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**(2001) 04 DEL CK 0132**

**In the Delhi High Court**

**Case No : IA. 3867/91 and Suit No. 546-A of 1991**

The Oriental Insurance Co. Ltd.

APPELLANT

Vs

Shri V.D. Jhunjunwala

RESPONDENT

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**Date of Decision : 23-04-2001**

**Acts Referred:**

Arbitration Act, 1940 — Section 20  
Contract Act, 1872 — Section 2, 65

**Citation :** (2001) 5 AD 100 : (2001) 91 DLT 496 : (2002) 1 RAJ 364

**Hon'ble Judges :** A.K. Sikri, J

**Bench :** Single Bench

**Advocate :** Mr. S.C. Sharda, for the Appellant; Mr. M.K. Vashisht, for the Respondent

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## **Judgement**

A.K. Sikri, J.—M/s. Oriental Fire and General Insurance Co.Ltd the petitioner in this petition is the successor in interest of M/s.Bharat General Reinsurance Ltd. who had filed the petition u/s 20 of the Arbitration Act, 1940 for appointment of Arbitrator and for reference of dispute to the Arbitrator for adjudication. In the said petition, petitioner had averred that Agreement dated 4.6.1968 was entered into between the petitioner and the respondent as per which respondent agreed to purchase 25000 shares of a company named M/s: Razabuland Sugar Co.Ltd. at the rate of Rs.10/-per share. It was further agreed that the entire sale consideration of Rs.2,50,000/- would be paid by the respondent to the petitioner company in four yearly Installments of Rs.62,500/- each. The Respondent paid two Installments but failed to pay remaining two Installments which were payable at the end of May, 1971 and May, 1972 respectively. Instead respondent had only made a part payment of Rs.35,000/- against the Installment of May, 1971 and no payment was made in respect of 4th Installment. The petitioner accordingly demanded the dues from the respondent and as the same were not paid, petition u/s 20 for appointment of an Arbitrator was filed. Respondent in its reply submitted that Agreement in question stood cancelled and/or determined and was not operative or binding on the parties and, Therefore, there being no

valid, legal or subsisting agreement, the petition u/s 20 was also not maintainable. By order dated 28.3.1979 this Court disposed of the petition by appointing Shri S.N. Andley, Ex.Chief Justice of this Court as the sole Arbitrator and referring the disputes contained in the petition as well as in the reply of the respondent for adjudication. This order was passed on the statement of learned counsel for the parties admitting the existence of agreement. Relevant portion to this effect, which has bearing on the present case reads as under:

"The respondent admitted the agreement but pleaded that the agreement was entered into on an understanding that the respondent would be entitled to the management of the Sugar Factory of M/s.Razabuland Sugar Company Ltd., but in the meanwhile the said sugar factory has been taken over by an ordinance promulgated by U.P. Government. The existence of the original agreement containing the arbitration clause, was admitted but it was pleaded that the agreement along with the arbitration clause, has since ceased to exist in view of the ordinance.

The matter was posted for today for being mentioned and the learned counsel for the parties have made their statement whereby the parties have admitted the existence of arbitration agreement and have stated that the disputes arising out of the petition and the reply filed by the respondent may be referred to the sole arbitration of Mr. S.N. Andley, Ex.Chief Justice, Delhi High Court".

2. The learned Arbitrator gave and published the Award allowing the claim of the petitioner. Objections against the said Award were filed by the respondent. In these objections, by consent of the parties order dated 12.5.1989 was passed setting aside the said Award and referring the disputes to Shri Jagdish Chandra, a retired Judge of this Court in terms of order dated 28.3.1979 passed in Suit No.525-A/75. After adjudication the learned Arbitrator has given his Award dated 22.1.1991. By means of IA.3867/91 the petitioner has filed objections to this Award.

