Tarapore and Company

Vs

Cochin Shipyard Ltd., Cochin and Another

Civil Appeal No. 3023 of 1980

(D. A. Desai, O. Chinnappa Reddy JJ)

06.03.1984

JUDGMENT

DESAI, J. -

1. In this appeal by special leave a very interesting question in the filed of law of arbitration which 'honest man dread more than the dreaded law suits' arises for our consideration.

2. First respondent Cochin Shipyard Limited ('respondent' for Short) invited tenders for construction of Building Dock at Cochin. As there was only one tender that of Tarapore and Company, the appellant, the respondent called fresh tenders some where in July, 1971. In December, 1971, the respondent invited tenders for construction of a Repair Dock also at Cochin. There were two tenders for Building Dock, namely, one of the appellant and one by M/s. National Building Construction Corporation, a Government of India undertaking, the value of the tender of the latter being double that of the appellant. For the construction of the Repair Dock, the only tender was of the appellant. In view of the limited number of tenders received, the appellant was invited to negotiate the terms of the tender. The value of the works to be executed was over Rs. 24 crores. In view of the huge investment in the project, the tenders were examined by a committee called the Tender Committee constituted in accordance with the approval of the Ministry of Shipping and Transport for examining and evaluating the tenders received for the Building Dock and the Repair Dock. The Tender Committee taking note of the poor response to the invitation to tender and costly affair note of the poor response to the invitation to tender and costly affair decided to accept the tender of the appellant inter alia for the reasons (i) that works of such complexity and magnitude have not been undertaken before by any Indian contractor, (ii) that the plant and equipment required for the work are not available indigenously, (iii) that if the contractor is to procure the specialised equipment required for this work, there is hardly any assurance that after these works are over, he would find any substantial use for the same, (iv) that excavation and subsequent construction involve de-watering which introduces considerable amount of uncertainty and that during the discussions, the apprehension of the tenders of this kind was voiced and noticed by the Committee, and (v) that RCC Piling also requires highly skilled and complex technical operations and it involves a large element of risk and uncertainty in the work. Both the tenders of the appellant were accepted, and contracts were entered into between the parties. Both the parties while entering into contracts were aware and conscious of the fact that equipment and technical know-how would have to be imported involving a huge outlay of foreign exchange. Appellant-contractor quoted rates on two alternative basis depending upon whether it had to import equipment know-how at its cost involving Rs. 2 crores in foreign exchange or the equipment and know-how were to be imported by the respondent at its cost and made available for use of the appellant in which case the appellant would be liable to pay hire charges for the pile driving plant at the rate of Rs. 23 per meter of 600 mm dia. RCC cast-in-situ

pipe and Rs. 16 per metre of 500 mm dia RCC cast-in-situ pipe and at the rate of 300 per tonne of steel sheet pipes driven to be recovered from the running bills payable to the appellant-contractor. The appellant was given to understand by a note in the invitation to tender that foreign exchange in yen credit to the tune of Rs. 38 lacs is earmarked for the purchase of construction equipment, accessories etc. from Japan for works of Building Dock, Repair Dock, the three Quays etc. On January 24, 1973, work order for Building Dock and Repair Dock was issued by the respondent in favour of appellant and in this work order as recommended by the Tender Committee, the respondent adopted the alternative B as set out in the tender, namely, that the contractor was to procure the equipment and know-how at a cost of about Rs. 2 crores in foreign exchange. In order to make this aspect specific, additional condition No. 31 was incorporated in the works order in order to provide for expense to be incurred and the amount of foreign exchange needed for importing equipment and technical know-how, relevant portion of which reads as under :

> Requisite foreign exchange, for importing piling plant and machinery, spares, technical know-how and hiring of experts necessary for both the Dock Works vide Work Order No. 13019/1/71-W-II dated January 24, 1973 for Building Dock etc. and Work Order No. 13012/15/71-W-II dated January 24, 1973 for Repair Dock etc., amounting to about Rs. 2 crores in all will be made available to the contractor from the Eleventh Yen Credit subject to his getting indigenous clearance and providing detailed justification. The details of such procurement shall be furnished by the contractor as soon as they are finalised.

In view of the huge investment, it was agreed that the respondent would make an advance payment of 75 per cent of the value of old machinery and 90 per cent of the value of new machinery brought to site by the contractor and in order to secure this advance payment, equipment would be hypothecated by the contractor to the respondent and the advance payment were to carry interest at 9 1/2 per cent p.a. on the outstanding balance of advance. The mode of recovery was also specified. The formal contract was signed on January 29, 1973 which included an arbitration clause to which we would turn a little later.

3. It so happened that the required pile driving equipment including the technical know-how against Eleventh Japanese Yen Credit were not available. The respondent also made inquiries in this behalf but without success. Ultimately International Foundation Group, Holland agreed to provide the rate of equipment conforming more or less to the same specification for which clearance was sought and received from the Government of India. After the respondent certified that the equipment and know-how offered by International Foundation Group, Holland conform to the earlier clearance and that the same equipment being not indigenously available or against Eleventh Japanese Yen Credit, the respondent requested the Government of India to give necessary clearance to the appellant to import the equipment. This approval was received on September 1, 1973 and the foreign exchange to the extend of Rs. 211.80 lakhs equal to 94,42,700 Dutch Florins was released in favour of the appellant. The entire imported equipment was received in four consignments between March/July, 1974. During the intervening period, there were variations in the rate of exchange and therefore the foreign exchange cost of equipment alone in terms of rupees worked out at Rs. 177.50 lakhs and of the technical know-how fees payable in 11 installments worked out at Rs. 105 lakhs. The customs duty went up by Rs. 21 lakhs as a consequence of the increase in rupee value of the imported equipment in terms of Dutch Florin.

4. The appellant made a tentative claim in the amount of Rs. 61.27 lakhs from the respondent on account of increase in cost of pile driving equipment and technical know-how fees on the ground

that the contractor was entitled to be compensated by the respondent for the same. In the letter dated May 28, 1975, the appellant has stated that the "tendered rates were based on certain total cost of machines which has since gone up considerably rendering the rates no longer workable. The appellant had provided for a cost of 150 lakhs of rupees for the equipment and the life of the equipment was taken as 12,000 hours and its probable period of engagement on this job was taken as 8000 hours. On this basis two-thirds of the cost of the equipment will be written off by way of depreciation on this job." It was also stated that there is an increase in the fees for the technical know-how. The letter concluded by saying that the loss sustained by the appellant upto May 15, 1975 on account of variation in the rate of foreign exchange was Rs. 61,27,317 and requested the respondent to compensate the loss at least upto the tune of Rs. 45 lakhs which is approximately 75 per cent of the loss suffered by the contractor in this behalf. The respondent responded to this letter as per its letter dated July 2, 1975 saying that the letter dated July 14, 1972 of the appellant which forms part of the contract documents clearly recites that the total foreign exchange required by the contractor for the equipment, spares, technical know-how and hiring of experts, was expected to be about Rs. 2 crores and that the expenditure incurred by the contractor in this behalf so far has been less then Rs. 2 crores and in the circumstances it was found difficult to accept the position that the tender was based on the assumptions indicated in the letter under reply and that rates for the pile driving should for the future be revised. There ensued further correspondence between the parties. Ultimately, the appellant by its letter dated March 1, 1976 informed the respondent that its claim for compensation for increase in the cost of imported pile driving equipment and technical know-how fees has not been entertained for over a year. It was further stated that "inasmuch as the dispute has thus arisen between us regarding the above claim, we are invoking the provisions for arbitration in our contracts and referring this dispute to arbitration". On March 17, 1976 Chief engineer of the respondent replied saying that the matter as set out in the letter dated March 1, 1976 invoking arbitration clause is receiving their immediate attention and the appellant will hear shortly in this behalf. On March 29, 1976, the respondent wrote to the appellant denying the claim for compensation of the appellant. Simultaneously the respondent framed three points covering the dispute so raised for reference to and decision by the arbitrator. The letter also sets out as required by Clause 40 a panel of three names from which anyone can be chosen by the appellant as the sole arbitrator. The appellant by its letter dated April 19, 1976 while refuting the contention of the respondent that the dispute would not be covered by Clause 40 i.e. arbitration clause in the contract, stated that the proper course would be to refer the dispute that has arisen between the parties to the decision of the arbitrator and not any particular issue or issues. Ultimately from amongst the three names indicated by the respondent the appellant selected Shri. C. Srinivasa Rao, Chief Bridge, Engineer, Southern Railway, Madras to be the sole arbitrator to decide the dispute. On receipt of this letter the respondent referred the dispute to Shri. C. Srinivasa Rao as sole arbitrator. While referring the dispute to the sole arbitration of Shri. C. Srinivasa Rao, the respondent retained the three points of reference set out in the letter dated March 29, 1976 but added one more. The arbitrator entered upon the reference on June 2, 1976. On being called upon by the arbitrator, the appellant filed its statement of claim on June 16, 1976. The appellant claimed Rs. 2,03,47,266 as per the Schedule to the Statement of Claim on account of increase in the cost of equipment and technical know-how fees. The respondent filed its reply to the Statement of Claim on July 19, 1976.

5. The points/disputes referred by the sole arbitrator read as under :

> 1. Does the claim of Messrs. Tarapore and Co. on Cochin Shipyard Ltd., for compensation for increase in the cost of imported pile driving equipment and technical know-how fees referred to in clauses (2) and (3) hereunder fall within the purview of the first paragraph of Clause 40 of the General Conditions of Contract

entered into between the two parties ?

