A VISHWANATH SOOD

v.

UNION OF INDIA & ANR.

JANUARY 24, 1989

B [SABYASACHI MUKHARJI AND S. RANGANATHAN, JJ.]

Arbitration Act, 1940: Section 3, 14, 17, 30, 31 and 33—Arbitration agreement—Clause providing penalty as compensation to Department for default on part of contractor in adhering to time schedule—Compensation to be determined by Superintending Engi-
C *neering and none else—Award of compensation—Whether liable to be questioned before Arbitrator.*

The appellant undertook the construction of a Farmers' Community Centre Building by an agreement entered into with the Union of India and the State of Himachal Pradesh, the respondents in the appeal.

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The agreement dated June 20, 1968 provided, by Clause 2, for the payment of compensation for delay, if the contractor should have been guilty of delay in commencing the work or in completing it, the quantum of compensation to be determined by the Superintending Engineer and that his decision was final. Clause 25 provided for settle-
E **ment of disputes by arbitration. It excluded from arbitration matters or disputes in respect of which provision had been made elsewhere or otherwise in the contract.**

Certain disputes arose between the parties, and in terms of clause 25 of the agreement they were referred to a sole arbitrator.

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The Contractor submitted a claim in respect of 9 items, and the department filed a counter claim to the effect that they were entitled to receive from the Contractor a sum of Rs.24,000 on account of payment of 10 per cent compensation for not executing the work in accordance with the terms and conditions of the agreement. The arbitrator gave his
G **award, and the same was filed in the Court.**

The Contractor filed objections for modification in respect of items 1, 8 and 9 of his claim and item no. 1 of the respondents' counter claim. The department also filed its objections.

H **The Single Judge dismissed the objections of the respondents and**

allowed the appellants' claim only in respect of item no. 1 of the respondents' counter claim. The single Judge took the view that a reading of clause 2 with clause 25 made it clear that any compensation under clause 2 could be adjudicated upon only by the Superintending Engineer or the Development Commissioner and that it was not open to the arbitrator to have entered upon a reference in regard to this claim at all.

Both parties filed appeals to the Division Bench. The Bench reversed the order of the Single Judge and restored the award to its original terms. It held that inasmuch as a bonafide dispute can be raised by the contractor in regard to his liability to compensation under clause 2 and as no machinery was provided in clause 2 for the resolution of such dispute, there is ample justification for holding that resort can be had to arbitration under clause 25. On this view of the matter, the Bench did not agree with the Single Judge that the arbitrator had travelled outside his jurisdiction in awarding compensation to the Government against the contractor for the delay in executing the work.

In the appeal to this Court it was contended on behalf of the appellants that the terms of Clause 2 clearly envisage the determination of the amount of compensation for the delay in the execution of the work only by the Superintending Engineer and specifically mentions that the decision of the Superintending Engineer in writing shall be final. The opening words of Clause 25, "Except otherwise provided in the contract" clearly take out of the purview of Clause 25 any dispute in respect of a claim under Clause 2. Even if Clause 25 be held applicable, the question of submitting a dispute in this regard to the arbitrator could only arise if there had been a determination and a dispute under Clause 2. It was further submitted that there was no dispute at all between the parties on the question of compensation and that a dispute cannot be said to arise merely because a counter-claim was for the first time put forward by the Department before the arbitrator.

On behalf of the respondent-Department the appeal was contested by contending that Clause 2 was in the nature of a penal clause which automatically takes effect irrespective of any default. The clause made the contractor liable for the penalty prescribed therein whenever there was a delay in the completion of the contract, whatsoever might have been the reason therefore, the question as to whether the contractor was at default or not being totally immaterial. The Department was, therefore, entitled to automatically deduct from the bills payable to the contractor, the compensation or penalty at the rate mentioned in Clause 2

A or such reduced amount as may be determined in a particular case by the Superintending Engineer and that if the contractor objected to the deduction that would give rise to a dispute which can be the subject matter of arbitration under Clause 25.

