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IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

ARBITRATION PETITION NO.240 OF 2013

Maharashtra State Electricity
Distribution Company Limited,
a Company Incorporated under
the provisions of the Companies
Act, 1956 having its Registered
Office at Prakashgad, 5th Floor,
Bandra (E), Mumbai 400 051.

...Petitioners

..Versus..

Vijai Electricals Limited
A Company incorporated under
the Provisions of the Companies
Act, 1956, having its Registered
Office at 6-3-640/182, Off. Raj
Bhavan Road, Somajiguda,
Hyderabad (Andhra Pradesh)

...Respondents

Mr. Kevic Setalvad, Senior Counsel with Mr. Awais Abmediji, Mr. S.D. Shetty and Mr. Rakesh Singh i/b M.V. Kini & Co. for the Petitioners.

Mr. Zal Andhyarujina with Mr. Harsh Meghan, Mr. Z. Jariwala and Mr. Jayesh Gawde i/b Thakore Jariwala & Associates for the Respondents.

CORAM _____ : R.D. DHANUKA, J.
RESERVED ON _____ : 15TH JANUARY, 2015
PRONOUNCED ON : 4TH FEBRUARY, 2015

ORAL JUDGMENT :-

1. By this petition filed under section 34 of the Arbitration & Conciliation Act, 1996 (for short the said Act), the petitioners seek to

impugn the arbitral award dated 26th October, 2012 made by the learned arbitrator allowing the claims made by the respondents. Some of the relevant facts for the purpose of deciding this petition are as under :

2. The petitioners were the original respondents before the learned arbitrator. The respondents herein were the original claimants before the learned arbitrator.

3. Some time in the year 2011, the petitioners floated 16 tenders for the supply, construction and commissioning of the sub-transmission lines, power transformers etc. for different parts of Maharashtra. The last date for submission of e-bids was 21st September, 2011. The respondents submitted the e-bids in respect of the 3 tenders which were in respect of Amravati Zone, Aurangabad – Nanded Zone and Baramati Zone on 21st September, 2011 i.e. within time stipulated for submission of the e-bids. The bids were required to be submitted in two parts : (a) technical bid and (b) price bid.

4. Under clause 19.1 of the bid conditions, a bidder was required to furnish as part of its technical proposal, bids securities for the amount designated in the bid data in each tender. The bid security could be furnished at the option of the bidder either in the form of demand draft or an unconditional bank guarantee. The respondents furnished three bank guarantees of Axis Bank Limited,

Secunderabad (A.B.) for a total sum of Rs.4,48,42,000/-. The said three bank guarantees were valid upto 31st January, 2012. Clauses 19.4, 19.5 and 19.6 of the bid conditions with reference to the bank guarantee are extracted as under :-

“19.4 : The bid security of the unsuccessful bidders will be returned as promptly as possible, after award and signing of the contract agreement or expiration of the period of bid validity, whichever is earlier ;

19.5 : The bid security of the successful bidder will be returned when the bidder has signed the contract agreement and furnished the required security deposit.

19.6 : The bid security may be forfeited ;

c) If the bidder withdraws its bid, except that written notice of the withdrawal of bid is received by the employer prior to the deadline for submission of bids;”

5. A relevant part of one of such bank guarantee is extracted as under :-

“The Bank binds himself, its successors and assigns by these presents. This guarantee will be payable at our branch office at Axis Bank Limited, Credit Management Centre (CBO), Ground Floor, Bombay Dyeing Mills Compound, Pandurang Budhkar Marg, Worli, Mumbai – 400025, SEALED with the Common Seal of the said Bank this 20th day of September, 2011.

THE CONDITIONS of this obligation are :

(1) if the Bidder withdraws his Bid during the period of Bid validity specified in the Form of Bid; or

(2) if the Bidder refuses to accept the correction of errors in his Bid; or

(3) if the Bidder is determined at any time prior to award of contract to have engaged in corrupt or fraudulent practices in competing for the contract; or

(4) if the Bidder, having been notified of the acceptance of his Bid by the Employer during the period of Bid validity:

(a) fails or refuses to execute the Form of Contract Agreement in accordance with the Instructions to Bidders; if required; or

(b) fails or refuses to furnish the Security deposit, in accordance with the Instructions to Bidders;

We undertake to pay to the Employer up to the above amount upon receipt of its first written demand, without the Employer having to substantiate his demand, provided that in its demand the Employer will note that the amount claimed by him is due to him owing to occurrence of one or all of the above conditions, specifying the occurred condition or conditions. This Guarantee will remain in force up to and including the date 118 days after the deadline for submission of bids as such deadline is stated in the Instructions to Bidders or as it may be extended by the Employer, notice of which extension(s) to the Bank is hereby waived. Any demand in respect of this Guarantee should reach the Bank not later than the above date i.e. upto 31.01.2012.

Notwithstanding anything contained herein above, our liability is restricted to **Rs.1,23,00,000/- (Rupees One Crore Twenty Three Lakhs Only)** in the aggregate. This Bank Guarantee will remain in force up to 31.01.2012 unless a claim or a demand in writing is made against the bank in terms of this guarantee on or before the expiry of 31.01.2012 and all your rights in the said guarantee shall be forfeited and we shall be relieved and discharged from all the liability there under irrespective of whether the original guarantee is received by us or not."

6. On 21st September, 2011, the technical bids were opened by the petitioners. Thereafter the evaluation of the technical bids were done by the concerned department of the petitioners.

7. On 15th October, 2011, the respondents addressed a letter to the then Engineer of the petitioners informing that the respondents would like to withdraw from the 3 tenders submitted by it on 21st September, 2011. The respondents requested the petitioners to accept the said request and to allow them to withdraw from the participation in the said 3 tenders. The respondents also mentioned about their appreciation supported by the petitioners in not taking steps and encashing the relevant bank guarantees. In the said letter the respondents requested the petitioners to consider their request and to return the bank guarantees as early as possible.

8. It is the case of the petitioners that when the technical bids were opened by the petitioners on 21st September, 2011, the petitioners asked the concerned evaluation department to submit a report on 14th October, 2011. On 18th October, 2011, a preliminary technical evaluation report of 11 bidders was submitted by the concerned department to the petitioners. It is the case of the petitioners that in the meantime on 15th October, 2011, the respondents withdrew their bids and the withdrawal of the bids by the respondents was in violation of clause 19.6 of the bid conditions.

9. It is the case of the petitioners that on 20th October, 2011, technical qualified bidders' names were published by the petitioners on the inter-net. On 24th October, 2011, the price bids of the technical bids were opened by the petitioners. In the meantime the bank guarantees furnished by the respondents were extended by the respondents from time to time at the request of the petitioners and was extended till 31st March, 2012.

10. It is the case of the petitioners that in the meeting held on 7th December, 2011, the board of directors of the petitioners decided that the contents of the letter written by the respondents vide letter dated 15th October, 2011 amounted to withdrawal of the bids in violation of clause 19.6(c) and therefore, the board of directors of the petitioners resolved as per clause 19.6(c) of the tender document, that the bid securities submitted by the respondents were liable to be forfeited.

11. On 21st March, 2012, the petitioners invoked the said three bank guarantees by addressing a letter to the Manager, Axis Bank Limited. By the said letter, the petitioners called upon the bank to pay a sum of Rs.4,48,42,000/- in terms of the bank guarantees submitted by the respondents. The extract of the said letter, which is relevant for the purpose of deciding this petition is as under :-

“Sir

You are called upon to pay Rs.4,48,42,000/- (in Rs.Four crores forty eight lakhs forty two thousand only) in terms of the Bank Guarantee as per below submitted by M/s.Vijal Electricals Ltd. However, M/s.Vijal Electricals Ltd. has failed, as per the terms & conditions of Tender as per Agency has withdrawn the Bids after the deadline of submission date.

Sr. No.	Tender No.	Name of Bank	Amount of Bank Guarantee Submitted by Bidder	Bank Guarantee Date	Bank Guarantee No.	Extended last date of its validity
1	R-APDRP Part B/T01	Axis Bank Ltd. Secunderabad (A.P.) payable at Mumbai	Rs.19102000/-	20.09.2011	00680100000182	31.03.2012
2	R-APDRP Part B/T02	"do"	Rs.13440000/-	"do"	00680100000483	"do"
3	R-APDRP Part B/T03	"do"	Rs.12300000/-	"do"	00680100000484	"do"

The amount has to be transferred within 48 hours on the A/C as below :

> Account Name – **Maharashtra State Electricity Distribution Co. Ltd.**

> Account Number – MSEDCL A/C "A" No.2004530376 4

> Bank – Bank of Maharashtra, Branch – Bandra (E), Mumbai -51

> IFSC Code – MAHBOOOO164 & MICR – 400014043

You have agreed unequivocally and unconditionally to pay the amount at Mumbai as per guarantee clause failing which it may please be noted that the Bank

Guarantee furnished by your various banks will never be accepted in future and there shall be no alternative but to file suit against your Bank and to report the matter to RBI/Banking Ombudsman.

We hope that you will not allow to take such an unpleasant action. The original Bank Guarantee will be handed over after transfer of the above amount on Maharashtra State Electricity Distribution Co. Ltd. Account.”

12. On 22nd March, 2012, the respondents filed a Writ Petition (No.831 of 2012) in this court against the petitioners and obtained an ad-interim injunction against the petitioners from invoking the bank guarantees. By an order dated 12th June, 2012, a Division Bench of this court was pleased to refer the said dispute for invocation of the bank guarantees to the sole arbitrator, a former Judge of the Supreme Court of India for adjudication.

13. Pursuant to the directions given by the learned arbitrator, the respondents filed statement of claim before the learned arbitrator inter-alia praying for a declaration that the petitioners herein were not entitled to encash / invoke the bank guarantees and for an order and direction against the petitioners to forthwith hand over to the respondents the original three bank guarantees dated 20th September, 2011 and prayed that the letter of invocation dated 21st March, 2012 be quashed and set-aside. The respondents also prayed for an order and direction against the petitioners to pay the entire amount of commission and other costs, charges and expenses

alleged to have been incurred by the respondents in renewal of the bank guarantees. The said claims made by the respondents were resisted by the petitioners by filing the written statement.

14. The learned arbitrator framed 3 points for determination. By an award dated 26th October, 2012, the learned arbitrator rendered a finding that the respondents herein were entitled to return all 3 bank guarantees and held that the petitioners were not entitled to forfeit the said bank guarantees as extended. The learned arbitrator accordingly declared that the petitioners were not entitled to invoke the bank guarantees and directed the petitioners to forthwith hand over to the respondents the said three original bank guarantees and all extensions / renewal duly discharged and/or cancelled. The learned arbitrator declared that Axis Bank Limited was not liable to make any payments under the said bank guarantees to the petitioners. The learned arbitrator in the said award, has set-aside the letter of invocation of the bank guarantees dated 21st March, 2012 and cancelled all three bank guarantees and all extensions thereof. The learned arbitrator directed the petitioners to pay costs of Rs,2,50,000/- to the respondents. This award has been impugned by the petitioners in this petition under section 34 of the said Act.

15. Mr.Setalvad, the learned senior counsel for the petitioners submits that under clause 19.6 of the instructions to bidders, the bid

securities submitted by the respondents were liable to be forfeited since the respondents had withdrawn its bid after the deadline for submission of the bids which was 21st September, 2011. The respondents had withdrawn its bid on 15th October, 2011.

16. It is submitted that in their letter dated 15th October, 2011, which was admittedly after expiry of the last date of submission of the bid i.e. 21st September, 2011, the respondents had requested the petitioners to return their bank guarantees as early as possible. It is submitted that though in the said letter the respondents had made a request to the petitioners to allow it to withdraw from the participation in the said three tenders, the respondents had appreciated the support of the petitioners in not taking steps for encashing the three bank guarantees and had requested to return the said three bank guarantees as early as possible. The learned senior counsel submits that before receiving the said letter dated 15th October, 2011, the technical bids of all the bidders, including the respondents were opened on 21st September, 2011. A preliminary technical evaluation report of 11 bidders were submitted by the concerned department of the petitioners to the petitioners on 18th October, 2011. Names of technically qualified bidders' were published on the inter-net on 20th October, 2011 and thereafter on 24th October, 2011 the price bids of technically qualified bidders were opened. The learned senior

counsel submits that since the respondents had withdrawn their bids, the price bids of the respondents were not opened on 24th October, 2011. It is submitted that even if the respondents would not have addressed any such letter on 15th October, 2011, the fact remains that after 21st September, 2011, no bidders could have withdrawn their bid, which was the last date of submission of the bids and thus its security bids were liable to be forfeited in terms of clause 19.6(a) of the instructions to bidders.

17. It is submitted by the learned senior counsel that the finding of the learned arbitrator that in view of the language of the letter dated 15th October, 2011, it was indicative of the request made by the respondents to the petitioners, there was no immediate withdrawal of the bids is concerned, the said finding of the learned arbitrator is contrary to the terms of the contract. It is submitted that the respondents itself had applied for return of the bank guarantees. No such letter for seeking any permission after the last date of submission of the bid could have even been addressed by any of the bidders. The consequences provided under clause 19.6 thus would automatically follow and the bid securities were liable to be forfeited. The learned senior counsel submits that if by the said letter dated 15th October, 2011 the respondents had not applied for permission to withdraw the bids, the respondents were not required to make any

request to return the bank guarantees.

