

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Reserved on: 05.12.2018
Pronounced on: 21.02.2019

CORAM:

THE HONOURABLE MR.JUSTICE S.VAIDYANATHAN**O.P.No.367 of 2014**

Pioneer Distilleries Limited,
Rep. by its Authorized Signatory,
8-2-311/C, Mithila Nagar,
Road No.10, Banjara Hills,
Hyderabad-500 034.

... Petitioner

-VS-

1. Hindustan Petroleum Corporation Ltd.,
Flat No.129-132, Chandralok Complex,
1st Floor, 111, Sarojini Devi Road,
Secundarabad-500 003.
2. J.S.Prasad
Office of General Manager, Pipelines,
Hindustan Petroleum Corporation Ltd.,
Hindustan Bhavan,
8, Shoorji Vallabhdas Marg,
Mumbai-400 001.

... Respondents 1 & 2

Prayer: This Petition is filed under Section 34 of The Arbitration and Conciliation Act, 1996 to set aside the Award dated 22.02.2013 passed by the 2nd Respondent herein and alternatively remit the matter to the 2nd Respondent to decide the issue in accordance with the findings of this Court.

For Petitioner	: Mr.Anirudh Krishnan
For R1	: Mr.O.R.SAnthana Krishnan

ORDER

This Original Petition has been filed, seeking to set aside the Award dated 22.02.2013 passed by the 2nd Respondent herein and alternatively remit the matter to the 2nd Respondent to decide the issue in accordance with the findings of this Court.

2. According to the petitioner, the 1st respondent floated a tender for supply of indigenous Anhydrous Ethanol to various locations in the State of Andhra Pradesh and pursuant to participation of the petitioner in the technical bid, an undated agreement was entered into for supply of Ethanol with a force majeure clause. As per Clause No.3 of the agreement, a “Take or Pay / Supply or Pay” was provided, under which both the parties agreed to supply / uplift minimum 90% of the supply order quantity placed within the financial years, failing which, an amount equivalent to 10% of the basic rate was payable by the supplier for undelivered quantity for a minimum of the 90% of the order quantity;

3. It was further submitted that a purchase order dated 29.03.2008 was placed on the petitioner for supply of 980 kilo litres of Ethanol to be supplied between 01.04.2008 and 31.12.2008. Since the petitioner was able to supply only 120 kilo litres, a fresh purchase order for the period between

07.12.2008 and 31.03.2008 for supply of balance 860 kilo litres was issued. In the meanwhile, the petitioner had informed the 1st respondent by letter dated 22.05.2008 that since the freight realization was lesser, the tankers and transporters were not interested in supplying the material, on account of which, they are facing certain difficulties.

4. The petitioner also submitted that though the 1st respondent owed to the petitioner an amount of Rs.21,66,776/- for the supplies already made, the 1st respondent had made a complaint on 27.08.2008 that the petitioner did not supply the required ethanol and sought to invoke the “Take or Pay / Supply or Pay” clause. In reply to the above, the petitioner had sent a letter dated 01.09.2008 to the 1st respondent, stating that the delay for non supply was on account of non availability of molasses, delay in payment and also delay in issuing 'C' forms. The petitioner also forwarded a copy of the Minutes of the Meeting dated 13.10.2008 held with the Ethanol suppliers to establish that the delay was not attributable to any fault of the petitioner.

5. It was further stated by the petitioner that though time for supply was extended, the petitioner was not in a position to supply the same due to prevalent of force majeure conditions. Subsequently, the 1st respondent had issued a show cause notice to the petitioner for non-supply of Ethanol and

invoked the “Take or Pay / Supply or Pay” clause under the Purchase Order dated 29.03.2018. Though there were several exchange of correspondences, finally, the 1st respondent had invoked the Arbitration proceedings and the Arbitrator, upon conclusion of the proceedings, has passed an Award dated 22.02.2013, holding that the 1st respondent is entitled to a sum of Rs.16,38,300/- towards penalty for non supply of required quantity of Ethanol. Aggrieved by the said Award, the petitioner is before this Court.

6. The petitioner has assailed the impugned Award on the following reasonings:

i) the 1st respondent has not adduced any iota of evidence to establish that it suffered any loss owing to the petitioner's alleged breach and it is incumbent on the 1st respondent to prove the loss;

ii) the Award is contrary to law and public policy, because though the actual damages are capable of being ascertained and proved in the Arbitration, the 1st respondent had not proved the same and the 1st respondent had not explained the mitigating circumstances to prove the loss;

iii) no damages or penalty would be payable by the petitioner, that the factors, which were the root cause for non-supply were an act of God, for

which the petitioner has no control over it and though the petitioner had claimed a sum of Rs.20,00,000/- for the supplies already made, the same was conveniently ignored by the Arbitrator / 2nd Respondent;

iv) it was the 1st respondent, which had failed to provide “C” forms and the same was a contributing factor for non-supply and the Arbitrator had not taken into account the said fact and ignored the same, while deciding the issue.

