

(2012) 03 DEL CK 0686
In the Delhi High Court
Case No : O.M.P. 108 of 2009

United Telecoms Limited

APPELLANT

Vs

Mahanagar Telephone Nigam Limited

RESPONDENT

Date of Decision : 13-03-2012

Acts Referred:

Arbitration and Conciliation Act, 1996 — Section 3, 34
Contract Act, 1872 — Section 74

Citation : (2012) 3 AD 306 : (2012) 190 DLT 724

Hon'ble Judges : Dr. S. Muralidhar, J

Bench : Single Bench

Advocate : D.K. Malhotra with Mr. Rajesh Malhotra and Mr. Pawan Behl, for the Appellant; Samir Sagar Vasishta, for the Respondent

Judgement

S. Muralidhar, J.—This petition u/s 34 of the Arbitration and Conciliation Act, 1996 ("Act") by United Telecoms Limited is directed against the Award dated 28th November 2008 passed by the learned Sole Arbitrator in the arbitration proceedings between it and the Respondent Mahanagar Telephone Nigam Limited ("MTNL").

Background facts

2. In response to a tender for procurement of CDMA WLL terminals of 2000-IX Technology for Delhi and Mumbai floated by the MTNL, the Petitioner submitted its bid which was found to be lowest. As a consequence, the MTNL issued a Letter of Intent ("LOI")/Advance Purchase Order ("APO") dated 27th February 2004 in favour of the Petitioner for supply of 50,000 terminals ("handsets"). In terms of Clause 4 of the General (Commercial) Conditions of Contract ["GCC"] applicable to the APO, the Petitioner was required to furnish a performance security to MTNL for an amount equal to 5% of the value of purchase order (PO) within 14 days from the date of issue of APO. Under Clause 4.2 of the GCC, "the proceeds of the performance security shall be payable to the purchaser as compensation for any loss resulting from the supplier's failure to complete its obligations under

the contract." Under Clause 4.3 of the GCC appended to the bid document, the performance bond "shall be in the form of bank guarantee ("BG") issued by a scheduled bank and in the form provided in Section IX of this bid document.

3. Accordingly, the Petitioner furnished MTNL a performance bank guarantee ("PBG") dated 1st March 2004, the relevant portions of which read as under:

We State Bank of Travancore, having our Branch at Residency Road, Bangalore - 560025 (hereinafter referred to as "the Bank") at the request of M/s. United Telecom Limited do hereby undertake to pay to the MTNL an amount not exceeding Rs. 90,07,603/- (Rupees Ninety lakh seven thousand six hundred three only) against any loss or damage caused to or suffered or would be caused to or suffered by the MTNL by reason of any breach by the said contractor of any of the terms or conditions contained in the said agreement.

4. The above amount was calculated at 5% of the total price of the terminals which was Rs. 18,01,52,050/-. Subsequently, the MTNL issued the purchase order ("PO") on 4th March 2004 in favour of the Petitioner. The delivery of the terminals was to start from 4th March 2004 and it was to be completed within two months, i.e., by 4th May 2004.

5. Clause 15 of the GCC which is relevant for the present case reads as under:

15. Delays in the Supplier's performance

15.1. Delivery of the goods and performance of the services shall be made by the supplier in accordance with the time schedule specified by the purchaser in its purchase order. In case supply is not completed in the stipulated delivery period, as indicated in the Purchase Order, purchaser reserves the right either to short close/cancel this purchase order and/or recover liquidated damage charges. The cancellation/short closing of the order shall be at the risk and responsibility of the supplier and purchaser reserves the right to purchase balance unsupplied item at the risk and cost of the defaulting vendors.

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 the performance of the contract, the supplier encounters condition impeding timely delivery of the goods and performance of service, the supplier shall promptly notify to the purchaser in writing the fact of the 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 period for performance of the contract (by not more than 20 weeks) subject to furnishing of additional performance security by the supplier @ 5% of the total value of the purchase order.

15.4. If the supplies are not completed in the extended delivery period, the

purchase order shall be short-closed and both the performance securities shall be forfeited."

