VERDICTUM.IN

2023INSC850

REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 1968 OF 2012

BATLIBOI ENVIRONMENTAL ENGINEERS LIMITED ..... APPELLANT

VERSUS

HINDUSTAN PETROLEUM CORPORATION LIMITED AND ANOTHER ..... RESPONDENTS

J U D G M E N T

SANJIV KHANNA, J.

This appeal by way of special leave by Batliboi Environmental Engineers Limited[1] takes exception to the judgment dated 02.11.2007, whereby the Division Bench of the High Court of Judicature at Bombay allowed the appeal[2] filed by Hindustan Petroleum Corporation Limited[3] under Section 37 of the Arbitration and Conciliation Act, 1996[4], and thereby has set aside the arbitral award dated 23.03.1999.

[1] For short, BEEL.
[2] Appeal No. 227 of 2001 in Arbitration Petition No. 280 of 1999.
[3] For short, HPCL.
[4] For short, A&C Act.

VERDICTUM.IN

2. On acceptance of tender and in terms of the letter of intent dated 27.02.1992, HPCL had awarded to BEEL the turnkey contract for detailed engineering including civil and structural design, supply and erection, testing and commissioning of 23 MLD capacity Sewage Water Reclamation Plant in Mahul Refinery area. The contract value was Rs.574.35 lakhs. The contract period was 18 months from the date of letter of intent, and accordingly the work was to be completed by 28.08.1993. There was delay in completion. On written requests/applications made by BEEL, the time for completion was extended on two occasions. Three revisions were also issued by HPCL. The last revision dated 20.09.1994 had extended the period for completion from 26.09.1994 by 10 months beginning from the date on which approval of electrical items was accorded by HPCL. BEEL carried on the work till 30.03.1996. Thereafter, BEEL abandoned the work. It is an accepted position that as on 30.03.1996, 80% of the work was complete.

3. On 04.07.1996, BEEL made a formal claim to HPCL for breach of contract on account of delay in execution, causing extra expenses and losses. By the letter dated 16.05.1997, BEEL sought an advance payment of Rs.50 lakhs to enable them to resume work,

VERDICTUM.IN

and simultaneously expressed its desire to resolve the dispute through conciliation. BEEL by the same letter also invoked the arbitration clause in the contract, if the proposal as given by BEEL was unacceptable to HPCL. HPCL by the letter dated 05.05.1997 refused to make payment, and relying on the terms of the contract had impressed upon BEEL to resume and complete the remaining work, even if the matter was to proceed for arbitration. BEEL did not agree and resume work.

4. The General Manager (Project), Mahul Refinery, HPCL, appointed Mr. K. Narayanan as the sole arbitrator to adjudicate upon the disputes and differences in the execution of the contract. Claim was filed by BEEL and reply/counter claim was filed by HPCL, to which rejoinder with supporting documents and sur-rejoinders were filed. In all about 14 hearings were held before the arbitral tribunal between the period 12.03.1998 and 07.01.1999 and oral arguments were addressed. Ocular evidence was not led. The learned arbitrator had conducted a site inspection on 24.12.1997.

5. The arbitral award dated 23.03.1999, substantially allows the Claims Nos. 1,2, and 4 of the BEEL. The relevant portion of the award dealing with the claims of the BEEL, reads:

VERDICTUM.IN

"*A. Claims of the Claimants:*

Claim No.1 – Compensation for loss of Overhead and profit and also profitability: Rs.3,38,38,460.00

The claim is forwards loss of Overheads and profit/profitability calculated on the basis of 48 months delay as of 27.08.1997. The Claimants have considered 10% of the Contract value towards Overheads and another 10% towards profit/profitability to arrive at the above figure, after taking into account the same percentages from the payments already received by them.

My finding is that the Owner Respondents are fully responsible for the huge delay that occurred by not taking proper and timely action in removing the various impediments and obstacles that stood in the way of completing the project in the given span of 18 months. The party had been tied down to a project, which was allowed to drift aimlessly, with the owner-respondents showing hardly any interest in completing it in time.

Even the basic approval for the Electrical scheme, with numerous revisions was kept pending, till the end without any decision. The Claimants could not have expected to complete the project without these clearances. The Respondents have thus evaded their own responsibilities and committed breach of contractual obligations.

As admitted by the Respondents, even the arrangement with MCGB for the supply of Sewage water for purification has not yet been finalised. This, as advised by the Respondents, is awaiting the intervention of the Chief Minister. It is any body's guess when this arrangement will be firmed up the necessary pumping station and underground pipelines etc. will be ready so that

VERDICTUM.IN

sewage water will flow to the plant being built for purification by the claimant. This is proof that the Respondents were not serious enough in implementing the project.

For reasons given above, I consider that the claimants are legitimately entitled for compensation towards both loss of Overheads and profit/profitability. In arriving at the compensation, the period upto 30.03.1996, when the claimants discontinued the work is being considered. The total period works out to 49 months. The original contract period being 18 months, the extended period comes to 31 months. The claimants had stated in their claim statement that they had provided for 22 months overheads in their estimate. I am allowing 3 months for internal administrative process of the Owner-Respondents and for unforeseen delays such as strike, red alerts etc. I also consider 10% of contract value towards loss of overheads and 10% towards loss of profit/profitability as reasonable. On these (sic) basis, the Compensation works out to Rs.78,68,833.00 towards loss of overheads and an equal amount of Rs.78,68,833.00 towards loss of profit/profitability, the total being Rs.1,57,37,666.00 after taking into account the same percentage from payments already received by them for the work done. I award this amount to the Claimants.

While awarding the above compensation, the existence of the means to mitigate the loss has been considered. According to me, the only means available to the claimants, was to work on Sundays and Holidays, to make up for the lost time to some extent, which was denied by the Respondents except for a brief period at the very end. This brief relaxation was not of much significance in determining the compensation payable to the claimants.

VERDICTUM.IN

Claim No.2 – Compensation for idle machinery and equipment: Rs.84,59,615.00

This claim is for machinery and equipment deployed in the execution of this contract, but had to idle for large part of the time, due to extended contract period. I have inspected the site. I am of the opinion that there is substance in the claim. After due consideration of all aspects, I award an amount of Rs.50,000.00 per month for a period of 24 months which comes to Rs.12,00,000.00

Claim No.3 – Compensation for losses incurred due to increased cost of Materials and Labour: Rs.26,89,638.00

Even though the escalation in cost of material and labour is a normal feature when Engineering Contracts such as this gets unduly delayed, since escalation is not permitted as per the contract the claim stands rejected totally.

