

Rajesh Gupta v. Ram Avtar

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Introduction

Contracts are the foundation of commercial transactions, which guarantee that the rights and responsibilities of parties are well-defined and enforceable by law. In real estate transactions, the accuracy of representations made by the seller plays a crucial role in influencing the buyer's decision. However, disagreements often occur when one party claims that the contract was induced by deception or when terms of the contract, like forfeiture clauses, are applied unfairly. The Indian Contract Act, 1872, offers legal remedies in these situations, especially under Section 74, which regulates the enforceability of forfeiture clauses, and Section 19, which permits rescission in cases of deception. The case of *Rajesh Gupta v. Ram Avtar* focuses on these legal issues, specifically the consequences of a seller's misrepresentation of property dimensions and the validity of earnest money forfeiture in the absence of proven loss.

The case arose when the buyer, Rajesh Gupta, signed a contract to purchase a property from Ram Avtar. The seller had represented a specific constructed area for the property, which later proved to be incorrect. After discovering the discrepancy, the buyer rescinded the contract and requested a refund of the ₹60,00,000 paid as earnest money. However, the seller refused to return the funds, claiming that the forfeiture was justified under the terms of the agreement. The Delhi High Court faced two important legal questions: whether the misrepresentation was material enough to warrant rescission under Section 19, and whether forfeiture of earnest

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money was valid without proof of actual loss, as required by Section 74 of the Indian Contract Act.

Another significant issue in the case was the application of the caveat emptor doctrine, which generally requires the buyer to verify the details of a transaction before proceeding. The seller of the property claimed that the buyer should have conducted due diligence before entering into the contract. However, the court clarified that caveat emptor does not absolve a seller of liability if the misrepresentation is material and has a direct impact on the buyer's decision. By ruling in favor of the buyer, the court reinforced the principle that sellers cannot make misleading claims and then use caveat emptor as a defense.

The reasoning, precedents, and wider ramifications of this case comment analyzes the Delhi High Court's reasoning, legal precedents, and broader implications of the ruling on contract law. The analysis of the ruling provides insight into the changing legal environment pertaining to earnest money forfeiture, misrepresentation, and striking a balance between contractual duties and equitable remedies in real estate transactions.

Facts

In an "Agreement to Sell and Purchase Cum Receipt," signed on December 5, 2008, Rajesh Gupta (the petitioner) and Ram Avtar (the respondent) agreed that Gupta would pay ₹1,60,00,000 for a manufacturing unit, including a built-up factory, on leasehold property No. C-37, Sector B-2, Tronica City, Loni, Ghaziabad (UP), along with all movable assets. Gupta acknowledged in the agreement that he had paid ₹60,000,000 as earnest money.

After signing the contract, Gupta found that the 10,000 square feet stated in the agreement was much smaller than the actual built-out factory space, which was only about 6,500 square feet. Because of this 3,500-square-foot disparity, Gupta claimed he had been misinformed about the property's actual size. When Gupta realized this, he sent out a legal notice on May 2, 2009, requesting a refund of the earnest money or a proportionate reduction in the sale price. However, Avtar did not reply to the legal notice, nor did they change the sale price or issue a refund. As a result, Gupta started legal action to get the earnest money and damages back.

Issues

1. Whether the petitioner had the right to void the agreement in accordance with Section 19 of the Indian Contract Act, 1872, because the respondent's representation of the property's constructed area constituted misrepresentation.
2. Whether, in the absence of evidence of actual loss, the respondent's forfeiture of ₹60,000,000 as earnest money under Section 74 of the Indian Contract Act, 1872, was justified.

Legal Provisions Involved

1. Indian Contract Act, 1872

- Section 19 of the Indian Contract Act, 1872 - The provision states that the party who was misled, defrauded, or coerced into entering into a contract has the right to either void the agreement or demand that it be performed.
- Section 74 of the Indian Contract Act of 1872 - This provision states that if a contract stipulates a penalty for a violation, the party who is complaining of the breach is only entitled to reasonable compensation up to the penalty amount, and only if actual damage can be demonstrated.

