

IN THE HIGH COURT OF JUDICATURE AT MADRAS

Judgment reserved on	30.10.2019
Judgment pronounced on	07.11.2019

CORAM

THE HONOURABLE Mr. JUSTICE **SENTHILKUMAR RAMAMOORTHY**

O.P. No.532 of 2014

M/s.3i Infotech Limited
Tower #5, 4th Floor,
International Infotech Park,
Vashi Station Complex,
Vashi, Navi Mumbai – 400 703
Rep. By its Authorised signatory.

... Petitioner

Vs.

1.Tamil Nadu e- Government Agency,
3rd Floor, TUFIDCO – POWERFIN Building,
490/3, Anna Salai, Nandanam,
Chennai – 600 035.

2.Mr.R.Thiagarajan, I.A.S.(Retd.),
2/640,River View Enclave,
Manapakkam, Chennai-600 125.

... Respondent

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Prayer:- Original Petition is filed under Section 34 of the Arbitration and Conciliation Act, 1996 to set aside the Award dated 06.06.2014, passed by the 2nd Respondent and allow the claims of the Petitioner.

For Petitioner : Mr.Anirudh Krishnan for
M/s.A.K.Law Chambers

For Respondents : Mr.M.Vijayan for
M/s.King & Partridge for R-1

ORDER

The claimant in the Arbitration is the Petitioner before this Court. The dispute arises out of a Master Services Agreement dated 8 July 2008 (the MSA) between the the Government of Tamil Nadu, the Petitioner and the first Respondent. The MSA was executed pursuant to a request for proposal (RFP) that was issued on 29 June 2007 in order to select a service provider. The Petitioner was one of the successful bidders and was consequently selected as a service provider on submission of a negative bid, which is the amount quoted by the Petitioner as payment to be made to the first Respondent per common service centre (CSC) per month, and Letter of Acceptance dated 17.03.2008 (the LoA) was issued to the Petitioner. As per the MSA, the Petitioner was required to set up CSCs for the provision of various web-enabled services that were categorised as Government to Consumer (G2C), business to business (B2B) and Business to Consumer (B2C). The Petitioner, i.e. the service provider, is referred to as the Service Centre Agency (SCA) and the first Respondent is referred to as the State Designated Agency (SDA) in the MSA. The MSA further envisages that the Petitioner and the first

Respondent would enter into service level agreements (SLAs) with the Government of Tamil Nadu and the government departments concerned in respect of the provision of particular services. In addition, it envisages that the Petitioner would enter into arrangements/agreements with Village Level Entrepreneurs (VLEs) for the day-to-day operations, maintenance and management of CSCs so as to effectively provide services at the local level.

2.It is the admitted position that the Petitioner was required to set up 4395 CSCs in 4 designated zones in Tamil Nadu across 26 districts within stipulated time limits but set up 2100 CSCs, as per the Petitioner, and about 1542 CSCs as per the first Respondent. Therefore, after issuing a show cause notice dated 11.03.2009, penalty/liquidated damages of Rs.2,30,22,000 was imposed by letter dated 27.05.2009 in respect of the failure to roll-out CSCs for the period 01.04.2009 to 30.04.2009. This was followed by a show cause termination notice dated 18.02.2010 from the first Respondent. In response, by reply dated 20.02.2010, the Petitioner requested that the scope of work be limited to 10 districts instead of 26 districts and not to levy penalty. Eventually, the first Respondent issued notice dated 6 March 2010 to terminate the MSA and the Petitioner initiated arbitration proceedings in respect of the dispute. In the said arbitration, by its claim statement, the Petitioner

made an aggregate claim for a sum of Rs.25,83,65,593/- with interest thereon at 18% per annum from 08.07.2008 till the date of payment and for a declaration that the Petitioner did not breach the MSA and that, consequently, the termination letter dated 06.03.2010 is invalid. By statement of defence and counter claim, the first Respondent requested that the claims of the Petitioner be dismissed and that the three counter claims of the first Respondent be awarded. The first counter claim is a cumulative claim of Rs.13,05,84,186/- in respect of liquidated damages, negative bid amount for 1542 rolled out CSCs up to 31.01.2010 and the differential amount claimed by the replacement SCA. After setting off the sum of Rs.6,42,22,000/- which was realised from the bank guarantee, a net sum of Rs.6,63,62,186/- was claimed under the first counter claim. The second counter claim is in respect of interest on the bank guarantee amount of Rs.6,42,22,000/- at 18% per annum from 16.03.2010 to 11.07.2011 and this claim is for a sum of Rs.1,52,65,481/-. The third counter claim is in respect of amounts payable towards negative bid for the four year period from 25.02.2011, which aggregates to a sum of Rs.2,93,47,200/- for the 2100 CSCs that were set up according to the Petitioner. Both parties adduced oral and documentary evidence in support of the claims and counter claims. By Arbitral Award dated 06.06.2014 (the Award), all the claims of the Petitioner were rejected. In respect of counter claim 1, it was held that the first Respondent is entitled to a gross

