
(2006) 05 DEL CK 0058
In the Delhi High Court
Case No : OMP No. 39 of 2000

Haryana Telecom Ltd.

APPELLANT

Vs

Union of India (UOI) and Another

RESPONDENT

Date of Decision : 11-05-2006

Acts Referred:

Arbitration and Conciliation Act, 1996 — Section 28(3), 34, 34(2), 55
Contract Act, 1872 — Section 73, 74

Citation : AIR 2006 Delhi 339 : (2006) 2 ARBLR 293 : (2006) 90 DRJ 211

Hon'ble Judges : Sanjay Kishan Kaul, J

Bench : Single Bench

Advocate : Amrita Sanghi and Shashi Kanodia, for the Appellant; Anil Nag, for the Respondent

Judgement

Sanjay Kishan Kaul, J.—The Department of Telecom, Union of India the respondent herein floated tender for obtaining PIJF underground cables of 1.66 LCKM. The tender was opened on 22.4.1994. The petitioner had submitted his bid in pursuance to the tender enquiry which was accepted by the respondent. Orders were placed on the petitioner for supply of cables on a cash basis and the petitioner was required to submit a performance bank guarantee worth Rs. 85 lacs as per Clause 4.1 of the bid documents. The petitioner accordingly furnished the bank guarantee dated 27.9.1994 issued by the State Bank of Patiala, Rajpura for the said amount.

2. The respondent took the decision to obtain additional quantity of the said cable of 85 LCKM under the same tender enquiry but on deferred payment terms and the petitioner being one of the approved bidders was accordingly informed about the proposal of additional allocation of 3.79 LCKMs. This quantity was enhanced to 4.77 LCKM on 5.12.1994 and distributed to different telecom circles. The Haryana Circle had to be supplied 1.64 LCKM, Punjab Circle 2.40 LCKM and Rajasthan Circle 0.73 LCKM. The petitioner was required to submit their conditional acceptance latest by 9.2.1995 and the same was duly done by the

petitioner. In view of this additional supply of 4.7 LCKM the petitioner was required under Clause 4.1 of the Agreement to submit an additional performance bank guarantee for Rs. 15.0 lacs to make the total performance bank guarantee of Rs. 1.0 crore and the petitioner duly complied with the same by furnishing the additional bank guarantee of Rs. 15.0 lacs issued by Canara Bank, IFB Branch, New Delhi. The petitioner was required to have separate agreements with the three Chief Managers of the three respective telecom circles under this deferred payment arrangement and the petitioner entered into such three separate agreements giving different scheduled dates of delivery.

3. The dispute arose between the parties on account of the failure of the petitioner to make the supplies and the respondent invoked the bank guarantees. In view of the existence of Clause 20 as the Arbitration Clause Shri A.K. Garg, General Manager, Telecom District Dheradun was appointed as the Arbitrator by the Government of India vide letter dated 8.9.1997. The Arbitrator made and published the award dated 17.12.1999. The petitioner aggrieved by the same has filed the present petition u/s 34 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to "the said Act").

4. Learned counsel for the petitioner, conscious of the limited jurisdiction of this Court under the provisions of Section 34(2) of the Act even in view of the extended jurisdiction as enunciated in Oil and Natural Gas Corporation Ltd. Vs. SAW Pipes Ltd., confined her submissions to three aspects.

5. The first aspect sought to be canvassed by the learned Counsel for the petitioner was that the rescission of the contract was not in terms of the contract and thus the bank guarantee could not be invoked. It was, however, not disputed that in view of the bank guarantee having been invoked and honoured, the issue did not really survive for consideration and what had to be examined was whether the respondent was entitled to the damages as determined.

6. The second issue thus canvassed, and which is the main issue, is the plea that the damages could have been awarded only if the loss has been suffered. The Arbitrator has recorded a finding that the respondent was able to obtain supplies at cheaper rate and that the losses were remote but despite this fact the respondent has been held within its rights to have recovered the amount of damages under the bank guarantee. The Arbitrator has arrived at a finding at page 11 of the Award as under:

...Though it cannot be denied that the respondent must have in one way or the other suffered due to non-performance of the contracts by the petitioners yet all the losses/damages being claimed are indirect and for non-performance of the agreement for which remedy is available only in Clause 4.2 of the agreement.

