REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 10531 OF 2014
(ARISING OUT OF SLP (CIVIL) NO.14767 OF 2012)

Associate Builders …Appellant

Versus

Delhi Development Authority …Respondent

J U D G M E N T

R.F.Nariman,J.

1. Leave granted.

2. The appellant herein was awarded a certain construction work contract by the DDA *vide* a letter of award dated 14th May, 1992. DDA was building a colony consisting of 7,000 houses in Trilok Puri in the trans-Yamuna area. 168 Middle Income Group houses and 56 Lower Income Group houses, Grade-A Pocket- B (balance work) was awarded for the tendered amount of Rs.87,66,678/-. The contract was to be completed in 9 months. Admittedly, it was ultimately completed only in 34 months, the contractor completing 166 Middle Income Group houses and 36 Lower Income Group houses. The total value of work that was done amounted to Rs.62,84,845/-. As many as 15

claims were made by the contractor and the High Court of Delhi appointed one Shri K.D. Bali to arbitrate the present dispute.

3. We are concerned here with claims 9, 10, 11 and 15, for these claims have been allowed by the Arbitrator and the DDA's objections have been dismissed by the learned Single Judge of the High Court of Delhi. The Division Bench in an appeal under Section 37 of the Arbitration Act, 1996 has stepped in to set aside the judgment of the Single Judge and negative these claims. We are also concerned with claims 12 and 13 which have been scaled down by the Division Bench.

4. Claims 9, 10, 11 and 15 read as follows:

> "Claim No.9: Claimants claim Rs. 20,950/- on account of hire charges of centering shuttering due to delay in laying of conduiting.
>
> a) That the respondents had granted certain work of electrification but the said agency did not lay the conduit resulting in delay in removing the shuttering and causing hire charges. This fact was reported to the respondents vide claimant's letter dated 30.10.92 followed by reminders and also found place in hindrance register.
>
> b) That this is the actual expenditure incurred and thus the claimant is entitled for its refund.
>
> c) That the detailed break-up of this claim has been appended separately.
>
> Claim No.10: Claimants claim Rs.33,450/- being the hire charges of shuttering due to stoppage of work in block no. 100 and 101.
>
> a) That the department had virtually stopped the work in block 100 & 101 on 20.7.93 and it continued up to 26.2.94. During this period no work was allowed to be executed in these two

blocks resulting in blockade or centering and shuttering in the said two blocks.

b) That by stoppage of work in these two blocks the claimants had suffered hire charges of shuttering due to respondent's lapses and defaults.

c) It is further stated that there was no justification for stoppage of work and the action was arbitrary and totally unjust.

d) That the detail of this claim has been outlined and appended separately and the same shall from part of the statement of facts.

Claim No. 11: Rs.2,00,000/- payable as damages on account of hire charges of tools & plants and scaffolding.

a) That due to prolongation of the contract on account of the respondents the claimants had to maintain tools & plants, scaffolding etc, during the prolongation of the contract resulting in expenditure for the same.

b) That the said articles remained at site beyond the stipulated period and the claimants suffered loss due to the said prolongation.

Claim No. 15: Claimants claim damages Rs.6,25,979/- on account of establishment due to prolongation of the contract.

a) That the claimants had contemplated maintenance of establishment during stipulated period of completion but the work was prolonged due to various delays and defaults on the part of the respondents.

b) It is further stated that the claimants had to pay the establishment payment during prolongation and the said expenditure was unproductive and un contemplated.

c) It is further stated that the claimants had maintained establishment beyond the stipulated completion due to the respondent's breach and thus entitled for payment.

d) That the respondents were also aware that the claimant has maintained regular establishment and thus, incurred expenditure and the claimants had also made several representations."

Claims 12 and 13 read as follows:

> "Claim No. 12: Claimants claim Rs.7,12,394/- as damages @20% for execution of the work.
>
> a) That the work was delayed because of the Respondents for the reasons as set out in the letter indicating hindrances encountered during execution of the work resulting delay in execution of the work for a period of 25 months.
>
> b) It is further stated that the claimants incurred unproductive after stipulated date of completion.
>
> c) It is further stated that during prolongation there had been steep rise in cost of material and labour.
>
> d) That the claim of 20% is also lent support from the cost index as issued by the competent authority and only applicable on the work which was executed during prolongation.
>
> e) That as per cost index it comes to more than 30% whereas the claimants had claimed 20 & being highly rational and just.
>
> f) That the claimants had appended the details of this claim separately based on cost index to show that the claimant had actually incurred this additional expenditure due to the respondents. Copy of the hindrances encountered during the execution of the work at the hands of the respondents has been enclosed.
>
> g) That the respondents had committed breach and thus liable for damages.
>
> h) It is further stated that the cost of material issued by the department has been deducted by assessing the cost.
>
> Claim No. 13: Claimants claim Rs.97,5000/- being the extra at 35% for the work executed in block 100 & 101 effective from 28.2.94 till actual completion.
>
> a) It is further stated that due to delayed execution of the work of these two blocks the claimants had to incur extra expenditure as the stoppage of work was utterly arbitrary.
>
> b) That the detailed break-up of this claim is appended with the statement of facts."

5. Though the challenge to claims 2, 3 and 4 were given up before the Division Bench, they are also relevant and read as follows:

> "Claim No.2: Claimants claim Rs.1,62,387/- being the reimbursement of statutory increase in labour under clause 10-C
>
> a) That the claimants submitted the tender on 6.2.92 and said offer was accepted on 14.5.92. The date of commencement was to be reckoned from 24.5.92. The date of stipulated completion was 9 months i.e. 23.2.93 but the work could be completed on 28.3.95.
>
> b) It is further stated that the claimants had submitted the bill for the value to the extent the work was executed till 4.10.94 for a sum of Rs. l,12,067/- as per the formula applicable.
>
> c) That the respondents however, did not make a single payment though, the work was executed after submission of the said bill.
>
> d) That however, a consolidated bill was furnished the respondents for a sum of Rs. l,62,287/-. Even the said payment has not been liquidated so far.
>
> e) That the claimants advised the statutory increase as and when enforced and the claimants also submitted the labour reports indicating the nature of the labour employed at site.
>
> f) That the respondents had also certified on the bill that the labour payment has been made as per the labour rate.
>
> g) That it is further stated that since it is a statutory increase, the same is payable by the respondents. Copy of the both the bills attached. And thus the claimants be awarded a sum of Rs. 1,62,287/- to the claimants.
>
> Claim No.3: Claimants claim Rs.l,49,862/- being the increase in cost of stone grit on account closure of the quarry by the order of the Supreme Court.
>
> a) That it is stated that the claimants had submitted the tender on the basis of the rate prevailing but due to the Hon'ble Court's directions for closure of the stone quarry resulting in shortage of stone chips in the market and consequently rates increased.
>
> b) That the claimants informed the quantum of the increase on 22.6.92 and followed by reminders.

c) That the respondents had agreed in principle to pay the increase which was prevailing in the market.

d) That the detailed break-up of this claim has been appended separately.

e) It is further stated that the claimant was not instrumental for increase in cost but due to the interference of the Hon'ble Supreme Court. And the said increase has been taken into account till the stipulated completion dated 23.2.93.

f) That the claimant is entitled for recovery of the said increase.

Claim No. 4: Claimants claim Rs.12,922/- payable by virtue of clause 10-C of the agreement and up to the stipulated period

a) That there was steep rise in cost of steel and the claimant was exposed and the respondents were liable to pay the increase in steel.

b) That the detailed break-up of this claim has been prepared and appended.

6. The Arbitrator by a reasoned award dated 23rd May, 2005 held that the entire delay of 25 months in the execution of the project was thanks to the DDA, none of this delay being attributable to the contractor. The learned Arbitrator found:

"That all the above four claims are inter linked being related to the overhead expenses and therefore dealt together.

That the date of commencement of work was 24.5.92 and the period for completion was 9 months and therefore, the disputed date of completion was 23.2.93 but the work could be actually completed on 28.3.95.

That there was delay of 25 months in completion of the work beyond the stipulated date of completion.

That the Claimants urged that there had been various delays in the execution of work due to the lapses and defaults of the Respondents from the very commencement of work. The progress was held up time and again and the claimants therefore, as back as

17.2.93 advised the Respondents (C-9 page 167) that the Claimants are not interested to execute the work beyond the stipulated date of completion and therefore, their contract be finalized on the stipulated date of completion as the Claimants shall be exposed to incur heavy expenditure in overheads for maintaining establishment watch and ward and tools and plants and other shuttering material but the Respondents did not refute. The chief reasons for delay are highlighted below:-

I) Delay in supply of structural and architectural drawings.

II) That out of 9 Blocks 2 blocks are abnormally delayed as the site of the said 21 blocks was made available in piecemeal which stretched till 26.2.94 whereas the stipulated completion was 23.2.93.