2. If the answer to (1) above is in the affirmative, in terms of the provisions of the contract are Messrs. Tarapore and Co. entitled to compensation for increase in the cost of imported pile driving equipment and technical know-how fees to be paid to them by Cochin Shipyard Ltd. ? If so, what is the amount ?

3. The dispute that has arises between Messrs. Tarapore and Co., and Cochin Shipyard Ltd. regarding the claim of M/s. Tarapore and Co., for compensation for increase in the cost of the imported pile driving equipment and the technical know-how fees.

4. Costs.

Parties appeared before the arbitrator through there respective counsel. The arbitrator gave his award on July 6, 1977. On Point No. 1 the arbitrator held as under :

> The claim of Messrs. Tarapore and Company on Cochin shipyard Limited for compensation for increase in the cost of imported pile driving equipment and technical know-how fees falls within the purview of the first paragraph of Clause 40 of the General Conditions of Contract entered into between the parties.

On Point No. 2 the arbitrator held that the appellant "Messrs. Tarapore and Company are entitled to compensation by the Cochin Shipyard Limited for the increase in the cost of imported pile driving equipment and the technical know-how fees by a sum of Rs. 99 lakhs only which amount shall be payable with interest at 9 1/2 per cent per annum from this date till date of payment or decree, whichever is earlier". On Point No. 3, the decision recorded was "that it is covered by the decision on Points Nos. 1 and 2". On Point No. 4, on the question of costs, the arbitrator having determined his fees and incidental expenses directed both the parties to bear the same equally. The award was typed on a stamp paper of the value of Rs. 150 at Madras. By his letter dated Nil July, 1977, the sole arbitrator forwarded the award to both parties.

6. The appellant moved a petition under Section 14 and 17 of the Arbitration Act in the Court of the Subordinate Judge, Ernakulam for filing the award and for making it a rule of the court. On October 7, 1977 the respondent moved O.P. 81 of 1977 being a combined petition under Sections 30 and 33 of the Arbitration Act before the subordinate Judge, Ernakulam praying for setting aside the award. The prayer for setting aside the award was founded on two grounds : (1) that the award is insufficiently stamped and (2) that the Arbitrator has exceeded his jurisdiction by miscontruing Clause 40 of the General Conditions of Contract (arbitration clause for short).

7. The learned subordinate Judge noted the fact that the award was originally engrossed on a stamp paper of Rs. 150 but before filing the award in the Court on August 4, 1977, the arbitrator on August 1, 1977 affixed additional stamp of Rs. 14,722.50 p which would be the requisite stamp under Article 12 read with Article 14 of the Kerala Stamp Act. The learned Subordinate Judge accordingly negatived the contention of the respondent that the award was insufficiently stamped. On the second point, the learned Judge held that the respondent having submitted the question whether the dispute raises by the appellant was covered by the arbitration clause cannot be permitted to controvert the jurisdiction of the arbitrator to decide this dispute and accordingly, negatived the contention of the respondent. The learned Judge after modifying the award of the arbitrator in the

matter of interest from 9 1/2 per cent as awarded by the arbitrator to 6 per cent granted the application of the applicant and made the award a rule of the court.

8. The respondent preferred M.F.A. 409 of 1979 in the High court of Kerala at Ernakulam. A Division Bench of the High Court agreed with the learned Subordinate Judge on the question of insufficiency of stamp. The Division Bench however, after expressing its displeasure about not making a reasoned award by the arbitrator proceeded to examine the contention whether the arbitration clause covers the dispute. The Court held that the question whether the dispute is arbitrable or not cannot be finally decided by the arbitrator because it is a matter relating to his jurisdiction. It was further held that the arbitrator cannot by an erroneous interpretation or construction of the clause confer jurisdiction on himself and the Court can go into the question whether the matter in dispute between the parties is covered by the arbitration clause. The specific contention of behalf of the appellant that once a specific question of law is referred to the arbitrator, the parties are bound by the decision of the arbitrator was negative by the High Court and it was held that as the respondent has joined arbitration under protest, it was not stopped from contesting the question and the award is not binding on it if it can be shown that the arbitration agreement did not cover the dispute raised by the appellant. The Court finally held that even though the arbitration clause was very wide, the dispute as to the compensation for increase in the cost of imported pile driving equipment and technical know-how fees would not be covered by the arbitration clause inter alia on the ground that by Clause 26 of the General Conditions of Contract every plant, machinery and equipment had to be provided by the contractor and any rise of escalation in the price of such equipment or machinery cannot be the subject matter of compensation by the respondent. Accordingly, the appeal of the respondent was allowed and the judgment and order of the trial court making the award rule of the court was set aside. The Court directed that the award be returned to the parties. Hence this appeal by the contractor by special leave.

9. Before we advert to the rival contentions, it would be advantageous to refer to the arbitration clause being Clause 40 of the General Conditions of Tender subject to which the contract was entered into, the relevant portion of which reads as under :

> Clause 40. Except where otherwise provided in the contract, all questions and disputes relating to the meaning of the Specifications, Instructions, Designs, Drawings hereinbefore mentioned and as to the quality or workmanship or materials used on the work or as to any other questions, claim, right, matter or thing whatsoever in any way arising out of or relating to the Contract, Designs, Drawings, Specifications, Estimates, Instructions, Orders or these conditions or otherwise concerning the works or the execution or failure to execute the same, whether arising during the progress of the work or after completion or abandonment thereof shall, after written notice by either party to the contract, to the either of them, be referred to the sole arbitration of a person appointed by the Chief Project Officer of the Cochin Shipyard Project or the Administrative Head of the Cochin Shipyard Project at the time of such appointment by whatever designation know, from panel of names given in Annexure II.

Over and above the extracted portion, the clause provides for the manner and method of appointing the sole arbitrator, the continuance of the work during progress of arbitration proceedings, the time and place of holding the arbitration proceedings, the power to enlarge the period for making the award and finality to be attached to the award of the arbitrator.

10. When the arbitration clause was invoked by the appellant, the respondent did contend that the dispute raised by the appellant was not covered by the arbitration clause. After specifying its demur, the respondent formulated the points in dispute on which the arbitrator was invited to give his award. Undoubtedly, the respondent proceeded to formulate the points in dispute between the parties on which the arbitrator was to be invited to give his award without prejudice to its right to contend that the dispute is not covered by the arbitration clause and that the appellant is not entitled to any compensation in respect of the increase in the cost of imported pile driving equipment and technical know-how fees. What is the effect of referring the specific question of law to arbitrate with prejudice to one's right to contend to the contrary will be presently examined. The fact remain that on the dispute arising out a claim for compensation on account of the increase in the cost of imported pile driving equipment and technical know-how fees, the respondent agreed to refer the dispute under two specific heads to the arbitrator. The dispute so raised have already been extracted. Briefly stated they are : (1) whether the claim for compensation would fall within the purview of the first para of the arbitration clause and (2) if it does the quantum of compensation, if any, to which the appellant would be entitled. Analysing the disputes, let it be made distinctly clear that the appellant asserted that its claim for compensation would be governed by the arbitration clause and the same was specifically denied by the respondent saying that the claim would be beyond the purview of the arbitration clause. On these rival positions, the specific issue was framed whether the claim for compensation would fall within the purview of the first part of the arbitration clause. This was the specific dispute referred to the arbitrator inviting him specifically to decide this dispute. If this issue specifically raises a question as to jurisdiction of the arbitrator to arbitrate upon the dispute set out in Point No. 2, it appears to have been specifically referred to the arbitrator for his decision. Parties, therefore, agreed to submit the specific question even with regard to the scope, ambit, width and the construction of the arbitration clause so as to define its parameters and contours with a view to ascertaining whether the claim advanced by the appellant and disputed by the respondent would be covered by the arbitration clause. Whether upon its true construction the arbitration clause would include within its compass the dispute thus raised between the parties was specifically put in issue because parties were at variance about it. Appellant asserted that its claim to compensation would from the subject matter of arbitration under Clause 40 and the respondent contenting to the contrary. While deciding this dispute, as to the scope, width and ambit of arbitration clause vis-a-vis the dispute, it is not necessary to decide whether the claim was tenable, justified or had any substance in it. That would fall within the second point of reference to the arbitrator which opens with a specific clause that it needs only to be decided if the answer to the first point of reference, namely jurisdiction of the arbitrator under Clause 40 is in the affirmative meaning thereby that the dispute so raised and subsisting between the parties would be covered by the arbitration agreement. In other words, if the dispute is covered by the arbitration agreement, the arbitrator was further required to decide whether there was any substance in the claim made, and if he found some substance in the disputed claim, to ascertain what amount the appellant would be entitled to recover as and by way of compensation from the respondent. The arbitrator was thus required and called upon first to decide whether the dispute is arbitrable as falling within the width and ambit of the arbitration agreement. If the answer is in the affirmative, then along the second point need be examined. If the answer to the first point of reference is in the negative in that if the arbitrator were of the opinion that the dispute is not arbitrable as it would not fall within the scope, width and ambit of the arbitration agreement, it would not be necessary for him to determine whether the appellant was entitled to recover anything by way of compensation. This aspect is being analysed in depth to point out that the parties specifically referred the question of construction of arbitration agreement, its width, ambit and parameters vis-a-vis the dispute raised so as to decide whether the dispute would fall within the purview of the arbitration agreement, in other words the

jurisdiction of the arbitrator.