18. It is submitted by the learned senior counsel that the petitioners also acted upon the letter of the respondents of 15th October, 2011 and accordingly did not open the price bids of the respondents which were admittedly opened after 15th October, 2011. The respondents did not dispute these facts. It is submitted by the learned senior counsel that invocation of the bank guarantees by the petitioners was absolutely in accordance with the terms and conditions of the bank guarantees. Once the petitioners had invoked such bank guarantees in accordance with the terms of the bank guarantees, the bank was liable to make payment under the said three bank guarantees to the petitioner unconditionally. It is submitted that all three bank guarantees were thus unconditional bank guarantees and the petitioners were entitled to forfeit all three bank guarantees and to recover the amounts under those three bank guarantees. The learned senior counsel invited my attention to the terms of the bank guarantees and also letter of invocation and would submit that in the letter of invocation the petitioners had notified categorically that the respondents had withdrawn the bids after expiry of the deadline of the bid submission date, the invocation of the bank guarantees thus was in terms of the bank guarantees furnished by the respondents through Axis Bank Limited.

19. In support of the submissions that the bank guarantees submitted by the respondents were unconditional bank guarantees and thus once the bank guarantees were invoked before expiry of the period of such bank guarantees, neither the bank nor the respondents could oppose such invocation on any ground whatsoever, the learned senior counsel placed reliance on the following judgments :-

1) The judgment of this Court in the case of *Karam Chand Thapar & Bros vs. Hindustan Construction Co. Ltd. in Arbitration Petition (Lodging) No.606 of 2012 delivered on 4th May, 2012* : (paras 4 and 6) ;

2) The judgment of this Court in the case of *Housing Development & Infrastructure Limited vs. Mumbai International Airport Pvt. Ltd. & Ors., in Arbitration Petition (Lodging) No.1538 of 2012, delivered on 29th November, 2012* (para 21) ;

3) The judgment of the Supreme Court in the case of *Mahatma Gandhi Sahakra Sakkare Karkhane vs. National Heavy Engg. Co-op. Ltd. & Anr., (2007) 6 SCC 470.* (para 22).

20. It is submitted by the learned senior counsel that on one hand the learned arbitrator has held that the petitioners had called upon the bank to pay in terms of the bank guarantees by a letter dated 21st March, 2012 stating that “ as the agency has withdrawn the

bids after the deadline of bid submission date” and on the other hand, has held that the condition for releasing the bank guarantee, which was stated in the letter of the respondents was in fact not fulfilled. The learned senior counsel submits that there is thus *ex-facie* inconsistency and contradictions in paragraph 22 of the impugned award. The learned senior counsel submits that even if it is held that the bank guarantees could be invoked only on the conditions mentioned in the bank guarantees, the fact remains that the petitioners had invoked such bank guarantees in terms of the bank guarantees by clearly mentioning that “as the agency has withdrawn the bids after deadline of the bid submission date” the terms and conditions of the bank guarantees were complied with by the petitioners. Once the reason for invocation of the bank guarantees was mentioned in the letter of invocation, which was in accordance with the terms of the bank guarantees, the conditions of the bank guarantees were complied with. The respondents as well as the bank thus could not have opposed the invocation of such bank guarantees on the ground that the condition for releasing the bank guarantees was in fact not fulfilled. The learned senior counsel submits that the finding of the learned arbitrator is thus *ex-facie* erroneous and contrary to the provisions of the contract, including the terms of the bank guarantees.

21. It is submitted by the learned senior counsel that the finding of the learned arbitrator that since the petitioners had not suffered any loss by reason of the letter dated 15th October, 2011, addressed by the respondents in view of the fact that the petitioners already having awarded the contract to the third parties, who had presumably furnished the securities to the petitioners and their price bid was lower than the price bid of the respondents is concerned, it is submitted that as the bank guarantees furnished by the respondents were in lieu of earnest money deposit and were furnished for the purpose of fulfilling their part of the obligation by not withdrawing the bid after expiry of the validity period, there was no question of proving any loss / damage for the purpose of invocation of such bank guarantees. In support of these submissions, the learned senior counsel placed reliance on the following judgments :-

- 1) In the case of *National Highways Authority of India vs. Ganga Enterprises & Anr.* (2003) 7 SCC 410 (paras 2, 3, 7, 9 and 10)
- 2) In the case of *State of Haryana & Ors. vs. Malik Traders*, (2011) 13 SCC 200 (paras 10 to 12)
- 3) In the case of *Pesticides India vs. State Chemicals & Pharmaceuticals Corporation of India & Ors.*, 53(1994) DLT 42 (paras 7 to 9)

4) In the case of *R.K. Construction Co. vs. State of Gujarat & Anr.* 111(2013) BC 658 (paras 8 to 10)

5) The judgment of this Court in the case of *M/s.ABG Kandla Container Terminal Ltd. vs. Axis Bank Ltd. & Anr. in Notice of Motion No.2 of 2013 in Suit No.1 of 2013, dated 12th April, 2013* (paras 20 and 22)

6) The judgment of the Supreme Court in the case of *Hindustan Construction Co. Ltd. vs. State of Bihar & Ors.* (1999) 8 SCC 436 (paras 12, 13 and 14).

7) The judgment of the Supreme Court in the case of *State of Maharashtra & Ors. vs. A.P. Paper Mills Ltd.* (2006) 4 SCC 209 (para 13).

22. It is submitted by the learned senior counsel that the finding of the learned arbitrator that since the petitioners had requested the respondents to extend the bank guarantees beyond 31st January, 2012, there was no reason as to why the petitioners did not encash the bank guarantees after 7th December, 2011 and upto 23rd January, 2012 is concerned, it is submitted that merely because the petitioners asked the respondents to extend the bank guarantees till 21st March, 2012 that would not preclude the petitioners from encashing the bank guarantees and to forfeit the bid securities. It is submitted that the respondents were fully aware about

the decision of the board of directors of the petitioners about the forfeiture of the security deposit and also of tender conditions. The respondents had challenged the action on the part of the petitioners by filing a writ petition in this Court. It is submitted that in view of the fact that the letter of request by the respondents for permission to withdraw the bids was admittedly after expiry of the last date of submission of the bid, whether the decision of the board of directors to forfeit the security deposit or not was conveyed to the respondents or not was of no significance.

23. Mr.Andhyarujina, the learned counsel for the respondents on the other hand submits that the learned arbitrator has rightly rendered a finding of fact that the letter dated 15th October, 2011 was only a request for permission to withdraw the bids without bids security after forfeiture and was not actual withdrawal of the bids. The learned arbitrator has rightly held that there was no immediate withdrawal of the bids. This court cannot interfere with such finding of fact rendered by the learned arbitrator.

24. It is submitted by the learned counsel that the learned arbitrator has rightly held that the conditions of the bank guarantees were not fulfilled by the petitioners while invoking the bank guarantees. It is submitted that the bids of the respondents were considered by the petitioners even after the alleged withdrawal of the

bids by the respondents. It is submitted by the learned counsel that in any event since no loss was caused to the petitioners by the respondents withdrawing the bids, the learned arbitrator has rightly rendered a finding that unless the loss was suffered by the petitioners, the bank guarantees could not have been invoked and forfeited by the petitioners. It is submitted that it was not in dispute that the petitioners had ultimately awarded the contract to a bidder whose bid amount was less than the bids amount submitted by the respondents and thus there was no loss of any nature whatsoever suffered by the petitioners which could be recovered by the petitioners by forfeiting the security deposit furnished by the respondents.

25. It is submitted by the learned counsel that the learned arbitrator has interpreted the letter dated 15th October, 2011 and has rightly rendered a finding that the said letter was not a letter withdrawing the bids and such interpretation is possible and reasonable interpretation, this court cannot substitute such interpretation by another interpretation.

26. It is submitted by the learned counsel that the petitioners themselves have considered the bids of the respondents after evaluating such bids and had found the respondents technical qualified and thus could not have forfeited the security deposit. The

petitioners did not convey the decision dated 7th December, 2011 as to why the name of the respondents was not included in the list of 20th October, 2011. The petitioners never conveyed the decision of the petitioners' board of directors and had accepted the request of the respondents for withdrawal of their bids and that itself would indicate that the petitioners never considered the letter of 15th October, 2011 of the respondents as letter of withdrawal. In none of the reports, the petitioners had indicated that the request of the respondents for withdrawal of the bids was accepted by the petitioners.

27. Mr.Andhyarujina placed reliance on the judgment of the Supreme Court in the case of *State of Rajasthan vs. Botamal Sachdeva*, (1989) 4 SCC 35 and more particularly paragraph 2 thereof.

28. Reliance is also placed on the judgment of the Delhi High Court in the case of *Jainsons Clothing Corporation vs. The State Trading Corporation of India Ltd. & Anr.* (1990) 68 Company Cases 526 and in particular paragraphs 6, 10, 12 and 13, and 18.

29. The learned counsel placed reliance on the judgment of the Supreme Court in the case of *Associate Builders vs. Delhi Development Authority*, 2014 SCC OnLine SC 937 and more particular in paragraphs 9, 10, 12 to 15, 17 to 22.

30. The learned counsel submits that the judgments relied

upon by the petitioners are clearly distinguishable in the facts of this case. It is submitted that the bank guarantees furnished by the respondents were not akin to the earnest money deposit. There was no guarantee that the contract would be awarded to the respondents. The amount was only to ensure that the respondents would not interfere with the bid process. For the purpose of forfeiting the security deposit, there has to be a breach of contract.

31. It is submitted that even under clause 19(6) of the instructions to bidders, the right of forfeiture was discretionary. The petitioners thus having decided not to forfeit security deposit did not convey its decision to forfeit the security deposit to the respondents.

32. Mr.Setalvad in re-joinder submits that the price bid of the respondents was never opened and thus the question of determination of a loss to the petitioners did not arise. The respondents never produced any material on record or to indicate that the bids ultimately accepted by the petitioners was lower in comparison to the bids submitted by the respondents. It is submitted that insofar as the security bids submitted by the respondents is concerned, the same was in the nature of earnest money deposit and was anterior to the award of contract. It is submitted that the submission of the bank guarantees under the contract was for sustaining the bid and without furnishing the bank guarantees by the

respondents, the bid could not be demonstrated and/or dealt with by the petitioners. The respondents themselves did not want to pursue their bids and had accordingly withdrawn the bids and had requested the petitioners to return of the bank guarantees.

33. On 24th October, 2011, when the price bids of the respondents were not opened, the respondents did not bother to make any enquiry or make any protest against the petitioners for not opening the price bids of the respondents. The withdrawal of the bids by the respondents was prior to the date of opening of the price bids by the petitioners. On 7th December, 2011, the petitioners had taken a decision to forfeit the security bids. The petitioners had relied upon the said resolution before the learned arbitrator. It is submitted that if the bid of the respondents would have been accepted, the respondents were liable to furnish the security deposit in terms of clause 41.1 of the contract for the purpose of securing the performance of the contract. It is submitted that the security bid which was in the nature of the earnest money deposit was not for the purpose of securing the performance of the contract and thus the petitioners were not required to prove any loss suffered, if any, in view of the respondents withdrawing the bid after expiry period. The learned senior counsel distinguished the judgments relied upon by Mr.Andhyarujina, the learned counsel for the respondents.

REASONS AND CONCLUSION :

34. A perusal of the instructions to bidders and in particular clauses 19.1 to 19.6 clearly indicates that the bidder was required to furnish the bids security in the form of demand draft or unconditional bank guarantee from a nationalized bank in favour of the petitioners in accordance with the sample form of bid security included in section 3 of the said instructions to bidders. Clause 19.4 provides that the bid security of the unsuccessful bidders would be returned as promptly as possible, after award and signing of the contract agreement or expiration of the period of bid validity, whichever is earlier. Clause 19.5 provides that the bid security of the successful bidder will be returned when the bidder had signed the contract agreement and furnishes the required security deposit. Clause 19.6 provides that the bid security may be forfeited on occurrence of any of the eventualities provided in the said clause including when the bidder withdraws its bid, except when written notice of the withdrawal of bid is received by the employer prior to the deadline for submission of bids.

35. A perusal of the said provision makes it clear that the submission of the bid security along with the bid by the bidder was mandatory. It also indicates that when the bidder applies for withdrawal of the bid prior to the deadline of the submissions of bid,

the employer shall not be entitled to forfeit the security bid but if on the other hand the bidder would have applied for withdrawal of the bid after deadline for submissions of the bid, the said bid security was liable to be forfeited.

36. The question that arose for consideration of the learned arbitrator was whether the respondents had applied for withdrawal of their bid and if so what was the consequence thereof. It is not in dispute that the last date for submission of the bid was 21st September, 2011. The respondents had submitted their bid along with the bid security on 21st September, 2011 itself. The technical bids were opened on 21st September, 2011. On 18th September, a preliminary technical evaluation report of the 11 bidders was submitted to the petitioners. It is not in dispute that on 15th October, 2011 the respondents had addressed a letter to the petitioners. A perusal of the said letter clearly indicates that the respondents had indicated to withdraw the three bids submitted by them on 21st September, 2011 and requested to return the bank guarantees as early as possible. The respondents also appreciated the support of the petitioners in not taking steps on encashing their bank guarantees.

37. A perusal of the record indicates that in view of the receipt of the letter dated 15th October, 2011, the price bids of the

respondents was not opened by the petitioners on 24th October, 2011. The respondents did not bother to make any enquiry as to why their price bid was not opened by the petitioners. The board of directors of the petitioners thereafter in the meeting held on 7th December, 2011 decided that the letter dated 15th October, 2011 of the respondents would amount to withdrawal of the bids and thus the bids security of the respondents in terms of clause 19.6(c) of the tender document was liable to be forfeited. The petitioners thereafter addressed a letter of invocation of the bank guarantees to the bank.

