Mitra Guha v. ONGC: Can determination of breach of contract be an 'excepted matter'?

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A. Introduction

Let me start with an obvious statement: party autonomy is one of the foundations of arbitration. Section 7(1) of the Arbitration and Conciliation Act, 1996 ("ACA") provides that by way of an arbitration agreement, the parties can submit all or *certain* disputes to arbitration. It is common for parties in a commercial contract to reserve some disputes for expert determination (or by any other means of dispute resolution), making them non-arbitrable.[1]

Disputes excluded from the scope of arbitration are, at times, referred to as "excepted matters." While the concept is well recognised, what matters can be 'excepted' is not a frequently discussed issue. In several government contracts with standard general conditions, determination of compensation for delay is left to be decided by an 'expert' typically employed by the government enterprise. Does such a clause mean that the in-house expert of a party has the power to determine liability, or does such a provision only confer an ability to quantify the compensation?

Fairly recently, this issue arose before the Supreme Court of India in *Mitra Guha Builders (India) Company* v. *Oil and Natural Gas Corporation Limited*, 2019 SCC OnLine SC 1442 ("*Mitra Guha*").

A construction contract had two sets of dispute resolution clauses – an expert determination clause (Clause 2) and an arbitration clause (Clause 25). The former provided that in the event of the contractor failing to comply with a stipulated condition, it shall be liable to pay compensation of an amount equal to ½ per cent per week ***as the Superintending Engineer may decide*** and whose decision shall be final. The latter clause specified that "the decision of the Superintending Engineer regarding the ***quantum*** of reduction […] will be ***final*** and will not be open to arbitration." The precise issue before the court was whether the levy of pre-estimated liquidated damages and reasonable compensation by the Superintending Engineer is arbitrable. The court concluded that Clause 2 conferred on the Superintending Engineer authority to decide on the liability and quantum of payment. The 'finality' in Clause 2, the court added, revealed the intention of the parties to make those disputes non-arbitrable.

This piece undertakes a closer analysis of this judgment, particularly given that the court did not assess all the relevant precedent. Notably, the court did not evaluate if reading into the clause a power to determine liability undermines the basic principle of fairness of having a neutral body for adjudication of disputes.

B. The backdrop of precedents

The following three decisions will help in properly assessing *Mitra Guha*:

(a) A 2-judge bench decision of 1989 in *Vishwanath Sood* v. *Union of India and another*, (1989) 1 SCC 657 ("*Sood*").

[1] Gary B. Born, 'Chapter 2: Legal Framework for International Arbitration Agreements', in Gary B. Born, *International Commercial Arbitration*, *Vol. 1*, 240 (2 ed., Wolters Kluwer, 2014).

(b) Another 2-judge bench decision of 2009 in *Bharat Sanchar Nigam Limited* v. *Motorola India Private Limited*, (2009) 2 SCC 337 ("*BSNL*").

(c) Another 2-judge bench decision of 2011 in *M/s JG Engineers Private Limited* v. *Union of India*, (2011) 5 SCC 758 ("*JG Engineers*").

Both *Sood* and *JG Engineers* had clauses very similarly worded to the one in *Mitra Guha*. In effect, *BSNL* also had a similar provision. The *Mitra Guha* court heavily relied on *Sood*, distinguished *BSNL* and did not refer to *JG Engineers* at all.

B1. The *Sood* judgment

A government works contract had a clause for compensation for a delay which provided that "in the event of the contractor failing to comply" with some conditions relating to timely execution of the contract, "he shall be liable to pay as compensation an amount equal to one per cent or such smaller amount as the Superintending Engineer (whose decision in writing shall be final) may decide … provided always that the entire amount of compensation … shall not exceed 10 per cent, on the estimated cost of the work as shown in the tender." A subsequent clause provided for arbitration of all disputes, but "except where otherwise provided in the contract." Was the issue of compensation arbitrable, or was it to be decided by the Superintending Engineer?

The court found that since compensation was payable "in the event of the contractor failing to comply" with the prescribed schedule, the levy was conditioned on some default or negligence on the part of the contractor. Further, the clause gave the Superintending Engineer the discretion to levy a maximum of 10 per cent and also to reduce the rate of penalty from one per cent. The court also noted that though the clause did not contemplate a notice to the contractor, as a matter of practice, compensation was initially levied by the Engineer-in-charge and the Superintending Engineer came into the picture only as some sort of revisional or appellate authority to whom the contractor appealed for redress. "The decision of the Superintending Engineer", the court said, "is in the nature of a considered decision which he has to arrive at after considering the various mitigating circumstances that may be pleaded by the contractor or his plea that he is not liable to pay compensation at all under this clause." Therefore, according to the court, the clause provided complete machinery for the determination of compensation.

