

## Kuriachen Vs Kerala State Electricity Board

**Court:** High Court Of Kerala

**Date of Decision:** Oct. 4, 1977

**Acts Referred:** Arbitration Act, 1940 " Section 34

**Hon'ble Judges:** Subramonian Poti, J; Kochu Thommen, J

**Bench:** Division Bench

**Advocate:** Panicker and Poti, for the Appellant; K. Raghava Kurup, for the Respondent

**Final Decision:** Allowed

### Judgement

Kochu Thommen, J.

This appeal arises from the order of the Subordinate Judge, Trichur, in I.A. No. 886 of 1976 in O.S. No. 136 of

1976. The learned Judge dismissed an application filed by the Appellant (Defendant in the suit) u/s 34 of the Arbitration Act, 1940.

2. The suit was filed by the Kerala State Electricity Board, to recover from the Defendant a sum of Rs. 65,950.13 with future interest by way of

damages for breach of contract. It is alleged in the plaint that an agreement was entered into between the Plaintiff and the Defendant on 7th August

1973 for the construction of temporary buildings at Mukkali in connection with the Silent Valley Hydro-Electric Project. The agreement provided

that the contract work was to be completed on or before 9th July 1973 and that all unused materials supplied by the Plaintiff to the Defendant had

to be returned to the Plaintiff, failing which the cost of such materials was recoverable from the Defendant at a penal rate as stipulated under the

contract. It is alleged that the Defendant, contrary to the provisions of the contract, failed to complete the work within the stipulated time and

furtively removed from the site the unused materials. When the Plaintiff came to know of the clandestine removal of materials, a complaint was

lodged with the Augali police and Cr. No. 16/75 was registered. Augali police investigated into the matter, but sent a final report to the Magistrate

of the I Class at Mannarghat to refer the case as a mistake of fact. In the circumstances the Plaintiff filed the suit for recovery of amounts as per the

contract.

3. The Defendant filed an application u/s 34 of the Arbitration Act, 1940, to stay the legal proceedings on the ground that the subject-matter of the

suit was covered by an arbitration agreement and the matter was therefore liable to be referred to the arbitrator.

4. The Plaintiff thereupon filed objections to the said application on various grounds. The Plaintiff contended that the subject-matter of the suit was

outside the scope of the arbitration clause; the award of the arbitrator would not bind the Plaintiff; there was no dispute between the parties which

could be referred to arbitration; and in view of the allegations of fraud and misappropriation, the civil court was the proper forum to decide such

questions and the arbitrator had no jurisdiction in respect of the same.

5. The learned Subordinate Judge in his order under appeal held that the subject-matter of the suit was a dispute which fell within the purview of

the arbitration clause and that an award made by the arbitrator in terms of the agreement would be binding on the Plaintiff as well as on the

Defendant. The court, however, held that in view of the allegations of fraud, misappropriation and breach of trust, it was the civil court that was the

proper forum. For that reason the application u/s 34 was dismissed.

6. Clause (22) of the agreement between the parties reads as follows:

In the event of dispute arising between the contractor and the department regarding the application of the contract, the same shall be submitted for

arbitration by a specific Arbitrator or Board as Arbitrator whose award shall be binding on the contractor.

7. The Respondent (Plaintiff) questions the finding of the learned Judge that the subject-matter of the suit is covered by the arbitration clause.

Plaintiff's counsel says that the main allegation in the plaint is that the Defendant misappropriated the unused materials. It is a tortious act which is

outside the purview of the arbitration clause.

8. We shall refer to the relevant allegations in the plaint. In paragraph 10 of the plaint it is stated:

As per the conditions of contract all materials supplied to the contractor shall remain the absolute property of the Board and shall not on any

account be removed from the work spot and shall at all times be open for the inspection of the Executive Engineer.... Unused balance, if any, at the

time of the completion or determination of the contract shall be returned to the Divisional Store; otherwise the costs of the materials shall be

recovered at Book value plus 20 per cent or at current market rates, whichever is higher and in addition specific penalty rates as may be fixed by

the Chief Engineer in the form of Board's circular orders from time to time shall also be recovered at the discretion of the Executive Engineer.

In para 11 of the plaint it is stated:

In view of the aforementioned provisions of the contract the contractor should have returned all the unused materials lying at the work spot to the

Divisional Store at Mannarghat. Instead of doing so he has clandestinely removed the materials to an unknown place making the Junior Engineer

believe that they are being taken to the Departmental Store. This action of the Defendant amounts to misappropriation of Board properties and

also breach of contract and trust. He is therefore liable to pay the costs of these materials at the market rate current at that time. The value of the

materials at the market rates amounts to Rs. 56,295. In addition to the total value of the materials the Defendant is also liable to pay 10 per cent of

the said amount as penal rate ordered by the Chief Engineer (Civil) which will come to Rs. 5,630. Both inclusive he is liable to pay Rs. 61,925 to

the Board. The Plaintiff is also entitled to claim interest at the rate of 12 per cent per annum on the costs of materials from 2nd March 1975 in view

of the provisions of the Interest Act and also because the sum payable to the Plaintiff is an ascertainable amount due under an agreement.