Claim No.4 – Compensation for carrying out Extra Work: Rs.19,00,225.00

The claim consists of the following 4 items:

(i)	*Transportation of excavated earth*	*Rs.12,05,000.00*
(ii)	*Dewatering charges incurred during delayed period*	*Rs.5,62,570.00*
(iii)	*Shifting charges for material*	*Rs.1,01,405.00*
(iv)	*Shifting charges for Filter media*	*Rs.31,250.00*

The above jobs have been carried out in relation to the main contract, but have figured as extra items due to certain omissions and commissions by the owner-respondents. The claimants have compelled and produced vouchers and documents in support of their claim. I am not

VERDICTUM.IN

satisfied with all the details furnished. Therefore, against the above claim, I awarded to the extent I am satisfied with the documentation, as under:

Item No.I	*Rs.1,20,000.00 towards transportation of excavated earth dumped by other contractors in the work site, prior to award of contract but after submission of the offer.*
Item No.II	*Nil amount*
Item No. III	*Rs.50,000.00 towards shifting of materials manually because of non-availability of approach to site for vehicle.*
Item No.IV	*Rs.25,000.00 towards charges for shifting the Filter Media Several times for paucity of space.*

Total Claim amount awarded: Rs.1,95,000.00 against Rs.19,00,225.00

Claim No.5 – Cost of repair and rectification: Amount to be assessed. No award on this as this refers to future course of action when project work is resumed.

INTEREST: The Claimants are also entitled to 18% interest per annum on all the claims awarded, effective from 16.05.1997, the date on which the notice invoking Arbitration clause was served on the Respondents (date on which cause of action arose) till the date of payment.

BANK GUARANTEE: The Claimants have specifically prayed for reduction of the performance Bank Guarantee amount by 50%. In view of the fact that about 80% of the work has been completed, and (in) view (of) (sic) the huge delay that has occurred the amount shall be reduced by 50%."

6. The award dated 23.03.1999 dismisses the counter claim of HPCL for liquidated damages of Rs.57.40 lakhs, on the ground that the

VERDICTUM.IN

delay was caused by omissions and commissions of HPCL. Claims by HPCL for rectification/rehabilitation cost of Rs.102.05 lakhs, costs of balance work of Rs.160 lakhs and de-watering cost of Rs.9 lakhs were denied on the ground that they relate to future works and therefore, would not fall within the ambit of arbitration in question.

7. We have intentionally quoted the entire findings and reasoning accorded by the learned arbitrator, while allowing the Claim Nos. 1,2 and 4 of BEEL. The first egregious and obvious flaw in the award is, the omnibus finding and conclusion that HPCL (referred to as the owner and the respondent in the quoted portion of the award) was fully responsible for the inordinate delay that had occurred by not taking proper and timely action in removal of various impediments and obstacles that stood in the way of completing the project within the stipulated period of 18 months. This finding, in our opinion, is bereft of analysis and examination of facts and contentions. The relevant and material facts and the respective stances of the parties are neither decipherable nor evaluated and no reason has been given for arriving at the conclusion. A conclusion without any discussion and reasons, is non-compliant and violates the mandate of sub - section (3) of

VERDICTUM.IN

Section 31 of the A& C Act[5], an aspect we would examine subsequently.

8. The second patent error relates to the computation and award of 10% of the contract value towards loss of overheads and another 10% towards loss of profits/profitability. The two amounts have been quantified at Rs.78,68,833/- each. Thus, Rs.1,57,37,666/- has been awarded and held as payable by HPCL to BEEL. The award is deficient being completely silent as to the method and the manner in which the arbitral tribunal has computed the figures. Therefore, it leaves us and the parties to wonder the basis for awarding and computing the amounts. We are not commenting or examining the merits of the computation, but complete absence of any justification and reason to allow the claim and quantification of the sum awarded. We would subsequently examine the chart furnished by BEEL in support of the said computation, *albeit* at this stage we would like to highlight the apparent contradiction in the award, which is the third ground to uphold the decision of the Division Bench of the High Court.

9. We begin our substantiation of the third ground, by referring to the

[5] Section 31 - Form and contents of arbitral award - (3) The arbitral award shall state the reasons upon which it is based, unless—
(a) the parties have agreed that no reasons are to be given, or
(b) the award is an arbitral award on agreed terms under section 30.

VERDICTUM.IN

first paragraph of the award quoted above, under the heading 'Claim No. 1 - Compensation for loss of overhead and profit and also profitability'. BEEL had based Claim No.1 for loss on account of overheads and profits/profitability upon 48 months delay as on 27.08.1997. BEEL for computation had considered 10% of the contract value towards overheads and other 10% towards profits/profitability for arriving at the figure of Rs. 3,38,38,460/-, after taking into "account the same percentages from the payments already received by them". In the subsequent portion of the award, dealing with Claim No. 1, the learned arbitrator has held that the total contract period was 49 months. The original contract period being 18 months, the extended period being 31 months. However, BEEL in the claim statement had accepted that it had provided for 22 months towards overheads in the estimates. Further, the learned arbitrator has allowed additional 3 months for internal administrative process, and for unforeseen delays, such as strikes, red alerts, and as force majeure events. In other words, the learned arbitrator, for the purpose of default, had excluded the period of 18 months, i.e., the original contract period, plus 4 months as provided by BEEL, and another 3 months on account of internal administrative process and force majeure events. Thus, the default period for which BEEL as per the award is entitled to claim damages/compensation

VERDICTUM.IN

towards overheads and loss of profits/profitability is 24 months.

10. BEEL had, as observed above, accepts the position that the loss towards overheads and profits/profitability has to be arrived at by applying the percentage formula, variant with the execution of the work. Thus, in our opinion, the loss towards overheads and profits/profitability is to be computed on the payments due for the un-executed work, and should exclude the payments received/receivable for the work executed. In other words, based on the value of the work executed by BEEL, the proportionate amount has to be reduced for computing the damage/compensation as a percentage of expenditure on overheads, and damages for loss of profit/profitability. Damages towards expenditure on overheads and loss of profit are proportionate, and not payable for the work done and paid/payable. Delay in payment on execution of the work has to be compensated separately.

11. It is an accepted position and specifically recorded in the award that the total value of the contract was Rs. 5,74,35,213.00p. In an earlier paragraph of the award, which has been not reproduced, the learned arbitrator has referred to R.A. Bill No.4 dated 31.08.1993, as per which BEEL had completed work of Rs.1,21,95,859.68p. It is also an accepted and admitted position that as on 30.03.1996,

VERDICTUM.IN

the date on which the work stopped, as per R.A. Bill No. 37, work valued at Rs. 2,92,07,619.13p had been executed. In other words, BEEL had executed and received payments of Rs. 2,92,07,619.13/- from HPCL from time to time, between the period 01.09.1993 and 30.03.1996. Eighty percent of the work was complete. BEEL has received total payment of Rs.4,14,03,478.81p in terms of running account bills till R.A. No. 37. The balance work was Rs. 1,14,87,042.00p. Twenty percent of Rs.1,14,03,478.81 is Rs.22,97,408.40p. In addition, BEEL is entitled to compensation for the delay in execution of the work of Rs.2,92,07,619.13/- till the date payments were made, *albeit*, the award directs payment of Rs. 18% interest per annum on all claims awarded effective from 16.05.1997.

