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IN THE HIGH COURT OF DELHI AT NEW DELHI

Reserved on: 12.08.2015

Pronounced on : 09.09.2015

+ FAO (OS) 654/2010

KLEN & MARSHALLS MANUFACTURERS AND EXPORTERS LTD.Appellant

Through: Ms. Mohna. M. Lal and Ms. Geetali Talukdar, Advocates.

Versus

POWER GRID CORPORATION INDIA LTD. AND ANR

.....Respondents

Through: Sh. S.B. Upadhyay, Sr. Advocate with Sh. P.K. Mishra, Advocate.

+ FAO (OS) 460/2011, C.M. APPL.9256/2013

POWER GRID CORPORATION OF INDIA LTD.

.....Appellant

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CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MS. JUSTICE DEEPA SHARMA

MR. JUSTICE S. RAVINDRA BHAT

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1. This common judgment will dispose of two cross appeals- one preferred by the Power Grid Corporation of India (PGC)- i.e FAO (OS) 460/2011 and the other, by Klen and Marshalls Manufacturers & Exporters Ltd (“Klen”) – FAO (OS) 654/2010. Both are directed against different findings of the Learned Single Judge rendered in OMP 262/2003 (by PGC) and OMP 88/2006- by Klen.

2. The facts necessary to decide the two appeals are that on 10.01.1995 PGC issued a Letter of Award to Klen for supply of line material (Bersimis Conductors and Earth wires) which was to be used by the contractors of PGC, i.e M/s Cobra, towards erection of towers and stringing, as part of the larger World Bank funded project of power evacuation from Jammu and Kashmir to other beneficiary neighboring states. In terms of the contract, the supplies were to be completed within 24 months, i.e by 10.01.1997. PGC contended that the delivery time was extended; firstly by a year. This was without prejudice to PGC’s rights to recover liquidated damages. Alleging that despite two extensions, Klen did not supply the entire contracted quantities and that substantial quantities of conductors remained unsupplied, PGC terminated the contract, on 03.09.1998. This led to disputes. Eventually, under Sections 8 and 11, of the Arbitration Act, 1996 this Court appointed a Sole Arbitrator, viz. Justice P.K. Bahri (Retired). The arbitral tribunal, by award dated 09.05.2003, directed payment of US \$ 1435006/- by PGC with a further amount of ₹45,10,798/- in Klen’s favour. The payments were directed to be made by PGC within two months, failing

which a further liability to pay 12% interest from the date of award, in the event of default in payment of the awarded amount. PGC was awarded some amounts, by way of liquidated damages.

3. Both PGC and Klen preferred applications/petitions under Section 34 of the Arbitration and Conciliation Act, 1996 (hereafter “the Act”) objecting to the award. Klen’s contention in its objection was that after concluding that PGC had delayed opening the Letter of Credit, the arbitral tribunal erred in holding that the termination of contract was justified. Klen stated that the award was bad because it did not consider that since it had imported raw material under a special Imprest License, it could not have disposed of the raw material or finished goods in the open market. To this effect, Klen challenged the conclusions in the award, found in Para 59. Likewise, Klen attacked the findings regarding rejection of its claim for reimbursement towards type testing and submitted that since the agreed agency at Chennai could not do it, a foreign concern, i.e EDF France, conducted it. Klen sought reimbursement of expenses incurred in that regard. The arbitrator however rejected that claim. Klen was also aggrieved by the fact that PGC had been awarded liquidated damages to the tune of ₹6,33,39,912/- in its favour despite a finding that it had not suffered any damage. Klen also argued that though PGC’s counter claim for ₹2,15,78,888/ (towards additional security) was rejected by the Arbitrator, yet no refund of that amount was directed in the impugned Award. In this connection, Klen referred to PGC’s exhibit Ex-R8 to say that the latter had admitted that it had retained amounts as additional security.

