Reportable

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 2755 OF 2007

Union of India ...
Appellant

Versus

Col. L.S.N. Murthy & Anr. ...
Respondents

J U D G M E N T

A. K. PATNAIK, J.

This is an appeal by way of special leave under Article 136 of the Constitution against the judgment dated 27.04.2006 of the Division Bench of the Andhra Pradesh High Court in Civil Miscellaneous Appeal No.322 of 2005 (for short 'the impugned judgment').

2. The facts in brief are that in August, 1999, the appellant invited tenders for supply of fresh fruits for its troops for the period from 01.10.1999 to 30.09.2000 and respondent No.2 amongst others submitted tenders and the tender of respondent No.2 was accepted. The respondent No.2 started supply of fresh fruits on 01.10.1999 and stopped the supply

on 06.06.2000. On 13.06.2000, the appellant issued a notice to respondent No.2 to show-cause why action should not be initiated for such non-supply of fresh fruits. The respondent No.2 submitted its reply dated 20.06.2000 saying that the prices of all variety of fruits had increased and that it was impossible on its part to perform the contract and that the appeals made by the respondent No.2 were not considered by the authorities. The appellant then rescinded the contract with respondent No.2 by letter dated 29.06.2000 and informed the respondent No.2 that its security deposit has been forfeited and that the appellant will recover the expenditures made by the appellant for purchase of fruits during the contract period.

3. As the contract provided for an arbitration clause, the dispute between the parties was referred to the arbitrator. The respondent No.2 made a claim of Rs.12,23,732/- before the arbitrator and the appellant made a claim of Rs.5,89,130.72 for purchase of fruits during the period 07.06.2000 to 30.09.2000 before the arbitrator. The arbitrator (respondent No.1) framed 4 Issues and answered the 4 Issues in his Award dated 06.06.2001 and awarded a sum of Rs.38,173/- towards prices of fresh fruits supplied by respondent No.2 to the appellant with interest at the rate of

18% per annum till payment and also directed the appellant to hand over the Fixed Deposit Certificates retained as security deposit to respondent No.2. The appellant filed O.P. No.1457 of 2001 under Section 34 of the Arbitration and Conciliation Act, 1996 (for short 'the Act') for setting aside the Award dated 06.06.2001 in the City Civil Court, Hyderabad. The Third Additional Chief Judge, City Civil Court, Hyderabad, by his order dated 05.11.2004 did not find any patent illegality in the Award and dismissed the application of the appellant under Section 34 of the Act. Aggrieved, the appellant filed Civil Misc. Appeal No.322 of 2005 under Section 37 of the Act against the order dated 05.11.2004 of the Third Additional Chief Judge, City Civil Court, Hyderabad, but by the impugned judgment, the Division Bench of the High Court has dismissed the appeal.

4. Learned counsel for the appellant challenged the findings of the arbitrator on Issue No.4. He submitted that Issue No.4 framed by the arbitrator was whether the contract between the appellant and the respondent No.2 was legally enforceable and the arbitrator has held in the Award that the contract was void *ab initio* and was not enforceable. He referred to the reasons given by the arbitrator in the Award to show that this finding of the arbitrator on issue No.4 was contrary to law. Learned

counsel for the appellant alternatively submitted that if it is held that the contract was void *ab initio*, then the arbitration clause which is part of the contract cannot be invoked. He cited the decision in *National Insurance Company Limited* v. *Boghara Polyfab Private Limited* [(2009) 1 SCC 267] in which this Court has held that where a contract is void *ab initio* and has no legal existence, the arbitration clause also cannot operate, for along with the original contract, it is also void. He submitted that on these two grounds the Award of the arbitrator should have been set aside and the application of the appellant under Section 34 of the Act should have been allowed.

5. Learned counsel for the respondent No.2, on the other hand, sought to sustain the Award of the arbitrator. He submitted that the arbitrator has held that even though the contract was void under Section 70 of the Indian Contract Act, 1892, the appellant is liable to pay compensation to the respondent No.2 for the supply of fruits made by respondent No.2 to the appellant and to the security deposit with interest at the rate of 18% per annum to the respondent No.2.

6. We have perused the Award of the arbitrator and we find that the arbitrator has framed the following 4 Issues:

Issue No.1 – Whether the parties to the contract were

discharged?

