IN THE HIGH COURT OF MADHYA PRADESH AT JABALPUR

Case No.	Arbitration Appeal No.13 Of 2017
Parties Name	M/s.C.M.I.Ltd. Vs. Union of India and others
Date of Judgment	09/12/2022
Bench Constituted	Justice S.A.Dharmadhikari
Judgment delivered by	Justice S.A.Dharmadhikari
Whether approved for reporting	Yes
Name of counsel for parties	For Appellant : Shri S.K.Gupta and Ms. Anjali Shrivastava -Advocates For Respondent nos.1 & 2 : Shri Sandeep Shukla-Advocate
Law laid down	An Arbitral award can be set aside by the Court, if the Court finds that award is vitiated by the patent illegality and if the same is apparent on the face of it. The learned Arbitrator and the trial court while rejecting the claim of the appellant, did not take into consideration Clause 702 of the IRS conditions. The loss ought to have been recovered from the subsequent contractor i.e. M/s. Sudarshan Telecom, Mumbai and not from the appellant, since the respondents have invoked the risk purchase clause on failure of the appellant to supply the material, therefore, the award is contrary to the terms and conditions of the agreement.
Significant paragraph numbers	Para Nos.14, 20, 21, 23, 24 & 25

(S.A.DHARMADHIKARI)
JUDGE

IN THE HIGH COURT OF MADHYA PRADESH AT JABALPUR

BEFORE

HON'BLE SHRI JUSTICE SUSHRUT ARVIND DHARMADHIKARI

ON THE 9th OF DECEMBER, 2022

ARBITRATION APPEAL No. 13 of 2017

BETWEEN:-

M/S C.M.I. LTD. THROUGH ITS GENERAL MANAGER (COMMERCIAL) C- 483, YOJNA VIHAR DELHI (DELHI)

.....APPELLANT

(BY SHRI S.K.GUPTA& MS.ANJALI SHRIVASTAVA-ADVOCATE)

AND

1. **UNION OF INDIA THROUGH ITS SECRETARY MINISTRY OF RAILWAY RAILWAY BHAWAN (DELHI)**
2. **GENERAL MANAGER WEST CENTRAL RAILWAY CORE BUILDING OPP. INDIRA MARKET JABALPUR (MADHYA PRADESH)**
3. **SH. ANURAG AGGARWAL SOLE ARBITRATOR SOUTH EASTERN RAILWAY CHAKRADHAR PUR, JHARKHADN (JHARKHAND)**

.....RESPONDENTS

(BY SHRI SANDEEP SHUKLA-ADVOCATE FOR RESPONDENT NOS.1 &2)

Reserved on : 08.09.2022

Pronounced on : 09.12.2022

This appeal having been heard and reserved for hearing, coming on for pronouncement this day, the court pronounced the following:

J U D G E M E N T

The instant appeal has been filed under section 37 (1)(B) of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as "the Act of 1996) being aggrieved by the Judgment dated 09.11.2016 passed in Arbitration Case No.76/2014 by the 10th Additional District Judge, Jabalpur (M.P.); whereby the application filed by the appellant under section 34 of the Act of 1996 has been dismissed and the Arbitration Award dated 20.01.2014 has been confirmed. The learned Arbitrator has rejected the claim of the appellant; wherein the quashment of recovery notice of Rs.49,80,049.06/- towards risk purchase amount was sought to be recovered.

2. The appellant is a Public Limited Company incorporated under the Companies Act, 1956, engaged in the production of signalling and Telecom cables, having its registered office at 501-503, New Delhi House, 27, Barakhamba Road, New Delhi. The appellant is a small scale industry, registered with National Small Industries Corporation (N.S.I.C.) and under Micro Small and Medium Enterprises Development (MSMED) Act, 2006. Since, the Railways is the only purchaser of the material produced by the appellant, the appellant/Company is solely dependent on the payment received from the Railway for running the industry. The production is

chalked out by the company keeping in view the flow of the funds from various Railway Zones and by taking the said funds, supplies were made to the various purchase orders.