9. The above pleadings show that it was specifically provided under the contract that the Defendant had an obligation to return to the Plaintiff all

unused materials, failing which the Plaintiff could recover the cost of the materials together with certain other damages as stipulated under the

contract. Clause 11 of the conditions of contract provided:

...Unused balance if any at the time of the completion or determination of the contract shall if, sound, be returned to the Executive Engineer's store;

otherwise the cost of materials either allowed to deteriorate or unaccounted, amounting as it does to an excess supply over sanctioned

requirements shall be recovered at book value plus 20 per cent or current market rates whichever is higher; and in addition specific penalty rates as

may be fixed by the Chief Engineer in the form of Board's circular orders from time to time shall also be recovered at the discretion of the

Executive Engineer and the contractor shall not be permitted to return remnants or deteriorated materials into the Executive Engineer's store or

claim any compensation for loss by wastage in such materials beyond what may be allowed in the estimate, it being assumed that all risk is

provided for in the tenders.

The Additional Conditions of Contract, Technical specifications and Schedules further provided in Clause (6):

\* \* \* \*

Any excess materials issued to the Contractor over and above that allowed in the departmental data shall be returned by the Contractor in kind,

failing which the cost of such materials recovered from the Contractor's bill at penal rates.

\* \* \* \*

The suit was filed for recovery of the stipulated damages on account of the alleged breach of contract. If the alleged misappropriation is

established, it would at best be a tortious act which arose in the execution of the contract. It would not be a tort which is independent of or outside

the contract. To establish the act of tort and claim damages for the same, it would be necessary for the Plaintiff to have recourse to the contract.

The amounts claimed for breach of the contract are calculated in terms of the contract and the success of the claim would therefore depend upon

the provisions of the contract. The alleged tort is thus closely related to the contract. As stated by Lord Asquith in *Welf v. Collis Removal Service*

(1947) 2 All E.R. 260 .

Claims which are entirely unrelated to the transaction covered by the contract would no doubt be excluded; but we are of opinion that, even if the

claim in negligence is not a claim "under the contract ", yet there is a sufficiently close connection between that claim and that transaction to bring

the claim within the arbitration clause even though framed technically in tort.

10. The arbitration clause refers to disputes ""regarding the application of the contract"". This expression is wide enough to include all matters which

arise under the contract or in the working of the contract. Even if the dispute relates to an alleged fraud in the implementation or in the carrying out

of the contractual obligations, such dispute would be covered by the clause. As stated by the Supreme Court in *The Printers (Mysore) Private Ltd.*

*Vs. Pothan Joseph*, at 1160:

The words "interpretation or application of the contract" are frequently used in arbitration agreements and they generally cover disputes between

the parties in regard to the construction of the relevant terms of the contract as well as their effect, and unless the context compels a contrary

construction, a dispute in regard to the working of the contract would generally fall within the clause in question.

11. The test for determining the question whether the arbitrator had jurisdiction to adjudicate upon the claim was laid down by the Supreme Court

in *Union of India (UOI) Vs. Salween Timber Construction (India) and Others*, at 228:

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 this case.

Viewed in this light we are of opinion that the subject-matter of the dispute squarely falls within the scope of the arbitration clause.

12. The question is whether the learned Judge was right in holding that in view of the allegations of fraud it was not proper to stay the proceedings

and refer the dispute to arbitration. In coming to that conclusion, he relied on the decision of the Supreme Court in Abdul Kadir Shamsuddin

Bubere Vs. Madhav Prabhakar Oak, . The Supreme Court in that case cited with approval the decision of Jessel M.R. in Russel v. Russel (1880)

14 Ch.D. 471 and stated as follows:

There is no doubt that where serious allegations of fraud are made against a party and the party who is charged with fraud desires that the matter

should be tried in open court, that would be a sufficient cause for the court not to order an arbitration agreement to be filed and not to make the

reference. But it is not every allegation imputing some kind of dishonesty, particularly in matters of accounts, which would be enough to dispose a

court to take the matter out of the forum which the parties themselves have chosen.... It is only in cases of allegations of fraud of a serious nature

that the court will refuse as decided in Russel's case....

The principle stated above shows that where serious allegations of fraud are levelled against a person and such person desires a public inquiry into

such allegations, he would not be deprived of such an opportunity by referring the dispute to arbitration. It is only in the interest of the person

charged with fraud that the court laid down the above principle, and not ordinarily in the interest of the person bringing those charges. This principle

was stated in Russel v. Russel (1880) 14 Ch.D. 471 as follows:

In a case where fraud is charged, the Court will in general refuse to send the dispute to arbitration if the party charged with the fraud desires a

public inquiry. But where the objection to arbitration is the party charging the fraud, the Court will not necessarily accede to it, and will never do so

unless a prima facie case of fraud is proved.

(head notes)

In the present case it is the Defendant who is charged with fraud; but it is he who desires a reference to arbitration. That being the position, the

principle stated by the Supreme Court does not apply to the instant case.

13. The Defendant does not want the charges levelled against him enquired into in a civil court, but insists upon reference of the dispute to the

forum accepted by the parties under the contract. In our view, the Defendant is perfectly within his right to insist upon strict adherence to the

arbitration clause. The learned Subordinate Judge was not justified in rejecting the Defendant's application u/s 34. The appeal is accordingly

allowed and consequently the application u/s 34 of the Arbitration Act will stand allowed. The Defendant is entitled to his costs.