III) Delay in laying the conduit by the electrical agency resulting in delay in casting of RCC slab and plastering work besides development work. The said hindrance was removed lastly on 28.3.95.

IV) Abnormal delay in making availability of the alignment sketch for electrical cables.

V) Inordinate delay in supply of stipulated material such as cement, steel and pipes.

VI) Delay in decision of finishing· work in kitchen and bath rooms.

VII) There was inordinate delay in making availability of colour scheme.

VIII) That the Respondents also abnormally delayed the supply of door shutters which were to be supplied by the Respondents. The same were supplied as late as 8.11.94.

IX) Inordinate delay in writing in the electrical conduits resulting in delay in completion of finishing work.

X) Suspension of work by the Respondents for the period 17.1.94 to 25.2.94 and from 7.8.94 to 22.3.95 because of non-removal of hindrances.

XI) Delayed payment due to non-sanction of Administrative Approval and Expenditure Sanction.

That all the delays as set out had been duly recorded 733 to 739 and M.A.S. register pages from 747 to 768 as highlighted by the

Claimants. The Claimants also relied upon certain documents of MAS Register supplied by the Respondents.

That the Claimants further stated that the Claimants had also filed reasons for delay and hold up of the work various defaults of the Respondents in Annexure pages 740 to 746. The Claimants also highlighted the correspondence made by the Claimants with Respondents.

That the Claimants further stated that the said hindrances were avoidable but the Respondents did not take timely steps.

That the Claimants also referred the contents of the letter dated 10.7.95 (page 885) wherein it was observed that the Superintending Engineer appreciated the working of the Claimants and also observed that there was no fault of the contractor and they have successfully completed the work. The Claimants further stated that, they had incurred heavy expenditure on overheads of the lapses and default of the Respondents.

As against this the Respondents stated that there was poor planning of the claimants and also contended that since the compensation has been levied under Clause 2 of the agreement therefore, claim of the claimants deserves to be rejected.

That on record it is conclusively proved that the Respondents committed breach of contract as they failed to discharge their obligations in time resulting in prolongations did not deny the deployment of the tools and plants and machinery at site besides watch and ward during the prolongation."

7. It is important to note that before the Division Bench, the learned counsel for the DDA conceded that this being a pure finding of fact, he would not be challenging it before the Division Bench.

8. Of the total claim of Rs.37.28 lakhs, the learned Arbitrator awarded an amount of Rs.23.39 lakhs. Further, the learned Arbitrator has laboriously gone through all the evidence and answered each claim giving reasons for the same.

9. By a judgment dated 3rd April, 2006, the learned Single Judge of the High Court of Delhi dismissed the objections of the DDA and upheld the award. In an appeal filed under Section 37 of the Arbitration Act, vide the impugned judgment dated 8th February, 2012, a Division Bench of the High Court of Delhi set aside the judgment of the Single Judge on claims 9, 10, 11 and 15, and negatived these claims in toto. Further, claims 12 and 13 were scaled down doing "rough and ready justice". Resultantly, the awarded amount of Rs.7,20,000/- was scaled down to Rs. 5,57,137.50/-.

10. We have heard learned counsel for the parties. Shri M. L. Verma, learned Senior Advocate appearing on behalf of the appellant, submitted that the Division Bench has lost sight of the law laid down by this Hon'ble Court when it comes to challenges made to arbitral awards under Section 34 of the Act. He has submitted that the Division Bench has acted as if this was a first appeal from the award and has further submitted that the Division Bench has taken into account facts which were neither pleaded nor proved before the learned Arbitrator in order to negative certain claims. He further submitted that it is not possible for a Bench hearing an objection against an arbitral award to do "rough and ready justice" – it is bound by the law laid down by this Hon'ble Court. In particular, he argued that the conceded position is that 25 months delay was due to the DDA alone. The award read as a whole is just, fair and reasonable as only certain claims have been granted and every claim granted has been supported with reasons. The Arbitrator is the sole judge of the quality

and quantity of evidence before him and he has decided on that evidence. No errors of law arise from the award and the award has, therefore, been wrongly set aside.

11. Mr. Amarendra Sharan, learned Senior Advocate appearing on behalf of the DDA has relied strongly on clause 10C and clause 22 to support the judgment of the Division bench and has further argued that there has been duplication so far as certain claims are concerned. He argued that an award in the teeth of clause 10C and clause 22 would be a jurisdictional error which would vitiate the award.

12. In as much as serious objections have been taken to the Division Bench judgment on the ground that it has ignored the parameters laid down in a series of judgments by this Court as to the limitations which a Judge hearing objections to an arbitral award under Section 34 is subject to, we deem it necessary to state the law on the subject.

Section 34 of the Arbitration and Conciliation Act reads as follows-

> **"Application for setting aside arbitral award.—**(1) Recourse to a Court against an arbitral award may be made only by an application for setting aside such award in accordance with sub-section (2) and sub-section (3).
>
> (2) An arbitral award may be set aside by the Court only if—
>
> (*a*) the party making the application furnishes proof that—
>
> (*i*) a party was under some incapacity; or

(*ii*) The arbitration agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law for the time being in force; or

(*iii*) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or

(*iv*) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration:

Provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the arbitral award which contains decisions on matters not submitted to arbitration may be set aside; or

(*v*) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Part from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Part; or

(*b*) the Court finds that—

(*i*) the subject-matter of the dispute is not capable of settlement by arbitration under the law for the time being in force, or

(*ii*) the arbitral award is in conflict with the public policy of India.

Explanation.—Without prejudice to the generality of sub-clause (*ii*), it is hereby declared, for the avoidance of any doubt, that an award is in conflict with the public policy of India if the making of the award was induced or affected by fraud or corruption or was in violation of Section 75 or Section 81.

(3) An application for setting aside may not be made after three months have elapsed from the date on which the party making that application had received the arbitral award or, if a request had been made under Section 33, from the date on which that request had been disposed of by the arbitral tribunal:

Provided that if the Court is satisfied that the applicant was prevented by sufficient cause from making the application within the said period of three months it may entertain the

application within a further period of thirty days, but not thereafter.

(4) On receipt of an application under sub-section (1), the Court may, where it is appropriate and it is so requested by a party, adjourn the proceedings for a period of time determined by it in order to give the arbitral tribunal an opportunity to resume the arbitral proceedings or to take such other action as in the opinion of arbitral tribunal will eliminate the grounds for setting aside the arbitral award."

This Section in conjunction with Section 5 makes it clear that an arbitration award that is governed by part I of the Arbitration and Conciliation Act, 1996 can be set aside only on grounds mentioned under Section 34 (2) and (3), and not otherwise. Section 5 reads as follows:

"5. Extent of judicial intervention.—Notwithstanding anything contained in any other law for the time being in force, in matters governed by this Part, no judicial authority shall intervene except where so provided in this Part."

It is important to note that the 1996 Act was enacted to replace the 1940 Arbitration Act in order to provide for an arbitral procedure which is fair, efficient and capable of meeting the needs of arbitration; also to provide that the tribunal gives reasons for an arbitral award; to ensure that the tribunal remains within the limits of its jurisdiction; and to minimize the supervisory roles of courts in the arbitral process.

It will be seen that none of the grounds contained in sub-clause 2 (a) deal with the merits of the decision rendered by an arbitral award. It is only when we come to the award being in conflict with the public policy of India that the

merits of an arbitral award are to be looked into under certain specified circumstances.

In **Renusagar Power Co. Ltd. v. General Electronic Co.,** 1994 Supp (1) SCC 644, the Supreme Court construed Section 7 (1)(b) (ii) of the Foreign Award (Recognition and Enforcement) Act, 1961.

> ***"7. Conditions for enforcement of foreign awards****.—(1) A foreign award may not be enforced under this Act—*
>
> *(b) if the Court dealing with the case is satisfied that—*
>
> *(ii) the enforcement of the award will be contrary to the public policy."*

In construing the expression "public policy" in the context of a foreign award, the Court held that an award contrary to

1. The fundamental policy of Indian law
2. The interest of India
3. Justice or morality,

would be set aside on the ground that it would be contrary to the public policy of India. It went on further to hold that a contravention of the provisions of the Foreign Exchange Regulation Act would be contrary to the public policy of India in that the statute is enacted for the national economic interest to ensure that the nation does not lose foreign exchange which is essential for the economic survival of the nation (see para 75). Equally, disregarding orders passed by the superior courts in India could also be a contravention of the

fundamental policy of Indian law, but the recovery of compound interest on interest, being contrary to statute only, would not contravene any fundamental policy of Indian law (see paras 85,95).