3. The brief facts, which are necessary for the just and proper adjudication of the case, are that on 26.05.2010, West Central Railway, Jabalpur (for short "WCR") floated a tender for supply of signalling cables and invited offers from the interested parties. The appellant was one of the bidders in the said tender. The tender was opened on 26.05.2010; wherein the appellant has been declared successful bidder. The terms and conditions of contract, as per the tender documents, include the IRS conditions (Indian Railway Standard Conditions of Contract). After appellant having been declared as a successful bidder, on 20.07.2010 advance acceptance letter was issued to the appellant by the respondents. A purchase order dated 07.09.2010 was also issued to the appellant for supply of 170 kms. PVC Armoured signalling cables 12 Core X 1.55 mm sq. valued at Rs.1,87,67,451.94/-.

4. Since over Rupees Four crores were due from various Railway Zones, it had become difficult for the appellant to supply the goods, therefore, on 11.02.2011 appellant requested the respondents for extension of time or to cancel the purchase order without any financial adversities. The respondents/Railways replied to the above request almost after 4 and ½ months.

5. On 03.03.2011 the respondents cancelled the contract and invoked Clause 702 of the IRS conditions for supply of the article, as ordered by the respondents and intimated to the

appellant that according to Clause 702 of the IRS condition, the Railways would purchase the material at various cost of the appellant. Even though the appellant was ready to supply the material; however, for want of funds extension of time was prayed for, but no reply was received from the Railways.

6. From the records, it is further revealed that on 24.06.2011 it was informed to the appellant that if he is interested in re-fixation of delivery period (DP) with liquidated damages, in that case the request of the appellant can be considered by the respondents. However, the appellant did not reply to the same, but sought extension of time to supply the material, as per tender conditions dated 26.05.2010 with a request to extend the time without liquidated damages.

7. On 03.08.2011 the respondents cancelled the contract of the appellant, in which it was also intimated that the fresh purchase shall be made after applying the clause of risk purchase at the risk of the appellant. On 08.08.2011, 10% amount of security was demanded by the respondents from the appellant on the count that appellant participated in the risk purchase tender and as per condition laid down in 702 of the IRS condition, 10% security amount is required to be deposited and in case the amount is not deposited then the person concerned cannot participate in the rebid process. Thereafter, on 06.09.2011 the risk purchase tender was opened by the respondents. Vide communication dated 24.10.2011 the appellant was informed that in case 10% security is not deposited, or no reply is submitted, in that case the risk purchase tender would be finalized at the risk and cost of the appellant. From the record it

appears that the appellant did not furnish the security as demanded by the respondents. However, the respondents again granted one opportunity vide communication dated 03.11.2011 to the appellant to furnish the security but from the record it is seen that the said security was not deposited by the appellant.

8. Thereafter advance acceptance of tender letter was issued by the respondents to one M/s. Sudarshan Telecom, Mumbai for an amount of Rs.2,37,47,501/-. It was also intimated that the counter offer was required to be accepted on or before 05.12.2011 and the purchase order would be issued at a later stage. Thus, it transpires that on 12.11.2011, no agreement was executed between the parties or in other words no agreement was in existence when the advance acceptance letter was issued by the respondents to M/s. Sudarshan Telecom, Mumbai. That in terms of Clause 702 of the IRS condition, if the Railways have placed an order to purchase the material from another supplier, the risk purchase clause would apply and the amount would have been recovered from the original contractor i.e the appellant, who failed to supply the material, as ordered according to the terms and conditions of contract.

9. It appears that purchase order was issued by the respondents in favour of M/s Sudarshan Telecom, Mumbai with DP. The same was awarded in a haste manner and after laps of 9 months from risk purchase tender. However, M/s. Sudarshan Telecom did not supply the material and ultimately the respondents cancelled the purchase order. As per the IRS conditions, advance acceptance letter was also time barred but despite that, tender was issued contrary to the terms and

conditions of contract. The respondents were not in a position to reply to the specific query in respect of issuance of advance acceptance letter and also could not satisfactorily answer. That even M/s Sudarshan Telecom failed to supply the goods, the respondents were constrained to issue purchase orders to various other companies namely;

(i) M/s Vindhya Telelinks Limited, Rewa

(ii) M/s Paramount Wires & Cables Limited, New Delhi

(iii) M/s Satellite Cables Private Limited, New Delhi

(iv) M/s Sriram Cables Private Limited, Alwar.