Thus, it was pleaded that the Award dated 22.02.2013 passed by the 2nd respondent is liable to be set aside and suitable direction may be issued to the 2nd respondent to decide the issue in accordance with the findings of this Court.

7. Learned counsel for the petitioner has relied upon the following judgments in support of his submission that though the 1st respondent can claim liquidated damages, which is only a cap, it will not inure to the benefits of the 1st respondent to claim damages by dispensing with the proof of damages, when the assertion of damages is possible.

i) **Kailash Nath Associates vs. Delhi Development Authority and another**, reported in **(2015) 4 SCC 136**;

"37. And finally in ONGC Ltd. v. Saw Pipes Ltd., (2003) 5 SCC 705, it was held:

"64. It is apparent from the aforesaid reasoning recorded by the Arbitral Tribunal that it failed to consider Sections 73 and 74 of the Indian Contract Act and the ratio laid down in Fateh Chand case [AIR 1963 SC 140: (1964) 1 SCR 515 at p. 526] wherein it is specifically held that jurisdiction of the court to award compensation in case of breach of contract is unqualified except as to the maximum stipulated; and compensation has to be reasonable. Under Section 73, when a contract has been broken, the party who suffers by such breach is entitled to receive compensation for any loss caused to him which the parties knew when they made the contract to be likely to result from the breach of it. This section is to be read with Section 74, which deals with penalty stipulated in the contract, inter alia (relevant for the present case) provides that when a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, the party complaining of breach is entitled, whether or not actual loss is proved to have been caused, thereby to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named. Section 74 emphasizes that in case of breach of contract, the party complaining of the breach is entitled to receive reasonable compensation whether or not actual loss is proved to have been caused by such breach. Therefore, the emphasis is on reasonable compensation. If the compensation named in the contract is by way of penalty, consideration would be different and the party is only entitled to reasonable compensation for the loss suffered. But if the compensation named in the contract for such breach is genuine pre-estimate of loss which the parties knew when they made the contract to be likely to result from the breach of it, there is no question of proving such loss or such party is not required to lead evidence to prove actual loss suffered by him.

67.....In our view, in such a contract, it would be difficult to prove exact loss or damage which the parties suffer because of the breach thereof. In such a situation, if the parties have pre-estimated such loss after clear understanding, it would be totally unjustified to arrive at the conclusion that the party who has committed breach of the contract is not liable to pay compensation. It would be against the specific provisions of Sections 73 and 74 of the Indian Contract Act. There was nothing on record that compensation contemplated by the parties was in any way unreasonable. It has been specifically mentioned that it was an agreed genuine pre- estimate of damages duly agreed by the parties. It was also mentioned that the liquidated damages are not by way of penalty. It was also provided in the contract that such damages are to be recovered

by the purchaser from the bills for payment of the cost of material submitted by the contractor. No evidence is led by the claimant to establish that the stipulated condition was by way of penalty or the compensation contemplated was, in any way, unreasonable. There was no reason for the Tribunal not to rely upon the clear and unambiguous terms of agreement stipulating pre-estimate damages because of delay in supply of goods. Further, while extending the time for delivery of the goods, the respondent was informed that it would be required to pay stipulated damages.

68. From the aforesaid discussions, it can be held that:

- (1) Terms of the contract are required to be taken into consideration before arriving at the conclusion whether the party claiming damages is entitled to the same.
- (2) If the terms are clear and unambiguous stipulating the liquidated damages in case of the breach of the contract unless it is held that such estimate of damages/compensation is unreasonable or is by way of penalty, party who has committed the breach is required to pay such compensation and that is what is provided in [Section 73](#) of the Contract Act.
- (3) [Section 74](#) is to be read along with [Section 73](#) and, therefore, in every case of breach of contract, the person aggrieved by the breach is not required to prove actual loss or damage suffered by him before he can claim a decree. The court is competent to award reasonable compensation in case of breach even if no actual damage is proved to have been suffered in consequence of the breach of a contract.
- (4) In some contracts, it would be impossible for the court to assess the compensation arising from breach and if the compensation contemplated is not by way of penalty or unreasonable, the court can award the same if it is genuine pre-estimate by the parties as the measure of reasonable compensation."

