

THE HIGH COURT OF DELHI AT NEW DELHI

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Judgment delivered on: 02.07.2008

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OMP. No. 5/2004

PURE PHARMA LIMITED

...Petitioner.

- versus -

UNION OF INDIA

...Respondent

Advocates who appeared in this case:

For the Petitioner : Mr Shiv Khorana.

For the Respondent : Ms Rajdeepa Behura with Mr Narender Singh.

CORAM:-

HON'BLE MR JUSTICE BADAR DURREZ AHMED

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| 1. Whether Reporters of local papers may be allowed to see the judgment ? | YES |
| 2. To be referred to the Reporter or not ? | YES |
| 3. Whether the judgment should be reported in Digest ? | YES |

BADAR DURREZ AHMED, J.

1. The petitioner seeks the setting aside of the award dated 22.09.2003 made by Justice C.L. Chaudhary, a former Judge of this Court, in his capacity as the sole arbitrator. Although, several grounds have been taken in the petition, Mr Shiv Khorana, the learned counsel appearing on behalf of the petitioner, pressed for the setting aside of the award on three grounds.

2. The first ground taken by him is that the learned Arbitrator had placed reliance on the decision of the Supreme Court in the case of **Oil & Natural Gas Corporation Ltd. V. Saw Pipes Ltd.**: (2003) 5 SCC 705, which was a decision that was not available to the parties prior to the date

when arguments had concluded and the learned arbitrator had reserved the award. It is contended that the award is based, *inter alia*, on the said decision of the Supreme Court which was decided in May, 2003, whereas the arguments had concluded and the written submissions of the parties had already been submitted much prior to that date. Consequently, it is submitted that the parties did not have the opportunity to make their submissions in respect of the said decision of the Supreme Court so as to bring out the distinction between the present case and the one which was before the Supreme Court. It was, therefore, contended that as the arbitrator did not give the parties such an opportunity, the award which is based on the said decision, is liable to be set aside.

3. The second ground taken by Mr Khorana is that time was not the essence of the contract and, therefore, the clause of liquidated damages cannot be invoked in view of Section 55 (2) of the Indian Contract Act, 1872, unless and until the exact extent of the loss is proved.

4. The third and main ground taken by Mr Khorana is that Clause 21.1 of Section II of the General Conditions of Contract did not reflect the genuine pre-estimate of damages but was one which was in the nature of a penalty and, therefore, it was incumbent upon the respondent to have proved the loss incurred by it on account of the alleged breach. In support of his contentions on this ground, Mr Shiv Khorana relied upon the following decisions:-

1. **Fateh Chand v. Balkishan Dass : AIR 1993 SC 1405.**
2. **Maula Bux v. Union of India: AIR 1970 SC 1955.**
3. **Oil and Natural Gas Corporation Ltd. v. Saw Pipes Ltd: AIR 2003 SC 2629.**
4. **Haryana Telecom Ltd. v. Union of India: 2006 (2) Arb. L.R. 293 (Del.)**

5. Ms Rajdeepa Behura, appearing for the respondent (Union of India) resisted the petition and supported the award. She submitted, with reference to the first ground taken up by Mr Khorana, that the arbitrator cannot be precluded from considering recent decisions. She also submitted that the ground raised by the petitioner on the basis of provisions of Section 55 of the Indian Contract Act, 1872, had been adequately dealt with by the learned arbitrator in the said award. With regard to the third and main ground raised by Mr Khorana, she submitted that the question of whether the clause was one for liquidated damages or by way of penalty is essentially a question of construction or in other words, interpretation of a clause of the contract. She submitted that questions of construction or interpretation of clauses of a contract lie purely within the domain of the arbitrator and the Courts do not interfere with the construction/interpretation arrived upon by the arbitrator unless some perversity is pointed out. She also submitted that for a clause to be regarded as one entailing liquidated damages, it need not be expressly mentioned therein that the sum named in the clause is a genuine pre-estimate of the damages that may be caused upon the breach of the contract. She submitted that there was no ambiguity in the said Clause 21.1 of Section II of the General Condition of Contract which

governs the parties and, therefore, no fault can be found with the arbitrator's finding that the parties had pre-estimated the loss and that the sum by way of compensation was not unreasonable. She submitted that no interference with the award is called for.

