

March 2025

## **Forfeiture of earnest money, if 'reasonable', does not amount to imposing a penalty and therefore does not fall under Section 74 of the Indian Contract Act, 1872**

The Supreme Court of India (“**Supreme Court**”) in *Godrej Projects Development Limited vs. Anil Karlekar and Ors.*<sup>1</sup>, has held that forfeiture of a reasonable amount of earnest money is permissible and does not constitute a penalty under Section 74 of the Indian Contract Act, 1872 (“**Contract Act**”), provided it is not excessive.

### **Brief facts**

1. The Respondents viz. Anil Karlekar and Ors. (“**Complainants/Respondents**”) booked an apartment with Godrej Projects Development Limited (“**Appellant/Developer**”) in its project styled as ‘Godrej Summit’ (“**Project**”) by paying an application money of INR 10,00,000 (Indian Rupees ten lakh).
2. The Appellant allotted an apartment to the Complainants in the Project. Pursuantly, an Apartment Buyer Agreement (“**Agreement**”) was executed between the parties.
3. Subsequently, the Appellant completed the construction of the Project and offered possession to the Complainants. However, the Complainants sought cancellation of the allotment and demanded a full refund of INR 51,12,310 (Indian Rupees fifty one lakh twelve thousand three hundred and ten).
4. Thereafter, the Complainants filed a Consumer Complaint (“**Complaint**”) against the Appellant before the National Consumer Disputes Redressal Commission (“**NCDRC**”), seeking a full refund along with 18% interest per annum.
5. The NCDRC, vide order dated October 25, 2022, disposed of the Complaint and held that the Appellant could deduct only 10% of the Basic Sale Price (“**BSP**”) as cancellation charges. In effect, the NCDRC directed the Appellant to refund the remaining amount along with 6% simple interest per annum, within a specified period. Aggrieved by the NCDRC’s decision, the Appellant filed an appeal before the Supreme Court.

### **Issue**

Whether forfeiture of a reasonable amount of earnest money deposit constitutes a penalty under Section 74 of the Contract Act?

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<sup>1</sup> Civil Appeal No. 3334 of 2023, decided on February 3, 2025

## Findings and analysis

While partly allowing the appeal, the Supreme Court held as follows:

1. forfeiture of earnest money is permissible, provided it is reasonable and not excessive or arbitrary. In such circumstances, it shall not amount to a 'penalty' under Section 74 of the Contract Act;
2. while relying on its judgment in *Maula Bux vs. Union of India*<sup>2</sup>, the Supreme Court reiterated that if the forfeiture of earnest money under a contract is reasonable, then it does not fall within Section 74 of the Contract Act, inasmuch as, such a forfeiture *does not amount to imposing a penalty*.
3. The Supreme Court further observed that if under the terms of the contract, the party in breach undertook to pay a sum of money or to forfeit a sum of money which he had already paid, such an undertaking is in the nature of a penalty and would attract the provisions of Section 74 of the Contract Act.
4. The Supreme Court also analysed and relied upon the decision rendered by the NCDRC in *DLF Limited vs. Bhagwanti Narula*<sup>3</sup> and *Ramesh Malhotra and Anr. vs. Emaar Mgf Land Limited and Anr.*<sup>4</sup>, wherein it was held that 10% of the BSP is a reasonable amount which is liable to be forfeited as earnest money. Additionally, the Supreme Court also relied on other decisions passed by it in *Ireo Grace Realtech Private Limited vs. Abhishek Khanna and Ors.*<sup>5</sup>, *Wing Commander Arifur Rahman Khan and Aleya Sultana and Ors. vs. DLF Southern Homes Private Limited and Ors.*<sup>6</sup>, *Pioneer Urban Land and Infrastructure Limited vs. Govindan Raghavan*<sup>7</sup>, and held that the forfeiture of the 20% of the BSP as earnest money by the Appellant was excessive, one-sided and unconscionable and therefore, not enforceable in law.

## Conclusion

The Supreme Court has reaffirmed that the forfeiture of earnest money is permissible, provided it is reasonable and proportionate. It upheld the validity of forfeiture of earnest money observing that such clauses should not be one-sided or excessively punitive and that such an amount must be just and fair not qualifying as a penalty under Section 74 of the Contract Act. Any forfeiture that is excessive, punitive, or one-sided amounts to a penalty.

While earnest money serves as security for contractual performance, its forfeiture should not be excessive to the extent that it qualifies as a penalty. If a forfeiture is deemed unreasonable or oppressive, the court has the authority to intervene and reduce the amount, ensuring that contractual terms remain equitable and enforceable.

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<sup>2</sup> (1969) 2 SCC 554

<sup>3</sup> 2015 SCC OnLine NCDRC 1613

<sup>4</sup> 2020 SCC OnLine NCDRC 789

<sup>5</sup> (2021) 3 SCC 241

<sup>6</sup> (2020) 16 SCC 512

<sup>7</sup> (2019) 5 SCC 725

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