6. Under Clause 16.1 GCC, MTNL was entitled to recover liquidated damages ("LD") in the event of failure of the Petitioner to deliver the consignment within the prescribed period. It also fixed the extent of LD under Clause 16.2. Under Clause 18, the MTNL had, without prejudice to any other remedy for breach of contract, the option of terminating the contract in whole or in part by written notice of default to the Petitioner upon the failure of the Petitioner to deliver any or all of the goods within the time specified in the contract.

7. The Petitioner on 29th March 2004 submitted to MTNL its delivery schedule for the supply of 5,000 terminals beginning 22nd April 2004 and ending on 24th July 2004. In response thereto, on 1st April 2004 the MTNL wrote to the Petitioner stating that the said proposed delivery schedule was totally unacceptable to it. MTNL asked the Petitioner to show cause notice why the MTNL should not short-close the PO at the risk and cost of the Petitioner and further forfeit the PBG.

8. Thereafter, negotiations took place between the parties and on 8th April 2004 the Petitioner submitted its revised time schedule to complete the supply by 6th July 2004. On 17th April 2004 the MTNL issued a memorandum accepting the Petitioner's request for extending the delivery schedule. In terms thereof 5,000 handsets (terminals) were to be delivered immediately and 10,000 by 28th April 2004. Supply of the remaining quantity was to be completed in a phased manner between 22nd May 2004 and 6th July 2004 with LD. Para 3 of the letter dated 17th April 2004 read as under:

3. In view of the delivery extension beyond scheduled D.P. in the P.O. M/s. UTL shall submit additional 5% PBG of value Rs. 90,07,603/- valid for one year within 15 days from the date of issue of this Memorandum. It is as per provision in Clause 15.3, Section III of the tender document. Consignee and Paying Authority shall not release any payment till clearance from this office regarding acceptance of this PBG.

9. On 13th April 2004 the first lot of 5,000 terminals was delivered and inspection commenced. On 5th May 2004 the MTNL wrote to the Petitioner stating that in terms of the report from the factory inspection team it was revealed that the first lot of 5,000 terminals had failed the burn-in test thrice. Accordingly, MTNL rejected the first lot and requested the Petitioner to test the handsets itself and offer them again for factory testing. The Petitioner was also requested to submit burn-in tests for next lot of 10,000 handsets "prior to the start of factory inspection". The Petitioner was reminded that it had to submit a further PBG in terms of the letter dated 17th April 2004 for the MTNL granting extension of the delivery period. The said letter further stated that if the Petitioner failed to comply, MTNL would initiate action to terminate the contract.

10. The Petitioner by its letter dated 11th May 2004 assured MTNL that it would supply the terminals within the extended delivery period and that the supply of

10,000 handsets was expected to be completed in the second week of May 2004.

11. Upon failure by the Petitioner to commence the supply within the extended time in terms of the letter dated 17th April 2004, MTNL on 24th May 2004 short-closed the PO and forfeited the first PBG submitted by the Petitioner. The operative portion of the letter reads as under:

Since the firm has failed to adhere to original delivery schedule and extended delivery schedule of first lots, therefore, it has been decided to:

(i) Short-close the subject P.O. and forfeit the PBG submitted initially with the P.O.;

(ii) impose a penalty of 5% of P.O. value with reference to additional PBG asked for by this office in accordance with Clause No. 15.3 and 15.4 Section III of the subject tender;

(iii) To bar your firm from participating in the MTNL tender floated for 10000 terminals on May 8, 2004 and schedule to open on 31st May 2004.

Kindly deposit payment equivalent of 5% additional PBG for Rs. 90,07,603/- within 15 days of issue of this letter failing which MTNL reserves its right to recover the same from any of pending dues.

Arbitral proceedings

12. Thereafter MTNL invoked the arbitration clause and referred the disputes to the arbitration of the learned Sole Arbitrator. MTNL filed its statement of claim before the learned Arbitrator on 24th February 2005. Paras 37 to 39 of the statement of claim and the prayer clause read as under:

37. Being aggrieved by the totally unreasonable, illegal and unjustified refusal on the part of the Respondent to pay to the Claimant the amount of Rs. 90,07,603/-, being the amount under the additional performance bank guarantee as per Clause 15.3 and 15.4 Section 3 of the tender document to which the Claimant is legally entitled to, the Claimant has preferred the instant claim before the Hon"ble Arbitrator.

