Supreme Court of India Oil & Natural Gas Corporation Ltd vs Saw Pipes Ltd on 17 April, 2003 Author: Shah Bench: M.B. Shah, Arun Kumar. CASE NO.: Appeal (civil) 7419 2001 of 518

PETITIONER: Oil & Natural Gas Corporation Ltd.

RESPONDENT: SAW Pipes Ltd.

DATE OF JUDGMENT: 17/04/2003

BENCH: M.B. SHAH & ARUN KUMAR.

JUDGMENT: J U D G M E N T Shah, J. COURT'S JURISDICTION UNDER SECTION 34 OF THE ARBITRATION AND CONCILIATION ACT, 1966 Before dealing with the issues involved in this appeal, we would first decide the main point in controversy, namely - the ambit and scope of Court's jurisdiction in case where award passed by the Arbitral Tribunal is challenged under Section 34 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as "the Act") as the decision in this appeal would depend upon the said finding. In other words - whether the Court would have jurisdiction under Section 34 of the Act to set aside an award passed by the Arbitral Tribunal which is patently illegal or in contravention of the provisions of the Act or any other substantive law governing the parties or is against the terms of the contract? Learned senior counsel Mr. Ashok Desai appearing for the appellant submitted that in case where there is clear violation of Sections 28 to 31 of the Act or the terms of the Contract between the parties, the said award can be and is required to be set aside by the Court while exercising jurisdiction under Section 34 of the Act. Mr. Dushyant Dave, learned senior counsel appearing on behalf of respondent - company submitted to the contrary and contended that the Court's jurisdiction under Section 34 is limited and the award could be set aside mainly on the ground that the same is in conflict with the 'Public Policy of India'. According to his submission, the phrase 'Public Policy of India' cannot be interpreted to mean that in case of violation of some provisions of law, the Court can set aside the award. For deciding this controversy, we would refer to the relevant part of Section 34 which reads as under:- "34. Application for setting aside arbitral award - (1) Recourse to a court against an arbitral award may be made only by an application for setting aside such award in accordance with sub-section (2) and sub-section (3). (2) An arbitral award may be set aside by the court only if- (a) the party making the application furnishes proof that- (i) a party was under some incapacity, or (ii) the arbitration agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law for the time being in force; or (iii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or (iv) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration; Provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted,

only that part of the arbitral award which contains decisions on matters not submitted to arbitration may be set aside; or (v) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Part from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Part; or (b) the court finds that- (i) the subject-matter of the dispute is not capable of settlement by arbitration under the law for the time being in force, or (ii) the arbitral award is in conflict with the public policy of India. Explanation-Without prejudice to the generality of sub-clause (ii), it is hereby declared, for the avoidance of any doubt, that an award is in conflict with the public policy of India if the making of the award was induced or affected by fraud or corruption or was in violation of Section 75 or Section 81." For our purpose, it is not necessary to refer to the scope of self explanatory Clauses (i) to (iv) of sub-section (2)(a) of Section 34 of the Act and it does not require elaborate discussion. However, clause (v) of sub-section 2(a) and clause (ii) of sub-section 2(b) require consideration. For proper adjudication of the question of jurisdiction, we shall first consider what meaning could be assigned to the term 'Arbitral Procedure'. 'ARBITRAL PROCEDURE' The ingredients of clause (v) are as under:- 1) The Court may set aside the award:- (i) (a) if the composition of the arbitral Tribunal was not in accordance with the agreement of the parties, (b) failing such agreement, the composition of the arbitral tribunal was not in accordance with Part-I of the Act. (ii) if the arbitral procedure was not in accordance with:- a) the agreement of the parties, or b) failing such agreement, the arbitral procedure was not in accordance with Part-I of the Act. However, exception for setting aside the award on the ground of composition of arbitral tribunal or illegality of arbitral procedure is that the agreement should not be in conflict with the provisions of Part-I of the Act from which parties cannot derogate. In the aforesaid sub-clause (v), the emphasis is on the agreement and the provisions of Part-I of the Act from which parties cannot derogate. It means that the composition of arbitral tribunal should be in accordance with the agreement. Similarly, the procedure which is required to be followed by the arbitrators should also be in accordance with the agreement of the parties. If there is no such agreement then it should be in accordance with the procedure prescribed in the Part-I of the Act i.e. Sections 2 to 43. At the same time, agreement for composition of arbitral tribunal or arbitral procedure should not be in conflict with the provisions of the Act from which parties cannot derogate. Chapter V of Part-I of the Act provides for conduct of arbitral proceedings. Section 18 mandates that parties to the arbitral proceedings shall be treated with equality and each party shall be given full opportunity to present his case. Section 19 specifically provides that arbitral tribunal is not bound by the Code of Civil Procedure, 1908 or the Indian Evidence Act, 1872 and parties are free to agree on the procedure to be followed by the arbitral tribunal in conducting its proceedings. Failing any agreement between the parties subject to other provisions of Part-I, the arbitral tribunal is to conduct the proceedings in the manner it considers appropriate. This power includes the power to determine the admissibility, relevance, the materiality and weight of any evidence.

Sections 20, 21 and 22 deal with place of arbitration, commencement of arbitral proceedings and language respectively. Thereafter, Sections 23, 24 and 25 deal with statements of claim and defence, hearings and written proceedings and procedure to be followed in case of default of a party. At this stage, we would refer to Section 24 which is as under:- "24. Hearings and written proceedings- (1) Unless otherwise agreed by the parties, the arbitral tribunal shall decide whether to hold oral hearings for the presentation of evidence or for oral argument, or whether the proceedings shall be conducted on the basis of documents and other materials; Provided that the arbitral tribunal shall hold oral hearings, at an appropriate stage of the proceedings, on a request by a party, unless the parties have agreed that no oral hearing shall be held. (2) The parties shall be given sufficient advance notice of any hearing and of any meeting of the arbitral tribunal for the purposes of inspection of documents, goods or other property. (3) All statements, documents or other information supplied to, or applications made to the arbitral tribunal by one party shall be communicated to the other party, and any expert report or evidentiary document on which the arbitral tribunal may rely in making its decision shall be communicated to the parties." Thereafter, Chapter VI deals with making of arbitral award and termination of proceedings. Relevant Sections which require consideration are Sections 28 and 31. Sections 28 and 31 read as under:- "28. Rules applicable to substance of dispute- (1) Where the place of arbitration is situate in India- (a) in an arbitration other than an international commercial arbitration, the arbitral tribunal shall decide the dispute submitted to arbitration in accordance with the substantive law for the time being in force in India; (b) in international commercial arbitration,- (i) the arbitral tribunal shall decide the dispute in accordance with the rules of law designated by the parties as applicable to the substance of the dispute; (ii) any designation by the parties of the law or legal system of a given country shall be construed, unless otherwise expressed, as directly referring to the substantive law of that country and not to its conflict of law rules; (iii) failing any designation of the law under clause (a) by the parties, the arbitral tribunal shall apply the rules of law it considers to be appropriate given all the circumstances surrounding the dispute. (2) The arbitral tribunal shall decide ex aequo et bono or as amiable compositeur only if the parties have expressly authorised it to do so. (3) In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction. 31. Form and contents of arbitral award- (1) An arbitral award shall be made in writing and shall be signed by the members of the arbitral tribunal. (2) For the purposes of sub-section (1), in arbitral proceedings with more than one arbitrator, the signatures of the majority of all the members of the arbitral tribunal shall be sufficient so long as the reason for any omitted signature is stated. (3) The arbitral award shall state the reasons upon which it is based, unless- (a) the parties have agreed that no reasons are to be given, or (b) the award is an arbitral award on agreed terms under section 30. (4) The arbitral award shall state its date and the place of arbitration as determined in accordance with section 20 and the award shall be deemed to have been made at that place. (5) After the arbitral award is made,