6. Although, Mr Khorana referred to a Division Bench decision of the Kerala High Court in the case of **M/s Delta Foundation and Constructions, Kochi and others v. Kerala State Construction Corporation Ltd., Ernakulam** : AIR 2003 Kerala 201, which took the view that when a Court relied upon decisions which were not cited at the bar and applied those decisions to the detriment of the party, it would be a sufficient ground for review, I am of the view that the first ground raised by Mr Khorana with regard to the consideration of the Supreme Court decision in **ONGC** (*supra*) is untenable. First of all, this is not a petition seeking a review but one seeking the setting aside of an award under Section 34 of the Arbitration and Conciliation Act, 1996. Secondly, the arbitrator was entitled to consider the recent decision of the Supreme Court in the case of **ONGC** (*supra*). Thirdly, the said decision of the Supreme Court, in my view, merely reiterated the principles governing Sections 73 and 74 of the Indian Contract Act, 1872 which had already been settled in **Fateh Chand** (*supra*) and **Maula Bux** (*supra*). For these reasons, the first ground of challenge raised by Mr Khorana is rejected.

7. As regards the second ground, the learned arbitrator discussed this at great length. The pleas of the petitioner/claimant were recorded. It is

mentioned in the award that the contention was that the respondent could not recover liquidated damages inasmuch as time was not of the essence of the contract and that no notice was issued under Section 55 of the Indian Contract Act, 1872 and that the respondent had failed to prove that it had suffered any loss on account of delay in supplying the material. The learned arbitrator referred to the letter dated 11.2.1995 whereby the petitioner sought extension of time from the respondent for making the contracted deliveries of Folic Acid Tablets. The letter has been set out in its entirety in the award. It is material to note that the petitioner's said letter dated 11.2.1995 carries the following statement:-

“Since there is a provision in the contract as penalty clause for late receipt of material i.e. @ 0.5% per week, the department should not have any objection in accepting the material.”

In response to the said letter requesting for extension of time for making deliveries of the contracted amount of Folic Acid Tablets, the respondent issued a letter dated 17.2.1995 extending the delivery period in respect of the first and second instalments. The letter also carried the following statement:-

“Please note that as per clause 21.1 of Section-II “General Conditions of Contract” a sum equivalent to 0.5% (half percent) per cent of free delivery at site price of the goods (including elements of taxes, duties, freight etc.) which you have failed to deliver within the period fixed for delivery i.e. upto 31.12.1994 (1st installment) and 23.1.1995 (2nd installment) in the Contract will be recovered from you as Liquidated Damages.”

The letter also carried the statement:-

“You are required to note that notwithstanding the extension in Delivery Period (if accepted by you) the time hereby extended for supply of stores shall be deemed to be the essence of Contract for and failure on your part to supply the stores by the

extended time shall entitle the Purchaser to take action as per Clause 22.1 (sic) of Section-II “General Conditions of Contract.”

The learned arbitrator after construing the said letters and the fact that the extension of time granted by the latter of the two letters was accepted by the petitioner came to the conclusion that the contention of the petitioner on this ground was without any merit because the delivery period was specifically extended by the respondent on the condition of payment of liquidated damages. It is also to be kept in mind that the letter dated 17.2.1995 clearly submitted that notwithstanding the extension of the delivery, time would be of the essence of the contract. The finding of the learned arbitrator cannot be faulted and, therefore, the second ground raised on behalf of the petitioner is also rejected.

8. The third and main ground canvassed by Mr Khorana was with regard to Clause 21.1 of Section-II “General Conditions of Contract.” The said Clause is set out hereinbelow:-

“21.1 Subject to Clause 23, if the Supplier fails to deliver any or all of the Goods or perform the Services within the time period (s) specified in the contract, the Purchaser shall, without prejudice to its other remedies under the Contract, deduct from the Contract price, as Liquidated Damages, a sum equivalent to 0.5% of the delivered price of the delayed Goods or unperformed Services for each week of delay until actual delivery or performance, upto a maximum deduction of 10% of the delayed Goods or Services contract price. Once the maximum is reached, the Purchaser may consider termination of the Contract.”

