M/S.Indian Drugs & Pharmaceuticals Ltd vs M/S. Indo Swiss Synthetics Gem ... on 14 November, 1995

Equivalent citations: 1996 AIR 543, 1996 SCC (1) 54, AIR 1996 SUPREME COURT 543, 1995 AIR SCW 4453, (1995) 2 CALLT 165, (1996) 1 CIVLJ 45, 1996 (1) ARBI TLR 77, 1996 ARBI TLR 1 77, 1996 (1) SCC 54, 1997 WLN(UC) 1 512, (1996) 1 CURCC 1, (1996) 1 LJR 193, (1997) 2 HINDULR 136, (1997) 2 CAL HN 88, (1997) 2 DMC 176, (1997) 3 ICC 553, (1995) 4 SCJ 741, (1997) 2 CIVLJ 281

Author: B.L Hansaria

Bench: B.L Hansaria, K. Ramaswamy

PETITIONER:
M/S.INDIAN DRUGS & PHARMACEUTICALS LTD.

Vs.

RESPONDENT:
M/S. INDO SWISS SYNTHETICS GEM MANUFACTURING CO.LTD. & ORS.

DATE OF JUDGMENT14/11/1995

BENCH:
HANSARIA B.L. (J)
BENCH:
HANSARIA B.L. (J)
RAMASWAMY, K.

CITATION:
1996 AIR 543 1996 SCC (1) 54
1995 SCALE (6)438

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T HANSARIA, J.

Special leave granted.

2. The appellant entered into an agreement with respondent No.2 (which was subsequently amalgamated with the first respondent and became one of its division) on 13.8.1982 whereunder the respondent was to undertake filling of vials with medicines. The agreement was for the period from 1.4.1982 to 31.3.1984, subject to renewal by mutual agreement thereafter. It was also subject to termination by either party by giving three months notice to the other. Such a notice was given by the appellant on 28.12.1983 stating that the agreement would stand terminated with effect from 1.4.1984. During the subsistence of the agreement, the respondent undertook some work which, according to the appellant, was not in terms of the agreement. After the defect came to the notice of the appellant, which was sometime in the second half of 1985, it called upon the respondent, by its letter of 10.11.1987, to reimburse the loss which was stated to be a sum of Rs.161.82 lacs. The respondent disputed the claim by its letter 27.11.1987, whereupon by invoking clause 19 of the agreement, the appellant referred the dispute to respondent No.3 who had been appointed by the Chairman and Managing Director of the appellant in exercise of power conferred by clause 19. The appointment was challenged by respondent No.2 by filing an application under s.33 of the Arbitration Act, 1940, read with certain provisions of the code of Civil Procedure, before the Court of Sub-ordinate Judge, Coimbatore, stating, inter alia, that clause 19 of the agreement could not be invoked to refer the matter to arbitration. In any case clause 19 did not permit resolution of the dispute of the type raised by the appellant. The Sub- ordinate Judge decided main issues in favour of the respondent, which order was challenged by the appellant in the High Court of Judicature at Madras. The High Court upheld the order of Sub-ordinate Judge. Hence this appeal under Article 136 of the Constitution.

3. The following questions arise for determination on the basis of the pleadings of the parties :

> (i) Whether the arbitration clause remained in existence by 1988 when the arbitrator was appointed on the face of termination of the agreement by the appellant with effect from 1.4.1984 ?
>
> (ii) Whether the arbitration clause, if held to be operative, could be invoked for the purpose at hand ?
>
> (iii) Whether the Court of Sub-ordinate Judge at Coimbatore had jurisdiction to entertain the application under section 33 of the Arbitration Act ?

Apart from the above, the first two respondents have raised the question of limitation also in these proceedings.

4. We propose to express our views on the four questions in the order noted by us.

5. Whether the arbitration clause remained in existence by 1988 when the arbitrator was appointed on the face of termination of the agreement by the appellant with effect from 1.4.1984?

This is the real bone of the contention between the parties. Shri Desai, duly assisted by Ms. Indu Malhotra, strenuously urged that as the appellant itself had terminated the agreement with effect

from 1.4.1984, the arbitration clause, which is a part of the agreement, had ceased to be operative after 1.4.1984. This contention is seriously disputed by the learned Attorney General appearing for the appellant.