7. The Arbitrator, however, finds that though the respondents have procured subsequently the cables on cheaper rates, the petitioners cannot escape from their responsibilities from honouring the agreement and thus held them liable under Clause 4.2 of the agreement. It may be noticed that the cables have

apparently been purchased subsequently by respondents at a price almost 30% cheaper than the rates at which petitioner was to make supply.

8. In order to appreciate the controversy in its correct perspective some of the Clauses of the agreement would have to be examined. The relevant Clauses are as under:

4.0.PERFORMANCE BANK GUARANTEE:

4.1 Performance Bank guarantee, 95% of the order value (exclusive of Excise, Sales Tax etc.) up to Rs. 4 crores and 2% for every extra crore order value subject to a total ceiling of Rs. 1. Crores is to be submitted by the supplier to the purchaser in the prescribed proforma enclosed herewith, from any Nationalised Scheduled Bank before signing of the Agreement. The supplier has already submitted a Performance Bank Guarantee No. PE/57/94-95 issued by STATE BANK OF PATIALA, RAJPURA, for Rs.85,00,000/- (Rs. Eighty Five Lacs Only) i.e. valid for three years up to 27.09.1997 and Bank Guarantee No. 34/95 issued by Canara Bank, New Delhi, for Rs. 15,00,000/- (Rs. Fifteen Lacs Only) is valid for three years up to 04.04.1993. The extension of the Performance Bank Guarantee shall be arranged by supplier/bank as and when required by the DOT till it is allowed to be lapsed by DOT.

4.2 The performance Guarantee shall be encased by the DOT on the supplier's failure to meet its obligations under the agreement.

18.0 DELAYS IN SUPPLIES PERFORMANCE.

18.1 XXXXXXXX

18.2 Delay by the supplier in the performance of its delivery obligations shall render the supplier liable to any or all the following sanctions, forfeiture of its performance security, imposition of liquidated damages and/or termination of the contract for default. The quantum of liquidated damages has been indicated in 19.2.

19.0 LIQUIDATED DAMAGES

19.1 The date of delivery of the goods stipulated in this Agreement should be deemed to be the essence of the contract and delivery must be completed not later than the dates specified therein. Extension will not be given except in exceptional circumstances. Should, however, deliveries be made after expiry of the contracted delivery period, without prior concurrence of DOT, and be accepted by the consignee, such deliveries will not deprive DOT of its right to recover liquidated damages under Clause 19.2 below. However, when supply is made within 21 days of the contracted original delivery period, the consignee may accept the stores and in such cases the provision of Clause 19.2 will not applied.

19.2 Should the supplier fail to deliver the goods or any consignment thereof within the period prescribed for delivery, the DOT shall be entitled to recover

0.5% of the value of the delayed supply for each week of delivery or Part thereof, subject to maximum of 5% of the value of the delayed supply provided that delayed portion of the supply does not, in any way, hamper the commissioning of the route. Where the delayed portion of the supply materially hampers installation and commissioning of the route. Liquidated damages charges shall be levied as above on the total value of the route. Liquidated damages so levied shall be deducted from the invoice value for computation of EQU as per para 12 above.

23.0 TERMINATION FOR DEFAULT

23.1 DOT may, without prejudice to any other remedy for breach of contract by written notice of default, sent to the supplier, terminate this Agreement in whole or in party.

a) If the supplier fails to deliver any or all the goods within the time period (s) specified in the Agreement or any extension thereof granted by DOT pursuant to Clause 7.0.

b) If the supplier fails to perform any other obligation(s) under the Agreement; and

c) If the supplier, in either of the above circumstances does not remedy his failure within a period of 30 days (or such longer period as DOT may authorise, in writing) after receipt of the default notice from DOT.