38. The claimant is entitled to receive the following amounts from the Respondent to which it is legally entitled to under and in terms of the contract between the parties:

A. Rs.90,07,603/-

Being the amount due under the additional at the rate of 5% of the total value in view of the extension given to the Respondent on 17th April 2004.

B. Rs.8,21,027/-

Interest @ 18% w.e.f. 24th May 2004 till the filing of the claim petition.

Total

Rs. 98,28,630.00

39. The Claimant is also entitled to the pendente lite and future interest @ 18% per annum on the sum found due and payable by the Respondent to the Claimant.

PrayerIt is, therefore, most respectfully prayed that the Hon''ble Tribunal may be pleased to:

- a. direct the Respondent to pay to the claimant the amount of Rs. 90,07,603/- being the amount under the additional performance bank guarantee @ 5% of the total contract value along with interest @ 18% per annum w.e.f. 24th May 2004.
- b. award pendente lite and future interest @ 18% per annum on the sum payable by the Respondent to the claimant; and
- c. pass any other such order as this Hon''ble Tribunal may deem fit and proper in the facts and circumstances of the case.

13. Apart from filing a reply to the claims, the Petitioner has also filed its counter claims on 19th March 2005. The Petitioner contended that apart from MTNL having acted illegally in cancelling the PO, it also illegally forfeited the first PBG. Consequently, in its counter claims the Petitioner prayed as under:

Wherefore, the claimant prays that this Hon''ble Tribunal be pleased to

(a) direct the claimant to refund a sum of Rs. 90.00 lakhs forfeited by it in terms of PBG:

(b) direct the claimant to pay a sum of Rs. 4.5 crores as damages for not accepting the HHTs.

(c) to award cost and interest at 18% per annum on the above said amounts.

14. On behalf of MTNL, Mr. Mukesh Kumar, DGM (MM) filed an affidavit by way of evidence on 2nd December 2005 before the Arbitral Tribunal. The Petitioner too filed its affidavit by way of evidence. Witnesses of both parties were cross-examined.

Arbitral Award

15. The first issue before the learned Arbitrator was whether the termination of the contract for supply of terminals by the PO dated 4th March 2004 by the MTNL was justified. It was concluded that notice of termination dated 22nd April 2004 had been issued by the MTNL to the Petitioner in terms of the contract and therefore, the order of termination of the PO was valid. The learned Arbitrator then held that MTNL could not have imposed a penalty of 5% of the amount for which the Petitioner was required to furnish second additional PBG since the MTNL "in its claim did not allege to have suffered any loss nor any evidence was produced to prove loss, if any." Consequently, it was held that "the imposition of penalty in the termination order in the present case was on the face of it illegal

and could not be imposed.

16. Turning to the requirement of the Petitioner having to furnish an additional PBG, it was held by the learned Arbitrator that extension of the delivery period had been given by MTNL subject to the submission of an additional PBG by the Petitioner and therefore, the prayer of the MTNL to recover the amount of the additional PBG was required to be allowed. The operative portion of the impugned Award reads as under:

(i) The contract regarding the supply of goods by the Purchase Order dated 4th March 2004 was validly and justifiably cancelled by the claimant due to the non-supply of the contracted goods.

(ii) The first Bank Guarantee furnished by the Respondent was validly forfeited. The direction of the claimant regarding the filing of the additional bank guarantee by the Respondent was not complied with. The additional bank guarantee not having been filed by the Respondent, the question of its forfeiture on the face of it does not arise.

(iii) In the interest of justice and fair play, it is directed that the claimant will be entitled 50% amount of the additional bank guarantee from the Respondent, if it is paid within six months from the date of the Award. Otherwise, the claimant will be entitled to recover the entire amount of the additional bank guarantee with interest @ 18% per annum till recovery.

(iv) The claimant MTNL was not justified in imposing penalty of 5% of the value of the terminals as no loss was alleged or proved by claimant.