38. It will be seen that when it comes to forfeiture of earnest money, in Fateh Chand's case, counsel for the appellant conceded on facts that Rs.1,000/- deposited as earnest money could be forfeited. (See: 1964 (1) SCR Page 515 at 525 and 531).

39. Shree Hanuman Cotton Mills & Another which was so heavily relied by the Division Bench again was a case where the appellants conceded that they committed breach of contract. Further, the respondents also pleaded that the appellants had to pay them a sum of Rs.42,499/- for loss and damage sustained by them. (See: 1970 (3) SCR 127 at Page 132). This being the fact situation, only two questions were argued before the Supreme Court: (1) that the amount paid by the plaintiff is not earnest money and (2) that forfeiture of earnest money can be legal only if the amount is

considered reasonable. (at page 133). Both questions were answered against the appellant. In deciding question two against the appellant, this Court held:-

"But, as we have already mentioned, we do not propose to go into those aspects in the case on hand. As mentioned earlier, the appellants never raised any contention that the forfeiture of the amount amounted to a penalty or that the amount forfeited is so large that the forfeiture is bad in law. Nor have they raised any contention that the amount of deposit is so unreasonable and therefore forfeiture of the entire amount is not justified. The decision in *Maula Bux's* [1970]1SCR928 had no occasion to consider the question of reasonableness or otherwise of the earnest deposit being forfeited. Because, from the said judgment it is clear that this Court did not agree with the view of the High Court that the deposits made, and which were under consideration, were paid as earnest money. It is under those circumstances that this Court proceeded to consider the applicability of [Section 74](#) of the Contract Act. (At page 143)"

40. From the above, it is clear that this Court held that *Maula Bux's* case was not, on facts, a case that related to earnest money. Consequently, the observation in *Maula Bux* that forfeiture of earnest money under a contract if reasonable does not fall within [Section 74](#), and would fall within [Section 74](#) only if earnest money is considered a penalty is not on a matter that directly arose for decision in that case. 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. It must not be forgotten that as has been stated above, forfeiture of earnest money on the facts in *Fateh Chand's* case was conceded. In the circumstances, it would therefore be correct to say that as earnest money is an amount to be paid in case of breach of contract and named in the contract as such, it would necessarily be covered by [Section 74](#).

41. It must, however, be pointed out that in cases where a public auction is held, forfeiture of earnest money may take place even before an agreement is reached, as DDA is to accept the bid only after the earnest money is paid. In the present case, under the terms and conditions of auction, the highest bid (along with which earnest money has to be paid) may well have been rejected. In such cases, [Section 74](#) may not be attracted on its plain language because it applies only "when a contract has been broken".

42. In the present case, forfeiture of earnest money took place long after an agreement had been reached. It is obvious that the amount sought to be forfeited on the facts of the present case is sought to be forfeited without any loss being shown. In fact it has been shown that far from

suffering any loss, DDA has received a much higher amount on re-auction of the same plot of land.

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:- 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.

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.

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

The Section applies whether a person is a plaintiff or a defendant in a suit.

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

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.

[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.

44. The Division Bench has gone wrong in principle. As has been pointed out above, there has been no breach of contract by the appellant. Further, we cannot accept the view of the Division Bench that the fact that the DDA made a profit from re-auction is irrelevant, as that would fly in the face of the most basic principle on the award of damages - namely, that compensation can only be given for damage or loss suffered. If damage or loss is not suffered, the law does not provide for a windfall.

45. A great deal of the argument before us turned on notings in files that were produced during cross-examination of various witnesses. We have not referred to any of these notings and, consequently, to any case law cited by both parties as we find it unnecessary for the decision of this case.

46. Mr. Sharan submitted that in case we were against him, the earnest money that should be refunded should only be refunded with 7% per annum and not 9% per annum interest as was done in other cases. We are afraid we are not able to agree as others were offered the refund of earnest money way back in 1989 with 7% per annum interest which they accepted. The DDA having chosen to fight the present appellant tooth and nail even on refund of earnest money, when there was no breach of contract or loss caused to it, stands on a different footing. We, therefore, turn down this plea as well.