sum of Rs.7,68,67,626/-, out of the aggregate claim of Rs.13,05,84,186/- by rejecting the claim for the alleged differential cost of Rs.5,37,16,500/- in respect of a replacement SCA, and a net sum of Rs.1,26,45,626/- was awarded (after setting off the amount realised by calling in the bank guarantee) with interest thereon at 18% per annum from 16.03.2010 till the date of realisation. In respect of counter claim 2, the Petitioner was directed to pay a sum of Rs.1,52,65,481/-. As regards counter claim 3(the negative bid claim), the Petitioner was directed to pay a sum of Rs.2,02,56,390/- in respect of the negative bid amount for the remaining 45 months subsequent to 31.01.2010. The Award is under challenge herein.

3.I heard Mr.Anirudh Krishnan, the learned counsel for the Petitioner, and Mr Vijayan, the learned counsel for the first Respondent.

4.The learned counsel for the Petitioner opened with an overview of the nature of the transaction and the MSA. At the outset, he submitted that the focus of the challenge is the Award in respect of counter claim 1 and 2. By way of background, he pointed out that when the challenge to the Award was under consideration by this Court, by order dated 26.03.2018, further proceedings in the Petition were adjourned for a period of four months and the matter was remitted to the

Arbitral Tribunal under Section 34(4) of the Arbitration and Conciliation Act,1996 (the Arbitration Act) so as to determine and quantify the liquidated damages or conclude that it cannot be quantified in the facts of the case. He further submitted that the Arbitral Tribunal determined the said issue by an Award dated 17.07.2019, which is also under challenge herein.

5.The main thrust of the submissions of the learned counsel for the Petitioner was that the Arbitral Tribunal committed a patent illegality and acted contrary to public policy in awarding liquidated damages to the first Respondent and in granting interest on the bank guarantee amounts to the first Respondent. In this regard, the first contention of the learned counsel for the Petitioner was that the Petitioner is not liable for breach of the MSA because the first Respondent failed in its obligation to enable G2C services. According to the learned counsel, especially in light of the negative bid by the Petitioner, unless the first Respondent performed its prior and corresponding obligation to enable the provision of G2C services, the obligation to roll out CSCs and, more importantly, the imposition of penalty in the event of failure to do so cannot be resorted to. In specific, he pointed out that G2C services are of two categories, namely, services that are already available for public access and services that can only be availed through SCAs like the

Petitioner. With regard to the latter category, he submitted that the first such service was made available on 13.01.2010. Thus, he submitted that the Petitioner did not commit breach of the MSA. Assuming without admitting that breach was committed, he submitted that the MSA provides for penalty and not liquidated damages for failure to roll out CSCs as per the MSA. In order to substantiate the submission, the learned counsel referred to the relevant provisions of the MSA. After referring to clause 2.1 of the MSA, which mandates that the SCA shall establish 4395 CSCs in the four zones of Tamil Nadu, he turned to clause 4 which deals with breach and rectification. Sub clause 4.1 (a) thereof deals with the failure to roll out CSCs and the said sub-clause reads as under:

"(a) if the SCA fails to roll out the CSCs as per the implementation schedule, the rectification and penalty payable shall be as indicated in Schedule 1. Failure to pay the total penalty shall also be construed as breach. The State Designated Agency may at its sole option, debit or set off the amounts of penalties, if any, through invocation or forfeiture of the Performance Security, in full or part, as the case may be."

6. The relevant entry in Schedule 1 reads as under:

S.No.	Parameter	Liquidated damages for breach	Material Breach	Stipulated period for mitigating material breach	Remedial performance required for non-termination
1.	Roll out of CSCs in phases as per the Scheme Roll out period specified. The CSC will be deemed to be operational only after being certified by State Designated Agency or its nominated agencies. SCA will be required to establish and operationalise CSCs in phases as per the time schedule prescribed as under:	Penalty of Rs.200 per CSC that has been delayed per additional day of delay from the schedule	Roll out being delayed by four weeks as per the roll out schedule	One month	Roll out of CSCs in the stipulated period for mitigating material breach as per the roll out schedule

S.No.	Parameter	Liquidated damages for breach	Material Breach	Stipulated period for mitigating material breach	Remedial performance required for non-termination
	(1).Completion of 20% of rollout of CSEs in four months from the date of issuance of letter of acceptance (LOA). (2).Completion of 50% of rollout of CSCs in seven months from the date of issuance of Letter of Acceptance (LOA). (3).Completion of 80% of rollout of CSCs in nine months from the date of issuance of Letter of Acceptance (LOA). (4).Completion of rollout of				

S.No.	Parameter	Liquidated damages for breach	Material Breach	Stipulated period for mitigating material breach	Remedial performance required for non-termination
	CSCs in 11 months from the date of issuance of Letter of Acceptance (LOA).				