a signed copy shall be delivered to each party. (6) The arbitral tribunal may, at any time during the arbitral proceedings, make an interim arbitral award on any matter with respect to which it may make a final arbitral award. (7)(a). Unless otherwise agreed by the parties, where and in so far as an arbitral award is for the payment of money, the arbitral tribunal may include in the sum for which the award is made interest, at such rate as it deems reasonable, on the whole or any part of the money, for the whole or any part of the period between the date on which the cause of action arose and the date on which the award is made. (b) A sum directed to be paid by an arbitral award shall, unless the award otherwise directs, carry interest at the rate of eighteen per centum per annum from the date of the award to the date of payment. (8) Unless otherwise agreed by the parties,- (a) the costs of an arbitration shall be fixed by the arbitral tribunal; (b) the arbitral tribunal shall specify,- (i) the party entitled to costs, (ii) the party who shall pay the costs, (iii) the amount of costs or method of determining that amount, and (iv) the manner in which the costs shall be paid. Explanation: For the purpose of clause (a),"costs" means reasonable costs relating to,- (i) the fees and expenses of the arbitrators and witnesses, (ii) legal fees and expenses, (iii) any administration fees of the institution supervising the arbitration, and (iv) any other expenses incurred in connection with the arbitral proceedings and the arbitral award." The aforesaid provisions prescribe the procedure to be followed by the arbitral tribunal coupled with its powers. Power and procedure are synonymous in the present case. By prescribing the procedure, the arbitral tribunal is empowered and is required to decide the dispute in accordance with the provisions of the Act, that is to say, the jurisdiction of the tribunal to decide the dispute is prescribed. In these sections there is no distinction between the jurisdiction/power and the procedure. In Harish Chandra Bajpai v. Triloki Singh [1957 SCR 370], while dealing with Sections 90 and 92 of the Representation of the People Act, 1951 (as it stood), this Court observed thus:- "It is then argued that S. 92 confers powers on the Tribunal in respect of certain matters, while S. 90(2) applies the CPC in respect of matters relating to procedure that there is a distinction between power and procedure, and that the granting of amendment being a power and not a matter of procedure, it can be claimed only under section 92 and not under S. 90(2). We do not see any antithesis between 'procedure' in S. 90(2) and 'powers' under S. 92. When the respondent applied to the Tribunal for amendment, he took a procedural step, and that he was clearly entitled to do under S. 90(2). The question of power arises only with reference to the order to be passed on the petition by the Tribunal. Is it to be held that the presentation of a petition is competent, but the passing of any order thereon is not? We are of opinion that there is no substance in the contention either." Hence, the jurisdiction or the power of the arbitral tribunal is prescribed under the Act and if the award is de hors the said provisions, it would be, on the face of it, illegal. The decision of the Tribunal must be within the bounds of its jurisdiction conferred under the Act or the contract. In exercising jurisdiction, the arbitral tribunal can not act in breach of some provision of substantive law or the provisions of the Act. The question, therefore, which requires consideration is - whether the award could be set aside, if the arbitral

tribunal has not followed the mandatory procedure prescribed under Sections 24, 28 or 31(3), which affects the rights of the parties? Under sub-section (1)(a) of Section 28 there is a mandate to the arbitral tribunal to decide the dispute in accordance with the substantive law for the time being in force in India. Admittedly, substantive law would include the Indian Contract Act, the Transfer of Property Act and other such laws in force. Suppose, if the award is passed in violation of the provisions of the Transfer of Property Act or in violation of the Indian Contract Act, the question would be - whether such award could be set aside? Similarly, under sub-section (3), arbitral tribunal is directed to decide the dispute in accordance with the terms of the contract and also after taking into account the usage of the trade applicable to the transaction. If arbitral tribunal ignores the terms of the contract or usage of the trade applicable to the transaction, whether the said award could be interfered? Similarly, if the award is non-speaking one and is in violation of Section 31(3), can such award be set aside? In our view, reading Section 34 conjointly with other provisions of the Act, it appears that the legislative intent could not be that if the award is in contravention of the provisions of the Act, still however, it couldn't be set aside by the Court. If it is held that such award could not be interfered, it would be contrary to basic concept of justice. If the arbitral tribunal has not followed the mandatory procedure prescribed under the Act, it would mean that it has acted beyond its jurisdiction and thereby the award would be patently illegal which could be set aside under Section 34. The aforesaid interpretation of the clause (v) would be in conformity with the settled principle of law that the procedural law cannot fail to provide relief when substantive law gives the right. Principle is - there cannot be any wrong without a remedy. In M.V. Elisabeth and others v. Harwan Investment & Trading Pvt. Ltd. [1993 Supp. (2) SCC 433] this Court observed that where substantive law demands justice for the party aggrieved and the statute has not provided the remedy, it is the duty of the Court to devise procedure by drawing analogy from other systems of law and practice. Similarly, in Dhanna Lal v. Kalawatibai and others [(2002) 6 SCC 16] this Court observed that wrong must not be left unredeemed and right not left unenforced. Result is - if the award is contrary to the substantive provisions of law or the provisions of the Act or against the terms of the contract, it would be patently illegal, which could be interfered under Section 34. However, such failure of procedure should be patent affecting the rights of the parties. WHAT MEANING COULD BE ASSIGNED TO THE PHRASE 'PUBLIC POLICY OF INDIA'? The next clause which requires interpretation is clause (ii) of sub-section 2(b) of Section 34 which inter alia provides that the Court may set aside arbitral award if it is in conflict with the 'Public Policy of India'. The phrase 'Public Policy of India' is not defined under the Act. Hence, the said term is required to be given meaning in context and also considering the purpose of the section and scheme of the Act. It has been repeatedly stated by various authorities that the expression 'public policy' does not admit of precise definition and may vary from generation to generation and from time to time. Hence, the concept 'public policy' is considered to be vague, susceptible to narrow or wider meaning depending upon the context in which it is used. Lacking precedent the

Court has to give its meaning in the light and principles underlying the Arbitration Act, Contract Act and Constitutional provisions. For this purpose, we would refer to few decisions referred to by the learned counsel for the parties. While dealing with the concept of 'public policy, this Court in Central Inland Water Transport Corporation Limited and another v. Brojo Nath Ganguly and another [(1986) 3 SCC 156] has observed thus: - "92. The Indian Contract Act does not define the expression"public policy" or "opposed to public policy". From the very nature of things, the expressions "public policy", "opposed to public policy", or "contrary to public policy" are incapable of precise definition. Public policy, however, is not the policy of a particular government. It connotes some matter which concerns the public good and the public interest. The concept of what is for the public good or in the public interest or what would be injurious or harmful to the public good or the public interest has varied from time to time. As new concepts take the place of old, transactions which were once considered against public policy are now being upheld by the courts and similarly where there has been a well recognized head of public policy, the courts have not shirked from extending it to the new transactions and changed circumstances and have at times not even flinched from inventing a new head of public policy. There are two schools of thought- "the narrow view" school and "the broad view" school. According to the former, courts cannot create new heads of public policy whereas the latter countenances judicial law-making in this area. The adherents of "the narrow view" school would not invalidate a contract on the ground of public policy unless that particular ground had been well- established by authorities. Hardly ever has the voice of the timorous spoken more clearly and loudly than in these words of Lord Davey in Janson v. Driefontein Consolidated Gold Mines Ltd. [(1902) AC 484, 500] : "Public Policy is always an unsafe and treacherous ground for legal decision". That was in the year 1902. Seventy-eight years earlier, Burrough, J., in Richardson v. Mellish [(1824) 2 Bing 229, 252] described public policy as "a very unruly horse, and when once you get astride it you never know where it will carry you." The Master of the Rolls, Lord Denning, however, was not a man to shy away from unmanageable horses and in words which conjure up before our eyes the picture of the young Alexander the Great taming Bucephalus, he said in Enderby Town Football Club Ltd. v. Football Assn. Ltd. [(1971) Ch. 591, 606]; "With a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles". Had the timorous always held the field, not only the doctrine of public policy but even the Common Law or the principles of Equity would never have evolved. Sir William Holdsworth in his "History of English Law", Volume III, page 55, has said: In fact, a body of law like the common law, which has grown up gradually with the growth of the nation, necessarily acquires some fixed principles, and if it is to maintain these principles it must be able, on the ground of public policy or some other like ground, to suppress practices which, under ever new disguises, seek to weaken or negative them. It is thus clear that the principles governing public policy must be and are capable, on proper occasion, of expansion or modification. Practices which were considered perfectly normal at one time have today become obnoxious and