23.2 In the event, DOT terminates the Agreement in whole or in party pursuant to para 23.1, DOT may procure, upon such terms and in such manner as it deems appropriate, goods similar to those undelivered and the supplier shall be liable to DOT for any excess cost for such similar goods. However, the supplier shall continue performance of the Agreement to the extent not terminated.

9. Learned counsel for the petitioner submitted that reading of Clause 4.2 would show that the performance guarantee was to be encased on supplier's failure to meet its obligation and the same was in the nature of compensation for the loss to be suffered by the petitioner. Thus the principles of Sections 73 and 74 of the Indian Contract Act, 1872 would come into play and this would be different from an amount stipulated as a genuine pre-estimate of damages not amounting to a penalty.

10. Learned counsel referred to the reply of the respondent in the present proceedings to contend that the respondent itself has treated the amount as a penalty and in para 12 of the reply it is stated "the penalty for delay/non-supply of cables to be imposed on the supplier is explained in Clauses 4.2, 7(b), 18, 19 and 23 of the agreements." Learned counsel submitted that the judgment of the Supreme Court in Oil and Natural Gas Corporation Ltd. v. Saw Pipes Ltd (Supra) has thus to be appreciated in its correct perspective. Learned counsel referred to the Judgment of the Apex Court in Fateh Chand Vs. Balkishan Das, to contend that where there is a breach of stipulation by way of penalty the compensation

has to be reasonable and the Court is not bound to award compensation when no legal injury has resulted. It was observed that in assessing damages the Court has, subject to the limit of the penalty stipulated, jurisdiction to award such compensation as it deems reasonable, having regard to all the circumstances of the case. It was observed that Section 74 merely dispenses with the proof of "actual loss or damage", but it does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted, as compensation for breach of contract can be awarded to make good the loss or damage which naturally arose in the usual course of things or which the party knew when they made the contract to be likely to result from the breach.

11. Learned counsel referred to the Judgment of Apex Court in *Maula Bux v. Union of India* AIR 1969 (2) SCC 554. It was held that forfeiture of reasonable amount paid as earnest money does not amount to imposing a penalty but if forfeiture is in the nature of penalty, Section 74 applies. Thus in every case of breach of contract the aggrieved person is not required to prove actual loss or damage suffered by him and the Court is competent to award reasonable compensation, if no actual damages are proven to have been suffered in consequence of the breach of contract. Thus where the Court is unable to assess the compensation, the sum named by the parties if it is recorded as a genuine estimate may be taken into consideration as the measure of reasonable compensation, but not if the sum named is in the nature of a penalty. Where loss in terms of money can be determined, the party claiming compensation must prove the loss suffered by him. In the given facts of the case it was held that the Government could have proved the rates at which they had purchased and all other incidental charges incurred by them in procuring the goods contracted while no such attempt was made, and thus amount could not be appropriated by the Government.

12. Learned counsel also referred to the Judgment in *Karsandas H. Thacker Vs. The Saran Engineering Co. Ltd.*, . On the issue of remoteness of damages it was held that remote and indirect loss or damage sustained by reason of breach will not entitle the party to any compensation. Thus it was held that as per illustration (k) of Section 73 of the Contract Act the person guilty of the breach had to pay to the other party the difference between contract price of the articles agreed to be sold and the sum paid by the other party for purchasing another article on account of the default of the first party. But the first party is not to pay the compensation which the second party had to pay to a third party, as he had not been told at the time of contract that the second party was making the purchase of the articles for delivery to such third party.

13. Learned counsel for the respondent on the other hand sought to canvass the proposition that no such damages were required to be proved by the respondent. Learned counsel submitted that the petitioner had approached this Court for stay against encashment of bank guarantee, when the petition was filed for reference to disputes for arbitration and it was held that the petitioner had agreed that the

respondent would be entitled to encash the performance guarantee, in case of failure to meet the obligations.

14. Learned counsel submitted that even though the cables were purchased at a more competitive price subsequently the petitioner has to pay for the failure to meet obligations, as there are other aspects such as compensation for delay. Clause 4.2, thus required only a failure to meet obligation to result in the consequences of the amount being forfeited.