38. A perusal of the award indicates that the learned arbitrator has in paragraph 14 of the impugned award held that the letter dated 15th October, 2011 of the respondents was indicative of a request made by the respondents in the petition and there was no immediate withdrawal of the bids. By the said letter the respondents had sought permission to withdraw from participation in the tenders without the bank guarantees being invoked by the respondents. The learned arbitrator also held that if there was a withdrawal of the bids, the petitioners herein should have forfeited the bank guarantees straightway. The said bank guarantees were valid till 31st January, 2012 but the petitioners did not encash the said three bank guarantees. It is held by the learned arbitrator that the petitioners thereafter considered the bids of the respondents and found that the

respondents are technically qualified. In the list of the technically qualified bidders released on 20th October, 2011, the name of the respondents was not listed. The learned arbitrator also held that if the petitioners had not listed the name of the respondents because the respondents had withdrawn the bids, it ought to have informed the respondents accordingly and should have invoked the bank guarantees. The petitioners however, did not send any communication to the respondents and therefore, the respondents legitimately believed that its technical bids were considered by the petitioners, as technically unqualified bidder.

39. A perusal of the record indicates that the preliminary technical evaluation report of the 11 bidders were submitted by the concerned department to the petitioners on 18th October, 2011. In the meantime, the respondents addressed the said letter dated 15th October, 2011. It is thus clear that in view of such letter addressed by the respondents to the petitioners, seeking permission to withdraw the bids after expiry of validity period, the name of the respondents was not placed in the list of technically qualified bidders. The respondents however, did not take any objection. The respondents also did not bother to make any enquiry. Even when the price bid of the respondents was not opened subsequently, the respondents did not lodge any protest or did not make any enquiry.

40. It is thus clear that even the respondents proceeded on the premise that its request for withdrawal of the bid beyond the deadline was accepted by the petitioners subject to tender conditions. In my view, the finding of the learned arbitrator that the letter dated 15th October, 2011 was merely a letter indicative of a request and there was no immediate withdrawal of the bids is totally contrary to the plain reading of the said letter of 15th October, 2011. By the said letter, the respondents had not only requested the petitioners to permit the respondents to withdraw it from participation from the tender but had categorically applied for return of the bank guarantees. The learned arbitrator, in my view, has totally overlooked this aspect in the matter and has rendered erroneous finding that there was no immediate withdrawal of the bids. The learned arbitrator also overlooked the subsequent events i.e. declaration of the list of technical qualified bidders and not opening the price bids of the respondents by the petitioners. The learned arbitrator also did not consider the effect of the resolution passed by the petitioners on 7th October, 2011 resolving to forfeit the security deposit of the respondents in view of the letter dated 15th October, 2011 addressed by the respondents to the petitioners.

41. A perusal of the award indicates that the learned arbitrator has rendered a finding in favour of the respondents merely on the

ground that the petitioners had not communicated its decision to forfeit the security deposit or that the petitioners had accepted the request of the respondents to permit the respondents from withdrawing from participation of the bids. The learned arbitrator was also impressed with the submission of the respondents that since the petitioners had not encashed the bank guarantees immediately upon the receipt of the letter dated 15th October, 2011, it would clearly indicate that the petitioners had rejected the request of the respondents and there was no withdrawal of the respondents from the bids.

42. In my view if according to the respondents, their requests for withdrawal from participation from the bid which was not accepted by the petitioners definitely the respondents ought to have taken action against the petitioners for not displaying the name of the respondents in the list of the technically qualified bidders and thereafter for not opening the price bid of the respondents. The respondents however, did not take any such action in the matter. Merely because the petitioners did not forfeit the security deposit immediately upon receipt of the letter dated 15th October, 2011 would not debar the petitioners from encashing such bank guarantees at the later date i.e. after opening of the tender of the technically qualified bidders and after awarding the contract to the successful bidder.

There was no provision in the contract prohibiting the petitioners from encashing the bank guarantees and/or forfeiting the security deposit beyond a particular period. The finding of the learned arbitrator in my view is thus patently illegal.

43. A perusal of paragraph 22 of the impugned award indicates that on one hand the learned arbitrator has rendered a finding that the bank guarantees required the petitioners herein to state the reason why the bank guarantees were being invoked and though had described such reason in the letter dated 21st March, 2012 of the petitioners to the bank calling upon the bank to pay in terms of the bank guarantees i.e. “ as the agency has withdrawn the bids after the deadline of bid submission date”, on the other hand the learned arbitrator has held that the condition for invoking the bank guarantees as set out in the bank guarantee document was in fact not fulfilled. A perusal of the bank guarantee would indicate that the bank had agreed and undertaken to pay to the petitioners under the said three bank guarantees upon receipt of its first written demand without the petitioners having to substantiate its demand provided that in its demand the petitioners would note that the amount claimed by it was due to it owing to occurrence of one or all of the conditions, specifying the occurred condition or conditions. One of the condition in the bank guarantee admittedly was “if the bidder withdraws his bid

during the period of bid validity specified in the form of bid”.

44. Though the learned arbitrator has rightly referred to the said condition in the letter of invocation of the bank guarantees by the petitioners has erroneously rendered a finding that the terms and conditions of the bank guarantees were not not fulfilled. The finding of the learned arbitrator in my view is patently illegal and erroneous apparent on the face of the award. The petitioners had on the face of it specified one of the condition which had occurred in its invocation letter. Once the said condition was specified, which was in accordance with the terms and conditions of the bank guarantees, the bank was liable to pay the amount under the said bank guarantees to the petitioners. Neither the bank nor the respondents could challenge the letter of invocation dated 21st March, 2012 on the ground that the conditions for releasing the bank guarantees were not fulfilled. The bank had categorically undertaken to pay to the petitioners upon receipt of its first written demand and without substantiating its demand. The only condition imposed in the said bank guarantees was that the employer had to note that the amount claimed was due to the employer owing to occurrence of one or other conditions set out therein. A perusal of the said letter dated 21st March, 2012 and summarized by the learned arbitrator in paragraph 22 of the impugned award clearly indicates that the condition set out in clause

1 of the bank guarantee had been specified by the petitioners as occurred and once that was notified, the bank was liable to pay to the employer without asking the employer to substantiate its demand. The award shows patent illegality on the face of the award.

45. Insofar as the finding of the learned arbitrator in paragraph 26 of the impugned award that since the petitioners had not suffered any damage by reason of the letter dated 15th October, 2011 and the petitioners having awarded the said contract to the third parties, who had presumably furnished the security to the petitioners and their price bid was lower than the price bid of the respondents is concerned, in my view, the said finding of the learned arbitrator is based on no evidence. Since the price bid of the respondents was not even opened and even otherwise the respondents had not disclosed the price quoted by the respondents, the question of the petitioners coming to know whether the bid of the successful bidder was lower than the bid of the respondents or not did not arise.

46. In my view the finding of the learned arbitrator that the petitioners could forfeit the bank guarantees given by way of earnest money deposit only if the petitioners would have suffered losses is patently illegal. The said finding of the learned arbitrator is contrary to the terms of clause 19.1 to 19.6 of the instructions to bidders. The learned arbitrator failed to appreciate that the bank guarantees

furnished by the respondents under clause 19.2 were by way of earnest money deposit (bid security) which could have been returned to the respondents only if its bid was rejected by the petitioners as non-responsive or was found unsuccessful. The petitioners were required to return the bid security of the successful bidders when the successful bidder had signed the contract agreement and had furnished the required security deposit. Under clause 41.1 of the instructions to bidders, the successful bidder was required to submit a performance security deposit within 14 days from the date of receipt of the Letter of Award. In my view, the learned arbitrator has mixed up the bids security which was in the name of the earnest money deposit with the security deposit which was required to be submitted (performance security deposit) by the successful bidder after the receipt of the Letter of Award. The petitioners were thus not liable to prove any loss for the purpose of forfeiting such earnest money deposit upon the respondents withdrawing its bid in breach of clause 19.6 of the instructions to bidders.

47. The Supreme Court in the case of *State of Haryana & Ors. vs. Malik Traders, (2011) 13 SCC 200*, has held that since the bidder who had agreed to keep the bid open for acceptance upto 90 days of the last date of receipt of the bid in terms of the tender and if had withdrawn its bid before expiry of the period of 90 days, such

bidder was liable to suffer the consequences i.e. forfeiture of full value of the bid security as agreed under the offer / bid. It is held by the Supreme Court that right to withdraw an offer before its acceptance cannot nullify agreement to tender conditions to suffer any penalty for withdrawal of offer against the terms of the agreement. Paragraphs 10 to 12 of the said judgment which are relevant and applicable to the facts of this case read as under :-

“ 10. For allowing the writ petition, the only reason stated by the High Court is that, since the writ petitioner (the respondent herein) had withdrawn its offer before it was accepted, there could be no acceptance of the offer and there could not be any consequence of the petitioner not honouring the commitment. However, we cannot agree with the view taken by the High Court. It is true that as per Section 5 of the Contract Act, 1872 (hereinafter referred to as “the Act”), a proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer. It is also true that before receipt of the letter of acceptance dated 26-11-2008, the respondent had sent a letter dated 15-11-2008 withdrawing its offer. However, admittedly, in Para 8 of the written offer/bid, the respondent had agreed to keep the bid open for acceptance up to 90 days after the last date of receipt of bid. The respondent had also agreed that it shall be bound by the communication of acceptance of the bid dispatched within the aforesaid period of 90 days. Hence, the respondent could not have withdrawn the bid before the expiry of the period of 90 days. It is not disputed that the acceptance of the respondent’s bid was communicated to the respondent within the said period of 90 days. Therefore, the respondent was bound by the said acceptance of the bid, despite its withdrawal by the respondent in the meanwhile.

11. In Para 10 of the offer/bid, the respondent had also agreed that the full value of the bid security would be forfeited without prejudice to any other right or remedy available to the Executive Engineer or his successor in office or his representative, should the respondent withdraw or modify its offer/bid during the period of bid validity (90 days) or extended validity period. Since the respondent withdrew its offer during the period of bid validity in violation of the abovementioned agreement in Para 8 of the offer/bid, the full value of bid security was liable to be forfeited in terms of the agreement contained in Para 10 of the offer/bid. Thus, even though under Section 5 of the Act a proposal may be revoked at any time before the communication of its acceptance is complete as against the proposer, the respondent was bound by the agreement contained in its offer/bid to keep the bid open for acceptance up to 90 days after the last date of receipt of bid and if the respondent withdrew its bid before the expiry of the said period of 90 days the respondent was liable to suffer the consequence (i.e. forfeiture of the full value of bid security) as agreed to by the respondent in Para 10 of the offer/bid. Under the cover of the provisions contained in Section 5 of the Act, the respondent cannot escape from the obligations and liabilities under the agreements contained in its offer/bid.

12. The right to withdraw an offer before its acceptance cannot nullify the agreement to suffer any penalty for the withdrawal of the offer against the terms of agreement. A person may have a right to withdraw his offer, but if he has made his offer on a condition that the bid security amount can be forfeited in case he withdraws the offer during the period of bid validity, he has no right to claim that the bid security should not be forfeited and it should be returned to him. Forfeiture of such bid security amount does not, in any way, affect any statutory right under Section 5 of the Act. The bid security was given by the respondent and taken by the appellants to ensure that the offer is not withdrawn during the bid validity period of 90 days and a contract comes into existence. Such conditions are included to ensure that only genuine

parties make the bids. In the absence of such conditions, persons who do not have the capacity or have no intention of entering into the contract will make bids. The very purpose of such a condition in the offer/bid will be defeated, if forfeiture is not permitted when the offer is withdrawn in violation of the agreement.”

48. The Supreme Court in the case of *State of Maharashtra & Ors. vs. A.P. Paper Mills Ltd. (2006) 4 SCC 209*, held in paragraph 13, which is extracted as under :-

“13. An offer under the tender was valid for a period of 45 days from the date of tender of sale and in the instant case from 15-7-1987. Stand of the respondent that the sale results should have been declared for getting approval of the competent authority by 14-8-1987 is clearly wrong. If the highest tender is not considered acceptable the final sale result was required to be declared within 45 days i.e. by 29-8-1987. The bid once made remains operative for a period of 45 days. Therefore, the decision could be taken on the bid on or before 29-8-1987. The withdrawal was made before the expiry of the period i.e. on 15-8-1987. Stand of the learned counsel for the respondent that another request was made after the expiry of the 45 days’ period does not change the situation. Clause 5(v) clearly spells out that once a tender is tendered the offer shall be considered valid for a period of 45 days from the date of tender sale in case of tenders which are under consideration. If this clause is read with clause 5(iv) the position is clear that once a tender is tendered no changes can be made and no tender can be withdrawn. We are not concerned with a case of consequences after acceptance of the tender by the successful bidder. In such a situation loss sustained in the resale and the amount realised less, shall be recovered from the bidder while adjusting the amount paid by him towards earnest money deposit. In this case the acceptance of the tender was after the validity (*sic* expiry) of the period. Therefore, this is not a case

which could authorise the Government to recover the loss from the respondent. But it is a case of withdrawal of tender and the effect of it is to be considered. Since the tender is valid for a period of 45 days and withdrawal is before expiry of the period the earnest money is to be forfeited. The stand of the respondent that because of delay in declaration of the final sale results there was no bar on withdrawal of the tender is clearly untenable. Once the tender is withdrawn the result is that the tenderer who withdraws the tender cannot take the stand that since the final sale result has not been declared there is no bar on the withdrawal.”