7. After referring to the above provisions, he submitted that the word "penalty" is used in the sub-clause pertaining to failure to roll out CSCs in contrast to the other sub-clauses of 4.1, namely, subclauses (b) to (e), wherein the word used is "liquidated damages" and the general interpretation clause, 1.2(i), would, therefore, only apply to sub-clauses 4.1(b) to (e) and not (a). According to the learned counsel, this difference in terminology is deliberate and indicates the intention of the parties to stipulate penalty for this breach and liquidated damages for other breaches. While the learned counsel conceded that the word or term or label that is used is not determinative, he submitted that the word or term used by the parties, nonetheless, cannot and should not be disregarded while interpreting the relevant clause. In addition to using the term "penalty" in the MSA, he pointed out that the term "penalty" was also used consistently in correspondence between the parties when the MSA

was in operation. By way of illustration, he referred to the letters from the first Respondent dated 11.03.2009 (pages 234-235 of Volume 1), 27.05.2009 (pages 242-243 of volume 1), 18.02.2010 (pages 264-268 of volume 1) and 06.03.2010 (pages 273-278 of volume 1) and submitted that the term "penalty" is used in all these letters. When viewed conjointly, he submitted that it is evident that clause 4.1(a) stipulates a penalty and not liquidated damages.

8. At a minimum, he contended that the burden of proof is on the party, which contends that it is a liquidated damages clause notwithstanding the use of the word "penalty", to establish that it is a liquidated damages clause and that, in this case, the first Respondent failed to discharge the said burden. He further submitted, in this regard, that the Arbitral Tribunal erred in concluding that Indian law does not differentiate between liquidated damages and penalty and that the said conclusion of the Arbitral Tribunal is directly contrary to several judgments of the Supreme Court on this issue. On account of failing to establish that it is liquidated damages and not penalty, the learned counsel submitted that the first Respondent was required to prove loss accurately and claim reasonable compensation on that basis, whereas he submitted that the first Respondent failed to prove loss and is, therefore, not entitled to the amounts awarded. In this connection, he submitted that the first

Respondent was directed to provide details of the income generated by the new CSC at the hearing before the Arbitral Tribunal on 30.04.2019 but failed to do so. Significantly, he pointed out that the award of amounts purportedly by way of liquidated damages without proof of loss is, therefore, directly contrary to the settled legal position and warrants interference under section 34 of the Arbitration Act.

9. In order to substantiate the submission that the term used in the contract should not and cannot be disregarded, the learned counsel for the Petitioner referred to and relied upon the following judgments:

(i) **Wilson v. Love (1896) 1 Q.B. 626** wherein, in the context of a lease, it was held by Lord Esther that the use of the word "penalty" is not decisive but cannot be disregarded. In addition, it was held that "... where the parties themselves call the sum made payable a "penalty", the onus lies on those who seek to shew that it is to be payable as liquidated damages". In the same judgment, A.L. Smith L.J. held that "the fact that they have called it a penalty is no doubt not conclusive; but I think that, where the sum is spoken of by the parties themselves as a penalty, a strong case is required to shew that it is nevertheless liquidated damages, and I cannot find this in the present case."

(ii) **K.K. Subbarama Sastri v. K.S. Raghavan (1987) 2 SCC 424** wherein, at paragraph 5, the Hon'ble Supreme Court held that the

question as to whether a particular stipulation in a contract is in the nature of a penalty has to be determined by the court by taking into account all relevant factors. Upon such consideration, if the court finds that the real purpose is that the stipulation should operate *in terrorem*, it would be construed as a penalty.

10. The learned counsel, thereafter, referred to the affidavit of the witness for the first Respondent with regard to loss and pointed out that the said evidence related to losses that would be incurred by the first Respondent and not by the public at large. By contrast, he submitted that the Arbitral Tribunal proceeded on the basis that the non-roll out of the CSC's would cause hardship and loss to the public. In this manner, he contended that the Arbitral Tribunal proceeded on a basis that was fundamentally different from the case projected by the first Respondent. He further referred to the leading judgments of the Hon'ble Supreme Court with regard to liquidated damages so as to establish that there is a distinction between liquidated damages and penalty under Indian law and also to establish that it is necessary to prove loss whenever it is possible to do so even though the stipulation is by way of liquidated damages. The judgments that were referred to, in this regard, were:

(a) **Fateh Chand v. Balkishan Dass (the Fateh Chand case), AIR 1963 SC 1405**, wherein, at paragraph 10, the Hon'ble Supreme

Court held, inter alia, that section 74 ".... merely dispenses with proof of "actual loss or damage"; it 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, of which the parties knew when they made the contract, to be likely to result from the breach." In the same judgment, at paragraph 15, it was held that "such compensation has to be ascertained having regard to the conditions existing on the date of the breach."

(b) **Maula Bux v. UOI (the Maula Bux case)(1969) 2 SCC 554**, wherein, at paragraph 6, it was held, inter alia, as follows:

".... 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 pre-estimate 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."