3. In the impugned Award the learned Arbitrator has held that Agreement dated 4.6.1968 in question which was entered into between the parties is illegal and void being in contravention of the provisions of Securities Contracts (Regulation) Act, 1956. The petitioner had raised the plea of res judicata submitting that this question could not be determined by the learned Arbitrator as respondent had admitted the existence of arbitration agreement between the parties. However, this plea of the petitioner was rejected by the learned Arbitrator on the ground that question of agreement being in contravention of statute was a pure question of law going to the root of the case and thus it could be raised by the respondent even though not specifically raised in his reply to petition u/s 20 filed by the petitioner. While declaring agreement to be void being violative of the statute, the learned Arbitrator has given his Award holding that petitioner is not entitled to any amount whatsoever from the respondent and on the other hand respondent is entitled to a sum of Rs.4,52,213/- subject to respondent's re-transfer back of the shares sold by the claimant to the respondent as per the

Company Law on the subject. This amount in favor of the respondent is awarded on the ground that the petitioner received this amount from the respondent in a void agreement and Therefore, respondent is entitled to restitution of the money paid under the provisions of Section 65 of the Contract Act.

4. Learned counsel for the petitioner Mr. S.C. Sharda, Advocate formulated his objections as under:

1. The Arbitrator exceeded his jurisdiction in giving the findings on the validity of the agreement inasmuch as this question was not referred to the Arbitrator at all. According to the learned counsel what was referred to was the disputes raised in the petition and in the reply thereto filed by the respondent. Therefore, the Arbitrator was supposed to confine himself to the reference made as per order dated 28.3.1979.

The question of Agreement dated 4.6.1968 could not be decided by the Arbitrator. It was submitted that Arbitration Clause was an integral part of the Agreement and once the contract goes the Arbitration Clause also perishes with that. Therefore, such a question could not have been decided by the Arbitrator and could be decided only by the Court in proceedings u/s 33 of the Arbitration Act.

2. In any case, it was submitted, the Arbitrator exceeded its jurisdiction in directing the payment of Rs.4,52,213/- to be made to the respondent inasmuch as respondent had not preferred any such claim in his reply to the petition u/s 20 and, Therefore, in the absence of such claim having been referred to the Arbitrator, he was not within his jurisdiction to decide this aspect. Alternatively, it was submitted that the provisions of Section 65 of the Contract Act were not applicable and the claim was wrongly awarded contrary to the provisions of law and it amounted to legal misconduct on the part of the learned Arbitrator.

5. In support of his submissions, learned counsel for the petitioner relied upon the following judgments:

1. Khardah Company Ltd. Vs. Raymon & Co. (India) Private Ltd.
2. Waverly Jute Mills Co. Ltd. Vs. Raymon and Co. (India) Private Ltd.,
3. Fertilizer Corporation of India Ltd. Vs. Rasananda Pradhan,
4. U.P.Rajkiya Nirman Nigam Ltd. Vs. Indure Private Ltd. & Ors. 1992 3 Del Law 298
5. Gaya Electric Supply Co. Ltd. Vs. The State of Bihar,
6. K.V. George Vs. Secretary to Government, Water and Power Department, Trivandrum and Another,
6. I shall deal with the aforesaid contentions seriatim
7. No.1. Insofar as the question of deciding the validity of Agreement dated

4.6.1968 is concerned, I do not think the Arbitrator exceeded his jurisdiction in deciding this question. It may be stated that the petitioner had filed the petition raising the dispute of non-payment of the dues by the respondent under this Agreement. In reply specific plea of the respondent was that the contract was invalid and stood terminated and, Therefore, the respondent was not under obligation to pay any amount. No doubt such a plea was not raised on the basis of provisions of Securities Contracts (Regulation) Act, 1956. The fact remains that plea was raised by the respondent challenging the validity of the Agreement in question. The relevant portion of the order dated 28.3.1979 as reproduced above specifically points out the plea of the respondent to this aspect. Further the operative part of the order dated 26.3.1979 while referring the disputes to the Arbitrator specifically mentions that "the disputes contained in petition and reply of the respondent" were directed to be referred for adjudication. The only plea raised in the reply was regarding the validity of the Agreement and thus this plea was referred for adjudication. Once respondent had challenged the validity of the Agreement and this plea was sought to be supported by the aid of provisions of Securities Contracts (Regulation) Act, 1956, the respondent was could to do so. It is more so when the plea was purely legal in nature.

