Reportable

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 4150 OF 2009
(Arising out of SLP [C] No.11117 of 2006)

M.R. Engineers & Contractors Pvt. Ltd. … Appellant

Vs.

Som Datt Builders Ltd. ... Respondent

J U D G M E N T

R.V. RAVEENDRAN, J.

Leave granted. Heard learned counsel for both parties. The matter relates to interpretation of sub-section (5) of section 7 of Arbitration and Conciliation Act, 1996 ('Act' for short) and the issue involved is whether an arbitration clause contained in a main contract, would stand incorporated by reference, in a sub-contract, where the sub-contract provided that it "shall be carried out on the terms and conditions as applicable to the main contract."

2. The Public Works Department, Government of Kerala, (in short 'PW Department') entrusted the work of "Four Laning and Strengthening of Alwaye – Vyttila and Aroor – Cherthala and Strengthening of Vyttila to

Aroor Section of NH 47 – N2 & N3 packages" which included the work of "Construction of Project Directorate Building for National Highway Four Laning Project at Edapally, Cochin" to the respondent. The said contract between PW Department and the respondent contained a provision for arbitration, as per clause 67.3 of the General Conditions of Contract. The relevant portion of the said clause is extracted below:

> "Arbitration 67.3.
> Any dispute in respect of which :
>
> (a) the decision, if any, of the Engineer has not become final and binding pursuant to Sub-Clause 67.1, and
>
> (b) amicable settlement has not been reached within the period stated in Sub-Clause 67.2.
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> shall be referred to the adjudication of a Committee of three arbitrators. The Committee shall be composed of one arbitrator to be nominated by the Employer, one to be nominated by the Contractor and the third who will act as the Chairman of the Committee, but not as umpire, to be nominated by the Director – General (Road Development), Ministry of Surface Transport (Roads Wing); Government of India. If either of the parties abstain or fail to appoint his arbitrator, within sixty days after receipt of notice for the appointment of such arbitrator, then the Director-General (Road Development), Ministry of Surface Transport, Government of India, himself shall appoint such arbitrator(s). A certified copy of the appointment made by the Director-General (Road Development), Ministry of Surface Transport, Govt. of India, shall be furnished to both parties."
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> x x x x x x x x x x

3. The appellant is a sub-contractor of the respondent. Respondent entrusted a part of the work entrusted to it by the PW Department namely "construction of Project Directorate building" to the appellant under its

work order dated 4.5.1994. The relevant portions of the work order are extracted below:

> "With reference to your offer and subsequent discussions, we are pleased to accept your offer for the construction of the office building at the unit, firm and fixed price of Rs.3150/- (Rupees Three Thousand One Hundred Fifty Only) per square metre. The construction shall be carried out as per the tender specifications and drawings issued for construction by the client.
>
> The square metre rate includes cost of all materials, labour, equivalent etc., required for the completion of building work but excludes the furniture required for the same. No escalation shall be payable on the above contracted price. The work shall be carried out as per the drawings furnished by the Department. **This sub-contract shall be carried out on the terms and conditions as applicable to main contract unless otherwise mentioned in this order letter.**
>
> In case there are any change in the foundation design from the tender drawing, suitable variation claim shall be submitted to the client by us and the amount approved and paid shall be payable to you after **deducting** twenty percent amount."
>
> x x x x x x x x x x
>
> The approximate cost of this order comes to Rs.33,07,500/-
>
> (emphasis supplied).

4. The appellant alleges that it informed the respondent that it executed certain extra items and excess quantities of agreed items on the instructions of the PW Department and requested the respondent to make a claim on the PW Department in that behalf; that the respondent accordingly made necessary claims in that behalf on the PW Department; that the said claims, as also several other claims of the respondent against the PW Department were referred to arbitration and the arbitrator made an award dated

18.8.1999. According to appellant, the Arbitrator awarded certain amounts in regard to its claims put through the respondent and in terms of the arrangement between the respondent and the appellant, the respondent is liable to pay to the appellant, eighty percent of the amounts awarded for such claims, that is Rs.37,55,893/-, along with Rs.1,55,807/- towards pre-reference interest upto 4.12.1996 and compensation at 18% per annum for non-payment of Rs.37,55,893/- from 5.12.1996. The appellant alleged that a sum of Rs.1,76,936/- was also due by the respondents towards unlawful deductions. The appellant therefore lodged a claim on the respondent by letter dated 5.7.2000, for payment of Rs.65,11,341/-. As the claim was not settled, the appellant sent a letter dated 6.12.2000 seeking reference of the disputes by arbitration.