47. In the result, the appeal is allowed. The judgment and order of the Single Judge is restored. Parties will bear their own costs."

ii) **Maula Bux vs. Union of India**, reported in **(1969) 2 SCC 554**;

"6. Counsel for the Union, however, urged that in the present case Rs. 10,000/- in respect of the potato contract and Rs. 8,500 in respect of the poultry contract were genuine preestimates of damages which the Union was likely to suffer as a result of breach of contract, and the plaintiff was not entitled to any relief against forfeiture. Reliance in support of this contention was placed upon the expression (used in s. 74 of the Contract Act), "the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation". It is true that in every case of breach of contract the person aggrieved by the breach is not required to prove actual loss or damage suffered by him before he can claim a decree, and the Court is competent to award reasonable compensation in case of breach even if no actual damage is proved to have been suffered in consequence of the breach of contract. But the expression "whether or not actual damage or loss is proved to have been caused thereby" is intended to cover different classes of contracts which come before the Courts. In case of breach of some contracts it may be impossible for the Court to assess compensation arising from breach, while in other cases compensation can be calculated in accordance with established rules. Where the Court is unable to assess the compensation, the sum named by the parties if it be regarded as a genuine preestimate may be taken into consideration as the measure of reasonable compensation, but not if the sum named is in the nature of a penalty. Where loss in terms of money can be determined, the party claiming compensation must prove the loss suffered by him."

7. Per contra, learned counsel appearing for the 1st respondent would contend that the Award passed by the Sole Arbitrator is in accordance with the terms and conditions of purchase orders and the agreement entered into between the petitioner and the 1st respondent. Though the 1st respondent

had given permits for supply of 920 KLs of Ethanol along with their indent and dispatch schedule, the petitioner had supplied only 120 KL of Ethanol in the month of June, 2008 and thereafter, no supply was made till the validity period of Agreement upto 31.03.2009. Since the petitioner was technically qualified, the purchase order with extension order was placed on the petitioner on 29.03.2008 and 07.12.2008 for supply of Ethanol at Ghatkesar Terminal, Andhra Pradesh and the petitioner did not fulfill the terms and conditions of agreement, which forced the 1st respondent to calculate the damages payable by the supplier for the undelivered quantity on financial year basis from minimum quantity of 90% of the order quantity.

8. Learned counsel for the 1st respondent would further contend that it is the bounden duty of the petitioner to supply the quantity of Ethanol as per LOI placed for the year 2008-2009 and the petitioner is estopped from making excuses for non-supply of the products and since there was no prayer for reimbursement of monies in the claim statement filed by the petitioner in the Arbitration Proceedings, the prayer for reimbursement of monies is beyond the scope of Arbitration Proceedings. It was also contended that the invocation of the clause "Take or Pay / Supply or Pay" is in line with the terms of the purchase orders, which cannot be faulted with. On the whole, it was prayed that the Award passed by the Sole Arbitrator does not warrant any interference by

this Court and the petition is liable to be dismissed *in limine*.

9. Heard the learned counsel on either side and also perused the material documents available on record.

10. A circumspection of the fact would reveal that the petitioner, being technically qualified for supply of Ethanol, was awarded a contract for supply of 980 Kilo Litres of Ethanol, but however the petitioner supplied only 120 kilo litres of Ethanol. According to the petitioner, even though the decision rendered by the Arbitrator is based on the finding of fact, the Arbitrator ought to have noticed that Sub-Clause-vi of Clause No.3 of the Agreement dated 13.10.2006 cannot be invoked, as in the present case on hand, there is a possibility of determination of the amount. The said clause would be applicable, where the loss could not be arrived at and since there was no determination of loss in this case, the said universal clause, namely, Sub-Clause-vi of Clause No.3 of the Agreement cannot be invoked blindly. For better understanding, the Sub-Clause-vi of Clause No.3 is extracted as under:

“Amount of Rs.-----/-KL (Rs.----- per KL) (equivalent to 10% of the basic rate) shall be payable by the Supplier for the undelivered quantity on financial year basis from minimum quantity of 90% of the order quantity (which according to the party is true estimated value of the damage / loss).”

11. The petitioner's contention is that the 1st respondent needs to prove the loss and if the loss is proved on account of non-supply of Ethanol, then only a decision could be arrived by the Arbitrator. As per Clause No.3 of the Contract read with Clause 10 of the Purchase Order, both the parties agreed to supply / uplift minimum 90% of the supply order quantity on financial year basis. Though it has been contended that there was drought, which is an act of God, during the period of contract, there was no invocation of Force Majeure clause citing the said drought and hence, the Arbitrator has rightly held that the said clause is not applicable at all to the present case on hand.

12. A glance at the Award and other documents makes it very clear that the petitioner has not established its case, much less the act of God beyond reasonable doubt, even though there was a communication by the petitioner dated 17.08.2009 to the 1st respondent. When the matter was argued extensively, this Court has pointed out to the learned counsel for the petitioner that since the petitioner had not supplied the required quantity of Ethanol to the 1st respondent and there was a shortfall of 762 KL of Ethanol, the petitioner cannot escape from its liability, for which learned counsel for the petitioner would reply that if the Court agrees with his contention that the loss could be easily arrived at based on the value of Ethanol per Kilo Litre and in case the loss

is proved, then the Arbitrator is entitled to foist the liability on the petitioner, for which the petitioner is willing to file an application under Section 34(4) of the Arbitration and Conciliation Act and the matter may be kept pending so as to enable the Arbitrator / 2nd respondent to determine the amount payable by the petitioner on proper calculation of the loss by the 2nd respondent.