2. Arbitration and Conciliation Act, 1996

- Section 8 of the Arbitration and Conciliation Act, 1996 - The provision states that the parties have a valid arbitration agreement, the court must refer the matter to arbitration upon one of the parties' requests
- Section 34 of the Arbitration and Conciliation Act, 1996- This provision states that a party may contest an arbitral award if it is determined to be against public policy, contains a decision that is outside the parameters of the arbitration agreement, or has procedural irregularities.

3. The Doctrine of Caveat Emptor (Buyer Beware)

- According to this common law principle, the buyer holds the risk of a transaction and is required to perform due diligence prior to making a purchase.

Arguments

Contentions by the Petitioner

1. The petitioner argued that the seller had given false information about the property's real built-up area. There was a 3,500 square foot discrepancy between the agreed-upon 10,000 square feet and the actual built-up area of 6,500 square feet. According to Section 19 of the Indian Contract Act of 1872, this was misrepresentation, and he was therefore entitled to cancel the agreement.
2. The petitioner contended that he was entitled to withdraw without consequence because his consent was acquired by deception.
3. The petitioner further argued that the seller had violated Section 74 of the Indian Contract Act, 1872, by failing to prove real loss, making the forfeiture of ₹60,000,000 illegal.
4. The petitioner contended that when a seller intentionally misrepresents, the caveat emptor (buyer beware) doctrine does not absolve the seller of responsibility.
5. Under Section 34 of the Arbitration and Conciliation Act, 1996, the petitioner contested the arbitral ruling dated April 19, 2012, claiming it contradicted public policy and disregarded binding precedents.

Contentions by the Respondent

1. The respondent claimed that the buyer had plenty of opportunity to view the property before making a purchase and that there had been no deception about its proportions.
2. According to the caveat emptor concept, the responder argued that the buyer should confirm the property's details before completing the deal.
3. According to the respondent, the agreement's forfeiture clause rendered the amount of ₹60,000,000 non-refundable in the event that the buyer withdrew.
4. The respondent argued that courts had a limited authority to interfere with arbitral verdicts under Section 34 of the Arbitration and Conciliation Act, 1996. He maintained that unless

there had been a flagrant breach of the law, the court should not overrule the tribunal's conclusions because they were final and binding.

5. The respondents contend that there was no lack of bona fides, as the buyer's withdrawal was caused by financial limitations rather than deception. They assert that it was not a legal flaw in the contract, but the buyer's abrupt decision to back out of the deal, that has been mischaracterized and does not reflect an absence of sincere purpose.

Judgment

The Arbitral Tribunal first decided in favor of the respondent, allowing the earnest money of ₹60,000,000 to be forfeited because the petitioner had not fulfilled his end of the bargain. The Tribunal further determined that the caveat emptor principle was applicable, putting the burden of confirming the property's measurements on the petitioner prior to signing the contract. The Delhi High Court, however, partially overturned the arbitral ruling after a challenge.

Since the actual space was about 25% smaller than indicated, the court determined that the respondent's misrepresentation of the constructed area was relevant which is significant in a property transaction. The court observed that when the buyer relies on an express representation made by the seller, the caveat emptor principle does not apply. Thus, in accordance with Section 19 of the Indian Contract Act, 1872, the petitioner has the right to cancel the agreement.

Analysis

The Delhi High Court's decision in *Rajesh Gupta v. Ram Avtar* is a landmark decision in contract law, especially when it comes to misrepresentation, earnest money forfeiture, and the application of the caveat emptor concept. The decision of the courts ensures equitable enforcement of contractual duties and prevents the abuse of forfeiture clauses to unfairly benefit one party.