Allowing the appeal,

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HELD: 1. Clause 2 of the contract makes the time specified for the performance of the contract a matter of essence and emphasises the need on the part of the contractor to scrupulously adhere to the time schedule approved by the Engineer-in-charge. With a view to compel the contractor to adhere to this time schedule, this clause provides a C kind of penalty in the form of a compensation to the Department for default in adhering to the time schedule. [297E-F]

2. Clause 2 contains a complete machinery for determination of the compensation which can be claimed by the Government on the ground of delay on the part of contractor in completing the contract as D per the time schedule agreed to between the parties. The decision of the Superintending Engineer is in the nature of a considered decision which he has to arrive at after considering the various mitigating circumstances that may be pleaded by the contractor or his plea that he is not liable to pay compensation at all under this clause. [298E-F]

E 3. The question regarding the amount of compensation leviable under Clause 2 has to be decided only by the Superintending Engineer and no one else. [298G]

4. The opening part of Clause 25 clearly excludes matters like those mentioned in Clause 2 in respect of which any dispute is left to be F decided by a higher official of the Department. [299C]

5. The question of awarding compensation under Clause 2 is outside the purview of the arbitrator and the compensation, determined under Clause 2 either by the Engineer-in-Charge or on further reference by the Superintending Engineer will not be capable of being G called in question before the arbitrator. [299D]

6. Clause 25 which is the arbitration clause starts with an opening phrase excluding certain matters and disputes from arbitration and these are matters or disputes in respect of which provision has been made elsewhere or otherwise in the contract. These words can have H reference only to provisions such as the one in paranthesis in Clause 2

by which certain types of determination are left to the administrative authorities concerned. [299B-C] A

7. The question of any negligence or default on the part of the contractor has many facets and to say that such an important aspect of the contract cannot be settled by arbitration but should be left to one of the contracting parties might appear to have far reaching effects. In the instant case, it is made clear that the decision regarding non arbitrability is only on the question of any compensation which the government might claim in terms of Clause 2 of the contract. This is not an undefined power. The amount of compensation is strictly limited to a miximum of 10 percent and with a wide margin of discretion to the Superintending Engineer. It is this power that is kept outside the scope of arbitration. [299E, F, H; 300A] B C

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 1524 of 1982.

From the Judgment and Order dated 5.9.1977 of the Himachal Pradesh High Court in F.A.O. No. 8 of 1975. D

A.B. Rohtagi, Mrs. Urmila Kapoor, Miss S. Janani and Naresh K. Sharma for the Appellant.

Miss A. Subhashini for the Respondents. E

The Judgment of the Court was delivered by

RANGANATHAN, J. The appellant Vishwanath Sood undertook the construction of a Farmers' Community Centre Building at Thanedhar by an agreement entered into with the Union of India and the State of Himachal Pradesh dated 20.6.1968. Certain disputes arose between the parties to the agreement and in terms of clause 25 of the agreement, they were referred to a sole arbitrator. The contractor submitted a claim of Rs. 1,28,000 while the respondents also submitted a counter-claim. By an award dated 20.3.1972, the abritrator awarded an amount of Rs.31,932 to the contractor and a sum of Rs.21,504 to the respondents. The award was filed in the court. The contractor filed an application in the court for modification or correction of the award in respect of three items of his claim (1, 8 and 9) and item no. 1 of the respondent's counter claim. The Department also filed its objections to the award and prayed that a sum of Rs.8,080.29 should be awarded in favour of the Department or the award remitted to arbitrator. The F G H

learned single Judge dismissed the objections of the respondents. So far as the appellant's prayers were concerned, he allowed the same only in respect of item 1 of the respondent's counter claim. He held that the arbitrator was not justified in granting to the Government a sum of Rs.20,000 against the contractor. Both the contractor and the respondents preferred appeals to the Division Bench. The Bench reversed the order of the learned single Judge. It set aside the order of the learned single Judge in so far as the sum of Rs.20,000 was deleted thereby from the award of the arbitrator. The award was restored to its original terms and the contractor was held entitled to interest at 6 per cent on the amount found due to him after adjusting the sum awarded by the arbitrator in favour of the Government against the sum awarded in favour of the contractor.

The contractor has preferred this appeal by special leave from the order of the Division Bench of the High Court.