13. This Court is not in agreement with the said contention raised by the learned counsel for the petitioner, because such a situation may not arise in the present case on hand, as from various exhibits, there was no objection raised at any point of time and the petitioner had also not denied the amount, when the show cause notice was issued. The petitioner, having kept mum for all these years, is precluded from taking such a stand of assertion of loss, as in terms of Section 4 of the Arbitration and Conciliation Act, the petitioner had already waived its right and has no *locus standi* to question the Award, on the ground that the Arbitrator has erroneously applied Sub-Clause-vi of Clause No.3 of the Agreement dated 13.10.2006 and that there was no determination of loss. Though it was vehemently argued by the petitioner that the findings of the Arbitrator would be against the specific provisions of Sections 73 and 74 of the Indian Contract Act, but in the present case on hand, the said provisions do not come in handy to support the case of the petitioner.

14. Even assuming for the sake of argument that the provisions of the Indian Contract Act have not been strictly adhered to, by the Arbitrator, it is an admitted fact that the petitioner did not supply the required quantity of Ethanol as per the agreement and therefore, the amount payable (against the non-supply) can easily be determined even by bare eyes and for this purpose, the case need not be remanded to the Arbitrator for determination of the amount payable by the petitioner, as it is only an arithmetic calculation. Therefore, the provisions of Sections 73 and 74 of the Indian Contract Act will not come in aid of the petitioner and will not attract to the present set of facts, set out by the petitioner.

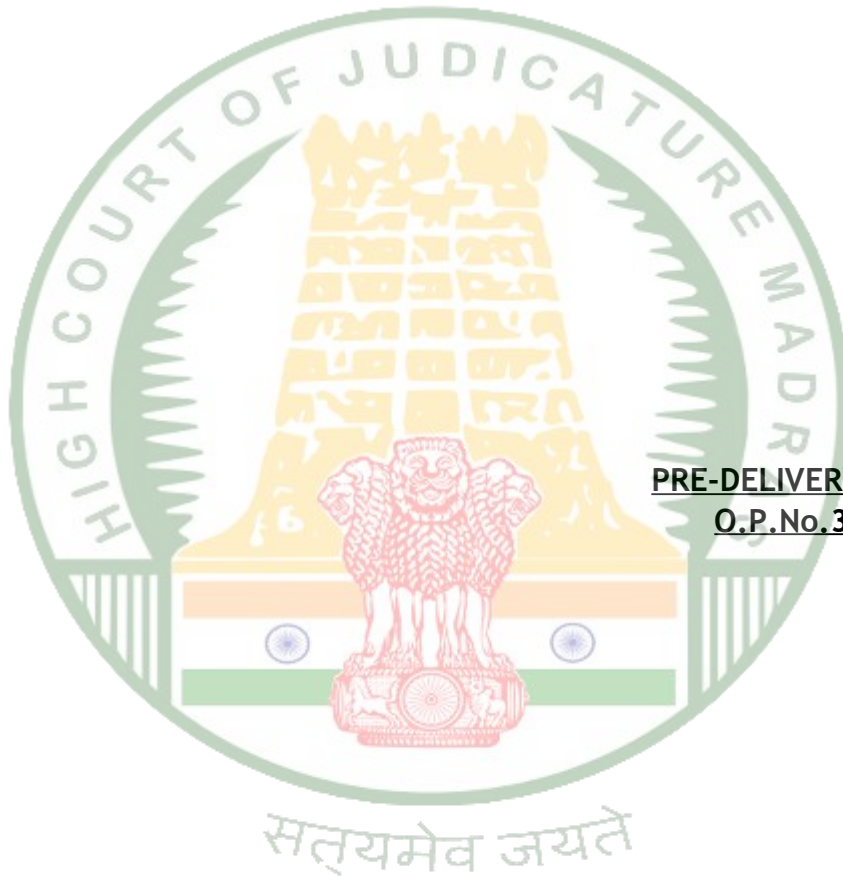
15. Considering the totality of the circumstances prevailing in this matter, in the considered opinion of this Court, the Award passed by the Arbitrator is a well-considered one and it does not require any interference by this Court. Accordingly, this Original Petition is dismissed. No costs.

21.02.2019

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S. VAIDYANATHAN, J.
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PRE-DELIVERY ORDER IN
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