49. The Supreme Court in the case of *National Highways Authority of India vs. Ganga Enterprises & Anr. (2003) 7 SCC 410* has construed the similar provisions for forfeiture of the security deposit and has held that the moment the bank guarantee was given and accepted by the employer the first portion of the offer, regarding bid security, stood accepted. That did not mean that a completed contract in respect of the contract in existence has come into existence. Paragraphs 2, 3, 7 to 10 of the said judgment, which are relevant and extracted as under :-

“2. Briefly stated, the facts are as follows:

The appellant issued a tender notice calling for tenders for collection of toll on a portion of the highway running through Rajasthan. The last date of submission of bid was 31-7-1997. It was also provided that toll plazas would be got completed by the authority and handed over to the selected enterprise. There were two types of securities to be furnished, one being a bid security in an amount of Rs 50 lakhs (Rupees fifty lakhs only); the other was a performance security by way of a bank guarantee of Rs 2 crores

(Rupees two crores only). Clauses 7.1 to 8 deal with bid security. They read as under:

“7. Bid security

7.1. The bidder shall furnish, as a part of his bid, a bid security in an amount of Rs 50 lakhs (Rupees fifty lakhs only), or an equivalent amount in a freely convertible currency. The bid security shall, at the bidder's option, be in the form of a bank draft, or guarantee from a bank located in India. The bank guarantee shall be in the form of bank guarantee for bid security included herein, valid for 150 days after the last date for submission of the bid.

7.2. A bid not accompanied by an acceptable bid security shall be rejected by the National Highways Authority of India as non-responsive.

7.3. The bid security of unsuccessful bidders will be returned by the National Highways Authority of India as promptly as possible but not later than 30 days after the expiration of the period of bid validity.

7.4. The bid security of the successful bidders will be returned by the National Highways Authority of India soon after the bidder has furnished the required performance security.

7.5. The bid security may be forfeited:

(a) if the bidder withdraws his bid during the period of bid validity; or

(b) in case the successful bidder fails within the specified period to

(i) furnish the required performance security; and

(ii) sign the agreement.

8. Bid validity

Bid shall remain valid for a period of 120 days after the last date of bid submission.”

Thus, it is to be seen that the bid security of Rs 50 lakhs was not for performance of the contract. It was in essence an earnest to be given to ensure that the bidder did not withdraw his bid during the period of bid validity and/or that after acceptance the performance security is furnished and the agreement signed. The other terms pertained to the anticipated contract for collection of toll. It must be mentioned that the bid validity period was 120 days.

3. In terms of this tender document the respondent gave his bid or offer. The offer/bid was in terms of the tender and thus it was also in two parts, the first part being an offer that the bid would not be withdrawn during the bid validity period and/or that on acceptance the performance security would be furnished and the agreement signed. The second part of the offer dealt with the terms and conditions pertaining to the performance of the contract of collection of tolls, if the offer was accepted. As earnest/security for performance (of the first part of the offer), the respondent along with his bid furnished a bank guarantee in a sum of Rs 50 lakhs as bid security. The bank guarantee furnished was an "on-demand guarantee" which specifically provided that the bank guarantee could be enforced "on demand" if the bidder withdraws his bid during the period of bid validity or if the bidder, having been notified of the acceptance of his bids, fails to furnish the performance security or fails to sign the agreement. The amount of the bank guarantee was to be paid by the bank without demur on a written demand merely stating that one of these conditions had been fulfilled. The moment the bank guarantee was given and accepted by the appellants the first portion of the offer, regarding bid security, stood accepted. Of course, this did not mean that a completed contract in respect of the work of toll collection had come into existence.

7. By the impugned judgment the writ petition has been allowed. The High Court holds that the offer was withdrawn before it was accepted and thus no completed contract had come into existence. The High

Court holds that in law it is always open to a party to withdraw its offer before its acceptance. To this proposition there can be no quarrel. We, therefore, did not permit Mr Dave to cite authorities for the proposition that an offer can be withdrawn before it is accepted.

.8. The High Court, however, then goes on to hold as under:

“The statutory right having been so exercised, the fetter imposed by the clause to the contrary in the tender documents and the bank guarantee could not override the provisions of the Indian Contract Act. Any clause insofar as it is contrary or comes in conflict with the provisions of the Indian Contract Act is inoperative and void and cannot be enforced. To have an enforceable contract there must be an offer and unconditional acceptance. A person who makes an offer has the right of withdrawing it before acceptance. Until the offer is accepted unconditionally it creates no legal right and the bid can be withdrawn at any time. Once it is held that there is no completed contract between the parties no further question can arise. There can be no breach of contract. There is no statutory rule or an Act whereunder the security deposit in the form of a bank guarantee could be claimed by Respondent 2. The position may, however, be different if there is a statutory rule having force of law precluding withdrawal of a bid before its acceptance. The petitioner was entitled to withdraw the bid because the prohibition against withdrawal does not have the force of law and there was no consideration to bind him down to the condition. In the present case there was no acceptance by Respondent 2 on the date of withdrawal of the bid by the petitioner. In the circumstances the invocation and encashment of the bank guarantee is illegal and void and is liable to be set aside.”

9. In our view, the High Court fell in error in so holding. By invoking the bank guarantee and/or enforcing the bid security, there is no statutory right, exercise of which was being fettered. There is no term

in the contract which is contrary to the provisions of the Indian Contract Act. The Indian Contract Act merely provides that a person can withdraw his offer before its acceptance. But withdrawal of an offer, before it is accepted, is a completely different aspect from forfeiture of earnest/security money which has been given for a particular purpose. A person may have a right to withdraw his offer but if he has made his offer on a condition that some earnest money will be forfeited for not entering into contract or if some act is not performed, then even though he may have a right to withdraw his offer, he has no right to claim that the earnest/security be returned to him. Forfeiture of such earnest/security, in no way, affects any statutory right under the Indian Contract Act. Such earnest/security is given and taken to ensure that a contract comes into existence. It would be an anomalous situation that a person who, by his own conduct, precludes the coming into existence of the contract is then given advantage or benefit of his own wrong by not allowing forfeiture. It must be remembered that, particularly in government contracts, such a term is always included in order to ensure that only a genuine party makes a bid. If such a term was not there even a person who does not have the capacity or a person who has no intention of entering into the contract will make a bid. The whole purpose of such a clause i.e. to see that only genuine bids are received would be lost if forfeiture was not permitted.

.10. There is another reason why the impugned judgment cannot be sustained. It is settled law that a contract of guarantee is a complete and separate contract by itself. The law regarding enforcement of an "on-demand bank guarantee" is very clear. If the enforcement is in terms of the guarantee, then courts must not interfere with the enforcement of bank guarantee. The court can only interfere if the invocation is against the terms of the guarantee or if there is any fraud. Courts cannot restrain invocation of an "on-demand guarantee" in accordance with its terms by looking at terms of the underlying contract. The existence or non-existence of an underlying

contract becomes irrelevant when the invocation is in terms of the bank guarantee. The bank guarantee stipulated that if the bid was withdrawn within 120 days or if the performance security was not given or if an agreement was not signed, the guarantee could be enforced. The bank guarantee was enforced because the bid was withdrawn within 120 days. Therefore, it could not be said that the invocation of the bank guarantee was against the terms of the bank guarantee. If it was in terms of the bank guarantee, one fails to understand as to how the High Court could say that the guarantee could not have been invoked. If the guarantee was rightly invoked, there was no question of directing refund as has been done by the High Court.”

50. The Supreme Court in the case of *Hindustan Construction Co. Ltd. vs. State of Bihar & Ors. (1999) 8 SCC 436* has held that the bank guarantee represents an independent contract between the bank and the beneficiary and both parties would be bound by the terms thereof. The invocation will have to be in accordance with the terms of the bank guarantee or else the invocation itself would be bad. Paragraph 9 of the said read as under :-

“9. What is important, therefore, is that the bank guarantee should be in unequivocal terms, unconditional and recite that the amount would be paid without demur or objection and irrespective of any dispute that might have cropped up or might have been pending between the beneficiary under the bank guarantee or the person on whose behalf the guarantee was furnished. The terms of the bank guarantee are, therefore, extremely material. Since the bank guarantee represents an independent contract between the bank and the beneficiary, both the parties would be bound by the terms thereof. The invocation, therefore, will have to be in accordance

with the terms of the bank guarantee, or else, the invocation itself would be bad."

51. The Delhi High Court in the case of *Pesticides India vs. State of Chemicals & Pharmaceuticals Corporation of India & Ors.* 53 (1994) DLT 42, has after construing the clause, has held that there was nothing in that clause that the earnest money could be forfeited only if the employer would have proved the actual loss suffered by him. Paragraphs 7 to 9 of the judgment, which are relevant for the purpose of deciding this case are extracted as under :-

"(7) As regard the contention of the learned counsel for the petitioner that since the respondent did not prove the actual loss suffered by them, they were not entitled to forfeit the security deposit and the finding of the learned arbitrator upholding forfeiture of the security deposit is illegal, I do not find any merit even in this contention. In this connection, it will be relevant to refer to Clause 3 of the terms and conditions, which reads as under :-

"FORFEITURE of earnest money :-earnest money given and bank guarantees furnished are liable to be forfeited in case of any default/failure on the part of the actual users/allottees in complying-with all or any other terms and conditions prescribed by Opc in regard to said registration and/or allocation order that may be issued by CPC."

(8) From the above clause, I find that there is nothing in this clause that the earnest money can be forfeited only if the respondent proves the actual loss suffered by them. In terms of the said clause, earnest money can be forfeited in case of any default/ failure on the part of the actual user/allottee in complying all or any

of the terms and conditions prescribed by CPC. The learned arbitrator while upholding the forfeiture of the earnest money has held that it is beyond dispute that the petitioner had to do the needful three days before the arrival of the vessel and the vessel concerned 'State of Punjab' arrived on 17.10.79 whereas petitioner had yet to complete the document seven on 20th October, 1979. He has also observed that it fulfilled its obligation on 26.10.79 and thus failed to comply with the terms of contract and the Corporation was justified in forfeiting the proportionate amount of earnest money i.e. Rs.2,08,800.00 . Thus there is relevant and proper evidence to support the conclusion of the Arbitrator .Here I may refer to a judgment of the Supreme Court reported in the case of Indian Oil Corporation Ltd. VS . [Indian Carbon Ltd.](#) : [1988]3SCR426 . In this case it was held that the Court can set aside the award only if it is apparent from the award that there is no evidence to support the conclusion or if the award is based upon any legal proposition which is erroneous. Accordingly, the objection raised in respect of the forfeiture of the earnest money being without any merit is dismissed.

(9) The judgments in the case of Fateh Chand (supra), Maula Baksh (supra) and Rampur Distillery & Chemical (supra) are of no assistance to the petitioner as in the present case there is no term and condition in the contract between the parties to the effect that the earnest money can be forfeited only in case the respondent Corporation proves that it has actually suffered the loss. In the case of Upper Ganges Valley Electricity Supply Co. Ltd. (supra) relied upon by the learned counsel for the petitioner. the Supreme Court held that an award can be set-aside only if there is an error of law on the face of record. Since there is no error of law on the face of record, as explained hereinabove, the present award cannot be set-aside."

52. The Division Bench of this court in the case of *ABG Kandla Container Terminal Ltd. vs. Axis Bank Ltd. & Anr.* delivered on

5th September, 2013 in Appeal (Lodging) No.198 of 2013 has dealt with the allegations of fraud while dealing with the application for injunction and has held that there must be evidence clear both as to the factum of fraud and as regards the knowledge of the bank. It is held that it must be established that irretrievable injury would be caused unless an injunction were to be issued. The irretrievable injury has to be of such a nature as would make it impossible for the guarantor to reimburse himself if it ultimately succeeds. It is held that neither the clause of forfeiture was made out by the respondents nor made out any case of irretrievable injury of such a nature that if the petitioners would have forfeited the bank guarantees, it would have been impossible for the respondents to recover the said amount from the petitioners. Paragraph 11 of the said judgment which is relevant reads thus :-

“11. The interim certificate which is issued by the independent engineer is clearly reflective of the fact that the obligations under the contract had not been fulfilled in their entirety and that a final completion was still to be certified at a future date. The Learned Single Judge noted that the bank guarantee was renewed by the Appellant as required from time to time which, apart from anything else, provides intrinsic evidence of the fact that the obligations under the agreement had remained to be fulfilled in their entirety. The law on the subject is clear. The invocation of a bank guarantee can be enjoined only in the case of an established fraud. The fraud must be a fraud in connection with the bank guarantee of a nature that would vitiate the very foundation of the guarantee. Such a situation can arise when it is proved that the

bank knows that any demand for payment already made or which may be thereafter made would be clearly fraudulent. The evidence must be clear both as to the factum of fraud and as regards the knowledge of the bank. These principles have been reiterated in the judgment of the Supreme Court in *Himadri Chemicals Industries Ltd. v. Coal Tar Refining Company*. Moreover, it must be established that irretrievable injury would be caused unless an injunction were to be issued. The irretrievable injury has to be of such a nature as would make it impossible for the guarantor to reimburse himself if it ultimately succeeds. In the present case, it is impossible to hold that there is a case of established fraud or of irretrievable injury of a nature that would sustain the issuance of an interim injunction restraining the invocation or encashment of a bank guarantee. There is neither any fraud nor a case of irretrievable injury. “

53. The Gujarat High Court in the case of *R.K. Construction Co. vs. State of Gujarat & Anr.*, 111(2013) BC 658 has followed the judgment of the Supreme Court in the case of *State of Haryana & Ors. vs. Malik Traders*, (supra) and has held that in view of withdrawal of the bid prior to the validity period, the employer is entitled to forfeit the security deposit. In paragraphs 9 and 10 the Gujarat High Court held as under :-

“9. In *State of Haryana and Others v. Malik Traders*, VI (2011) SLT 415 : 2011(13) SCC 200, Hon'ble the Supreme Court has held and observed in para 12 as under:

12. The right to withdraw an offer before its acceptance cannot nullify the agreement to suffer any penalty for the withdrawal of the offer against the terms of agreement. A person may have a right to withdraw his offer, but if he has made his offer on a condition that the Bid Security amount can be forfeited

in case he withdraws the offer during the period of bid validity, he has no right to claim that the Bid Security should not be forfeited and it should be returned to him. Forfeiture of such Bid Security amount does not, in any way, affect any statutory right under Section [5](#) of the Act. The Bid Security was given by the respondent and taken by the appellants to ensure that the offer is not withdrawn during the bid validity period of 90 days and a contract comes into existence. Such conditions are included to ensure that only genuine parties make the bids. In the absence of such conditions, persons who do not have the capacity or have no intention of entering into the contract will make bids. The very purpose of such a condition in the offer/bid will be defeated, if forfeiture is not permitted when the offer is withdrawn in violation of the agreement.