12. The award also reduces the performance bank guarantee amount by 50%, without any discussion, elucidation and reason.

13. In order to justify the computation made in the award and also the principle or the method adopted by the arbitral tribunal, BEEL has referred to the Hudson's formula and relied upon judgments of this Court in ***McDermott International Inc.*** v. ***Burn Standard Company Limited and Others.***[6], and ***Associate Builders*** v. ***Delhi***

[6] (2006) 11 SCC 181 (for short, McDermott International Inc.).

VERDICTUM.IN

Development Authority[7], in addition to an earlier decision of this Court in ***A.T Brij Paul Singh and Others*** v. ***State of Gujarat***[8], and a few judgments of the High Courts.

14. In ***McDermott International Inc.*** this Court has referred to various methods of computation of damages in paragraphs 102 to 107. In particular, reference has been made to Hudson's formula, Emden's formula, and Eichleay's formula in the following terms:

> *"Method for computation of damages*
>
> ***102****. [Ed.: Para 102 corrected vide Official Corrigendum No. F.3/Ed.B.J./52/2006 dated 31-7-2006] . What should, however, be the method of computation of damages is a question which now arises for consideration. Before we advert to the rival contentions of the parties in this behalf, we may notice that in M.N. Gangappa v. Atmakur Nagabhushanam Setty & Co. [(1973) 3 SCC 406] this Court held that the method used for computation of damages will depend upon the facts and circumstances of each case.*
>
> ***102-A****. In the assessment of damages, the court must consider only strict legal obligations, and not the expectations, however reasonable, of one contractor that the other will do something that he has assumed no legal obligation to do. (See Lavarack v. Woods of Colchester Ltd. [(1967) 1 QB 278 : (1966) 3 All ER 683 : (1966) 3 WLR 706 (CA)] , All ER p. 690 G.)*

[7] (2015) 3 SCC 49 (for short, Associate Builders).
[8] (1984) 4 SCC 59.

***103**. The arbitrator quantified the claim by taking recourse to the Emden Formula. The learned arbitrator also referred to other formulae, but, as noticed hereinbefore, opined that the Emden Formula is a widely accepted one.*

***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:

"Head office overhead and profit / *100* × *Contract sum* / *Contract period* × *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

Contract billings / *Total billings for contract period* × *Total overhead for contract period* = *Overhead allocable to the contract*

Step 2

Allocable overhead / *Total days of contract* = *Daily overhead rate*

Step 3

VERDICTUM.IN

Daily contract overhead rate	×	*Number of days of delay*	=	*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*

VERDICTUM.IN

other formula, having regard to the facts and circumstances of a particular case, would eminently fall within the domain of the arbitrator.

***107**. If the learned arbitrator, therefore, applied the Emden Formula in assessing the amount of damages, he cannot be said to have committed an error warranting interference by this Court."*

15. ***McDermott International Inc***. refers to Sections 55[9] and 73[10] of the Indian Contract Act, 1872[11], which deal with the effect of failure to perform at fixed time in contracts where time is of essence, and computation of damages caused by breach of contract, respectively, and states that these Sections neither lay down the

[9] **Section 55** - Effect of failure to perform at fixed time, in contract in which time is essential - When a party to a contract promises to do a certain thing at or before a specified time, or certain things at or before specified times, and fails to do any such thing at or before the specified time, the contract, or so much of it as has not been performed, becomes voidable at the option of the promisee, if the intention of the parties was that time should be of the essence of the contract.
Effect of such failure when time is not essential.—If it was not the intention of the parties that time should be of the essence of the contract, the contract does not become voidable by the failure to do such thing at or before the specified time; but the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure.
Effect of acceptance of performance at time other than that agreed upon.—If, in case of a contract voidable on account of the promisor's failure to perform his promise at the time agreed, the promisee accepts performance of such promise at any time other than that agreed, the promisee cannot claim compensation for any loss occasioned by the non-performance of the promise at the time agreed, unless, at the time of such acceptance, he gives notice to the promisor of his intention to do so.

[10] **Section 73** - Compensation for loss or damage caused by breach of contract. - When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it.
Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.
Compensation for failure to discharge obligation resembling those created by contract. When an obligation resembling those created by contract has been incurred and has not been discharged, any person injured by the failure to discharge it is entitled to receive the same compensation from the party in default, as if such person had contracted to discharge it and had broken his contract.
Explanation - In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account.

[11] For short, Contract Act.

VERDICTUM.IN

mode nor how and in what manner computation of damages for compensation has to be made. As computation depends upon attendant facts and circumstances and methods to compute damages, how the quantum thereof should be determined is a matter which would fall within the domain and decision of the arbitrator.

16. This is without doubt, a sound legal and correct proposition. However, the computation of damages should not be whimsical and absurd resulting in a windfall and bounty for one party at the expense of the other. The computation of damages should not be disingenuous. The damages should commensurate with the loss sustained. In a claim for loss on account of delay in work attributable to the employer, the contractor is entitled to the loss sustained by the breach of contract to the extent and so far as money can compensate. The party should to be placed in the same situation, with the damages, as if the contract had been performed. The principle is that the sum of money awarded to the party who has suffered the injury, should be the same quantum as s/he would have earned or made, if s/he had not sustained the wrong for which s/he is getting compensated.[12]

[12] See - Robinson v. Harman (1848) 1 Ex 850 at 855 and Livingstone v. Rawyards Coal Co (1879-80) L.R. 5880 cases 25

VERDICTUM.IN

17. We shall subsequently catechise the Hudson's formula, suffice at this stage is to notice that the learned arbitrator does not specifically refer to any formula or the method, and the figures to compute damages under the head of loss on account of overheads and profits/profitability. The award, as quoted above, does refer to Sections 55 and 73 of the Contract Act.

18. Having examined the award and the contents, we would now like to refer to the chart produced by BEEL by way of additional or new material, which it is claimed, is drawn on the basis of the statement of claims filed in the arbitration proceedings, to which the column with the heading "explanation" has been added for the benefit of the court. The chart is as under:

Sr. No.	Particulars	Amount (Rs.)	Explanation
1.	Contract Sum	5,74,35,213.00	Total Contract Value
2.	Overheads (10%) and profits (10%) included in the above sum	1,14,87,042.00	20% of Rs.5,74,35,213.00 (1) i.e. contract value
3.	Time limit for completion of the work	22 Months	Though the contract was for 18 Months, Petitioner estimated that the site would have to be maintained for 22 Months i.e. 4 months over and above contract term.
4.	Overheads and Profits per month [(2) divided by (3)]	5,22,138.27 Per month	Total Overheads and Profits divided by months of work (22 Months)