oppressive to public conscience. If there is no head of public policy which covers a case, then the court must in consonance with public conscience and in keeping with public good and public interest declare such practice to be opposed to public policy. Above all, in deciding any case which may not be covered by authority our courts have before them the beacon light of the Preamble to the Constitution. Lacking precedent, the court can always be guided by that light and the principles underlying the Fundamental Rights and the Directive Principles enshrined in our Constitution. 93. The normal rule of Common Law has been that a party who seeks to enforce an agreement which is opposed to public policy will be non-suited. The case of A. Schroeder Music Public Co. Ltd. v. Macaulay [(1974) 1 WLR 1308], however, establishes that where a contract is vitiated as being contrary to public policy, the party adversely affected by it can sue to have it declared void. The case may be different where the purpose of the contract is illegal or immoral. In Kedar Nath Motani v. Prahlad Rai [(1960) 1 SCR 861], reversing the High Court and restoring the decree passed by the trial court declaring the appellants' title to the lands in suit and directing the respondents who were the appellants' benamidars to restore possession, this Court, after discussing the English and Indian law on the subject, said (at page 873): The correct position in law, in our opinion, is that what one has to see is whether the illegality goes so much to the root of the matter that the plaintiff cannot bring his action without relying upon the illegal transaction into which he had entered. If the illegality be trivial or venial, as stated by Williston and the plaintiff is not required to rest his case upon that illegality, then public policy demands that the defendant should not be allowed to take advantage of the position. A strict view, of course, must be taken of the plaintiff's conduct, and he should not be allowed to circumvent the illegality by resorting to some subterfuge or by misstating the facts. If, however, the matter is clear and the illegality is not required to be pleaded or proved as part of the cause of action and the plaintiff recanted before the illegal purpose was achieved, then, unless it be of such a gross nature as to outrage the conscience of the court, the plea of the defendant should not prevail. The types of contracts to which the principle formulated by us above applies are not contracts which are tainted with illegality but are contracts which contain terms which are so unfair and unreasonable that they shock the conscience of the court. They are opposed to public policy and require to be adjudged void." Further, in Renusagar Power Co. Ltd. v. General Electric Co. [1994 Supp. (1) SCC 644], this Court considered Section 7(1) of the Arbitration (Protocol and Convention) Act, 1937 which inter alia provided that a foreign award may not be enforced under the said Act, if the Court dealing with the case is satisfied that the enforcement of the award will be contrary to the Public Policy. After elaborate discussion, the Court arrived at the conclusion that Public Policy comprehended in Section 7(1)(b)(ii) of the Foreign Awards (Recognition and Enforcement) Act, 1961 is the 'Public Policy of India' and does not cover the public policy of any other country. For giving meaning to the term 'Public Policy', the Court observed thus:- "66. Article V(2)(b) of the New York Convention of 1958 and Section 7(1)(b)(ii) of the Foreign Awards Act do not postulate refusal of recognition and enforcement of a

foreign award on the ground that it is contrary to the law of the country of enforcement and the ground of challenge is confined to the recognition and enforcement being contrary to the public policy of the country in which the award is set to be enforced. There is nothing to indicate that the expression"public policy" in Article V(2)(b) of the New York Convention and Section 7(1)(b)(ii) of the Foreign Awards Act is not used in the same sense in which it was used in Article I(c) of the Geneva Convention of 1927 and Section 7(1) of the Protocol and Convention Act of 1937. This would mean that "public policy" in Section 7(1)(b)(ii) has been used in a narrower sense and in order to attract to bar of public policy the enforcement of the award must invoke something more than the violation of the law of India. Since the Foreign Awards Act is concerned with recognition and enforcement of foreign awards which are governed by the principles of private international law, the expression "public policy" in Section 7(1)(b)(ii) of the Foreign Awards Act must necessarily be construed in the sense the doctrine of public policy is applied in the field of private international law. Applying the said criteria it must be held that the enforcement of a foreign award would be refused on the ground that it is contrary to public policy if such enforcement would be contrary to (i) fundamental policy of Indian law; or (ii) the interests of India; or (iii) justice or morality." The Court finally held that:- "76. Keeping in view the aforesaid objects underlying FERA and the principles governing enforcement of exchange control laws followed in other countries, we are of the view that the provisions contained in FERA have been enacted to safeguard the economic interests of India and any violation of the said provisions would be contrary to the public policy of India as envisaged in Section 7(1)(b)(ii) of the Act." This Court in Murlidhar Agarwal and another v. State of U.P. and others [1974 (2) SCC 472] while dealing with the concept of 'public policy' observed thus:- "31. Public policy does not remain static in any given community. It may vary from generation to generation and even in the same generation. Public policy would be almost useless if it were to remain in fixed moulds for all time. 32. ... The difficulty of discovering what public policy is at any given moment certainly does not absolve the Judges from the duty of doing so. In conducting an enquiry, as already stated, Judges are not hidebound by precedent. The Judges must look beyond the narrow field of past precedents, though this still leaves open the question, in which direction they must cast their gaze. The Judges are to base their decision on the opinions of men of the world, as distinguished from opinions based on legal learning. In other words, the Judges will have to look beyond the jurisprudence and that in so doing, they must consult not their own personal standards or predilections but those of the dominant opinion at a given moment, or what has been termed customary morality. The Judges must consider the social consequences of the rule propounded, especially in the light of the factual evidence available as to its probable results. .... The point is rather that this power must be lodged somewhere and under our Constitution and laws, it has been lodged in the Judges and if they have to fulfil their function as Judges, it could hardly be lodged elsewhere." Mr. Desai submitted that the narrow meaning given to the term 'public policy' in Renusagar's case is in context of the fact that the question

involved in the said matter was with regard to the execution of the award which had attained finality. It was not a case where validity of the Award is challenged before a forum prescribed under the Act. He submitted that the scheme of Section 34 which deals with setting aside the domestic arbitral award and Section 48 which deals with enforcement of foreign award are not identical. A foreign award by definition is subject to double exequatur. This is recognized inter alia by Section 48 (1) and there is no parallel provision to this clause in Section 34. For this, he referred to Lord Mustill & Stewart C. Boyd QC's "Commercial Arbitration" 2001 wherein [at page 90] it is stated as under:- "Mutual recognition of awards is the glue which holds the international arbitrating community together, and this will only be strong if the enforcing court is willing to trust, as the convention assumes that they will trust, the supervising authorities of the chosen venue. It follows that if, and to the extent that the award has been struck down in the local court it should be a matter of theory and practice be treated when enforcement is sought as if to the extent it did not exist." He further submitted that in foreign arbitration, the award would be subject to being set aside or suspended by the competent authority under the relevant law of that country whereas in the domestic arbitration the only recourse is to Section 34. The aforesaid submission of the learned senior counsel requires to be accepted. From the judgments discussed above, it can be held that the term 'public policy of India' is required to be interpreted in the context of the jurisdiction of the Court where the validity of award is challenged before it becomes final and executable. The concept of enforcement of the award after it becomes final is different and the jurisdiction of the Court at that stage could be limited. Similar is the position with regard to the execution of a decree. It is settled law as well as it is provided under Code of Civil Procedure that once the decree has attained finality, in an execution proceeding, it may be challenged only on limited grounds such as the decree being without jurisdiction or nullity. But in a case where the judgment and decree is challenged before the Appellate Court or the Court exercising revisional jurisdiction, the jurisdiction of such Court would be wider. Therefore, in a case where the validity of award is challenged there is no necessity of giving a narrower meaning to the term 'public policy of India'. On the contrary, wider meaning is required to be given so that the 'patently illegal award' passed by the arbitral tribunal could be set aside. If narrow meaning as contended by the learned senior counsel Mr. Dave is given, some of the provisions of the Arbitration Act would become nugatory. Take for illustration a case wherein there is a specific provision in the contract that for delayed payment of the amount due and payable, no interest would be payable, still however, if the Arbitrator has passed an award granting interest, it would be against the terms of the contract and thereby against the provision of Section 28(3) of the Act which specifically provides that "arbitral tribunal shall decide in accordance with the terms of the contract". Further, where there is a specific usage of the trade that if the payment is made beyond a period of one month, then the party would be required to pay the said amount with interest at the rate of 15 per cent. Despite the evidence being produced on record for such usage, if the arbitrator refuses to grant such interest on the ground of equity,