Issue No.2 – Whether the disputed contract was discharged in the following ways:

(a) By performance of the contract
(b) By breach of the contract
(c) By impossibility of performance

Issue No.3 – Construction of ASE Specification No.68;

Issue No.4 – Whether the contract was legally enforceable?

On Issue No. 1, the arbitrator has held that the respondent No.2 by not supplying fruits to the appellant had discharged the appellant from its obligations under the contract and the appellant had the right to sue for breach of contract for damages for loss caused to it in accordance with the provisions of the Indian Contract Act. On Issue No. 2, the arbitrator has held that the contention of respondent No.2 that he was disabled to perform from his part of the contract due to impossibility of performance caused by short supply of fruits is not correct. On Issue No.3, the arbitrator has held that the contention of respondent No.2 regarding ASE Specification No.68 and the note thereto failed because respondent No.2 has accepted and signed the chart and performed his part of the contract upto June, 2000. On Issue No.4, however, the arbitrator has held that the contract was void *ab initio* and was

not enforceable and therefore no right accrued to any of the parties for breach of contract.

7. We, however, find that the reasons given by the arbitrator in his Award for recording this finding on issue No.4 that the contract was void *ab initio* are not tenable in law. The arbitrator has found that the Government of India, Ministry of Defence in its letter dated 31.08.1990 has issued an instruction that if the rate quoted by a tenderor was lower than 20% of the reasonable rates, the rate should be treated as fictitious and the tender should be rejected by a panel of officers. The arbitrator has held that as the rates quoted by respondent No.2 were below 20% of the reasonable rates the agreement entered into with respondent No.2 for supply of fruits at the tendered rates was hit by the letter dated 31.08.1990 of the Government of India, Ministry of Defence. The arbitrator has further held that under Article 13(3)(a) of the Constitution of India, law includes a notification of the Government and therefore the letter dated 31.08.1990 of the Government of India, Ministry of Defence was law and as the consideration or object of the agreement between the appellant and the respondent No.2 defeated a provision of law, the agreement was void under Section 23 of the Indian Contract Act. In our considered opinion, the arbitrator has failed to

appreciate not only the provisions of Article 13(3)(a) of the Constitution but also of Section 23 of the Indian Contract Act.

8. Article 13 of the Constitution is quoted hereinbelow:

> "13. **Laws inconsistent with or in derogation of the fundamental rights** – (1) All laws in force in the territory of India immediately before the commencement of this Constitution, in so far as they are inconsistent with the provisions of this Part, shall to the extent of such inconsistency, be void.
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> (2) The State shall not make any law which takes away or abridges the rights conferred by this Part and any law made in contravention of this clause shall, to the extent of the contravention, be void.
>
> (3) in this article, unless the context otherwise requires –
>
> (a) "law" includes any Ordinance, order, bye-law, rule, regulation, notification, custom or usage having in the territory of India the force of law;
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> (b) "laws in force" includes laws passed or made by a Legislature or other competent authority in the territory of India before the commencement of this Constitution and not previously repealed, notwithstanding that any such law or any part thereof may not be then in operation either at all or in particular areas.
>
> (4) Nothing in this article shall apply to any amendment of this Constitution made under article 368."

A reading of clause (2) of Article 13 of the Constitution quoted above would show that by the said clause the State is prohibited from making any law which takes away or abridges the fundamental rights conferred by Part-III of the Constitution. Clause (2) of Article 13 of the Constitution

further provides that any law made in contravention of clause (2) shall to the extent of the contravention be void. In clause (3)(a) of Article 13 of the Constitution, the word "law" has been defined for the purpose of Article 13 to include any Ordinance order, bye-law, rule, regulation, notification, custom or usage having in the territory of India the force of law. Clause (3)(a) of Article 13 of the Constitution therefore makes it clear that not only law made by the legislature but also an order or notification which takes away or abridges the fundamental rights conferred by Part-III of the Constitution would be void. Thus, clause (3)(a) of Article 13 of the Constitution is relevant, where an order or notification of the Government attempts to take away or abridge the fundamental rights conferred by Part-III of the Constitution and this provision of the Constitution has no relevance in deciding a question whether an agreement is void and is not enforceable in law.