Learned counsel for the appellant pressed the contentions in respect of the four items to which he had objected before the learned single Judge and the Division Bench. Three of these items pertain to the claims put forward by the contractor which were rejected by the arbitrator and held by the courts to have been rightly rejected. The first claim (item no. 1) made by the contractor was of a sum of Rs. 12,720 which, according to him, was the loss incurred by him by reason of the Department's delay in handing over the site to him for executing the contract. The learned single Judge discussed this aspect of the matter at length. He observed that, on this point, there was, on the one hand, oral evidence adduced on behalf of the Department while there was only the bare denial of the contractor on the other. He pointed out that the arbitrator had fully considered the matter and that it was not open to the court to re-assess the evidence and that there was no error apparent on the face of the record. The second claim (item no. 8) was for a sum of Rs.6,172 being the amount kept as security with the respondent. In respect of this item also the learned single Judge discussed the evidence which showed that the security amount had been properly adjusted by the Department which had been constrained to take up the work departmentally at the cost and risk of the contractor. He held that this was an aspect which had been considered by the arbitrator and a proper conclusion arrived at. The third claim put forward by the petitioner (item no. 9) was for a sum of Rs.30,000, claimed as compensation for an amount spent by the contractor for the purchase of a truck for this work. The learned single Judge here again pointed out that no material had been placed before

the arbitrator by the contractor to show that he was entitled to the amount and that, in any event, having regard to the fact that the work was executed by the Department at the cost and risk of the contractor, there was no question of the contractor preferring any claim in respect of this item. The above three claims of the petitioner were also rejected by the Division Bench which pointed out that the award made by the arbitrator was not a speaking award and that the face of the award did not show any error. We do not think that so far as these claims are concerned, that the appellant has any arguable case at all. As pointed out by the Division Bench of the High Court, the award was a non-speaking award. The arbitrator had considered the materials placed before him and had arrived at his conclusions. The award does not on the face of it disclose any error, much less any error of law, which needs to be set right. We therefore, hold that the High Court was justified in affirming the award so far as the rejection of these three claims is concerned.

The position in regard to the counter claim of the respondents which was allowed by the arbitrator and the Division Bench stands on a different footing. The respondents' claim before the arbitrator was that they were entitled to receive from the contractor "Rs.24,000 on account of payment of 10 per cent compensation on the tendered amount for not executing the work in accordance with the terms and conditions of the agreement". As against this claim the arbitrator awarded the respondents a sum of Rs.20,000. The learned single Judge took the view that having regard to clause 2 of the contract (pertaining to the claim by the respondent) read with clause 25 it was clear that any compensation under clause 2 could be adjudicated upon only by the superintending Engineer or the Development Commissioner and that it was not open to the arbitrator to have entered upon a reference in regard to this claim at all. In order to appreciate the finding of the learned single Judge it will be useful to set out clauses 2 and 25 of the conditions of contract on which his decision was based:

> "Clause 2: *Compensation for delay*: The time allowed for carrying out the work as entered in the tender shall be strictly observed by the contractor and shall be deemed to be the essence of the contract on the part of the contractor and shall be reckoned from the fifteenth day after the date on which the order to commence the work is issued to the contractor. The work shall throughout the stipulated period of the contract be proceeded with all due diligence and the contractor shall pay as compensation an amount

A equal to one per cent, or such smaller amount as the Superintending Engineer (whose decision in writing shall be final) may decide on the amount of the estimated cost of the whole work as shown in the tender for every day that the work remains uncommenced, or unfinished, after proper dates. And further, to ensure good progress during
B the execution of the work, the contractor shall be bound in all cases in which the time allowed for any work exceeds, one month (save for special jobs to complete one-eighth of the whole of the work before one-fourth of the whole time allowed under the contract has elapsed; three-eighth of the work, before one-half of such time has elapsed, and three-
C fourth of the work, before three-fourth of such time has elapsed. However, for special jobs if a time-schedule has been submitted by the Contractor and the same has been accepted by the Engineer-in-charge, the contractor shall comply with the said time-schedule. In the event of the contractor failing to comply with this condition, he shall be
D liable to pay as compensation an amount equal to one per cent or such smaller amount as the Superintending Engineer (whose decision in writing shall be final) may decide on the said estimated cost of the whole work for every day that the due quantity of work remains incomplete; provided always that the entire amount of compensa-
E tion to be paid under the provisions of this clause shall not exceed ten per cent, on the estimated cost of the work as shown in the tender."