(c) **ONGC v. Saw Pipes Ltd. (the ONGC case) (2003) 5 SCC 705**, wherein, at paragraph 64, the court held that "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."

(d) **Kailash Nath Associates v. DDA (the Kailash Nath case)**

(2015) 4 SCC 136, wherein, at paragraph 43.6, it was held as under:

" 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."

11. Thereafter, the learned counsel for the Petitioner made two submissions on a demurrer. In particular, he submitted that even assuming without admitting that the Petitioner committed breach and that clause 4.1 (a) provides for liquidated damages, the award of liquidated damages during the initial period of alleged failure to roll out CSCs between 1 April 2009 and 30 April 2009 is completely untenable because no losses were incurred during this period when admittedly no G2C services were ready for provision to the target audience. Therefore, he submitted, in conclusion, that the Award is, at a minimum, liable to be set

aside in respect of the sum of Rs.2,30,22,000/- for this period. Likewise, he submitted that the interim order obtained by the Petitioner was valid only up to 25.02.2011 and, therefore, the grant of interest on the bank guarantee amount for the period commencing from 26.02.2011 to 11.07.2011 is liable to be set aside.

12. In response and to the contrary, the learned counsel for the first Respondent made submissions. He opened by pointing out that the Petitioner claimed that it had opened 2100 CSCs and that in spite of the termination of the MSA, the Petitioner was permitted to continue to operate the said 2100 CSCs by an order of this Court. However, after obtaining such order, he pointed out that the Petitioner had unilaterally shut down all the CSCs without disclosing this fact in the pending proceedings and that this fact was eventually elicited in cross-examination. He next pointed out as to how liquidated damages for failure to roll out CSCs were estimated at the time of contract formation. In this connection, he referred to the RFP at page 41 volume 1 and pointed out that it provides a fair indication of the projected digital transaction volumes. He, thereafter, contended that the SCA, namely, the Petitioner herein was required to enter into the SLAs after setting up the requisite number of CSC's. He further pointed out that the RFP stipulated that the bidder should formulate a business plan and that the Petitioner herein did

formulate such a business plan and that the operation of this business plan required the establishment of the total number of CSC's within 11 months from the date of the LoA. He further submitted that the first Respondent had offered assistance in connection with the performance of obligations under the MSA but the Petitioner replied that no assistance was required for the purposes of fulfilling obligations under the MSA.

13.He further submitted that time is not of the essence of the MSA and that the Petitioner was permitted to establish CSCs beyond the stipulated 11 month period subject to the first Respondent's right to impose liquidated damages. In this regard, he pointed out that when the first Respondent threatened to impose liquidated damages by show cause notices dated 11.03.2009 and 27.05.2009, the Petitioner, by reply dated 20.02.2010, merely requested that the scope of the MSA be modified so as to limit the obligations of the Petitioner to 10 districts. In other words, instead of remedying the breach, the Petitioner affirmed that it was not in a position to fulfil its obligations under the MSA. Therefore, he submitted that the first Respondent did not have an option other than termination.

14.With regard to the legal question as to whether clause 4.1 (a) stipulates liquidated damages or penalty, he submitted that Indian law does not use the expression liquidated damages. Further, he submitted

that Indian law does not differentiate between stipulated payments in the event of a breach and stipulations by way of penalty. In order to establish this proposition, he referred to paragraph 8 of the judgment of the Hon'ble Supreme Court in the **Fateh Chand case**. He also contended that the term or word used is not conclusive and that it should be examined as to whether the stipulation is *in terrorem* or not. In this case, he submitted that evidence was adduced before the Arbitral Tribunal as to the manner in which the projected loss was estimated at the time of contract formation. Consequently, he contended that the first Respondent discharged its obligation to prove that the stipulation in clause 4.1 (a) is a genuine pre-estimate of loss and that, therefore, there is no need to prove actual loss in order to be awarded liquidated damages.

15. By way of rejoinder, the learned counsel for the Petitioner submitted that the contention that there is no distinction under Indian law between liquidated damages and penalty is erroneous and that this would be evident by referring to relevant paragraphs of the leading judgments of the Hon'ble Supreme Court on the issue. Therefore, he submitted that the finding of the Arbitral Tribunal to this effect is an error apparent on the face of the Award. He further submitted that no evidence was let in until the S.34(4) remittal with regard to the basis of the alleged pre-estimate of loss. He further submitted that the other SCA also rolled out G2C

services only on 13.01.2010. Accordingly, he contended that no losses could have been incurred by the first Respondent earlier. He also submitted that all the letters with regard to the provision of G2C services are from late 2009 onwards and that the order of performance of obligations is not MSA, CSC and SLA as wrongly contended by the learned counsel for the first Respondent. In order to establish the submission, he referred to in clause 2.6 of the MSA which provides that SLA's may be executed along with the MSA or separately. He also referred to article 3 of the template SLA in this connection.

