

(2017) 04 DEL CK 0098

In the Delhi High Court

Case No : 299 of 2003

MAHANAGAR TELEPHONE NIGAM LIMITED

APPELLANT

Vs

HARYANA TELECOM LIMITED

RESPONDENT

Date of Decision : 21-04-2017

Acts Referred:

Contract Act, 1872, Section 73, Section 74 - Compensation for loss or damage caused by breach of contract - Compensation for breach of contract where penalty stipulated for Ar

Citation : (2017) 04 DEL CK 0098

Hon'ble Judges : S. Muralidhar

Bench : SINGLE BENCH

Advocate : Raman Kapur, ?Vivek Malik, Mukul Thakur, Narendra Mohan Sharma, bhishek? Sharma, Suman Rastogi

Final Decision : Allowed

Judgement

1. Mahanagar Telephone Nigam Limited ("MTNL") has filed this petition under Section 34 of the Arbitration & Conciliation Act, 1996 ("Act") challenging an Award dated 12th March, 2003 passed by the Arbitral Tribunal ("AT") in the disputes between MTNL and the Respondent, Haryana Telecom Limited ("HTL").

2. The background facts are that MTNL floated a tender dated 4th March, 1994 for procurement of 55 LCKM of underground Jelly Filled Telephone Cables ranging between 10 to 2400 pairs. Pursuant to the above tender, HTL submitted an offer which was accepted by MTNL. Pursuant thereto, MTNL issued the following Purchase Orders ("POs") to HTL:

(a) 20-80(527)/94-MM/HTL/94-95/56 dated 16-8-1994. (b) 20-80(527)/94-MM/HTL/94-95/89 dated 21-9-1994. (c) 20-80(527)/94-MM/HTL/94-95/91 dated 29-9-1994. (d) 20-80(527)/94-MM/HTL/94-95/108 dated 18-10-1994.

3. The relevant clauses in the Contract pertaining to delays in the supplier's

performance and levy of liquidated damages ("LD") read as under:

"15. Delays in the supplier's performance

15.1 Delivery of the goods and performance of services shall be made by the supplier in accordance with the time schedule specified by the purchaser in its purchase order.

15.2 Delay by the supplier in the performance of its delivery obligations shall render the supplier liable to any or all of the following sanctions; forfeiture of its performance security, imposition of liquidated damages and/or termination of the contract for default.

15.3 If at any time during performance of the contract, the supplier or its subcontractor(s) should encounter conditions impeding timely delivery of the goods and performance of service, the supplier shall promptly notify the purchaser in writing of the fact of delay, its likely duration and its cause(s). As soon as practicable after receipt of the supplier's notice, the purchaser shall evaluate the situation and may at its discretion extend the discussion with the supplier.

15.4 In case of delayed supplies period, the advantage of after delivery reduction of taxes/duties shall be passed on to the purchaser i.e. MTNL and no benefit of increase will be permitted to the suppliers.

16. Liquidated damages

16.1 The date of delivery of the stores stipulated in the acceptance of tender should be deemed to be the essence of the contract and delivery must be specified completed not later than the therein. Extension will dates not be given except in exceptional circumstances. Should, however, deliveries be made after expiry of the contract delivery period, without prior concurrence of the Purchaser, and be accepted by the consignee, such deliveries will not deprive the purchaser of his right to recover liquidated damages under clause 16.2 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 16.2 will not apply. The grace period of 21 days shall be applicable only "for delivery of stores and not for inspection.

16.2 Should the tenderer fail to deliver the stores or any consignment thereof within the period prescribed for delivery the Chairman and Managing Director, MTNL shall be entitled to recover 1/2% of the value of the delayed supply for each week of delay or part thereof, subject to maximum of 10% of the value of the delayed supply, provided that delayed portion of the supply does not in any way hamper the commissioning of the system. Where the delayed portion of the supply material hampers installation and commissioning of the system, liquidated damages (not as a penalty) shall be levied as above on the total value of the contract."