11. Correspondence placed on record would unmistakably show that a specific question as to the jurisdiction of the arbitrator was specifically referred by the parties to the arbitrator. Appellant-contractor by his letter dated March 1, 1976 to the Chief Engineer of the respondent invited his attention to the claim for compensation for increase in cost of pile driving equipment and technical know-how fees raised about a year ago and further invited his attention to the letter dated October 6, 1975 of the respondent informing the appellant that the claim cannot be entertained. The appellant proceeded further to state as under :

> Inasmuch as a dispute has thus arisen between us regarding the above claim, we are invoking the provisions for arbitration in our contracts and referring this dispute to arbitration.

The respondent by his letter dated March 17, 1976 informed the appellant that the matter raised in the letter dated March 1, 1976 in the matter of compensation is receiving their immediate attention and the appellant will shortly hear from them in this connection. Thereafter the respondent by his letter dated March 29, 1976 informed the appellant as under :

> We have dealt with the merits of your claims in the previous correspondence on the subject and we reiterate that no amounts whatever are due to you in respect of these claims. It is also our view that such claim does not fall within the purview of Clause 40 of the General Conditions of Contract and hence does not qualify for arbitration.

However, in view of your insistence and without prejudice to our position, we propose that, the following be the issues to be referred to arbitration :

> 1. Does the claim of M/s. Tarapore and Co., on Cochin Shipyard Ltd., for compensation for increase in the cost of imported pile driving equipment and technical know-how fees fall within the purview of the first para of Clause 40 of the General Conditions of Contract entered into between the two parties ?
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> 2. If the answer to 1 is in the affirmative in terms of the provisions of the concerned contract, are Messrs. Tarapore and Co. entitled to compensation for increase in the cost of imported pile driving equipment and technical know-how fees to be paid to them by Cochin Shipyard Ltd. ? If so, what is the amount ?
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> 3. Costs.

The respondent proceeded to notify the panel of names and invited the appellant to choose the arbitrator as agreed to between the parties and set out in Clause 40. The appellant by his letter dated April 19, 1976 while reasserting that the claim made by it would be covered by Clause 40 further stated that the proper course would be to refer the dispute that has arisen between the parties on the matter of compensation to the decision of the arbitrator and not any particular issue or issues. It was also suggested that framing of the issues will be the function of the arbitrator after he enters upon the reference and after he has the pleadings of both the parties before him. The appellant also suggested what dispute should be referred to the arbitrator and set it out as under :

> The decision of the dispute that has arisen between M/s. Tarapore and Co., and the Cochin Shipyard Limited, regarding the claim of M/s. Tarapore and Co., for

> compensation for the increase in the cost of the imported pile driving equipment and of the technical know-how fees.

The appellant proceeded to suggest that Shri. C. Srinivasa Rao from amongst the panel be appointed as the sole arbitrator. The respondent by his letter dated April 27/28, 1976 annexing three earlier letters dated March 1, 1976, March 29, 1976 and April 19, 1976 referred the four points hereinbefore set out for the decision of the arbitrator.

12. This correspondence would unmistakably show that while the appellant wanted a general reference about its claim, it was the respondent who now contests that no specific question of law was specifically referred to the arbitrator for his decision was specific about the points to be referred for the decision of the arbitrator. The first point extracted hereinabove would clearly show that the specific question about the jurisdiction of the arbitrator to arbitrate upon the dispute set out in Points Nos. 2, 3, and 4 was specifically referred to the arbitrator. On the first point, the arbitrator had to decide whether the claim made by the appellant and disputed by the respondent would be covered by Clause 40 i.e. the arbitration clause. In other words, the specific question referred to the arbitrator was about his jurisdiction to arbitrate upon the disputes covered by Points Nos. 2, 3 and 4, if any only if, upon a true construction of (sic) the arbitration clause that is first paragraph of Clause 40, would cover the disputed claim for compensation he can enter into the merits of the dispute and decide it. It is upon the decision on Point No. 1 that the arbitrator would have jurisdiction to decide the dispute involved in Points Nos. 2, 3 and 4. The first point of reference is clearly a specific question of law touching upon the jurisdiction of the arbitrator and this was framed and referred to by none other than, despite the initial objection of the petitioner, the respondent. Therefore, the respondent invited the arbitrator by the specific point of reference which involves a specific question of law touching upon the jurisdiction of the arbitrator to decide the same. This becomes further clear from the fact that both the learned counsel appearing before the arbitrator submitted agreed draft issues for the decision of the arbitrator. The first issue amongst the agreed draft issues reads as under :

> Does, the claim of the claimant fall within the purview of the first para of Clause 40 of the General Conditions of Contract entered into between the two parties ?

This point was not to be incidentally decided while deciding the dispute referred to the arbitrator his jurisdiction to entertain the dispute is questioned. In fact, here by the reference of the specific point of law touching upon the jurisdiction of the arbitrator the parties invited the arbitrator to decide this specific question. It was he who was asked by the submission or terms of reference to decide his jurisdiction first and then proceed to decide the dispute on merits. We referred to Issue No. 1 in the agreed draft issues only to buttress the conclusion that it was at the instance of the respondent that the arbitrator was called upon to decide the question of the scope, ambit and width of arbitration clause the decision on which would confer jurisdiction upon him to decide the dispute as to compensation. In this context it would be advantageous to refer to paragraphs 11 and 12 of the counter-statement filed by the respondent before the arbitrator which reads as under :

> 11. It is submitted that the claim in question relating to the increase in the cost of machinery and equipment as also technical know-how fees payable by the contractors/claimants is fully outside the purview of the contract. There is no liability on the part of the respondent to procure the machinery and equipment or technical know-how required by the contractor nor was there any liability to pay any part of the cost, whether it be the original assumed cost or the increased cost. The claim thus

> is completely outside the purview of the contract and it is submitted, therefore, that the same does not fall within the purview of the first paragraph of Clause 40 of the General Conditions of Contract and thus not arbitrable.
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> 12. It is submitted that the question of arbitrability of the dispute should be decided as a preliminary point before proceeding with the other issues.

The formulation of the specific question of law by the respondent along with its suggestion to decide it as a preliminary issue and becoming a party to the agreed draft Issue No. 1 would conclusively establish that the specific question of law touching upon the jurisdiction of the arbitrator was referred to the arbitrator for his decision. Therefore, the conclusion is inescapable that a specific question of law touching upon the jurisdiction of the arbitrator which is indisputably a question of construction of Clause 40 and therefore a question of law was specifically referred by the parties to the arbitrator for his decision and by the terms of Clause 40 agreed to abide by his decision as final and binding.

13. Mr. F. S. Nariman, learned counsel for the appellant urged that Section 16(1)(c) may permit the Court to remit or set aside the award on the ground that there is an error of law apparent on the face of it, yet where a specific question of law has been referred to the arbitrator for decision, the fact that the decision is erroneous does not make the award bad on its face so as to permit its being set aside. Expanding the submission, it was urged that a decision on a question of law by a arbitrator may be given in two different and distinct situations : firstly where while deciding a dispute referred to him incidentally a question of law may arise which an arbitrator may decide in order to dispose of the reference and if in such a situation any error of law appears of the fact of the award, the Court can interfere with the award. But there is altogether an independent and a distinct situation in which a question of law might arise such as where the parties to the dispute may frame the specific question of law and refer it to the arbitrator for his decision. In the later situation, it was urged that the decision of the arbitrator even if erroneous would not permit the Court to interfere with the award. Proceeding along it was urged that in this case a specific question of law touching upon the jurisdiction of the arbitrator was specifically referred to the arbitrator for his decision and therefore, the decision of the arbitrator is binding on the parties and the Court cannot proceed to inquire whether upon a true construction of the arbitration clause, the dispute referred to the arbitrator for arbitration would be covered by the arbitration clause so as to clothe the arbitrator with the jurisdiction to arbitrate upon the dispute.

14. Mr. Pai, learned counsel for the respondent countered by saying that jurisdiction of the arbitrator cannot be left to the decision of the arbitrator so as to be binding on the parties and it is always for the Court to decide whether the arbitrator has jurisdiction to decide the dispute. Alternatively, it was submitted that the arbitrator cannot by a misconstruction of the arbitration agreement clothe himself with or confer upon himself the jurisdiction to decide the dispute. The Court it was said always retains to itself the jurisdiction to look at the arbitration agreement to determine its scope and ambit and if it is found that the dispute referred to the arbitrator does not fall within the arbitration agreement, the Court must interfere on the ground that the award disclosed an error of law apparent on the face of it.