10. Learned counsel for the appellant contended that the original award as well as the order passed by the trial court deserves to be set aside. Neither the Arbitrator nor the trial court had considered the aspect of violation of Condition No.0702 of the IRS Conditions. The subsequent purchase order was beyond the period of 9 months. Only in one sitting, the Arbitrator disposed of the case. The second supplier i.e. M/s Sudarshan Telecom, Mumbai also became defaulter. No findings have been recorded in respect of liquidated damages either by the Arbitrator or the trial court. On these grounds, the order of the learned trial court deserves to be set aside.

11. On the other hand, learned counsel for the Railways opposed the prayer and supported the order by the Arbitral Tribunal as well as the trial court and contended that on failure of M/s Sudarshan Telecom in supply the materials, the respondents were constrained to issue purchase order to other companies. Moreover, on account of purchase from other 4 companies, the respondents suffered a huge financial loss,

therefore, an amount of Rs.49,80,040.06/- was demanded by the respondents from the appellant and under the head "Risk Purchaser Tender" was sought to be recovered. In view of the aforesaid dispute arose between the parties, the demand was issued. As a consequence, the arbitration clause was invoked by the appellant and a request was made for appointment of an Arbitrator. The respondents accordingly appointed a sole Arbitrator for adjudication of the claim of appellant. The arbitral proceedings commenced. Statement of claim, statements of defence and other relevant material and documents were filed by the parties and after considering the pleadings, the award was passed on 20.01.2014 by the sole Arbitrator. The sole Arbitrator in its award rejected the claim of the appellant and confirmed the demanded made the respondents.

12. Being dissatisfied by the said award, an application under section 34 of the Act of 1996 was filed before the trial court and the same was rejected on 09.11.2016. Being aggrieved, the present appeal under section 37 (1)(B) of the Act of 1996 has been filed.

13. I have heard the learned counsel for parties at length and also perused the record of the case.

14. It is seen from the statement of claim that no other point has been raised by either of the parties, apart from the pleadings and the submissions made before this Court. However, few important questions, which require consideration for determination of the dispute in the present appeal, are as under :-

(i) Whether Clause 702 of the IRS conditions have been considered either by the Arbitrator or by the

trial court while rejecting the claim of the appellant?

(ii) Whether the risk purchase tender or the liability of the risk purchase tender can be fastened on the appellant despite the fact that the risk purchase tender also failed since M/s Sudarshan Telecom, Mumbai, who is the subsequent contractor, also failed to supply the material as requested ?

(iii) Whether under section 34(2) of the Act of 1996 can the Court enlarge the jurisdiction to set aside the award passed by the Arbitrator as well as the Civil Court ?

(iv) Whether the scope of section 37 of the Act of 1996 is limited to the findings recorded by the Arbitral Tribunal or by the learned trial court or on the ground of patent illegality or contravention of the terms of the agreement, award may be interfered by this Court and upto what extent ?

15. Now this Court would deal with question nos.1 and 2 simultaneously. It is not in dispute that the tender was floated for supply of the required material, as indicated in the tender document dated 26.05.2010.

16. The demand has been affirmed by the sole Arbitrator in favour of the respondents. Clause 702 of the IRS Conditions would have to be examined since the entire case of the appellant is based on the aforesaid condition, which is reproduced below :-

"0702. Failure and Termination:- If the Contractor fails to deliver the stores or any instalment thereof within the period fixed for such delivery in the contract or as extended or at any time repudiates the contract before the expiry of such period the Purchaser may without prejudice to his other rights:-

Recover from the Contractor as agreed liquidated damages and not by way of penalty a sum equivalent to 2 per cent of the price of any stores (including elements of taxes, duties, freight, etc.) which the Contractor has failed to deliver within the period fixed for delivery in the contract or as extended for each month or part of a month during which the delivery of such stores may be in arrears where delivery thereof is accepted after expiry of the aforesaid period, or

Cancel the contract or a portion thereof and if so desired purchase or authorize the purchase of the stores not so delivered or others of a similar description (where stores exactly complying with particulars are not in the opinion of the Purchaser, which shall be final, readily procurable) at the risk and cost of the Contractor. It shall, however, be in the discretion of the purchaser to collect or not, the security deposit from the firm/firms on whom the contract is placed at the risk and expense of the defaulted firm.