4. It is stated that HTL failed to adhere to the delivery schedule. There was a delay of about 1 to 8 months in making the supplies. It is stated that at the request of HTL, MTNL granted extension letters/amendments to the POs from time to time subject to conditions regarding deduction of LD charges. Clause 9 of the Contract dated 16th August, 1994 was amended on 13th March, 1995 whereby it was provided that the delivery period would be extended up to 26th March, 1995 "with application of liquidated damages."

5. MTNL deducted a sum of Rs.1,03,20,763 from the payments made to HTL by invoking Clause 16.2. This gave rise to disputes between the parties which were referred to the three-member AT.

6. The sole question formulated by the AT for determination was:

"Whether the first part of clause 16.2 which provides for recovery of "% of the value of the delayed supply for each week of delay or part thereof, subject to maximum of 10% of the value of the delayed supply, is a genuine pre-estimate of damages or is a clause in the nature of a penalty or terrorem."

7. The above question was answered by the AT by holding that since MTNL failed to prove the actual loss or damage on account of delayed delivery of goods and since mere delay in supplies was unlikely to cause damages, the question of even fixing a reasonable compensation under Section 74 of the Indian Contract Act, 1872 ("ICA") did not arise. The conclusions of the AT were as under:

"1. The Clause is penal in nature;

2. The first part of clause 16.2 is enforceable only to the extent of the loss proved to have been suffered by reason of late delivery, and in no case for more than the amount named as a penalty. This is the effect of Section 74;

3. Forfeiture of part of price is out of all proportion to the damage;

4. It is unconscionable for the purchaser to retain and withhold part of the price; and

5. That no loss or injury has been proved on the record."

8. Consequently, MTNL was asked to refund HTL the aforementioned sum of Rs. 1,03,20,763 together with interest @ 12% from the date of Award till the date of payment.

9. Earlier, a learned Single Judge of this Court by a judgment dated 18th March, 2010 allowed the present petition and set aside the impugned Award dated 12th March, 2003. It was held that the AT had proceeded on a wrong interpretation of Section 74 of the ICA, which was in the teeth of the decision of the Supreme Court in ONGC v. Saw Pipes Limited (2003) 5 SCC 705. It was held that the interpretation of sub-clause 16.2 by the AT was perverse since it linked the fact situation in the present case to the latter part of sub-clause 16.2 whereas the earlier part was to apply.

10. Aggrieved by the above decision, HTL filed FAO (OS) No. 446/2010 before the Division Bench ("DB") of this Court. By the order dated 4th July, 2014, the DB set aside the decision dated 18th March, 2010 and remanded the matter to the single Judge for fresh adjudication. It was observed as under:

"7. ...neither in the OMP nor in the Appeal the pleadings of the parties before the learned Arbitrator were filed. The learned Single Judge could not have decided the objections filed to the Award sans a reference to the pleadings before the learned Arbitrator.

8. Under the circumstances, the appeal is disposed of setting aside the impugned order dated March 18, 2010. OMP No.299/2003 is restored for fresh adjudication. Parties shall file the pleadings before the Arbitrator in the OMP. Thereafter the same shall be decided afresh."

11. This Court has heard the submissions of Mr. Raman Kapur, learned Senior Advocate appearing for the MTNL and Mr. Narendra Sharma, learned counsel appearing for HTL.

12. At the outset, it requires to be noticed that although the DB had remanded the matter only so that the pleadings before the Arbitrator in OMP could be examined and the matter decided afresh, the arbitral record was not available. It took several dates between 4th August, 2014 and 18th February, 2016 to try and trace out the arbitral record.

13. As it turns out, the record had to be re-constructed as the original record was not available. What has now been filed before the Court is the Statement of Claims ("SOCs") filed by HTL, the reply filed by MTNL, the rejoinder thereto and the written submissions.

