DAMODAR VALLEY CORPORATION

v.

K. K. KAR

November 12, 1973

[P. JAGANMOHAN REDDY AND S. N. DWIVEDI, JJ.]

Arbitration Act, 1940 (10 *of* 1940)—*Repudiation of contract—If arbitration clause perishes with repudiation.*

On the respondent's failure to fulfil the terms of the contract, the appellant repudiated it and imposed certain penalties in accordance with the terms of the contract. The appellant later waived the penalties and paid certain sums due to the respondent. The appellant claimed that these payments, including the return of the deposit money finally settled the claims of the respondent. The respondent on the other hand claimed from the appellant certain sums, including damages for repudiation of the contract. The appellant not having agreed, the respondent appointed an arbitrator whom he later named as the sole arbitrator. The validity of the appointment of the sole arbitrator was challenged by the appellant under ss. 9(b) and 33 of the Indian Arbitration Act, 1940. The arbitration clause in the contract was to the effect that in case of a dispute "upon" or "in relation to" or "in connection with" the contract the matter shall be referred to arbitration. The Subordinate Judge permitted the appellant to adduce evidence to establish whether the contract was put an end to by final payment and whether the arbitration clause contained in the contract perished with it. The High Court in revision set aside the order of the Subordinate Judge and dismissed the application of the appellant in toto.

It was contended that since there had been a full and final settlement under the contract, the rights and obligations under the contract did not subsist and consequently the arbitration clause also perished along with the settlement.

HELD : (i) Where in a contract there is an arbitration clause, notwithstanding the plea that there was a full and final settlement between the parties, that dispute can be referred to the arbitration's. The High Court was in error in directing the dismissal of the appellant's petition in toto. The question whether there has been a full and final settlement of a claim under the contract is itself a dispute arising 'upon' or 'in relation to' or 'in connection with' the contract. These words are wide enough to cover the dispute sought to be referred. On the facts of this case when the appellant refused to accept the goods, the respondent could claim damages for breach of contract. Such a claim for damages is a dispute or difference which arises between the respondent and appellant and is "upon" or "in relation to" or "in connection with" the contract. [248C; 243C-D]

A contract is the creature of an agreement between the parties and where the parties under the terms of the contract agree to incorporate an arbitration clause, that clause stands apart from the rights and obligations under that contract, as it has been incorporated with the object of providing a machinery for the settlement of disputes arising in relation to or in connection with that contract. The questions of unilateral repudiation of the rights and obligations under the contract or of a full and final settlement of the contract relate to the performance or discharge of the contract. Far from putting an end to the arbitration clause, they fall within the purview of it. A repudiation by one party alone does not terminate the contract. It takes two to end it and hence it follows that as the contract subsists for the determination of the rights and obligations of the parties, the arbitration clause also survives. [243F-G]

(ii) In cases where the dispute between the parties is that the contract itself did not subsist either as a result of its being substituted by a new contract or by rescission or alteration, that dispute could not be referred to the arbitration as the arbitration clause itself would perish if the averment was found to be valid. As the very jurisdiction of the arbitrator is dependent upon the existence of the arbitration clause under which he is appointed, the parties have no right to invoke a clause which perishes with the contract. [244B-C]

(iii) The contract being concensual, the question whether the arbitration clause survives or perishes would depend upon the nature of the controversy and its effect upon the existence or survival of the contract itself. Where the binding nature of the contract is not disputed, but a difference has arisen between the parties thereto as to whether there has been a breach by one side or the other or whether one or both the parties have been discharged from further performance such differences are "upon" or "in relation to" or "in connection with" the contract. That a contract has come to an end by frustration does not put an end to the contract for all purposes because there may be rights and obligations which had arisen earlier when it had not come to an end, as it is only the future performance of the contract that has come to an end. A dispute as to the binding nature of the contract cannot be determined by resort to arbitration clause because the arbitration clause itself stands or falls according to the determination of the question in dispute. [244D-F]

The question whether the termination was valid or not and whether damages were recoverable for such wrongful termination did not affect the arbitration clause or the right of the respondent to invoke it for appointment of an arbitrator.

Union of India v. *Kishorilal Gupta & Brothers*, [1960] 1 S.C.R. 493 relied.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 851 of 1972.

Appeal from the Judgment and Order dated the 25th January, 1971 of the Calcutta High Court in Civil Rule No. 1683 of 1970.