5. As the respondent failed to comply, the appellant filed an application under section 11 of the Act. According to the appellant clause 67.3 of the General Conditions of Contract forming part of the contract between the PW Department and the respondent, providing for arbitration, was imported into the sub-contract between respondent and appellants. The appellant relies upon the term in the work order dated 4.5.1994 that the "sub-contract shall be carried out on the terms and conditions as applicable to main contract" to

contend that the entire contract between the department and the respondent, including clause 67.3 relating to arbitration, became a part and parcel of the contract between the parties. The appellant also contended that having regard to section 7(5) of the Arbitration & Conciliation Act, 1996, the arbitration clause contained in the main contract between the PW Department and the respondent, constituted an arbitration agreement between the respondent and appellant on account of the incorporation thereof by reference in the contract between the appellant and respondent. The respondent denied the said claim and contention.

6. The designate of the Learned Chief Justice by order dated 31.1.2003 rejected the said application on the ground that the arbitration clause (in the contract between PW Department and the respondent) was not incorporated by reference in the contract between the respondent and appellant. The said order is challenged in this appeal by special leave. The question that arises for consideration is whether the provision for arbitration contained in the contract between principal employer and the contractor, was incorporated by reference in the sub-contract between the contractor and sub-contractor.

7. Section 7 of the Act defines 'arbitration agreement'. Sub-sections (1) and (5) of section 7, relevant for our purpose, are extracted below:

> "7. Arbitration agreement.--- (1) In this Part, "arbitration agreement" means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.
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> x x x x x
>
> (5) The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing *and the reference is such as to make that arbitration clause part of the contract*."
>
> [emphasis supplied]

Having regard to section 7(5) of the Act, even though the contract between the parties does not contain a provision for arbitration, an arbitration clause contained in an independent document will be imported and engrafted in the contract between the parties, by reference to such independent document in the contract**, if the reference is such as to make the arbitration clause in such document, a part of the contract**. The wording of Sec. 7(5) of the Act makes it clear that a mere reference to a document would not have the effect of making an arbitration clause from that document, a part of the contract. The reference to the document in the contract should be such that shows the intention to incorporate the arbitration clause contained in the document, into the contract. If the legislative intent was to import an arbitration clause from another document, merely on reference to such document in the

contract, sub-section (5) would not contain the significant later part which reads : "and the reference is such as to make that arbitration clause part of the contract", but would have stopped with the first part which reads : "The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing." Section 7(5) therefore requires a **conscious** acceptance of the arbitration clause from another document, by the parties, as a part of their contract, before such arbitration clause could be read as a part of the contract between the parties. But the Act does not contain any indication or guidelines as to the conditions to be fulfilled before a reference to a document in a contract, can be construed as a reference incorporating an arbitration clause contained in such document, into the contract. In the absence of such statutory guidelines, the normal rules of construction of contracts will have to be followed.

8. There is a difference between reference to another document in a contract and incorporation of another document in a contract, by reference. In the first case, the parties intend to adopt only specific portions or part of the referred document for the purposes of the contract. In the second case, the parties intend to incorporate the referred document in entirety, into the contract. Therefore when there is a reference to a document in a contract, the

court has to consider whether the reference to the document is with the intention of incorporating the contents of that document in entirety into the contract, or with the intention of adopting or borrowing specific portions of the said document for application to the contract. We will give a few instances of incorporation and mere reference to explain the position (illustrative and not exhaustive).

