A K.N. SATHYAPALAN (DEAD) BY LRS.

v.

STATE OF KERALA AND ANR.

NOVEMBER 30, 2006

B [DR. AR. LAKSHMANAN AND ALTAMAS KABIR, JJ.]

Arbitration Act, 1940—s.17—Non-completion of work within stipulated time—Extension of time on condition that contractor not eligible to escalation costs for work done during extended period—Arbitrator allowing the claims on account of escalation costs—High Court setting aside the same holding that arbitrator had exceeded its jurisdiction in granting award—Justification of—Held, not justified as delay had occurred due to law and order problem at the work site which should have been avoided by the State Government.

C

D **The appellant entered into an agreement with the Respondent-State whereby it undertook the construction work. The whole work could not be completed on the scheduled dates and under clause 50 of the General Conditions of Contract extension of time was sought by the appellant. The respondents extended the time of completion but while doing so made it conditional that such extension of time would be subject to execution of a**

E **Supplemental Agreement to the effect that the contractor would not be eligible for any enhanced rate for the work done during the extended period. The dispute arose and the matter was referred to the sole arbitrator.**

F **Appellant raised claims under various heads. Arbitrator allowed some of the claims and awarded a sum of Rs. 42 lacs with 12% interest per annum on account of losses suffered by appellant due to interruption of work by anti social elements and failure of State in removing such miscreants from the sites causing heavy financial losses by way of idle men and machinery; price escalation of material that had taken place during**

G **extended period of completion; failure of State to handover a suitable quarry which resulted in bringing rubble and metal from far off places involving additional transportation costs; and non-availability of a suitable dumping yard for dumping excess earth.**

H

Appellant filed O.P. under S.17 of Arbitration Act for passing a decree in terms of the award. The Respondent-State filed petition under S.30 which was dismissed. On appeal, High Court set aside the award holding that the Arbitrator had exceeded its jurisdiction in granting the award. Hence the present appeal.

Allowing the appeal, the Court

HELD: 1.1. Admittedly, the original Agreement did not contain a clause for escalation of rates. On the other hand, the Supplemental Agreement contained a specific provision that the contractor would not claim any enhanced rate for such item of work on account of the extension of time either due to the increase in the rate of labour or materials or on any other ground whatsoever. Ordinarily, the parties would be bound by the terms agreed upon in the contract, but in the event one of the parties to the contract is unable to fulfil its obligations under the contract which has a direct bearing on the work to be executed by the other party, the Arbitrator is vested with the authority to compensate the second party for the extra costs incurred by him as a result of the failure of the first party to live up to its obligations.

[870-G, H; 874-E-F]

P.M. Paul v. *Union of India,* [1989] Supp. 1 SCC 368; *T.P. George* v. *State of Kerala and Anr.,* [2001] 2 SCC 758; *M/s. Alopi Parshad & Sons Limited* v. *The Union of India,* [1960] 2 SCR 793 and *State of U.P.* v. *Patel Engg. Co. Ltd. and Ors.,* [2004] 10 SCC 566, referred to.

1.2. The appellant was prevented by unforeseen circumstances from completing the work within the stipulated period of eleven months. Such delay could have been prevented had the State Government stepped in to maintain the law and order problem which had been created at the work site. It is also clear that the rubble and metal, which should have been available at the departmental quarry had to be obtained from quarries which were situated at double the distance, and even more, resulting in doubling of the transportation charges. Even the space for dumping of excess earth was not provided by the respondents which compelled the appellant to dump the excess earth at a place which was far away from the work site entailing extra costs for the same. [875-B-C]

2. In the aforesaid circumstances, the Arbitrator *appears to have* acted within his jurisdiction in allowing some of the claims on account of

escalation of costs which was referable to the execution of the work during the extended period. The view taken by the High Court was on a rigid interpretation of the terms of contract and the Supplemental Agreement executed between the parties, which was not warranted by the turn of events. [875-D]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 4806 of 2000.

From the Judgment and Order dated 31-7-1998 of the High Court of Kerala at Ernakulam in M.F.A. No. 980/1990 C.

Dushyant Dave, M.K. Chandra Mohan Das, M.N. Nandarajan, Ramesh Singh and Syed Shahid Hussain Rizvi for the Appellants.

Jayanth Muth Raj and P.V. Dinesh for the Respondents.