such award would also be in violation of sub-sections (2) and (3) of Section 28. Section 28(2) specifically provides that arbitrator shall decide ex aequo et bono [according to what is just and good] only if the parties have expressly authorised him to do so. Similarly, if the award is patently against the statutory provisions of substantive law which is in force in India or is passed without giving an opportunity of hearing to the parties as provided under Section 24 or without giving any reason in a case where parties have not agreed that no reasons are to be recorded, it would be against the statutory provisions. In all such cases, the award is required to be set aside on the ground of 'patent illegality'. The learned senior counsel Mr. Dave submitted that the Parliament has not made much change while adopting Article 34 of UNCITRAL Model Law by not providing error of law as a ground of challenge to the arbitral award under Section 34 of the Act. For this purpose, he referred to Sections 68, 69 and 70 of the Arbitration Act, 1996 applicable in England and submitted that if the legislature wanted to give a wider jurisdiction to the Court, it would have done so by adopting similar provisions. Section 68 of the law applicable in England provides that the award can be challenged on the ground of serious irregularities mentioned therein. Section 68 reads thus: - "68. Challenging the award: serious irregularity- (1) A party to arbitral proceedings may (upon notice to the other parties and to the tribunal) apply to the court challenging an award in the proceedings on the ground of serious irregularity affecting the tribunal, the proceedings or the award. A party may lose the right to object (see Section 73) and the right to apply is subject to the restrictions in section 70(2) and (3). (2) Serious irregularity means an irregularity of one or more of the following kinds which the court considers has caused or will cause substantial injustice to the applicant- (a) failure by the tribunal to comply with section 33 (general duty of tribunal); (b) the tribunal exceeding its powers (otherwise than by exceeding its substantive jurisdiction: see section 67); (c) failure by the tribunal to conduct the proceedings in accordance with the procedure agreed by the parties; (d) failure by the tribunal to deal with all the issues that were put to it; (e) any arbitral or other institution or person vested by the parties with powers in relation to the proceedings or the award exceeding its powers; (f) uncertainty or ambiguity as to the effect of the award; (g) the award being obtained by fraud or the award or the way in which it was procured being contrary to public policy; (h) failure to comply with the requirement as to the form of the award; or (i) any irregularity in the conduct of the proceedings or in the award which is admitted by the tribunal or by any arbitral or other institution or person vested by the parties with powers in relation to the proceedings or the award. (3) If there is shown to be serious irregularity affecting the tribunal, the proceedings or the award, the court may- (a) remit the award to the tribunal, in whole or in part, for reconsideration; (b) set the award aside in whole or in part, or (c) declare the award to be of no effect, in whole or in part. The Court shall not exercise its power to set aside or to declare an award to be of no effect, in whole or in part, unless it is satisfied that it would be inappropriate to remit the matters in question to the tribunal for reconsideration. (4) The leave of the Court is required for any appeal from a decision of the court under this section." Sim-

ilarly, Section 69 provides that appeal on point of law would be maintainable and the procedure thereof is also provided. Section 70 provides supplementary provisions. It is true that Legislature has not incorporated exhaustive grounds for challenging the award passed by the arbitral tribunal or the ground on which appeal against the order of the Court would be maintainable. On this aspect, eminent Jurist & Senior Advocate Late Mr. Nani Palkhivala while giving his opinion to 'Law of Arbitration and Conciliation' by Justice Dr. B.P. Saraf and Justice S.M. Jhunjhunuwala, noted thus:- "I am extremely impressed by your analytical approach in dealing with the complex subject of arbitration which is emerging rapidly as an alternate mechanism for resolution of commercial disputes. The new arbitration law has been brought in parity with statutes in other countries, though I wish that the Indian law had a provision similar to section 68 of the English Arbitration Act, 1996 which gives power to the Court to correct errors of law in the award. I welcome your view on the need for giving the doctrine of"public policy" its full amplitude. I particularly endorse your comment that Courts of law may intervene to permit challenge to an arbitral award which is based on an irregularity of a kind which has caused substantial injustice. If the arbitral tribunal does not dispense justice, it cannot truly be reflective of an alternate dispute resolution mechanism. Hence, if the award has resulted in an injustice, a Court would be well within its right in upholding the challenge to the award on the ground that it is in conflict with the public policy of India." From this discussion it would be clear that the phrase 'public policy of India' is not required to be given a narrower meaning. As stated earlier, the said term is susceptible of narrower or wider meaning depending upon the object and purpose of the legislation. Hence, the award which is passed in contravention of Sections 24, 28 or 31 could be set aside. In addition to Section 34, Section 13(5) of the Act also provides that constitution of the arbitral tribunal could also be challenged by a party. Similarly, Section 16 provides that a party aggrieved by the decision of the arbitral tribunal with regard to its jurisdiction could challenge such arbitral award under Section 34. In any case, it is for the Parliament to provide for limited or wider jurisdiction to the Court in case where award is challenged. But in such cases, there is no reason to give narrower meaning to the term 'public policy of India' as contended by learned senior counsel Mr. Dave. In our view, wider meaning is required to be given so as to prevent frustration of legislation and justice. This Court in Rattan Chand Hira Chand v. Askar Nawaz Jung (Dead) By LRs and others [(1991) 3 SCC 67], this Court observed thus:- "17. .. It cannot be disputed that a contract which has a tendency to injure public interests or public welfare is one against public policy. What constitutes an injury to public interests or welfare would depend upon the times and climes. ... The legislature often fails to keep pace with the changing needs and values nor as it realistic to expect that it will have provided for all contingencies and eventualities. It is, therefore, not only necessary but obligatory on the courts to step in to fill the lacuna. When courts perform this function undoubtedly they legislate judicially. But that is a kind of legislation which stands implicitly delegated to them to further the object of the legislation and to promote the goals of the society. Or to put it negatively,

to prevent the frustration of the legislation or perversion of the goals and values of the society." Learned senior counsel Mr. Dave submitted that the purpose of giving limited jurisdiction to the Court is obvious and is to see that the disputes are resolved at the earliest by giving finality to the award passed by the forum chosen by the parties. As against this, learned senior counsel Mr. Desai submitted that in the present system even the arbitral proceedings are delayed on one or the other ground including the ground that the arbitrator is not free and the matters are not disposed of for months together. He submitted that the legislature has not provided any time limit for passing of the award and this indicates that the contention raised by the learned counsel for the respondent has no bearing in interpreting Section 34. It is true that under the Act, there is no provision similar to Sections 23 and 28 of the Arbitration Act, 1940, which specifically provided that the arbitrator shall pass award within reasonable time as fixed by the Court. It is also true that on occasions, arbitration proceedings are delayed for one or other reason, but it is for the parties to take appropriate action of selecting proper arbitrator(s) who could dispose of the matter within reasonable time fixed by them. It is for them to indicate the time limit for disposal of the arbitral proceedings. It is for them to decide whether they should continue with the arbitrator(s) who cannot dispose of the matter within reasonable time. However, non-providing of time limit for deciding the dispute by the arbitrators could have no bearing on interpretation of Section 34. Further, for achieving the object of speedier disposal of dispute, justice in accordance with law cannot be sacrificed. In our view, giving limited jurisdiction to the Court for having finality to the award and resolving the dispute by speedier method would be much more frustrated by permitting patently illegal award to operate. Patently illegal award is required to be set at naught, otherwise it would promote injustice. Therefore, in our view, the phrase 'Public Policy of India' used in Section 34 in context is required to be given a wider meaning. It can be stated that the concept of public policy connotes some matter which concerns public good and the public interest. What is for public good or in public interest or what would be injurious or harmful to the public good or public interest has varied from time to time. However, the award which is, on the face of it, patently in violation of statutory provisions cannot be said to be in public interest. Such award/judgment/decision is likely to adversely affect the administration of justice. Hence, in our view in addition to narrower meaning given to the term 'public policy' in Renusagar's case (supra), it is required to be held that the award could be set aside if it is patently illegal. Result would be - award could be set aside if it is contrary to: - (a) fundamental policy of Indian law; or (b) the interest of India; or (c) justice or morality, or (d) in addition, if it is patently illegal. Illegality must go to the root of the matter and if the illegality is of trivial nature it cannot be held that award is against the public policy. Award could also be set aside if it is so unfair and unreasonable that it shocks the conscience of the Court. Such award is opposed to public policy and is required to be adjudged void. NOW ON FACTS:- The brief facts of the case are as under:- Appellant - ONGC which is a Public Sector Undertaking, has challenged the arbitral award dated 2nd May, 1999 by filing Arbitration