When it came to construing the expression "the public policy of India" contained in Section 34 (2) (b) (ii) of the Arbitration Act, 1996, this Court in **ONGC v. Saw Pipes,** 2003 (5) SCC 705, held-

> ***"31.*** *Therefore, in our view, the phrase "public policy of India" used in Section 34 in context is required to be given a wider meaning. It can be stated that the concept of public policy connotes some matter which concerns public good and the public interest. What is for public good or in public interest or what would be injurious or harmful to the public good or public interest has varied from time to time. 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 [1994 Supp (1) SCC 644] it is required to be held that the award could be set aside if it is patently illegal. The result would be — award could be set aside if it is contrary to:*
>
> *(a) Fundamental policy of Indian law; or*
>
> *(b) The interest of India; or*
>
> *(c) Justice or morality, or*
>
> *(d) in addition, if it is patently illegal.*
>
> *Illegality must go to the root of the matter and if the illegality is of trivial nature it cannot be held that award is against the public policy. Award could also be set aside if it is so unfair and unreasonable that it shocks the conscience of the court. Such award is opposed to public policy and is required to be adjudged void.*
>
> ***74.*** *In the result, it is held that:*

(A) (1) The court can set aside the arbitral award under Section 34(2) of the Act if the party making the application furnishes proof that:

(i) a party was under some incapacity, or

(ii) the arbitration agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law for the time being in force; or

(iii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or

(iv) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration.

(2) The court may set aside the award:

(i)(a) if the composition of the Arbitral Tribunal was not in accordance with the agreement of the parties,

(b) failing such agreement, the composition of the Arbitral Tribunal was not in accordance with Part I of the Act.

(ii) if the arbitral procedure was not in accordance with:

(a) the agreement of the parties, or

(b) failing such agreement, the arbitral procedure was not in accordance with Part I of the Act.

However, exception for setting aside the award on the ground of composition of Arbitral Tribunal or illegality of arbitral procedure is that the agreement should not be in conflict with the provisions of Part I of the Act from which parties cannot derogate.

(c) If the award passed by the Arbitral Tribunal is in contravention of the provisions of the Act or any other substantive law governing the parties or is against the terms of the contract.

(3) The award could be set aside if it is against the public policy of India, that is to say, if it is contrary to:

(a) fundamental policy of Indian law; or

(b) the interest of India; or

(c) justice or morality; or

(d) if it is patently illegal.

(4) It could be challenged:

(a) as provided under Section 13(5); and

(b) Section 16(6) of the Act.

(B)(1) The impugned award requires to be set aside mainly on the grounds:

(i) there is specific stipulation in the agreement that the time and date of delivery of the goods was of the essence of the contract;

(ii) in case of failure to deliver the goods within the period fixed for such delivery in the schedule, ONGC was entitled to recover from the contractor liquidated damages as agreed;

(iii) it was also explicitly understood that the agreed liquidated damages were genuine pre-estimate of damages;

(iv) on the request of the respondent to extend the time-limit for supply of goods, ONGC informed specifically that time was extended but stipulated liquidated damages as agreed would be recovered;

(v) liquidated damages for delay in supply of goods were to be recovered by paying authorities from the bills for payment of cost of material supplied by the contractor;

(vi) there is nothing on record to suggest that stipulation for recovering liquidated damages was by way of penalty or that the said sum was in any way unreasonable.

(vii) In certain contracts, it is impossible to assess the damages or prove the same. Such situation is taken care of by Sections 73 and 74 of the Contract Act and in the present case by specific terms of the contract."

The judgment in **ONGC v. Saw Pipes** has been consistently followed till date.

In **Hindustan Zinc Ltd. v. Friends Coal Carbonisation,** (2006) 4 SCC 445, this Court held:

> ***"14.*** *The High Court did not have the benefit of the principles laid down in Saw Pipes [(2003) 5 SCC 705] , and had proceeded on the assumption that award cannot be interfered with even if it was contrary to the terms of the contract. It went to the extent of holding that contract terms cannot even be looked into for examining the correctness of the award. This Court in Saw Pipes [(2003) 5 SCC 705] has made it clear that it is open to the court to consider whether the award is against the specific terms of contract and if so, interfere with it on the ground that it is patently illegal and opposed to the public policy of India."*

In **McDermott International Inc. v. Burn Standard Co. Ltd.**, (2006) 11 SCC 181, this Court held:

> ***"58.*** *In Renusagar Power Co. Ltd. v. General Electric Co. [1994 Supp (1) SCC 644] this Court laid down that the arbitral award can be set aside if it is contrary to (a) fundamental policy of Indian law; (b) the interests of India; or (c) justice or morality. A narrower meaning to the expression "public policy" was given therein by confining judicial review of the arbitral award only on the aforementioned three grounds. An apparent shift can, however, be noticed from the decision of this Court in ONGC Ltd.v. Saw Pipes Ltd. [(2003) 5 SCC 705] (for short "ONGC"). This Court therein referred to an earlier decision of this Court in Central Inland Water Transport Corpn. Ltd. v. Brojo Nath Ganguly [(1986) 3 SCC 156 : 1986 SCC (L&S) 429 : (1986) 1 ATC 103] wherein the applicability of the expression "public policy" on the touchstone of Section 23 of the Indian Contract Act and Article 14 of the Constitution of India came to be considered. This Court therein was dealing with unequal bargaining power of the workmen and the employer and came to the conclusion that any term of the agreement which is patently arbitrary and/or otherwise arrived at because of the unequal bargaining power would not only be ultra vires Article 14 of the Constitution of India but also hit by Section 23 of the Indian Contract Act. In ONGC [(2003) 5 SCC*

705] this Court, apart from the three grounds stated in Renusagar [1994 Supp (1) SCC 644] , added another ground thereto for exercise of the court's jurisdiction in setting aside the award if it is patently arbitrary.

***59.** Such patent illegality, however, must go to the root of the matter. The public policy violation, indisputably, should be so unfair and unreasonable as to shock the conscience of the court. Where the arbitrator, however, has gone contrary to or beyond the expressed law of the contract or granted relief in the matter not in dispute would come within the purview of Section 34 of the Act. However, we would consider the applicability of the aforementioned principles while noticing the merits of the matter.*

***60.** What would constitute public policy is a matter dependent upon the nature of transaction and nature of statute. For the said purpose, the pleadings of the parties and the materials brought on record would be relevant to enable the court to judge what is in public good or public interest, and what would otherwise be injurious to the public good at the relevant point, as contradistinguished from the policy of a particular Government. (See State of Rajasthan v. Basant Nahata [(2005) 12 SCC 77].)"*

In **Centrotrade Minerals & Metals Inc.** v. **Hindustan Copper Ltd.,** (2006) 11 SCC 245, Sinha, J., held:

***"103.** Such patent illegality, however, must go to the root of the matter. The public policy, indisputably, should be unfair and unreasonable so as to shock the conscience of the court. Where the arbitrator, however, has gone contrary to or beyond the expressed law of the contract or granted relief in the matter not in dispute would come within the purview of Section 34 of the Act."*

***104.** What would be a public policy would be a matter which would again depend upon the nature of transaction and the nature of statute. For the said purpose, the pleadings of the parties and the materials brought on record would be relevant so as to enable the court to judge the concept of what was a public good or public interest or what would otherwise be injurious to the public good at the relevant point as*

contradistinguished by the policy of a particular government. (See State of Rajasthan v. Basant Nahata [(2005) 12 SCC 77].)"

In **DDA v. R.S. Sharma and Co.,** (2008) 13 SCC 80, the Court summarized the law thus:

***"21.** From the above decisions, the following principles emerge:*

(a) An award, which is

(i) contrary to substantive provisions of law; or

(ii) the provisions of the Arbitration and Conciliation Act, 1996; or

(iii) against the terms of the respective contract; or

(iv) patently illegal; or

(v) prejudicial to the rights of the parties;

is open to interference by the court under Section 34(2) of the Act.

(b) The award could be set aside if it is contrary to:

(a) fundamental policy of Indian law; or

(b) the interest of India; or

(c) justice or morality.

(c) The award could also be set aside if it is so unfair and unreasonable that it shocks the conscience of the court.

(d) It is open to the court to consider whether the award is against the specific terms of contract and if so, interfere with it on the ground that it is patently illegal and opposed to the public policy of India.

With these principles and statutory provisions, particularly, Section 34(2) of the Act, let us consider whether the arbitrator as well as the Division Bench of the High Court were justified in granting the award in respect of Claims 1 to 3 and Additional Claims 1 to 3 of the claimant or the appellant DDA has made out a case for setting aside the award in respect of

those claims with reference to the terms of the agreement duly executed by both parties."