VERDICTUM.IN

Sr. No.	Particulars	Amount (Rs.)	Explanation
5.	Value of work done till R.A. Bill No.4 dated 31.08.1993	1,21,95,859.68	Contract period was up to 31.08.1993 i.e. 18 months from 22 February 1992
6.	Pro-rata overheads and profits received till 31.08.1993	24,39,171.00	20% of (5). Since the Petitioner received payment of bill at (5), the overheads and profits for the work done covered by bill at (5) have been deducted by the Arbitrator in (7).
7.	Net loss suffered as on 01.09.1993 [(2) – (6)]	90,47,871.00	As above, for 22 months of work, the Petitioner was to get Rs. 1,14,87,042.00/- (2) towards overheads and profits. However, out of this, the Petitioner received Rs. 24,39,171.00/- (6), the same has been deducted. Rs.90,47,871.00/- is the outstanding receivable by the Petitioner towards overheads and profits for the contract period.
8.	Delay in months	24 months	Total time spent was 49 Months (*Pg.56 of SLP*) (22 February 1992 to 31 March 1996). Out of this, since 22 months were contemplated by the Petitioner for the work, the same have been deducted from 49 months by the Arbitrator. (*Pg.56 of SLP*).

VERDICTUM.IN

Sr. No.	Particulars	Amount (Rs.)	Explanation
			A further period of 3 months on account of Force Majeure has been deducted by the Arbitrator. Thus 49 – 22 – 3 = 24 Months extra work. (*Pg.56 of SLP*).
9.	Overheads and profit expected during the extra period [(8) * (4)]	1,25,31,318.48	This is the amount for the extra time spent i.e. 24 Months. 244 Months multiplied by per month overhead and profit. 24 * Rs.5,22,138.27 = Rs. 1,25,31,318.48
10.	Value of work executed during the extended period upto 30.03.1996 (R.A. Bill No.37)	2,92,07,619.13	This is the amount received for the work done during extended period i.e. August 1993 to March 1996.
11.	Pro-rata overheads and profits received during the extended period.	58,41,523.80	This is 20% of 2,92,07,619.13 (10). Since the petitioner received payment of bill at (10), the overheads and profits for the work done covered by bill at (10), have been deducted by the Arbitrator in (11)
12.	Net loss suffered till 27.08.1997 [(9) – (11)]	66,89,791.68	This is loss of overhead and profits for the extra period of 24 Months. As stated in (9), overheads and profits for

VERDICTUM.IN

Sr. No.	Particulars	Amount (Rs.)	Explanation
			extra time of 24 months was Rs.1,25,31,318.48. Since, the Petitioner received a sum of Rs.58,41,523.80 (11), the same has been deducted by the Arbitrator.
13.	Total loss on overheads and profit on this count till 27.08.1997 [(7) – (12)]	1,57,37,665.68	This amount is the sum of overhead and profits due during contract period plus the overhead and profits for the extra period of 24 Months. Awarded by the Arbitrator (*Pg.56 of SLP*)

19. The chart and explanations given in the chart, we believe, are an afterthought and futile finagle to work backwards to somehow justify the computation and award of damages. These explanations are *ex facie* irrational and eristic for the following reasons:

(i) S.No.7 computes the net loss suffered by BEEL as Rs.90,47,871/-as on 01.09.1993, that is for the period of 18 months. The computation ignores and does not add the period of 4 months as mentioned by BEEL in the claim statement. Further, the arbitrator had added another period of 3 months for internal administrative process and force majeure events. Thus, the date 01.09.1993 referred to in S.No.7 is incorrect and not the basis of the computation made

VERDICTUM.IN

in the award. S.No.7 fails to taken into consideration the seven-month period, which as per the award has to be added.

(ii) The figure of Rs.90,47,871/- would have been relevant, in absence of work done and in fact payments post 01.09.1993. However, it is an accepted and admitted position that payment of Rs.2,92,07,619.13p was made on different dates between 01.09.1993 till 30.03.1996 upon completion of the proportionate value of the work. Claim on account of loss of profits/profitability and overheads, as has been explained above and also elucidated herein-after with reference to several judgments and treatise, is payable if and when there is an increase in cost of off-site and on-site overheads due to delay in completion of work post the agreed or contractual period which is caused by the employer.[13] Further, loss on account of profit earning capacity is paid when the contractor's profit earning capacity is affected due to it being retained longer in the contract in question, without corresponding increase in the monetary benefit earned and

[13] In this case, as noticed, the contract bars claims for compensation for losses due to enhancement/escalation of costs etc. We make no comments in this regard. Interpretation and validity of such clauses is not subject matter of this appeal. When such clauses, which are apparently one-sided and absolve breach with immunity, are subjected to judicial scrutiny, the courts/tribunals invariably tend to interpret the clauses in a restrictive manner to grant just and fair relief. Courts should be slow to interfere, unless the award falls within the ambit of the parameters set out in Section 34 of the A&C Act.

VERDICTUM.IN

without being free to move elsewhere to earn profit which it might otherwise be able to do. It is not the case of BEEL that they are entitled to enhance or increase in cost on account of delay in execution of the work. Pertinently, Claim No. 3 for compensation of losses incurred due to increase in cost of material and labour has been specifically rejected, as escalation in prices/costs are barred by the terms of the contract.

(iii) The computation of loss under S.No.7 of Rs.90,47,871/- is, therefore, unsustainable and cannot be justified by any calculation and in terms of the Contract Act.

(iv) As per the chart, in addition to Rs.90,47,871/-, the arbitrator has awarded at S.No.12, a further amount of Rs.66,89,794.68p. on account of loss of overheads and profits for the extra period of 24 months, that is, till 27.08.1997. The figure as per S.No.12 is arrived at after reducing *pro rata* overheads and profits during the extended period as mentioned in S.No.9. The computation belies and defies logic. It clearly amounts to double payment towards compensation and damages, as it fails to notice that the sum mentioned in S.No.7 of Rs. 90,47,871/- is on account of compensation towards overheads and profits/profitability.

VERDICTUM.IN

Therefore, 20% of the value of the unfinished work had already been included in the computation and awarded under S.No.7. The date 27.08.1997 is at best, an assumption of BEEL and not mentioned anywhere or decipherable from the award.

20. We have briefly referred to the principle applicable for computing the claim for compensation/damages in case of partial prevention, i.e., where the breach by the employer is not fundamental and does not entitle the builder/contractor to cease the work, or, being fundamental, is not treated as repudiation by the builder/contractor. Measure of compensation/damages in such cases is the loss of profit arising from reduced profitability or added expense of the work carried out.[14] In a given case, where there is a fundamental breach by the employer, *albeit,* the builder/contractor does not immediately elect to treat the contract as repudiated, he may still be entitled to raise a claim for loss of profit on the uncompleted work. Offsite expenses or overheads are all administrative or executive costs incidental to the management supervision or capital outlay as distinguished from operating charges. These charges cannot be fairly charged to one stream of work or job, and rather be distributed

[14] See Hudson's Building Contracts (10th edn) pp 450, 596.