15. Learned counsel for the respondent strongly relied upon the Judgment of the Apex Court in *Oil and Natural Gas Corporation Ltd. v. Saw Pipes Ltd.* (Supra) and referred to the discussion on a similar aspect therein. The factual matrix of the said case is that the order was placed for supply of steel plates which was the raw material required for manufacturing the pipes. The material was not delivered within time and extension was granted with the specific stipulation that the amount equivalent to liquidated damages for delay in supply of pipes would be recovered from the supplier which was so done. It was that dispute which was referred to arbitration.

16. The tribunal held that it was for the suffering party to establish that loss had been caused because of the breach committed by the supplier within the prescribed time limit and the amount was found to be wrongly withheld. One of the questions which arose before the Supreme Court, as canvassed by the counsel, was whether the award was vitiated on the ground that there was delay on the part of the supplier and for that delay the other party was entitled to recover agreed liquidated damages. In view thereof, the award was alleged to be contrary to Section 28(3) of the said Act.

17. The aforesaid plea was opposed on the ground that in case of breach of contract, the provisions of Section 74 of the Contract Act would be applicable and compensation/damages could be awarded only if the loss is suffered because of the breach of contract. Thus the party claiming the liquidated damages was required to prove the loss suffered by it. It was thus canvassed that the award could not be interfered with u/s 34 of the Act. The Supreme Court proceeded to examine the relevant portion of the Clause which is as under:

11. Failure and Termination Clause/Liquidated Damages:

Time and date of delivery shall be essence of the contract. If the contractor fails to deliver the stores, or any Installment thereof within the period fixed for such delivery in the schedule or at any time repudiates the contract before the expiry of such period, the purchaser may, without prejudice to any other right or remedy, available to him to recover damages for breach of the contract:

(a) Recovery from the contractor as agreed liquidated damages are not by way of penalty, a sum equivalent to 1% (one per cent.) of the contract price of the whole unit per week for such delay or part thereof (this is an agreed, genuine pre-estimate of damages duly agreed by the parties) which the contractor has

failed to deliver within the period fixed for delivery in the schedule, where delivery thereof is accepted after expiry of the aforesaid period. It may be noted that such recovery of liquidated damages may be up to 10% of the contract price of whole unit of stores which the contractor has failed to deliver within the period fixed for delivery, or

18. The scope of the enquiry thus came to the crucial issue based on the plea that where the parties had expressly agreed that recovery from contractor for breach of contract is pre-estimated genuine liquidated damage and is not by way of penalty duly agreed by the parties, there was no justifiable reason for the arbitral tribunal to arrive at a contrary conclusion, since the tribunal is required to decide the dispute in accordance with the terms of the contract.

19. The Supreme Court considered the Judgment in Fateh Chand's case (Supra) and Maula Bux's case (Supra) and found merit in the contention raised on behalf of the appellants against the award. The Supreme Court also dealt with the plea of the respondent before it that even if the award passed by the tribunal was erroneous, if two views are possible with regard to interpretation of statutory provisions or facts, the Court would refuse to interfere with such award. The Supreme Court made a distinction between a general reference for deciding a contractual dispute which is based on erroneous legal propositions, as against the case where a specific question of law is submitted to the arbitrator. In the first case the Supreme Court held that a Court would interfere. It was held that the award was erroneous and in violation of the terms of the contract and would thus violate Section 28(3) of the said Act, as it was only a general reference made.