4. PGC had, on the other hand argued that the award did not call for interference on the grounds urged by Klen. In its objections under Section

34, it argued that the arbitral tribunal disallowed its claim towards encashment of the performance guarantee on the ground that the same was included in PGC's claim for liquidated damages. PGC stated that this view of the Arbitrator was contrary to Clause 22.2 of General Conditions of Contract ("GCC") read with Clause 9 of the Letter of Award which specifically provided that PGC would be entitled to encashment of bank guarantee in addition to liquidated damages. This claim, PGC argued was without prejudice to its other rights under the Contract.

5. The Learned Single Judge examined the award and various judgments of the Supreme Court. The impugned judgment held that the scope of interference in relation to arbitral awards was extremely narrow; relying on *McDermott International Inc. v. Burn Standard Co. Ltd.*, (2006) 11 SCC 181; *Development Authority vs. R.S. Sharma* (2008) 13 SCC 80 and *Oil and Natural Gas Commission vs. Saw Pipes*, (2003) 5 SCC 705 it was concluded that Klen's objections as to the award of liquidated damages was merited; however, the learned Single Judge held that instead of damages on that head, PGC was entitled to the performance guarantee amount in view of a specific condition in the contract for that purpose.

6. Ms. Mohna M. Lal, learned counsel for Klen argued that the learned Single Judge fell into error in not interfering with the award on the ground urged by them. Learned counsel contended that the arbitral tribunal erred in not holding that the raw material imported for PGC for the Kishenpur Moga Transmission Line and the finished goods produced therefrom, can only be utilized for the said project alone as they were goods specially exempted from import duty for purposes of the World Bank project. It was further argued that if the raw materials and finished goods worth US \$ 2,148,011/-

(in respect of the price of raw material not utilized by the Appellant for the contract) and US \$713,800 - (in respect of the cost of 172 Kms. of the Bersimis conductors not taken delivery of by PGC) are sold in the open market, Klen and its joint venture partners will suffer penal consequences.

7. It was next argued by Klen that construction of 172.734 kms of Bersimis conductors was ready to be delivered by it but delivery was not taken by the PGC. The Arbitrator failed to appreciate that Klen was accordingly entitled to the sum of \$ 2,148,011/- (towards price of raw material not utilized by it for the contract) and US \$713,800- (towards cost of 172 Kms. of the Bersimis conductors not taken delivery of by the Respondent), and interest thereon at the rate of 18% per annum from 03.09.1998 till the date of the Award and thereafter at the rate of 12% per annum from 09.07.2003 till the date of actual payment by the Respondent (pursuant to the Award). Ms. Lal highlighted that when PGC suffered no damages on account of delayed supply, there could have been no question of liquidated damages or any other kind of damages, by retention of guarantee money. She emphasized the fact that the sub-contractor, M/s Cobra, had not finished the work awarded to it; consequently the question of any adverse impact due to Klen's alleged default could not have arisen. Here, it was argued that Cobra had terminated its contract with PGC on 1.7.1998. This contract was revived only in October 1998. Thus, termination of contract with Klen was not only bad but was pre-mature. This was because the goods which were to be supplied to Cobra, could not be accessed by the latter on account of an injunction order.

8. It was argued that the approach of the Arbitrator was contrary to public policy in India as embodied in provisions of Section 73 and 74 of the

Contract Act. Once it was held that PGC itself was blameworthy, the award could nevertheless not have attributed any fault on the part of Klen, especially when no damages accrued to PGC on account of its so called default. Learned counsel relied on *Union of India Vs. Rampur Distillery* AIR 1973 SC 1093 to say that the learned Single Judge erred in directing the award of performance guarantee amounts. In that decision, the Supreme Court said:

"the party to a contract taking security deposit from the other party to ensure due performance of the contract is not entitled to forfeit the deposit on ground of default when no loss is caused to him in consequence of such default".

Reliance was also placed on *Fateh Chand Vs. Bal Kishan Dass* AIR 1973 SC 1098 where it was held that:

"it (law) does not justify the award of compensation when in consequence of the breach no legal injury at all has resulted because compensation for breach of contract can be awarded to make good loss or damage which naturally arose in the usual course of things".