9. For deciding whether an agreement is void and is not enforceable, we have to refer to Section 23 of the Indian Contract Act, which is quoted hereinbelow:

> "23. What **consideration and objects are lawful, and what not** – The consideration of object of an agreement is lawful, unless –
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> it is forbidden by law; or
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> is of such a nature that, if permitted, it would

> defeat the provisions of any law; or is fraudulent; or
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> Involves or implies, injury to the person or property of another; or the Court regards it as immoral, or opposed to public policy.
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> In each of these cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void."

Section 23 of the Indian Contract Act *inter alia* states that the consideration or object of an agreement is lawful, unless the consideration or object of an agreement is of such a nature that, if permitted, it would defeat the provision of law and in such a case the consideration or object is unlawful and the agreement is void. In Pollock & Mulla in Mulla Indian Contract and Specific Relief Acts, 13th Edition, Volume-I published by LexisNexis Butterworths, it is stated at page 668:

> "The words 'defeat the provisions of any law' must be taken as limited to defeating the intention which the legislature has expressed, or which is necessarily implied from the express terms of an Act. It is unlawful to contract to do that which it is unlawful to do; but an agreement will not be void, merely because it tends to defeat some purpose ascribed to the legislature by conjecture, or even appearing, as a matter of history, from extraneous evidence, such as legislative debates or preliminary memoranda, not forming part of the enactment."

It is thus clear that the word "law" in the expression "defeat the provisions of any law" in Section 23 of the Indian Contract Act is limited to the expressed terms of an Act of the

legislature.

10. In *Shri Lachoo Mal vs. Shri Radhey Shyam* [(1971) 1 SCC 619] this Court while deciding whether an agreement was void and not enforceable under Section 23 of the Indian Contact Act held:

> "What makes an agreement, which is otherwise legal, void is that its performance is impossible except by disobedience of law. Clearly no question of illegality can arise unless the performance of the unlawful act was necessarily the effect of an agreement."

We are, therefore, of the opinion that unless the effect of an agreement results in performance of an unlawful act, an agreement which is otherwise legal cannot be held to be void and if the effect of an agreement did not result in performance of an unlawful act, as a matter of public policy, the court should refuse to declare the contract void with a view to save the bargain entered into by the parties and the solemn promises made thereunder. As has been observed by Lord Wright in *Vita Food Products Incorporated vs. Unus Company Ltd. (in liquidation)* [(1939) AC 277 at p. 293]:

> "Nor must it be forgotten that the rule by which contracts not expressly forbidden by statute or declared to be void are in proper cases nullified for disobedience to a statute is a rule of public policy only, and public policy understood in a wider sense may at times be better served by refusing to nullify a bargain save on serious and sufficient grounds."

11. The arbitrator was, therefore, not right in law in coming to the conclusion that the agreement between the appellant and the respondent No.2 was void and not enforceable as the consideration or object of the agreement was hit by the letter dated 31.08.1990 of the Government of India, Ministry of Defence. This letter may be an instruction to the officers of the Defence Department to reject a tender where the rate quoted by the tenderor is more than 20% below the reasonable rates but the letter was not an Act of the legislature declaring that any supply made at a rate below 20% of the reasonable rates was unlawful. The finding of the arbitrator on Issue No.4 is thus patently illegal and opposed to public policy. In *Oil and Natural Gas Corporation Ltd.* vs. *Saw Pipes Ltd.* (2003) 5 SCC 705 at page 727], this Court after examining the grounds on which an award of the arbitrator can be set aside under Section 34 of the Act has said:

> "31……However, the award which is, on the face of it, patently in violation of statutory provisions cannot be said to be in public interest. Such award/judgment/decision is likely to adversely affect the administration of justice. Hence, in our view in addition to narrower meaning given to the term "public policy" in Renusagar case it is required to be held that the award could be set aside if it is patently illegal."

12. We accordingly set aside the Award of the arbitrator and the judgments of the City Civil Court, Hyderabad and the

High Court and remit the matter to the arbitrator for deciding the claims of the appellant and the respondent No.2 in accordance with the findings in the Award on Issue Nos. 1, 2 and 3 and in accordance with this judgment. The appeal is allowed with no order as to costs.

.....J.
(P. Sathasivam)

.....J.
(A. K. Patnaik)

New Delhi,
November 23, 2011.