J.G. Engineers (P) Ltd. v. **Union of India,** (2011) 5 SCC 758, held:

> ***"27.*** *Interpreting the said provisions, this Court in ONGC Ltd. v. Saw Pipes Ltd.[(2003) 5 SCC 705] held that a court can set aside an award under Section 34(2)(b)(ii) of the Act, as being in conflict with the public policy of India, if it is (a) contrary to the fundamental policy of Indian law; or (b) contrary to the interests of India; or (c) contrary to justice or morality; or (d) patently illegal. This Court explained that to hold an award to be opposed to public policy, the patent illegality should go to the very root of the matter and not a trivial illegality. It is also observed that an award could be set aside if it is so unfair and unreasonable that it shocks the conscience of the court, as then it would be opposed to public policy."*

Union of India v. Col. L.S.N. Murthy, (2012) 1 SCC 718, held:

> ***"22.*** *In ONGC Ltd. v. Saw Pipes Ltd. [(2003) 5 SCC 705] 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: (SCC p. 727, para 31)*
>
> *"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 [Renusagar Power Co. Ltd. v. General Electric Co., 1994 Supp (1) SCC 644] it is required to be held that the award could be set aside if it is patently illegal".*

<u>Fundamental Policy of Indian Law</u>

Coming to each of the heads contained in the Saw Pipes judgment, we will first deal with the head "fundamental policy of Indian Law". It has already

been seen from the Renusagar judgment that violation of the Foreign Exchange Act and disregarding orders of superior courts in India would be regarded as being contrary to the fundamental policy of Indian law. To this it could be added that the binding effect of the judgment of a superior court being disregarded would be equally violative of the fundamental policy of Indian law.

In a recent judgment, **ONGC Ltd. v. Western Geco International Ltd**., 2014 (9) SCC 263, this Court added three other distinct and fundamental juristic principles which must be understood as a part and parcel of the fundamental policy of Indian law. The Court held-

> ***"35.*** *What then would constitute the "fundamental policy of Indian law" is the question. The decision in ONGC [ONGC Ltd. v. Saw Pipes Ltd., (2003) 5 SCC 705] does not elaborate that aspect. Even so, the expression must, in our opinion, include all such fundamental principles as providing a basis for administration of justice and enforcement of law in this country. Without meaning to exhaustively enumerate the purport of the expression "fundamental policy of Indian law", we may refer to three distinct and fundamental juristic principles that must necessarily be understood as a part and parcel of the fundamental policy of Indian law. The first and foremost is the principle that in every determination whether by a court or other authority that affects the rights of a citizen or leads to any civil consequences, the court or authority concerned is bound to adopt what is in legal parlance called a "judicial approach" in the matter. The duty to adopt a judicial approach arises from the very nature of the power exercised by the court or the authority does not have to be separately or additionally enjoined upon the fora concerned. What must be remembered is that the importance of a judicial approach in judicial and quasi-judicial determination lies in the fact that so long as the court, tribunal or the authority exercising powers that affect the rights or obligations of the parties before them shows fidelity to judicial approach, they cannot act in an*

arbitrary, capricious or whimsical manner. Judicial approach ensures that the authority acts bona fide and deals with the subject in a fair, reasonable and objective manner and that its decision is not actuated by any extraneous consideration. Judicial approach in that sense acts as a check against flaws and faults that can render the decision of a court, tribunal or authority vulnerable to challenge.

38. *Equally important and indeed fundamental to the policy of Indian law is the principle that a court and so also a quasi-judicial authority must, while determining the rights and obligations of parties before it, do so in accordance with the principles of natural justice. Besides the celebrated audi alteram partem rule one of the facets of the principles of natural justice is that the court/authority deciding the matter must apply its mind to the attendant facts and circumstances while taking a view one way or the other. Non-application of mind is a defect that is fatal to any adjudication. Application of mind is best demonstrated by disclosure of the mind and disclosure of mind is best done by recording reasons in support of the decision which the court or authority is taking. The requirement that an adjudicatory authority must apply its mind is, in that view, so deeply embedded in our jurisprudence that it can be described as a fundamental policy of Indian law.*

*3****9.*** *No less important is the principle now recognised as a salutary juristic fundamental in administrative law that a decision which is perverse or so irrational that no reasonable person would have arrived at the same will not be sustained in a court of law. Perversity or irrationality of decisions is tested on the touchstone of Wednesbury principle [Associated Provincial Picture Houses Ltd. v. Wednesbury Corpn., (1948) 1 KB 223: (1947) 2 All ER 680 (CA)] of reasonableness. Decisions that fall short of the standards of reasonableness are open to challenge in a court of law often in writ jurisdiction of the superior courts but no less in statutory processes wherever the same are available.*

40. *It is neither necessary nor proper for us to attempt an exhaustive enumeration of what would constitute the fundamental policy of Indian law nor is it possible to place the expression in the straitjacket of a definition. What is important in the context of the case at hand is that if on facts proved before them the arbitrators fail to draw an inference which ought to have been drawn or if they have drawn an inference which is on the face of it, untenable resulting in miscarriage of justice, the adjudication even when made by an Arbitral Tribunal that enjoys considerable*

latitude and play at the joints in making awards will be open to challenge and may be cast away or modified depending upon whether the offending part is or is not severable from the rest."

It is clear that the juristic principle of a "judicial approach" demands that a decision be fair, reasonable and objective. On the obverse side, anything arbitrary and whimsical would obviously not be a determination which would either be fair, reasonable or objective.

The *Audi Alteram Partem* principle which undoubtedly is a fundamental juristic principle in Indian law is also contained in Sections 18 and 34 (2) (a) (iii) of the Arbitration and Conciliation Act. These Sections read as follows:

***"18. Equal treatment of parties**.— The parties shall be treated with equality and each party shall be given a full opportunity to present his case.*

34. Application for setting aside arbitral award.—

(2) An arbitral award may be set aside by the Court only if —

(a) the party making the application furnishes proof that—

(iii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; "

The third juristic principle is that a decision which is perverse or so irrational that no reasonable person would have arrived at the same is important and requires some degree of explanation. It is settled law that where-

1. a finding is based on no evidence, or

2. an arbitral tribunal takes into account something irrelevant to the decision which it arrives at; or

3. ignores vital evidence in arriving at its decision,

such decision would necessarily be perverse. A good working test of perversity is contained in two judgments. In **H.B. Gandhi, Excise and Taxation Officer-cum-Assessing Authority v. Gopi Nath & Sons,** 1992 Supp (2) SCC 312 at p. 317, it was held:

> ***"7.*** *….....It is, no doubt, true that if a finding of fact is arrived at by ignoring or excluding relevant material or by taking into consideration irrelevant material or if the finding so outrageously defies logic as to suffer from the vice of irrationality incurring the blame of being perverse, then, the finding is rendered infirm in law."*

In **Kuldeep Singh v. Commr. of Police,** (1999) 2 SCC 10 at para 10, it was held:

> ***"10.*** *A broad distinction has, therefore, to be maintained between the decisions which are perverse and those which are not. If a decision is arrived at on no evidence or evidence which is thoroughly unreliable and no reasonable person would act upon it, the order would be perverse. But if there is some evidence on record which is acceptable and which could be relied upon, howsoever compendious it may be, the conclusions would not be treated as perverse and the findings would not be interfered with."*

It must clearly be understood that when a court is applying the "public policy" test to an arbitration award, it does not act as a court of appeal and consequently errors of fact cannot be corrected. A possible view by the

arbitrator on facts has necessarily to pass muster as the arbitrator is the ultimate master of the quantity and quality of evidence to be relied upon when he delivers his arbitral award. Thus an award based on little evidence or on evidence which does not measure up in quality to a trained legal mind would not be held to be invalid on this score[1]. Once it is found that the arbitrators approach is not arbitrary or capricious, then he is the last word on facts. In **P.R. Shah, Shares & Stock Brokers (P) Ltd. v. B.H.H. Securities (P) Ltd.,** (2012) 1 SCC 594, this Court held:

> ***"21.*** *A court does not sit in appeal over the award of an Arbitral Tribunal by reassessing or reappreciating the evidence. An award can be challenged only under the grounds mentioned in Section 34(2) of the Act. The Arbitral Tribunal has examined the facts and held that both the second respondent and the appellant are liable. The case as put forward by the first respondent has been accepted. Even the minority view was that the second respondent was liable as claimed by the first respondent, but the appellant was not liable only on the ground that the arbitrators appointed by the Stock Exchange under Bye-law 248, in a claim against a non-member, had no jurisdiction to decide a claim against another member. The finding of the majority is that the appellant did the transaction in the name of the second respondent and is therefore, liable along with the second respondent. Therefore, in the absence of any ground under Section 34(2) of the Act, it is not possible to re-examine the facts to find out whether a different decision can be arrived at."*

It is with this very important caveat that the two fundamental principles which form part of the fundamental policy of Indian law (that the arbitrator

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Very often an arbitrator is a lay person not necessarily trained in law. Lord Mansfield, a famous English Judge, once advised a high military officer in Jamaica who needed to act as a Judge as follows:

> "General, you have a sound head, and a good heart; take courage and you will do very well, in your occupation, in a court of equity. My advice is, to make your decrees as your head and your heart dictate, to hear both sides patiently, to decide with firmness in the best manner you can; but be careful not to assign your reasons, since your determination may be substantially right, although your reasons may be very bad, or essentially wrong".