9. It was urged that once the arbitrator directed refund of the 10% of the advance payment made by PGC, it meant that the latter got the goods free given the fact that advance bank guarantee amount was also retained by it; it did not also pay for the goods supplied. In other words, PGC was compensated for not having incurred any loss and also for not having invested any sums towards procurement of goods from Klen. Admittedly, PGC did not pay anything and had only sought to give adjustments of the monies lying with it belonging to Klen in its counter claim. It was submitted that this was an error which went into the root of the matter and the award

was contrary to law and public policy.

10. Mr. S.B. Upadhyay, learned senior counsel for PGC at the outset has fairly submitted that PGC's grievance with respect to the guarantee had been redressed and highlighted that it was constrained to file a cross appeal on account of Klen's challenge to the impugned judgment. It was submitted that the arbitrator's determination and analysis of the facts cannot be faulted as perverse, unreasonable or contrary to law. Nor was there any procedural irregularity in his findings. The only grievance of PGC was that the arbitrator had overlooked Clause 22.2 of the GCC and Clause 9 of Letter of Award, which entitled it to claim the amounts underlying the performance guarantee value. It was highlighted, by placing reliance on *Kailash Nath Associates v. DDA* (2015) 4 SCC 136 that PGC could not be deprived of the right to invoke the guarantee on account of the failure by Klen to adhere to the time schedule, regardless of the other findings. Mr. Upadhyay relied on the findings in the award for this purpose and submitted that the conditions entitling PGC to invoke the guarantee were independent of the stipulation for payment of liquidated damages. It was argued that so far as the amount of \$ 2,148,011/- (towards price of raw material not utilized by Klen for the contract) the Arbitrator did not allow it. So the question of Klen becoming entitled to it, due to rejection of any counter claim, did not arise.

Analysis and Conclusions

11. The arbitral tribunal held that there was some delay in opening the Letter of Credit, on the part of PGC. However, the award held that invocation of the liquidated damages clause was warranted. The reason furnished was as follows:

"However, it is evident that the supplies made by the claimant throughout were never adequate to fully utilize the amounts of various letters of credit. Thus the delay in opening of letters of credit materially did not have much bearing in failure of the claimant to make adequate supply of the goods."

Keeping this finding in mind, the learned Single Judge held that award of liquidated damages was not warranted. However, the encashment of bank guarantee was upheld, on the basis of the Arbitrator's following reasoning:

"34. The respondent thus was justified legally to terminate the contract as the claimant committed breach of the terms of the contract in not supplying the conductors in terms of the amendment to the contract.

35. It was not legally incumbent upon the respondent to wait till expiry of last date of delivery before resorting to terminate of the contract. The claimant was obligated to supply particular quantity every month. Despite reminders by respondent making its intention clear that if supplies were not augmented in terms of the contract, it would terminate the contract the claimant failed to respond in positive manner. Thus I hold that the respondent was legally justified in terminating the contract.

36. Mere fact that the respondent restored the contract of M/s.Kobra is no ground that the respondent ought to have given more time to the claimant for completing the supplies. The respondent was to get completed a huge project and has to keep in view that no factor should remain which may impede the expeditious completion of the project. The claimant's poor record of supplying the goods over an extended period was justification enough for the respondent to terminate the contract and look for alternate supplier. In hind sight the respondent succeeded well in procuring the balance quantity from other contractors and also at much lower prices..."

12. The condition entitling PGC to liquidated damages and performance

guarantee invocation are as follows:

Clause 22.2 of GCC

"22.2 An unexcused delay by the Supplier in the performance of its delivery obligations shall render the Supplier liable to any or all of the following sanctions forfeiture of its performance security, imposition of liquidated damages and or termination of the Contract for default."

