 74 of the Contract Act. Because the public is interested in the performance of such duties, the employee is liable to pay the full sum on breach of the condition.

> "Exception to Section 74 of the Indian Contract Act, 1872 provides that recognisance or other instrument of the same nature or under the provisions of any law, or under the orders of the Central Government or of any State Government, gives any bond for the performance of any public duty or act in which the public are interested, he shall be liable upon breach of the condition of any such instrument to pay the whole sum mentioned therein."

HIGH COURT OF RAJASTHAN · 2023 SOURCE RJHC010380292015

23 Essem Enterprise v. Kolkata Municipal Corporation

CALCUTTA HIGH COURT · 2023-04-05 · APO/67/2021

The appellant, a proprietorship concern, challenged the forfeiture of its Earnest Money Deposit (EMD) by the Kolkata Municipal Corporation (KMC). After participating in a tender process, the appellant extended the validity of its bid but later requested a refund of the EMD, arguing that the validity period had already expired. KMC maintained that the refund request during the extended validity period constituted a withdrawal of the bid, triggering forfeiture under the tender terms. The High Court, noting that a proprietorship is not a legal entity, allowed the substitution of the proprietor as the petitioner. On the merits, the court upheld the forfeiture, finding that the appellant had indeed withdrawn its bid prematurely during the valid period, rendering the forfeiture lawful under the tender contract.

HELD Forfeiture clauses under Section 74 are enforceable only if some loss is caused by the breach of contract. However, the section does not apply to the forfeiture of earnest money under a public auction or tender conditions before a formal contract agreement is concluded.

> "Section 74 of the Contract Act, 1872, is sandwiched between Sections 73 and 75… Section 74 will apply to cases of forfeiture of earnest money under a contract. Where, however, forfeiture takes place under the terms and conditions of a public auction before agreement is reached, Section 74 would have no application."

CALCUTTA HIGH COURT · 2023 | SOURCE WBCHC00009842021

DISCLAIMER