14. The precise pleadings as far as HTL's SOC in regard to the aforementioned deduction as stated in paras 6, 7 and 8 read as under:

"6. The Claimant further submits that the Respondent has made the aforesaid deduction of Rs.1,03,20,763 without having incurred any loss at all.

7. The claimant submits that in any event, the Respondent did not suffer any loss or damages, assuming though not admitting that there was any unreasonable delay, the same did not hamper the installation and commissioning of systems for which cables were required. In the said premises, the claimant submits that the respondent has committed an illegal act by making deduction purportedly on account of liquidated damages.

8. The claimant submits that the aforesaid deductions made by the Respondent is contrary to law, in as much as no loss was ever suffered by it on account of alleged delays in supply by the Claimant."

15. It is further pleaded that Clause 16 was a nullity inasmuch as it has entitled MTNL to recover LD even where the delayed supply did not cause any loss or damage.

16. In the reply to the aforementioned SOC of HTL, MTNL stated inter alia that HTL itself by a letter No. Nil dated 6th May, 1995 addressed to MTNL agreed to pay LD charges "since the supplies are to be made in 1995-96 we are ready to accept the price and L/d as acceptable to MTNL." This was enclosed as Annexure C to the reply. It was pointed out that Clause 9 of the Delivery Schedule of the PO was of much importance. Further, the supply was also intimated beforehand through a Letter of Intent ("LOI") affirming that it accepted the terms and conditions of the Supply Schedule. It is only after the acceptance of the LOI, its terms and conditions and the Delivery Schedule that the PO was issued to the supplier.

17. It was further pleaded in ground M of the reply filed by MTNL that the aforementioned letter dated 6th May, 1995 amounted to an "amendment to the contract relating to delivery period and price" and that by such amendment "the price is deemed to have been reduced by the amount of LD charges." It is further averred that if HTL was not interested to make the supplies subject to the LD charges, it was open to them to stop further supplies. Having asked for and obtained the extension of the delivery period, it was not open to the HTL to dispute MTNL's right to deduct the LD in terms of Clause 16.2. Reference was made to Section 55 of the ICA, which stated that where time was the essence of the contract, and one party failed to discharge its obligation, the contract was voidable at the option of the other. Instead of avoiding the contract, the parties agreed to substitute the original time and Delivery Schedule and this was binding on both parties.

18. In the rejoinder to the above reply, it was reiterated by HTL that Clauses 15 and 16 were penal in nature and therefore null and void. It was contended that the letter dated 6th May, 1995 was "wholly immaterial, unenforceable and does not give any right to the Respondent to levy liquidated damages. The LD is not a reduction of the price." It was stated that the supplies were delayed due to circumstances beyond the control of HTL and which were created "by the Department or other force majeure conditions." It was denied that no installation work had suffered because of the late delivery of the goods.

19. Interestingly, in the written submissions before the AT in para 9, MTNL stated as under:

"9. In the present case, the parties to the contract are fully aware of the nature of the business involved and they agreed not only at the time of entering into the contract but at the time of extension of the period of supply that the named sum as liquidated damage was reasonable. It might not have been stated in so many words; but the fact that extension was agreed to on payment of liquidated damages and later on by the letter of 5th May it was reaffirmed that the claimant was ready to make such payment, clearly indicated that the liquidated damages in the present case was a genuine pre-estimate."

20. It was further contended that if HTL had pleaded that the amount stipulated

as LD was far in excess of what could be termed as a genuine pre- estimate, "MTNL would have adduced necessary evidence. However, in the absence of such a pleading, all that MTNL had to do was to deny the averments and assertions of the claimant, which it did." It is further stated in para 11 that the LD charges were only "nominal compared to the volume of the trade involved." In para 8 it was stated that "MTNL being a huge public corporation, purchases material required for providing telecommunication from several sources. The delay caused by one of the suppliers by itself cannot be pleaded and proved. The present case, therefore, falls within that class where the Court may not be able to assess the compensation on account of breach of contract to supply some material. Therefore, the sum named by the parties, if it be regarded as a genuine pre-estimate may be taken into consideration as the measure of reasonable compensation. However, if the sum named is in the nature of penalty, it cannot be awarded."