20. The question which the Supreme Court examined was whether the party claiming compensation "must prove" the loss suffered by him. The Supreme Court found that the tribunal had failed to consider Sections 73 and 74 of the Indian Contract Act and the ratio laid down in Fateh Chand's case (Supra) wherein it was specifically held that the jurisdiction of the Court to award compensation in case of breach of trust is unqualified except as to the maximum stipulated and the compensation has to be reasonable. Both the provisions thus had to be read together. It was thus held that the party complaining of the breach was entitled to receive reasonable compensation whether or not actual loss was proved to have been caused by such breach. The emphasis was on reasonable compensation. However, if the compensation named in the contract is by way of penalty, considerations would be different and the party is only entitled to reasonable compensation for the loss suffered. But if the compensation named is genuine pre-estimate of loss, there is no question of proving such loss or such party is not required to lead evidence to prove actual loss suffered by him. It was further observed "burden is on the other party to lead evidence for proving that no loss is likely to occur by such breach". The conclusion in respect of this are set out in para 69 as under:

From the aforesaid discussions, it can be held that:

(1) Terms of the contract are required to be taken into consideration before arriving at the conclusion whether the party claiming damages is entitled to the same.

(2) If the terms are clear and unambiguous stipulating the liquidated damages in case of the breach of the contract unless it is held that such estimate of damages/compensation is unreasonable or is by way of penalty, party who has committed the breach is required to pay such compensation and that is what is proved in Section 73 of the Contract Act.

(3) Section 74 is to be read along with Section 73 and, Therefore, in every case of breach of contract, the person aggrieved by the breach is not required to prove actual loss or damage suffered by him before he can claim a decree. The Court is competent to award reasonable compensation in case of breach even if no actual damage is proved to have been suffered in consequences of the breach of a contract.

(4) In some contract/s, it would be impossible for the Court to assess the compensation arising from breach and if the compensation contemplated is not by way of penalty or unreasonable, Court can award the same if it is genuine pre-estimate by the parties as the measure of reasonable compensation.

21. Learned counsel for the petitioner also relied upon the aforesaid Judgment to contend that a reading of the Clause in question aforesaid itself would show that the same was applicable where the compensation was not as a penalty. In the present case the respondents themselves specify the amount to be in the nature of a penalty and that is how the arbitrator has treated the same. Thus the window made available in the judgment Oil and Natural Gas Corporation Ltd. v. Saw Pipe's case (Supra) is available in the present case, since the judgment itself distinguishes a case of penalty by referring on the earlier Judgments of the Apex Court.

22. Learned counsel submitted that the facts noted in the award itself show that the rates at which the respondent purchased were 30% cheaper. Thus the burden, if any, on the petitioner was discharged as the undisputed fact is that the cables were purchased at a much cheaper rate. The award itself states that there was remoteness of the damages and only in view of the amounts stipulated in the contract had proceeded to fix the said amount as recoverable by the respondent from the petitioner.

23. A discussion on the aforesaid legal position, in my considered view, leaves no manner of doubt that in case the amount stipulated is a genuine pre-estimate of damages, no evidence has to be led in that behalf. However, if the amount stipulated was in the nature of a penalty, the respondent was liable to prove the damages.

24. The judgment in Oil and Natural Gas Corporation Ltd. v. Saw Pipe's case (Supra) also makes clear this question of law by referring to the earlier

judgments and to that extent there is force in the contention of learned Counsel for the petitioner that in case the amount stipulated is by way of penalty, proof of damages is required. The only question, thus, to be considered is whether in the present case the amount stipulated is by way of penalty or a genuine pre-estimate of damages.

25. In my considered view, the stand of the respondent itself shows that the amount is really in the nature of penalty. This is how the respondent has treated the same and so as the Arbitrator, but despite this fact the Arbitrator has failed to appreciate the distinction between an amount stipulated by way of penalty. The stand of the respondent even in the reply filed in the present proceedings is that a penalty for delay/non-supply of cables was to be imposed and this fact, as set out in para 12 of the reply, has already been referred to above. The respondent was able to procure the cables at a much cheaper rate by almost 30%. Other than a general reference to the fact that delay would cause other damages, no material has been placed on record by the respondent to establish the same. In that sense, the facts are similar to *Maula Bux's case* (Supra) where also it was found that the Government could have placed material to prove the damages and all other incidental charges, but no such attempt was made. The extent of delay and the consequences thereof even in broad terms has not been set out except for a mere allegation. The clauses of contract had to be read as a whole and the fact that this Court permitted encashment of bank guarantee would not imply that this aspect is not to be examined. Clauses 4.1, 4.2 and 18.1 have to be read together. Any delay on the part of the petitioner in performance of its obligations could have resulted in forfeiture of the performance security, imposition of liquidated damages and/or termination of the contract for default. In terms of Clause 4.2, the performance guarantee had to be encashed on failure of the petitioner to meet with its obligations under the contract. A reading of the said clauses shows that the encashment of bank guarantee and imposition of liquidated damages is as a compensation for the loss and, thus, the principles of Sections 73 and 74 of the Contract Act would come into play.