16. By way of a brief sur-rejoinder, the learned counsel for the first Respondent contended that, under Indian law, whether the stipulation is by way of penalty or otherwise, the amount stipulated is the maximum that is payable by way of reasonable compensation and that this amount is payable without proof of actual loss. In support of this proposition, he relied upon a Division Bench judgment of the Kerala High Court in **State of Kerala v. United Shippers and Dredgers Limited (the United Shippers case)**, AIR 1982 Ker 281, wherein at paragraph 13 it was held as follows:

".... The second point of departure is that while the English common law penalty clause has to be completely ignored and the party claiming compensation has to prove the extent of loss or

damage suffered in fact or actually, and obtain compensation on that basis, Section 74 dispenses with such proof of the extent of real or actual or factual loss or damage, but provides for grant of reasonable compensation, subject to the condition that it shall not exceed the sum stipulated as penalty in the contract. The proof of the extent of loss or damage suffered in fact, i.e. proof of extent of actual damage or loss suffered is sought to be dispensed with in Section 74 of the Act. It is only in this light that the expression "whether or not actual damage or loss is proved to have been caused thereby" has been introduced in Section 74 of the Act. This historical background of the provision would explain the purport of Section 74 of the Act. "

17. The records were examined and the oral and written submissions of both sides were considered carefully. The principal question that is required to be answered is whether the stipulation in clause 4.1 (a) of the MSA, read with Schedule 1 thereto, is a stipulation by way of liquidated damages or penalty. The ancillary questions that arise are: (i) whether the Award in favour of the first Respondent is liable to be interfered with both/either in relation to the period between 1 April 2009 and 30 April 2009 and/or the period between 1 November 2009 and 31 January 2010 on the assumption that the stipulation is by way of liquidated damages; and (ii) whether the award of interest on the bank

guarantee is liable to be interfered with and, if so, in respect of which period.

18. In order to answer the principal question set out in the preceding paragraph, it is important to closely examine the relevant provisions of the RFP, MSA, the correspondence between the parties, the pleadings and evidence. Upon such examination, the following aspects are clear:

(i) The RFP uses the term "liquidated damages" in relation to the failure to roll out CSC's but the MSA uses the term "penalty".

(ii) The term "liquidated damages" is used in all other sub-clauses of clause 4.1, namely, subclauses (b) to (e).

(iii) Schedule 1 uses the column heading "liquidated damages" but the relevant entry relating to failure to roll out CSCs uses the term "penalty". The aforesaid column heading is common not only to the failure to roll out CSCs but also covers other breaches under clause 4.1 of the MSA.

(iv) In the letters dated 11 March 2009, 27 May 2009, 18 February 2010 and 6 March 2010, the first Respondent used both expressions although the word/s "penalty" or "penal action" was used more frequently.

(v) The first Respondent adduced evidence so as to establish that the stipulation in clause 4.1 (a) of the MSA is a genuine pre-estimate of

loss by providing a calculation of the anticipated revenue for the first Respondent from the provision of G2C services.

(vi) Compensation was claimed for two periods, namely, 1 April 2009 to 30 April 2009 and 1 November 2009 to 31 January 2010. No compensation was claimed for the period commencing from 1 May 2009 to 31 October 2009.

19. Against this background, the relevant law may be examined and the perfect place to begin is section 74 of the Contract Act, which reads, in relevant part, as under:

"74. Compensation for breach of contract where penalty stipulated for – when a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for...."

20. A plain reading of Section 74 evidences that the Contract Act provides for two categories of stipulations that could operate in case

of breach. The first category is a sum named in the contract as the amount to be paid in case of breach, which could be described as stipulated compensation, and the second category is any other stipulation by way of penalty. Thus, the learned counsel for the first Respondent is correct in contending that Section 74 does not use the term "liquidated damages". The learned counsel for the first Respondent also contended that there is no distinction between liquidated damages and penalty as per Indian law. On examining the five judgments of the Hon'ble Supreme Court, one judgment of the Kerala High Court and one judgment of the English court that were relied upon, it is clear that an attempt was made to depart from English law with regard to the elaborate distinction between liquidated damages and penalty. However, the critical issue is: to what extent and in what manner has the distinction been departed from or modified? As correctly pointed out by the learned counsel for the Petitioner, the judgments of the Supreme Court and, in particular, paragraphs 11, 6, 64 and 43.1 of **the Fateh Chand case, the Maula Bux case, the ONGC case and the Kailash Nath case**, respectively, make it abundantly clear that the distinction between liquidated damages and penalty has not been obliterated or effaced under Indian law and the indication to that effect in the judgment of the Kerala High Court in the **United Shippers case** should be viewed in light of the binding Supreme Court judgments to the contrary. Nevertheless, it is also clear from the

aforesaid judgments and that of the English court in the **Wilson case** that stipulations by way of penalty are not enforceable under English law, whereas they are enforceable under Indian law. As stated above, the relevant passages of the judgments of the Supreme Court in the **Fateh Chand case, Maula Bux case and the ONGC case** clarify that stipulations by way of penalty are treated differently and that the similarity between these two categories is limited to two aspects, namely, that the amount stipulated constitutes the ceiling or maximum amount that may be awarded and that both categories of stipulations are enforceable albeit differently.