15. The contention may be examined both on principle and on the precedents.

16. Complexity of rights and obligations in national and international trade and commerce would certainly generate disputes between the parties and be treated as a normal incident of commercial

life and till commercial arbitration came to be recognised as a civilised way of resolving such disputes, prolix and time-consuming litigation was the only method of resolving such disputes. As an alternative to court proceedings, arbitration as a method of resolving disputes by domestic tribunal constituted by the choice of parties because acceptable. The basic difference between the court proceedings and the arbitration is the choice of the tribunal. Ordinarily, all matters in which relief can be claimed from the Court may become subject matter of arbitration. Now if in a law court incidental questions of law arise in the course of proceeding, the court has an obligation to decide those questions of law. But when it came to a tribunal not endowed with the judicial power of the State but by conferment by the parties to the dispute or which acquires jurisdiction by a submission of the parties to the dispute to invite the decision by the forum of their choice and to be bound by it a question arose whether a pure questions of law it at all can be referred to an arbitrator for his decision and even if he decides, can the decision be questioned on the ground that there is an error apparent on the face of the award in deciding the question. Now as stated a short while ago, a question of law may figure before an arbitrator in two ways. It may arise as an incidental point while deciding the main dispute referred to the arbitrator or in a given case parties may refer a specific question of law to the arbitrator for his decision. There is no more gainsaying the fact that a pure question of law may and can be referred to an arbitrator for his decision. Russel on the Law of Arbitration, Twentieth Edition at page 22 states as under :

A pure question of law may be referred to an arbitrator; and where such a question is specifically referred his award will not be set aside merely upon the ground that his decision is wrong.

In Halsbury's Laws of England, Vol. 2, Para 623, Fourth Edition the statement of law reads as under :

> If a specific question of law is submitted to the arbitrator for his decision and he decides it, the fact that the decision is erroneous does not make the award bad on its face so as to permit its being set aside; and where the question referred for arbitration is a question of construction, which is, generally speaking, a question of law, the arbitrator's decision cannot be set aside only because the court would itself have come to a different conclusion.

With the ever-widening expansion of international trade and commerce, complex questions of private International Law, effect of local laws on contracts between parties belonging to different nations are certainly bound to crop up. Arbitration has been considered a civilised way of resolving such disputes avoiding court proceedings. There is no reason why the parties should be precluded from referring a specific question of law to an arbitrator for his decision and agree to be bound by the same. This approach manifests faith of parties in the capacity of the tribunal of their choice to decide even a pure question of law. If they do so, with eyes wide open, and there is nothing to preclude the parties from doing so, then there is no reason why the Court should try to impose its view of law superseding the view of the tribunal whose decision the parties agreed to abide by. Therefore, on principle it appears distinctly clear that when a specific question of law is referred to an arbitrator for his decision including the one touching upon the jurisdiction of the arbitrator, the decision of the arbitrator would be binding on both the parties and it would not be open to any of the two parties to wriggle out of it by contending that the arbitrator cannot clutch at or confer jurisdiction upon himself by misconstruing the arbitration agreement.

17. This conclusion is borne out by a long line of decisions both Indian and foreign to which we would now turn.

18. The earliest case to which we would refer is the decision of the House of Lords in Kelantan Government v. Duff Development Co. Ltd. ((1923) All ER Rep 349, 360 : (1923) AC 395), in which Lord Trevethin in his speech said as under :

> If your Lordships should be of opinion that the award is bad in law upon its face, it should be set aside, for this is not, in my view, a submission to arbitration of such a nature that, although the law is bad upon the face of the award, the decision cannot be questioned. That happens only when the submission is of a specific question of law and is such that it can be fairly construed to show that the parties intended to give up their rights to resort to the King's courts and in lieu thereof to submit that question to the decision of a tribunal of their own .....
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> Same distinction was also brought out by Lord Parmoor when he said that "the principle applicable where a specific question of law has been submitted to the decision of arbitration is well expressed by Channell, J., in Re King and Duveen ((1913) 2 KB 32 : 108 LT 844), in which it was said that "where a specific question of law is referred to an arbitrator for his decision, the award cannot be set aside on the ground of an error apparent on the face of the award because the question of law was wrongly decided". At a later stage, it was observed that if the court, before which it is sought to impeach the award, comes to the conclusion that the alleged error in law even if it can be maintained, arises in the decision of a question of law directly submitted to the arbitrator for his decision, then the principle stated by Channell, J., in Re King and Duveen ((1913) 2 KB 32 : 108 LT 844) applies, is attracted and the parties having chosen their tribunal, and not having applied successfully to the court under either Section 4 or Section 19 of the Arbitration Act, 1889, are not in a position to question the award or to maintain a claim to set it aside. This decision is an authority of the proposition that where a question of construction is the very point referred for arbitration, then the decision of the arbitrator upon that point cannot be set aside by the court only because the court would itself have come to a different conclusion.

19. In F. R. Absalom Ltd. v. Great Western (London) Garden Village Society Ltd. ((1933) All ER Rep 616 : (1933) AC 592), the contention was that the award was bad by reason of an error in law appearing on the face of it. The submission was not before the Court and a reference to the pleadings had to be made for the purpose of ascertaining whether any specific question of law was in dispute, and was referred to the arbitrator for his decision. The pleadings disclosed that the whole dispute between parties was as to the amount due to the contractor in respect of the value of the work done and of the materials on the site upto and including a certain date. In the background of this fact, Lord Warrington in his speech said that no specific question of construction arose. In order to decide whether the award was bad by reason of an error of law on the face of it, Lord Russel in his speech pointed out at page 621 that "it is essential to keep the case where disputes are referred to an arbitrator in the decision of which a question of law becomes material distinct from the case in which a specific question of law has been referred to him for decision". Thereafter he proceeded to state :

> The authorities make a clear distinction between these two cases, and as they appear to me, they decide that in the former case the court can interfere if an when any error of law appears on the face of the award, but that in the latter case no such interference is possible upon the ground that it so appears that the decision upon the

> question of law is an erroneous one.

In reaching this conclusion, the decision in Kelantan Government v. Duff Development Co. Ltd. ((1923) All ER Rep 349, 360 : (1923) AC 395) was affirmed. On the facts, it was found that no specific question of law was referred to the arbitrator for his decision.

20. In Durga Prosad Chamria v. Sewkishendas Bhattar (AIR 1949 PC 334, 337 : 54 CWN 74 : 1979 ALJ 490 : (1949) 2 MLJ 760), the award was sought to be set aside inter alia on the ground that the award was bad on account of an error a law apparent on the face of it. The errors of law relied upon were : (a) the arbitrator had admitted as evidence the family settlement and the partnership arrangement of 1916, neither of which, though each related (it was said) to immovable property, had been registered as required by the Indian Registration Act, and (b) the arbitrator ought to have held that Anardeyi's suit was in any event barred by limitation. The Privy Council first noticed the issues settled by Panckridge, J.; amongst them were the two following :

> (1)(b) Is the agreement dated November 16, 1916, relating to the alleged family settlement valid or admissible in evidence ?
>
> (9) Is the Plaintiff's claim or any portion thereof barred by limitation ?
>
> After these issues had been settled, the parties agreed to refer to arbitration "the outstanding matters in the suit". In a motion for setting aside the award it was urged that there was an error of law apparent on the face of the award both with regard as to the admissibility of the alleged family settlement and about the suit of Anardeyi being barred by limitation. Rejecting the motion, the Privy Council observed as under : (p. 337, para 11)
>
> However that may be, their Lordships are satisfied that the two points of law as to which it is said that the arbitrator's error vitiates the award were specifically referred to him to decide : and, if this is so, it would be contrary to well-established principles such as are laid down in In re King and Duveen ((1913) 2 KB 32 : 108 LT 844) and F. R. Absalom Ltd. v. Great West (London) Garden Village Society ((1933) All ER Rep 616 : (1933) AC 592), for a Court of law to interfere with the award even if the Court itself would have taken a different view of either of the points of law had they been before it.

Turning to the decisions of our Court, reference may first be made to Seth Thawardas Pherumal v. Union of India ((1955) 2 SCR 48, 53 54 : AIR 1955 SC 468). In that case, the question was whether the award was bad on account of error of law apparent on the face of it, as provided in Section 16(1)(c) of the Arbitration Act. Examining this contention, this Court observed as under :

> This covers cases in which an error or law appears on the face of the award. But in determining what such an error is, a distinction must be drawn between cases in which a question of law is specifically referred and those in which a decision on a question of law is incidentally material (however necessary) in order to decide the question actually referred. If a question of law is specifically referred and it is evident that the parties desire to have a decision from the arbitrator about that rather than one from the Courts, then the Courts will not interfere, though even there, there is authority for the view that the courts will interfere is it is apparent that the

> arbitrator has acted illegally in reaching his decision, that is to say, if he has decided on inadmissible evidence or on principles of construction that the law does not countenance or something of that nature. See the speech of Viscount Cave in Kelantan Government v. Duff Development Co. ((1923) All ER Rep 349, 360 : (1923) AC 395) at page 409. But that is not a matter which arises in this case.

The law about this is, in our opinion the same in England as here and the principles that govern this class of case have been reviewed at length and set out with clarity by the House of Lords in F. R. Absalom Ltd. v. Great Western (London) Garden Village Society ((1933) All ER Rep 616 : (1933) AC 592) and in Kelantan Government v. Duff Development Co. ((1923) All ER Rep 349, 360 : (1923) AC 395) In Durga Prosad v. Sewkishendas (AIR 1949 PC 334, 337 : 54 CWN 74 : 1949 ALJ 490 : (1949) 2 MLJ 760) the Privy Council, applied the law expounded in Absalom case ((1933) All ER Rep 616 : (1933) AC 592) to India : see also Champsey Bhara & Co. v. Jivraj Balloo Spinning and Weaving Co. (50 IA 324 : AIR 1923 PC 66) and Saleh Mahomed Umer Dossal v. Nothoomal Kessamal (54 IA 427 : AIR 1927 PC 164). The wider language used by Lord Macnaghten in Ghulam Jilani v. Muhammad Hassan (29 IA 51 : 29 Cal 167) had reference to the revisional powers of the High Court under the Civil Procedure Code and must be confined to the facts of that case where the question of law involved there, namely, limitation, was specifically referred. An arbitrator is not a conciliator and cannot ignore the law or misapply it is order to do what he thinks is just and reasonable. He is a tribunal selected by the parties to decide their disputes according to law and so is bound to follow and apply the law, and if he does not, he can be set right by the Courts provided his error appears on the face of the award. The single exception to this is when the parties choose specifically to refer a question of law as a separate and distinct matter.