6. To decide this dispute between the parties, it would be enough to note clauses 17 and 19 of the agreement which read as below :

> "17. The agreement will be for the period from 1.4.1982 to 31.3.1984 subject to renewal by mutual agreement thereafter. The agreement is subject to termination by either party by giving three months notice to other party.
>
> 19. Any dispute regarding the interpretation or application of this agreement and any difference about the quality of the material shall be referred to an arbitrator appointed by the Chairman and Managing Director of IDPL, whose decision shall be final and binding on both the parties."

(emphasis ours)

7. Learned Attorney General submitted that, as to when on termination of an agreement, arbitration clause would also cease to be operative, has been well explained by a three- Judge Bench of this Court in Union of India vs. Kishorilal Gupta & Bros., 1960 (1) SCR 493. In that case Subba Rao, J., as he then was, speaking for the majority stated at pages 513 to 514 of the report that the discussion of the law on the subject led to the emergence of the following principles in this regard :

"(1) An arbitration clause is a collateral term of a contract as distinguished from its substantive terms; but nonetheless it is an integral part of it;

(2) however comprehensive an arbitration clause may be, the existence of the contract is a necessary condition for its operation, it perishes with the contract;

(3) the contract may be non est in the sense that it never came legally into existence or it was void ab initio;

(4) though the contract was validly executed, the parties may put an end to it as if it had never existed and substitute a new contract for it solely governing their rights and liabilities thereunder;

(5) in the former case, if the original contract has no legal existence, the arbitration clause also cannot operation, for along with the original contract, it is also void, in the case, as the original contract is extinguished by the substituted one, the arbitration clause of the original contract perishes with it, and (6) between the two fall many categories of disputes in connection with a contract, such as the question of repudiation, frustration, breach etc. In these cases it is the performance of the contract that has come to an end, but the contract is still in existence for certain purposes in respect of disputes arising under it or in connection with it. As the contract subsists for certain purposes, the arbitration clause operates in respect of these purposes."

8. So, an arbitration clause, howsoever comprehensive in terms, can be operative only if the contract is in existence (vide point (2) above). Under point No.6, however, it has been stated that when a question of breach of contract, inter alia, is raised after the termination of the contract, it is the performance of the contract that comes to an end on termination of the contract, but the same remains in existence for certain purposes in respect of disputes arising under it or in connection with it. It was, therefore, stated under this point that as the contract subsist for certain purposes, the arbitration clause operates in respect of these purposes.

9. Shri Desai, appearing for the respondents, has not disputed that the law laid down in Kishorilal Gupta's case is still good law, which is apparent from what was stated by a two-Judge Bench in Damodar Valley Corporation vs. K.K. Kar, 1974 (2) SCR 240, which decision Shri Desai seeks to rely in support of his submission. The learned counsel read out to us that portion of the judgment which finds place at pages 243 to 244, which is as below :

> "As the contract is an outcome of the agreement between the parties it is equally open to the parties thereto to agree to bring it to an end or to treat it as if it never existed. It may also be open to the parties to terminate the previous contract and substitute in its place a new contract or alter the original contract in such a way that it cannot subsist. In all these cases, since the entire contract is put an end to, the arbitration clause, which is a part of it, also perishes along with it. Section 62 of the contract Act incorporates this principle when it provides that if the parties to a contract agree to substitute a new contract or to rescind or alter it, the original contract need not be performed. Where, therefore, the dispute between the parties is that the contract itself, does not subsist either as a result of its being substituted by a new contract or by rescission or alteration, that dispute cannot be referred to the arbitration as the arbitration clause itself would perish if the averment is found to be valid. As the very jurisdiction of the arbitrator is dependent upon the existence of the arbitration clause under which he is appointed, the parties have no right to invoke a clause which perishes with the contract."

10. This shows that the arbitration clause would perish in case where either there is substitution of a new contract, or rescission or alteration of the original contract. The present is apparently and admittedly not such a case. Therefore, what has been stated in this decision cannot assist the respondents. On the other hand, the ratio of Kishorilal Gupta squarely applies. We, therefore, hold that clause 19 dealing with arbitration did survive despite the contract having come to an end with effect from 1.4.1984.

11. Whether the arbitration clause, if held to be operative, could be invoked for the purpose at hand ? On this, the contention of the respondent is that the clause 19 visualises arbitration on "any difference about the quality of the material", whereas in the present case the dispute is about the vials as filled up containing less quantity and not as per specification. As to this, the stand of the appellant is that if the quantity would be less and not as per specification, the quality would get affected. We do not propose to express any opinion on this aspect of the matter. Suffice to say in this proceeding that if the case of the appellant be correct the arbitration clause would get attracted.