"Clause 25: *Settlement of disputes by Arbitration:* Except where otherwise provided in the contract, all questions and
F disputes relating to the meaning of the specifications, designs drawings and instructions hereinbefore mentioned and as to the quality of workmanship or materials used on the work or as to any other question, claim, matter or thing whatsoever, in any way arising out of or relating to the contract, designs, drawings, specifications, estimates, ins-
G truction, order, or these conditions or otherwise concerning the works or the execution or failure to execute the same whether arising during the progress of the work or after the completion or abandonment thereof shall be referred to the sole arbitration of the person appointed by the Chief Engineer, Himachal Pradesh Public Works Depart-
H ment ....."

The Division Bench did not agree with the view of the learned single Judge. It pointed out that, while in the ordinary course, the rate of compensation payable by the contractor is one per cent of the amount of the estimated cost of the whole work, under clause 2, the Superintending Engineer is authorised to depart from this figure and determine the compensation at a smaller amount if there are any extenuating circumstances in favour of the contractor. The question however was whether the compensation determined under clause 2 is excluded from the scope of arbitration under clause 25. The Division Bench answered this question in the negative. It pointed out that the *sine qua non* of clause 2 was that the contractor should have been guilty of delay in commencing the work or in completing it but the clause did not specify either the authority or the procedure for determining whether the contractor is responsible for the default. Observing that there can be a serious dispute in a particular case as to the person who is responsible for the delay, the Bench took the view that the determination of this dispute cannot be excluded from the scope of clause 25. The Bench observed that inasmuch as a *bona fide* dispute can be raised by the contractor in regard to his liability to compensation under clause 2 and no machinery is provided in clause 2 for the resolution of that dispute, there is ample justification for holding that resort can be had to arbitration under clause 25. The statement in clause 2 that the decision of the Superintending Engineer is final, according to the Bench, merely constituted a declaration that no officer in the Department could disturb his quantification. But this finality cannot be construed as extending to exclude the jurisdiction of the arbitrator under clause 25. On this view of the matter, the Division Bench found itself unable to agree with the learned single Judge that the arbitrator had travelled outside his jurisdiction in awarding a sum of Rs.20,000 as compensation to the Government against the contractor for the delay in executing the work.

It will be seen from the narration above that so far as this item was concerned, both parties proceeded on the footing that the claim of the Government was a claim under clause 2 and that the arbitrator had awarded the sum only in terms of clause 2. This is also borne out by the fact that the claim of the Department was based on a percentage of the total cost of the work and the restriction of the claim to 10% also appears to have been the result of the proviso to clause 2. The award, therefore, on a fair reading of it, contains a grant by the arbitrator of compensation to the Government in terms of clause 2. It is therefore open to the parties to urge before this Court, as they did before the High Court also, that, on a proper construction of clauses 2 and 25,

this award was not justified. It is in this respect that this counter claim of the Department stands on a different footing from the earlier claims of the contractor which have been rejected and which, we have held above, have been rightly rejected.

Learned counsel for the appellants contends that the terms of clause 2 clearly envisage the determination of the amount of compensation for the delay in the execution of the work only by the Superintending Engineer and specifically mentions that the decision of the Superintending Engineer in writing shall be final. The opening words of clause 25: "Except where otherwise provided in the contract" clearly take out of the purview of clause 25 any dispute in respect of a claim under clause 2. He submitted that the clause authorised only the Superintending Engineer to go into the question whether there is any delay or not and the reasons therefor and to determine the rate at which compensation should be charged from the contractor. If the Engineer-in-charge levies a compensation under clause 2, the contractor can apply to the Superintending Engineer. If the Superintending Engineer finds that there was no fault on the part of the contractor at all he could waive the compensation under clause 2 and that cannot be challenged by the Department before the arbitrator. *Per contra*, where the Superintending Engineer confirms that there has been a delay for which compensation should be charged, it will not be open to the contractor to challenge the conclusion before the arbitrator. Learned counsel also submitted that even if clause 25 were to be held applicable, the question of submitting a dispute in this regard to the arbitrator could only arise if there had been a dertermination and a dispute under clause 2. Clause 2 envisages that the Engineer-in-charge should, in appropriate cases, levy a compensation at the rate specified in that clause. If he did, it was open to the contractor to dispute the same and approach the Superintending Engineer to reduce or waive the compensation for any reason whatsoever. Or, it may be that, even where the Engineer-in-charge levied no compensation, the Superintending Engineer could, either on his own motion or on being moved by the department, after considering the facts charge a compensation with the quantum of which the department may not be satisfied in which event a dispute could arise. But in the present case neither the Engineer-in-charge nor the Superintending Engineer had determined any liability at all under clause 2. There was no compensation levied against which there was any protest by the contractor, and there was no matter submitted to the Superintending Engineer for determination. In these circumstances, the submission of the learned counsel for the appellant is that there was no dispute at all between the parties on