VERDICTUM.IN

as they relate to the general business or the work of the contractor/builder being undertaken or to be undertaken, as the overheads are relatable to the builder/contractor's business in entirety.

21. The usage of formulae such as Hudson's, Emden's, or Eichleay's formulae to ascertain the loss of overheads and profits has been judicially approved in the English cases of ***Peak Construction (Liverpool) Ltd*** v. ***McKinney Foundations Limited***[15]***, Whittal Builders*** v. ***Chesterle-Street District Council***[16], and ***JF Finnegan Ltd*** v. ***Sheffield City Council***[17] and in the Canadian case of ***Ellis-Don*** v. ***Parking Authority of Toronto***[18]. The three formulae deal with theoretical mathematical equations, but are based on factual assumptions, and therefore can produce three different and unrelated compensation/damages. Therefore, while applying a particular equation or method, the assumptions should be examined, and the satisfaction of the assumption(s) ascertained in the facts and circumstances.

22. The formula suggested by Hudson in his 10th edition of the book Building and Engineering Contracts for the computation of

[15] (1970) 1 BLR 114.
[16] (1987) 40 BLR 82.
[17] (1988) 43 BLR 124.
[18] (1978) 28 BLR 98.

VERDICTUM.IN

damages takes the head office and profit percentage as a proportion of the contract value. The formula assumes that the profit judged by the builder/contractor is in fact capable of being earned by her/him elsewhere had the builder/contractor been free to leave the contract at the proper time. The formula is couched on three assumptions. First, that the contractor is not habitually or otherwise underestimating the cost when pricing; secondly the profit element was realistic at that time; and lastly, there was no fluctuation in the market conditions and the work of the same general level of profitability would be available to her/him at the end of the contract period. Satisfaction of these assumptions should be ascertained when we apply Hudson's formula for computing the damages. Material should be furnished by the claimant to justify and assure that the assumptions for applying Hudson's formula are met.

23. Ordinarily, when the completion of a contract is delayed and the contractor claims that s/he has suffered a loss arising from depletion of her/his income from the job and hence turnover of her/his business, and also for the overheads in the form of workforce expenses which could have been deployed in other contracts, the claims to bear any persuasion before the arbitrator or a court of law, the builder/contractor has to prove that there was other work available that he would have secured if not for the delay,

by producing invitations to tender which was declined due to insufficient capacity to undertake other work. The same may also be proven from the books of accounts to demonstrate a drop in turnover and establish that this result is from the particular delay rather than from extraneous causes. If loss of turnover resulting from delay is not established, it is merely a delay in receipt of money, and as such, the builder/ contractor is only entitled to interest on the capital employed and not the profit, which should be paid. The High Court of Justice Queen's Bench Division in the case of ***Property and Land Contractors Ltd*** v. ***Alfred McAlpine Homes North Ltd.***[19] succinctly points the in-exactitude of Hudson's formulae, by observing:

> *"Furthermore the Emden formula, in common with the Hudson formula (see Hudson on Building Contracts, (11th edn, 1995) paras 8–182 et seq) and with its American counterpart the Eichleay formula, is dependent on various assumptions which are not always present and which, if not present, will not justify the use of a formula. For example the Hudson formula makes it clear that an element of constraint is required (see Hudson para 8.185) ie in relation to profit, that there was profit capable of being earned elsewhere and there was no change in the market thereafter affecting profitability of the work. It must also be established that the contractor was unable to deploy resources elsewhere and had no possibility of recovering cost of the overheads from other sources, eg from an increased volume of the work.*

[19] (1995) 76 BLR 59.

VERDICTUM.IN

> *Thus such formulae are likely only to be of value if the event causing delay is (or has the characteristics of) a breach of contract."*

24. As mentioned in ***McDermott International Inc.,*** Hudson's 11th Edition has referred to Eichleay formula, which gives the resultant figures with greater precision and accuracy. This formula, which emerged in 1960s[20], is far more nuanced and rigorous, as it requires the builder/contractor to itemise and quantify the total fixed overheads during the contract period. It takes into consideration all the contracts of the contractor/builder during the contract period with those of the individually delayed contract to determine the proportionate faction of the total fixed overheads. However, in both Hudson's and Eichleay's formulae, the amount to be recovered is determined weekly or monthly, which the delay in the contract completion is expected to earn.

25. Hudson's formula might result in double recovery as the profit being added to the profit is already subsumed within the 'contract sum'. To avert this double-recovery, it has been suggested that the formula should be modified to 'contract sum less overhead and profit'[21]. Any increase in the value of the final account for extra works

[20] The formula borrows the name from the Armed Services Board of Contract Appeals decision in *Eichleay Corporation* case, ASBCA No. 5183, 60-2 BCA.
[21] *Ibid.*

VERDICTUM.IN

such as variations contain their own element of overheads and profits. Therefore, Hudson's formula like other formulae, which are only rough approximations of the cost impact of unabsorbed overhead, should be applied with great care and caution to ensure fair and just computation.[22]

26. Hudson in his 14th Edition refers to claim for management or overheads during the period of delay. The author has referred to Hudson's formula as well as Eichleay's formula, and observes that recently limitations of Hudson's approach have received greater emphasis as the English courts have become more generous in their approach and assessment of claims for time management. The authors accept what has been highlighted above, and the need to take care in delay cases to avoid any double recovery, overlap with other claims, or when payments are obtained by the contractor on account of variation(s), or any damages for breach have to be concluded by using contract price. "Thickening", by adding unreasonable expenses, should not be accepted. It is observed that in the total cost method, there is difficulty in linking cause and effect convincingly, *albeit* is more precise and factually accurate. Thus, Hudson's method should be taken as the basis for computation with

[22] Claims for head office overheads - alternatives to formulae, John W. Pettet, 1999.

VERDICTUM.IN

caution and as a last resort, where no other way to compute damages is feasible or mathematically accurate. Inaccuracies in Hudson's computation should not be overlooked, and should be accounted and neutralized. Hudson's formula when applied should be with full care and caution not to over-award the damages.

27. Arbitral tribunal in the present case has given complete go by to these principles well in place, overlooked care and caution required and taken a one-sided view grossly and abnormally inflated the damages. The figures quoted in paragraph 11 *supra* show the over-statement and aggrandizement in awarding Rs. 1,57,37,666/-, towards loss of overheads and loss of profits/profitability, in a contract of Rs. 5,74,35,213/-. Rs.1,21,95,859.68/- was paid for the work done within the term. Rs. 2,92,07,619.13 was paid for the work done post the term. Thus, Rs. 4,14,03,478.81/- was paid for 80% of the work. The balance was Rs.1,14,87,042.00/. The amount awarded towards loss of overheads and profits/profitability is Rs.1,57,37,666/-. No justification for computation of the loss is elucidated or can be expounded. Even if one were to rely upon the chart given by the BEEL, and ignore the contradictions in findings, the amount awarded is highly disproportionate and exorbitant. It is clearly a case of overlapping or at least a part doubling of the loss/damages.