Petition No. 917/1999 before the High Court of Bombay. Learned Single Judge dismissed the same. Appeal No.256/2000 preferred before the Division Bench of the High Court was also dismissed. Hence, the present appeal. It is stated that in response to a tender, respondent-Company which is engaged in the business of supplying equipment for Offshore Oil exploration and maintenance by its letter dated 27th December, 1995 on agreed terms and conditions, offered to supply to the appellants 26" diameter and 30" diameter casing pipes. The appellant by letter of intent dated 3rd June, 1996 followed by a detailed order accepted the offer of the respondent-Company. As per terms and conditions, the goods were required to be supplied on or before 14th November, 1996. It was the contention of the respondent that as per clause (18) of the agreement, the raw materials were required to be procured from the reputed and proven manufacturers/suppliers approved by the respondent as listed therein. By letter dated 8th August, 1996, respondent placed an order for supply of steel plates, that is, the raw material required for manufacturing the pipes with Liva Laminati, Piani S.P.A., Italian suppliers stipulating that material must be shipped latest by the end of September 1996 as timely delivery was of the essence of the order. It is also their case that all over Europe including Italy there was a general strike of the steel mill workers during September/October 1996. Therefore, respondent by its letter dated 28th October, 1996 conveyed to the appellant that Italian suppliers had faced labour problems and was unable to deliver the material as per agreed schedule. Respondent, therefore, requested for an extension of 45 days time for execution of the order in view of the reasons beyond its control. By letter dated 4th December, 1996, the time for delivery of the pipes was extended with a specific statement inter alia that the amount equivalent to liquidated damages for delay in supply of pipes would be recovered from the respondent. It is the contention of the respondent that the appellant made payment of the goods supplied after wrongfully deducting an amount of US $ 3,04,970.20 and Rs.15,75,559/- as liquidated damages. That deduction was disputed by the respondent and, therefore, dispute was referred to the arbitral tribunal. The arbitral tribunal arrived at the conclusion that strikes affecting the supply of raw material to the claimant are not within the definition of 'Force Majeure' in the contract between the parties, and hence, on that ground, it cannot be said that the amount of liquidated damages was wrongfully withheld by the appellant. With regard to other contention on the basis of customs duty also, the arbitral tribunal arrived at the conclusion that it would not justify the delay in the supply of goods. Thereafter, the arbitral tribunal considered various decisions of this Court regarding recovery of liquidated damages and arrived at the conclusion that it was for the appellant to establish that they had suffered any loss because of the breach committed by the respondent in not supplying the goods within the prescribed time limit. The arbitral tribunal thereafter appreciated the evidence and arrived at the conclusion that in view of the statement volunteered by Mr. Arumoy Das, it was clear that shortage of casing pipes was only one of the other reasons which led to the change in the deployment plan and that it has failed to establish its case that it has suffered any loss in terms of money because of delay in supply of goods under the contract.

Hence, the arbitral tribunal held that appellant has wrongfully withheld the agreed amount of US $ 3,04,970.20 and Rs.15,75,559/- on account of customs duty, sales tax, freight charges deducted by way of liquidated damages. The arbitral tribunal further held that the respondent was entitled to recover the said amount with interest at the rate of 12 per cent p.a. from 1st April 1997 till the date of the filing of statement of claim and thereafter having regard to the commercial nature of the transaction at the rate of 18 per cent per annum pendente lite till payment is made. For challenging the said award, learned senior counsel Mr. Desai submitted that:- (1) the award is vitiated on the ground that there was delay on the part of respondent in supplying agreed goods/ pipes and for the delay, appellant was entitled to recover agreed liquidated damages i.e. a sum equivalent to 1% of the contract price for whole unit per week of such delay or part thereof. Thereby, the award was contrary to Section 28(3) which provides that the arbitral tribunal shall decide the dispute in accordance with the terms of the contract; (2) the award passed by the arbitrator is on the face of it illegal and erroneous as it arrived at the conclusion that the appellant was required to prove the loss suffered by it before recovering the liquidated damages. He submitted that the arbitral tribunal misinterpreted the law on the subject; (3) in any set of circumstances, the award passed by the arbitrator granting interest on the liquidated damages deducted by the appellant is, on the face of it, unjustified, unreasonable and against the specific terms of the contract, namely clause 34.4 of the agreement, which provides that on 'disputed claim', no interest would be payable. As against this, learned senior counsel Mr. Dave submitted that it is settled law that for the breach of contract provisions of Section 74 of the Contract Act would be applicable and compensation / damages could be awarded only if the loss is suffered because of the breach of contract. He submitted that this principle is laid down by the Privy Council as early as in 1929 in Bhai Panna Singh and others v. Bhai Arjun Singh and others [AIR 1929 PC 179], wherein the Privy Council observed thus: - "The effect of S. 74, Contract Act of 1872, is to disentitle the plaintiffs to recover simplicitor the sum of Rs.10,000/- whether penalty or liquidated damages. The plaintiffs must prove the damages they have suffered." He submitted that this Court has also held that the plaintiff claiming liquidated damages has to prove the loss suffered by him. In support of this contention, he referred to and relied upon various decisions. In any case, it is his contention that even if there is any error in arriving at the said conclusion, the award cannot be interfered with under Section 34 of the Act. At this stage, we would refer to the relevant terms of the contract upon which learned counsel for the appellant has based his submissions, which are as under: - "11. Failure and Termination Clause/Liquidated Damages:- Time and date of delivery shall be essence of the contract. If the contractor fails to deliver the stores, or any installment thereof within the period fixed for such delivery in the schedule or at any time repudiates the contract before the expiry of such period, the purchaser may, without prejudice to any other right or remedy, available to him to recover damages for breach of the contract:- (a) Recovery from the contractor as agreed liquidated damages are not by way of penalty, a sum equivalent to 1% (one percent) of the contract price of the whole

unit per week for such delay or part thereof (this is an agreed, genuine pre-estimate of damages duly agreed by the parties) which the contractor has failed to deliver within the period fixed for delivery in the schedule, where delivery thereof is accepted after expiry of the aforesaid period. It may be noted that such recovery of liquidated damages may be upto 10% of the contract price of whole unit of stores which the contractor has failed to deliver within the period fixed for delivery, or (e) It may further be noted that clause (a) provides for recovery of liquidated damages on the cost of contract price of delayed supplies (whole unit) at the rate of 1% of the contract price of the whole unit per week for such delay or part thereof upto a ceiling of 10% of the contract price of delayed supplies (whole unit). Liquidated damages for delay in supplies thus accrued will be recovered by the paying authorities of the purchaser specified in the supply order, from the bill for payment of the cost of material submitted by the contractor or his foreign principals in accordance with the terms of supply order or otherwise. (f) Notwithstanding anything stated above, equipment and materials will be deemed to have been delivered only when all its components, parts are also delivered. If certain components are not delivered in time the equipment and material will be considered as delayed until such time all the missing parts are also delivered. 12. Levy of liquidated damages (LD) due to delay in supplies. LD will be imposed on the total value of the order unless 75% of the value ordered is supplied within the stipulate delivery period. Where 75% of the value ordered has been supplied within stipulated delivery period. LD will be imposed on the order value of delayed supply(ies). However, where in judgment of ONGC, the supply of partial quantity does not fulfill the operating need, LD will be imposed on full value of the supply order. 34.4 Delay in Release of Payment: - In case where payment is to be made on satisfactory receipt of materials at destination or where payment is to be made after satisfactory commissioning of the equipment as per terms of the supply order. ONGC shall make payment within 60 days of receipt of invoice / claim complete in all respects. Any delay in payment on undisputed claim / amount beyond 60 days of the receipt of invoice / claim will attract interest @ 1% per month. No interest will be paid on disputed claims. For interest on delayed payments to small scale and Ancillary Industrial Undertakings, the provisions of the"Interest of delayed payments to small scale and Ancillary Industrial Undertakings Act, 1993 will govern." Mr. Desai referred to the decision rendered by this Court in Delta International Ltd. v. Shyam Sundar Ganeriwalla and another [(1999) 4 SCC 545] and submitted that for the purpose of construction of contracts, the intention of the parties is to be gathered from the words they have used and there is no intention independent of that meaning. It cannot be disputed that for construction of the contract, it is settled law that the intention of the parties is to be gathered from the words used in the agreement. If words are unambiguous and are used after full understanding of their meaning by experts, it would be difficult to gather their intention different from the language used in the agreement. If upon a reading of the document as a whole, it can fairly be deduced from the words actually used therein that the parties had agreed on a particular term, there is nothing in law which prevents them