B. Sen and *D. N. Mukherjee*, for the appellant.

V. S. Desai and *M. M. Kshatriya*, for the respondent.

The Judgment of the Court was delivered by

JAGANMOHAN REDDY, J.—On an application under ss. 9(b) and 33 of the Arbitration Act 10 of 1940—hereinafter called 'the Act'—challenging the propriety of a reference to the arbitration of the sole arbitrator, the Subordinate Judge, Alipore permitted the appellant to adduce evidence to establish whether the contract was put an end to by final payment, and if it was whether the arbitration clause contained in the contract will perish with it. Against this order the respondent filed a revision in the High Court of Calcutta which while setting aside the order of the Subordinate Judge dismissed the application filed by the appellant. This appeal is by certificate against that decision.

In order to appreciate the significance of the question which has to be determined, a few relevant facts may be stated. The respondent entered into a contract with the appellant to supply certain quantities of coal at certain price but as he failed to do so in accordance with the terms of the contract, the appellant repudiated the contract, imposed certain penalties in accordance with the terms of the contract which he later waived and ultimately paid certain sums to the respondent which were due to him for the supply of coal. It is the case of the appellant that these payments including the return of the deposit amount finally settled the claims of the respondent. No doubt the respondent was asked to submit his bill along with a receipt stating that he received the payment in full and final settlement of all payments and that there was no other claim. But the respondent while

submitting his bill did not give the receipt as desired. The amount of the bill was, however, paid, after receipt of which the respondent claimed further sums from the appellant including damages for repudiation of the contract. When the appellant did not agree to comply with the demands the respondent served a notice of his intention to refer the matter to the arbitration under the arbitration clause contained in the contract. By that notice he intimated the appellant that he has appointed J. N. Mullick as his arbitrator and requested the appellant to appoint its own arbitrator. The appellant did not agree to it, whereupon the respondent by a further notice intimated the appellant that the arbitrator nominated by him would be the sole arbitrator for adjudicating the dispute between the parties. Soon thereafter the sole arbitrator J. N. Mullick issued a notice to the appellant and consequently the appellant had to file an application under ss. 9(b) and 33 of the Act challenging the validity of the appointment of the sole arbitrator. In paragraph-16 of the petition the appellant stated :

> ".....all claims and demands as between the petitioner and the contractor standing fully paid and adjusted there was no dispute in the absence whereof the entire proceedings in the above case do not lie and the instant case is not maintainable under the Arbitration Act being outside its fold."

As stated earlier, the Subordinate Judge held that the appellant could adduce evidence that the contract had come to an end in order to determine that the arbitration clause perished with the contract.

On the pleas raised before the Subordinate Judge, the following questions were considered :

(1) Has the Court jurisdiction to decide the points raised in paragraph-16 of the appellant's petition ?

(2) Whether the arbitration clause between the parties would cease to exist with the termination of the agreement; and

(3) Whether oral evidence touching the dispute in respect of the alleged final settlement of the claim would be admissible in the proceedings.

The Subordinate Judge answered these questions in the affirmative and held that the appellant could adduce evidence to establish that the contract had come to an end and that as a consequence the arbitration clause perished with it.

On these facts the short question for determination is : where one of the parties refers a dispute or disputes to arbitration and the other party takes a plea that there was a final settlement of all claims, is the Court, on an application under ss. 9(b) and 33 of the Act, entitled to enquire into the truth and validity of the averment as to whether there was or was not a final settlement on the ground that if that was proved, it would bar a reference to the arbitration inasmuch as the arbitration clause itself would perish.

The respondent purported to refer the dispute to arbitration under the following clause of the agreement :

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> ". . . . . if at any time any question, dispute or difference whatsoever shall arise between the Corporation and the successful tenderer upon or in relation to, or in connection with the contract, either party may forthwith give to the other, notice in writing of the existence of such question, dispute or difference, and the same shall be referred to the adjudication of two arbitrators, one to be nominated by the
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> Corporation and the other to be nominated by the successful tenderer. . . . . and the award of the arbitrators. . . . . shall be final and binding on the parties and the provisions of Indian Arbitration Act, 1940, and of the Rules thereunder and any statutory modification thereof shall be deemed to apply to and be incorporated in this contract. . . . . "

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It appears to us that the question whether there has been a full and final settlement of a claim under the contract is itself a dispute arising 'upon' or 'in relation to' or 'in connection with' the contract. These words are wide enough to cover the dispute sought to be referred. The respondent's contention is that the contract has been repudiated by the appellant unilaterally as a result of which he had no option but to accept that repudiation because if the appellant

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was not ready to receive the goods he could not supply them to him or force him to receive them. In the circumstances, while accepting the repudiation, without conceding that the appellant had a right to repudiate the contract, he could claim damages for breach of contract. Such a claim for damages is a dispute or difference which arises between himself and the appellant and is 'upon' or 'in relation to' or 'in connection with' the contract.