the question of compensation and that a dispute cannot be said to arise merely because a counter claim is for the first time put forward by the Department before the arbitrator. A

On the other hand, the learned counsel for the Department contended that clause 2 is in the nature of a penal clause which automatically takes effect irrespective of any default. He described it as an "agreed penalty" clause. He stated that the clause made the contractor liable for the penalty prescribed therein whenever there was a delay in the completion of the contract, whatsoever might have been the reason therefor, the question as to whether the contractor was at default or not being totally immaterial. The Dapartment was, therefore, entitled to automatically deduct from the bills payable to the petitioner the compensation or penalty at the rate mentioned in clause 2 or such reduced amount as may be determined in a particular case by the Superintending Engineer and that if the contractor objected to this deduction that would give rise to a dispute which can be the subject matter of arbitration under clause 25. He therefore submitted that the Division Bench has rightly construed the terms of the contract and confirmed the award made by the arbitrator. B C D

We have gone through the judgment of the Division Bench of the High Court and we have also considered the arguments advanced on both sides. With great respect, we find ourselves unable to agree with the interpretation placed by the Division Bench on the terms of the contract. Clause 2 of the contract makes the time specified for the performance of the contract a matter of essence and emphasises the need on the part of the contractor to scrupulously adhere to the time schedule approved by the Engineer-in charge. With a view to compel the contractor to adhere to this time schedule, this clause provides a kind of penalty in the form of a compensation to the Department for default in adhering to the time schedule. The clause envisages an amount of compensation calculated as a percentage of the estimated cost of the whole work on the basis of the number of days for which the work remains uncommenced or unfinished to the prescribed extent on the relevant dates. We do not agree with the counsel for the respondent that this is in the nature of an automatic levy to be made by the Engineer-in charge based on the number of days of delay and the estimated amount of work. Firstly, the reference in the clause to the requirement that the work shall throughout the stipulated period of the contract be proceeded *with due diligence* and the reference in the latter part of the clause that the compensation has to be paid "in the event of the contractor *failing* to comply with" the prescribed time E F G H

schedule make it clear that the levy of compensation is conditioned on some default or negligence on the part of the contractor. Secondly, while the clause fixes the rate of compensation at 1 per cent for every day of default it takes care to prescribe the maximum compensation of 10 per cent on this ground and it also provides for a discretion to the Superintending Engineer to reduce the rate of penalty from 1 per cent. Though the clause does not specifically say so, it is clear that any moderation that may be done by the Superintending Engineer would depend upon the circumstances, the nature and period of default and the degree of negligence or default that could be attributed to the contractor. This means that the Superintending Engineer, in determining the rate of compensation chargeable, will have to go into all the aspects and determine whether there is any negligence on the part of the contractor or not. Where there has been no negligence on the part of the contractor or where on account of various extraneous circumstances referred to by the Division Bench such as *vis major* or default on the part of the Government or some other unexpected circumstance which does not justify penalising the contractor, the Superintending Engineer will be entitled and bound to reduce or even waive the compensation. It is true that the clause does not in terms provide for any notice to the contractor by the Superintending Engineer. But it will be appreciated that in practice the amount of compensation will be initially levied by the Engineer-in-charge and the Superintending Engineer comes into the picture only as some sort of revisional or appellate authority to whom the contractor appeals for redress. As we see it, clause 2 contains a complete machinery for determination of the compensation which can be claimed by the Government on the ground of delay on the part of the contractor in completing the contract as per the time schedule agreed to between the parties. The decision of the Superintending Engineer, it seems to us, is in the nature of a considered decision which he has to arrive at after considering the various mitigating circumstances that may be pleaded by the contractor or his plea that he is not liable to pay compensation at all under this clause. In our opinion the question regarding the amount of compensation leviable under clause 2 has to be decided only by the Superintending Engineer and no one else.