Submissions of Learned Counsel

17. Mr. D.K. Malhotra, Learned Counsel for the Petitioner, submitted that under Clause 4.2 of the GCC read with first PBG furnished by the Petitioner, the proceeds of the performance security under the said PBG shall be payable to MTNL only "as compensation for any loss resulting from the supplier's failure to complete its obligations under the contract." He submitted that in the entire claim petition filed by the MTNL, there was no averment by it that it had suffered any loss. MTNL also failed to produce any evidence to prove any loss suffered by it resulting from the Petitioner's alleged failure to comply with its obligations under the contract. He contended that no breach of contract had been committed by the Petitioner. The time for replacing the first lot of 5,000 terminals (handsets) had not expired by the time MTNL issued the termination letter. It was contended that MTNL in fact had put on hold the supply of the next lot of 10,000 terminals awaiting satisfactory test results and therefore there was in fact no default committed by the Petitioner. It is submitted that the learned Arbitrator having conclusively held in para 13 of the Award that MTNL had failed to prove loss and therefore, was not entitled to levy 5% of the PO as penalty, erred in requiring the Petitioner to compensate MTNL for the amount under the additional PBG. It is further submitted that in light of the law explained by the Supreme

Court in Union of India (UOI) Vs. Rampur Distillery and Chemical Co., Ltd., , Haryana Telecom Ltd. Vs. Union of India (UOI) and Another, and of this Court in Indian Oil Corporation v. M/s. Lloyds Steel Industries 144 (2007) DLT 659 it was incumbent on the MTNL not only to raise a specific plea in respect of the loss suffered by it but also prove such loss occasioned by the Petitioner's failure to complete supplies of the terminals in terms of the PO dated 4th March 2004. Mr. Malhotra finally pointed out that the learned Arbitrator failed to deal with the Petitioner's counter claims and even on this score, the impugned Award requires to be set aside.

18. Mr. Samir Sagar Vasishta, Learned Counsel appearing for the Respondent defended the impugned Award and stated that there was a breach of contract committed by the Petitioner in failing to supply the first lot of 5,000 terminals (handsets) consistent with the specifications stipulated under the contract. At no point in time did the Petitioner adhere to the delivery schedule even in terms of the extended period in terms of the letter dated 17th April 2004. He submitted that the extension granted was conditional upon the Petitioner furnishing an additional PBG which it failed to do. Consequently, the learned Arbitrator was justified in holding that there was a breach of contract by the Petitioner. The learned Arbitrator was justified in holding that MTNL had validly terminated the contract and further in requiring the Petitioner to compensate MTNL for the amount of the additional PBG.

19. Mr. Vasishta submitted that although in the statement of claim MTNL may not have specifically urged that it suffered a loss, in para 30 it was averred that the default on the part of the Petitioner in keeping to its commitment in terms of the contract "adversely affected the interests and performance of the Claimant." Further, in reply to a question in cross-examination, MTNL's witness denied that the Petitioner had suffered any loss and stated that in fact MTNL had suffered "huge losses" due to nonavailability of the handsets. He relied upon the decision of the Calcutta High Court in W.J. Younie and Others Vs. Tulsiram Jankiram and Others, to urge that MTNL could have validly sought to recover from the Petitioner the amount governed by the additional PBG even when it was not furnished by the Petitioner. Relying on the decision of this Court in Mahanagar Telephone Nigam Limited v. Haryana Telecom Limited 2010 (2) Arb. LR 60 (Del) it was submitted that it was not necessary for MTNL to actually prove the loss suffered by it and that it was obvious that on account of the Petitioner's failure to complete supplies in terms of the PO, MTNL would have suffered loss. Lastly, it was submitted that the scope of interference with the Award u/s 34 of the Act is limited and there was no warrant in the case for the Court to re-appreciate the evidence and come to a different conclusion only because it was a plausible one.