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The contention that has been canvassed before us is that as there has been a full and final settlement under the contract, the rights and obligations under the contract do not subsist and consequently the arbitration clause also perishes along with the settlement. If so, the dispute whether there has or has not been a settlement cannot be the subject of an arbitration. There is, in our view, a basic fallacy underlying this submission. A contract is the creature of an agree-

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ment between the parties and where the parties under the terms of the contract agree to incorporate an arbitration clause, that clause stands apart from the rights and obligations under that contract, as it has been incorporated with the object of providing a machinery for the settlement of disputes arising in relation to or in connection with that contract. The questions of unilateral repudiation of the

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rights and obligations under the contract or of a full and final settlement of the contract relate to the performance or discharge of the contract. Far from putting an end to the arbitration clause, they fall within the purview of it. A repudiation by one party alone does not terminate the contract. It takes two to end it, and hence it follows that as the contract subsists for the determination of the rights and obligations of the parties, the arbitration clause also

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survives. This is not a case where the plea is that the contract is void, illegal or fraudulent etc., in which case, the entire contract along with the arbitration clause is *non est,* or voidable. As the contract is an outcome of the agreement between the parties it is equally

open to the parties thereto to agree to bring it to an end or to treat it as if it never existed. It may also be open to the parties to terminate the previous contract and substitute in its place a new contract or alter the original contract in such a way that it cannot subsist. In all these cases, since the entire contract is put an end to, the arbitration clause, which is a part of it, also perishes along with it. Section 62 of the Contract Act incorporates this principle when it provides that if the parties to a contract agree to substitute a new contract or to rescind or alter it, the original contract need not be performed. Where, therefore, the dispute between the parties is that the contract itself does not subsist either as a result of its being substituted by a new contract or by rescission or alteration, that dispute cannot be referred to the arbitration as the arbitration clause itself would perish if the averment is found to be valid. As the very jurisdiction of the arbitrator is dependent upon the existence of the arbitration clause under which he is appointed, the parties have no right to invoke a clause which perishes with the contract.

In certain circumstances, it may be that there has been a termination of the contract unilaterally and as a consequence the parties may agree to rescind the contract. In such a situation the rescission would put an end to the performance of the contract *in futuro*, but it may remain alive for claiming damages either for previous breaches or for the breach which constituted the termination.

We have adverted to these several aspects merely to show that contracts being consensual, the question whether the arbitration clause survives or perishes would depend upon the nature of the controversy and its effect upon the existence or survival of the contract itself. Where the binding nature of the contract is not disputed, but a difference has arisen between the parties thereto as to whether there has been a breach by one side or the other or whether one or both the parties have been discharged from further performance such differences are "upon" or "in relation to" or "in connection with" the contract. That a contract has come to an end by frustration does not put an end to the contract for all purposes, because there may be rights and obligations which had arisen earlier when it had not come to an end, as it is only the future performance of the contract that has come to an end. It is, therefore, clear that a dispute as to the binding nature of the contract cannot be determined by resort to arbitration, because as we have stated earlier, the arbitration clause itself stands or falls according to the determination of the question in dispute. It may be stated that the Privy Council had in *Hirji Mulji* v. *Cheong Yue Steamship Company*(1) held that as the authority of a person claiming arbitral jurisdiction depends on the existence of some submission to him by the parties of the subject-matter of the complaint, "a contract that has determined is in the same position as one that has never been concluded at all". The observations of Lord Sumner in that case as to the effect of frustration of the contract before its performance on the arbitration clause inasmuch as frustration operates automatically and the contract

(1) [1926] A.C. 497.