21. This leads to the next questions, namely, whether the term used in the contract is conclusive and whether it can be disregarded. In **Dunlop Pneumatic Tyre Company Limited v. New Garage and Motor Company Limited [1915] A.C. 79 (HL)** (the **Dunlop Pneumatic case**), the House of Lords held, in the speech of Lord Dunedin, at page 86 of the Report, that "though the parties to a contract who use the words "penalty" or "liquidated damages" may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages." From the discussion in the Supreme Court judgments that were referred to by the learned counsel, it

is clear that the same position obtains in Indian law. Nonetheless, the question as to whether the term should be disregarded is a separate and distinct question. The general rule in contractual interpretation is to ascertain the intention of parties from the language of the contract. I see no reason to completely depart from the said general rule in the context of stipulations by way of liquidated damages or penalty. As held by the English court in the **Wilson case**, while the term used by the parties is not conclusive or determinative, it does not mean that the term used by the parties is to be disregarded. Thus, it becomes necessary for the party contending that the wrong term was used to discharge the burden of proving that the wrong expression or term was used in the contract.

22.The principles relating to the basis for distinguishing between stipulations by way of liquidated damages and penalty remain to be considered. In this regard, in **Clydebank Engineering and Shipbuilding Company Limited v. Don Jose Ramos Yzquierdo Y Castaneda [1905] A.C. 6 (the Clydebank case)**, the House of Lords held, through the speech of Lord Davey, at page 16 of the Report, that "... when you find that the sum payable is proportioned to the amount if I may so call it, or at the rate of non-performance of the agreement-for instance, if you find that it is so much per acre for ground which has been spoilt for mining operations, or if you find, as in the present case, that it is

so much per week during the whole time for which non-delivery of vessels beyond the contract time was delayed-then you may infer that prima facie the parties intended the amount to be liquidate damages and not penalty...." In effect, the stipulation is by way of liquidated damages if it bears a reasonable correlation to the anticipated loss at the time of contract formation. Therefore, by way of illustration, a clause that imposes liquidated damages of Rs.10 crore for delay irrespective of the extent of delay would be construed as a penalty clause and a clause that provides for proportionate amounts as compensation depending on the extent of delay is likely to be construed as a liquidated damages clause notwithstanding the terminology used in the contract. Thus, the determinative feature is the existence of a reasonable correlation to the loss that is anticipated, at the time of contract formation, in case of breach, and stipulations that impose a uniform consequence without regard to the gravity of the breach are likely to be construed as penalty clauses unless it can be shown that a single or multiple breaches of uniform gravity was anticipated.

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23.The following principles emerge upon consideration of the judgments on liquidated damages and penalty and from the foregoing analysis:

(i) Section 74 of the Contract Act provides for two categories of stipulated payments for breach: (a) a sum named in the contract as the amount to be paid in case of breach, which could be called stipulated compensation; and (b) stipulations by way of penalty.

(ii) The principal difference between English law and Indian law, in this regard, is that a stipulation by way of penalty is unenforceable under English law whereas it is enforceable under Indian law.

(iii) In both categories of stipulated payments under section 74, the sum stipulated operates as the maximum amount or ceiling. In this respect also, the two categories are similar.

(iv) The term or label used, namely, liquidated damages, penalty or even price reduction, in the relevant clause, is not conclusive or determinative. However, it cannot be disregarded and the person contending that the label or term used is not the correct term would be required to discharge the burden of establishing the said assertion.

(v) The primary test for identifying and distinguishing between liquidated damages and penalty clauses is whether, when tested as of contract formation, the stipulated sum bears a reasonable correlation to anticipated loss; if so, it would be construed as a liquidated damages clause and, if not, as a penalty clause. A stipulated sum that bears such reasonable correlation to anticipated loss is considered as a genuine pre-estimate of loss.

(vi) As regards enforcement, the two categories are treated differently. In case the court concludes that the stipulated payment is a genuine pre-estimate of anticipated loss in case of breach, the sum stipulated would be ordered to be paid if the court also concludes that it is difficult or impossible to prove loss in the facts and circumstances. Such pre-estimate is to be made at the time of contract formation although evidence thereof may be adduced when there is a dispute.

(vii) Even if the court concludes that the stipulated compensation is a genuine pre-estimate of loss, the party claiming such compensation is required to prove that loss was incurred as a consequence of breach and what is dispensed with is the obligation to prove the loss accurately by also proving quantum of loss as per the claim. To put it differently, even in such a situation, a claim cannot be sustained in an *injuria sine damnum* scenario.