21. In the first place, this Court is called upon to examine if the AT's interpretation of clause 16.2 of the contract, which provides for levy of LD, is erroneous as to warrant the Court's interference.

22. This discussion has to be prefaced with a statement of the settled legal position as explained by the Supreme Court in *NHAI v. ITD Cementation* (2015) 14 SCC 21 as under:

"25. It is thus well settled that construction of the terms of a Contract is primarily for an arbitrator to decide. He is entitled to take the view which he holds to be the correct one after considering the material before him and after interpreting the provisions of the Contract. The court while considering challenge to an arbitral award does not sit in appeal over the findings and decisions unless the arbitrator construes the Contract in such a way that no fair minded or reasonable person could do." (emphasis supplied)

23. Clause 16.2 is in two parts. The first part of clause 16.2 envisages the following:

- i. The tenderer should fail to deliver the stores within the period prescribed for delivery;
- ii. In such event, MTNL would be entitled to recover 1/2% of the value of the delayed supply for each week of delay or part thereof, subject to maximum of 10% of the value of the delayed supply;
- iii. The recovery under (ii) above would further be subject to the condition that the delayed portion of the supply does not in any way hamper the commissioning of the system.

24. The second portion of Clause 16.2 envisages the following:

- i. There is a failure of the tenderer to deliver the stores within the time prescribed;

ii. The delayed portion of the supply hampers the installation and commissioning of the system.

iii. In the event of the (ii) above, LD (not as penalty) shall be levied on the total value of the contract (as opposed to the value of only the delayed supply as provided in the first part of Clause 16.2).

25. At the outset, it requires to be noticed that it is not shown or even pleaded by MTNL in the present case that the delayed supply has hampered the installation, commissioning of any particular system. MTNL is, in fact, conscious of this and has chosen not to invoke the latter part of Clause 16.2 by levying 1/2% on the total value of the contract.

26. A perusal of the impugned Award of the AT shows that the AT has proceeded as if the latter part of Clause 16.2 applied and not the earlier part. This appears to be a fundamental error in the approach of the AT. What MTNL was advancing as an argument before the AT, as is evident from its written submissions, is that the first part of Clause 16.2 contains a genuine pre-estimate of damages which was agreed to be paid by the defaulter.

27. The law in this regard is stands fully explained in ONGC v. Saw Pipes Limited (supra) as under:

"64. It is apparent from the aforesaid reasoning recorded by the Arbitral Tribunal that it failed to consider Sections 73 and 74 of the Indian Contract Act and the ratio laid down in Fateh Chand case wherein it is specifically held that jurisdiction of the court to award compensation in case of breach of contract is unqualified except as to the maximum stipulated; and compensation has to be reasonable. Under Section 73, when a contract has been broken, the party who suffers by such breach is entitled to receive compensation for any loss caused to him which the parties knew when they made the contract to be likely to result from the breach of it. This section is to be read with Section 74, which deals with penalty stipulated in the contract, inter alia (relevant for the present case) provides that 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, the party complaining of breach is entitled, whether or not actual 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. Section 74 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. Therefore, the emphasis is on reasonable compensation. If the compensation named in the contract is by way of penalty, consideration would be different and the party is only entitled to reasonable compensation for the loss suffered. But if the compensation named in the contract for such breach is genuine pre- estimate of loss which the parties knew when they made the contract to be likely to result from the breach of it, there is no question of proving such loss or such party is not required to lead evidence

to prove actual loss suffered by him. Burden is on the other party to lead evidence for proving that no loss is likely to occur by such breach. Take for illustration: if the parties have agreed to purchase cotton bales and the same were only to be kept as a stock-in-trade. Such bales are not delivered on the due date and thereafter the bales are delivered beyond the stipulated time, hence there is breach of the contract. The question which would arise for consideration is --

whether by such breach the party has suffered any loss. If the price of cotton bales fluctuated during that time, loss or gain could easily be proved. But if cotton bales are to be purchased for manufacturing yarn, consideration would be different.

