REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.1854 OF 2007

M/s. Gayatri Project Ltd.
....Appellant(s)

Versus

M/s. Sai Krishna Construction ....
Respondent(s)

O R D E R

This appeal is filed against the order passed by the High Court in an application under Section 11(5) and (6) of the Arbitration and Conciliation Act, 1996 (for short the 'Act') directing that the matter be referred to arbitration by a former Judge of the Andhra Pradesh High Court.

The respondent moved the aforesaid application on the basis that it is a partnership firm, carrying on business of civil works relating to irrigation structures. The Irrigation

Department of Government of Andhra Pradesh had given the work to the appellant herein. Thus, the appellant was the main contractor and respondent was the sub-contractor working under the appellant. The works involved earth work excavation and cohesive non-swelling soil filling in KC Canal including CC lining and structures form KMs 156.650 to KMs 170-00 of Package ICB-10' in Kurnool District of Andhra Pradesh. The appellant identified the respondent as a suitable agency for execution of the work and entrusted the work to the respondent as a sub-contractor. After due negotiations, an agreement dated 29.1.2001 was entered into between the parties. The agreement *inter alia* provides various terms and conditions including the nature of work to be executed by the respondent, security deposits, penalties leviable, commission to which the appellant would be entitled to, method of payment for the work undertaken, taxes and Government levies. The agreement also contained an arbitration clause which reads as under:-

> **"All disputes relating to the original contract shall be properly referred and correspond by the work contractor. However, the settlement of disputes and consequential awards shall be to the account of principal contractor and work contractor. All disputes relating to the work contract under this agreement shall be mutually settled between the**

work contractor and the principal contractor. In case of any differences, the same will be decided by a sole arbitrator appointed by the principal contractor and work contractor."

Clause 6 of the agreement provides that the measurements shall be taken for the work done once in a month. Payment shall be released as and when principal contractor received payment from the Department, duly deducting the commission and other recoveries as mentioned in Clause 6 above. Final payment shall be released after completion of the work satisfactorily. Clause 5 provided that the work contractor (sub-contractor) shall be paid the balance amount after deducting certain amounts from the gross amount of running account bills. Relevant part of clause 5 is as under:-

"The work contractor shall be paid the balance amount after deducting the following from the gross amount of running account bills.
i. a. Earth work excavation in bed and slopes including sectioning and leveling @ 14% (Fourteen percent only) of Agreement rate.

b. Filling bed and slopes with CNS soils as directed and as per specifications @ 17% (Seventeen percent only) of Agreement rates.

ii. Sales Tax/Turnover Tax

iii. Income Tax in the running account bills.

iv. Value of materials etc., if any, supplied by the department or by the principal contractor and hire charges of machinery given.

v. Any other recoveries affected by the department in the account bills.

The agreement further provided that the final payment shall be released after completion of the work satisfactorily.

The respondent claims that it has executed the work to the satisfaction of the appellant and the State Government. The appellant having received all the amounts from the Government of Andhra Pradesh failed to make corresponding payments to the respondent after deducting commission as stipulated under the agreement. The respondent, therefore, approached and tried to persuade the appellant to make the payment of the outstanding amount after the completion of the entire work. However, the appellant failed to pay. Since the amounts were not paid by the appellant, the respondent served a Claim Notice on 6.5.2004 demanding the payment of Rs.1,01,27,776/-. On 17.8.2004, the Appellant sent a reply to the aforesaid notice not only disputing the various claims but also raising a counter claim in the amount of Rs.32,12,950/-. The appellant claimed that the accounts had been reconciled. The parties had signed a full and final settlement document on

6.6.2003, under which the respondent acknowledged the receipt of certain amounts. The balance of Rs.17,32,843/- was to be paid in two or three instalments before 30.6.2003. After receiving the entire payment, the respondent was falsely claiming further amounts with mala fide intentions. On receipt of the reply with the counter-claim, the respondent sent a further reply reiterating its claim and also disputing the counter claim of the appellant as being frivolous and false. The respondent in the aforesaid reply also stated that unless the entire claim is satisfied, it will seek the remedy by way of arbitration. In spite of the above, the appellant still made efforts to settle the entire dispute but without any useful results.