8. The matter can be looked into even from another angle. The petitioner had to establish its claim and in order to substantiate the same it was required to prove that the money was payable to the petitioner by the respondent in an agreement which was valid and proper. Thus once the dispute regarding validity of the agreement itself was raised, the learned Arbitrator was required to decide this question which went to the root of the matter as learned Arbitrator could not direct any payment to be made to the petitioner by the respondent under an agreement without deciding as to whether the Agreement in question itself was a valid Agreement or not. Therefore, even in deciding the claim of the petitioner, learned Arbitrator was required to decide the validity of the Agreement.

9. In this view of the matter, none of the judgments cited by the petitioner would be applicable.

10. Therefore, I do not find any merit in this objection raised by the petitioner. It is hereby rejected.

11. No.2. Insofar as awarding of the claim in favor of the respondent is concerned, there is a force in the submission made by the petitioner. The respondent in his reply to the petitioner u/s 20 of the Arbitration Act had only challenged the validity of the Agreement. The respondent did not prefer any claim for restitution of the money paid under the said contract. It is now a well settled proposition in law that the Arbitrator derives his jurisdiction from the order of reference and once the disputes are referred to the Arbitrator by the Court in a petition filed u/s 20 of the Arbitration Act the jurisdiction of the Arbitrator is limited to the extent of reference made by such an order passed in petition u/s 20 of the Arbitration Act. The Supreme Court held to this effect way back in the

year 1977 in the case of Orissa Mining Corporation Ltd. Vs. Prannath Vishwanath Rawlley, . The following pertinent observations made in paras 10 and 11 which read as under:

"Para 10: On a reading of the plaint, we are satisfied that the claim for transporting the iron ore for the extra distance is limited to Rs.68,582 and the whole claim after including the claim for construction of the road is confined only to Rs.93,582. The arbitrator having disallowed Rs.25,000 being the claim for construction of the road should have confined his award only to Rs.68,582. The claim of additional Rs.68,582 before the arbitrator was clearly beyond the order of reference which incorporated the reliefs prayed for in the plaint by the respondent herein. It would have been different if the entire claim relating to the transport of the iron ore for the extra distance was made without specifying the amount of claim. When the amount has been specified in the plaint and when the reference is confined to the claim made in the plaint the arbitrator would have to restrict his award only to the claim. We are satisfied that in this case the arbitrator has exceeded his jurisdiction in embarking on the claim that was for the first time put forward before him by the respondent. There is Therefore an error apparent on the face of the award.

Para 11: Section 20(1) of the Arbitration Act, 10 of 1940, provides that where a difference has arisen and where any persons have entered into an arbitration agreement they may apply to the court having jurisdiction in the matter to which the agreement relates, that the agreement be filed in court. Sub-section (4) to S.20 provides that the court shall order the agreement to be filed, and shall make an order of reference to the arbitrator appointed by the parties. When an agreement is filed in court and order of reference is made then the claim as a result of the order of reference is limited to a particular relief and the arbitrator cannot enlarge the scope of the reference and entertain fresh claims without a further order of reference from the court. On a construction of S.20 of the Arbitration Act the plea on behalf of the appellant will have to be accepted. In the circumstances of the case we do not think that the award should be set aside as the learned counsel for the appellant has also no objection in accepting the award in so far as it relates to Rs. 68,582 and interest at the rate of 6 per cent per annum from the date of the award be confirmed. Regarding the direction as to return of security deposits and earnest money, as it is not the case of the appellant that the respondent is not entitled to the amount, we do not feel called upon to interfere with the order directing the appellant to pay the amount to the respondent with interest at 6% per annum from the date of the award i.e. May 31, 1974. The parties will bear their own costs."