12. Whether the Court of Sub-ordinate Judge at Coimbatore had jurisdiction to entertain the application under section 33 of the Arbitration Act ?

On the question of jurisdiction being raised by the appellant, a queer view was taken inasmuch as the court stated that the petitioner before him (who is respondent herein) having business at Coimbatore, the court there had jurisdiction. This has really put section 20 of the Code of Civil Procedure on its head, as it permits assumption of jurisdiction by that court where the opposite party carries on business, and not the petitioner or plaintiff. The other point urged to sustain jurisdiction was that the respondent's letter dated 27.11.1987 had been issued from Coimbatore. This fact could not have conferred jurisdiction because the fact of mere reply to the notice of the appellant did not give rise to any part of "cause of action"

> within the jurisdiction of Coimbatore court. We are, therefore, of the view that Coimbatore court had no jurisdiction.

13. Was the reference to the arbitrator barred by limitation ?

The plea of limitation had not been urged earlier. That, however, is not material as a plea of limitation can be raised virtually at any point of time because it is relatable to jurisdiction to entertain a matter. According to Shri Desai as the appellant had for the first time required the respondent to reimburse the supposed loss by its letter of 10.11.1987, which was after about 4 years of the supply, the invocation of arbitration clause was apparently barred by limitation, which period could at best at three years as provided by Article 137 of the Limitation Act, 1963. We are referred in this connection to a Bench decision of this Court to which one of us (K.Ramaswamy, J.) was a party- the same being in the case of Panchu Gopal Bose vs. Board of Trustees for Port of Calcutta, 1993 (4) SCC

338. This decision has held the Limitation Act applies to arbitration proceedings and the period visualised by different provisions of the Limitation Act would decide the question of limitation in an arbitration proceeding.

14. In reply, the learned Attorney General brings to our notice the averments finding place in the Rejoinder of the appellant. We are referred to the Rejoinder because the plea of limitation was raised for the first time in the counter- affidavit of the respondent in its para 14. The relevant reply in the Rejoinder is as below :

> "It is stated that the respondents were informed of the rejection of the frugs supplied by them as early as in 1985 on account of short filling of vials by reference to the complaints received from the customers particularly Defence Department. Following this, Shri Chander Sekharan of the Respondent Company visited the petitioner's office at Madras on 3.5.1985 and 10.7.1985 for discussions in the matter. It is mutually agreed that a joint inspection of samples from all the batches should be conducted in the laboratory of IDPL at Madras. Accordingly, the reference samples from the respondent's factory were brought for the purpose of joint inspection to the

> petitioner's factory at Madras. However, the respondent did not sent any representative for participation in the joint inspection and ultimately after waiting for considerable time, the petitioner had to undertake inspection and tests on 22.7.1985 by itself and found that the drugs had not been filled as per the specifications and the weight verification was also not within the permissible limit."

15. Thus, the complaint from the customers, particularly Defence Department, came to be known by the appellant in early 1985 whereafter the matter was taken up with the respondent and the tests ultimately were done in July, 1985. If these facts be correct, it has to be held that the cause of action to claim damages really accrued by July, 1985 which was thereafter made by a letter of November, 1987 followed by appointment of arbitrator in May, 1988. The arbitration was thus not "manifestly barred" as contended by Shri Desai. We do not propose to say anything more on this aspect at this stage.

16. In the aforesaid premises, we do not find any threshold infirmity in the invocation of clause 19 and to the reference of the dispute to respondent No.3. Shri Desai submits that respondent No.3 may not be required to arbitrate inasmuch as he being an appointee of the Chairman and Managing Director of the appellant himself, respondents' case may not be fairly examined. He prays that any retired High Court Judge may be appointed as an arbitrator by us. We have not felt inclined to accept this submission, because arbitration clause states categorically that the difference/dispute shall be referred "to an arbitrator appointed by the Chairman and Managing Director of IPDL"

> (Indian Drugs & Pharmaceutical Limited) who is the appellant. This provision in the arbitration clause cannot be given a go-bye merely at the askance of the respondent unless he challenged its binding nature in an appropriate proceeding which he did not do.

17. In the result, we allow the appeal and leave the appointed arbitrator to deal with difference/dispute in accordance with law. In the facts and circumstances of the case, let the parties bear their own costs.