
(2006) 05 DEL CK 0091
In the Delhi High Court
Case No : OMP No. 66 of 2001

Titanium Tantalum Products Ltd.

APPELLANT

Vs

Shriram Alkali and Chemicals

RESPONDENT

Date of Decision : 11-05-2006

Acts Referred:

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

Citation : (2006) 2 ARBLR 366

Hon'ble Judges : Sanjay Kishan Kaul, J

Bench : Single Bench

Advocate : Sudhir Chandra and M. Chinnaswamy, for the Appellant; D.K. Malhotra and Rajesh Malhotra, for the Respondent

Final Decision : Allowed

Judgement

Sanjay Kishan Kaul, J.—The respondent placed an order dated 04.11.1997 on the petitioner for designing, fabrication & supply of one CS Rubber Lined Single Stage Blower. This blower was to be used for recycling of chlorine, which was a by-product of the manufacturing processes of the respondent. The agreed price was Rs. 4,66,348/- and the payment had to be made as per the terms and conditions agreed upon.

2. The blower was supplied, though belatedly, and according to the respondent it failed to perform satisfactorily and was not as per the specifications. This resulted in disputes between the parties and the matter was referred to arbitration through the Federation of Indian Chambers of Commerce and Industry. Justice M.K. Chawla (Retd.) was appointed as the Sole Arbitrator, who entered upon reference and made and published the Award dated 29.12.2000. The petitioner aggrieved by the same has filed the present objections u/s 34 of the Arbitration and Conciliation Act, 1996 (hereinafter to be referred to as, "the said Act").

3. The Arbitrator has found that the blower supplied by the petitioner was

defective and, thus, the respondent was liable to be refunded the cost paid to the petitioner. Apart from this aspect, the claim of the respondent for losses suffered as a consequence of the non-supply of the blower was also granted. The following amounts were held liable to be paid by the petitioner.

1. Rs. 4,66,348.00 paid in advance to the respondent towards the cost of the blower.

2. Rs. 38,38,009.38 towards the financial loss suffered by the claimant for the non-supply of the C.S. Rubber Lined Single Stage Blower as per the Purchase Order dated 04.11.1997 (for the period from April, 1998 to May, 1999 - as Annexure - G filed with the Rejoinder).

3. Rs. 25,000/- towards the expenses incurred by the claimant in sending their officers to the factory / office of the respondent and making phone-calls, fax, etc.

4. The Arbitrator also awarded interest @ 18% p.a. on the aforesaid amounts and cost of the arbitration proceedings fixed at Rs. 25,000/-.

5. Learned senior counsel for the petitioner, conscious of the limitation of scrutiny of this Court in exercise of jurisdiction under Sub-section (2) of Section 34 of the said Act, confined the submissions to the question of damages awarded as also the rate of interest. This is so since the findings arrived at by the Arbitrator of the blower supplied by the petitioner not being as per specifications and not fulfilling the requirement of the respondent is based on the appreciation of the terms and conditions agreed to between the parties and the evidence placed on record.

6. Learned senior counsel contended that in order to determine the loss or damage, which could be awarded, the terms and conditions of the purchase order were relevant. The relevant clause in this behalf is Clause 6.0, which is as under:

6.0 PENALTY / BONUS

In the event of delay in supply of above Blower than the delivery schedule as stipulated in Clause 1.0 above, penalty @ 1/2% (half per cent) per week of delay subject to maximum of 5% or order value is applicable Penalty for period less than one week shall be calculated on pro rata basis. The date of Transporter's LR shall be considered as date of delivery for applicability of penalty clause. A grace period of 15 days shall be allowed for computation of penalty amount, beyond the delayed period.

7. Learned senior counsel contended that in the event of delay in supply, penalty has been provided for subject to maximum of 5% of the order value. It was, thus, submitted that if the petitioner had failed to supply the blower, at best, this penalty of 5% could have been imposed. Learned senior counsel further submitted that the damages have to be computed in terms of the principles laid down in Sections 73 and 74 of the Indian Contract Act, 1872 (hereinafter to the

referred to as, "the Contract Act"), which read as under:

73. Compensation for loss or damage caused by breach of contract. ?- When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

... ..

74. Compensation for breach of contract where penalty stipulated for. A -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, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or 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 or, as the case may be, the penalty stipulated for.

... ..