The Court further proceeded to examine whether in the facts of that case, the arbitrator was specifically asked to construe Clause 6 of the contract or any part of the contact or whether any question of law was specifically referred. The Court emphasised the word 'specifically' by pointing out that "parties who made a reference to arbitration have the right to insist that the tribunal of their choice shall decide their dispute according to law, so before the right can be denied to them in any particular matter, the Court must be very sure that both sides wanted the decision of the arbitrator on a point of law rather than that of the Court and that they wanted his decision on that point to be final". The Court then proceeded to examine the various clauses of the contract and held that this is not the kind of specific reference on a point of law that the law of arbitration requires. The Court held that when a question of law is the point at issue, unless both sides specifically agree to refer it and agree to be bound by the arbitrator's decision, the jurisdiction of the courts to set and arbitration right when the error is apparent on the face of the award is not ousted. The mere fact that both parties submit incidental arguments about a point of law in the course of the proceedings is not enough. This decision is an authority for the proposition that where the parties specifically agree to refer a specific question of law for the decision of the arbitrator, and agree to be bound by it, the Court cannot set aside the award on the ground on an error of law apparent on the face of it even though the decision of the arbitrator may not accord with the law as understood by the Court. If on the other hand, the question of law is incidentally decided by the arbitrator, it is not enough to oust the jurisdiction of the Court to set aside the award on the ground that there is an error apparent on the face of the award.

21. In M/s. Alopi Parshad & Sons Ltd. v. Union of India ((1960) 2 SCR 793 : AIR 1960 SC 588), the Court reiterated the observations in Seth Thawardas case ((1955) 2 SCR 48, 53, 54 : AIR 1955 SC 468) observed that if a specific question is submitted to the arbitrator and he answers it, the fact that the answer involves an erroneous decision in point of law, does not make the award bad on its

face so as to permit of its being set aside. In the facts of the case, this Court agreeing with the High Court held that there is no foundation for the view that a specific reference, submitting a question of law for the adjudication of the arbitrators, was made, It may be stated in passing that a brief reference to the claim put forward before the arbitrator on behalf of the appellants in that case, set out at page 798 of the report, would clearly show that no specific question of law was referred by the parties for the decision of the arbitrator. Mr. Pai learned counsel for the respondent pointed out that the Court has also observed following the decision of the Privy Council in Champsey Bhara and Company v. Jivraj Balloo Spinning and Weaving Company Ltd. (50 IA 324 : AIR 1923 PC 66), that "the extent of the jurisdiction of the Court to set aside an award on the ground of an error in making the award is well-defined. The award of an arbitrator may be set aside on the ground of an error on the face thereof only when in the award or in any document incorporated with it, as for instance, a note appended by the arbitrators, stating the reasons for his decision, there is found some legal proposition which is the basis of the award and which is erroneous". This observation does not help in deciding the point under discussion and just after this statement, there follows the observation about the effect of referring a specific question of law for the decision of the arbitrator and the jurisdiction of the Court to set aside the award on the ground that there is an error of law apparent on the face of it.

22. In Union of India v. A. L. Rallia Ram ((1964) 3 SCR 164 : AIR 1963 SC 1685), this Court after referring to the decision in Champsey Bhara and Company (50 IA 324 : AIR 1923 PC 66) reaffirmed that "the rule in that decision does not apply where questions of law are specifically referred to the arbitrator for his decision; the award of the arbitrator on those questions is binding upon the parties, for by referring specific questions the parties desire to have a decision from the arbitrator on those questions rather than from the Court, and the Court will not, unless it is satisfied that the arbitrator had proceeded illegally interfere with the decision". After referring to the decision hereinabove examined by us, the Court came to the conclusion that "no specific questions of law were referred to the arbitrators, the decision whereof is binding upon the parties".

23. In M/s. Kapoor Nilokheri Co-op. Dairy Farm Society Ltd. v. Union of India (AIR 1973 SC 1338 : (1973) 1 SCC 708), the Court agreed with the submission on behalf of the respondent-Government of India that the appellants having specifically stated their claims are based on the agreement and on nothing else and all that the arbitrator had to decide was as to the effect of the agreement, the arbitrator had really to decide a question of law i.e. of interpreting the document, the agreement dated May 6, 1953 and therefore the decision is not open to challenge. In fact, this decision is hardly of any assistance and we leave it at that.

24. In N. Chellappan v. Secretary, Kerala State Electricity Board ((1975) 2 SCR 811 : (1975) 1 SCC 289 : AIR 1975 SC 230), by a consent order, the umpire was appointed as the sole arbitrator, and the respondent-Board without a demur participated in the proceedings before the umpire and took the chance of an award in its favour, this Court said that it cannot turn round and say that the umpire had no inherent jurisdiction and therefore its participation in the proceedings before the umpire is of no avail. This decision is not of much assistance on the point under discussion.

25. Mr. Pai on the other hand urged that the jurisdiction of the arbitrator could not be determined by him nor can he arrogate jurisdiction to himself by misconstruction of the contract and thereby clutch at jurisdiction and in such a situation, the Court always retains to itself to set at naught the award on the ground of an error of law apparent on the face of the award. In terms, he stated that the issue about the jurisdiction of the arbitrator has never been parted with by the Court. Generally speaking, common law courts were very reluctant to part with their jurisdiction to set at naught an award on

the ground that the arbitrator had no jurisdiction to entertain and decide the dispute. The Court went so far as to say that the arbitrator cannot confer jurisdiction upon himself by deciding in its own favour some preliminary points upon which its jurisdiction rests. In facts, that is a non-issue. It cannot be disputed that even the question of jurisdiction of an arbitrator can be the subject matter of a specific reference. If the parties agree to refer the specific question whether the dispute raises is covered by the arbitration agreement, it becomes a specific question of law even if it involves the jurisdiction of the arbitrator and if it is so, a decision of the arbitrator on specific question referred to him for decision even if it appears to be erroneous to the Court is binding on the parties. The decisions relied upon by Mr. Pai do not derogate from this legal position. We may briefly refer to those decisions.

26. In Produce Brokers Co. Ltd. v. Olympia Oil and Cake Co. Ltd. ((1914-15) All ER Rep 133 : (1916) 1 AC 314 (HL)), it was held that "if the question which the arbitrator takes upon himself to decide is not in fact within the submission the award is a nullity. The arbitrator cannot make his award binding by holding contrary to the true facts when the question which he affects to determine is within the submission". Let us emphasise the ratio of the decision that the arbitrator takes upon himself to decide a question not within the submission. This would mean that the question of law was not specifically referred to the arbitrator for his decision but it was incidentally raised. In fact, nowhere it was contended that any specific question of law was referred to the arbitrator and if so what would be its effect on the binding character of the decision was ever raised in that case. In that case after an answer was returned to the special case submitted for the opinion of the Court, the Committee of Appeal unreservedly accepted the said answers upon the construction of the contract as a matter of law apart from the custom of the trade, but proceeded further to hold that there was a long established and well-recognised custom of the trade in cases of re-sales that buyers under the form of contract in question impliedly agreed with their sellers that they would accept the original shipper's appropriation if passed on without delay. On a motion by the buyers to have the award set aside, of which notice was given, the Divisional Court held that the arbitrators had no jurisdiction to find conclusively the existence of a trade custom, and the Court of Appeal on the authority of precedents but against their own opinion, affirmed the decision. The appellant-seller's company appealed to the House of Lords. Lord Loreburn in his speech observed that "these men of business made contracts and therein agreed to arbitrate upon all disputes arising out of their contracts. Yet there have already been seven distinct stages of argument and decision, four of them in courts of law, upon a dispute arising on those contracts, and the end is not yet. I do not know how many more stages there will be. Parties have a right to prefer what some may consider the imperfect though expeditious wisdom of arbitrators to the slower and more costly justice of His Majesty's courts. It is to be regretted when they have to encounter the inconveniences of both methods with the advantage of neither". Approaching the matter from this angle, the appeal was allowed and the decision of the Committee of Appeal, taking note of the custom of the trade, allowed the award to stand. This decision can in no way help the respondent.

27. In Attorney-General For Manitoba v. Kelly (1922 All ER Rep 69 : (1922) 1 AC 268) it was observed that "Whenever there is a difference of opinion between the parties as to the authority conferred on an umpire or arbitrator under an agreed submission the decision rests ultimately with the court and not with the umpire or arbitrator". This is predicated upon a proposition to set at naught an award if the arbitrator confers jurisdiction upon himself by deciding in his own favour some preliminary point upon which his jurisdiction rests.