Clause 23 referred to in the above Clause 21.1 is the Force Majeure Clause, which does not arise for consideration in the present case. A plain reading of Clause 21.1 makes it clear that if the supplier failed to deliver the goods within the time period specified in the contract, the purchaser was entitled, without prejudice to its other remedies under the Contract, to deduct from the contract price, as liquidated damages, a sum equivalent to 0.5% of the delivered price of the delayed goods for each week of delay until actual delivery or performance, upto a maximum deduction of 10% of the delayed goods or services contract price. It is also clear that once the maximum is reached, the purchaser may consider termination of the contract. This Clause has been construed by the learned Arbitrator to be one where the parties have pre-estimated the loss after reaching a clear understanding and not to be a clause by way of penalty. The learned arbitrator observed that this clause coupled with the two letters dated 11.2.1995 and 17.2.1995 clearly demonstrate that the petitioner/claimant unequivocally agreed to pay liquidated damages as stipulated in the contract. The learned arbitrator regarded such stipulation to be by way of pre-estimation of the loss which was likely to be caused by the breach of contract and that such pre-estimation was arrived at after a clear understanding. The learned arbitrator found that in such circumstances, it would be totally unjustified to arrive at a conclusion that the party who has committed breach of contract is not liable to pay the compensation. The learned arbitrator also concluded that there is nothing on record to show or establish that the compensation contemplated by the parties in the said clause was in any way unreasonable. He was of the view that the pre-estimate of damages was duly agreed upon

by the parties and that no evidence was led by the claimant to establish that the stipulated condition was by way of penalty or that the compensation stipulated was in any way unreasonable. The learned arbitrator concluded that he had no reason not to rely upon the clear and unambiguous terms of the agreement stipulating pre-estimated damages because of delay in supply of the stores. It is in this context that the learned arbitrator held that the case in hand was squarely covered on facts and law by the Supreme Court in case of *Oil and Natural Gas Corporation (supra)*. Consequently, the claim of the petitioner of Rs 31,70,538.48 towards recovery of the said amount which had been allegedly withheld by the respondent as liquidated damages, was rejected.

9. Considering the discussion on this aspect of the matter in the impugned award, I am unable to accept the contentions raised by Mr Khorana. The award, on this aspect also, does not call any further interference. Mr Khorana has referred to the four decisions, three by the Supreme Court and one by a learned Single Judge of this Court in the case of (Haryana Telecom). The last of these decisions does not call for any further discussion in view of the fact that the law on the subject has been declared by the Supreme Court in the three decisions in the case of *Fateh Chand (supra)*, *Maula Bux (supra)* and *O.N.G.C. (supra)*. The first decision on the point was by a Constitution Bench. In *Fateh Chand (supra)*, the Constitution Bench noted with clarity that the English common law which brought about a distinction between cases which pertain to a stipulation providing payment for liquidated damages and a stipulation

which was in the nature of penalty, were sought to be eliminated by the introduction of Section 74 of the Indian Contract Act, 1872. It was also noted that at common law, genuine pre-estimate of damages by mutual agreement was regarded as a stipulation naming liquidated damages and was binding between the parties. On the other hand, a stipulation in a contract in terrorem was a penalty and the courts refused to enforce it and merely awarded reasonable compensation to the aggrieved party. By virtue of Section 74 of the Indian Contract Act, 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.

Section 74 of the India Contract Act, 1872 reads as under:-

“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.”

The decision in *Fateh Chand (supra)* made it clear that a uniform principle was applicable to all stipulations whether the stipulations were by way of naming amounts to be paid in case of breach or the stipulations were by way of penalty. The facts of the case in *Fateh Chand (supra)* pertained to a stipulation by way of penalty and the Supreme Court held that in such a case the party complaining of the breach would be entitled to reasonable compensation not exceeding the penalty stipulated. While considering the

provisions of Section 74 of the Indian Contract Act, 1872, the Supreme Court, in ***Fateh Chand*** (*supra*) observed that although proof of “actual loss or damage” was dispensed with, there must, however, be legal injury before compensation can be claimed. The Court further made it clear that in all cases, the Court will award only reasonable compensation not exceeding the amount named or penalty stipulated.