The Judgment of the Court was delivered by

ALTAMAS KABIR, J. The appellant entered into an agreement with the State of Kerala on 10th October, 1985 whereunder he was entrusted with the construction work of the Chavara Distributory from Ch.7440M to 9440M and 10475M to 14767M. Disputes having arisen between the parties, the matter was referred to arbitration. The Superintending Engineer, Siruvani Project, Palghat, the designated Arbitrator in terms of the contract, was appointed as the sole Arbitrator. By his award, which was published on 2nd September, 1989, the Arbitrator awarded a total sum of Rs. 42,21,000/- with 12% interest per annum from the date of the award. Upon the passing of the award the appellant herein filed O.P. (Arb.) 40/89 in the court below under Section 17 of the Arbitration Act for passing a decree in terms of the award. The State of Kerala filed a petition under Section 30 of the Act challenging the award and for setting aside the same.

The application filed by the State was dismissed and aggrieved thereby the State of Kerala preferred an appeal in the High Court of Kerala at Ernakulam, being MFA No. 980 of 1990 C.

The appellant herein raised claims under 12 different heads but the Arbitrator allowed only claims (a), (e), (g), (i) and (k). Although, in the memorandum of appeal, the entire award in favour of the appellant had been challenged, but the arguments were addressed only with regard to claims under heads (a), (g), (i) and (k). A preliminary objection was raised in the

appeal that the Superintending Engineer, who had been appointed as the Arbitrator and had entered on the reference, had been suspended from service for gross mal-practice, and the Government had informed all concerned that the Arbitrator was not to continue with the reference. The Arbitrator retired on superannuation while he was under suspension and the award was made after his retirement. According to the State of Kerala, in the circumstances, the award passed by the Arbitrator was without jurisdiction.

The aforesaid objection being preliminary in nature, the same was taken up first for consideration and it was held by the High Court that such an objection was without any merit. The Arbitrator, who was working as Superintending Engineer was placed under suspension on 31st May, 1989. As per an agreement between the parties on 14th February, 1989, the time for making and publishing the award was extended upto 14th June, 1989. Even after the Arbitrator was suspended from service, both sides had agreed on 14th June, 1989 to extend the time further for making and publishing the award upto 14th October, 1989. The Arbitrator retired from service while under suspension on 30th June, 1989. In the light of the said facts, the High Court agreed that the court below could not revoke the authority of the Arbitrator, which could only be done under Section 5 of the Arbitration Act, with the leave of the Court. Accordingly, the preliminary objection raised on behalf of the State of Kerala that the Arbitrator had no authority to continue with the arbitration after his suspension or retirement, was rejected by the High Court.

Claim (a) of the appellant herein involved the claimant's entitlement to get compensation for interruption of work by anti-social elements and failure of the Department in removing such miscreants from the sites which caused the claimant heavy financial losses by way of idle men and machinery, plant and equipment. The claim made under the aforesaid head was for a sum of Rs.11,40,000/-. The Arbitrator was satisfied that there was interruption of work by anti-social elements and that the State had failed to remove such obstruction from the site. Accordingly, the Arbitrator awarded a sum of Rs. 7,30,000/- under this claim.

Claim (g) was confined to the question as to whether the claimant was entitled to compensation for the losses suffered by him on account of price escalation of materials that had taken place during the extended period of completion when such extension of time was necessitated by departmental failure, although there was no provision for escalation of costs in the contract. Under the said clause the appellant claimed an amount of Rs.39,90,198/- but

A was awarded a sum of Rs.11,70,000/- over and above the amount as per the rates in the agreement for the work done after the original period of contract till 9th February, 1987.

Claim (i) was confined to the question regarding the claimant's entitlement for compensation for the losses purported to have been suffered B by him because the Department was unable to hand over a suitable quarry which resulted in the claimant having to bring rubble and metal from far off places involving additional transportation costs. The Arbitrator came to a positive finding that the claimant had procured rubble from quarries situated at different places. According to the initial estimate, the quarry ought to have C been within 25 Kms. from the place of work, but from the evidence it would be clear that the nearest quarry from which the claimant had to procure rubble would be about 47 Km. away from the site of the work. The other quarries were even further away from the work site. It was the definite finding of the Arbitrator that the average extra lead involved would be not less than 22 Kms. and accordingly while the claimant had claimed a sum of Rs.24,86,574/-, the D Arbitrator awarded a sum of Rs.13,35,000/- under this head for the work executed up to 9th February, 1987.

The other claim which was pressed by the appellant was claim (k) relating to losses suffered by him on account of non-availability of a suitable dumping yard for dumping excess earth. While a claim for a sum of Rs.13,72,554/ E - was made in this regard, the Arbitrator awarded a sum of Rs.6,62,000/- under this head.