10. Thus, as held by Hon'ble the Supreme Court, a person may have a right to withdraw his offer, but if he has made his offer on a condition that the Bid Security amount can be forfeited in case he withdraws the offer during the period of bid validity, he has no right to claim that the Bid Security should not be forfeited and it should be returned to him. The Bid Security was given by the respondent and taken by the appellants to ensure that the offer is not withdrawn during the bid validity period of 90 days and a contract comes into existence. Such conditions are included to ensure that only genuine parties make the bids. In the absence of such conditions, persons who do not have the capacity or have no intention of entering into the contract will make bids. The very purpose of such a condition in the offer/bid will be defeated, if forfeiture is not permitted when the offer is withdrawn in violation of the agreement. In light of the above, learned appellate Judge has rightly held that the respondent No. 2 was entitled to forfeit the amount of earnest money deposit even though the offer of the appellant was revoked before acceptance thereof by the competent authority. In view of the condition of tender, as per the law laid down by Hon'ble the Supreme Court, it can not be said that such forfeiture of the earnest money deposit amounts to penalty- Therefore,

I do not find that the learned appellate Judge has committed any error in reversing the judgment and decree passed by the learned trial Judge. The appeal is, therefore, required to be dismissed. Hence same is dismissed.”

I am in agreement with the view expressed by the Gujarat High Court in the above judgment.

54. A perusal of the above referred judgment of the Supreme Court and this Court and also of the Gujarat High Court and Delhi High Court it clearly indicates that the purpose of the earnest money deposit and the security deposit which is issued for the purpose of securing the performance of the contract after the award of contract are for different and distinct purposes. The purpose of obtaining the earnest money deposit at the time of submission of the bid is to ensure that only the genuine parties may bid. In the absence of such conditions, the persons who do not have capacity or have no intention of entering into contract will make bids. Every performance of such a condition in offer / bid will be defeated if forfeiture is not permitted when offer is withdrawn in violation of the agreement. In my view the respondents having agreed not to withdraw the bid otherwise than in accordance with the instructions to bidders and more particularly recorded under clauses 19.1 to 19.6, the respondents were liable to face consequences and the petitioners were entitled to forfeit the security deposit. The earnest money

deposit which was submitted by the respondents, so as to secure the conditions before award of the contract cannot be mixed up with the security deposit for securing the performance of the contract which is submitted after the award of the contract. The question of proving any loss for the purpose of forfeiting such earnest money deposit by the employer while the bidder has committed a breach of the terms and conditions of the tender, did not arise.

55. The finding of the learned arbitrator that the petitioners having suffered no loss in view of the petitioners having awarded the contract to some other contractor whose price bid was lower than the bid of the respondents, is patently illegal and even otherwise based on no evidence. In my view the said finding of the learned arbitrator is also contrary to the principles of law laid down by the Supreme Court in the above referred judgments. The learned arbitrator has decided contrary to the terms of the tender documents which were binding on the parties. The learned arbitrator cannot decide contrary to and in ignorance of the tender conditions. The learned arbitrator having decided contrary to the terms of the tender conditions and thus the award is *ex-facie* in conflict with the public policy and deserves to be set-aside on this ground also.

56. Insofar as the submission of Mr.Andhyarujina, the learned counsel for the respondent that the learned arbitrator having

rendered a finding of fact and/or has interpreted the terms of the contract and the interpretation of the learned arbitrator being possible interpretation and thus cannot be substituted by any interpretation by this Court is concerned, in my view there is no substance in this submission of the learned counsel for the reason that the findings rendered by the learned arbitrator are perverse and the interpretation of the learned arbitrator of the provisions of the tender document being an impossible interpretation, this Court has ample power under section 34 of the said Act to interfere with such award which discloses patent illegalities on the face of award.

57. Insofar as the judgment of the Supreme Court in the case of State of *Rajasthan vs. Botamal Sachdeva*, (1989) 4 SCC 35 relied upon by the learned counsel for the respondents is concerned, a perusal of the said judgment indicates that there was no provision for forfeiture of the security deposit in the agreement, which was considered by the Supreme Court in the said judgment. The employer neither proved the amount of damage incurred by it nor had proved the extra amount of cost incurred by it for getting the uncompleted work done departmentally. The amount deducted by the employer was towards the security deposit for securing the performance. In this case, there is no such security furnished by the respondents. In this case there was specific provision allowing the employer to forfeit the

security deposit. The said judgment of the Supreme Court relied upon by the learned counsel for the respondents therefore, does not assist the respondents. Paragraphs 1 and 2 of the judgment which are extracted as under :-

“ 1. This is an appeal on a certificate under Article 133(1)(a) of the Constitution before its amendment. The respondent (original plaintiff) was given a contract by the appellant (original defendant) for carrying out construction work on a certain project. According to the appellant, the respondent did not complete the construction work in time and some part of it had to be completed departmentally, as a result of which some excess cost was incurred. The suit filed by the respondent was decreed by the trial court in the sum of Rs 15,652.42 only. Both the parties preferred appeals to the High Court. The High Court by its impugned judgment, partly allowed the respondent's appeal and dismissed the appellant's appeal. The decree passed by the trial court was modified insofar as the principal amount thereof was raised to Rs 1,16,496.45. We have heard learned counsel for the appellant at length. He has, however, not been able to convince us that the High Court has committed an error in the conclusion at which it arrived. The only contention urged by learned counsel for the appellant was that the appellant was entitled to forfeit the amount kept back by the appellant as security deposit out of the amount payable to the respondent for the work done by the respondent as the respondent did not complete the work within the stipulated time.

2. We find that there is no term in the agreement between the parties enabling the appellant to forfeit the security deposit. The only right given to the appellant was to deduct out of the security deposit the amount of loss incurred by the appellant which was caused to them by reason of non-completion of the work by the respondent in time and to recover the extra cost of the work which had to be completed by

the appellant departmentally on account of default of the respondent, subject to certain limits. The appellant has neither proved the amount of damage incurred by it nor has it proved the extra amount of cost incurred by it for getting the uncompleted work done departmentally. Thus, the argument that the appellant was entitled to forfeit the security deposit or any part of the same, must fail. Moreover, there is no letter addressed to the respondent stating that the security deposit has been forfeited. There is no merit in the appeal. In the result, the appeal fails and is dismissed with costs."

58. Insofar as the judgment of the Delhi High Court in the case of *Jainsons Clothing Corporation vs. The State Trading Corporation of India Ltd. & Anr.* (supra) relied upon by the learned counsel for the respondents is concerned, the Delhi High Court had considered the terms of the bank guarantee which provided that for encashing of the bank guarantee, the plaintiff should have committed a default in performance of the contract and the beneficiary should submit a certificate to the bank which would be final and conclusive and binding on the bank. After considering such clause of the bank guarantee, the Delhi High Court held that the performance of the bank guarantee was to meet the liability which resulted from a breach of the contract by the supplier and as it was the case of the beneficiary itself that there was no loss and there was no claim under back to back contract by other party, the bank guarantee could not have been encashed. The clause of the bank guarantee in this case as well as the tender condition are totally different. The said judgment

of the Delhi High Court is thus not applicable to the facts of this case. Reliance on the said judgment by the learned counsel for the respondent is thus totally misplaced.

59. Mr. Andhyarujina, the learned counsel for the respondents relied upon the judgment of the Supreme Court in the case of *Associate Builders vs. Delhi Development Authority*, 2014 SCC OnLine SC 937 and in particular paragraphs 9, 10, 12 to 15, 17 to 22 which are extracted as under :-

“9. By a judgment dated 3rd April, 2006, the learned Single Judge of the High Court of Delhi dismissed the objections of the DDA and upheld the award. In an appeal filed Under Section [37](#) of the Arbitration Act, vide the impugned judgment dated 8th February, 2012, a Division Bench of the High Court of Delhi set aside the judgment of the Single Judge on claims 9, 10, 11 and 15, and negatived these claims in toto. Further, claims 12 and 13 were scaled down doing "rough and ready justice". Resultantly, the awarded amount of Rs. 7,20,000/- was scaled down to Rs. 5,57,137.50/-.

10. We have heard learned Counsel for the parties. Shri M.L. Verma, learned Senior Advocate appearing on behalf of the Appellant, submitted that the Division Bench has lost sight of the law laid down by this Hon'ble Court when it comes to challenges made to arbitral awards Under Section [34](#) of the Act. He has submitted that the Division Bench has acted as if this was a first appeal from the award and has further submitted that the Division Bench has taken into account facts which were neither pleaded nor proved before the learned Arbitrator in order to negative certain claims. He further submitted that it is not possible for a Bench hearing an objection against an arbitral award to do "rough and ready justice"-it is

bound by the law laid down by this Hon'ble Court. In particular, he argued that the conceded position is that 25 months delay was due to the DDA alone. The award read as a whole is just, fair and reasonable as only certain claims have been granted and every claim granted has been supported with reasons. The Arbitrator is the sole judge of the quality and quantity of evidence before him and he has decided on that evidence. No errors of law arise from the award and the award has, therefore, been wrongly set aside.

12. In as much as serious objections have been taken to the Division Bench judgment on the ground that it has ignored the parameters laid down in a series of judgments by this Court as to the limitations which a Judge hearing objections to an arbitral award Under Section [34](#) is subject to, we deem it necessary to state the law on the subject.

Section [34](#) of the Arbitration and Conciliation Act reads as follows-

“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](#).

(3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the arbitral award or, if a request had been made Under Section [33](#), from the date on which that request had been disposed of by the arbitral tribunal:

Provided that if the Court is satisfied that the applicant was prevented by sufficient cause from making the application within the said period of three months it may entertain the application within a further period of thirty days, but not thereafter.

(4) On receipt of an application Under Sub-section (1), the Court may, where it is appropriate and it is so requested by a party, adjourn the proceedings for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the opinion of arbitral tribunal will eliminate the grounds for setting aside the arbitral award.

This Section in conjunction with Section [5](#) makes it clear that an arbitration award that is governed by part I of the Arbitration and Conciliation Act, 1996 can be set aside only on grounds mentioned Under Section [34\(2\)](#) and (3), and not otherwise. Section [5](#) reads as follows:

5. Extent of judicial intervention.--Notwithstanding anything contained in any other law for the time being in force, in matters governed by this Part, no judicial authority shall intervene except where so provided in this Part.

It is important to note that the 1996 Act was enacted to replace the 1940 Arbitration Act in order to provide for an arbitral procedure which is fair, efficient and capable of meeting the needs of arbitration; also to provide that the tribunal gives reasons for an arbitral award; to ensure that the tribunal remains within the limits of its jurisdiction; and to minimize the supervisory roles of courts in the arbitral process.

It will be seen that none of the grounds contained in Sub-clause 2(a) deal with the merits of the decision rendered by an arbitral award. It is only when we come to the award being in conflict with the public policy of India that the merits of an arbitral award are to be looked into under certain specified circumstances.

In **Renusagar Power Co. Ltd. v. General Electronic Co.** 1994 Supp (1) SCC 644, the Supreme Court construed Section [7\(1\)\(b\)\(ii\)](#) of the Foreign Award (Recognition and Enforcement) Act, 1961.

7. Conditions for enforcement of foreign awards.--

(1) A foreign award may not be enforced under this Act-

(b) if the Court dealing with the case is satisfied that-

(ii) the enforcement of the award will be contrary to the public policy.

In construing the expression "public policy" in the context of a foreign award, the Court held that an award contrary to

1. The fundamental policy of Indian law
2. The interest of India
3. Justice or morality,

would be set aside on the ground that it would be contrary to the public policy of India. It went on further to hold that a contravention of the provisions of the Foreign Exchange Regulation Act would be contrary to the public policy of India in that the statute is enacted for the national economic interest to ensure that the nation does not lose foreign exchange which is essential for the economic survival of the nation (see para 75). Equally, disregarding orders passed by the superior courts in India could also be a contravention of the fundamental policy of Indian law, but the recovery of compound interest on interest, being contrary to statute only, would not contravene any fundamental policy of Indian law (see paras 85, 95).

When it came to construing the expression "the public policy of India" contained in Section [34\(2\)\(b\)\(ii\)](#) of the Arbitration Act, 1996, this Court in **ONGC v. Saw Pipes** 2003 (5) SCC 705, held-

31. *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 case : 1994 Supp (1) SCC 644] it is required to be held that the award could be set aside if it is patently illegal. The 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.

74. *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 the 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; or

(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 of 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 of by Sections [73](#) and [74](#) of the Contract Act and in the present case by specific terms of the contract.

The judgment in **ONGC v. Saw Pipes** has been consistently followed till date.

In **Hindustan Zinc Ltd. v. Friends Coal Carbonisation** : (2006) 4 SCC 445, this Court held:

14. The High Court did not have the benefit of the principles laid down in Saw Pipes : (2003) 5 SCC 705], and had proceeded on the assumption that award cannot be interfered with even if it was contrary to the terms of the contract. It went to the extent of holding that contract terms cannot even be looked into for examining the correctness of the award. This Court in Saw Pipes : (2003) 5 SCC 705] has made it clear that it is open to the court to consider whether the award is against the specific terms of contract and if so, interfere with it on the ground that it is patently illegal and opposed to the public policy of India.