9. If a contract refers to a document and provides that the said document shall form part and parcel of the contract, or that all terms and conditions of the said document shall be read or treated as a part of the contract, or that the contract will be governed by the provisions of the said document, or that the terms and conditions of the said document shall be incorporated into the contract, the terms and conditions of the document in entirety will get bodily lifted and incorporated into the contract. When there is such incorporation of the terms and conditions of a document, every term of such document, (except to the extent it is inconsistent with any specific provision in the contract) will apply to the contract. If the document so incorporated contains a provision for settlement of disputes by arbitration, the said arbitration clause also will apply to the contract.

10. On the other hand, where there is only a reference to a document in a contract in a particular context, the document will not get incorporated in entirety into the contract. For example if a contract provides that the specifications of the supplies will be as provided in an earlier contract or another purchase order, then it will be necessary to look to that document only for the limited purpose of ascertainment of specifications of the goods to be supplied. The referred document cannot be looked into for any other purpose, say price or payment of price. Similarly if a contract between X and Y provides that the terms of payment to Y will be as in the contract between X and Z, then only the terms of payment from the contract between X and Z, will be read as part of the contract between X and Y. The other terms, say relating to quantity or delivery cannot be looked into.

11. Sub-section (5) of Section 7 merely reiterates these well settled principles of construction of contracts. It makes it clear that where there is a reference to a document in a contract, and the reference shows that the document was not intended to be incorporated in entirety, then the reference will not make the arbitration clause in the document, a part of the contract, unless there is a special reference to the arbitration clause so as to make it applicable.

12. The following passages from Russell on Arbitration throws considerable light on the position while dealing with Section 6(2) of (English) Arbitration Act, 1996 corresponding to Sec.7(5) of the Indian Act. (23rd Edition, see pages 52-55):

> **"Reference to another document.** The terms of a contract may have to be ascertained by reference to more than one document. Ascertaining which documents constitute the contractual documents and in what, if any, order of priority they should be read is a problem encountered in many commercial transactions, particularly those involving shipping and construction. This issue has to be determined by applying the usual principles of construction and attempting to infer the parties' intentions by means of an objective assessment of the evidence. This may make questions of incorporation irrelevant, if for example it is clear that the contractual documents in question are entirely separate and no intention to incorporate the terms of one in the other can be established. However, the contractual document defining and imposing the performance obligations may be found to incorporate another document which contains an arbitration agreement. If there is a dispute about the performance obligations, that dispute may need to be decided according to the arbitration provisions of that other document. This very commonly occurs when the principal contractual document refers to standard form terms containing an arbitration agreement. However the standard form wording may not be apt for the contract in which the parties seek to incorporate it, or the reference may be to another contract between parties at least one of whom is different. In these circumstances it may be possible to argue that the purported incorporation of the arbitration agreement is ineffective. The draftsmen of the Arbitration Act 1996 were asked to provide specific guidance on the issue, but they preferred to leave it to the court to decide whether there had been a valid incorporation by reference. "
>
> [Para : 2.044]

> **"Subject to drawing a distinction between incorporation of an arbitration agreement contained in a document setting out standard form terms and one contained in some other contract**

> **between different parties, judicial thinking seems to have favoured the approach of Sir John Megaw in *Aughton,* namely that general words of incorporation are not sufficient. Rather, particular reference to the arbitration clause needs to be made to comply with s. 6 of the Arbitration Act 1996, unless special circumstances exit."**
>
> [Para : 2.047]

> **"Reference to standard form terms.** If the document sought to be incorporated is a standard form set of terms and conditions the courts are more likely to accept that general words of incorporation will suffice. This is because the parties can be expected to be more familiar with those standard terms including the arbitration clause."
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> [Para : 2.048]

After referring to the view of Sir John Megaw, in *Aughton Ltd.* v. *M.F. Kent Services Ltd.* [1991 (57) BLR 1] that specific words were necessary to incorporate an arbitration clause and that the reference in a sub-contract to another contract's terms and conditions would not suffice to incorporate the arbitration clause into the sub-contract, followed in *Barrett & Son (Brickwork) Ltd*. v. *Henry Boot Nanagement Ltd.* [1995 CILL 1026, *Trygg Hansa Insurance Co. Ltd.* v *Equitas Ltd*. [1998 (2) Lloyds' Rep.439) and *Anonymous Greek Co of General Insurances (The "Ethniki")* v. *AIG Europe (UK)* [2002 (2) All ER 566] and *Sea Trade Maritime Corp. v. Hellenic Mutual War Risks Association (Bermuda) Ltd. (The "Athena") No.2* – [2006] EWHC 2530, Russell concludes:

> "The current position therefore seems to be that if the arbitration agreement is incorporated from a standard form a general reference to those terms is sufficient, but at least in the case of

> reference to a non-standard form contract in the context of construction and reinsurance contracts and bills of lading a specific reference to the arbitration agreement is necessary."