The Division Bench has construed the expression in clause 2 in paranthesis that "the Superintending Engineer's decision shall be final" as referring only to a finality *qua* the department; in other words, that it only constitutes a declaration that no officer in the department can determine the quantification and that the quantum of compensation levied by the Superintending Engineer shall not be

changed without the approval of the Government. After referring to certain judicial decisions regarding the meaning of the word "final" in various statutes, the Division Bench concluded that the finality cannot be construed as excluding the jurisdiction of the arbitrator under clause 25. We are unable to accept this view. Clause 25 which is the arbitration clause starts with an opening phrase excluding certain matters and disputes from arbitration and these are matters or disputes in respect of which provision has been made elsewhere or otherwise in the contract. These words in our opinion can have reference only to provisions such as the one in paranthesis in clause 2 by which certain types of determinations are left to the administrative authorities concerned. If that be not so, the words "except where otherwise provided in the contract" would become meaningless. We are therefore inclined to hold that the opening part of clause 25 clearly excludes matters like those mentioned in clause 2 in respect of which any dispute is left to be decided by a higher official of the Department. Our conclusion, therefore, is that the question of awarding compensation under clause 2 is outside the purview of the arbitrator and that the compensation, determined under clause 2 either by the Engineer-in-charge or on further reference by the Superintending Engineer will not be capable of being called in question before the arbitrator.

We may confess that we had some hesitation in coming to this conclusion. As pointed out by the Division Bench, the question of any negligence or default on the part of the contractor has many facets and to say that such an important aspect of the contract cannot be settled by arbitration but should be left to one of the contracting parties might appear to have far reaching effects. In fact, although the contractor in this case might object to the process of arbitration because it has gone against him, contractors generally might very well prefer to have the question of such compensation decided by the arbitrator rather than by the Superintending Engineer. But we should like to make it clear that our decision regarding non arbitrability is only on the question of any compensation which the Government might claim in terms of clause 2 of the contract. We have already pointed out that this is a penalty clause introduced under the contract to ensure that the time schedule is strictly adhered to. It is something which the Engineer-in-charge enforces from time to time when he finds that the contractor is being recalcitrant, in order to ensure speedy and proper observance of the terms of the contract. This is not an undefined power. The amount of compensation is strictly limited to a maximum of 10% and with a wide margin of discretion to the Superintending Engineer, who might not only reduce the percentage but who, we think, can even reduce it

A to *nil,* if the circumstances so warrant. It is this power that is kept outside the scope of arbitration. We would like to clarify that this decision of ours will not have any application to the claims, if any, for loss or damage which it may be open to the Government to lay against the contractor, not in terms of clause 2 but under the general law or under the Contract Act. As we have pointed out at the very outset so far as this case is concerned the claim of the Government has obviously proceeded in terms of clause 2 and that is the way in which both the learned single Judge as well as the Division Bench have also approached the question. Reading clauses 2 and 25 together we think that the conclusion is irresistible that the amount of compensation chargeable under clause 2 is a matter which has to be adjudicated in accordance with that clause and which cannot be referred to arbitration under clause 25.

As stated earlier, an alternative ground was urged by the learned counsel for the appellant that, no penalty under clause 2 having been imposed by the respondents in the first instance, no dispute had at all arisen which could have been referred to arbitration. This point was not taken before the High Court and the relevant facts are not on record. That apart, in the view we have taken, it is unnecessary to express any opinion on this argument and we refrain from doing so.

For the reasons above mentioned, we restore the judgment of the learned single Judge. In the result, the amount of compensation of Rs.20,000 awarded by the arbitrator in favour of the Government will stand deleted. The amount of interest payable to the contractor, if any, will be worked out on the basis of the award as modified by us above.

The appeal is allowed. We however make no order as to costs in the circumstances of the case.

N.V.K. Appeal allowed.