The agreement relating to the handing over of the site to the claimant was executed on 10th October, 1985 and on 25th October, 1985, the F respondents instructed the claimant to start the work and to complete the same within the agreement period of eleven months. However, while the period of completion of eleven months for the whole work was to expire on 24th September, 1986, the same could not be completed on the scheduled dates and under clause 50 of the General Conditions of Contract extension of time was sought by the appellant for completing the work. Clause 50 of G the General Conditions of Contract provides that if failure to complete the work was the result of delays on the part of Government in supplying materials or equipment it had undertaken to supply under the contract or from delays in handing over sites or from increase in the quantity of the work to be done under the contract or *force majeure,* an appropriate extension of time would H be given. Finding that the said clause was operative, the respondents extended

the time of completion but while doing so made it conditional that such extension of time would be subject to execution of a Supplemental Agreement to the effect that the contractor would not be eligible for any enhanced rate for the work done during the extended period. According to the appellant, he had no option but to sign the agreement, though under protest, since he had undertaken to complete the work.

The appellant appears to have moved to the site and commenced the work on 1st November, 1985 but he was not allowed to proceed with the work because of external interference involving law and order problems created by local miscreants and anti-social elements under cover of union activities. Although, initially such a claim was denied on behalf of the respondents and the law and order situation was said to be only a labour dispute between the claimant and his workers, ultimately from the evidence the Arbitrator came to the finding that the issue was one of law and order which could only have been controlled by the Governmental agencies.

The Arbitrator also came to a finding that in order to maintain peace at the work site, the claimant had to keep the entire local work force in the muster rolls and to pay wages when the actual work was done with bull dozers. The Arbitrator was satisfied that although the claimant had aimed to complete the work within the original period, he was faced with adverse site conditions which are not usually met with at construction sites.

The Arbitrator was also satisfied with the claimant's contention that adequate space had not been provided for dumping the excess earth which had to be conveyed to distant places for dumping. On assessment of the evidence and the ground realities under which the claimant was constrained to execute the Supplemental Agreement, the Arbitrator was convinced that the claim made by the claimant under the different heads could not be brushed aside.

Apart from the preliminary objection taken with regard to the competence of the Arbitrator to complete the arbitration proceedings and to publish his award, it was also contended before the Arbitrator that the State had no responsibility in settling the disputes between the claimant and his employees and it was really due to the non-cooperation of the claimant that a settlement could not be arrived at with the workers. It was contended that under such circumstances claim (a) could not be granted.

It was also contended that there was no provision in the Agreement by

A which the Department could be made liable to compensate any loss sustained by the contractor because of intervention of third parties. It was contended that it is one thing to say that the State is responsible for maintaining law and order and on the other hand to make the State liable under the terms of the Agreement to compensate the contractor for losses allegedly suffered during the period of disturbance.

B

On consideration of the case made out on behalf of the respective parties, the Arbitrator made his award in respect of each of the several heads of claims on the losses actually suffered by the appellant while trying to carry out and complete the tender work. The Arbitrator filed his award before the C Subordinate Judge, Kottarakkara, on which a decree was passed in terms of the award but modifying the appellant's claim for interest. The respondents preferred an appeal to the High Court of Kerala at Ernakulam.

The stand taken before the Arbitrator was reiterated by the parties before the High Court of Kerala at Ernakulam in the said appeal. In addition, D arguments were addressed on the scope of interference by the High Court in an award passed by the Arbitrator, which award was a speaking award. On looking into the Agreement, the High Court was of the view that the Arbitrator had exceeded his jurisdiction in granting claim (a). The High Court felt that the Arbitrator had travelled outside the Agreement and had acted without jurisdiction in granting such claim.

E

Even in respect of claim (g), the High Court took note of the fact that by virtue of the Supplemental Agreement which had to be executed for extension of the original period of completion of the work, the appellant herein was not entitled to enhanced rates during the extended period. In respect of F claim (g) also, the High Court found that the Arbitrator had travelled outside the terms of the contract and had mis-conducted himself.