A ceases to exist for all purposes save for the enforcement of claims vested before that date of which there were none, were dissented from in *Heyman and another* v. *Darwins Ltd.*(1), though Lord Macmillan did not want to express any opinion on this question. Be that it may, in *Heyman's* case(2) Lord Macmillan pointed out at pp. 370-371 :

B "If it appears that the dispute is whether there has ever been a binding contract between the parties, such a dispute cannot be covered by an arbitration clause in the challenged contract. If there has never been a contract at all, there has never been as part of it an agreement to arbitrate. The greater includes the less. Further, a claim to set aside a contract on such grounds as fraud, duress or essential error C cannot be the subject-matter of a reference under an arbitration clause in the contract sought to be set aside. Again, an admittedly binding contract containing a general arbitration clause may stipulate that in certain events the contract shall come to an end. If a question arises whether the contract has for any such reason come to an end I can see no reason why the arbitrator should not decide that question. D It is clear, too, that the parties to a contract may agree to bring it to an end to all intents and purposes and to treat it as if it had never existed. In such a case, if there be an arbitration clause in the contract, it perishes with the contract. If the parties substitute a new contract for the contract which they have abrogated the arbitration clause in the abrogated contract cannot be invoked for the determination of questions under the new agreement. All this is E more or less elementary."

The above observations of Lord Macmillan as well as the observations of other Law Lords in *Heyman's case*(1) were considered by this Court in *The Union of India* v. *Kishorilal Gupta and Bros.*(3) where the respondents had entered into three contracts with the F appellant each of which contained an arbitration clause. Before the contracts had been fully executed, disputes arose between the parties, one alleging that the other was committing a breach of the contract. The parties then entered into three fresh contracts on successive dates purporting to settle these disputes on the terms therein contained. By the first two of these settlement contracts the respondents agreed to pay to the appellant certain moneys in settlement respec- G tively of the disputes relating to the first two original contracts. By the last of these settlement contracts the respondents agreed to pay to the appellant in specified instalments certain moneys in settlement of the disputes relating to the third original contract as also the moneys which had then become due on the first two settlement contracts and had not been paid. This settlement further undertook to hypothecate certain properties to secure the due repayment of these H moneys. In the end it provided as follows :

(1) [1942] A.C. 356. (2) [1942] A.C. 356.

(3) [1960] 1 S.C.R. 493.

"The contracts stand finally concluded in terms of the settlement and no party will have any further or other claim against the other."

On a question whether the arbitration clauses in the original contracts had ceased to have any effect and the contracts stood finally determined as a result of the settlement contracts, the Calcutta High Court held that the first original contract had not been abrogated by the settlement in respect of it, but the third original contract and the arbitration clause contained in it had ceased to exist as a result of the last settlement, as such the arbitrator had no jurisdiction to arbitrate under that arbitration clause. Imam and Subba Rao, JJ., (Sarkar, J., dissenting) confirmed the High Court's decision. They held that the three contracts were settled and the third settlement contract was in substitution of the three contracts; and, after its execution, all the earlier contracts were extinguished and the arbitration clause contained therein also perished along with them. They further held that the new contract was not a conditional one and after its execution the parties should work out their rights only under its terms. Sarkar, J., however, held that the award was valid and could not be set aside as the third settlement neither expressly put an end to the arbitration clause, nor, considered as an accord and satisfaction, did it have that effect. He observed that an arbitration clause stands apart from the rest of the contract in which it is contained. It does not impose on the one party an obligation in favour of the other; it only embodies an agreement that if any dispute arises with regard to any obligation which one party has undertaken to the other, such dispute shall be settled by arbitration. An accord and satisfaction which is concerned with the obligations arising from the contract, does not affect an arbitration clause contained in it. It will be observed that while the decision rested on the interpretation of the settlement clause as to whether the original contracts were put an end to and in their place new contracts were substituted with the result that the arbitration clause did not survive, the principle of law that where the parties put an end to the contract as if it had never existed and substitute it with a new contract governing the rights and obligations of the parties thereunder, the arbitration clause also perishes along with it, was accepted as correct by all the learned Judges.