It is very important to bear this in mind when awards of lay arbitrators are challenged.

must have a judicial approach and that he must not act perversely) are to be understood.

Interest of India

The next ground on which an award may be set aside is that it is contrary to the interest of India. Obviously, this concerns itself with India as a member of the world community in its relations with foreign powers. As at present advised, we need not dilate on this aspect as this ground may need to evolve on a case by case basis.

Justice

The third ground of public policy is, if an award is against justice or morality. These are two different concepts in law. An award can be said to be against justice only when it shocks the conscience of the court. An illustration of this can be given. A claimant is content with restricting his claim, let us say to Rs. 30 lakhs in a statement of claim before the arbitrator and at no point does he seek to claim anything more. The arbitral award ultimately awards him 45 lakhs without any acceptable reason or justification. Obviously, this would shock the conscience of the court and the arbitral award would be liable to be set aside on the ground that it is contrary to "justice".

Morality

The other ground is of "morality". Just as the expression "public policy" also occurs in Section 23 of the Indian Contract Act, so does the expression

"morality". Two illustrations to the said section are interesting for they explain to us the scope of the expression "morality".

> *"(j) A, who is B's Mukhtar, promises to exercise his influence, as such, with B in favour of C, and C promises to pay 1,000 rupees to A. The agreement is void, because it is immoral.*
>
> *(k) A agrees to let her daughter to hire to B for concubinage. The agreement is void, because it is immoral, though the letting may not be punishable under the Indian Penal Code (XLV of 1860)."*

In **Gherulal Parekh v. Mahadeo Dass Maiya,** 1959 Supp (2) SCR 406, this Court explained the concept of "morality" thus-

> *"Re. Point 3 - Immorality: The argument under this head is rather broadly stated by the learned Counsel for the appellant. The learned counsel attempts to draw an analogy from the Hindu Law relating to the doctrine of pious obligation of sons to discharge their father's debts and contends that what the Hindu Law considers to be immoral in that context may appropriately be applied to a case under s. 23 of the Contract Act. Neither any authority is cited nor any legal basis is suggested for importing the doctrine of Hindu Law into the domain of contracts. Section 23 of the Contract Act is inspired by the common law of England and it would be more useful to refer to the English Law than to the Hindu Law texts dealing with a different matter. Anson in his Law of Contracts states at p. 222 thus:*
>
> *"The only aspect of immorality with which Courts of Law have dealt is sexual immorality..... ."*
>
> *Halsbury in his Laws of England, 3rd Edn., Vol. 8, makes a similar statement, at p. 138 :*
>
> *"A contract which is made upon an immoral consideration or for an immoral purpose is unenforceable, and there is no distinction in this respect between immoral and illegal contracts. The immorality here alluded to is sexual immorality."*
>
> *In the Law of Contract by Cheshire and Fifoot, 3rd Edn., it is stated at p. 279:*

"Although Lord Mansfield laid it down that a contract contra bonos mores is illegal, the law in this connection gives no extended meaning to morality, but concerns itself only with what is sexually reprehensible."

In the book on the Indian Contract Act by Pollock and Mulla it is stated at p. 157:

"The epithet "immoral" points, in legal usage, to conduct or purposes which the State, though disapproving them, is unable, or not advised, to visit with direct punishment."

The learned authors confined its operation to acts which are considered to be immoral according to the standards of immorality approved by Courts. The case law both in England and India confines the operation of the doctrine to sexual immorality. To cite only some instances: settlements in consideration of concubinage, contracts of sale or hire of things to be used in a brothel or by a prostitute for purposes incidental to her profession, agreements to pay money for future illicit cohabitation, promises in regard to marriage for consideration, or contracts facilitating divorce are all held to be void on the ground that the object is immoral.

The word "immoral" is a very comprehensive word. Ordinarily it takes in every aspect of personal conduct deviating from the standard norms of life. It may also be said that what is repugnant to good conscience is immoral. Its varying content depends upon time, place and the stage of civilization of a particular society. In short, no universal standard can be laid down and any law based on such fluid concept defeats its own purpose. The provisions of S. 23 of the Contract Act indicate the legislative intention to give it a restricted meaning. Its juxtaposition with an equally illusive concept, public policy, indicates that it is used in a restricted sense; otherwise there would be overlapping of the two concepts. In its wide sense what is immoral may be against public policy, for public policy covers political, social and economic ground of objection. Decided cases and authoritative text-book writers, therefore, confined it, with every justification, only to sexual immorality. The other limitation imposed on the word by the statute, namely, "the court regards it as immoral", brings out the idea that it is also a branch of the common law like the doctrine of public policy, and, therefore, should be confined to the principles recognized and settled by Courts. Precedents confine the said concept only to sexual immorality and no case has been brought to our notice where it

has been applied to any head other than sexual immorality. In the circumstances, we cannot evolve a new head so as to bring in wagers within its fold."

This Court has confined morality to sexual morality so far as section 23 of the Contract Act is concerned, which in the context of an arbitral award would mean the enforcement of an award say for specific performance of a contract involving prostitution. "Morality" would, if it is to go beyond sexual morality necessarily cover such agreements as are not illegal but would not be enforced given the prevailing mores of the day. However, interference on this ground would also be only if something shocks the court's conscience.

Patent Illegality

We now come to the fourth head of public policy namely, patent illegality. It must be remembered that under the explanation to section 34 (2) (b), an award is said to be in conflict with the public policy of India if the making of the award was induced or affected by fraud or corruption. This ground is perhaps the earliest ground on which courts in England set aside awards under English law. Added to this ground (in 1802) is the ground that an arbitral award would be set aside if there were an error of law by the arbitrator. This is explained by Lord Justice Denning in **R v. Northumberland Compensation Appeal Tribunal. Ex Parte Shaw.,** 1952 1 All ER 122 at page 130:

"Leaving now the statutory tribunals, I turn to the awards of the arbitrators. The Court of King's Bench never interfered by certiorari with the award of an arbitrator, because it was a

private tribunal and not subject to the prerogative writs. If the award was not made a rule of court, the only course available to an aggrieved party was to resist an action on the award or to file a bill in equity. If the award was made a rule of court, a motion could be made to the court to set it aside for misconduct of the arbitrator on the ground that it was procured by corruption or other undue means: see the statute 9 and 10 Will. III, c. 15. At one time an award could not be upset on the ground of error of law by the arbitrator because that could not be said to be misconduct or undue means, but ultimately it was held in Kent v. Elstob, (1802) 3 East 18, that an award could be set aside for error of law on the face of it. This was regretted by Williams, J., in Hodgkinson v. Fernie, (1857) 3 C.B.N.S. 189, but is now well established."

This, in turn, led to the famous principle laid down in **Champsey Bhara Company v. The Jivraj Balloo Spinning and Weaving Company Ltd.,** AIR 1923 PC 66, where the Privy Council referred to **Hodgkinson** and then laid down:

"The law on the subject has never been more clearly stated than by Williams, J. in the case of Hodgkinson v. Fernie (1857) 3 C.B.N.S. 189.

"The law has for many years been settled, and remains so at this day, that, where a cause or matters in difference are referred to an arbitrator a lawyer or a layman, he is constituted the sole and final judge of all questions both of law and of fact …… The only exceptions to that rule are cases where the award is the result of corruption or fraud, and one other, which though it is to be regretted, is now, I think firmly established viz., where the question of law necessarily arises on the face of the award or upon some paper accompanying and forming part of the award. Though the propriety of this latter may very well be doubted, I think it may be considered as established."

"Now the regret expressed by Williams, J. in Hodgkinson v. Fernie has been repeated by more than one learned Judge, and it is certainly not to be desired that the exception should be in any way extended. An error in law on the face of the award means, in their Lordships' view, that you can find in the award or a

document actually incorporated thereto, as for instance, a note appended by the arbitrator stating the reasons for his judgment, some legal proposition which is the basis of the award and which you can then say is erroneous. It does not mean that if in a narrative a reference is made to a contention of one party that opens the door to seeing first what that contention is, and then going to the contract on which the parties' rights depend to see if that contention is sound. Here it is impossible to say, from what is shown on the face of the award, what mistake the arbitrators made. The only way that the learned judges have arrived at finding what the mistake was is by saying: "Inasmuch as the Arbitrators awarded so and so, and inasmuch as the letter shows that then buyer rejected the cotton, the arbitrators can only have arrived at that result by totally misinterpreting Cl.52." But they were entitled to give their own interpretation to Cl. 52 or any other article, and the award will stand unless, on the face of it they have tied themselves down to some special legal proposition which then, when examined, appears to be unsound. Upon this point, therefore, their Lordships think that the judgment of Pratt, J was right and the conclusion of the learned Judges of the Court of Appeal erroneous."

This judgment has been consistently followed in India to test awards under Section 30 of the Arbitration Act, 1940.