28. Mr. Pai also referred to the decisions of the Privy Council in Champsey Bhara & Co. (50 IA 324 : AIR 1923 PC 66) and Hirji Mulji v. Cheong Yue Steam-ship Co. Ltd. (1926 All ER Rep 51 : 1926

AC 497) Both these decisions are of no assistance on the question about the reference of a specific question of law touching upon the jurisdiction of the arbitrator for his decision and its effect. In fact, the decision in Champsey Bhara case (50 IA 324 : AIR 1923 PC 66) clearly turns upon as to what constitutes an error of law apparent on the face of the award.

29. The next case referred to was Heyman v. Darwins Ltd. ((1942) 1 All ER 337 : 1942 AC 356 (HL)). It reasserts that as a rule arbitrator cannot clothe himself with jurisdiction.

30. Turning to the decisions of this Court, reference was first made to Jivarajbhai Ujamshi Sheth v. Chintamanrao Balaji ((1964) 5 SCR 480 : AIR 1965 SC 214). Shah, J. speaking for himself and Justice Sarkar at page 499 observed that "this is not a case in which the arbitrator has committed a mere error of fact or law in reaching his conclusion on the disputed question submitted for his adjudication. It is a case of assumption of jurisdiction not possessed by him, and that renders the award, to the extent to which it is beyond the arbitrator's jurisdiction, invalid". It may be pointed out that these observations are in the context of the facts of that case and there was no contention before the Court that any specific question of law touching upon the jurisdiction of the arbitrator was referred to for his decision by the parties.

31. The last decision in this context referred to was Dr. S. B. Dutt v. University of Delhi ((1964) 5 SCR 480 : AIR 19965 SC 214). In that case the arbitrator gave by his award a direction to enforce that contract of personal service. This was stated as an error of law apparent on the face of the award and the award was set aside. Again it may be pointed out that the reference to the point set out in the letter of reference extracted at page 1240 clearly spells out that no specific question of law touching upon the jurisdiction of the arbitrator was referred to the arbitrator for his decision.

32. On a conspectus of these decisions, it clearly transpires that if a question of law is specifically referred and it becomes evident that the parties desired to have a decision on the specific question from the arbitrator about that rather than one from court, then the court will not interfere with the award of the arbitrator on the ground that there is an error of law apparent on the face of the award even if the view of law taken by the arbitrator does not accord with the view of the court. This view of law taken in England was stated by this Court to be the same in this country and since the decision in Seth Thawardas case ((1955) 2 SCR 48, 53, 54 : AIR 1955 SC 468) which follows earlier decisions in England and India, it has not been departed from. The view canvassed for by Mr. Pai that common law courts were very reluctant to part with their jurisdiction has hardly any relevance where a specific question of law including the one touching the jurisdiction of the arbitrator is referred to the arbitrator for his decision. Even if the decision of the arbitrator does not accord with the view of the court, the award cannot be set aside on the sole ground that there is an error of law apparent on the face of it.

33. Before we conclude on this point we must take note of a contention of Mr. Pai that the respondent cannot be stopped from contending that the arbitrator had no jurisdiction to entertain the dispute as the respondent agreed to the submission without prejudice to its rights to contend to the contrary. It is undoubtedly true that in the letter dated March 29, 1976 by which the respondent agreed to refer the dispute to the arbitrator, it was in terms stated that the reference is being made without prejudice to the position of the respondent as adopted in the letter meaning thereby without prejudice to its rights to contend that the claim of the appellant is not covered by the arbitration clause. In the context in which the expression 'without prejudice' is used, it would only mean that the respondent reserved the right to contend before the arbitrator that the dispute is not covered by the arbitration clause. It does not appear that what was reserved was a contention that no specific

question of law was specifically referred to the arbitrator. It is difficult to spell out such a contention from the letter. And the respondent did raise the contention before the arbitrator that he had no jurisdiction to entertain the dispute as it would not be covered by the arbitration clause. Apart from the technical meaning which the expression 'without prejudice' carries depending upon the context in which it is used, in the present case on a proper reading of the correspondence and in the setting in which the term is used, it only means that the respondent reserved to itself the right to contend before the arbitrator that a dispute raises or the claim made by the contractor was not covered by the arbitration clause. No other meaning can be assigned to it. An action taken without prejudice to one's right cannot necessarily mean that the entire action can be ignored by the party taking the same. In this case, the respondent referred the specific question of law to the arbitrator. This was according to the respondent without prejudice to its right to contend that the claim or the dispute is no covered by the arbitration clause. The contention was to be before the arbitrator. If the respondent wanted to assert that it had reserved to itself the right to contend that no specific question of law was referred to the arbitrator, in the first instance, it should not have made the reference in the terms in which it is made but should have agreed to the proposal of the appellant to make a general reference. If the appellant insisted on the reference of a specific question which error High Court appears to have committed, it could have declined to make the reference of a specific question of law touching his jurisdiction and should have taken recourse to the Court by making an application under Section 33 of the Arbitration Act to have effect of the arbitration agreement determined by the Court. Not only the respondent did not have recourse to an application under Section 33 of the Arbitration Act, but of its own it referred a specific question of law to the arbitrator for his decision, participated in the arbitration proceeding, invited the arbitrator to decide the specific question and took chance of a decision. It cannot therefore, now be permitted to turn round and contend to the contrary on the nebulous plea that it had referred the claim/dispute to the sole arbitrator without prejudice to its right to contend to the contrary. Therefore, there is no merit in the contention of Mr. Pai.

34. In this case, as earlier pointed out a specific question as to whether the claim of compensation made by the appellant-contractor and demurred and disputed by the respondent would be covered within the scope, ambit and width of the arbitration clause, was specifically referred by the parties for the decision of the arbitrator. Therefore, it is a case where a specific question of law touching upon the jurisdiction of the arbitrator was referred for the decision of the arbitrator by the parties. Even if the view taken by the arbitrator may not accord with the view of the Court about the scope, ambit and width of the arbitration clause, the award cannot be set aside on the ground that there is an error of law apparent on the face of the award. The view taken by the High Court is palpably untenable and has to be reversed. On this short point, the appeal can be allowed. However, it was strenuously urged by both the sides that the dispute arising out of the claim for compensation made by the appellant on account of the increase in the cost of the pile driving equipment and technical know-how fees would or would not be covered by the first paragraph of Clause 40, we would briefly examine the same to point out that it would be covered.

35. In order to ascertain whether the claim for compensation for increase in the price of pile driving equipment and technical know-how fees would be covered by the arbitration clause, it is necessary briefly to refer to the negotiations and discussion leading to the formation of the contract for construction of the Repair Dock and the Building Dock. The value of the works to be executed was over Rs. 24 crores. In respect of the construction of Repair Dock, there was only the tender of the appellant and in respect of the Building Dock, there were two tenders; one of the appellant and another by M/s. National Building Construction Corporation, the tendered value of the latter being double that of the former. Indisputably, the respondent had a very limited or realistically no choice.

In such a situation the Tender Committee took notice of the fact of the poor response to the invitation to tender. The Committee took notice of such salient features of the work being the complexity and magnitude of the works to the undertaken by any Indian contractor and the non-availability of plant and equipment required for the works and more especially that if the contractor was to procure the specialised equipment required for the works, there was hardly any assurance that after the works were over, the machinery would be so much depreciated to have any substantial use or utility to the contractor. In the invitation to tender, it was indicated that requisite foreign exchange for importing pile driving equipment and machinery, spares and technical know-how amounting to about Rs. 2 crores in all would be made available to the contractor from the Eleventh Yen Credit from Japan, subject to his getting indigenous clearance and providing detailed justification. Annexure IV to the General Conditions of Contract clearly specifies that the tenderers while quoting shall give separately the full details of the equipment for which they would be requiring foreign exchange assistance. And they shall also indicate the financial implication if any, for providing/not providing the foreign exchange assistance indicated for the various equipments. Two things emerge from recital of the facts herein enumerated in the course of formation of the contact : (1) that the pile driving equipment will have to be imported from outside India and technical know-how fees will have to be paid both in foreign currency and (2) this would necessitate investment of about Rs. 2 crores by the contractor. The contractor in his letter dated July 14, 1972 specifically invited the respondent to confirm the modifications in the terms of contract as set out therein. In paragraph 31(E)(1), the contractor states that all foreign exchange for the equipment, spares, technical know-how and hiring of experts shall be provided to the contractor and that the total foreign exchange on all these accounts will be about Rs. 2 crores. A sort of an assurance was thus extended to the contractor that the same would be made available to him from the Eleventh Yen Credit from Japan. This is not disputed. It is also an admitted position that the necessary equipment, machinery, spares and technical know-how were not available from Japan and the availability of the Eleventh Yen Credit from Japan lost all significance. Further the respondent by its letter dated January 24, 1973 to the appellant while accepting the tender of the appellant on behalf of Cochin Shipyard Limited specifically stated as under :

> You shall provide at your cost all construction plant and machinery (including that requiring import) for all items of work including RCC piling and steel sheet piling works. Departmental machinery likely to be made available for issue to the Contractor shall be as in Annexure IV of the General Conditions of Tender.

You shall furnish an inventory of all plant and machinery proposed to be used on the works including items of imported machinery with probable date of their availability at site for use on the work. This should match with the Detailed Working Programme indicated as above.

At this stage a reference to the Additional Terms and Conditions Modifications to the General Conditions and Specifications of the Departmental Tender Documents, would be advantageous. It reads as under :

All Piling Equipment shall be procured by the Contractor .....