(viii) If it is not difficult or impossible to prove loss, the person claiming liquidated damages is required to prove loss, including the quantum of loss, even if the sum stipulated is a genuine pre-estimate and, therefore, qualifies as a claim for liquidated damages. In contrast with the contract formation stage evidence with regard to genuine pre-estimate, needless to say, actual loss would be required to be proved with reference to the breach and the direct consequences flowing therefrom.

(ix) Given the fact that a party claiming liquidated damages cannot claim more than the stipulated sum, once such party establishes that the stipulated compensation is a genuine pre-estimate, a high standard of proof would not be insisted upon to prove difficulty or impossibility of proving loss. In other words, the court would bear in mind that parties negotiated and concluded the contract on the basis of risk allocation, whereby the party claiming liquidated damages forecloses the possibility of claiming an amount higher than the sum stipulated, by way of proving higher actual loss, so as to enjoy the benefit of the relative ease and certainty of establishing a claim for liquidated damages as opposed to a claim for unliquidated damages.

(x) On the contrary, if it is concluded that the stipulation is by way of penalty, the person claiming such penalty would be required to prove loss accurately, including the quantum of loss, and claim reasonable compensation on that basis.

24.If the above principles are applied to the facts of this case, as stated above, the term "penalty" is used in clause 4.1 (a) of the MSA and in Schedule 1 thereto. Therefore, the first Respondent was required to discharge the burden of establishing that the stipulation is by way of liquidated damages and not by way of penalty. In this connection, the first Respondent adduced oral evidence to the effect that the sum stipulated in

clause 4.1 (a) of the MSA read with Schedule 1 thereto is a genuine pre-estimate, at the time of contract formation, of anticipated loss in revenue from the provision of G2C services. In addition, it is clear from the RFP, the MSA and the correspondence between the parties that the two expressions have been used interchangeably, albeit the expression "penalty" was used more frequently in this context. Apart from the above factors, I find that clause 4.1 (a) read with Schedule 1 thereto provides for payment of a stipulated sum of Rs.200 per CSC per day of delay and, therefore, the text is indicative of a reasonable correlation with anticipated loss on breach. Thus, it is a liquidated damages and not a penalty clause.

25. Notwithstanding the above conclusion, it remains to be considered as to whether the award of liquidated damages to the first Respondent warrants interference in the facts and circumstances. As per the judgments of the Hon'ble Supreme Court, even if the stipulation is by way of liquidated damages, it is necessary to prove that loss was incurred and, in fact, if such loss is capable of being proved, to prove the loss accurately. In this case, the first Respondent, as stated above, adduced evidence that the stipulation is a genuine pre-estimate. This was done with reference to the anticipated revenue from G2C services. From the facts on record, it is evident that the Petitioner contended, for instance, in

letters dated 30.03.2009, 13.05.2009 and 10.06.2009, that G2C services were unavailable, at that juncture, and I do not find any rebuttal by the first Respondent in contemporaneous correspondence. All the documents that were filed by the first Respondent, in this regard, are letters issued in October 2009 or later. However, the Arbitral Tribunal did not attach much significance to these documents. Nonetheless, keeping in mind the legal requirement of proving the factum of loss in April 2009, when the first installment of liquidated damages was imposed, these documents are vital for such purpose and should not have been disregarded. It is also evident that the first Respondent did not claim or receive proportionate compensation for the period prior to April 2009 or for the six-month period beginning from 01.05.2009 and ending on 31.10.2009 and no explanation has been provided as to why compensation was not claimed for this period. When viewed from this perspective and keeping in mind the manner in which the genuine pre-estimate requirement was established, i.e. on the basis of anticipated G2C revenue losses, I am of the view that the first Respondent failed to prove any loss in April 2009 and, therefore, is not entitled to the sum of Rs.2,30,22,000/- in respect of the above period. The Arbitral Tribunal committed a patent illegality, in this regard, in not considering that it is necessary to prove the factum of loss even in the context of a claim for liquidated damages although proof of quantum of loss may be dispensed with if it is difficult or impossible to

prove. As regards the period commencing from 01.11.2009 until 31.01.2010, it is clear that G2C services had been rolled out by then and, therefore, loss was incurred. As regards proof of loss, including the quantum thereof, the Arbitral Tribunal held that the first Respondent would have incurred revenue loss on account of the failure by the Petitioner to roll out CSCs and that, in addition, the public incurred losses as a result of the non-roll out of the services. Although it was contended that this finding is not based on the pleading of the first Respondent, I find that the first Respondent pleaded that it is not possible to prove the loss on account of the failure to establish the CSCs and, in that factual context, I do not think interference is warranted with this finding of the Arbitral Tribunal.

26.It may be noted that an arbitral award may be set aside wholly or in part by applying the principle of severance, as held in **R.S.Jiwari vs. Ircon International Ltd, 2010 (112) Bom LR 491(FB)**, and consequential changes may be made in the award as held in **ONGC vs. Western Geco International Ltd,(2014) 9 SCC 263**.