In **McDermott International Inc. v. Burn Standard Co. Ltd.** : (2006) 11 SCC 181, this Court held:

58. In Renusagar Power Co. Ltd. v. General Electric Co. : 1994 Supp (1) SCC 644] this Court laid down that the arbitral award can be set aside if it is contrary to (a) fundamental policy of Indian law; (b) the interests of India; or (c) justice or morality. A narrower meaning to the expression "public policy" was given therein by confining judicial review of the arbitral award only on the aforementioned three grounds. An apparent shift can, however, be noticed from the decision of this Court in ONGC Ltd. v. Saw Pipes Ltd. : (2003) 5 SCC 705] (for short "ONGC"). This Court therein referred to an earlier decision of this Court in Central Inland Water Transport Corporation Ltd. v. Brojo Nath Ganguly : (1986) 3 SCC 156 : 1986 SCC (L and S) 429 : (1986) 1 ATC 103] wherein the applicability of the expression "public policy" on the touchstone of Section [23](#) of the Indian Contract Act and Article [14](#) of the Constitution of India came to be considered. This Court therein was dealing with unequal bargaining power of the workmen and the employer and came to the conclusion that any term of the agreement which is patently arbitrary and/or otherwise arrived at because of the unequal bargaining power would not only be ultra vires Article [14](#) of the Constitution of India but also hit by Section

[23](#) of the Indian Contract Act. In *ONGC : (2003) 5 SCC 705*] this Court, apart from the three grounds stated in *Renusagar : 1994 Supp (1) SCC 644*], added another ground thereto for exercise of the court's jurisdiction in setting aside the award if it is patently arbitrary.

59. Such patent illegality, however, must go to the root of the matter. The public policy violation, indisputably, should be so unfair and unreasonable as to shock the conscience of the court. Where the arbitrator, however, has gone contrary to or beyond the expressed law of the contract or granted relief in the matter not in dispute would come within the purview of Section [34](#) of the Act. However, we would consider the applicability of the aforementioned principles while noticing the merits of the matter.

60. What would constitute public policy is a matter dependent upon the nature of transaction and nature of statute. For the said purpose, the pleadings of the parties and the materials brought on record would be relevant to enable the court to judge what is in public good or public interest, and what would otherwise be injurious to the public good at the relevant point, as contradistinguished from the policy of a particular Government. (See *State of Rajasthan v. Basant Nahata : (2005) 12 SCC 77*].)

In **Centrotrade Minerals and Metals Inc. v. Hindustan Copper Ltd. : (2006) 11 SCC 245**, Sinha, J., held:

103. Such patent illegality, however, must go to the root of the matter. The public policy, indisputably, should be unfair and unreasonable so as to shock the conscience of the court. Where the arbitrator, however, has gone contrary to or beyond the expressed law of the contract or granted relief in the matter not in dispute would come within the purview of Section [34](#) of the Act.

104. What would be a public policy would be a matter which would again depend upon the nature of

transaction and the nature of statute. For the said purpose, the pleadings of the parties and the materials brought on record would be relevant so as to enable the court to judge the concept of what was a public good or public interest or what would otherwise be injurious to the public good at the relevant point as contradistinguished by the policy of a particular government. (See State of Rajasthan v. Basant Nahata : (2005) 12 SCC 77].)

In **DDA v. R.S. Sharma and Co.** (2008) 13 SCC 80, the Court summarized the law thus:

21. *From the above decisions, the following principles emerge:*

(a) An award, which is

- (i) contrary to substantive provisions of law; or*
- (ii) the provisions of the Arbitration and Conciliation Act, 1996; or*
- (iii) against the terms of the respective contract; or*
- (iv) patently illegal; or*
- (v) prejudicial to the rights of the parties;*

is open to interference by the court Under Section [34\(2\)](#) of the Act.

(b) The 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.*
- (c) The award could also be set aside if it is so unfair and unreasonable that it shocks the conscience of the court.*
- (d) It is open to the court to consider whether the award is against the specific terms of contract and if so, interfere with it on the ground that it is patently illegal and opposed to the public policy of India.*

With these principles and statutory provisions, particularly, Section [34\(2\)](#) of the Act, let us consider whether the arbitrator as well as the Division Bench of

the High Court were justified in granting the award in respect of Claims 1 to 3 and Additional Claims 1 to 3 of the claimant or the Appellant DDA has made out a case for setting aside the award in respect of those claims with reference to the terms of the agreement duly executed by both parties.

J.G. Engineers (P) Ltd. v. Union of India (2011) 5 SCC 758, held:

27. Interpreting the said provisions, this Court in ONGC Ltd. v. Saw Pipes Ltd. (2003) 5 SCC 705] held that a court can set aside an award Under Section [34\(2\)\(b\)\(ii\)](#) of the Act, as being in conflict with the public policy of India, if it is (a) contrary to the fundamental policy of Indian law; or (b) contrary to the interests of India; or (c) contrary to justice or morality; or (d) patently illegal. This Court explained that to hold an award to be opposed to public policy, the patent illegality should go to the very root of the matter and not a trivial illegality. It is also observed that an award could be set aside if it is so unfair and unreasonable that it shocks the conscience of the court, as then it would be opposed to public policy.

Union of India v. Col. L.S.N. Murthy (2012) 1 SCC 718, held:

22. In ONGC Ltd. v. Saw Pipes Ltd. (2003) 5 SCC 705] this Court after examining the grounds on which an award of the arbitrator can be set aside Under Section [34](#) of the Act has said: (SCC p. 727, para 31)

31. ...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 case [Renusagar Power Co. Ltd. v. General Electric Co. 1994 Supp (1) SCC 644] it is required to be held that the award could be set aside if it is patently illegal.

Fundamental Policy of Indian Law

Coming to each of the heads contained in the Saw Pipes judgment, we will first deal with the head "fundamental policy of Indian Law". It has already been seen from the Renusagar judgment that violation of the Foreign Exchange Act and disregarding orders of superior courts in India would be regarded as being contrary to the fundamental policy of Indian law. To this it could be added that the binding effect of the judgment of a superior court being disregarded would be equally violative of the fundamental policy of Indian law.

In a recent judgment, **ONGC Ltd. v. Western Geco International Ltd.** 2014 (9) SCC 263, this Court added three other distinct and fundamental juristic principles which must be understood as a part and parcel of the fundamental policy of Indian law. The Court held-

35. *What then would constitute the "fundamental policy of Indian law" is the question. The decision in ONGC [ONGC Ltd. v. Saw Pipes Ltd. (2003) 5 SCC 705] does not elaborate that aspect. Even so, the expression must, in our opinion, include all such fundamental principles as providing a basis for administration of justice and enforcement of law in this country. Without meaning to exhaustively enumerate the purport of the expression "fundamental policy of Indian law", we may refer to three distinct and fundamental juristic principles that must necessarily be understood as a part and parcel of the fundamental policy of Indian law. The first and foremost is the principle that in every determination whether by a court or other authority that affects the rights of a citizen or leads to any civil consequences, the court or authority concerned is bound to adopt what is in legal parlance called a "judicial approach" in the matter. The duty to adopt a judicial approach arises from the very nature of the power exercised by the court or the authority does not have to be separately or additionally enjoined upon the fora concerned. What must be remembered is that the importance of a*

judicial approach in judicial and quasi-judicial determination lies in the fact that so long as the court, tribunal or the authority exercising powers that affect the rights or obligations of the parties before them shows fidelity to judicial approach, they cannot act in an arbitrary, capricious or whimsical manner. Judicial approach ensures that the authority acts bona fide and deals with the subject in a fair, reasonable and objective manner and that its decision is not actuated by any extraneous consideration. Judicial approach in that sense acts as a check against flaws and faults that can render the decision of a court, tribunal or authority vulnerable to challenge.

38. *Equally important and indeed fundamental to the policy of Indian law is the principle that a court and so also a quasi-judicial authority must, while determining the rights and obligations of parties before it, do so in accordance with the principles of natural justice. Besides the celebrated audi alteram partem rule one of the facets of the principles of natural justice is that the court/authority deciding the matter must apply its mind to the attendant facts and circumstances while taking a view one way or the other. Non-application of mind is a defect that is fatal to any adjudication. Application of mind is best demonstrated by disclosure of the mind and disclosure of mind is best done by recording reasons in support of the decision which the court or authority is taking. The requirement that an adjudicatory authority must apply its mind is, in that view, so deeply embedded in our jurisprudence that it can be described as a fundamental policy of Indian law.*

39. *No less important is the principle now recognised as a salutary juristic fundamental in administrative law that a decision which is perverse or so irrational that no reasonable person would have arrived at the same will not be sustained in a court of law. Perversity or irrationality of decisions is tested on the touchstone of Wednesbury principle [Associated Provincial Picture Houses Ltd. v. Wednesbury Corporation (1948) 1 KB 223 : (1947) 2 All ER 680 (CA)] of reasonableness. Decisions that fall short of the standards of*

reasonableness are open to challenge in a court of law often in writ jurisdiction of the superior courts but no less in statutory processes wherever the same are available.

40. *It is neither necessary nor proper for us to attempt an exhaustive enumeration of what would constitute the fundamental policy of Indian law nor is it possible to place the expression in the straitjacket of a definition. What is important in the context of the case at hand is that if on facts proved before them the arbitrators fail to draw an inference which ought to have been drawn or if they have drawn an inference which is on the face of it, untenable resulting in miscarriage of justice, the adjudication even when made by an Arbitral Tribunal that enjoys considerable latitude and play at the joints in making awards will be open to challenge and may be cast away or modified depending upon whether the offending part is or is not severable from the rest.*

It is clear that the juristic principle of a "judicial approach" demands that a decision be fair, reasonable and objective. On the obverse side, anything arbitrary and whimsical would obviously not be a determination which would either be fair, reasonable or objective.

The *Audi Alteram Partem* principle which undoubtedly is a fundamental juristic principle in Indian law is also contained in Sections [18](#) and [34\(2\)\(a\)\(iii\)](#) of the Arbitration and Conciliation Act. These Sections read as follows:

18. Equal treatment of parties.--*The parties shall be treated with equality and each party shall be given a full opportunity to present his case.*

34. Application for setting aside arbitral award.-

(2) An arbitral award may be set aside by the Court only if-

(a) the party making the application furnishes proof that-

(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;

The third juristic principle is that a decision which is perverse or so irrational that no reasonable person would have arrived at the same is important and requires some degree of explanation. It is settled law that where-

a finding is based on no evidence, or

an arbitral tribunal takes into account something irrelevant to the decision which it arrives at; or

ignores vital evidence in arriving at its decision,

such decision would necessarily be perverse. A good working test of perversity is contained in two judgments. In **H.B. Gandhi, Excise and Taxation Officer-cum-Assessing Authority v. Gopi Nath and Sons** at p. 317, it was held:

7. ...It is, no doubt, true that if a finding of fact is arrived at by ignoring or excluding relevant material or by taking into consideration irrelevant material or if the finding so outrageously defies logic as to suffer from the vice of irrationality incurring the blame of being perverse, then, the finding is rendered infirm in law.

In **Kuldeep Singh v. Commr. of Police** (1999) 2 SCC 10 at para 10, it was held:

10. A broad distinction has, therefore, to be maintained between the decisions which are perverse and those which are not. If a decision is arrived at on no evidence or evidence which is thoroughly unreliable and no reasonable person would act upon it, the order would be perverse. But if there is some evidence on record which is acceptable and which could be relied upon, howsoever compendious it may be, the conclusions would not be treated as perverse and the findings would not be interfered with.

It must clearly be understood that when a court is applying the "public policy" test to an arbitration award, it does not act as a court of appeal and consequently errors of fact cannot be corrected. A possible view by the arbitrator on facts has necessarily to pass muster as the arbitrator is the ultimate master of the quantity and quality of evidence to be relied upon when he delivers his arbitral award. Thus an award based on little evidence or on evidence which does not measure up in quality to a trained legal mind would not be held to be invalid on this score¹. Once it is found that the arbitrators approach is not arbitrary or capricious, then he is the last word on facts. In **P.R. Shah, Shares and Stock Brokers (P) Ltd. v. B.H.H. Securities (P) Ltd.** (2012) 1 SCC 594, this Court held:

21. A court does not sit in appeal over the award of an Arbitral Tribunal by reassessing or reappreciating the evidence. An award can be challenged only under the grounds mentioned in Section 34(2) of the Act. The Arbitral Tribunal has examined the facts and held that both the second Respondent and the Appellant are liable. The case as put forward by the first Respondent has been accepted. Even the minority view was that the second Respondent was liable as claimed by the first Respondent, but the Appellant was not liable only on the ground that the arbitrators appointed by the Stock Exchange under Bye-law 248, in a claim against a non-member, had no jurisdiction to decide a claim against another member. The finding of the majority is that the Appellant did the transaction in the name of the second Respondent and is therefore, liable along with the second Respondent. Therefore, in the absence of any ground Under Section 34(2) of the Act, it is not possible to re-examine the facts to find out whether a different decision can be arrived at.

It is with this very important caveat that the two fundamental principles which form part of the fundamental policy of Indian law (that the arbitrator must have a judicial approach and that he must not act perversely) are to be understood.

Interest of India

The next ground on which an award may be set aside is that it is contrary to the interest of India. Obviously, this concerns itself with India as a member of the world community in its relations with foreign powers. As at present advised, we need not dilate on this aspect as this ground may need to evolve on a case by case basis.