...

67. Take for illustration construction of a road or a bridge. If there is delay in completing the construction of road or bridge within the stipulated time, then it would be difficult to prove how much loss is suffered by the society/State. Similarly, in the present case, delay took place in deployment of rigs and on that basis actual production of gas from platform B-121 had to be changed. It is undoubtedly true that the witness has stated that redeployment plan was made keeping in mind several constraints including shortage of casing pipes. The Arbitral Tribunal, therefore, took into consideration the aforesaid statement volunteered by the witness that shortage of casing pipes was only one of the several reasons and not the only reason which led to change in deployment of plan or redeployment of rigs Trident II platform B- 121. In our view, in such a contract, it would be difficult to prove exact loss or damage which the parties suffer because of the breach thereof. In such a situation, if the parties have pre-estimated such loss after clear understanding, it would be totally unjustified to arrive at the conclusion that the party who has committed breach of the contract is not liable to pay compensation. It would be against the specific provisions of Sections 73 and 74 of the Indian Contract Act. There was nothing on record that compensation contemplated by the parties was in any way unreasonable. It has been specifically mentioned that it was an agreed genuine pre-estimate of damages duly agreed by the parties. It was also mentioned that the liquidated damages are not by way of penalty. It was also provided in the contract that such damages are to be recovered by the purchaser from the bills for payment of the cost of material submitted by the contractor. No evidence is led by the claimant to establish that the stipulated condition was by way of penalty or the compensation contemplated was, in any way, unreasonable. There was no reason for the Tribunal not to rely upon the clear and unambiguous terms of agreement stipulating pre-estimate damages because of delay in supply of goods. Further, while extending the time for delivery of the goods, the respondent was informed that it would be required to pay stipulated damages.

68. 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 provided 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 consequence of the breach of a contract.

(4) In some contracts, 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, the court can award the same if it is genuine pre-estimate by the parties as the measure of reasonable compensation."

28. The law has been reiterated in *Kailash Nath Associates v. Delhi Development Authority* (2015) 4 SCC 136 in the following passage: "43. On a conspectus of the above authorities, the law on compensation for breach of contract under Section 74 can be stated to be as follows:

1. Where a sum is named in a contract as a liquidated amount payable by way of damages, the party complaining of a breach can receive as reasonable compensation such liquidated amount only if it is a genuine pre-estimate of damages fixed by both parties and found to be such by the Court. In other cases, where a sum is named in a contract as a liquidated amount payable by way of damages, only reasonable compensation can be awarded not exceeding the amount so stated. Similarly, in cases where the amount fixed is in the nature of penalty, only reasonable compensation can be awarded not exceeding the penalty so stated. In both cases, the liquidated amount or penalty is the upper limit beyond which the Court cannot grant reasonable compensation.

2. Reasonable compensation will be fixed on well known principles that are applicable to the law of contract, which are to be found inter alia in Section 73 of the Contract Act.

3. Since Section 74 awards reasonable compensation for damage or loss caused by a breach of contract, damage or loss caused is a sine qua non for the applicability of the Section.

4. The Section applies whether a person is a Plaintiff or a Defendant in a suit.

5. The sum spoken of may already be paid or be payable in future.

6. 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.

7. 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."