Where action is taken under Sub clause (b) above, the Contractor shall be liable for any loss which the Purchaser may sustain on that account provided the purchase, or, if there is an agreement to purchase 1 such agreement is made, in case of failure to deliver the stores within the period fixed for such delivery in the contract or as extended within six months from the date of such failure and in case of repudiation of the contract before the expiry of the aforesaid period of delivery, within six months

> from the date of cancellation of the contract. The Contractor shall not be entitled to any gain on such purchase and the manner and method of such purchase shall be in the entire discretion of the Purchaser. It shall not be necessary for the Purchaser to serve a notice of such purchase on the Contractor.
>
> Note- In respect of the stores which are not easily available in the market and where procurement difficulties are experienced the period for making risk purchase shall be nine months instead of six months provided above."

That from the aforesaid Clause 702 of the IRS Conditions, it is clear that the respondents could have invoked the risk purchase clause in case of failure of the contractor to supply the requisite material and according to the conditions mentioned in the RDSO upto unit, exemption to furnish the security deposit under Para (b)(2) has been provided, therefore, the appellant was not required to furnish the security in the risk purchase tender. However despite that, security deposit was demanded by the respondents from the appellant. Time was also extended to deposit the security amount.

17. Clause 702 of the IRS conditions further stipulates that the material is required to be purchased within a period of 6 months after cancellation of the contract. The records show that in the present case the material was purchased or ordered after a lapse of more than 9 months from the date of cancellation of contract. The subsequent supplier i.e. M/s Sudarshan Telecom, Mumbai also failed to supply the material. Therefore, the Arbitral Tribunal had committed an error in holding that demand

of difference amount of raw material purchased by the respondents from other private suppliers is proper; whereas the Arbitral Tribunal ought to have seen that Clau**se** 702 of the IRS conditions is required to be looked into strictly, which has not been done in the present case. It is pertinent to mention at this stage that since M/s Sudarshan Telecom failed to supply the material, then the liability could not have been fastened on the appellant. Therefore, in the light of agreement and section 34 (2)(B)(ii) of the Act of 1996, award can be interfered. Since it appears that the award passed by the Arbitrator is contrary to the terms and conditions of the agreement, the same is liable to be set aside.

18. This Court cannot re-appreciate the evidence and the findings recorded by the Arbitrator are just and proper. Accordingly, the question nos.1 and 2 are answered in favour of the appellant.

19. Now this Court shall deal with the question nos.3 and 4 simultaneously. The plea of the respondents is that the material was purchased from other suppliers and the tender was floated by the respondents. It is also an admitted fact that one M/s. Sudarshan Telecom was awarded the risk purchase tender but also failed to supply the material. It is also pertinent to mention here that the last date for supply of material by the appellant was 13.02.2011 and the risk purchase notice was issued to the appellant on 03.03.2011. Prior to 03.03.2011, the appellant had forwarded a letter showing its inability to supply the raw material on account of shortage and requested the respondents to either cancel the contract or re-fix the delivery

period. However, no reply was submitted by the respondents. Not only this, risk tender was opened after lapse of 10 months. Thus, the argument of the Railways that there was urgent requirement of material, has no legs to stand. The respondents as well as the sole Arbitrator ought to have taken into consideration this aspect, in absence of which the patent illegality has been committed by the respondents as well as the Arbitrator, thus on this pretext only, the award can be interfered by this Court. Accordingly, question nos.3 and 4 are answered.

20. The findings recorded by the Tribunal appear to be wrong inasmuch as the letter dated 12.11.2011 in favour of M/s Sudarshan Telecom is not ante-dated and risk purchase was rightly concluded, therefore, the appellant is liable to make payment of Rs.49,00,849.06/-, however, the Arbitral Tribunal failed to give findings in respect of the conclusion of the risk purchase contract between the respondents/Railways and M/s Sudarshan Telecom, who could not supply the material, therefore, loss sustained by the Railways could have been recovered from the subsequent supplier i.e. M/s Sudharshan Telecom and not from the appellant.

21. Thus, in view of the aforesaid discussions and also taking into consideration the fact that the main Clause of 702 of IRS conditions, which has a statutory force, it is apparent that :-

i. The demand is based upon risk purchase agreement according to clause 702 but the respondents failed to produce any material to demonstrate that any agreement executed as an

outcome of risk purchase tender within the statutory period.

ii. The sole Arbitrator failed to justify the demand of the bidders that Annexure B is not a part of the contract between appellant and the respondents.

iii. No agreement was executed by the respondents with M/s Sudarshan Telecom and apart from this M/s Sudarshan Telecom was not asked to make good the loss, therefore, the conclusion of the Arbitral Tribunal is contrary to the terms of the agreement and falls within the purview of the Section 34(2)(B)(ii) of the Act of 1996

iv. The demand is without any basis, thus, the respondents have failed to establish any losses suffered on non-supply of the material by the appellant.