Justice

The third ground of public policy is, if an award is against justice or morality. These are two different concepts in law. An award can be said to be against justice only when it shocks the conscience of the court. An illustration of this can be given. A claimant is content with restricting his claim, let us say to Rs. 30 lakhs in a statement of claim before the arbitrator and at no point does he seek to claim anything more. The arbitral award ultimately awards him 45 lakhs without any acceptable reason or justification. Obviously, this would shock the conscience of the court and the arbitral award would be liable to be set aside on the ground that it is contrary to "justice".

Morality

The other ground is of "morality". Just as the expression "public policy" also occurs in Section [23](#) of the Indian Contract Act, so does the expression "morality". Two illustrations to the said section are interesting for they explain to us the scope of the expression "morality".

(j) A, who is B's Mukhtar, promises to exercise his influence, as such, with B in favour of C, and C promises to pay 1,000 rupees to A. The agreement is void, because it is immoral.

(k) A agrees to let her daughter to hire to B for concubinage. The agreement is void, because it is immoral, though the letting may not be punishable under the Indian Penal Code (XLV of 1860).

In **Gherulal Parekh v. Mahadeo Dass Maiya** 1959 Supp (2) SCR 406, this Court explained the concept of "morality" thus-

Re. Point 3-Immorality: The argument under this head is rather broadly stated by the learned Counsel for the Appellant. The learned Counsel attempts to draw an analogy from the Hindu Law relating to the doctrine of pious obligation of sons to discharge their father's debts and contends that what the Hindu Law considers to be immoral in that context may appropriately be applied to a case under Section 23 of the Contract Act. Neither any authority is cited nor any legal basis is suggested for importing the doctrine of Hindu Law into the domain of contracts. Section 23 of the Contract Act is inspired by the common law of England and it would be more useful to refer to the English Law than to the Hindu Law texts dealing with a different matter. Anson in his Law of Contracts states at p. 222 thus:

The only aspect of immorality with which Courts of Law have dealt is sexual immorality....

Halsbury in his Laws of England, 3rd Edn., Vol. 8, makes a similar statement, at p. 138:

A contract which is made upon an immoral consideration or for an immoral purpose is unenforceable, and there is no distinction in this respect between immoral and illegal contracts. The immorality here alluded to is sexual immorality.

In the Law of Contract by Cheshire and Fifoot, 3rd Edn., it is stated at p. 279:

Although Lord Mansfield laid it down that a contract contra bonos mores is illegal, the law in this connection gives no extended meaning to morality, but concerns itself only with what is sexually reprehensible.

In the book on the Indian Contract Act by Pollock and Mulla it is stated at p. 157:

The epithet "immoral" points, in legal usage, to conduct or purposes which the State, though disapproving them, is unable, or not advised, to visit with direct punishment.

The learned authors confined its operation to acts which are considered to be immoral according to the standards of immorality approved by Courts. The case law both in England and India confines the operation of the doctrine to sexual immorality. To cite only some instances: settlements in consideration of concubinage, contracts of sale or hire of things to be used in a brothel or by a prostitute for purposes incidental to her profession, agreements to pay money for future illicit cohabitation, promises in regard to marriage for consideration, or contracts facilitating divorce are all held to be void on the ground that the object is immoral.

The word "immoral" is a very comprehensive word. Ordinarily it takes in every aspect of personal conduct deviating from the standard norms of life. It may also be said that what is repugnant to good conscience is immoral. Its varying content depends upon time, place and the stage of civilization of a particular society. In short, no universal standard can be laid down and any law based on such fluid concept defeats its own purpose. The provisions of Section [23](#) of the Contract Act indicate the legislative intention to give it a restricted meaning. Its juxtaposition with an equally illusive concept, public policy, indicates that it is used in a restricted sense; otherwise there would be overlapping of the two concepts. In its wide sense what is immoral may be against public policy, for public policy covers political, social and economic ground of objection. Decided cases and authoritative text-book writers, therefore, confined it, with every justification, only to sexual immorality. The other limitation imposed on the word by the statute, namely, "the court regards it as immoral", brings out the idea that it is also a branch of the common law like the

doctrine of public policy, and, therefore, should be confined to the principles recognized and settled by Courts. Precedents confine the said concept only to sexual immorality and no case has been brought to our notice where it has been applied to any head other than sexual immorality. In the circumstances, we cannot evolve a new head so as to bring in wagers within its fold.

This Court has confined morality to sexual morality so far as Section [23](#) of the Contract Act is concerned, which in the context of an arbitral award would mean the enforcement of an award say for specific performance of a contract involving prostitution. "Morality" would, if it is to go beyond sexual morality necessarily cover such agreements as are not illegal but would not be enforced given the prevailing mores of the day. However, interference on this ground would also be only if something shocks the court's conscience.

Patent Illegality

We now come to the fourth head of public policy namely, patent illegality. It must be remembered that under the explanation to Section [34\(2\)\(b\)](#), an award is said to be in conflict with the public policy of India if the making of the award was induced or affected by fraud or corruption. This ground is perhaps the earliest ground on which courts in England set aside awards under English law. Added to this ground (in 1802) is the ground that an arbitral award would be set aside if there were an error of law by the arbitrator. This is explained by Lord Justice Denning in **R v. Northumberland Compensation Appeal Tribunal. Ex Parte Shaw.** at page 130:

Leaving now the statutory tribunals, I turn to the awards of the arbitrators. The Court of King's Bench never interfered by certiorari with the award of an arbitrator, because it was a private tribunal and not subject to the prerogative writs. If the award was not made a rule of court, the only course available to an aggrieved party was to resist an action on the award

or to file a bill in equity. If the award was made a rule of court, a motion could be made to the court to set it aside for misconduct of the arbitrator on the ground that it was procured by corruption or other undue means: see the statute 9 and 10 Will. III, c. 15. At one time an award could not be upset on the ground of error of law by the arbitrator because that could not be said to be misconduct or undue means, but ultimately it was held in Kent v. Elstob , that an award could be set aside for error of law on the face of it. This was regretted by Williams, J., in Hodgkinson v. Fernie , but is now well established.

This, in turn, led to the famous principle laid down in **Champsey Bhara Co. v. The Jivraj Balloo Spinning and Weaving Co. Ltd.** AIR 1923 PC 66, where the Privy Council referred to **Hodgkinson** and then laid down:

The law on the subject has never been more clearly stated than by Williams, J. in the case of Hodgkinson v. Fernie .

The law has for many years been settled, and remains so at this day, that, where a cause or matters in difference are referred to an arbitrator a lawyer or a layman, he is constituted the sole and final judge of all questions both of law and of fact The only exceptions to that rule are cases where the award is the result of corruption or fraud, and one other, which though it is to be regretted, is now, I think firmly established viz., where the question of law necessarily arises on the face of the award or upon some paper accompanying and forming part of the award. Though the propriety of this latter may very well be doubted, I think it may be considered as established.

Now the regret expressed by Williams, J. in Hodgkinson v. Fernie has been repeated by more than one learned Judge, and it is certainly not to be desired that the exception should be in any way extended. An error in law on the face of the award means, in their Lordships' view, that 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 seeing first what that contention is, and then going to the contract on which the parties' rights depend to see if that contention is sound. Here it is impossible to say, from what is shown on the face of the award, what mistake the arbitrators made. The only way that the learned judges have arrived at finding what the mistake was is by saying: "Inasmuch as the Arbitrators awarded so and so, and inasmuch as the letter shows that then buyer rejected the cotton, the arbitrators can only have arrived at that result by totally misinterpreting Clause 52." But they were entitled to give their own interpretation to Clause 52 or any other article, and the award will stand unless, on the face of it they have tied themselves down to some special legal proposition which then, when examined, appears to be unsound. Upon this point, therefore, their Lordships think that the judgment of Pratt, J was right and the conclusion of the learned Judges of the Court of Appeal erroneous.

This judgment has been consistently followed in India to test awards Under Section [30](#) of the Arbitration Act, 1940.

In the 1996 Act, this principle is substituted by the 'patent illegality' principle which, in turn, contains three sub heads-

(a) a contravention of the substantive law of India would result in the death knell of an arbitral award. This must be understood in the sense that such illegality must go to the root of the matter and cannot be of a trivial nature. This again is a really a contravention of Section [28\(1\)\(a\)](#) of the Act, which reads as under:

28. Rules applicable to substance of dispute.--(1)
Where the place of arbitration is situated 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) a contravention of the Arbitration Act itself would be regarded as a patent illegality-for example if an arbitrator gives no reasons for an award in contravention of Section [31\(3\)](#) of the Act, such award will be liable to be set aside.

(c) Equally, the third sub-head of patent illegality is really a contravention of Section [28\(3\)](#) of the Arbitration Act, which reads as under:

28. Rules applicable to substance of dispute.--(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.

This last contravention must be understood with a caveat. An arbitral tribunal must decide in accordance with the terms of the contract, but if an arbitrator construes a term of the contract in a reasonable manner, it will not mean that the award can be set aside on this ground. Construction of the terms of a contract is primarily for an arbitrator to decide unless the arbitrator construes the contract in such a way that it could be said to be something that no fair minded or reasonable person could do.

In **McDermott International Inc. v. Burn Standard Co. Ltd.** (2006) 11 SCC 181, this Court held as under:

112. *It is trite that the terms of the contract can be express or implied. The conduct of the parties would also be a relevant factor in the matter of construction of a contract. The construction of the contract agreement is within the jurisdiction of the arbitrators having regard to the wide nature, scope and ambit of the arbitration agreement and they cannot be said to*

have misdirected themselves in passing the award by taking into consideration the conduct of the parties. It is also trite that correspondences exchanged by the parties are required to be taken into consideration for the purpose of construction of a contract. Interpretation of a contract is a matter for the arbitrator to determine, even if it gives rise to determination of a question of law. (See Pure Helium India (P) Ltd. v. ONGC (2003) 8 SCC 593] and D.D. Sharma v. Union of India (2004) 5 SCC 325)).

113. *Once, thus, it is held that the arbitrator had the jurisdiction, no further question shall be raised and the court will not exercise its jurisdiction unless it is found that there exists any bar on the face of the award.*

In **MSK Projects (I) (JV) Ltd. v. State of Rajasthan** (2011) 10 SCC 573, the Court held:

17. *If the arbitrator commits an error in the construction of the contract, that is an error within his jurisdiction. But if he wanders outside the contract and deals with matters not allotted to him, he commits a jurisdictional error. Extrinsic evidence is admissible in such cases because the dispute is not something which arises under or in relation to the contract or dependent on the construction of the contract or to be determined within the award. The ambiguity of the award can, in such cases, be resolved by admitting extrinsic evidence. The rationale of this rule is that the nature of the dispute is something which has to be determined outside and independent of what appears in the award. Such a jurisdictional error needs to be proved by evidence extrinsic to the award. (See Gobardhan Das v. Lachhmi Ram AIR 1954 SC 689], Thawardas Pherumal v. Union of India AIR 1955 SC 468], Union of India v. Kishorilal Gupta and Bros. AIR 1959 SC 1362], Alop Parshad and Sons Ltd. v. Union of India AIR 1960 SC 588], Jivarajbhai Ujamshi Sheth v. Chintamanrao Balaji AIR 1965 SC 214] and Renusagar Power Co. Ltd. v. General Electric Co. (1984) 4 SCC 679 : AIR 1985 SC 1156)).*

In **Rashtriya Ispat Nigam Ltd. v. Dewan Chand Ram**

Saran (2012) 5 SCC 306, the Court held:

43. *In any case, assuming that Clause 9.3 was capable of two interpretations, the view taken by the arbitrator was clearly a possible if not a plausible one. It is not possible to say that the arbitrator had travelled outside his jurisdiction, or that the view taken by him was against the terms of contract. That being the position, the High Court had no reason to interfere with the award and substitute its view in place of the interpretation accepted by the arbitrator.*

44. *The legal position in this behalf has been summarised in para 18 of the judgment of this Court in SAIL v. Gupta Brother Steel Tubes Ltd. (2009) 10 SCC 63 : (2009) 4 SCC (Civ) 16] and which has been referred to above. Similar view has been taken later in Sumitomo Heavy Industries Ltd. v. ONGC Ltd. (2010) 11 SCC 296 : (2010) 4 SCC (Civ) 459] to which one of us (Gokhale, J.) was a party. The observations in para 43 thereof are instructive in this behalf.*

45. *This para 43 reads as follows: (Sumitomo case (2010) 11 SCC 296 : (2010) 4 SCC (Civ) 459], SCC p. 313)*

43. *...The umpire has considered the fact situation and placed a construction on the clauses of the agreement which according to him was the correct one. One may at the highest say that one would have preferred another construction of Clause 17.3 but that cannot make the award in any way perverse. Nor can one substitute one's own view in such a situation, in place of the one taken by the umpire, which would amount to sitting in appeal. As held by this Court in Kwaliti Mfg. Corporation v. Central Warehousing Corporation (2009) 5 SCC 142 : (2009) 2 SCC (Civ) 406] the Court while considering challenge to arbitral award does not sit in appeal over the findings and decision of the arbitrator, which is what the High Court has practically done in this matter. The umpire is legitimately entitled to take the view which he holds to be the correct one after considering the material before him and after interpreting the provisions of the*

agreement. If he does so, the decision of the umpire has to be accepted as final and binding.

13. Applying the tests laid down by this Court, we have to examine whether the Division Bench has exceeded its jurisdiction in setting aside the arbitral award impugned before it.