The court also reasoned that the words "except where otherwise provided in the contract" in the arbitration clause were a reference to the compensation-for-delay and other like clauses by which certain types of determinations are left to the administrative authorities, and any other interpretation would render such words meaningless. Then, recognising a critical aspect of the case, the court said that it had "some hesitation" in coming to its conclusion because "the question of any negligence or default on the part of the contractor has many facets and to say that such an important aspect of the contract cannot be settled by arbitration but should be left to one of the contracting parties might appear to have far-reaching effects."

However, the court overcame its hesitation because the power of the Superintending Engineer "is not an undefined power" and "the amount of compensation is strictly limited to a maximum of 10 per cent and with a wide margin of discretion to the Superintending Engineer, who might not only reduce the percentage but who, we think, can even reduce it to nil, if the circumstances so warrant."

B2. The *BSNL* judgment

In *BSNL*, a turn-key contract contained a similar provision— clause 16.2, under which "should the tenderer fail to deliver the goods and services on turn-key basis within the period prescribed," the purchaser was entitled

to recover damages, and the "quantum of liquidated damages assessed and levied by the purchaser shall be final and not challengeable by the supplier."

Another clause (20.1) made all the disputes arbitrable "except as to the matters, the decision to which is specifically provided under this agreement."

Relying on *Sood*, it was argued that both clauses read together established that the determination of quantum of damages was an excepted matter.

The court rejected the argument. It noted that there was a dispute on the question if there was a breach in the first place. Clause 16.2 contemplated a *decision regarding the quantification of the liquidated damages and not any decision regarding fixing the liability of the supplier*. It cited *State of Karnataka* v. *Shree Rameshwara Rice Mills*, (1987) 2 SCC 160 for the proposition that the right conferred to assess damages arising from a breach of condition does not include a right to decide upon a dispute relating to the very breach of terms.

It also observed that an adjudicatory process could only determine delay on the part of the supplier, and there was nothing in clause 16.2 to suggest that it contained such a process.

The *BSNL* court distinguished *Sood* stating that in *Sood,* "the Superintendent Engineer acted as the revisional authority to decide disputes between the two parties by an adjudicatory process, there being complete machinery for settlement of the disputes in the relevant clause and most importantly, the Superintendent Engineer had the discretion on consideration of the facts and circumstances including mitigating facts, held no damages was payable."

B3. The *JG Engineers* judgment

JG Engineers involved the interpretation of a combination of clauses. One of them was worded almost identical to the provision in *Sood* (and also later in *Mitra Guha*). It stated that "in the event of the contractor failing to comply" with the time-schedule, "he shall be liable to pay as compensation an amount equal to one per cent or such small amount as the Superintending Engineer (whose decision in writing shall be final) may decide on the said estimated cost of the whole work for every day that the due quantity of work remains incomplete."

Again, just like in *Sood*, the clause which made all disputes arbitrable opened with the rider "except where otherwise provided in the contract …."

Speaking for the 2-judge bench, Raveendran J observed that the clause contemplated decision regarding quantification of damages and not regarding fixation of liability. What is made final under the term, he noted, is not the decision of any authority whether the contractor was responsible for the delay. Instead, the decision on consequential issues relating to quantification, if there is no dispute as to who had committed the breach. The party alleging breach cannot decide the question of whether there was a breach, and that question is reserved to be *resolved only by an adjudicatory forum*.

The court relied on *Shree Rameshwara Rice Mills* and *BSNL* but did not refer to *Sood*.

C. Reflections on *Mitra Guha*

Mitra Guha establishes a wrongful precedent of determining a breach of contract by an expert. The fallibility of the judgment is discussed below on three counts.

Firstly, *Mitra Guha* , in its conclusion, observes that "a reading of Clause 2 makes it clear that Superintending Engineer has been conferred with not only a right to levy compensation; but it also provides a mechanism for the determination of the *liability/quantum* of compensation."[2] It is surprising to see how two separate concepts, namely '*liability*' and '*quantum*', have been used interchangeably by the court. Liability is the determination of the fact which establishes breach and is a pre-condition to the factum of 'quantum'. A violation of a condition of contract and adjudication on the quantum of damages arising out of the breach are two distinct concepts. The right to quantify damages arising out of a breach does not include a right to decide if there was any breach in the first place.[3] While '*quantum*' can be decided by an expert, '*liability*' can only be determined by an authority reflecting judicial characteristics. As recognised in *Sood* itself, the question of negligence or default on the part of the contractor has several facets. To leave such an essential aspect of the contract to be decided by one of the contracting parties might appear to have far-reaching effects.[4]

Secondly, the court's emphasis on the finality of Clause 2 is perplexing. It concluded that "the parties have consciously agreed to have a finality to the decision of the Superintending Engineer and the same cannot be frustrated by challenging the same as illegal." It also observed that two other clauses of the agreement (clauses 13 and 14) provided for compensation, but they did not have a finality clause, which meant that they could be referred to arbitration. In the author's view, this is a misplaced emphasis on 'finality'. The critical question was what was made final—determination of liability or quantification? It is erroneous to say that the clause envisaged determination of liability because it was 'final'!