22. However, for the purpose of convenience, Section 34 of the Act of 1996 is reproduced below :-

> "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
(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.

(5) An application under this section shall be filed by a party only after issuing a prior notice to the other party and such application shall be accompanied by an affidavit by the applicant endorsing compliance with the said requirement.

(6) An application under this section shall be disposed of expeditiously, and in any event, within a period of one year from the date on which the notice referred to in sub-section (5) is served upon the other party."

Section 37 of the Act of 1996 also reads as under :-

"37. Appealable orders.—

(1) An appeal shall lie from the following orders (and from no others) to the Court authorised by law to hear appeals from original

> decrees of the Court passing the order, namely:—
> (a) granting or refusing to grant any measure under section 9;
> (b) setting aside or refusing to set aside an arbitral award under section 34.
> (2) An appeal shall also lie to a Court from an order granting of the arbitral tribunal.—
> (a) accepting the plea referred in sub-section (2) or sub-section (3) of section 16; or
> (b) granting or refusing to grant an interim measure under section 17.
> (3) No second appeal shall lie from an order passed in appeal under this section, but nothing in this section shall affect or take away any right to appeal to the Supreme Court."

23. On bare reading of the language of aforesaid sections of the Act of 1996, it is clear that an Arbitral award arising out of Arbitration, other than international/Commercial Arbitration, may be set aside by the Court, if the Court finds that award is vitiated by the patent illegality and if the same is apparent on the face of it, the Arbitral Tribunal has incorrectly applied Clause 702 of IRS conditions in the present case. The Arbitral Tribunal has seriously erred in not appreciating the admitted fact that the subsequent supplier i.e. M/s Sudarshan Telecom did not supply the requisite material as ordered by the respondents though advance acceptance letter dated 12.11.2011 was issued, therefore, the recovery of an amount of Rs.49,00,849.06/- is patently illegal, therefore, the Court in exercise of powers under section 37 of the Act of 1996 can certainly interfere. Since the award passed by the Arbitral Tribunal is not justified, therefore, the same is liable to be set aside. This Court is very well

conscious of the fact that to interfere with the award as also the order of trial court, the power of appellate court is similar to section 34 of the Act of 1996. As the trial court has exercised its jurisdiction capriciously, arbitrarily and the same is perverse, the orders can be interfered.

24. The appellate Court can interfere with the award only if there is an error on the face of award or basically if the Arbitrator has ignored the terms and conditions of contract. In this case, Clause 702 of the IRS conditions has been ignored by the Arbitral Tribunal as well as the Arbitrator. The demand of Rs.49,00,849.06/- is unreasonable and contrary to the terms and conditions. Thus, the award of the Arbitrator is hereby set aside so also the demand is also quashed.

25. At the stage, it is relevant to mention that in the light of sections 73 and 74 of the Contract Act and particularly Clause 702 of the IRS conditions, in case of breach, the purchaser would be entitled for the actual loss suffered by it by way of compensation. Hypothetical figures cannot be considered to cover up the loss. In the present case, the respondents have failed to establish as to how much loss have been sustained and the risk purchase agreement has been materialized or not.

26. The Apex Court in the case of ***Associate Builders Vs. Delhi Development Authority (2015) 3 SCC 49*** has held that if the arbitral award is in conflict with the public policy of India, then the same can be interfered. The relevant paras are reproduced below :-

> **"28.** In a recent judgment, *ONGC Ltd.* v. *Western Geco International Ltd.* [(2014) 9

SCC 263 : (2014) 5 SCC (Civ) 12] , 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: (SCC pp. 278-80, paras 35 & 38-40)

"*35*. What then would constitute the 'fundamental policy of Indian law' is the question. The decision in *ONGC* [(2003) 5 SCC 705 : AIR 2003 SC 2629] 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 for a 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.

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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.

39. 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* [*Associated Provincial Picture Houses Ltd.* v. *Wednesbury Corpn.*, (1948) 1 KB 223 : (1947) 2 All ER 680 (CA)] principle 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."

(emphasis in original)

29. 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.