14. A large part of the judgment is an extract from the arbitral award. It is important to note that the Division Bench held:

9. A perusal of the award would reveal, from the portions extracted herein above, that with reference to evidence led before him the learned Arbitrator has held delay attributable to DDA, a finding of fact which is based on evidence and rightly conceded to by Sh. Bhupesh Narula, Advocate who appears for DDA as being beyond judicial review power of this Court pertaining to a reasoned award. But, while awarding Rs. 8,27,960/- the reasoning adopted by the learned Arbitrator is questioned as being the result of ignoring the well-recognized legal principles on the subject, learned Counsel argued that the reasoning is the ipse dixit of the learned Arbitrator.

15. The Division Bench while considering claims 9, 10, 11 and 15 found fault with the application of Hudson's formula which was set out by the learned Arbitrator in order to arrive at the claim made under these heads. The Division Bench said that it was not possible for an Arbitrator to mechanically apply a certain formula however well understood in the trade. This itself is going outside the jurisdiction to set aside an award Under Section [34](#) in as much as in **McDermott's** case (supra), it was held:

104. *It is not in dispute that MII had examined one Mr. D.J. Parson to prove the said claim. The said witness calculated the increased overheads and loss of profit on the basis of the formula laid down in a manual*

published by the Mechanical Contractors Association of America entitled "Change Orders, Overtime, Productivity" commonly known as the Emden Formula. The said formula is said to be widely accepted in construction contracts for computing increased overheads and loss of profit. Mr. D.J. Parson is said to have brought out the additional project management cost at US\$ 1,109,500. We may at this juncture notice the different formulas applicable in this behalf.

(a) Hudson Formula: In Hudson's Building and Engineering Contracts, Hudson Formula is stated in the following terms:

<i>"Contract head office overhead and profit percentage"</i>	<i>Contract period</i>	<i>Period of delay"</i>
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In the Hudson Formula, the head office overhead percentage is taken from the contract. Although the Hudson Formula has received judicial support in many cases, it has been criticised principally because it adopts the head office overhead percentage from the contract as the factor for calculating the costs, and this may bear little or no relation to the actual head office costs of the contractor.

(b) Emden Formula: In Emden's Building Contracts and Practice, the Emden Formula is stated in the following terms:

<i>"Head office overhead and profit 100"</i>	<i>Contract sum</i>	<i>Period of delay"</i>
	<i>Contract period</i>	

Using the Emden Formula, the head office overhead percentage is arrived at by dividing the total overhead cost and profit of the contractor's organisation as a whole by the total turnover. This formula has the advantage of using the contractor's actual head office overhead and profit percentage rather than those contained in the contract. This formula has been

widely applied and has received judicial support in a number of cases including *Norwest Holst Construction Ltd. v. Coop. Wholesale Society Ltd.* [Decided on 17-2-1998,], *Beechwood Development Co. (Scotland) Ltd. v. Mitchell* [Decided on 21-2-2001,] and *Harvey Shopfitters Ltd. v. Adi Ltd.* [Decided on 6-3-2003, (2004) 2 All ER 982 : [2003] EWCA Civ 1757].

(c) *Eichleay Formula*: The *Eichleay Formula* was evolved in America and derives its name from a case heard by the Armed Services Board of Contract Appeals, *Eichleay Corporation*. It is applied in the following manner:

Step 1

Contract billings	Total overhead for	Overhead allocable
Total billings for contract period	contract period =	to the contract

Step 2

Allocable overhead	=	Daily overhead rate
Total days of contract		

Step 3

Daily contract overhead rate	Number of days = of delay	Amount of unabsorbed overhead"
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This formula is used where it is not possible to prove loss of opportunity and the claim is based on actual cost. It can be seen from the formula that the total head office overhead during the contract period is first determined by comparing the value of work carried out in the contract period for the project with the value of work carried out by the contractor as a whole for

the contract period. A share of head office overheads for the contractor is allocated in the same ratio and expressed as a lump sum to the particular contract. The amount of head office overhead allocated to the particular contract is then expressed as a weekly amount by dividing it by the contract period. The period of delay is then multiplied by the weekly amount to give the total sum claimed. The Eichleay Formula is regarded by the Federal Circuit Courts of America as the exclusive means for compensating a contractor for overhead expenses.

105. *Before us several American decisions have been referred to by Mr. Dipankar Gupta in aid of his submission that the Emden Formula has since been widely accepted by the American courts being *Nicon Inc. v. United States* [Decided on 10-6-2003 (), : ()], *Gladwynne Construction Co. v. Mayor and City Council of Baltimore* [Decided on 25-9-2002, :] and *Charles G. William Construction Inc. v. White* [: ()].*

106. *We do not intend to delve deep into the matter as it is an accepted position that different formulae can be applied in different circumstances and the question as to whether damages should be computed by taking recourse to one or the other formula, having regard to the facts and circumstances of a particular case, would eminently fall within the domain of the arbitrator.*

17. The Division Bench then went on to hold:

17. There is admittedly no evidence that the contractor i.e. the Respondent had a central establishment. It appears to be a case where the contractor is petty contractor and the only expenses incurred are at the site. The claim is towards hire charges paid for centering and shuttering, hiring tools, plants and scaffoldings i.e. the claim is not for the contractor's own equipment lying idle. There is just no evidence that the contractor paid charges as claimed by him. Not a single bill raised by the alleged person who let on hire the equipment to the

contractor has been filed nor any evidence adduced for the payment made. Except for listing a 10 HP Water Pump, 4 number 1 HP water pump, 3 mixers, 250 scaffolding bamboos, 150 ballis and 2 vibrators in Annexure-J to the Statement of Claim, no document proving hiring the same and brought at the site has been led. We highlight that the claim is on account of hire Charges paid and there is no evidence of said payment. It does happen that where a work is stopped, the person who taken an equipment on hire returns the same and re-hires the same when work recommences. Thus, Claim No. 9, 10 and 11 cannot be allowed because there is no evidence to support the claims. Damages on account of establishment expenses incurred during period contract got prolonged have certainly to be recompensed, but we find no evidence in the form of books of accounts, vouchers etc. to show payments to the staff or expenses incurred in maintaining an establishment at site in the form of a site office. The wages register, photocopy whereof was filed before the Arbitrator, pertains to wages paid to the unskilled, semiskilled and skilled labour deployed to execute the works. The pleadings pertaining to the claim would show that as per the contractor he had deployed one Executive Officer, one Graduate Engineer, one Junior Engineer, one Accountant, one Storekeeper and Supervisor and one Mechanic at the site and had also deployed watch and ward. Details of the persons employed have been listed in Annexure-N to the Statement of Claim and the documents filed to establish the same would evidence that the contractor has filed photocopies of the salary register, which are available from pages No. 1255 to 1322, but unfortunately for the contractor, the cat is out of the bag when we look at the documents. They pertain to payments made for a site at Mayur Vihar. We highlight that the contract in question pertains to flats and houses at Trilokpuri and

not Mayur Vihar. It is apparent that the contractor has tried to pull the wool on the eyes of the primary adjudicator of the claim. It is not the case of the contractor that these persons were simultaneously supervising the work at two sites. Assuming this was the case, the matter would then have been adjudicated with reference to same number of persons supervising two sites and the time spent at each site by them.

18. Thus, the award pertaining to Claim Nos. 9, 10, 11 and 15 is liable to be sent aside and it is so set aside. We need not therefore take corrective action on the apparent error i.e. the learned Arbitrator has worked out the claim on the original contract value of Rs. 87,66,678/-, of course by reducing it by 15%, but ignoring that final work executed was only in sum of Rs. 62,84,845/-.

18. Mr. Verma argued correctly that there is nothing on record to show that the contractor is a petty contractor and that the only expenses incurred are at the site. He has shown us that the contract itself required execution of the work by a Class-I contractor and has further shown us that Class-I contractors require to have certain stipulated numbers of works worth large amounts before they can apply for the tender and that their financial soundness has to be attested too by banker's certificate showing that their worth is over 10 crores of rupees. Further, he has pointed out from the statement of claims before the Arbitrator that there was evidence for claims 9, 10 and 11 laid before the Arbitrator which the Arbitrator has in fact accepted. Also establishment expenses were set out in great detail before the Arbitrator and it is only on this evidence that the Arbitrator ultimately has awarded these claims. Mr. Verma is also right in saying that the Division Bench was completely wrong in stating that the establishment expenses pertained to payments for a site at Mayur Vihar as opposed to Trilok Puri which were where the aforesaid houses were to be constructed. He pointed out that in the

completion certificate dated 30th May, 1997 given by the DDA to the Appellant, it is clear that the houses that were, in fact, to be constructed were in Mayur Vihar, Phase-II, which is part of the Trilok Puri trans-Yamuna area.

It is most unfortunate that the Division Bench did not advert to this crucial document at all. This document shows not only that the Division Bench was wholly incorrect in its conclusion that the contractor has tried to pull the wool over the eyes over the DDA but it should also have realized that the DDA itself has stated that the work has been carried out generally to its satisfaction barring some extremely minor defects which are capable of rectification. It is clear, therefore, that the Division Bench obviously exceeded its jurisdiction in interfering with a pure finding of fact forgetting that the Arbitrator is the sole Judge of the quantity and quality of evidence before him and unnecessarily bringing in facts which were neither pleaded nor proved and ignoring the vital completion certificate granted by the DDA itself. The Division Bench also went wrong in stating that as the work completed was only to the extent of Rs. 62,84,845/-, Hudson's formula should have been applied taking this figure into account and not the entire contract value of Rs. 87,66,678/- into account.

19. Here again, the Division Bench has committed a grave error. Hudson's formula as is quoted in **McDermott's** case is as follows:

(a) Hudson Formula: In Hudson's Building and Engineering Contracts, Hudson Formula is stated in the following terms:

"Contract head office overhead and profit percentage"	Period of Contract period	delay"
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In the Hudson Formula, the head office

overhead percentage is taken from the contract. Although the Hudson Formula has received judicial support in many cases, it has been criticised principally because it adopts the head office overhead percentage from the contract as the factor for calculating the costs, and this may bear little or no relation to the actual head office costs of the contractor.

20. It is clear that to apply this formula one has to take into account the contract value that is awarded and not the work completed. On this score again, the Division Bench is to be faulted.

21. In dealing with claims 12 and 13, the Division Bench stated:

19. Pertaining to Claim No. 12 and 13, the learned Arbitrator has recompensed the contractor 20% price hike in the cost of material and labour noting, that there was a steep hike in the period in question when the contract got prolonged by 25 months. We highlight that though the Arbitrator has found the delay to be 25 months, recompense has been restricted to only 20 months.

20. As noted herein above, partial recompense under Clause 10C, has been granted to the contractor, but the same i.e. the Clause in question requiring applicability during contract stipulated period, it is apparent that the contractor would be entitled to full recompense for price hike during the extended 25 months period and not the 20 months to which the learned Arbitrator has restricted the recompense to.

21. But, for the benefit granted under Clause 10C wherein Rs. 1,62,387/-, Rs. 46,184/- and Rs. 12,922/- have been awarded under Claim Nos. 2, 3 and 4, said amounts have to be adjusted, but not in full, for the reason these include the amounts payable during the

contract stipulated period.

22. The total of the three sums comes to Rs. 2,21,493/-. We have another problem. Neither counsel could help us identify the components thereof i.e. the component relatable to the 9 months during which the work had to be completed and the 25 months during which the contract got prolonged. Thus, we apply the Rule of 'Rough and Ready Justice'. We divide the sum by 34 to work out the proportionate increase per month. Rs. 2,21,493/- divided by 34 = Rs. 6,514.50 and multiplying the same by 25, the figure comes to Rs. 1,62,862.50.

23. Adopting, for the reasons given by the Arbitrator, that 20% hike in the balance work done after the contract stipulated period i.e. benefit to be granted under this head for work done in sum of Rs. 37,02,066/- and accepting the sum of Rs. 7,20,000/- being the resultant figure, subtracting Rs. 1,62,862.50, the figure arrived at is Rs. 5,57,137.50.

22. Here again, the Division Bench has interfered wrongly with the arbitral award on several counts. It had no business to enter into a pure question of fact to set aside the Arbitrator for having applied a formula of 20 months instead of 25 months. Though this would inure in favour of the Appellant, it is clear that the Appellant did not file any cross objection on this score. Also, it is extremely curious that the Division Bench found that an adjustment would have to be made with claims awarded under claims 2, 3 and 4 which are entirely separate and independent claims and have nothing to do with claims 12 and 13. The formula then applied by the Division Bench was that it would itself do "rough and ready justice". We are at a complete loss to understand how this can be done by any court under the jurisdiction exercised Under Section [34](#) of the Arbitration Act. As has been held above, the expression "justice" when it comes to setting aside an award under the public policy ground can only mean that an award shocks the conscience

of the court. It cannot possibly include what the court thinks is unjust on the facts of a case for which it then seeks to substitute its view for the Arbitrator's view and does what it considers to be "justice". With great respect to the Division Bench, the whole approach to setting aside arbitral awards is incorrect. The Division Bench has lost sight of the fact that it is not a first appellate court and cannot interfere with errors of fact."

60. On perusal of the judgment relied upon by the learned counsel for the respondents in *Associate Builders vs. Delhi Development Authority* (supra), it is clear that the Court can set-aside the award if the award is against justice or morality, discloses patent illegality, contrary to the terms of the contract and not in accordance with the substantive law of India. In my view, the petitioners have made out a case that the award is patently illegal on the face of record and the learned arbitrator has decided contrary to the terms of the tender documents and has also decided contrary to the law laid down by the Supreme Court and this Court and thus this Court has ample power to set-aside such award under section 34 of the said Act.

61. I therefore, pass the following order :-

i). The arbitration petition is made absolute in terms of prayer clause (a). The impugned award dated 26th October, 2012 is set-aside.

- ii). There shall be no order as to costs.

(R.D. DHANUKA, J.)