Clause 9 of Letter of Award:

If you fail to deliver any or all of the Goods or perform the Services within the time period(s) specified in the Contract, or any extension thereof granted by POWERGRID, then POWERGRID shall without prejudice to its other remedies under the contract, deduct from the Contract Price as Liquidated damages, a sum equivalent to half percent (0.5%) of the delivered price of the delayed Goods or unperformed Services for each week of delay or part thereof until actually delivery or performance, upto a maximum deduction of Ten percent (10%) of the delayed Goods or Services Contract Price. Once the maximum is reached, POWERGRID may consider termination of the Contract in line with Clause No. 23 Section GCC, Bidding document, Vol-I.

POWER GRID may, without prejudice to any other method of recovery, deduct the amount of such damages with any monies due to or to become due to you. The payment or deduction of such damages shall not relieve you from your obligation to complete the works or from any of your other obligations and liabilities under the contract."

13. *Kailash Nath Associates v. DDA* (2015) 4 SCC 136 is an authority of recent vintage on the question of the power of the principal to invoke the performance guarantee condition, notwithstanding its inability to recover liquidated damages specified in a contract. The Supreme Court had

considered the law in *Fateh Chand's case* and several other decisions, and held as follows:

"The law laid down by a Bench of 5 Judges in Fateh Chand's case is that all stipulations naming amounts to be paid in case of breach would be covered by Section 74. This is because Section 74 cuts across the rules of the English Common Law by enacting a uniform principle that would apply to all amounts to be paid in case of breach, whether they are in the nature of penalty or otherwise..."

43. On a conspectus of the above authorities, the law on compensation for breach of contract under Section 74 can be stated to be as follows:

1. Where a sum is named in a contract as a liquidated amount payable by way of damages, the party complaining of a breach can receive as reasonable compensation such liquidated amount only if it is a genuine pre-estimate of damages fixed by both parties and found to be such by the Court. In other cases, where a sum is named in a contract as a liquidated amount payable by way of damages, only reasonable compensation can be awarded not exceeding the amount so stated. Similarly, in cases where the amount fixed is in the nature of penalty, only reasonable compensation can be awarded not exceeding the penalty so stated. In both cases, the liquidated amount or penalty is the upper limit beyond which the Court cannot grant reasonable compensation.

2. Reasonable compensation will be fixed on well known principles that are applicable to the law of contract, which are to be found inter alia in Section 73 of the Contract Act.

3. Since Section 74 awards reasonable compensation for damage or loss caused by a breach of contract, damage or loss caused is sine qua non for the applicability of the Section.

4. The Section applies whether a person is a plaintiff or a

defendant in a suit.

5. The sum spoken of may already be paid or be payable in future.

6. The expression "whether or not actual damage or loss is proved to have been caused thereby" means that where it is possible to prove actual damage or loss, such proof is not dispensed with. It is only in cases where damage or loss is difficult or impossible to prove that the liquidated amount named in the contract, if a genuine pre-estimate of damage or loss, can be awarded.

7. Section 74 will apply to cases of forfeiture of earnest money under a contract. Where, however, forfeiture takes place under the terms and conditions of a public auction before agreement is reached, Section 74 would have no application."

14. *Saw Pipes (supra)* is authority that unless an award is contrary to substantive law or provisions of the Arbitration Act or contract, an award cannot be interfered with. It was held that:

"If the award is contrary to the substantive provisions of law or the provisions of the Act or against the terms of the contract, it would be patently illegal, which could be interfered under Section 34. However, such failure of procedure should be patent affecting the rights of the parties." (paragraph 14)

The Court also held that "public policy", under Section 34(2)(b)(ii), was to be given a "broad meaning", and included situations where an award was "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." (paragraph 30)

R.S. Sharma (supra) is another instance, where the Court set aside an arbitral award on the ground that the arbitral tribunal had failed to "advert to Clause 3.16" of the disputed contract, which happened to be at the heart of the disagreement, and had given no reason for doing so. The Court held this to be "an error apparent on the face of the record as well as contrary to the terms of the Agreement."