Thirdly, the 3-judge bench did not comprehensively evaluate the precedent. It cited *Sood* and concluded that it squarely applies to the facts. Had *JG Engineers* been before the court, it would have noted a direct conflict between the two.

Sood was decided on the logic that an inquiry into various circumstances was necessary to determine the exact quantum of compensation. The compensation could also be nil. How else would the expert decide this unless he considered all the details? In effect, an answer to this is contained in *JG Engineers*. Raveendran J had concluded that such a clause would only be triggered if the breach was an admitted one, and then the decision of the expert as to quantification was final. But if the breach was disputed, that question could be determined not by the expert but by an adjudicatory process. Unfortunately, *JG Engineers* did not refer to *Sood* at all.

Closely seen, *BSNL* was also based on the same rationale. It emphasised the fact that the breach was disputed in the case. In other words, it implied that the clause in question got triggered only if the breach was admitted. The *Mitra Guha* court distinguished *BSNL* by saying that in *BSNL,* the phrases "value of delayed quantity" and "for each week of delay"[5] showed that it is necessary to find out whether there has been a delay on the part of the supplier in discharging his obligation. Thus, in *BSNL's* case, a process of adjudication was envisaged to determine delay. But here in *Mitra Guha*, the clause was a complete mechanism for the determination of liability.

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[2] *Mitra Guha Builders (India) Company* v. *Oil & Natural Gas Corporation*, 2019 SCC OnLine SC 1442, para 17.

[3] *State of Karnataka* v. *Shree Rameshwara Rice Mills*, (1987) 2 SCC 160.

[4] *Vishwanath Sood* v. *Union of India & another*, (1989) 1 SCC 657, para 10.

[5] 16.2. Should the tenderer fail to deliver the goods and services on turn-key basis within the period prescribed, the purchaser shall be entitled to recover 0.5% of the value of the delayed quantity of the goods and services, for each week of delay or part thereof, for a period up to 10 weeks and thereafter at the rate of 0.7% of the *value of the delayed quantity of the goods and services for each week of delay* or part thereof for another 10 weeks of delay. In the present case of turn-key solution of supply, installation, and commissioning, where the delayed portion of the delivery and provisioning of services materially hampers effective user of the systems, liquidated damages charged shall be levied as above on the total value of the package concerned of the purchase order. Quantum of liquidated damages assessed and levied by the purchaser shall be final and not challengeable by the supplier." (emphasis added)

As to the phraseology in *BSNL*, the *Mitra Guha* court missed that adjudication of delay is one thing, the person adjudicating it is quite another matter. In all cases, it appears to be common ground that delay needed to be adjudicated as a first step, but that does not mean that the clause empowered the Superintending Engineer to do it.

As to the "complete mechanism" theory, the court merely makes a conclusory finding without providing any reasons. It relied on *Sood*, but both *Sood* and *Mitra Guha* do not consider the possible interpretation that the mechanism may be complete, but only for quantification.

D. Conclusion

The ruling in *Mitra Guha* gives legitimacy to parties reserving issues as fundamental as the breach of contract within the ambit of 'excepted matter' thus, rendering them non-arbitrable. It does not use the expression 'party autonomy, but that appears to be an underlying basis for the decision.

It undercuts the true spirit of dispute resolution if the power to determine breach is left to the control of one of the parties. Simply put, a party to an agreement cannot be a judge in its own cause. Interests of justice and equity require that where a party to a contract disputes commission of breach, the adjudication should be by an independent person or body and not by the other party to the contract. *JG Engineers* applies this principle to interpret the contract and correctly so in the author's view.

A 3-judge bench heard *Mitra Guha*. It is not apparent if it was aware of the decision in *JG Engineers*. The most satisfactory course would have been for it to evaluate the reasoning in *Sood* in light of the reasoning in *JG Engineers*. Even if it considered only *Sood*, given that *Sood* itself had expressed a 'hesitation' in reaching its conclusions, the *Mitra Guha* court should have been slow to accept its reasoning.

A misplaced interpretation of such clauses would hurt the aggrieved party and would delimit the judicial remedy available in such circumstances. The court must not act in haste when deciding upon the arbitrability of subject-matter and must keep in mind that the fundamental questions relating to the breach have to be necessarily determined by an adjudicatory forum and not by any other authority that works under the dominance of one of the parties.