8. Learned senior counsel, thus, contended that the compensation for any loss or damage has to be "which naturally arose in the usual course of things from such breach" or "which the parties knew, when they made the contract, to be likely to result from the breach of it". Section 73 of the Contract Act further provides that compensation is not to be given for any remote or any indirect loss or damage sustained by reason of the breach

9. h. Section 74 of the Contract Act provides that if an amount has been stated in the contract payable in case of breach and the same is a reasonable pre-estimate of damages, then the same is liable to be paid without proving the damages. However, if the same is in the nature of penalty, then the amount has to be proved. Learned senior counsel contended by reference to Clause 6.0 aforesaid that the amount stipulated is stated to be by way of penalty and even if it be assumed that the full amount is payable, damages cannot exceed 5%.

10. Learned senior counsel in this behalf has referred to a judgment of the Division Bench of Kerala High Court in State of Kerala Vs. K. Bhaskaran, , wherein it was observed in paras 11 and 12 as under:

11. Alderson B delivering the judgment of the court of Exchequer in Hadley v. Baxendale stated as follows:

Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may be fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach

of contract itself, or such as may be reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.

It is now well settled that Section 73 of the Contract Act reflects in full the principles in *Hadley v. Baxendale*. Section 73 reads thus:

Compensation for loss or damage caused by breach of contract:

When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage used to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.

Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

12. So the question that has to be decided by the court is whether the 10% profit claimed by the plaintiff as a loss of gain prevented can fairly and reasonably be considered as a loss "arising naturally", i.e., according to the usual course of things. We think Section 73 of the Indian Contract Act allows as damages, the loss of reasonable profits arising from a breach of contract. The rule that is applicable can be summarised as follows:

The defendant is liable only for "natural and proximate consequences of a breach or those consequences which were in the contract". The above quoted phrases are words of art and usually represent two ways of expressing a single requirement. Proximate and natural consequences are those that flow directly or closely from the breach in the usual and normal course of events - those which a "reasonable man" or a person of ordinary prudence would when the bargain is made foresee, as expectable results of later breach. The phrase "in the parties' contemplation" normally means in the reasonable contemplation of the defendant. Thus understood, it has got only the same meaning as the companion phrase "natural and proximate". Brevity and clarity are better served by abandoning these traditional phrases of legal art and using instead that gist of their meaning. We propose the following statement of the rule. The defendant is liable only for reasonably foreseeable losses - those that a normally prudent person, standing in his place possessing his information when contracting would have had reason to foresee as probable consequences of future breach.

11. Learned counsel for the respondent on the other hand, contended that Section 55 of the Contract Act would come into play, which reads as under:

55. Effect of failure to perform at a fixed time, in contract in which time is essential. ?- When a party to a contract promises to do a certain thing at or before a specified time, or certain things at or before a specified time, and fails to do such thing at or before a specified time, the contract, or so much of it as has not been performed, becomes voidable at the option of the promisee, if the

intention of the parties was that time should be of essence of the contract.

Effect of such failure when time is not essential. ?- If it was not the intention of the parties that time should be of the essence of the contract, the contract does not become voidable by the failure to do such thing at or before the specified time; but the promises entitled to compensation from the promisor for any loss occasioned to him by such failure.

Effect of acceptance of performance at time other than agreed upon. ? If, in case of a contract voidable on account of the promisor's failure to perform his promise at the time agreed, the promise accepts performance of such promise at any time other than agreed, the promise cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed, unless, at the time of acceptance, he gives notice to the promisor of his intention to do so.

12. Learned counsel, thus, contended that the respondent is entitled to compensation from the petitioner for any loss occasioned by failure to supply the blower as per specifications. Learned counsel further contended that the Arbitrator has considered all these aspects and has come to a finding which ought not to be interfered with in exercise of jurisdiction u/s 34 of the said Act.

13. The scope of scrutiny by the Court u/s 34 of the said Act undoubtedly stands expanded in view of the judgment of the Supreme Court in Oil and Natural Gas Corporation Ltd. Vs. SAW Pipes Ltd., . One of the grounds available now in view of the expanded definition of the "Public Policy" is where the award is contrary to statutory provisions and the law of the land. It, thus, cannot be said, in my considered view, that it is open to an Arbitrator to compute damages contrary to the provisions of Sections 73 and 74 of the Contract Act. The question, however, to be examined is whether the said provisions have, in fact, been violated.