Selection of equipment will be done by the Contractor in consultation with the Cochin Shipyard authorities. No hire charges for the equipment procured by the Contractor is payable to the Shipyard .....

Requisite foreign exchange, for importing piling plant and machinery, spares, technical know-how

and hiring of experts necessary for both the Dock Works, vide Work Order .... for Repair Dock etc. amounting to about Rs. 2 crores in all will be made available to the Contractor from the Eleventh Yen Credit subject to his getting indigenous clearance and providing detailed justification.

It is thus unquestionably established that the appellant whose tender was accepted after negotiations and scrutiny by the Tender Committee was expected to invest Rs. 2 crores in importing pile driving equipment and technical know-how fees. The tender was accepted and a formal contract was entered into on this basis. In works contract of such magnitude, the value whereof was over Rs. 24 crores, and which was being undertaken by an Indian contractor for the first time negotiations prior to the finalisation of the contract and the correspondence leading to the formation of contract supply the basis on which contract was finally entered into. Undoubtedly, if in the final written contract, there is something contrary to the basic under - standing during the formative stage of the contract, the written contract would prevail. But if the contract does not indicate to the contrary and the assumptions appeared to be the foundation of the contract, obviously that aspect cannot be overlooked while determining what were the obligations undertaken under the formal contract. It may be recalled that the two alternative rates were quoted by the contractor : (i) the respondent were to import the pile driving equipment and technical know-how for its operation, the same would be leased to the contractor at negotiated rates or (ii) the contractor were to import the same the rates to be paid to contractor. The second alternative was accepted by the parties on the fundamental assumption that the investment in this behalf would be Rs. 2 crores. This is the agreed position on which contract was entered into. To continue the narrative, it may be pointed out that this fundamental foundation of the contract was not left to guesswork, but is specifically referred to in the notice inviting tender and in the specifications and modifications as addenda to the General Conditions of Contract. It was clearly understood between the parties that the contractor has to invest roughly Rs. 2 crores in foreign exchange for importing pile driving equipment and technical know-how fees without which this work could never have been undertaken and without which it would not have been entrusted at the contractor. The contractor when he quoted his terms must obviously have made appropriate calculations, one of which in this case appears to be that it will have to invest Rs. 2 crores in foreign exchange and this fact files in the face that after the work was over, the imported machinery would depreciate to this extent that it would have hardly any use or utility to the contractor as noticed by the Tender Committee. The rates quoted by the contractor were obviously interrelated to the basic assumption. The fact that such was also the understanding of the respondent may now be pointed out.

36. The respondent by its letter dated July 31, 1973 to Industrial Adviser (HME), Directorate General of Technical Development requested him to issue necessary clearance to the appellant for import of the equipment set out in the Annexure to the letter on the ground that the appellant tried its level best to get the equipment from the Japanese courses, but they could not get positive response for such equipments. They had also tried their best to get suitable offers from UK, USA, USSR, Canada, West Germany and Holland. It was also pointed out that the respondent itself also made independent enquiries in Japan for getting suitable officers for the above equipment without success. Thus it becomes clear that to the knowledge of the respondent, the Eleventh Yen Credit became irrelevant. The Government of India by its letter dated September 1, 1973 to the respondent conveyed its approval to the release of the foreign exchange in favour of the appellant to the extent of Rs. 211-80 lacs (Rupees two crores eleven lacs and eighty thousand only) equivalent to DFL 9,442,700 at the specified exchange rate. Thereafter the appellant by its letter dated May 28, 1975 amongst others requested the respondent to take note of the fact that the tendered rates were based on certain total cost of machines which has since gone up considerably rendering the rates no longer workable. The contractor proceeded to point out the utter irrelevancy of the rates in view of the

higher outlay of imported machinery and technical know-how. It pointed out the loss sustained by the contractor and requested for compensation in this behalf. This was followed by the letter dated July 1, 1975 by the contractor, to the respondent, emphasising the fact that the tendered rates had become unworkable and unrealistic owing to the increases in the cost of equipment, know-how etc. as a result of the increase in the foreign exchange rate of Dutch Guilders as related to the Rupee. In response to the last letter the respondent replied by its letter dated July 2, 1975, relevant portion of which may be extracted :

In this connection, a king reference is invited to your letter dated July 14, 1972 (which forms a part of the contract documents) wherein you had indicated that the total foreign exchange required by you for the equipment, spares, technical know-how and hiring of experts, was expected to be about Rs. 2 crores. From the data enclosed with your letter under reply, it is seen that the foreign exchange expenditure incurred by you so far in connection with this contract had been less than Rs. 2 crores. In the circumstances, it is difficult to accept the position that your tender was based on assumptions indicated by you and that the rates for pile driving should now be revised.

This letter furnishes proof, if one was needed that parties were ad idem that the investment for imported pile driving equipment and foreign exchange know-how would be about Rs. 2 crores. The respondent does not contest the claim for compensation under this head as is now sought to be done on the ground that as the contractor had to provide imported pile driving equipment and technical know-how, the respondent is not entitled to compensation, even if the initial estimate has been found to be unrealistic. On the contrary, the claim for compensation is disputed and controverted on the ground that the foreign exchange expenditure incurred by the contractor so far in connection with imported pile driving equipment and technical know-how has been less then Rs. 2 crores. From this correspondence, it would emerge that both the parties were agreed that the contractor would have to invest Rs. 2 crores in foreign exchange for importing pile driving equipment and technical know-how which could only be used after approval of the same by the respondent. The appellant by its letter dated August 9, 1975 contended the at escalation of expenditure under this head is taken care of in the contract and more specifically in Clauses 13 and 16 of the works order. We would have occasion to refer to these clauses a little later. The respondent by its letter dated August 29, 1975 reasserted its position that the foreign exchange element of the expenditure incurred by the contractor works out to Rs. 1.96 crores, which is less than the figure of Rs. 2 crores that was expected to be invested in foreign exchange which was to be provided by the contractor. The respondent also referred to the assessment of expenditure made by the contractor as per its letter dated July 14, 1972. This has already been referred to by us. The respondent further asserted that the estimate so made till that date has not been exceeded and therefore, any argument based on fluctuation in the exchange rate is not valid or tenable. It may be repeated that the refusal to entertain the claim for compensation was predicated upon the estimates having not exceeded the basic minimum of Rs. 2 crores by the contractor on which rats were worked out and agreed, and not that such claim cannot be entertained under the contract. By its letter dated September 18, 1975, the contractor reiterated its position. In its letter dated October 6, 1975, the respondent when it was faced with the situation that the expenditure incurred under this head in foreign exchange had risen to Rs. 214.33 lacs i.e. it had exceeded the expected investment of Rs. 2 crores under this head took a summersault and stated that the respondent had at no stage stated that the contractor was "not entitled to any claim because the amount of foreign exchange has not yet exceeded Rs. 200 lacs." One has merely to call attention to the two letters dated July 2, 1975 and August 29, 1975 to reach the conclusion that the respondent has gone back upon its original position and having found that the expenditure under this head has gone up beyond the estimated expenditure, made a volte-face, the two positions so adopted being entirely inconsistent with each other. Thereafter, the matter was

referred to arbitration.

37. From the commencement i.e. from the stage of inviting tenders and through the negotiations and the finalisation of the contract, at every stage, the respondent assured that foreign exchange would be made available from Eleventh Yen Credit. As the equipment was not available from Japan, the availability of Yen Credit became otiose from the contractor's point of view. At the instance of an with the active participation of the respondent, the contractor made enquiries in various countries and ultimately procured the necessary equipment and technical know-how which was approved by the respondent and imported the same. In the time lag, the price as well as the foreign exchange rates in relation to rupee underwent an upward change, with the result that the contractor had to invest, as made out by it and not seriously controverted before the arbitrator in all Rs. 275.40 lacs for imported pile driving equipment and spares and Rs. 18,64,337.61 on technical services-cum-know-how fees and a further sum for higher custom duty. Details of the claim have been set out in Annexure 1 and 2 respectively to the statement of claim submitted by the appellant to the arbitrator. The respondent in its counter-statement did not controvert the details of the claim and the expenditure involved under the two heads. The whole of the counter-claim was concerned with the denial of its liability to compensate the contractor coupled with the contention that the claim would not be covered by the arbitration agreement and therefore, the arbitrator had no jurisdiction to entertain and adjudicate the claim. It may also be mentioned that at no time since the award, the claim. It may also be mentioned that at no time since the award, the respondent ever disputed or questioned the amount awarded by the arbitrator. It is thus satisfactorily established the contractor had to invest something far in excees of Rs. 2 crores which it was expected to invest in foreign exchange for imported pile driving equipment and technical know-how fees. The whole contract was concluded on this understanding. Being aware of the fluctuating position in this behalf, the contractor had tendered two alternative rates for completion of the work as pointed out earlier; one based on equipment being imported by the respondent and leased to the appellant and alternatively rates on the basis that the contractor would import pile driving equipment and technical know-how. In respect of the second alternative, which was ultimately agreed to between the parties, it was clearly and unmistakably understood agreed to between the parties that the contractor would have to invest Rs. 2 crores and the rates were co-related to this investment with the knowledge of the fact that when work was completed, the equipment would depreciate to the tune of 75 per cent of its capability and would be hardly of any use to the contractor. The estimated expenditure having far exceeded, a claim for compensation would certainly be tenable at the instance of the contractor.