10. What was meant by reasonable compensation was somewhat elaborated upon by the Supreme Court in ***Maula Bux*** (*supra*). The Supreme Court took the view that where it was not possible to assess the loss and thereby arrive at the compensation which ought to be awarded to the aggrieved party, the Court was required to assess reasonable compensation on two different criteria. If the sum named in the contract was a genuine pre-estimate then such sum could be regarded as a measure of reasonable compensation. However, if the sum named in the contract was regarded as a stipulation by way of penalty, then the sum named need not be taken as a measure of reasonable compensation and the Court would have to exercise its judicial discretion to arrive at such a measure subject to the maximum of the amount stipulated in the contract. Where it was possible for the Court to assess the loss in terms of money, the party claiming compensation was required to prove the loss suffered by him. The position, therefore, after ***Maula Bux*** (*supra*) is that where the sum named in a contract is to be regarded as a genuine pre-estimate then that sum would be a measure of reasonable compensation and the Court can award the same without the requirement of proof of actual loss or damage. However, where

the clause is by way of penalty, then, if it is possible to assess the loss in terms of money, the party claiming compensation must prove the loss suffered by him. However, if it is not possible to assess the loss in terms of money then the Court can award reasonable compensation not exceeding the amount stipulated by way of penalty.

11. The Supreme Court decision in *O.N.G.C. (supra)*, in my view, merely reiterates what has already been held in *Fateh Chand (supra)* and *Maula Bux (supra)*. This is clear from the fact that the Supreme Court in *O.N.G.C. (supra)* concluded that in case of a genuine pre-estimate (where parties knew that a particular loss was likely to result), there was no necessity of proving loss or damages and the stipulated amount could be awarded by the Court unless it was demonstrated by the other party that there was no loss likely to occur because of the breach. This is nothing but what was said in *Fateh Chand (supra)* that, while proof of actual loss or damages is dispensed with, there must be legal injury before compensation can be claimed. In *O.N.G.C. (supra)*, it was further held that in case the stipulation in the clause was by way of penalty then the aggrieved party would be entitled to reasonable compensation not exceeding the amount named on proof of damages. As observed by the Supreme Court in paragraph 65 of the *O.N.G.C. (supra)* decision, the emphasis of Section 74 of the Indian Contract Act, 1872 is on reasonable compensation. In case of a genuine pre-estimate, the named amount would be reasonable compensation, whereas, in the case of a clause, which is by way of penalty, the Court would have to determine reasonable compensation not exceeding

the amount named in the clause. Importantly, it was also held in *O.N.G.C. (supra)* that the burden was on the other party (other than the aggrieved party) to prove that there was no loss likely to occur because of the alleged breach.

12. In the present case, the learned arbitrator has interpreted Clause 21.1 to be a genuine pre-estimate of the loss which was likely to occur on account of delayed supplies. He also held that the compensation provided for in the said Clause was not unreasonable and that, as noted above, no evidence was led by the claimant to establish that the stipulated condition was by way of penalty. The claimant was also not able to demonstrate either before the arbitrator or before this Court that on account of the delay in the supply of the contracted goods, no legal injury was or would be suffered by the respondent or no loss was likely to occur on account of the delayed supplies. It may also be noted that in *Mcdermott International Inc. v. Burn Standard Co. Ltd & Others*: (2006) 11 SCC 181, the Supreme Court observed that “*interpretation of a contract is a matter for arbitrator to determine even if it gives rise to determine the question of law*” (see *Pure Helium India (P) Ltd v. ONGC*: (2003) 8 SCC 593 and *D.D. Sharma v. UOI*: (2004) 5 SCC 325.) In these circumstances, no interference with the award is called for.

For the foregoing reasons, the petition is dismissed. No costs.

**BADAR DURREZ AHMED
(JUDGE)**

July 02, 2008
J