from setting up that term. {Re: Modi & Co. v. Union of India [(1968) 2 SCR 565]}. Further, in construing a contract, the Court must look at the words used in the contract unless they are such that one may suspect that they do not convey the intention correctly. If the words are clear, there is very little the court can do about it. {Re: Provash Chandra Dalui and another v. Biswanath Banerjee and another [1989 Supp (1) SCC 487]}. Therefore, when parties have expressly agreed that recovery from the contractor for breach of the contract is pre-estimated genuine liquidated damages and is not by way of penalty duly agreed by the parties, there was no justifiable reason for the arbitral tribunal to arrive at a conclusion that still the purchaser should prove loss suffered by it because of delay in supply of goods. Further, in arbitration proceedings, the arbitral tribunal is required to decide the dispute in accordance with the terms of the contract. The agreement between the parties specifically provides that without prejudice to any other right or remedy if the contractor fails to deliver the stores within the stipulated time, appellant will be entitled to recover from the contractor, as agreed, liquidated damages equivalent to 1% of the contract price of the whole unit per week for such delay. Such recovery of liquidated damage could be at the most up to 10% of the contract price of whole unit of stores. Not only this, it was also agreed that:- (a) liquidated damages for delay in supplies will be recovered by paying authority from the bill for payment of cost of material submitted by the contractor; (b) liquidated damages were not by way of penalty and it was agreed to be genuine, pre-estimate of damages duly agreed by the parties; (c) This pre-estimate of liquidated damages is not assailed by the respondent as unreasonable assessment of damages by the parties. Further, at the time when respondent sought extension of time for supply of goods, time was extended by letter dated 4.12.1996 with a specific demand that the clause for liquidated damages would be invoked and appellant would recover the same for such delay. Despite this specific letter written by the appellant, respondent had supplied the goods which would indicate that even at that stage, respondent was agreeable to pay liquidated damages. On this issue, learned counsel for the parties referred to the interpretation given to Sections 73 and 74 of the Indian Contract Act in Sir Chunilal V. Mehta & Sons Ltd. v. The Century Spinning and Manufacturing Co. Ltd. [1962 Supp. (3) SCR 549], Fateh Chand v. Balkishan Das [(1964) 1 SCR 515 at 526], Maula Bux v. Union of India [(1969) 2 SCC 554] Union of India v. Rampur Distillery and Chemical Co. Ltd. [(1973) 1 SCC 649] and Union of India v. Raman Iron Foundry [(1974) 2 SCC 231]. Relevant part of Sections 73 and 74 of Contract Act are 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.- 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. Explanation.- A stipulation for increased interest from the date of default may be a stipulation by way of penalty." From the aforesaid Sections, it can be held that when a contract has been broken, the party who suffers by such breach is entitled to receive compensation for any loss which naturally arise in the usual course of things from such breach. These sections further contemplate that if parties knew when they made the contract that a particular loss is likely to result from such breach, they can agree for payment of such compensation. In such a case, there may not be any necessity of leading evidence for proving damages, unless the Court arrives at the conclusion that no loss is likely to occur because of such breach. Further, in case where Court arrives at the conclusion that the term contemplating damages is by way of penalty, the Court may grant reasonable compensation not exceeding the amount so named in the contract on proof of damages. However, when the terms of the contract are clear and unambiguous then its meaning is to be gathered only from the words used therein. In a case where agreement is executed by experts in the field, it would be difficult to hold that the intention of the parties was different from the language used therein. In such a case, it is for the party who contends that stipulated amount is not reasonable compensation, to prove the same. Now, we would refer to various decisions on the subject. In Fateh Chand's case (supra), the plaintiff made a claim to forfeit a sum of Rs.25000/- received by him from the defendant. The sum of Rs.25000/- consisted of two items - Rs.1000/- received as earnest money and Rs.24000/- agreed to be paid by the defendant as out of sale price against the delivery of possession of the property. With regard to earnest money, the Court held that the plaintiff was entitled to forfeit the same. With regard to claim of remaining sum of Rs.24000/-, the Court referred to Section 74 of Indian Contract Act and observed that Section 74 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. The Court observed thus: - "The measure of damages in the case of breach of a stipulation by way of penalty is by S. 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 damages"; 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. The Court further observed as under: - .... Duty not to enforce the penalty clause but only to award reasonable compensation is statutorily imposed upon courts by S. 74. In all cases, therefore, where there is a stipulation in the nature of penalty for forfeiture of an amount deposited pursuant to the terms of contract which expressly provides for forfeiture, the court has jurisdiction to award such sum only as it considers reasonable, but not exceeding the amount specified in the contract as liable to forfeiture." From the aforesaid decision, it is clear that the Court was not dealing with a case where contract named a sum to be paid in case of breach but with a case where the contract contained stipulation by way of penalty. The aforesaid case and other cases were referred to by three Judge Bench in Maula Bux's case (supra) wherein the Court held thus: - "... 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." In Rampur Distillery and Chemical Co. Ltd.'s (supra) also, two Judge Bench of this Court referred to Maula Bux's case and observed thus: - " ... It was held by this Court that forfeiture of earnest money under a contract for sale of property does not fall within Section 70 of the Contract Act, if the amount is reasonable, because the forfeiture of a reasonable sum paid as earnest money does not amount to the imposition of a penalty. But, "where under the terms of the contract the party in breach has undertaken to pay a sum of money or to forfeit a sum of money which he has already paid to the party complaining of a breach of contract, the undertaking is of the nature of a penalty." In Raman Iron Foundry's case (supra), this Court considered clause 18 of the Contract between the parties and arrived at the conclusion that it applied only where the purchaser has a claim for a sum presently due and payable by the contractor. Thereafter, the Court observed thus: - "11. Having discussed the proper interpretation of Clause 18, we may now turn to consider what is the real nature of the claim for recovery of which the appellant is seeking to appropriate the sums due to the respondent under other contracts. The claim is admittedly one for damages for breach of the contract between the parties. Now, it is true

that the damages which are claimed are liquidated damages under Clause 14, but so far as the law in India is concerned, there is no qualitative difference in the nature of the claim whether it be for liquidated damages or for unliquidated damages. Section 74 of the Indian Contract Act eliminates the somewhat elaborate refinements made under the English common law in distinguishing between stipulations providing for payment of liquidated damages and stipulations in the nature of penalty. Under the common law a genuine pre- estimate of damages by mutual agreement is regarded as a stipulation naming liquidated damages and binding between the parties : a stipulation in a contract in terrorem is a penalty and the Court refuses to enforce it, awarding to the aggrieved party only reasonable compensation. The Indian Legislature has sought to cut across the web of rules and presumptions under the English common law, by enacting a uniform principle applicable to all stipulations naming amounts to be paid in case of breach, and stipulations by way of penalty, and according to this principle, even if there is a stipulation by way of liquidated damages, a party complaining of breach of contract can recover only reasonable compensation for the injury sustained by him, the stipulated amount being merely the outside limit. It, therefore, makes no difference in the present case that the claim of the appellant is for liquidated damages. It stands on the same footing as a claim for unliquidated damages. Now the law is well settled that a claim for unliquidated damages does not give rise to a debt until the liability is adjudicated and damages assessed by a decree or order of a Court or other adjudicatory authority. When there is a breach of contract, the party who commits the breach does not eo instanti incur any pecuniary obligation, nor does the party complaining of the breach becomes entitled to a debt due from the other party. The only right which the party aggrieved by the breach of the contract has is the right to sue for damages." Firstly, it is to be stated that in the aforesaid case Court has not referred to earlier decision rendered by the five Judge Bench in Fateh Chand's case or the decision rendered by the three Judge Bench in Maula Bux's case. Further, in M/s H.M. Kamaluddin Ansari and Co. v. Union of India and others [(1983) 4 SCC 417], three Judge Bench of this Court has over-ruled the decision in Raman Iron Foundry's case (supra) and the Court while interpreting similar term of the contract observed that it gives wider power to Union of India to recover the amount claimed by appropriating any sum then due or which at any time may become due to the contractors under other contracts and the Court observed that clause 18 of the Standard Contract confers ample powers on the Union of India to withhold the amount and no injunction order could be passed restraining the Union of India from withholding the amount. In the light of the aforesaid decisions, in our view, there is much force in the contention raised by the learned counsel for the appellant. However, the learned senior counsel Mr. Dave submitted that even if the award passed by the arbitral tribunal is erroneous, it is settled law that when two views are possible with regard to interpretation of statutory provisions and or facts, the Court would refuse to interfere with such award. It is true that if the arbitral tribunal has committed mere error of fact or law in reaching its conclusion on the disputed question submitted to it for adjudication then the Court would have no jurisdiction to