12. This principle of law remains valid till date and is followed by this Court in number of cases some of which are as under:

1. M/s.Kochhar Construction Co. Vs. Union of India & Another 1987 Arb. LR 109
2. Punjab Dairy Development Corpn. Vs. Multisack Corporation 1991 RLR 363

3. Natwar Lal Shamal Das and Co. Vs. Minerals and Metals Trading Corporation of India,

13. There is yet another aspect which cannot be ignored. While awarding this amount the learned Arbitrator has referred to the provisions of Section 65 of the Contract Act. The provisions of Section 65 are clearly misapplied as the language of this Section would clearly demonstrate. Section 65 reads as under:

"Section-65. Obligation of person who has received advantage under void agreement, or contract that becomes void.- When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it".

14. The provisions are, Therefore, applicable only it after the entering into the agreement it is discovered that the Agreement was void or it becomes void subsequent to the entering into the Agreement. It does not apply to the situation where at the time of entering into agreement itself the parties were aware or could be aware of the fact that agreement was opposed to a particular provision of law. In Dhanna Munda and Another Vs. Mt. Kosila Banian, Patna High Court while interpreting Section 65 of the Contract Act held as under:

"The next point is with regard to the consideration for the sale. The defendants claim that they are entitled to recover the five hundred rupees which they paid to the plaintiff for the transfer. They base their claim on S.65, Contract Act. That section provides:

When an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage under such agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he received it.

If this section means what has been contended for on behalf of the defendants-appellants, it is clear that the door will be left wide open for evading the provisions of statutes like the Chota Nagpur Tenancy Act which have been enacted to prevent or restrict transfers of raiyati land. The scope of S.65 has been explained in 43 Cal 115 (At page 122) where it was said:

The case before us is however not that of an agreement "discovered" to be or "becoming" void. The agreement is void on the face of it and it was void ab initio, while the words of the section can only be aptly applied in such cases as that of an agreement which is subsequently found to be void on account of some latent defect or of circumstances unknown at the date of the agreement or of an agreement which is afterwards made void by circumstances which supervene.

In this view of the law the Section cannot be held to apply to a case of a contract void as being contrary to the statute law which the parties must be presumed to have known at the time when they entered into the contract. In 15 C W N 408 it was held that the section has no application when the object of the agreement is

illegal to the knowledge of both parties at the time when it was made".

15. The authoritative pronouncement of the Apex Court came in the case of *Kuju Collieries Ltd. Vs. Jharkhand Mines Ltd. and Others*, holding as under:

"The Section makes a distinction between an agreement and a contract. According to Section 2 of the Contract Act an agreement which is enforceable by law is a contract and an agreement which is not enforceable by law is said to be void. Therefore, when the earlier part of the section speaks of an agreement being discovered to be void it means that the agreement is not enforceable and it, Therefore, not a contract. It means that it was void. It may be that the parties or one of the parties to the agreement may not have, when they entered into the agreement, known that the agreement was in law not enforceable. They might have come to know later that the agreement was not enforceable. The second part of the section refers to a contract becoming void. That refers to a case where an agreement which was originally enforceable and was, Therefore, a contract, becomes void due to subsequent happenings. In both these cases any person who has received any advantage under such agreement or contract is bound to restore such advantage, or to make compensation for it to the person from whom he received it. But where even at the time when the agreement is entered into both the parties knew that it was not lawful and Therefore void there was no contract but only an agreement and it is not a case where it is discovered to be void subsequently. Nor is it a case of the contract becoming void due to subsequent happenings. Therefore, Section 65 of the Contract Act did not apply".

16. This part of the Award is, Therefore, liable to be set-aside.

17. The objections of the petitioner are accordingly allowed partly. While holding that the petitioner is not entitled to any amount whatsoever from the respondent as the Agreement in question itself was contrary to the law on the basis of which petitioner had made its claim, the Respondent is also not entitled to any amount from the petitioner.

18. The impugned award is modified and modified award would read as under:

"Petitioner is not entitled to any amount whatsoever from the respondent as the Agreement in question itself was contrary to the law on the basis of which petitioner had made its claim. Respondent is also not entitled to any amount from the petitioner. Costs are left to be borne by the parties".

19. Judgment is pronounced in terms of modified award which is made a rule of the Court. Decree be prepared accordingly.

20. Application and suit stand disposed of.