VERDICTUM.IN

28. The arbitral tribunal has accepted that principle of mitigation is applicable but observes that the only way BEEL could have abased the loss, was to work on Sundays or holidays. This reasoning is again *ex facie* fallacious and wrong. The principle of mitigation with regard to overhead expenses does not mandate working on Sundays or holidays.

29. We would like to refer to Claim No.2 for idle machinery and equipment. This was on account of extended period of contract. This claim of more than Rs.84,00,000/- has been accepted for Rs.12,00,000/-, by simply stating that the learned arbitrator had inspected the site and, in his opinion, there is substance in the claim. Inspection of the site was post the appointment of the arbitrator after August 1997, whereas BEEL had abandoned the contract more than a year ago in March 1996. The amount awarded is merely on *ipsi dixit* without giving any reasons and basis for awarding the amount.

30. The scope and ambit of the court's power to review the awards under Section 34 of the A&C Act has been contentious viz., on the interpretation to the expression 'in conflict with the public policy of India'. There have been legislative interventions as well as judicial pronouncements. In the context of the present case, we are

VERDICTUM.IN

required to interpret the provisions as they existed on the date on which the objections to the award were filed i.e., on 21.06.1999. Accordingly, the amendment introduced to Section 34 of the A&C Act *vide* Act No. 3 of 2016 with retrospective effect from 23.10.2015 and the judgments of this Court examining the amended Section 34 of the A&C Act need not be examined.

31. Post award interference and the extent of the second look by the courts under Section 34 of the A&C Act has been a subject matter of perennial parley. The foundation of arbitration is party autonomy. Parties have the freedom to enter into an agreement to settle their disputes/claims by an arbitral tribunal, whose decision is binding on the parties.[23] It is argued that the purpose of arbitration is fast and quick one-stop adjudication as an alternative to court adjudication, and therefore, post award interference by the courts is un-warranted, and an anathema that undermines the fundamental edifice of arbitration, which is consensual and voluntary departure from the right of a party to have its claim or dispute adjudicated by the judiciary. The process is informal, and need not be legalistic[24]. *Per contra*, it is argued that party autonomy should not be treated

[23] See ***Vidya Drolia and Others*** v. ***Durga Trading Corporation and Others***, (2021) 2 SCC 1, which examines arbitrability and non-arbitrability of subject matters and claims, which aspect will not be examined in this case.

[24] The expression "judicially", does not equate arbitration with formal/court proceedings, and would include a just and fair decision.

VERDICTUM.IN

as an absolute defence, as a party despite agreeing to refer the disputes/claims to a private tribunal consensually, does not barter away the constitutional and basic human right to have a fair and just resolution of the disputes. The court must exercise its powers when the award is unfair, arbitrary, perverse, or otherwise infirm in law. While arbitration is a private form of dispute resolution, the conduct of arbitral proceedings must meet the juristic requirements of due process and procedural fairness and reasonableness, to achieve a 'judicially' sound and objective outcome. If these requirements, which are equally fundamental to all forms of adjudication including arbitration, are not sufficiently accommodated in the arbitral proceedings and the outcome is marred, then the award should invite intervention by the court.

32. To disentangle and balance the competing principles, the degree and scope of intervention of courts when an award is challenged by one or both parties needs to be stated. Reconciliation as a statement of law and in particular application in a particular case has not been an easy exercise. We begin by first referring to the views expressed by this Court in interpreting the width and scope of the post award interference by the courts under Section 34 of the A&C Act.

VERDICTUM.IN

33. Section 34 of the A&C Act, prior to amendment effected *vide* Act No. 3 of 2016 with retrospective effect from 23.10.2015, reads as under:

> *"34. 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*

VERDICTUM.IN

(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."

34. Sub-section (1) to Section 34 of the A&C Act requires that the recourse to a court against an arbitral award is to be made by a party filing an application for setting aside of an award in

VERDICTUM.IN

accordance with sub-sections (2) and (3) of Section 34. Sub-section (2) to Section 34 of the A&C Act stipulates seven grounds on which a court may set aside an arbitral award. Sub-section (2) consists of two clauses, (a) and (b). Clause (b) consists of two sub-clauses, namely, sub-clause (i) which states that when the subject matter of the dispute is not capable of settlement by arbitration under the law for the time being in force, and sub-clause (ii), which states that the court can set aside an arbitral award when the award is 'in conflict with public policy of India'. We shall subsequently examine the decisions of this Court interpreting 'in conflict with public policy of India' and the explanation.

35. Under sub-clause (a) to sub-section (2) to Section 34 of the A&C Act, a court can set aside an award on the grounds in sub-clauses (i) to (v) namely, when a party being under some incapacity; arbitration agreement is not valid under the law for the time being in force; when the party making an application under Section 34 is not given a proper notice of appointment of the arbitrator or the arbitration proceedings, or was unable to present its case; and when the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement between the parties, unless such agreement was in conflict with the mandatory and binding non-derogable provision, or was not in accordance with

VERDICTUM.IN

Part I of the A&C Act. Sub-clause (iv) states that the arbitral award can be set aside when it deals with a dispute not contemplated by, or not falling within the terms of submission of arbitration, or it contains a decision on matters beyond the scope of submission to arbitration. However, the proviso states that the decision in the matters submitted to arbitration can be separated from those not submitted, then that part of the arbitral award which contains the decision on the matter not submitted to arbitration can be set aside. In the present case, we are not required to examine sub-clauses to clause (a) to sub-section (2) to Section 34 of the A&C Act in detail. Hence, this decision should not be read as making any observation, even as *obiter dicta* on the said clauses.

36. Explanation to sub-clause (ii) to clause (b) to Section 34(2) of the A&C Act, as quoted above and before its substitution by Act No.3 of 2016, had postulated and declared for avoidance of doubt that an award is 'in conflict with the public policy of India', if the making of the award is induced or affected by fraud or corruption, or was in violation of Sections 75 or 81 of the A&C Act. Both Sections 75 and 81 of the A&C Act fall under Part III of the A&C Act, which deal with conciliation proceedings. Section 75 of the A&C Act relates to confidentiality of the settlement proceedings and Section 81 deals with admissibility of evidence in conciliation proceedings. Suffice it

VERDICTUM.IN

is to note at this stage that while 'fraud' and 'corruption' are two specific grounds under 'public policy', these are not the sole and only grounds on which an award can be set aside on the ground of 'public policy'.