38. The High Court quoted Clauses 16, 26 and 31 in its judgment but did not dilate upon the provisions of the clauses so as to co-relate them with its decision. Clause 16 envisaged a situation where since the formation of the contract any fresh law is enacted which has the bearing on the price of materials incorporated in the works and/or wages of labour, the terms of contract shall accordingly be varied. Clause 26 provided for supply of materials. Plants, tools, appliances etc. by the contractor. Clause 2 provides for the liability of the contractor to supply construction, plant and machinery including the item to be imported and a further obligation is cast in the contractor to furnish inventory of the same. Clause 31 amongst others, provided that the pile driving equipment shall be procured by the contractor, and the selection of equipment shall be done by the contractor, in consultation with the respondent. These clauses were presumably referred to in the context of an argument that the price escalation clause does not cover the claim for compensation for additional expenditure on imported plant and machinery and technical know-how because the contract substantially provides for the same to be supplied by the contractor. In our opinion, this over-simplification of the clauses of the contract involving works of such magnitude is impermissible. The whole gamut of discussions, negotiations and correspondence must be taken into consideration

to arrive at a true meaning of what was agreed to between the parties. And in this case there is no room for doubt that the parties agreed that the investment of the contractor under this head would be Rs. 2 crores and the tendered rates were predicated upon and co-related to this understanding. When an agreement is predicated upon an agreed fact situation, if the latter ceases to exist the agreement to that extent becomes irrelevant or otiose. The rates payable to the contractor were related to the investment of Rs. 2 crores under this head by the contractor. Once the rates became irrelevant on account of circumstances beyond the control of the contractor, it was open to the contractor to make a claim for compensation. Therefore, it appears satisfactorily established that the claim arose while implementing the contract and in relation to the contract.

39. The next question is whether this claim made by the contractor and disputed by the respondent would be covered by the arbitration clause. The arbitration clause has already been extracted. Even the High Court admits that Clause 40 is very widely worded. It inter alia provides that "all questions and disputes relating to the meaning of the Specifications, Estimates, Instructions, Designs, Drawings here in before mentioned and as to the quality of the workmanship or materials used on the work or as to any other questions, claim, right, matter or thing whatsoever in any way arising out of or relating to the contract ... or otherwise concerning the works or the execution ... whether arising during the progress of the work or after completion ... shall be referred to the sole arbitrator etc.". The scope, width and the ambit of the arbitration clause is of widest amplitude and any claim arising out of or relating to the contract or otherwise concerning the works or the execution thereof would be covered by the arbitration clause. The material portion of Clause 40 which would assist us in deciding the question is "claim, right, matter or thing whatsoever in any way arising out of or relating to the contract ... estimates or otherwise concerning the works or the execution etc." Briefly stated any claim arising out of or relating to the contract, estimates or otherwise concerning the works or the execution thereof would be covered by the arbitration clause. The question to be posed is "does the claim made by the contractor arise out of or relates to the contract, estimates, or is otherwise concerning works or execution thereof ? "Phrases such as 'claim arising out of contract' or 'relating to the contract' or 'concerning the contract' on proper construction would mean that if while entertaining or rejecting the claim or the dispute in relation to claim may be entertained or rejected after reference to the contract, it is a claim arising out of contract. Again the language of Clause 40 shows that any claim arising out of the contract in relation to estimates made in the contract would be covered by the arbitration clause. If it becomes necessary to have recourse to the contract to settle the dispute one way or the other then certainly it can be said that it is a dispute arising out of the contract. And in this case the arbitration clause so widely worded as disputes arising out of the contract or in relation to the contract or execution of the works would comprehend within its compass a claim for compensation related toe estimates and arising out of the contract. The test is whether it is necessary to have recourse to the contract to settle the dispute that has arisen (See Russel on Arbitration, Twentieth Ed., page 85).

40. We may now turn to some decisions to which our attention was drawn. The first case we would like to refer to is A. M. Mair & Co. v. Gordhandass Sagarmull (1950 SCR 792 : AIR 1951 SC 9). The Court was concerned with the arbitration clause drawn up as : "as matters, questions, disputes, differences and/or claims, arising out of and/or concerning, and/or in connection and/or in consequence of, or relating to, the contract etc.". The question arose whether the due date under the contract was extended within the time, earlier reserved. The arbitrator held that the due date of the contract has been extended by a mutual agreement and the respondents were held liable to pay a sum of Rs. 4116 together with interest at the rates specified in the award. It was contended that the dispute is not covered by the arbitration clause. This Court while holding that the dispute is covered by the arbitration clause observed that looking to the rival contentions, such a dispute, the

determination of which turns on the true construction of the contract, would also seem to be a dispute under or arising out of or concerning the contract. The test formulated was that if in settling a dispute, a reference to the contract is necessary, such a dispute would be covered by the arbitration clause.

41. In Ruby General Insurance Co. Ltd. v. Pearey Lal Kumar (1952 SCR 501, 507 : AIR 1952 SC 119 : (1952) 22 Com Cas 111) this Court was concerned with the clause in a policy of insurance which provided that differences arising out of the policy shall be referred to the decision of the arbitrator. In construing this clause, this Court observed as under :

> The test is whether recourse to the contract by which the parties are bound is necessary for the purpose determining the matter in dispute between them. If such recourse to the contract is necessary, the matter must come within the scope of the arbitrator's jurisdiction .....

In Union of India v. Salween Timber Construction (India) ((1969) 2 SCR 224 : AIR 1969 SC 488), this Court observed that "the test for determining the question is whether recourse to the contract by which both the parties are bound is necessary for the purpose of determining whether the claim of the respondent firm is justified or otherwise. If it is necessary to take recourse to the terms of the contract for the purpose of deciding the matter in dispute, it must be held that the matter is within the scope of the arbitration clause and the arbitrators have jurisdiction to decide the same". In so stating the proportion of law, reliance was placed on Heyman v. Darwins Ltd. (1942 AC 356, 366), in which it was held that "where the parties are at one in asserting that they entered into a binding contract, but a difference has arisen between them whether there has been a breach by one side or the other, or whether circumstances have arisen which have discharged one or both parties from further performance, such differences should be regarded as differences which have arisen "in respect of 'or' with regard to' or 'under' the contract, and an arbitration clause which uses these, or similar expressions should be construed accordingly". The Court affirmed the decision in Ruby General insurance Co. Ltd. case (1952 SCR 501, 507 : AIR 1952 SC 119 : (1952) 22 Com Cas 111).

42. In Astro Vencedor Compania Naviera S. A. of Panama v. Mabanaft GmbH ((1971) 2 QB 588 : (1971) 2 All ER 1301 : (1971) 3 WLR 24), a question arose whether a claim in tort would be covered by the arbitration clause ? It was admitted that the claim for wrongful arrest is a claim in tort. And it was contended that a claim in tort cannot come within the arbitration clause. The Court of Appeal speaking through Lord Denning held that the claim in tort would be covered by the arbitration clause, if the claim or the issue has a sufficiently close connection with the claim under the contract.

43. In Gunter Henck v. Andre & CIE S. A. ((1970) 1 Lloyd's Law Reports 235), the Court Queen's Bench Division (Commercial Court) held that the words 'arising out of clearly extend the meaning than would otherwise be applied to the clause were limited to 'all disputes arising under the contract'.

44. In the facts before, us, the respondent in para 4 of its counter-statement filed before the arbitrator specifically referred to Clause 16 of the General Condition of Contract and to the Additional Terms and Conditions/Modifications forming part of the contract document. In paragraph 11, it was stated that the claim of the appellant was completely outside the purview of the contract and the same does not fall within the purview of the first paragraph of Clause 40. It was further stated in paragraph 13 that the contract provides for escalation in certain respects and that is

the only escalation which is admissible in terms of the contract, and the claim made by the appellant does not come within the escalation clause nor in the agreed formula relating to such escalation. The contractor relied upon Clause 13 of the Additional Terms and Conditions/Modifications which form part of the contract document to sustain its claim. From the pleadings, it clearly transpires that both the parties had recourse to the contract which is admittedly entered into in support of the rival contentions and therefore, the claim made by the appellant would be covered by the arbitration clause, which is of the widest amplitude. It is thus satisfactorily established that the claim made by the contractor would be covered by the arbitration clause.

45. Mr. Nariman also wanted us to examine whether the claim made by the arbitrator would be admissible on the principle of quantum merit. It is not necessary to examine this aspect at all in the view which we are taking.

46. He also wanted us to adopt an approach that the effort of the Court must be to upheld the award and not to reject it. We consider it unnecessary to dilate upon it.

47. The discussion leads to the inescapable conclusion that a specific question of law touching the jurisdiction of the arbitrator was specifically referred to the arbitrator and therefore the arbitrator's decision is binding on the parties and the award cannot be set aside on the sole ground that there was an error of law apparent on the on face of the award. It is also established that the claim for compensation made by the arbitrator which led to the dispute was covered by the arbitration clause. The quantum of compensation awarded by the arbitrator was never disputed nor questioned. Therefore, the High Court was clearly in error in reversing the decision of the trial court.

48. Accordingly this appeal succeeds and is allowed and the Judgment of the High Court is set aside and the Judgment and Order of the Subordinate Judge, Ernakulam dated March 30, 1979 is restored with costs throughout.

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