26. The Arbitrator has arrived at a finding about the remoteness of damages, but at the same time has upheld the claim on the ground that no actual loss or damage was required to be proved and the amount was a pre-estimate of damages. If the real finding of the amount being in the nature of penalty is coupled with the finding of remoteness of damages, it was not open to the respondent to have recovered the amount. The principles laid down in *Fateh Chand's case* (Supra) that if there is no legal injury, the damages are not required to be granted, would thus come into play. In *Karsandas H. Thacker's case* (Supra), the Apex Court has held that remote and indirect loss or damage sustained by reason of breach would not entitle the party to any compensation.

27. The Arbitrator found that the losses/damages being claimed were indirect, but did not go into further details. The Arbitrator noted that the respondent had procured the underground cable at cheaper rates, but thereafter goes on to

record that the petitioner cannot be allowed to escape from its responsibility of honouring the agreement. In my considered view, this legal principle is erroneous as if the consequence of the petitioner being in breach of the agreement is to benefit the respondent then the amount cannot be recovered as there is no loss caused. This is naturally on the basis that the amount stipulated is really by way of penalty.

28. In view of the aforesaid position, I am of the considered view that the award on this account cannot be sustained.

29. The last aspect canvassed by learned Counsel for the petitioner was on the basis of the plea that time was not the essence of contract. This was so as there was a clause for extension. Learned counsel relied upon judgment of the Apex Court in *M/s. Arosan Enterprises Ltd. Vs. Union of India and Another*, wherein it was observed in paras 13 and 14 as under:

13. Incidentally the law is well settled on this score on which no further dilation is required in this judgment to the effect that when the contract itself provides for extension of time, the same cannot be termed to be the essence of the contract and default however, in such a case does not make the contract voidable either. It becomes voidable provided the matter in issue can be brought within the ambit of the first paragraph of Section 55 and it is only in that event that the Government would be entitled to claim damages and not otherwise.

14. In *Pollock & Mulla's Indian Contract & Specific Relief Acts*, three several cases have been very lucidly discussed, where time can be termed to be the essence of contract:

1. Where the parties have expressly stipulated in their contract that the time fixed for performance must be exactly complied with;
2. Where the circumstances of the contract or the nature of the subject matter indicate that the fixed date must be exactly complied with; and
3. Where time was not originally of the essence of the contract, but one party has been guilty of undue delay, the other party may give notice requiring contract to be performed within reasonable time and what is reasonable time is dependent on the nature of the transaction and on proper reading of the contract in its entirety.

30. A reading of the clauses of contract between the parties would show that time has been made the essence of contract. It is only Clause 19.1 which further stipulates that should delivery be made after expiry of the contracted delivery period without prior concurrence of DOT and be accepted by the consignee, such deliveries will not deprive DOT of its right to recover liquidated damages. A reading of these clauses does not show that time was to be treated not as the essence of contract when any delivery made even during extended period was to invite liquidated damages. It is not a case where there is a clause for extension of contract in normal course and such extension had been granted. I, thus, do

not find force in this submission of learned Counsel for the petitioner.

31. The result is that the Award of the Sole Arbitrator, Shri A.K. Garg, is liable to be set aside and the respondent is held not entitled to recover the amount of Rs. 68,31,107/- as directed by the Arbitrator. The amount is liable to be refunded back to the petitioner along with interest @ 9% p.a. simple interest from the date of recovery till the date of payment.

32. Parties are left to bear their own costs.