Admittedly, the original Agreement did not contain a clause for escalation of rates. On the other hand, the Supplemental Agreement contained a specific provision that the contractor would carry out all further works G within the extended period at the rates and in the manner agreed to in the Agreement and would not claim any enhanced rate for such item of work on account of the extension of time either due to the increase in the rate of labour or materials or on any other ground whatsoever. The High Court took the view that although the Arbitrator had come to a finding that the appellant had to execute the Supplemental Agreement under the force of circumstances,

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there was no material before the Arbitrator in support of such contention. On such finding also, the High Court held that the Arbitrator had acted beyond his jurisdiction in allowing claim (g). A

The award of the Arbitrator against claim (i) also met the same fate and the High Court held that the Arbitrator had travelled outside the contract in granting such claim and thus mis-conducted himself. B

The only claim which was allowed by the High Court was claim (k).

The High Court accordingly set aside the judgment and decree of the court below to the extent it affirmed the award as far as claims (a), (g) and (i) are concerned. C

The said order of the High Court is the subject-matter of the present appeal.

Appearing for the appellant, Mr. Dushyant Dave, learned senior advocate, urged that the High Court while reversing the award under claims (a), (g) and (i) had failed to take into consideration the finding of the Arbitrator that the appellant had suffered heavy losses on account of the law and order problem which had been created at the work site and that he had been compelled to complete the work under duress. Reference was made to the letter dated 7th September, 1985 addressed by the appellant to the Superintending Engineer, K.I.P.(RB) Circle, Kottarakkara, regarding extension of time to complete the work under tender with the hope that the Department would reciprocate his gesture and consider the special circumstances under which he had given his consent for extension of the period for completion of the work. D E

Reference was also made to another letter dated 24th September, 1986 written by the appellant to the said Superintending Engineer informing him of the problems that were being faced for completion of the work and requesting that his accounts be settled and that he be freed from the entanglements. F

The last letter referred to by Mr. Dave was written by the appellant to the said Superintending Engineer on 30th September, 1986 indicating that he was carrying out the work despite all the difficulties although the same was not a solution to the genuine problems being faced by him as indicated in the earlier letters. G

It was urged that having regard to the ground realities, it was within the H

A powers of the Court to grant relief on account of escalation of costs in interrupted projects, although there may not be any specific provision for such escalation in the contract itself.

In support of his submissions, Mr. Dave firstly referred to the decision of this Court in *P.M. Paul* v. *Union of India,* [1989] Supp. 1 SCC 368, wherein B a dispute arose regarding payment of escalated costs. By an order of this Court, the dispute between the parties was referred to a retired Judge of this Court to ascertain who was responsible for the delay in completion of the building, what was the repercussions of the delay and how the consequences were to be apportioned. It had been contended therein that in the absence C of any escalation clause it was not permissible for the Arbitrator to grant any escalation price sought by the contractor. The Arbitrator, however, noted that the claim related to the losses caused due to increase in prices of materials and costs of labour and transport during the extended period of the contract and accordingly allowed 20 per cent of the compensation sought. The question before this Court was whether the Arbitrator had travelled beyond his D jurisdiction in awarding escalation costs and charges. This Court came to a finding that the Arbitrator had not mis-conducted himself in awarding the amount as he had done. Once it was found that there was delay in execution of the contract due to the conduct of the respondent, respondent was liable for the consequences of the delay, namely, increase in prices. It was held that E the claim was not outside the purview of the contract and arose as an incidence of the contract and the Arbitrator had jurisdiction to make such award.

Reference was then made to the decision of this Court in *T.P. George* v. *State of Kerala And Anr.,* [2001] 2 SCC 758, where a similar situation arose F and the contractor was compelled to execute a Supplemental Agreement. Although, a question was raised as to whether the Supplemental Agreement debarred the contractor from pursuing his claims, the Arbitrator allowed the claims which were however set aside by the High Court. This Court in appeal held that the High Court had erred in setting aside the award regarding those claims notwithstanding the fact that the Supplemental Agreement had been G executed between the appellant and the State Government. The grant of interest by the Arbitrator, which had been disallowed by the High Court, was also allowed by this Court.

Mr. Dave contended that even in the absence of any escalation clause, H if it is found that the escalation of costs had been occasioned by circumstances

which were not anticipated at the initial stage and was attributable to the respondents, there was no reason why the Arbitrator could not take notice of the ground reality and to award escalation costs. It was urged that had the respondents provided for the rubble to be obtained for the work from the quarry at Mannady, the appellant would not have had to bear the extra transportation charges for bringing such rubble from far away quarries. The same applied to providing a suitable place for dumping of excess earth and the failure of the respondents to maintain the law and order problem that had been created at the site.