A general reference to another contract will not be sufficient to incorporate the arbitration clause from the referred contract into the contract under consideration. There should be a special reference indicating a mutual intention to incorporate the arbitration clause from another document into the contract.

The exception to the requirement of special reference is where the referred document is not another contract, but a Standard form of terms and conditions of a Trade Associations or Regulatory institutions which publish or circulate such standard terms & conditions for the benefit of the members or others who want to adopt the same. The standard forms of terms and conditions of Trade Associations and Regulatory Institutions are crafted and chiselled by experience gained from trade practices and conventions, frequent areas of conflicts and differences, and dispute resolutions in the particular trade. They are also well known in trade circles and parties using such formats are usually well versed with the contents thereof including the arbitration clause therein. Therefore, even a general reference to such

standard terms, without special reference to the arbitration clause therein, is sufficient to incorporate the arbitration clause into the contract.

13. The scope and intent of section 7(5) of the Act may therefore be summarized thus:

(i) An arbitration clause in another document, would get incorporated into a contract by reference, if the following conditions are fulfilled : (i) The contract should contain a clear reference to the documents containing arbitration clause, (ii) the reference to the other document should clearly indicate an intention to incorporate the arbitration clause into the contract, (iii) The arbitration clause should be appropriate, that is capable of application in respect of disputes under the contract and should not be repugnant to any term of the contract.

(ii) When the parties enter into a contract, making a general reference to another contract, such general reference would not have the effect of incorporating the arbitration clause from the referred document into the contract between the parties. The arbitration clause from another contract can be incorporated into the contract (where such reference is made), only by a specific reference to arbitration clause.

(iii) Where a contract between the parties provides that the execution or performance of that contract shall be in terms of another contract (which contains the terms and conditions relating to performance and a provision for settlement of disputes by arbitration), then, the terms of the referred contract in regard to execution/performance alone will apply, and not the arbitration agreement in the referred contract, unless there is special reference to the arbitration clause also.

(iv) Where the contract provides that the standard form of terms and conditions of an independent Trade or Professional Institution (as for example the Standard Terms & Conditions of a Trade Association or Architects Association) will bind them or apply to the contract, such

standard form of terms and conditions including any provision for arbitration in such standard terms and conditions, shall be deemed to be incorporated by reference. Sometimes the contract may also say that the parties are familiar with those terms and conditions or that the parties have read and understood the said terms and conditions.

(v) Where the contract between the parties stipulates that the Conditions of Contract of one of the parties to the contract shall form a part of their contract (as for example the General Conditions of Contract of the Government where Government is a party), the arbitration clause forming part of such General Conditions of contract will apply to the contract between the parties.

14. The Learned counsel for appellant relied on two decisions to contend that even a general reference to the main contract (between PW Department and the respondent) in the sub-contract was sufficient to incorporate the arbitration clause in the main contract, into the sub-contract, even if there was no special reference to the arbitration clause. We will refer to them briefly.

14.1 The first case referred is *Atlas Export Industries v. Kotak & Co.* [1999 (7) SCC 61]. In that case, the appellant had contracted to supply goods to a foreign buyer through the respondent. The contract entered among them provided that the terms and conditions of standard contract No.15 of the Grain & Food Trade Association Ltd., London (for short GAFTA Contract 15) would apply. The contract also confirmed that both buyers and sellers

were familiar with the text of GAFTA contract and agreed to be bound by its terms and conditions. Clause 27 of GAFTA contract 15 provided for settlement of disputes by Arbitration in London in accordance with the Arbitration Rules of GAFTA. This Court upheld the decision of the High Court rejecting the appellant's objection that there was no agreement in writing between parties requiring the disputes being referred to arbitration in accordance with the arbitration rules of GAFTA, holding that the arbitration clause from GAFTA Contract 15, was incorporated by reference, into the contract.