29. Mr. Raman Kapur, learned Senior Counsel appearing for MTNL, sought to place considerable reliance on the decision dated 15th April, 2014 of the DB in FAO (OS) No.441/2010 titled Haryana Telecom Ltd. v. Bharat Sanchar Nigam Ltd. where while interpreting the same Clause 16.2 and upholding the order of the learned Single Judge, the DB observed as under:

"5. The fault found by the learned Single Judge is two-fold. The first is that the case belongs to a genre of cases where actual loss or damages is impossible to be proved and for which the learned Single Judge has referred to the law declared in the opinion reported as (2003) 5 SCC 705 ONGC vs. Saw Pipes Ltd. The second is to the reasoning that since the loss was not reflected in the account books the evidence concerning loss had to be overlooked is a perverse finding.

6. We agree with the view taken by the learned Single Judge. Just as in cases such as award to construct a bridge by a Government department which would be used by public, if contractor defaults on the time schedule, it would be impossible for the Government to prove loss but would warrant damages to be levied because public at large would suffer due to belated construction of the bridge and capital incurred would remain blocked. In a case where cables are not supplied within time to BSNL thereby delaying laying of the network and hence delaying making available telecommunication services to the public, damages would have to be paid on the same principle as applicable to a bridge.

7. Besides, in the instant case there is evidence of loss of revenue in the form of telecommunication services being delayed and revenue to be earned not being earned for the period of delay. The reasoning of the learned Arbitrator that this loss not being reflected in the books of accounts has to be ignored has rightly been held to be a perverse reasoning by the learned Single Judge. We would only add that a loss may be of two kinds. The first is when the buyer has to pay more money to purchase the same goods. This loss would be reflected in the books of accounts in the form of higher capital spent. The second kind of loss would be income not earned from carrying on business, which will never be reflected in the books of account.

8. The appeals are dismissed but without any order as to costs."

30. Indeed, even in the present case, it is not possible for the Court to agree

with the submission on behalf of HTL that MTNL was required to prove the actual loss suffered by it. The purpose of the first part of Clause 16.2 is to provide for a genuine pre-estimate of damages payable as LD even without the requirement of having to prove the actual loss. Section 74 of the ICA emphasises that in case of a breach of contract the party complaining the breach is entitled to reasonable compensation whether or not actual loss is proved to have been caused.

31. In the present case, the AT proceeded on the erroneous basis that the first part of Clause 16.2 required proof of actual loss. In fact, the first part of the said clause applied only where "the delayed portion of the supply does not in any way hamper the commissioning of the system." If it did, then the second part of Clause 16.2 applies. The very interpretation of Clause 16.2 and of Section 74 of the ICA by the AT was, therefore, flawed.

32. Specifically, the AT has overlooked the legal position as explained in *ONGC v. Saw Pipes Limited* (supra) and, in particular, its observation that "in some contracts, 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, the court can award the same if it is genuine pre-estimate by the parties as the measure of reasonable compensation." The conclusions of the AT that: "Forfeiture of part of price is out of all proportion to the damage" and that "It is unconscionable for the purchaser to retain and withhold part of the price" is not on the basis of analysis of the pleadings or the evidence. Specifically, the plea of MTNL in para 8 of its reply that it purchases materials from several sources and "the delay caused by one of the suppliers by itself cannot be pleaded and proved" and, therefore, the present case "falls within that class where the Court may not be able to assess the compensation on account of breach of contract to supply some material" was not even discussed by the AT. The purport of HTL's letter No. Nil dated 6th May, 1995 to MTNL stating that it was ready to "accept the price and L/d as acceptable to MTNL" was also not examined.

33. The interpretation of Clause 16.2 by the AT is such that no fair minded or reasonable person would adopt in the facts and circumstances of the case. The impugned Award is also contrary to the settled legal position as regards Section 74 of the ICA.

34. Consequently, the impugned Award dated 12th March, 2003 is set aside on the ground that it is contrary to the provisions of the contract, the ICA and also opposed to the fundamental policy of Indian law as explained in the aforementioned decisions of the Supreme Court.

35. The result is that MTNL is not liable to return the sum claimed from it by HTL. The petition is allowed in the above terms but in the circumstances, with no orders as to costs.