37. Act No. 3 of 2016 with retrospective effect from 23.10.2015 has substituted the explanation referred to above, by two new explanations that are differently worded.[25] Sub-section (2-A) to Section 34 of the A&C Act, which was instituted by Act No. 3 of 2016 with retrospective effect from 23.10.2015, states that the arbitral award arising out of arbitrations other than international commercial arbitrations can be set aside by the court, if it is vitiated by patent illegality appearing on the face of the award. The proviso to sub-section (2-A) to Section 34 of the A&C Act also states that the award shall not be set aside merely on the ground of erroneous

[25] Explanations 1 and 2 to sub-clause (ii) to clause (b) to Section 34(2) of the A&C Act substituted *vide* Act No. 3 of 2016 read as under:
Explanation 1.—For the avoidance of any doubt, it is clarified that an award is in conflict with the public policy of India, only if,—
(i) the making of the award was induced or affected by fraud or corruption or was in violation of Section 75 or Section 81; or
(ii) it is in contravention with the fundamental policy of Indian law; or
(iii) it is in conflict with the most basic notions of morality or justice.
Explanation 2.—For the avoidance of doubt, the test as to whether there is a contravention with the fundamental policy of Indian law shall not entail a review on the merits of the dispute.

Sub-section 2A to Section 34(2) of the A&C Act inserted *vide* Act No. 3 of 2016 reads as under:
(2-A) An arbitral award arising out of arbitrations other than international commercial arbitrations, may also be set aside by the court, if the court finds that the award is vitiated by patent illegality appearing on the face of the award:
Provided that an award shall not be set aside merely on the ground of an erroneous application of the law or by reappreciation of evidence.

VERDICTUM.IN

application of law or by reappreciation of evidence. The aforesaid sub-section need not be examined in the facts of the present case, as we are not required to interpret and apply the substituted explanations to (ii) to sub-clause (b) to 34(2) of the A & C Act in the present case.

38. The expression 'public policy' under Section 34 of the A&C Act is capable of both wide and narrow interpretation. Taking a broader interpretation, this Court in ***ONGC Limited.*** v. ***Saw Pipes Limited***.,[26] held that the legislative intent was not to uphold an award if it is in contravention of provisions of an enactment, since it would be contrary to the basic concept of justice. The concept of 'public policy' connotes a matter which concerns public good and public interest. An award which is patently in violation of statutory provisions cannot be held to be in public interest. Thus, expanding on the scope and expanse of the jurisdiction of the court under Section 34 of the A&C Act, it was held that an award can 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

[26] (2003) 5 SCC 705 (for short, Saw Pipes Limited).

(d) in addition, if it is patently illegal.

Nevertheless, the decision holds that mere error of fact or law in reaching the conclusion on the disputed question will not give jurisdiction to the court to interfere. However, this will depend on three aspects: (a) whether the reference was made in general terms for deciding the contractual dispute, in which case the award can be set aside if the award is based upon erroneous legal position; (b) this proposition will also hold good in case of a reasoned award, which on the face of it is erroneous on the legal proposition of law and/or its application; and (c) where a specific question of law is submitted to an arbitrator, erroneous decision on the point of law does not make the award bad, unless the court is satisfied that arbitrator had proceeded illegally. In the said case, the court set aside the award on the ground that the award had not taken into consideration the terms of the contract before arriving at the conclusion as to whether the party claiming the damages is entitled to the same. Reference was made to the provisions of Sections 73 and 74 of the Contract Act, which relate to liquidated damages, general damages and penalty stipulations. This view had held the field for a long time and was applied in subsequent judgments of this Court in ***Hindustan Zinc Ltd.*** v. ***Friends Coal***

VERDICTUM.IN

Carbonisation[27], ***Centrotrade Minerals and Metals Inc.*** v. ***Hindustan Copper Limited***[28], ***Delhi Development Authority*** v. ***R.S. Sharma and Co***[29]., ***J.G. Engineers (P) Ltd***. v. ***Union of India and Another***[30], and ***Union of India*** v. ***L.S.N. Murthy***.[31]

39. In 2006, this Court in ***McDermott International Inc.*** despite following the *ratio* of ***Saw Pipes Limited***, made succinct observations regarding the restrictive role of courts in the post-award interference. In addition to the three grounds introduced in ***Renusagar Power Co. Limited*** v. ***General Electric Co***[32], as noticed above, an additional ground of 'patent illegality' was introduced ***Saw Pipes Limited***, for exercise of the court's jurisdiction in setting aside an arbitral award. This Court, in ***McDermott International Inc,*** held that patent illegality, must be such which goes to the root of the matter. The public policy violation should be so unfair and unreasonable as to shock the conscience of the court. Arbitrator where s/he acts contrary to or beyond the express law of contract or grants relief, such awards fall within the purview of Section 34 of the A&C Act. Further, what would

[27] (2006) 4 SCC 445.
[28] (2006) 11 SCC 245.
[29] (2008) 13 SCC 80.
[30] (2011) 5 SCC 758.
[31] (2012) 1 SCC 718.
[32] 1994 Supp (1) SCC 644.

VERDICTUM.IN

constitute public policy is a matter dependent upon the nature of transaction and the statute. Pleadings of the party and material brought before the court would be relevant to enable the court to judge what is in public good or public interest, or what would otherwise be injurious to public good and interest at a relevant point. So, this must be distinguished from public policy of a particular government.

40. A similar view was expressed in ***Rashtriya Ispat Nigam Ltd.*** v. ***Dewan Chand Ram Saran***[33] with the clarification that where a term of the contract is capable of two interpretations and the view taken by the arbitrator is a plausible one, it cannot be said that the arbitrator travelled outside the jurisdiction or the view taken the arbitrator is against the terms of the contract. The court cannot interfere with the award and substitute its view with the award and interpretation accepted by the arbitrator, the reason being the court does not sit in appeal over the findings and decision of the arbitrator, while deciding an application under Section 34 of the A&C Act. The arbitrator is legitimately entitled to take a view after considering the material before him/her and interpret the agreement. The judgment should be accepted as final and binding.

[33] (2012) 5 SCC 306.

VERDICTUM.IN

41. Subsequently, in ***ONGC Ltd***. v. ***Western Geco International Ltd***.,[34] a three Judge Bench of this Court observed that the Court, in ***Saw Pipes Ltd.***, did not examine what would constitute 'fundamental policy of Indian law'. The expression 'fundamental policy of Indian law' in the opinion of this Court includes all fundamental principles providing as basis for administration of justice and enforcement of law in this country. There were three distinct and fundamental juristic principles which form a part and parcel of 'fundamental policy of Indian law'. The first and the foremost principle is that in every determination by a court or an authority that affects rights of a citizen or leads to civil consequences, the court or authority must adopt a judicial approach. Fidelity to judicial approach entails that the court or authority should not act in an arbitrary, capricious or whimsical manner. The court or authority should act in a *bona fide* manner and deal with the subject in a fair, reasonable and objective manner. Decision should not be actuated by extraneous considerations. Secondly, the principles of natural justice should be followed. This would include the requirement that the arbitral tribunal must apply its mind to the attending facts and

[34] (2014) 9 SCC 263, (for short, Western Geco)

VERDICTUM.IN

circumstances while taking the view one way or the other. Non-application of mind is a defect that is fatal to any adjudication. Application of mind is best done by recording reasons in support of the decision. As noticed above, Section 31(3)(a) of the A&C[35] states that the arbitral award shall state the reasons on which it is based, unless the parties have agreed that no reasons are to be given. Sub-clauses (i) and (iii) to Section 34(2) also refer to different facets of natural justice. In a given case sub-clause to Section 34(2) and sub-clause (ii) to clause (b) to Section 34(2) may equally apply. Lastly, is the need to ensure that the decision is not perverse or irrational that no reasonable person would have arrived at the same or be sustained in a court of law. Perversity or irrationality of a decision is tested on the touchstone of Wednesbury principle of reasonableness[36]. At the same time, it was cautioned that this Court was not attempting an exhaustive enumeration of what would constitute 'fundamental policy of Indian law', as a straightjacket definition is not possible. 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 on the face of it, is untenable resulting in injustice, the adjudication made by an arbitral

[35] *Supra* footnote 5.