In the 1996 Act, this principle is substituted by the 'patent illegality' principle which, in turn, contains three sub heads -

(a) a contravention of the substantive law of India would result in the death knell of an arbitral award. This must be understood in the sense that such illegality must go to the root of the matter and cannot be of a trivial nature. This again is a really a contravention of Section 28(1)(a) of the Act, which reads as under:

> ***"28. Rules applicable to substance of dispute**.—(1) Where the place of arbitration is situated in India,—*
>
> *(a) in an arbitration other than an international commercial arbitration, the arbitral tribunal shall decide the dispute submitted to arbitration in accordance with the substantive law for the time being in force in India;"*

(b) a contravention of the Arbitration Act itself would be regarded as a patent illegality- for example if an arbitrator gives no reasons for an award in contravention of section 31(3) of the Act, such award will be liable to be set aside.

(c) Equally, the third sub-head of patent illegality is really a contravention of Section 28 (3) of the Arbitration Act, which reads as under:

> ***"28. Rules applicable to substance of dispute**.— (3) In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction."*

This last contravention must be understood with a caveat. An arbitral tribunal must decide in accordance with the terms of the contract, but if an arbitrator construes a term of the contract in a reasonable manner, it will not mean that the award can be set aside on this ground. Construction of the terms of a contract is primarily for an arbitrator to decide unless the arbitrator construes the contract in such a way that it could be said to be something that no fair minded or reasonable person could do.

In **McDermott International Inc. v. Burn Standard Co. Ltd.,** (2006) 11 SCC 181, this Court held as under:

"112. *It is trite that the terms of the contract can be express or implied. The conduct of the parties would also be a relevant factor in the matter of construction of a contract. The construction of the contract agreement is within the jurisdiction of the arbitrators having regard to the wide nature, scope and ambit of the arbitration agreement and they cannot be said to have misdirected themselves in passing the award by taking into consideration the conduct of the parties. It is also trite that correspondences exchanged by the parties are required to be taken into consideration for the purpose of construction of a contract. Interpretation of a contract is a matter for the arbitrator to determine, even if it gives rise to determination of a question of law. (See Pure Helium India (P) Ltd. v. ONGC [(2003) 8 SCC 593] and D.D. Sharma v. Union of India [(2004) 5 SCC 325]).*

113. *Once, thus, it is held that the arbitrator had the jurisdiction, no further question shall be raised and the court will not exercise its jurisdiction unless it is found that there exists any bar on the face of the award."*

In **MSK Projects (I) (JV) Ltd. v. State of Rajasthan,** (2011) 10 SCC 573, the Court held:

"17. *If the arbitrator commits an error in the construction of the contract, that is an error within his jurisdiction. But if he wanders outside the contract and deals with matters not allotted to him, he commits a jurisdictional error. Extrinsic evidence is admissible in such cases because the dispute is not something which arises under or in relation to the contract or dependent on the construction of the contract or to be determined within the award. The ambiguity of the award can, in such cases, be resolved by admitting extrinsic evidence. The rationale of this rule is that the nature of the dispute is something which has to be determined outside and independent of what appears in the award. Such a jurisdictional error needs to be proved by evidence extrinsic to the award. (See Gobardhan Das v. Lachhmi Ram [AIR 1954 SC 689], Thawardas Pherumal v. Union of India [AIR 1955 SC 468], Union of India v. Kishorilal Gupta & Bros. [AIR 1959 SC 1362], Alopi Parshad & Sons Ltd. v. Union of India [AIR 1960 SC 588], Jivarajbhai Ujamshi Sheth v. Chintamanrao Balaji [AIR 1965 SC 214] and Renusagar Power Co. Ltd. v. General Electric Co. [(1984) 4 SCC 679 : AIR 1985 SC 1156])."*

In **Rashtriya Ispat Nigam Ltd. v. Dewan Chand Ram Saran,** (2012) 5 SCC 306, the Court held:

> ***"43.*** *In any case, assuming that Clause 9.3 was capable of two interpretations, the view taken by the arbitrator was clearly a possible if not a plausible one. It is not possible to say that the arbitrator had travelled outside his jurisdiction, or that the view taken by him was against the terms of contract. That being the position, the High Court had no reason to interfere with the award and substitute its view in place of the interpretation accepted by the arbitrator.*
>
> ***44.*** *The legal position in this behalf has been summarised in para 18 of the judgment of this Court in SAIL v. Gupta Brother Steel Tubes Ltd. [(2009) 10 SCC 63: (2009) 4 SCC (Civ) 16] and which has been referred to above. Similar view has been taken later in Sumitomo Heavy Industries Ltd. v. ONGC Ltd. [(2010) 11 SCC 296: (2010) 4 SCC (Civ) 459] to which one of us (Gokhale, J.) was a party. The observations in para 43 thereof are instructive in this behalf.*
>
> ***45.*** *This para 43 reads as follows: (Sumitomo case [(2010) 11 SCC 296 : (2010) 4 SCC (Civ) 459] , SCC p. 313)*
>
> > *"43. … The umpire has considered the fact situation and placed a construction on the clauses of the agreement which according to him was the correct one. One may at the highest say that one would have preferred another construction of Clause 17.3 but that cannot make the award in any way perverse. Nor can one substitute one's own view in such a situation, in place of the one taken by the umpire, which would amount to sitting in appeal. As held by this Court in Kwality Mfg. Corpn. v. Central Warehousing Corpn. [(2009) 5 SCC 142 : (2009) 2 SCC (Civ) 406] the Court while considering challenge to arbitral award does not sit in appeal over the findings and decision of the arbitrator, which is what the High Court has practically done in this matter. The umpire is legitimately entitled to take the view which he holds to be the correct one after considering the material before him and after interpreting the provisions of the*

agreement. If he does so, the decision of the umpire has to be accepted as final and binding."

13. Applying the tests laid down by this Court, we have to examine whether the Division Bench has exceeded its jurisdiction in setting aside the arbitral award impugned before it.

14. A large part of the judgment is an extract from the arbitral award. It is important to note that the Division Bench held:

> *"9. A perusal of the award would reveal, from the portions extracted herein above, that with reference to evidence led before him the learned Arbitrator has held delay attributable to DDA, a finding of fact which is based on evidence and rightly conceded to by Sh. Bhupesh Narula, Advocate who appears for DDA as being beyond judicial review power of this Court pertaining to a reasoned award. But, while awarding Rs.8,27,960/- the reasoning adopted by the learned Arbitrator is questioned as being the result of ignoring the well-recognized legal principles on the subject, Learned counsel argued that the reasoning is the ipse dixit of the learned Arbitrator."*

15. The Division Bench while considering claims 9, 10, 11 and 15 found fault with the application of Hudson's formula which was set out by the learned Arbitrator in order to arrive at the claim made under these heads. The Division Bench said that it was not possible for an Arbitrator to mechanically apply a certain formula however well understood in the trade. This itself is going outside the jurisdiction to set aside an award under Section 34 in as much as in **McDermott's** case (supra), it was held:

"104. *It is not in dispute that MII had examined one Mr D.J. Parson to prove the said claim. The said witness calculated the increased overheads and loss of profit on the basis of the formula laid down in a manual published by the Mechanical Contractors Association of America entitled "Change Orders, Overtime, Productivity" commonly known as the Emden Formula. The said formula is said to be widely accepted in construction contracts for computing increased overheads and loss of profit. Mr D.J. Parson is said to have brought out the additional project management cost at US$ 1,109,500. We may at this juncture notice the different formulas applicable in this behalf.*

(a) Hudson Formula: In Hudson's Building and Engineering Contracts, Hudson Formula is stated in the following terms:

$$\text{"Contract head office overhead and profit percentage"} \times \frac{\text{Contract sum}}{\text{Contract period}} \times \text{Period of delay"}$$

In the Hudson Formula, the head office overhead percentage is taken from the contract. Although the Hudson Formula has received judicial support in many cases, it has been criticised principally because it adopts the head office overhead percentage from the contract as the factor for calculating the costs, and this may bear little or no relation to the actual head office costs of the contractor.

(b) Emden Formula: In Emden's Building Contracts and Practice, the Emden Formula is stated in the following terms:

$$\frac{\text{"Head office overhead and profit}}{100} \times \frac{\text{Contract sum}}{\text{Contract period}} \times \text{Period of delay"}$$

Using the Emden Formula, the head office overhead percentage is arrived at by dividing the total overhead cost and profit of the contractor's organisation as a whole by the total turnover. This formula has the advantage of using the contractor's actual head office overhead and profit percentage rather than those contained in the contract. This formula has been widely applied and has received judicial support in a number of cases including Norwest

Holst Construction Ltd. v. Coop. Wholesale Society Ltd. [Decided on 17-2-1998, [1998] EWHC Technology 339], Beechwood Development Co. (Scotland) Ltd. v. Mitchell [Decided on 21-2-2001, (2001) CILL 1727] and Harvey Shopfitters Ltd. v. Adi Ltd. [Decided on 6-3-2003, (2004) 2 All ER 982 : [2003] EWCA Civ 1757].