After a review of the relevant case law, Subba Rao, J., as he then was, speaking for the majority enunciated the following principles: "(1) An arbitration clause is a collateral term of a contract as distinguished from its substantive terms; but none the less it is an integral part of it; (2) however comprehensive the terms of an arbitration clause may be, the existence of the contract is a necessary condition for its operation; it perishes with the contract; (3) the contract may be *non est* in the sense that it never came legally into existence or it was void *ab initio;* (4) though the contract was validly executed, the parties may put an end to it as if it had never existed and substitute a new contract for it solely governing their rights and liabilities thereunder; (5) in the former case, if the original contract has no legal existence, the arbitration clause also

A cannot operate, for along with the original contract, it is also void; in the latter case, as the original contract is extinguished by the substituted one, the arbitration clause of the original contract perishes with it; and (6) between the two falls many categories of disputes in connection with a contract, such as the question of repudiation, frustration, breach etc. In those cases it is the performance of the B contract that has come to an end, but the contract is still in existence for certain purposes in respect of disputes arising under it or in connection with it. As the contract subsists for certain purposes, the arbitration clause operates in respect of these purposes." In those cases, as we have stated earlier, it is the performance of the contract that has come to an end but the contract is still in existence for certain purposes in respect of disputes arising under it or in C connection with it. We think as the contract subsists for certain purposes, the arbitration clause operates in respect of those purposes.

Sarkar, J., did not dissent from the propositions enunciated by Subba Rao, J., but only disagreed with the majority on the effect of the settlement on the arbitration clause. He also referred to the observations of Lord Macmillan in *Hayman's* case(1) and observed D at p. 519: "An arbitration agreement, of course, is the creature of an agreement and what is created by agreement may be destroyed by agreement." Again at p. 521 he said: "It is well settled that such a clause (arbitration clause) in a contract stands apart from the rest of the contract." It was, however, pointed out by him that an accord and satisfaction which secures a release from an obligation arising under a contract, is really based on the existence of the E contract instead of treating it as non-existent. The contract is not annihilated but the obligations under it cease to be enforceable. Therefore it is that when an action is brought for the appropriate remedy for non-performance of these obligations that an accord and satisfaction furnishes a good defence. The defence is not that the contract has come to an end but that its breach has been satisfied by accord and satisfaction and, therefore, the plaintiff in the action is F not entitled to the usual remedy for the breach. In the circumstances, he thought that the arbitration clause did survive to settle the dispute as to whether there was or was not an accord and satisfaction.

In this case, we are not troubled with the question whether there has been novation, rescission or substitution of the contract, nor have the parties in their pleadings ever contended that the contract is G *non est* as it has been substituted by a new contract. Where, however, as in this case, there was a termination of the contract due to non-performance, the existence of the contract has been assumed for the purposes of such termination. Similarly the question whether there has been a settlement of all the claims arising in connection with the contract also postulates the existence of the contract. The principle laid down by Sarkar, J., in *Kishorilal Gupta Bros's* case(2) H that accord and satisfaction does not put an end to the arbitration clause was not dissented to by the majority. On the other hand

1. [1942] A. C. 356. (2) [1960] 1 S.C.R. 493.

proposition (6) seems to lend weight to the views of Sarkar, J. In these circumstances, the question whether the termination was valid or not and whether damages are recoverable for such wrongful termination does not affect the arbitration clause, or the right of the respondent to invoke it for appointment of an arbitrator.

While so, we think the High Court was in error in directing the dismissal of the appellant's petition in toto. In that petition several other contentions were urged one of which was that the appointment of J. N. Mullick as the sole arbitrator should be set aside for non-conformity with the provisions of s. 9(b) of the Act. It may also be observed that under the proviso to that section the Court is empowered to set aside any appointment as a sole arbitrator made under cause (b) and either on sufficient cause being shown allow further time to the defaulting party to appoint an arbitrator or pass such other order as it thinks fit. The Subordinate Judge did not decide any of the aforesaid matters, which he should have been allowed to do. The learned Advocate for the respondent also frankly conceded that the High Court was not justified in dismissing the petition altogether. In the circumstances, as we have held that where in a contract there is an arbitration clause, notwithstanding the plea that there was a full and final settlement between the parties, that dispute can be referred to the arbitration, the Subordinate Judge is directed to dispose of the petition of the appellant according to law.

After this judgment was prepared the respondent filed Civil Miscellaneous Petition No. 9566 of 1973 seeking directions on the ground that the learned counsel who represented him during the hearing made the above concession that the High Court was not justified in dismissing the petition altogether, on a misapprehension of the real facts. The reasons for further consideration on this aspect were fully set out in the petition which was placed before us on November 6, 1973. After hearing the learned counsel for the respondent we found no justification for giving any directions or for changing our view that the High Court was in error in dismissing the petition under s. 9(b) read with s. 33 of the Act. We accordingly dismissed the Civil Miscellaneous Petition.

In the result the appeal is partly allowed, but in the circumstances without costs.

P.B.R. *Appeal partly allowed.*