30. 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.

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34.*Application for setting aside arbitral award*.—(1)***

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

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

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(*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;"

Patent Illegality

40. 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 Denning, L.J. in *R.* v. *Northumberland Compensation Appeal Tribunal, ex p Shaw* [(1952) 1 All ER 122 : (1952) 1 KB 338 (CA)] : (All ER p. 130 D-E : KB p. 351)

"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* Statutes 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 : 102 ER 502], 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 CB (NS) 189 : 140 ER 712] , but is now well established."

42.1. (*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 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;"

42.3. (*c*) Equally, the third subhead 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***.—(1)-(2)***

(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."

27. Similarly, in the case of ***Patel Engineering Limited Vs. North Eastern Electric Power Corporation Ltd.(NEEPCO), SLP(C) Nos3584-85 Of 2020*** the patent illegality has been defined by the Apex Court in which the reliance has been placed on the judgment of ***Associate Builders (Supra).*** The Apex Court has further held that if the award is contrary to section 31(3), then also the same comes within the purview of patent illegality. The Arbitral Tribunal did not record any finding on Clause 702 of the IRS conditions and the demand is purely based upon the purchase agreement. Thus in light of this, the award is not sustainable and as a consequence the order of trial court also deserves to be quashed.

The relevant paras are reproduced below :-

> "17. In the subsequent judgment of Associate Builders, this Court discussed the ground of patent illegality as a ground under public policy for setting aside a domestic award. The relevant extract of the judgment in Associate Builders case (supra) reads as follows :-
>
> **"40.** ***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 Denning, L.J. in *R.* v. *Northumberland Compensation Appeal Tribunal, ex p Shaw* [(1952) 1 All ER 122 : (1952) 1 KB 338 (CA)] : (All ER p. 130 D-E : KB p. 351)

> "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* Statutes 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 : 102 ER 502] , 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 CB (NS) 189 : 140 ER 712] , but is now well established."

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

42.1. (*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 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;"

42.2. (*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.

42.3. (*c*) Equally, the third subhead 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***.—(1)-(2)***

(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.(emphasis supplied)"

18. The Law Commission in its 246th Report recommended the insertion of the ground of 'patent illegality' for seeting aside a domestic award by the insertion of clause (2A) in Section 34 of the Act. The relevant extract from the Report of the Law Commission is extracted herein below :-

"It is for this reason that the Commission has recommended the addition of section 34 (2A) to deal with purely domestic awards, which may also be set aside by the Court if the Court finds that such award is vitiated by "patent illegality appearing on the face of the award." In order to provide a balance and to avoid excessive intervention, it is clarified in the proposed proviso to the proposed section 34 (2A) that such "an award shall not be set aside merely on the ground of an erroneous application of the law or by reappreciating evidence." The Commission believes that this will go a long way to assuage the fears of the judiciary as well as the other users of arbitration law who expect, and given the circumstances prevalent in our country, legitimately so, greater redress against purely domestic awards. This would also do away with the unintended consequences of the decision of the Supreme Court in ONGC vs. Saw Pipes Ltd, (2003) 5 SCC 705, which, although in the context of a purely domestic award, had the unfortunate effect 22 of being extended to apply equally to both awards arising out of international commercial arbitrations as well as foreign awards, given the statutory language of the Act"(emphasis supplied)).

> To give effect to the said recommendation, it was suggested that:
>
> "(iii) After the Explanation in sub-section (2), insert sub-section "(2A) 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 re-appreciating evidence."
>
> [NOTE: The proposed S 34(2A) provides an additional, albeit carefully limited, ground for setting aside an award arising out of a domestic arbitration (and not an international commercial arbitration). The scope of review is based on the patent illegality standard set out by the Supreme Court in ONGC Ltd. v. Saw Pipes Ltd., (2003) 5 SCC 705. The proviso creates exceptions for erroneous application of the law and re-appreciation of evidence, which cannot be the basis for setting aside awards.]" (emphasis supplied)"

28. In view of aforesaid analysis, the appeal is **allowed** and the demand of Rs.49,80,049.06/- as also the impugned order dated 09.11.2016 passed by the trial court under section 34 of the Act of 1996 are hereby set aside.

29. Looking to the facts and circumstances of the case, there shall be no order as to costs.

(SUSHRUT ARVIND DHARMADHIKARI)
JUDGE