(c) Eichleay Formula: The Eichleay Formula was evolved in America and derives its name from a case heard by the Armed Services Board of Contract Appeals, Eichleay Corporation. It is applied in the following manner:

Step 1

$$\frac{\text{Contract billings}}{\text{Total billings for contract period}} \times \text{Total overhead for contract period} = \text{Overhead allocable to the contract}$$

Step 2

$$\frac{\text{Allocable overhead}}{\text{Total days of contract}} = \text{Daily overhead rate}$$

Step 3

$$\text{Daily contract overhead rate} \times \text{Number of days of delay} = \text{Amount of unabsorbed overhead”}$$

This formula is used where it is not possible to prove loss of opportunity and the claim is based on actual cost. It can be seen from the formula that the total head office overhead during the contract period is first determined by comparing the value of work carried out in the contract period for the project with the value of work carried out by the contractor as a whole for the contract period. A share of head office overheads for the contractor is allocated in the same ratio and expressed as a lump sum to the particular contract. The amount of head office overhead allocated to the particular contract is then expressed as

a weekly amount by dividing it by the contract period. The period of delay is then multiplied by the weekly amount to give the total sum claimed. The Eichleay Formula is regarded by the Federal Circuit Courts of America as the exclusive means for compensating a contractor for overhead expenses.

105. *Before us several American decisions have been referred to by Mr. Dipankar Gupta in aid of his submission that the Emden Formula has since been widely accepted by the American courts being Nicon Inc. v. United States [Decided on 10-6-2003 (USCA Fed Cir), 331 F. 3d 878 (Fed. Cir. 2003)], Gladwynne Construction Co. v. Mayor and City Council of Baltimore [Decided on 25-9-2002, 807 A. 2d 1141 (2002) : 147 Md. App. 149] and Charles G. William Construction Inc. v. White [271 F 3d 1055 (Fed. Cir. 2001)].*

106. *We do not intend to delve deep into the matter as it is an accepted position that different formulae can be applied in different circumstances and the question as to whether damages should be computed by taking recourse to one or the other formula, having regard to the facts and circumstances of a particular case, would eminently fall within the domain of the arbitrator."*

16. Obviously, the Division Bench has exceeded its jurisdiction in interfering with a possible view of the Arbitrator on facts.

17. The Division Bench then went on to hold:

"17. There is admittedly no evidence that the contractor i.e. the respondent had a central establishment. It appears to be a case where the contractor is petty contractor and the only expenses incurred are at the site. The claim is towards hire charges paid for centering and shuttering, hiring tools, plants and scaffoldings i.e. the claim is not for the contractor's own equipment lying idle. There is just no evidence that the contractor paid charges as claimed by him. Not a single bill raised by the alleged person who let on hire the equipment to the contractor has been filed nor any evidence adduced for the payment made. Except for listing a 10 HP Water Pump, 4 number 1 HP water pump, 3 mixers, 250 scaffolding bamboos, 150 ballis and 2 vibrators in Annexure-J to the Statement of Claim, no document proving hiring the same and

brought at the site has been led. We highlight that the claim is on account of hire Charges paid and there is no evidence of said payment. It does happen that where a work is stopped, the person who taken an equipment on hire returns the same and re-hires the same when work recommences. Thus, Claim No. 9, 10 and 11 cannot be allowed because there is no evidence to support the claims. Damages on account of establishment expenses incurred during period contract got prolonged have certainly to be recompensed, but we find no evidence in the form of books of accounts, vouchers etc. to show payments to the staff or expenses incurred in maintaining an establishment at site in the form of a site office. The wages register, photocopy whereof was filed before the Arbitrator, pertains to wages paid to the unskilled, semi-skilled and skilled labour deployed to execute the works. The pleadings pertaining to the claim would show that as per the contractor he had deployed one Executive Officer, one Graduate Engineer, one Junior Engineer, one Accountant, one Storekeeper and Supervisor and one Mechanic at the site and had also deployed watch and ward. Details of the persons employed have been listed in Annexure-N to the Statement of Claim and the documents filed to establish the same would evidence that the contractor has filed photocopies of the salary register, which are available from pages No.1255 to 1322, but unfortunately for the contractor, the cat is out of the bag when we look at the documents. They pertain to payments made for a site at Mayur Vihar. We highlight that the contract in question pertains to flats and houses at Trilokpuri and not Mayur Vihar. It is apparent that the contractor has tried to pull the wool on the eyes of the primary adjudicator of the claim. It is not the case of the contractor that these persons were simultaneously supervising the work at two sites. Assuming this was the case, the matter would then have been adjudicated with reference to same number of persons supervising two sites and the time spent at each site by them.

18. Thus, the award pertaining to Claim Nos. 9, 10, 11 and 15 is liable to be sent aside and it is so set aside. We need not therefore take corrective action on the apparent error i.e. the learned Arbitrator has worked out the claim on the original contract value of Rs. 87,66,678/-, of course by reducing it by 15%, but ignoring that final work executed was only in sum of Rs.62,84,845/-."

18. Mr. Verma argued correctly that there is nothing on record to show that the contractor is a petty contractor and that the only expenses incurred are at the site. He has shown us that the contract itself required execution of the work by a Class-I contractor and has further shown us that Class-I contractors require to have certain stipulated numbers of works worth large amounts before they can apply for the tender and that their financial soundness has to be attested too by banker's certificate showing that their worth is over 10 crores of rupees. Further, he has pointed out from the statement of claims before the Arbitrator that there was evidence for claims 9, 10 and 11 laid before the Arbitrator which the Arbitrator has in fact accepted. Also establishment expenses were set out in great detail before the Arbitrator and it is only on this evidence that the Arbitrator ultimately has awarded these claims. Mr. Verma is also right in saying that the Division Bench was completely wrong in stating that the establishment expenses pertained to payments for a site at Mayur Vihar as opposed to Trilok Puri which were where the aforesaid houses were to be constructed. He pointed out that in the completion certificate dated 30th May, 1997 given by the DDA to the appellant, it is clear that the houses that were, in fact, to be constructed were in Mayur Vihar, Phase-II, which is part of the Trilok Puri trans-Yamuna area.

It is most unfortunate that the Division Bench did not advert to this crucial document at all. This document shows not only that the Division Bench was wholly incorrect in its conclusion that the contractor has tried to

pull the wool over the eyes over the DDA but it should also have realized that the DDA itself has stated that the work has been carried out generally to its satisfaction barring some extremely minor defects which are capable of rectification. It is clear, therefore, that the Division Bench obviously exceeded its jurisdiction in interfering with a pure finding of fact forgetting that the Arbitrator is the sole Judge of the quantity and quality of evidence before him and unnecessarily bringing in facts which were neither pleaded nor proved and ignoring the vital completion certificate granted by the DDA itself. The Division Bench also went wrong in stating that as the work completed was only to the extent of Rs. 62,84,845/-, Hudson's formula should have been applied taking this figure into account and not the entire contract value of Rs.87,66,678/- into account.

19. Here again, the Division Bench has committed a grave error. Hudson's formula as is quoted in **McDermott's** case is as follows:

> *"(a) Hudson Formula: In Hudson's Building and Engineering Contracts, Hudson Formula is stated in the following terms:*
>
> $$\text{"Contract head office overhead and profit percentage"} \times \frac{\text{Contract sum}}{\text{Contract period}} \times \text{Period of delay"}$$
>
> *In the Hudson Formula, the head office overhead percentage is taken from the contract. Although the Hudson Formula has received judicial support in many cases, it has been criticised principally because it adopts the head office overhead percentage from the contract as the factor for calculating the costs, and this may bear little or no relation to the actual head office costs of the contractor."*

20. It is clear that to apply this formula one has to take into account the contract value that is awarded and not the work completed. On this score again, the Division Bench is to be faulted.

21. In dealing with claims 12 and 13, the Division Bench stated:

> *"19. Pertaining to Claim No.12 and 13, the learned Arbitrator has recompensed the contractor 20% price hike in the cost of material and labour noting, that there was a steep hike in the period in question when the contract got prolonged by 25 months. We highlight that though the Arbitrator has found the delay to be 25 months, recompense has been restricted to only 20 months.*
>
> *20. As noted herein above, partial recompense under Clause 10C, has been granted to the contractor, but the same i.e. the Clause in question requiring applicability during contract stipulated period, it is apparent that the contractor would be entitled to full recompense for price hike during the extended 25 months period and not the 20 months to which the learned Arbitrator has restricted the recompense to.*
>
> *21. But, for the benefit granted under Clause 10C wherein Rs. 1,62,387/-, Rs.46,184/- and Rs.12,922/- have been awarded under Claim Nos. 2, 3 and 4, said amounts have to be adjusted, but not in full, for the reason these include the amounts payable during the contract stipulated period.*
>
> *22. The total of the three sums comes to Rs, 2, 21,493/-. We have another problem. Neither counsel could help us identify the components thereof i.e. the component relatable to the 9 months during which the work had to be completed and the 25 months during which the contract got prolonged. Thus, we apply the Rule of 'Rough and Ready Justice'. We divide the sum by 34 to work out the proportionate increase per month. Rs. 2,21,493/- divided by 34 = Rs.6,514.50 and multiplying the same by 25, the figure comes to Rs.1,62,862.50.*
>
> *23. Adopting, for the reasons given by the Arbitrator, that 20% hike in the balance work done after the contract stipulated period i.e. benefit to be granted under this head for work done in sum of Rs.37,02,066/- and accepting the sum of Rs.7,20,000/- being the*

resultant figure, subtracting Rs.1,62,862.50, the figure arrived at is Rs.5,57,137.50."