Validity of termination of the contract

20. At the outset it requires to be noticed that the PO for supply of 50,000 terminals was premised on the urgency of the requirement of such terminals by MTNL. The period for the supply of the terminals (handsets) was a short one of

two months as was evident from the PO itself. The period for the supply of terminals was only two months. Clauses 15 and 16 of the GCC further indicated that time was the essence of the contract. Clearly there was a failure by the Petitioner to supply the terminals (handsets) within the period stipulated in the contract as extended by the letter dated 17th April 2004. It is not denied that the first lot of 5,000 terminals failed the burn-in test thrice. The assurance held out by the Petitioner in its letter dated 5th May 2004 that it would complete the supply of 10,000 handsets by the second week of May 2004 was obviously not adhered to. This by itself was a sufficient reason for MTNL to have terminated the contract.

21. Reliance was placed by Mr. Malhotra on the following paragraph, in the affidavit by way of evidence of Mr. Mukesh Kumar, to urge that MTNL had put on hold delivery of the next lot of 10000 terminals (handsets):

G. I say that the Respondent was informed and advised that the further testing of the next lot of 10K would commence only after receipt of satisfactory reply from the Respondent on the observations and deficiencies pointed out by the testing team and also the in-house test report by the Respondent. I say that the second lot of 10000 handsets which were to be supplied by the Respondent on 28th April 2004 was not available at the Respondent's factory at Bangalore even on 30th April 2004 and the officers of the claimant were informed that the supply was expected in the second week of May 2004.

22. A careful reading of the above paragraph shows that only the further testing of the next lot of 10,000 terminals was to commence after the receipt of a satisfactory reply from the Petitioner on the deficiencies pointed out by the testing team. By no means did it imply that the Petitioner was not to complete the delivery of the second lot of 10,000 handsets by 28th April 2004 as stipulated in the extension letter dated 17th April 2004. Consequently, the conclusion of the learned Arbitrator that the Petitioner was in breach of the contract and that the PO was validly terminated by MTNL does not call for interference.

MTNL's failure to plead and prove loss

23. The central issue however concerns the encashment by MTNL of the first PBG furnished by the Petitioner and MTNL's claim for a further amount equivalent to 5% of the value of the PO on account of the failure by the Petitioner to furnish the additional PBG.

24. It is important to note that in the present case MTNL has not invoked the clause relating to LD. In other words it has not sought to recover LD in terms of Clause 16.2 GCC. Apart from encashing the first PBG, it has sought to recover the amount covered by the additional PBG, which if furnished would have been worded no different from the first PBG. Recovery both under the first and the second PBG therefore hinged upon MTNL actually suffering loss on account of the Petitioner's failure to supply the terminals within the stipulated time under the

PO. Clause 4.2 of the GCC makes it clear that proceeds of the performance security shall be payable to the MTNL "as compensation for any loss resulting from the suppliers" failure to complete its obligations under the contract." The performance security bond was to be furnished in the form prescribed by the MTNL itself. The wording of the operative portion of the first PBG was identical to Clause 4.2 of the GCC. The amount under the PBG was payable to MTNL "against any loss or damage caused to or suffered or would be caused to or suffered by the MTNL by reason of any breach by the said Contractor of any of the terms or conditions contained in the said Agreement." While the Bank which issued the PBG had to pay the amount on demand by MTNL, and in fact it did so in the present case, MTNL was obliged to satisfy the condition for encashing the BG. In other words it was incumbent on MTNL not only to have pleaded that it suffered loss on account of the failure of the Petitioner to comply with its obligation under the contract but to also prove the extent of loss claimed by it.

25. This is consistent with the law explained by the Supreme Court in *Fateh Chand Vs. Balkishan Das*, , while discussing Section 74 of the Contract Act 1872:

10. Section 74 of the Indian Contract Act deals with the measure of damages in two classes of cases (i) where the contract names a sum to be paid in case of breach and (ii) where the contract contains any other stipulation by way of penalty. We are in the present case not concerned to decide whether a contract containing a covenant of forfeiture of deposit for due performance of a contract falls within the first class. The measure of damages in the case of breach of a stipulation by way of penalty is by Section 74 reasonable compensation not exceeding the penalty stipulated for. 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. Jurisdiction of the Court to award compensation in case of breach of contract is unqualified except as to the maximum stipulated; but compensation has to be reasonable, and that imposes upon the Court duty to award compensation according to settled principles. The section undoubtedly says that the aggrieved party is entitled to receive compensation from the party who has broken the contract, whether or not actual damage or loss is proved to have been caused by the breach. Thereby it merely dispenses with proof of "actual loss or damage"; it does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted, because compensation for breach of contract can be awarded to make good loss or damage which naturally arose in the usual course of things, or which the parties knew when they made the contract, to be likely to result from the breach.