The submissions advanced on behalf of the appellant were strongly opposed on behalf of the State Government with particular reference to the award in respect of claims (a) and (g) since the Original Agreement did not provide for such escalation and the Supplemental Agreement which had been executed clearly stipulated that no extra rates would be allowed. It was contended that the Department had never failed to perform its contractual obligations, and, in any event, the delay in completing the work was not on account of any neglect on the part of the State but on account of labour trouble involving the appellant and his workmen at the site.

Mr. Jayant Muth Raj, who appeared for the State, contended that as had been observed by this Court as far back as in 1960 in *M/s. Alopi Parshad & Sons Limited* v. *The Union of India,* reported in [1960] 2 SCR 793, provision for payment of charges at rates specified had been made in the contract and the arbitrators could not ignore the express covenants between the parties and award amounts not agreed to be paid. It was observed further that a contract is not frustrated merely because the circumstances in which it is made is altered and that the Courts have no general power to absolve a party from the performance of his part of the contract merely because its performance has become onerous on account of an unforeseen turn of events. According to Mr. Muth Raj the award made in the instant case could not also be justified on the basis of quantum meruit since such a concept would be applicable when services are rendered but the price thereof is not fixed by a contract.

Mr. Muth Raj also referred to various other decisions of this Court, including the decision in *State of U.P.* v. *Patel Engg. Co. Ltd. And Ors.,* reported in [2004] 10 SCC 566, where a question arose as to whether on the basis of a modified contract which specifically excluded payment of freight charges, claims for variation in payment of such charges could be awarded by the arbitrator. It was held that the arbitrators had exceeded their jurisdiction

A in awarding freight charges in respect of steel and handling transportation charges and that the District Judge had rightly held that the same was not sustainable *inasmuch* as the claimant was not entitled to such freight charges. It was urged that when no provision had been made in the contract for escalation of costs and the Supplemental Agreement entered into between the parties specifically provided that the contractor would not claim any enhanced B rate for the work performed during the extended period of the contract, the Arbitrator had wrongly allowed some of the claims made by the appellant on account of escalation of costs and the High Court had rightly disallowed the same.

C The question which we are called upon to answer in the instant appeal is whether in the absence of any price escalation clause in the Original Agreement and a specific prohibition to the contrary in the Supplemental Agreement, the appellant could have made any claim on account of escalation of costs and whether the Arbitrator exceeded his jurisdiction in allowing such claims as had been found by the High Court.

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Ordinarily, the parties would be bound by the terms agreed upon in the contract, but in the event one of the parties to the contract is unable to fulfil its obligations under the contract which has a direct bearing on the work to be executed by the other party, the Arbitrator is vested with the authority to compensate the second party for the extra costs incurred by him as a result E of the failure of the first party to live up to its obligations. That is the distinguishing feature of cases of this nature and *M/s. Alopi Parshad's* case (supra) and also *Patel Engg.'s* case (supra). As was pointed out by Mr. Dave, the said principle was recognized by this Court in *P.M. Paul's* (supra), where a reference was made to a retired Judge of this Court to fix responsibility for F the delay in construction of the building and the repercussions of such delay. Based on the findings of the learned Judge, this Court gave its approval to the excess amount awarded by the arbitrator on account of increase in price of materials and costs of labour and transport during the extended period of the contract, even in the absence of any escalation clause.

G The said principle was reiterated by this Court in *T.P. George's* case (supra).

We have intentionally set out the background in which the Arbitrator made his award in order to examine the genuineness and/or validity of the appellant's claim under those heads which had been allowed by the Arbitrator.

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It is quite apparent that the appellant was prevented by unforeseen circumstances from completing the work within the stipulated period of eleven months and that such delay could have been prevented had the State Government stepped in to maintain the law and order problem which had been created at the work site. It is also clear that the rubble and metal, which should have been available at the departmental quarry at Mannady, had to be obtained from quarries which were situated at double the distance, and even more, resulting in doubling of the transportation charges. Even the space for dumping of excess earth was not provided by the respondents which compelled the appellant to dump the excess earth at a place which was far away from the work site entailing extra costs for the same.

In the aforesaid circumstances, the Arbitrator appears to have acted within his jurisdiction in allowing some of the claims on account of escalation of costs which was referable to the execution of the work during the extended period. In our judgment, the view taken by the High Court was on a rigid interpretation of the terms of contract and the Supplemental Agreement executed between the parties, which was not warranted by the turn of events.

We accordingly allow the appeal and set aside the order passed by the High Court and restore the award made by the Arbitrator.

There will, however, be no order as to costs.

D.G. Appeal allowed.