

**IN THE SUPREME COURT OF INDIA**

Civil Appeal No. 4806 of 2000

Decided On: 30.11.2006

(From the Judgment and Order dated 31.7.1998 of the High Court of Kerala at Ernakulam in M.F.A. No. 980/1990 C)

Appellants: **K.N. Sathyapalan (Dead) by LRs.**

**Vs.**

Respondent: **State of Kerala and Anr.**

**Hon'ble**

AR. Lakshmanan and Altamas Kabir, JJ.

**Judges:**

**Counsels:**

For Appellant/Petitioner/Plaintiff: Dushyant Dave, Sr. Adv., M.K. Chandra Mohan Das, M.N. Nandarajan, Ramesh Singh and Syed Shahid Hussain Rizvi, Advs.

For Respondents/Defendant: Jayanth Muth Raj and P.V. Dinesh, Advs.

**Subject: Arbitration**

**Acts/Rules/Orders:**

Arbitration Act - Sections 5, 17 and 30

**Cases**

**Referred:**

P.M. Paul v. Union of India 1989 Supp.(1) SCC 368; T.P. George v. State of Kerala and anr. (2001) 2 SCC 758; Alopri Parshad & Sons Limited v. The Union of India [MANU/SC/0057/1960](#); State of U.P. v. Patel Engg. Co. Ltd. and Ors. reported in (2004) 10 SCC 566

**Equivalent Citation:** 2006(4)ARBLR275(SC), [2007(2)JCR9(SC)], JT2006(10)SC615, 2006(12)SCALE654

**Disposition:**

Appeal allowed

**Case**

**Note:**

**Arbitration — Arbitrator — Jurisdiction of —Appellant-contractor was awarded contract of construction — Due to disruption, construction could not be completed within time and a supplemental agreement was signed between Appellant and Respondent extending time of contract — Disputes arose between parties and matter was referred to Arbitrator — Arbitrator passed award allowing claims of Appellant on account of interruption of work, price escalation of materials, losses purported to have been suffered by Appellant due to inability of department to hand over a suitable quarry and losses due to non-availability of a suitable dumping yard — High Court held that Arbitrator had traveled outside contract in granting claims of Appellant — High Court allowed claim of Appellant regarding non-availability of suitable dumping yard and disallowed other claims made by Appellant — Hence present appeal — Held, Ordinarily, parties would be bound by terms agreed upon in contract, but in event one of parties to contract is unable to fulfil its obligations under**

contract which has a direct bearing on work to be executed by other party, Arbitrator is vested with authority to compensate second party for extra costs incurred by him as a result of failure of first party to live up to its obligations — Respondent failed to control antisocial elements and that prevented Appellant from completing the work within stipulated time — Further, Appellant was forced obtain rubble and metal from far away place as same was not available in Government quarry and Appellant was also forced to dump excess earth in far away place resulting increase in the transportation cost — Arbitrator acted within his jurisdiction in allowing claims on account of escalation of costs— Appeal allowed

#### Ratio

#### Decidendi:

*"Ordinarily, parties would be bound by terms agreed upon in contract, but in event one of parties to contract is unable to fulfil its obligations under contract which has a direct bearing on work to be executed by other party, Arbitrator is vested with authority to compensate second party for extra costs incurred by him as a result of failure of first party to live up to its obligations."*

### JUDGMENT

**Altamas Kabir, J.**

1. The appellant entered into an agreement with the State of Kerala on 10<sup>th</sup> October, 1985 whereunder he was entrusted with the construction work of the Chavara Distributory from Ch.7440M to 9440M and 10475M to 14767M. Page 5273 Disputes having arisen between the parties, the matter was referred to arbitration. The Superintending Engineer, Siruvani Project, Palghat, the designated Arbitrator in terms of the contract, was appointed as the sole Arbitrator. By his award, which was published on 2<sup>nd</sup> September, 1989, the Arbitrator awarded a total sum of Rs. 42,21,000/- with 12% interest per annum from the date of the award. Upon the passing of the award the appellant herein filed O.P. (Arb.) 40/89 in the court below under Section 17 of the Arbitration Act for passing a decree in terms of the award. The State of Kerala filed a petition under Section 30 of the Act challenging the award and for setting aside the same. The application filed by the State was dismissed and aggrieved thereby the State of Kerala preferred an appeal in the High Court of Kerala at Ernakulam, being MFA No. 980 of 1990 C.