[36] As expounded in the case of ***Associated Provincial Picture Houses Ltd***. v. ***Wednesbury Corporation***., (1948) 1 KB 223: (1947) 2 All ER 680 (CA).

VERDICTUM.IN

tribunal that enjoys considerable latitude and play at the joints in making awards, may be challenged and set aside.

42. The decision of this Court in ***Associate Builders*** elaborately examined the question of public policy in the context of Section 34 of the A&C Act, specifically under the head 'fundamental policy of Indian law'. It was firstly held that the principle of judicial approach demands a decision to be fair, reasonable and objective. On the obverse side, anything arbitrary and whimsical would not satisfy the said requirement.

43. Referring to the third principle in ***Western Geco***, it was explained that the decision would be irrational and perverse if (a) it is based on no evidence; (b) if the arbitral tribunal takes into account something irrelevant to the decision which it arrives at; or (c) ignores vital evidence in arriving at its decision. The standards prescribed in ***Excise and Taxation Officer-cum-Assessing Authority*** v. ***Gopi Nath & Sons***[37] and ***Kuldeep Singh*** v. ***Commissioner of Police***[38] should be applied and relied upon, as good working tests of perversity. In ***Gopi Nath & Sons*** it has been held that apart from the cases where a finding of fact is arrived at by ignoring or

[37] 1992 Supp (2) SCC 312, (for short, Gopi Nath & Sons).
[38] (1999) 2 SCC 10.

VERDICTUM.IN

excluding relevant materials or taking into consideration irrelevant material, the finding is perverse and infirm in law when it outrageously defies logic as to suffer from vice of irrationality. ***Kuldeep Singh*** clarifies that a finding is perverse when it is based on no evidence or evidence which is thoroughly unreliable and no reasonable person would act upon it. If there is some evidence which can be acted and can be relied upon, however compendious it may be, the conclusion should not be treated as perverse. This Court in ***Associate Builders*** emphasised that the public policy test to an arbitral award does not give jurisdiction to the court to act as a court of appeal and consequently errors of fact cannot be corrected. Arbitral tribunal is the ultimate master of quality and quantity of evidence. An award based on little evidence or no evidence, which does not measure up in quality to a trained legal mind would not be held to be invalid on this score. Every arbitrator need not necessarily be a person trained in law as a Judge. At times, decisions are taken acting on equity and such decisions can be just and fair should not be overturned under Section 34 of the A&C Act on the ground that the arbitrator's approach was arbitrary or capricious. Referring to the third ground of public policy, justice or morality, it is observed that these are two different concepts. An award is against justice when it shocks the conscience of the court,

VERDICTUM.IN

as in an example where the claimant has restricted his claim but the arbitral tribunal has awarded a higher amount without any reasonable ground of justification. Morality would necessarily cover agreements that are illegal and also those which cannot be enforced given the prevailing mores of the day. Here again interference would be only if something shocks the court's conscience. Further, 'patent illegality' refers to three sub-heads: (a) contravention of substantive law of India, which must be restricted and limited such that the illegality must go to the root of the matter and should not be of a trivial nature. Reference in this regard was made to clause (a) to Section 28(1) of the A&C Act, which states that the dispute submitted to arbitration under Part I shall be in accordance with the substantive law for the time being in force. The second sub-head would be when the arbitrator gives no reasons in the award in contravention with Section 31(3) of the A&C Act. The third sub-head deals with contravention of Section 28(3) of the A&C Act which states that the arbitral tribunal shall decide all cases in accordance with the terms of the contract and shall take into account the usage of the trade applicable to the transaction. This last sub-head should be understood with a caveat that the arbitrator has the right to construe and interpret the terms of the contract in a reasonable manner. Such interpretation should not be a ground to

VERDICTUM.IN

set aside the award, as the construction of the terms of the contract is finally for the arbitrator to decide. The award can be only set aside under this sub-head if the arbitrator construes the award in a way that no fair-minded or reasonable person would do.

44. As observed previously, we need not examine the amendment made to the A&C Act *vide* Act No. 3 of 2016 with retrospective effect from 23.10.2015 and the judgments that deal with the amended Section 34 of the A&C Act. Pertinently, the amendment to Section 34 of the A&C Act was effected, pursuant to the observations of the Supplementary Report to Report No. 246 on Amendments to Arbitration and Conciliation Act, 1996 by the Law Commission of India, titled '***Public Policy – Developments post-Report No. 246***' published in February 2015. This Supplementary Report observed that the power to review an arbitral award on merits under Section 34 of the A&C Act, as elucidated in the case of ***Western Geco***, subsequently followed in ***Associate Builders***, is contrary to the object of the A&C Act and international practice on minimization of judicial intervention. A reference can also be conveniently made to ***MMTC Ltd.*** v. ***Vedanta Ltd***.,[39] and ***Ssangyong Engg. & Construction Co. Ltd***. v. ***National Highways Authority of India***[40],

[39] (2019) 4 SCC 163 (for short, MMTC Ltd.).
[40] (2019) 15 SCC 131(for short, Ssangyong Engg).

VERDICTUM.IN

which examine the scope of intervention of courts under Section 34 of the A&C Act as amended by Act No. 3 of 2016. ***MMTC Ltd.*** and ***Ssangyong Engg.,*** and other judgments which deal with the amended Section 34 of the A&C Act that are not applicable in the present case.

45. We have extensively analysed the award, its patent flaws and illegalities which emanate from it, like the manifest lack of reasoning in arriving at the conclusions and the calculation of amounts awarded, which, in fact, amount to double or part-double payments, besides being contradictory etc. In view of our aforesaid reasoning, the award has been rightly held to be unsustainable and set aside by the division bench of the High Court exercising power and jurisdiction under Section 37 read with Section 34 of the A & C Act.

46. In view of the aforesaid discussion, the appeal is dismissed without any order as to costs.

.....J.
(SANJIV KHANNA)

.....J.
(M.M. SUNDRESH)

NEW DELHI;
SEPTEMBER 21, 2023.