27.As stated at the outset, the challenge was focused on the award of liquidated damages and interest on the bank guarantee amount and not on the negative bid portion of the Award. Therefore, in view of

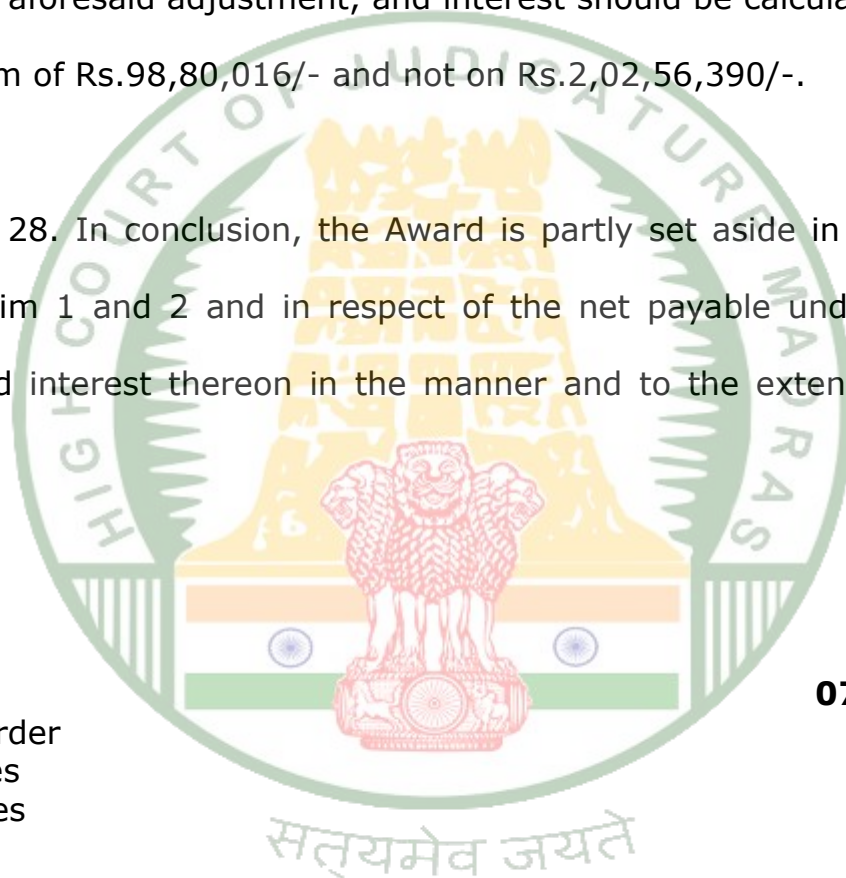
the above analysis, the Award is liable to be and is partly set aside with regard to the award of liquidated damages for the period commencing on 01.04.2009 and ending on 30.04.2009. As a consequence, the amount payable would be required to be revised to an aggregate sum of Rs.5,38,45,626/- (Rs.7,68,67,626/- - Rs.2,30,22,000/-) for counter claim 1. In effect, the realisation from the bank guarantee exceeded this sum by Rs.1,03,76,374/- (Rs.6,42,22,000/- - Rs.5,38,45,626/-) and, therefore, the award of interest on Rs.1,26,45,626/-, i.e. the shortfall in realisation as per the Award, is also liable to be and is set aside. As regards interest on the bank guarantee amount, i.e. counter claim 2, once again, as contended by the learned counsel for the Petitioner, this claim is liable to be restricted to the period when the first Respondent was unable to enforce the guarantee on account of the interim order. Consequently, interest should not have been awarded for the period subsequent to the discharge of the said interim order. In effect, the interest claim is liable to be revised so as to coincide with the date of discharge of the interim order that prevented the first Respondent from enforcing the bank guarantee. In sum, interest should be re-calculated from 16.03.2010 to 25.02.2011. Counter claim 3 relates to the negative bid amount and the Award, in this respect, is not liable to be interfered with except to the limited consequential extent indicated below. On an overall basis, the net amount payable towards counter claim 3 should be revised after adjusting the

realisation from the bank guarantee against counter claim 1 and partly, i.e. to the extent of Rs.1,03,76,374/-, against counter claim 3. Consequently, net amount of Rs.98,80,016/- (Rs.2,02,56,390/- - Rs.1,03,76,374/-) would be payable in respect of counter claim 3, after making the aforesaid adjustment, and interest should be calculated on the said net sum of Rs.98,80,016/- and not on Rs.2,02,56,390/-.

28. In conclusion, the Award is partly set aside in respect of counter claim 1 and 2 and in respect of the net payable under counter claim 3 and interest thereon in the manner and to the extent indicated above.

Speaking order
Index: Yes
Internet: Yes
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07.11.2019



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SENTHILKUMAR RAMAMOORTHY, J.
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