26. This was reiterated in *Maula Bux Vs. Union of India (UOI)*, where it was observed (SCC, p.558):

It is true that 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, and 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 contract. But the expression "whether or not actual damage or loss is proved to have been caused thereby" is intended to cover different classes of contracts which come before the Courts. In case of breach of some contracts it may be impossible for the Court to assess compensation arising from breach, while in other cases compensation can be calculated in accordance with established rules. Where the Court is unable to assess the compensation, 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, 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.

27. The Supreme Court in *Union of India v. Rampur Distillery & Chemical Company Limited* rejected the claim of the appellants since on the facts of that case it was found that "the Appellants, in fact, made no attempt to establish that they had suffered any loss or damage on account of the breach committed by the Respondents.

28. In the present case, as noticed by the learned Arbitrator, MTNL had not invoked the Clauses 16.1 and 16.2 of the GCC which provided for LD. In that event MTNL may not have required to prove any loss or damages. On the other hand MTNL sought to place reliance entirely on the requirement of the Petitioner having to furnish the additional PBG. It relied on the Clause 15.4 of the GCC which stated that if the said supply was not completed within the extended period, the PO shall be short closed and "both the performance securities shall be forfeited."

29. A perusal of the statement of claims shows that there is indeed no specific averment by the MTNL that it had suffered losses or damages. In para 30 it is stated in passing that the default on the part of the Petitioner in keeping its commitment in terms of the contract "adversely affected" the interests and performance of the Claimant. However, this by no means satisfied the requirement of MTNL having to plead and prove that it had suffered loss. The reply given by the MTNL's witness in the cross-examination that MTNL had suffered "huge losses" was again only by a side wind and was not backed up by any evidence placed on record by the MTNL. Importantly MTNL did not challenge the categorical finding in para 13 of the impugned Award by the learned Arbitrator as under:

13. It is well established that in a contract on its breach, penalty can be levied on the defaulting party only if the other party (Claimant in this case) had suffered loss and the same is proved. The penalty could not be levied in this case, as the claimant in its claim did not allege to have suffered any loss nor any evidence was produced to prove loss, if any. Thus imposition of penalty in the termination order in the present case was on the fact of it illegal and could not be imposed.

30. Consistent with the above finding in para 13 of the Award the learned Arbitrator held that MTNL was not justified in imposing on the Petitioner a penalty of 5% of the value of the terminals "as no loss was alleged or proved by MTNL". Having held as above, the learned Arbitrator erred in upholding the forfeiture by MTNL of the first PBG and in further requiring the Petitioner to furnish within six months 50% amount of the additional PBG with interest @ 18% per annum till recovery. Further, it is plain from a reading of the impugned Award that the learned Arbitrator failed to notice that the Petitioner had filed counter claims and consequently failed to decide the counter claims.

Conclusion

31. Consequent upon the above discussions, it is concluded as under:

(i) The finding of the learned Arbitrator that MTNL validly terminated the contract regarding supply of terminals under the PO dated 4th March 2004 due to non-supply of the contracted goods by the Petitioner is upheld.

(ii) The finding of the learned Arbitrator that the MTNL was not justified in imposing on the Petitioner the penalty of 5% of the value of the terminals, as no loss was alleged or proved by MTNL, is also upheld.

(iii) The finding of the learned Arbitrator that the first BG furnished by the Petitioner was validly forfeited by MTNL and that the Petitioner is required to pay MTNL 50% amount of the additional PBG within six months failing which the MTNL would be entitled to recover the entire amount of the additional PBG with interest @ 18% per annum till recovery, is set aside.

32. The petition is accordingly disposed of. It will be open to the Petitioner to seek appropriate remedies as regards its counter claims against MTNL in accordance with law.