Since the agreement claimed that the developed space was 10,000 square feet, while the actual measurement was 7,506 square feet, the court properly determined that the misrepresentation about the built-up extent of the land was substantial. According to Section 19 of the Indian Contract Act of 1872, this significant deficiency was a legitimate reason for contract

revocation. The court's logic is consistent with the rules set forth in *Fateh Chand v. Balkishan Dass*,¹ where it was decided that deception undermines a contract's fundamental terms and gives the harmed party the right to terminate it.

The judgment's severe stand on earnest money forfeiture is among its most admirable features. The court correctly determined that the seller's attempt to keep ₹60,000,000 without proving any real loss was unwarranted.

Paragraph 42 of the judgment makes it very evident that forfeiture is only allowed in cases where actual loss or damage may be demonstrated. This opinion is in line with the Supreme Court's decision in *Kailash Nath Associates v. DDA*², which found that forfeiture clauses cannot be used as a form of punishment unless the non-breaching party has experienced measurable injury. The court also noted *Maula Bux v. Union of India*³, which upheld the requirement that adequate compensation be given based on actual damages, even in cases where contracts expressly permit forfeiture, as stipulated by Section 74 of the Indian Contract Act.

The respondent's reliance on the caveat emptor concept was also properly rejected by the court. The court clarified that the theory does not apply in situations of active misrepresentation, despite the seller's argument that the buyer should have done due diligence before signing the contract. The judgment's paragraph 29 made clear that a vendor who intentionally gives incorrect information cannot subsequently place the onus on the customer. *Dhanrajmal Gobindram v. Shamji Kalidas & Co.*,⁴ which determined that caveat emptor does not release a seller from obligation in cases of willful misrepresentation, lends weight to this position.

Setting a criteria for identifying material misrepresentation is one area, where the ruling could have been stronger. Although the court recognized that there was a significant 2,500 square foot gap in the built space, it could not offer a precise legal standard to distinguish between serious misrepresentation and minor inconsistencies. A more methodical approach, like the

¹ *Fateh Chand v. Balkishan Dass* (1964) 1 SCR 515

² *Kailash Nath Associates v. DDA* (2015) 4 SCC 136

³ *Maula Bux v. Union of India* (1969) 2 SCC 554

⁴ *Dhanrajmal Gobindram v. Shamji Kalidas & Co.*, (1961) 3 SCR 1020

"reasonable reliance test" used in English contract law, might have clarified what qualifies as a material misstatement that calls for contract revocation.

The dismissal of the arbitral award in accordance with Section 34 of the Arbitration and Conciliation Act of 1996 is another notable aspect of the court's decision. The forfeiture was wrongly upheld by the arbitral tribunal because it applied the incorrect legal test and ignored precedents that required proof of actual loss. According to paragraph 45 of the ruling, the award may be revoked because the tribunal's conclusions were in direct opposition to accepted principles of contract law. This follows the Supreme Court's ruling in *Associate Builders v. DDA*⁵, where it was held that arbitral decisions that disregard legally binding precedents or apply the law incorrectly are against public policy and are subject to reversal. The Delhi High Court's approach strengthens judicial oversight arbitration, ensuring that arbitral tribunals do not make verdicts that violate basic contract law principles.

Conclusion

The court's stringent adherence to contract law principles assures that parties cannot utilize forfeiture provisions to penalize the other party, which is critical for preserving fairness in commercial agreements. The decision, however, should have clarified the threshold for material misrepresentation even while it successfully invalidates an unfair forfeiture clause and preserves the buyer's right to withdraw the contract. However, by reaffirming that deception voids consent, forfeiture necessitates proof of loss, and arbitral verdicts must be consistent with established legal principles, the decision fortifies the legal framework governing contractual disputes. The Delhi High Court's decision establishes a significant precedent, guaranteeing that contract law is enforced properly and that purchasers are not unjustly punished for depending on false information.

⁵ *Associate Builders v. DDA* (2015) 3 SCC 49