22. Here again, the Division Bench has interfered wrongly with the arbitral award on several counts. It had no business to enter into a pure question of fact to set aside the Arbitrator for having applied a formula of 20 months instead of 25 months. Though this would inure in favour of the appellant, it is clear that the appellant did not file any cross objection on this score. Also, it is extremely curious that the Division Bench found that an adjustment would have to be made with claims awarded under claims 2, 3 and 4 which are entirely separate and independent claims and have nothing to do with claims 12 and 13. The formula then applied by the Division Bench was that it would itself do "rough and ready justice". We are at a complete loss to understand how this can be done by any court under the jurisdiction exercised under Section 34 of the Arbitration Act. As has been held above, the expression "justice" when it comes to setting aside an award under the public policy ground can only mean that an award shocks the conscience of the court. It cannot possibly include what the court thinks is unjust on the facts of a case for which it then seeks to substitute its view for the Arbitrator's view and does what it considers to be "justice". With great respect to the Division Bench, the whole approach to setting aside arbitral awards is incorrect. The Division Bench has lost sight of the fact that it is not a first appellate court and cannot interfere with errors of fact.

23. We come now to the arguments of Mr. Sharan in support of the Division Bench judgment. The learned counsel strongly relied on clause 10C and clause 22. These two clauses are set out as below:

Clause 10C of the agreement reads as follows:

> *"If during the progress of the works, the price of any material incorporated in the works, (not being a material supplied from the Engineer-in-Charge's stores in accordance with Clause 10 hereof and/or wages of labour increases as direct result of the coming into force of any fresh law, or statutory rule or order (but not due to any changes in sales tax) and such increase exceed ten per cent of the price and/or wages prevailing at the time of receipt of the tender for the work, and contractor thereupon necessarily and properly pays in respect of the material (incorporated in the work) such increased price and/or in respect of labour engaged on the execution of the work such increased wages, then the amount of the contract shall accordingly be varied provided always that any increase so payable is not, in the opinion of the Superintending Engineer (whose decision shall be final and binding) attributable to delay in execution of the contract within the control of the contractor. Provided, however, no reimbursements shall be made if the increase is not more than 10% of the said prices/wages and if so the reimbursements shall be made only on the excess over 10% and provided further that any such increase shall not be payable if such increase has become operative after the contract or extended date of completion of the work in question.*
>
> *If during the progress of the works, the price of any material incorporated in the works (not being a material supplied from the Engineer-in-Charge's stores in accordance with Clause 10 hereof) and/or wages of labour is decreased as a direct result of the coming into force of any fresh law or statutory rule or order (but not due to any changes in sales tax) and such decrease exceeds ten per cent of the prices and/or wages prevailing at the time of receipt of the tender for the work, Delhi Development Authority shall in respect of materials incorporated in the work (not being materials supplied from the Engineer-in-Charge's stores in accordance with Clause 10 hereof) and/or labour engaged on the execution of the work after the date of coming into force of such law, statutory rule or order be entitled to deduct from the dues of*

the contractor such amount as shall be equivalent of difference between the prices of materials and/ or wages as they prevailed at the time of receipt of tender for the work minus ten per cent thereof and the prices of materials and/ or wages of labour on the coming into force of such law, statutory rule or order.

The contractor shall for the purpose of this condition keep such books of account and other documents as are necessary to show the amount of any increase claimed or reduction available and shall allow inspection of the same by a duly authorised representative of Delhi Development Authority and further shall, at the request of the Engineer-in-Charge furnish, verified in such a manner as the Engineer-in-Charge may require. Any document, so kept and such other information as the Engineer-in-Charge may require.

The contractor shall, within a reasonable time of his becoming aware of any alteration in the prices of any such materials and/ or wages of labour give notice thereof to the Engineer-in- Charge stating that the same is given in pursuance to the condition together with all information relating thereto which he may be in a position to supply."

Clause 22 reads as follows:

"All sums payable by way of compensations under any of these conditions shall be, considered as reasonable compensation to be applied to this use of Delhi Development Authority without reference to the actual loss or damage sustained, and whether or not any damage shall have been sustained.

<u>Specifications and Conditions</u>:

1. The contractor must get acquainted with the proposed site for the works and study specifications and conditions carefully before tendering. The work shall be executed as per programme approved by the Engineer-in-Charge. If part of site is not available for any reasons or there is some unavoidable delay in supply of materials stipulated by the Departments, the programme of construction shall be modified accordingly and the contractor shall have no claim for any extras or compensation on this account."

24. Clause 10C concerns itself with the price of material incorporated in the works or wage or labour increases. It has been seen that claims 9, 10 and 11 have nothing to do with either of the aforesaid subjects. In seeking to apply this clause to claim 15, the simple answer is that this clause will not apply when a claim for damages is made. Further, the Arbitrator considered this clause in detail and only awarded amounts under this clause in excess of 10 percent as required by the clause when it came to awarding amounts under claims 2, 3 and 4, which fell within the ambit of clause 10C. The DDA in the appeal before the Division Bench correctly gave up any challenge to these claims as has been recorded in paragraph 4 of the order under appeal.

25. The Arbitrator has dealt with this clause in detail and has construed and applied the same correctly while dealing with claims 2, 3 and 4 and has obviously not applied the said clause to claims 9, 10, 11 and 15 as no occasion for applying the same arose. The award cannot be faulted on this ground.

26. Also, so far as clause 22 is concerned, the DDA did not raise any argument based on this clause before the learned Arbitrator. However, it must in fairness be stated that it was argued before the learned Single Judge. In para 15 of his judgment, the learned Judge sets the clause out and then follows a judgment of the High Court of Delhi in **Kochhar Construction Works v. DDA & Anr.**, (1998) 2 Arb. LR 209. Apart from the fact that a learned Single Judge of the same court is bound by a previous judgment of a Single Judge, the conclusion of the learned Single Judge that if the appellant is at fault and the

contract is prolonged for an inordinate period of time, it cannot be said that the respondents cannot be compensated for the same is correct. Besides, this point was not urged before the Division Bench and must be taken to be given up. Mr. Sharan cited **Harsha Constructions v. Union of India & Ors.,** (2014) 9 SCC 246 to say that in respect of excepted matters, no arbitration is possible, and that this being a jurisdictional point, he should be allowed to raise it before us. Unfortunately for Mr. Sharan, the clause does not operate automatically. It only operates if an objection is taken stating that part of the site is not available for any reason. Nowhere has the DDA stated which part of the site is not available for any reason. Further, the learned Single Judge's reason for rejecting an argument based on this clause also commends itself to us as the object of this clause is that no claim for extras should be granted only if there is an unavoidable delay. We have seen that the delay was entirely avoidable and caused solely by the DDA itself.

27. One more point needs to be noted. An argument was made before the learned Single Judge that there has been a duplication of claims awarded. The learned Judge dealt with this argument as follows:

> *"18. Learned counsel for the petitioner in respect of ground P, once again makes a reference to the issue that there is overlapping of the claim. I am unable to accept the submission made by the learned counsel. The consequence of delay may have more than one ramifications including the cost of material the supervision required at the site, the inability of the contractor to utilise the manpower at some other place, the inability of the contractor to make, profits from some other contract by utilisation of the same resources. All these aspects are liable to be*

considered. The Arbitrator has considered the claims separately and has dealt with, claims 9, 10, 11 & 15 together. Claims 12 & 13 have been thereafter dealt with on the same principles since it was found that it was not the respondent, who was responsible for the delay for a period of 25 months beyond the stipulated condition of 9 months.

19. There is thus no question of overlapping in different heads and the grievance of the petitioner is rejected."

28. The Single Judge is clearly right. We have gone through all the 15 claims supplied to us and we find that none of these claims are in fact overlapping. They are all contained under separate heads. This argument, therefore, must also fail.

29. The appeal is, therefore, allowed and the judgment of the Division Bench is set aside. The judgment of the Single Judge is upheld and consequently, the Arbitral award dated 23rd May, 2005 is as a whole upheld. There will be no order as to costs.

.....J.
(Ranjan Gogoi)

……..J.
(R.F. Nariman)

New Delhi,
November 25, 2014