14.2 The second case relied upon by the appellant is a decision rendered by a designate of the Learned Chief Justice of India in *Groupe Chimique Tunisien SA v. Southern Petrochemicals Industries Corpn. Ltd.* - 2006 (5) SCC 275. In that case a purchase order placed by the respondent on the petitioner stated that "all other terms and conditions are as per FAI terms. ("FAI Terms" referred to the terms and conditions for sale and purchase of phosphoric acid of Fertilizer Association of India). Clause 15 of FAI terms provided for settlement of disputes by arbitration. Certain disputes having arisen, the petitioner appointed its arbitrator and called upon the respondent to appoint its arbitrator. When respondent failed to comply, the petitioner

filed a petition under Section 11 of the Act for appointment of the second Arbitrator. In the counter to the petition under Sec. 11 of the Act, the respondent did not deny the fact that the purchase orders were placed with the petitioner nor denied the fact that the purchase orders were all placed subject to FAI terms and conditions, including clause 15 of FAI terms which provided for arbitration. This court held that the purchase orders placed by the respondents with the petitioner having been made subject to FAI terms which contained the arbitration clause, the arbitration clause contained in the FAI terms would constitute the arbitration agreement between the parties.

14.3 Both the decisions are not of any assistance to the appellant. Both relate to reference to standard terms & conditions of Trade Associations. In both cases the parties had agreed to be bound by the standard terms and conditions of the Trade Association thereby clearly showing an intention to subject themselves to the provision for arbitration contained in the standard terms of the Trade Association. The said two decisions therefore relate to cases referred to Para 13(iii) above, whereas the case on hand falls under para 13(ii) above.

15. The work order (sub-contract), relevant portions of which have been extracted in para 3 above, shows that the intention of the parties was not to incorporate the main contract (between the PW Department and respondent) in entirety into the sub contract. The use of the words "This sub-contract shall be carried out on the terms and conditions as applicable to main contract" in the work order would indicate an intention that only the terms and conditions in the main contract relating to execution of the work, were adopted as a part of the sub-contract between respondent and appellant, and not the parts of the main contract which did not relate to execution of the work, as for example the terms relating to payment of security deposit, mobilization advance, the itemised rates for work done, payment, penalties for breach etc., or the provision for dispute resolution by arbitration. An arbitration clause though an integral part of the contract, is an agreement within an agreement. It is a collateral term of a contract, independent of and distinct from its substantive terms. It is not a term relating to 'carrying out' of the contract. In the absence of a clear or specific indication that the main contract in entirety including the arbitration agreement was intended to be made applicable to the sub-contract between the parties, and as the wording of the sub-contract discloses only an intention to incorporate by reference the terms of the main contract relating to execution of the work as contrasted

from dispute resolution, we are of the view that the arbitration clause in the main contract did not form part of the sub-contract between the parties. We are fortified in this view, by the decision in *Alimenta SA.* v. *National Agricultural Co-op. Marketing Federation of India Ltd.* [1987 (1) SCC 615]. The NAFED – the respondent therein entered into two contracts with *Alimenta S.A.* for the supply of certain goods referred to HPS. Clause 11 of the first contract stipulated that "*other terms and conditions as per FOSFA-20 contract terms"*. (FOSFA-20 being a standard form of contract of the Federation of Oils, Seeds and Fats Association Ltd. containing an Arbitration clause). Clause 9 of the second contract provided that "*all other terms and conditions for supply not specifically shown and covered hereinabove shall be as per previous contract signed between us for earlier supplies of HPS"*. The question before this court was whether the arbitration clause in FOSFA -20 was incorporated in the first contract by way of Clause 11 and in the second contract by virtue of Clause 9. The Court held that while the Arbitration clause was incorporated in the first contract, the same was not incorporated in the second contract. The following reasoning of the Court while dealing with the second contract is relevant for our purpose:

> "There is a good deal of difference between Clause 9 of this contract and Clause 11 of the first contract. Clause 11 has been couched in general words, but Clause 9 refers to all other terms

> and conditions for supply. The High Court has taken the view that by Clause 9 the terms and conditions of the first contract which had bearing on the supply of HPS were incorporated into the second contract, and the *term about arbitration not being incidental to supply of goods, could not be held to have been lifted as well from the first contract into the second one."*
>
> "It is, however, contended on behalf of the appellant that the High Court was wrong in its view that a term about arbitration is not a term of supply of goods. We do not think that the contention is sound. It has been rightly pointed out by the High Court that the *normal incidents of terms and conditions of supply are those which are connected with supply, such as, its mode and process, time factor, inspection and approval, if any, reliability for transit, incidental expenses etc*. We are unable to accept the contention of the appellant that an arbitration clause is a term of supply. There is no proposition of law that when a contract is entered into for supply of goods, the arbitration clause must form part of such a contract. The parties may choose some other method for the purpose of resolving any dispute that may arise between them. But in such a contract the incidents of supply generally form part of the terms and conditions of the contract. The first contract includes the terms and conditions of supply and as Clause 9 reference to these terms and conditions of supply, it is difficult to hold that the arbitration clause is also referred to and, as such, incorporated into the second contract. *When the incorporation clause refers to certain particular terms and conditions, only those terms and conditions are incorporated and not the arbitration clause. In the present case, Clause 9 specifically refers to the terms and conditions of supply of the first contract and the second contract and accordingly, only those terms and conditions are incorporated into the second contract and not the arbitration clause.* The High Court has taken the correct view in respect of the second contract also".
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> *(emphasis supplied)*

16. Even assuming that the arbitration clause from the main contract had been incorporated into the sub-contract by reference, we are of the view that the appellant could not have claimed the benefit of the arbitration clause. This is in view of the principle that the document to which a general

reference is made, contains an arbitration clause whose provisions are clearly inapt or inapplicable with reference to the contract between the parties, it would be assumed or inferred that there was no intention to incorporate the arbitration clause from the referred document. In this case the wording of the arbitration clause in the main contract between the PW Department and contractor makes it clear that it cannot be applied to the sub-contract between the contractor and the sub-contractor. The arbitration clause in the main contract states that the disputes which are to be referred to the committee of three arbitrators under clause 67(3) are disputes in regard to which the decision of the Engineer ('Engineer' refers to person appointed by State of Kerala to act as Engineer for the purpose of the contract between PW Department and the respondent) has not become final and binding pursuant to sub-clause 67.1 or disputes in regard to which amicable settlement has not been reached between the State of Kerala and the respondent within the period stated in sub-clause 67.2. Obviously neither 67.1 nor 67.2 will apply as the question of 'Engineer' issuing any decision in a dispute between the contractor and sub-contractor, or any negotiations being held with the Engineer in regard to the disputes between the contract and sub-contractor does not arise. The position would have been quite different if the arbitration clause had used the words "all disputes arising

between the parties" or "all disputes arising under this contract". Secondly the arbitration clause contemplates a committee of three arbitrators, one each to be appointed by the State of Kerala and the respondent and the third (Chairman) to be nominated by the Director General, Road Development Ministry of Surface, Transport, Roads Wing, Govt. of India. There is no question of such nomination in the case of a dispute between the contractor and sub-contractor. It is thus seen that the entire arbitration agreement contained in the main contract between the employer and the contractor was tailor-made to meet the requirements of the contract between the employer and the contractor and is wholly inapt and inapplicable in the context of a dispute between the contractor and the sub-contractor. This makes it clear that the arbitration clause contained in the main contract would not apply to the disputes arising with reference to the sub-contract.

17. In view of our finding that there is no arbitration agreement between the parties, it is unnecessary to examine the contention of the respondent that no dispute existed between the parties in view of the full and final settlement receipt executed by the appellant.

18. We are therefore of the view that there is no error in the order of the High Court rejecting the application of the appellant on the ground that there is no arbitration agreement.

…….J.
(R V Raveendran)

New Delhi;
July 7, 2009.

……..J.
(J M Panchal)