2. The appellant herein raised claims under 12 different heads but the Arbitrator allowed only claims (a), (e), (g), (i) and (k). Although, in the memorandum of appeal, the entire award in favour of the appellant had been challenged, but the arguments were addressed only with regard to claims under heads (a), (g), (i) and (k). A preliminary objection was raised in the appeal that the Superintending Engineer, who had been appointed as the Arbitrator and had entered on the reference, had been suspended from service for gross mal-practice, and the Government had informed all concerned that the Arbitrator was not to continue with the reference. The Arbitrator retired on superannuation while he was under suspension and the award was made after his retirement. According to the State of Kerala, in the circumstances, the award passed by the Arbitrator was without jurisdiction. The aforesaid objection being preliminary in nature, the same was taken up first for consideration and it was held by the High Court that such an objection was without any merit. The Arbitrator, who was working as Superintending Engineer was placed under suspension on 31<sup>st</sup> May, 1989. As per an agreement between the parties on 14<sup>th</sup> February, 1989, the time for making and publishing the award was extended upto 14<sup>th</sup> June, 1989. Even after the Arbitrator was suspended from service, both sides had agreed on 14<sup>th</sup> June, 1989 to extend the time further for making and publishing the award upto 14<sup>th</sup> October, 1989. The Arbitrator retired from service while under suspension on 30<sup>th</sup> June, 1989. In the light of the said facts, the High Court agreed that the court below could not revoke the authority of the

Arbitrator, which could only be done under Section 5 of the Arbitration Act, with the leave of the Court. Accordingly, the preliminary objection raised on behalf of the State of Kerala that the Arbitrator had no authority to continue with the arbitration after his suspension or retirement, was rejected by the High Court.

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

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Claim (g) was confined to the question as to whether the claimant was entitled to compensation for the losses suffered by him on account of price escalation of materials that had taken place during the extended period of completion when such extension of time was necessitated by departmental failure, although there was no provision for escalation of costs in the contract. Under the said clause the appellant claimed an amount of Rs. 39,90,198/- but was awarded a sum of Rs. 11,70,000/- over and above the amount as per the rates in the agreement for the work done after the original period of contract till 9<sup>th</sup> February, 1987.

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

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

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

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

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5. The appellant appears to have moved to the site and commenced the work on 1<sup>st</sup> November, 1985 but he was not allowed to proceed with the work because of external interference involving law and order problems created by local miscreants and anti-social elements under cover of union activities. Although, initially such a claim was denied on behalf of the respondents and the law and order situation was said to be only a labour dispute between the claimant and his workers, ultimately from the evidence the Arbitrator came to the finding that the issue was one of law and order which could only have been controlled by the Governmental agencies. The Arbitrator also came to a finding that in order to maintain peace at the work site, the claimant had to keep the entire local work force in the muster rolls and to pay wages when the actual work was done with bull dozers. The Arbitrator was satisfied that although the claimant had aimed to complete the work within the original period, he was faced with adverse site conditions which are not usually met with at construction sites. The Arbitrator was also satisfied with the claimant's contention that adequate space had not been provided for dumping the excess earth which had to be conveyed to distant places for dumping. On assessment of the evidence and the ground realities under which the claimant was constrained to execute the Supplemental Agreement, the Arbitrator was convinced that the claim made by the claimant under the different heads could not be brushed aside.

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

finding that the appellant had to execute the Supplemental Agreement under the force of circumstances, there was no material before the Arbitrator in support of such contention. On such finding also, the High Court held that the Arbitrator had acted beyond his jurisdiction in allowing claim (g).

10. The award of the Arbitrator against claim (i) also met the same fate and the High Court held that the Arbitrator had travelled outside the contract in granting such claim and thus mis-conducted himself. The only claim which was allowed by the High Court was claim (k). The High Court accordingly set aside the judgment and decree of the court below to the extent it affirmed the award as far as claims (a), (g) and (i) are concerned. The said order of the High Court is the subject-matter of the present appeal.

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

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

20. Ordinarily, the parties would be bound by the terms agreed upon in the contract, but in the event one of the parties to the contract is unable to fulfil Page 5279 its obligations under the contract which has a direct bearing on the work to be executed by the other party, the Arbitrator is vested with the authority to compensate the second party for the extra costs incurred by him as a result of the failure of the first party to live up to its obligations. That is the distinguishing feature of cases of this nature and M/s. Alopi Parshad's case (supra) and also Patel Engg.'s case (supra). As was pointed out by Mr. Dave, the said principle was recognized by this Court in P.M. Paul's (supra), where a reference was made to a retired Judge of this Court to fix responsibility for the delay in construction of the building and the repercussions of such delay. Based on the findings of the learned Judge, this Court gave its approval to the excess amount awarded by the arbitrator on account of increase in price of materials and costs of labour and transport during the extended period of the contract, even in the absence of any escalation clause. The said principle was reiterated by this Court in T.P. George's case (supra).

22. In the aforesaid circumstances, the Arbitrator appears to have acted within his jurisdiction in allowing some of the claims on account of escalation of costs which was referable to the execution of the work during the extended period. In our judgment, the view taken by the High Court was on a rigid interpretation of the terms of contract and the Supplemental Agreement executed between the parties, which was not warranted by the turn of events. We accordingly allow the appeal and set aside the order passed by the High Court and restore the award made by the Arbitrator. There will, however, be no order as to costs.