interfere with the award. But, this would depend upon reference made to the arbitrator: (a) If there is a general reference for deciding the contractual dispute between the parties and if the award is based on erroneous legal proposition, the Court could interfere; (b) It is also settled law that in a case of reasoned award, the Court can set aside the same if it is, on the face of it, erroneous on the proposition of law or its application; (c) If a specific question of law is submitted to the arbitrator, erroneous decision in point of law does not make the award bad, so as to permit of its being set aside, unless the Court is satisfied that the arbitrator had proceeded illegally. In the facts of the case, it cannot be disputed that if contractual term, as it is, is to be taken into consideration, the award is, on the face of it, erroneous and in violation of the terms of the contract and thereby it violates Section 28(3) of the Act. Undisputedly, reference to the arbitral tribunal was not with regard to interpretation of question of law. It was only a general reference with regard to claim of respondent. Hence, if the award is erroneous on the basis of record with regard to proposition of law or its application, the Court will have jurisdiction to interfere with the same. Dealing with the similar question, this Court in M/s Alopi Parshad & Sons Ltd. v. The Union of India [(1960) 2 SCR 793] observed that the extent of jurisdiction of the Court to set aside the award on the ground of an error in making the award is well defined and held thus:- "The award of an arbitrator may be set aside on the ground of an error on the face thereof only when in the award or in any document incorporated with it, as for instance, a note appended by the arbitrators, stating the reasons for his decision, there is found some legal proposition which is the basis of the award and which is erroneous-Champsey Bhara and Company v. Jivaraj Balloo Spinning and Weaving Company Limited [L.R. 50 IA 324]. If however, a specific question is submitted to the arbitrator and he answers it, the fact that the answer involves an erroneous decision in point of law, does not make the award bad on its face so as to permit of its being set aside-In the matter of an arbitration between King and Duveen and others [LR (1913) 2 KBD 32] and Government of Kelantan v. Duff Development Company Limited [LR 1923 AC 395]. Thereafter, the Court held that if there was a general reference and not a specific reference on any question of law then the award can be set aside if it demonstrated to be erroneous on the face of it. The Court, in that case, considering Section 56 of the Indian Contract Act held that the Indian Contract Act does not enable a party to a contract to ignore the express provisions thereof and to claim payment of consideration for performance of the contract at rates different from the stipulated rates, on some vague plea of equity and that the arbitrators were not justified in ignoring the expressed terms of the contract prescribing the remuneration payable to the agents. The aforesaid law has been followed continuously. {Re. Rajasthan State Mines & Minerals Ltd. v. Eastern Engineering Enterprises and another [(1999) 9 SCC 283], Sikkim Subba Associates v. State of Sikkim [(2001) 5 SCC 629] and G.M., Northern Railway and another v. Sarvesh Chopra [(2002) 4 SCC 45]}. There is also elaborate discussion on this aspect in Union of India v. A.L. Rallia Ram [(1964) 3 SCR 164] wherein the Court succinctly observed as under:-". But it is now firmly established that an award is bad on the ground of error of law on

the face of it, when in the award itself or in a document actually incorporated in it, there is found some legal proposition which is the basis of the award and which is erroneous. An error in law on the face of the award means : "you can find in the award or a document actually incorporated thereto, as for instance, a note appended by the arbitrator stating the reasons for his judgment, some legal proposition which is the basis of the award and which you can then say is erroneous. It does not mean that if in a narrative a 'reference is made to a contention of one party, that opens the door to setting first what that contention is, and then going to the contract on which the parties' rights depend to see if that contention is sound" Champsey Bhara and Company v. Jivraj Balloo Spinning and Weaving Company Ltd. [(1932) L.R. 50 I.A. 324] But this rule does not apply where questions of law are specifically referred to the arbitrator for his decision; the award of the arbitrator on those questions is binding upon the parties, for by referring specific questions the parties desire to have a decision from the arbitrator on those questions rather than from the Court, and the Court will not unless it is satisfied that the arbitrator had proceeded illegally interfere with the decision." The Court thereafter referred to the decision rendered in Seth Thawardas Pherumal v. The Union of India [(1955) 2 SCR 48] wherein Bose, J. delivering the judgment of the Court had observed: "Therefore, when a question of law is the point at issue, unless both sides specifically agree to refer it and agree to be bound by the arbitrator's decision, the jurisdiction of the Courts to set an arbitration right when the error is apparent on the face of the award is not ousted. The mere fact that both parties submit incidental arguments about point of law in the course of the proceedings is not enough." The learned Judge also observed at p. 59 after referring to F.R. Absalom Ltd. v. Great Western (London) Garden Village Society [1933] AC 592, 616: Simply because the matter was referred to incidentally in the pleadings and arguments in support of, or against, the general issue about liability for damages, that is not enough to clothe the arbitrator with exclusive jurisdiction on a point of law." The Court also referred to the test indicated by Lord Russell of Killowen in F.R. Absalom Ltd. v. Great Western (London) Garden Village Society Ltd., and observed that the said case adequately brings out a distinction between a specific reference on a question of law, and a question of law arising for determination by the arbitrator in the decision of the dispute. The Court quoted the following observations with approval: - " .. it is, I think, essential to keep the case where disputes are referred to an arbitrator in the decision of which a question of law becomes material distinct from the case in which a specific question of law has been referred to him for decision. x x x x The authorities make a clear distinction between these two cases, and, as they appear to me, they decide that in the former case the Court can interfere if and when any error of law appears on the face of the award, but that in the latter case no such interference is possible upon the ground that it so appears that the decision upon the question of law is an erroneous one." Further, in Maharashtra State Electricity Board v. Sterilite Industries (India) and Another [(2001) 8 SCC 482], the Court observed as under:- "9. The position in law has been noticed by this Court in Union of India v. A.L. Rallia Ram [AIR 1963 SC 1685] and

Madanlal Roshanlal Mahajan v. Hukumchand Mills Ltd. [(1967) 1 SCR 105] to the effect that the arbitrator's award both on facts and law is final that there is no appeal from his verdict; that the court cannot review his award and correct any mistake in his adjudication, unless the objection to the legality of the award is apparent on the face of it. In understanding what would be an error of law on the face of the award, the following observations in Champsey Bhara & Co. v. Jivraj Balloo Spg and Wvg. Co. Ltd, [(1922-23) 50 IA 324] a decision of the Privy Council, are relevant (IA p. 331)"An error in law on the face of the award means, in Their Lordship's view, that you can find in the award on a document actually incorporated thereto, as for instance, a note appended by the arbitrator stating the reasons for his judgment, some legal proposition which is the basis of the award and which you can then say is erroneous." 10. In Arosan Enterprises Ltd. v. Union of India [1999 (9) SCC 449], this Court again examined this matter and stated that where the error of finding of fact having a bearing on the award is patent and is easily demonstrable without the necessity of carefully weighing the various possible viewpoints, the interference in the award based on an erroneous finding of fact is permissible and similarly, if an award is based by applying a principle of law which is patently erroneous, and but for such erroneous application of legal principle, the award could not have been made, such award is liable to be set aside by holding that there has been a legal misconduct on the part of the arbitrator." Next question is - whether the legal proposition which is the basis of the award for arriving at the conclusion that ONGC was not entitled to recover the stipulated liquidated damages as it has failed to establish that it has suffered any loss is erroneous on the face of it? The arbitral tribunal after considering the decisions rendered by this Court in the cases of Fateh Chand, Maula Bux and Rampur Distillery (supra) arrived at the conclusion that "in view of these three decisions of the Supreme Court, it is clear that it was for the respondents to establish that they had suffered any loss because of the breach committed by the claimant in the supply of goods under the contract between the parties after 14th November, 1996. In the words we have emphasized in Maula Bux decision, it is clear that if loss in terms of money can be determined, the party claiming the compensation 'must prove' the loss suffered by him". Thereafter the arbitral tribunal referred to the evidence and the following statement made by the witness Das: "The re-deployment plan was made keeping in mind several constraints including shortage of casing pipes." Further, the arbitral tribunal came to the conclusion that under these circumstances, the shortage of casing pipes of 26" diameter and 30" diameter pipes was not the only reason which led to redeployment of rig Trident II to Platform B 121. The arbitral tribunal also appreciated the other evidence and held that the attempt on the part of the ONGC to show that production of gas on Platform B 121 was delayed because of the late supply of goods by the claimant failed. Thereafter, the arbitral tribunal considered the contention raised by the learned counsel for the ONGC that the amount of 10% which had been deducted by way of liquidated damages for the late supply of goods under the contract was not by way of penalty. In response thereto, it was pointed out that it was not the case of learned counsel Mr. Setalwad on behalf of the claimants that "these