15. In *Steel Authority of India Ltd. vs. Gupta Brothers* (2009) 10 SCC 63., the Court held that Section 34 would be attracted in cases where an arbitrator "travels beyond the contract", or makes an award "contrary to the terms of the contract". Section 34 however, the Court stated, cannot be used to set aside awards in which there was an "error relatable to interpretation of the contract", or if it was based on a "possible view of the matter", or if it was based on a finding of law in a case where a "*specific question of law [had been] submitted to the arbitrator*". In short, it was not the task of the Courts to examine the award in an appellate review process. In that case, the question was whether the breaches of contract alleged by the respondent were covered by the clause in the contract that contained the stipulation for damages under certain conditions. The arbitrator had found that they were not, and this finding was challenged. Refusing to set aside the award under Section 34, the Court held:

"The arbitrator's view about non-applicability of Clause 7.2 for refusal to supply materials in July-September, 1988 quarter and delayed supply of materials for October-December, 1988 quarter is founded on diverse grounds elaborately discussed in the award. Whether this is or is not a totally correct view is really

immaterial but such view is a possible view that flows from reasonable construction of Clause 7.2. The view of the arbitrator being possible view on construction of Clause 7.2, and having not been found absurd or perverse or unreasonable by any of the three Courts, namely, Sub-Judge, District Judge and the High Court, we are afraid, no case for interference is made out in exercise of our jurisdiction under Article 136 of the Constitution... Once the arbitrator has construed Clause 7.2 in a particular manner, and such construction is not absurd and appears to be plausible, it is not open to the courts to interfere with the award of the arbitrator. Legal position is no more res integra that the arbitrator having been made the final arbiter of resolution of disputes between the parties, the award is not open to challenge on the ground that arbitrator has reached at a wrong conclusion. The courts do not interfere with the conclusion of the arbitrator even with regard to construction of a contract, if it is a possible view of the matter." (paragraphs 31-32)

16. In the opinion of this Court, the learned Single Judge correctly modified the award and held PGC entitled to the amounts secured under the guarantee: regardless of its inability to recover liquidated damages, spelt out in the contract. The inability of Klen to make timely supplies justified such a course, which is sanctioned on a fair reading of *Kailash Nath Associates* (supra). Therefore, Klen's submission that once it was held that PGC could not invoke the liquidated damages condition in the GCC, it was also barred from invoking the contract, i.e the bank guarantee is incorrect; it is accordingly rejected.

17. As far as the liberty granted to Klen to seek another reference by way of arbitration is concerned with reference to \$ 2,148,011/- (towards price of raw material not utilized by it for the contract), this Court is of opinion that Mr. Upadhyay is justified in articulating the grievance. This was a claim specifically urged before the Arbitrator. There is no finding on the part of

the arbitrator which is inconsistent with his conclusion that such claim is inadmissible. The arbitrator specifically dealt with the issue of value of unutilized raw materials in Paras 32-34, in the section regarding Klen's diligence in performance of the contract and ruled out this figure by saying that *"...it is not the question of procurement of raw material which is relevant, the point to be seen is whether the claimant remained capable of supplying the goods within the last extended period of contract or not."* This was the basis for denial of \$ 2,148,011/-. Later, in Para 59 of the Award, the Arbitrator yet again reiterated these findings. Such being the findings, which were not set aside, the question of granting liberty to Klen to seek another reference could not have arisen. To that extent, PGC's appeal is entitled to succeed. The Court is unconvinced with the submissions of Klen with respect to other claims, urged in the appeal. All of them pertain to factual findings which were not disturbed by the learned Single Judge.

18. For the above reasons, FAO (OS) 460/2011 has to succeed in part and is allowed; the liberty granted to Klen to seek another reference is hereby set aside. FAO (OS) 654/2010 (Klen's appeal) is without merit and is dismissed. There shall be no order as to costs.

S. RAVINDRA BHAT
(JUDGE)

DEEPA SHARMA
(JUDGE)

SEPTEMBER 9, 2015