14. A reading of the award shows that the relevant issue No. 5 has been examined by the Arbitrator by coming to the conclusion that the blower supplied by the petitioner had failed to perform when tested for the process, it had to carry out and the same was lying unutilized in the factory of the respondent. The respondent was apparently intimating the petitioner from time to time regarding the financial loss being suffered on account of delay in suppl / non-performance of the blower and this is the factor which has been taken into account by the learned Arbitrator. The Arbitrator has come to the conclusion that Clause 6.0 relates to penalty imposed for late delivery of the blower and cannot be attributed in the present case where the blower has failed to perform satisfactorily and all the documents relied upon by the petitioner are in respect of the failure of performance of the blower. The object for which the respondent installed the blower was to save money by way of preventing the loss of chlorine and on account of failure of the same, the respondent had to use a mixture of caustic soda and HYPO. The Arbitrator found that it is difficult to come to any specific methodology to compute this amount other than the prices prevalent of HYPO and caustic soda in the market and the Arbitrator found no reason to

disbelieve the figures given by the respondent.

15. In my considered view, learned Arbitrator fell into an error while considering the question of damages on the assumption that the petitioner knew the consequences of the breach of contract when the complaints were made and the losses suffered by the respondent were informed. The relevant time to be considered in view of the provisions of Section 73 of the Contract Act is when the contract was entered into. It is at this stage that the parties must know as to the result of the breach. The phraseology used is "when they made the contract" and not "after the breach of contract occurred". The petitioner knew the purpose for which the blower was to be put to use, but could never contemplate the consequences of such huge amount of damages of a breach when they entered into the contract.

16. The aforesaid is further borne out from the fact that Clause 6.0 provides the consequences of delay. It is correct that Clause 6.0 refers only to the same, but it cannot be lost sight of that the maximum damages contemplated under Clause 6.0 are 5% of the total contract value. Thus, if the petitioner failed to supply or the supply was not satisfactory, it would be reasonable to presume that the parties would expect the damages to be in the range of 5% of the contract value. In fact, the damages are stated to be by way of penalty and even if the maximum penalty of 5% is taken into consideration, the amount would be much smaller. It is relevant to note that that all that the petitioner has supplied is worth Rs. 4.66 lakhs. The Arbitrator in terms of the Award seeks to impose damages for the same to the tune of Rs. 38.38 lakhs, which could never be reasonably contemplated.

17. The principles of damages are well settled and the damages must bear proximity to the breach. In *Karsandas H. Thacker Vs. The Saran Engineering Co. Ltd.*, while examining 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.

18. In fact, the principles in respect of such breach laid down in the well-known case of *Hadley v. Baxendale* 156 ER 145 find incorporation in Section 73 of the Contract Act. The rule has been succinctly set out by the Division Bench of the Kerala High Court in *State of Kerala v. K. Bhaskaran's case* (supra). Thus, the respondent is only liable for the natural and proximate consequences of breach. The Arbitrator has taken the consequences of what would happen if caustic soda was sold in the market and what profits the respondent would have earned.

19. In my considered view, such astronomical damages for the value of the goods supplied can hardly be said to be reasonable. The test of a normal prudent person, when applied to the present case, cannot give rise to a finding that for the defective supply of a blower of the value of Rs. 4.66 lakhs, the consequences would be the damages of Rs. 38.38 lakhs and that too only for a period from April, 1998 to May, 1999.

20. In working out a reasonable level of damages, I am of the considered view that taking into consideration Clause 6.0 and applying the principles of Sections 73 and 74 of the Contract Act, at best, apart from the refund of the advance paid, 5% amount of the contract value could have been awarded as damages. The result is that the petitioner is entitled to succeed on this account and the award granting special damages of Rs. 38.38 lakhs approximately is set aside holding that the respondent is entitled to only a sum of 5% of the contract value of Rs. 4,66,348/- totalling to Rs. 23,317/-.

21. Insofar as the rate of interest is concerned, the Arbitrator has granted the maximum rate of 18% p.a. The rates of interest have been falling during the relevant period of time and, in my considered view, such high rate of interest would not be justified. If the prevailing rates of interest are applied, I am of the considered view that the interest rate should be reduced to 12% p.a. simple interest instead of 18% p.a.

22. The result is that the Award dated 29.12.2000 made and published by the Sole Arbitrator, Justice M.K. Chawla (Retd.) is sustained insofar as Item Nos. 1 and 3 amounting to Rs. 4,66,348/- and Rs. 25,000/- respectively are concerned. Item No. 2 stands reduced to Rs. 23,317/- and the rate of interest payable is reduced to 12% p.a. There is no interference in the award of cost. However, the petitioner shall be entitled to the return of machinery since, according to the respondent itself, it is not in use and the petitioner has been directed to refund back the full advance receipt of the machinery with interest.

23. The petition is accordingly allowed leaving the parties to bear their own costs.