stipulations in the contract for deduction of liquidated damages was by way of penalty". Further, the arbitral tribunal observed that in view of the decisions rendered in Fateh Chand and Maula Bux cases, "all that we are required to consider is whether the respondents have established their case of actual loss in money terms because of the delay in the supply of the Casing Pipes under the contract between the parties". Finally, the arbitral tribunal held that as the appellant has failed to prove the loss suffered because of delay in supply of goods as set out in the contract between the parties, it is required to refund the amount deducted by way of liquidated damages from the specified amount payable to the respondent. 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's case (supra) 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. Question which would arise for consideration is - whether by such breach 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. In Maula Bux's case (supra), plaintiff - Maula Bux entered into a contract with the Government of India to supply potatoes at the Military Head Quarters, U.P. Area and deposited an amount of Rs.10000/- as security for due performance of the contract. He entered into another contract with the

Government of India to supply at the same place poultry eggs and fish for one year and deposited an amount of Rs.8500/- for due performance of the contract. Plaintiff having made persistent default in making regular and full supplies of the commodities agreed to be supplied, the Government rescinded the contracts and forfeited the amounts deposited by the plaintiff, because under the terms of the agreement, the amounts deposited by the plaintiff as security for the due performance of the contracts were to stand forfeited in case plaintiff neglected to perform his part of the contract. In context of these facts, Court held that it was possible for the Government of India to lead evidence to prove the rates at which potatoes, poultry, eggs and fish were purchased by them when the plaintiff failed to deliver "regularly and fully" the quantities stipulated under the terms of the contracts and after the contracts were terminated. They could have proved the rates at which they had to be purchased and also the other incidental charges incurred by them in procuring the goods contracted for. But no such attempt was made. Hence, claim for damages was not granted. In Maula Bux's case (supra), the Court has specifically held that 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 a case of breach even if no actual damage is proved to have been suffered in consequence of the breach of contract. The Court has also specifically held that in case of breach of some contracts it may be impossible for the Court to assess compensation arising from breach. Take for illustration construction of a road or a bridge. If there is delay in completing the construction of road or bridge within 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. 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 party who has committed breach of the contract is not liable to pay compensation. It would be against the specific provisions of Section 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 stipulated condition was by way of penalty or the compensa-

tion 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, respondent was informed that it would be required to pay stipulated damages. 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 consequences 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, Court can award the same if it is genuine pre-estimate by the parties as the measure of reasonable compensation. For the reasons stated above, the impugned award directing the appellant to refund the amount deducted for the breach as per contractual terms requires to be set aside and is hereby set aside. WHETHER THE CLAIM OF REFUND OF THE AMOUNT DEDUCTED BY THE APPELLANT FROM THE BILLS IS DISPUTED OR UNDISPUTED CLAIM? As the award directing the appellant to refund the amount deducted is set aside, question of granting interest on the same would not arise. Still however, to demonstrate that the award passed by the arbitral tribunal is, on the face of it, erroneous with regard to grant of interest, we deal with the same. Arbitral Tribunal arrived at the conclusion that the appellant wrongfully withheld/deducted the aggregate amount of US $ 3,04,970.20 on account of delay in supply of goods and amount of Rs.15,75,559/- on account of excise duty, sales tax, freight charges deducted as and by way of liquidated damages from the amount payable by the respondent and thereafter arrived at the conclusion that the said amount was deducted from undisputed invoice amount, therefore, the said claim of the respondent cannot be held to be 'disputed claim'. It is apparent that the claim of the contractor to recover the said amount was disputed mainly because it was agreed term between the parties that in case of delay in supply of goods appellant was entitled to recover damages at the rate as specified in the agreement. It was also agreed that the said liquidated damages were to be recovered by paying authorities from the bills for payment of the cost of material submitted by the contractor. If this agreed amount is deducted and thereafter contractor claims it back on the ground that the appellant was not entitled to deduct the same as it has failed to prove loss suffered by it, the said claim undoubtedly would be a 'disputed claim'. The arbitrators were required to decide by considering the facts and the law applicable, whether the deduction

was justified or not? That itself would indicate that the claim of the contractor was 'disputed claim' and not 'undisputed'. The reason recorded by the arbitrators that as the goods were received and bills are not disputed, therefore, the claim for recovering the amount of bills cannot be held to be 'disputed claim' is, on the face of it, unjust, unreasonable, unsustainable and patently illegal as well as against the expressed terms of the contract. As quoted above, clause 34.4 in terms provides that no interest would be payable on 'disputed claim'. It also provides that in which set of circumstances, interest amount would be paid in case of delay in payment of undisputed claim. In such case, the interest rate is also specified at 1% per month on such undisputed claim amount. Despite this clause, the arbitral tribunal came to the conclusion that it was undisputed claim and held that in law, appellant was not entitled to withhold these two payments from the invoice raised by the respondent and hence directed that the appellant was liable to pay interest on wrongful deductions at the rate of 12% p.a. from 1.4.1997 till the date of filing of the statement of claim and thereafter having regard to the commercial nature of the transaction at the rate of 18% p.a. pendente lite till payment. It is to be reiterated that it is the primary duty of the arbitrators to enforce a promise which the parties have made and to uphold the sanctity of the contract which forms the basis of the civilized society and also the jurisdiction of the arbitrators. Hence, this part of the award passed by the arbitral tribunal granting interest on the amount deducted by the appellant from the bills payable to the respondent is against the terms of the contract and is, therefore, violative of Section 28(3) of the Act. CONCLUSIONS:- In the result, it is held that:- A. (1) The Court can set aside the arbitral award under Section 34(2) of the Act if the party making the application furnishes proof that:- (i) a party was under some incapacity, or (ii) the arbitration agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law for the time being in force; or (iii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or (iv) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration; 2) The Court may set aside the award:- (i) (a) if the composition of the arbitral tribunal was not in accordance with the agreement of the parties, (b) failing such agreement, the composition of the arbitral tribunal was not in accordance with Part-I of the Act. (ii) if the arbitral procedure was not in accordance with:- (a) the agreement of the parties, or (b) failing such agreement, the arbitral procedure was not in accordance with Part-I of the Act. However, exception for setting aside the award on the ground of composition of arbitral tribunal or illegality of arbitral procedure is that the agreement should not be in conflict with the provisions of Part-I of the Act from which parties cannot derogate. (c) If the award passed by the arbitral tribunal is in contravention of provisions of the Act or any other substantive law governing the parties or is against the terms of the contract. (3) The award could be set aside if it is against the public policy of India, that is to say, if it is contrary to:- (a) fundamental policy of Indian

law; (b) the interest of India; or (c) justice or morality, or (d) if it is patently illegal. (4) It could be challenged:- (a) as provided under Section 13(5); and (b) Section 16(6) of the Act. B. (1) The impugned award requires to be set aside mainly on the grounds:- (i) there is specific stipulation in the agreement that the time and date of delivery of the goods was the essence of the contract; (ii) in case of failure to deliver the goods within the period fixed for such delivery in the schedule, ONGC was entitled to recover from the contractor liquidated damages as agreed; (iii) it was also explicitly understood that the agreed liquidated damages were genuine pre-estimate of damages; (iv) on the request of the respondent to extend the time limit for supply of goods, ONGC informed specifically that time was extended but stipulated liquidated damages as agreed would be recovered; (v) liquidated damages for delay in supply of goods were to be recovered by paying authorities from the bills for payment of cost of material supplied by the contractor; (vi) there is nothing on record to suggest that stipulation for recovering liquidated damages was by way of penalty or that the said sum was in any way unreasonable. (vii) In certain contracts, it is impossible to assess the damages or prove the same. Such situation is taken care by Sections 73 and 74 of the Contract Act and in the present case by specific terms of the contract. For the reasons stated above, the impugned award directing the appellant to refund US $ 3,04,970.20 and Rs.15,75,559/- with interest which were deducted for the breach of contract as per the agreement requires to be set aside and is hereby set aside. The appeal is allowed accordingly. There shall be no order as to costs.