Instead of accepting the full and final settlement dated 6.6.2003, the respondent, in fact, raised a further claim for the amount of Rs.25,50,048/- towards the value of HSD oil supply and exemption of excise duties and sales tax which had been availed by the appellant. A claim in this regard was sent to the appellant on 30-5-2006. According to the respondent, the total claim finally comes to Rs.1,26,77,824/- with interest accrued thereon at 18% per annum from 6-5-2004. The appellant on

24.6.2004 denied the aforesaid claim. The dispute not having been resolved, the respondent served a legal notice on the appellant dated 19.6.2006. The appellant again denied the claim. The respondent thereafter moved the application under Section 11(5) and (6) of the Arbitration Act. The appellant filed a reply to the application disputing and denying the claims of the appellant. The appellant stated that the application for appointment of Arbitrator is liable to be dismissed. It was pleaded that Agreement dated, 29.1.2001 which contains the arbitration clause has been superseded by the full and final settlement agreement dated 6.6.2003. It was further the case of the appellant that the respondent having received the entire amount in terms of the "full and final settlement" dated 6-6-2003 is estopped from filing the application under Section 11 (5) and (6) of the Arbitration Act. According to the Appellant, since the entire dispute had been settled, no reference could be made to arbitration. The appellant had also pleaded that the respondent had failed to disclose that the parties had entered into a full and final settlement on 6-6-2003. The plea was also raised to the effect that invocation of the arbitration on 9-6-2006 is time barred as the cause of action for filing the

application arose on 6-6-2003 when the "full and final settlement" was entered into between the parties.

It was also the case of the appellant that the works executed by the respondent not being of the required standard and specifications, were rejected by the Government. Consequently, the appellant had to rectify the defects and incur extra expenses. These were liable to the deducted from the amount claimed by the respondent. It is also the claim of the appellant that since the works had not been satisfactorily completed, the agreement itself was terminated on 16-11-2001. The appellant had also pleaded that pursuant to the Settlement dated 6-6-2003, the respondent had received a sum of Rs.16 lakhs. Therefore, there is no arbitrable dispute which can be referred to arbitration. It is also the case of the appellant that he has actually suffered a loss as it has incurred an expenditure of Rs.32,13,950/- in rectification of the works which were unsatisfactorily performed by the respondent. The appellant also claims that in order to maintain cordial relations, it had entered into a "full and final settlement" with the respondent with regard to the entire claims of the sub-contractor.

Upon examination of the entire factual as well as the legal position, the High Court has allowed the application under Section 11 (5) and (6) of the Act. This Appeal has been filed against the aforesaid Judgment of the High Court.

We have heard learned Counsel for the parties.

Mr. Arun Kathpalia, learned Advocate appearing for the appellant relied heavily on the "full and final settlement" and submitted that the settlement has been duly signed by a representative of the respondent. Therefore, the respondent cannot now be permitted to submit that there was no "full and final settlement". He further submitted that once there was "full and final settlement", no arbitrable dispute remains which could have been referred to the Arbitrator. To make good his submissions, Mr. Kathpalia submitted that the respondent had been negligent in the performance of the works which were entrusted to the sub-contractor. This had ultimately led to the termination of the Agreement on 16-11-2001. In fact, the appellant had incurred huge amount of expenses in rectifying the defects in the works executed by the respondent. Mr. Kathpalia relied on clauses 5 and 6 of the Agreement and submitted that the appellant was entitled to be compensated

for the rectification work which had to be performed to the satisfaction of the Andhra Pradesh Government. Learned counsel also submitted that the respondent would be entitled to the final payment only upon satisfactory completion of the work entrusted to the sub-contractor. In order to settle the dispute between the parties and to maintain a cordial relationship, the parties have entered into a voluntary settlement on 6-6-2003 which is evidenced by the signatures appended on the same by the Manager of the respondent sub-contractor. In such circumstances, learned counsel submitted that there was no arbitrable dispute which could have been left to the Arbitrator and, therefore, the judgment of the High Court allowing the application under Section 11 (5) and (6) of the Act is erroneous. He further submitted that in case the respondent intend to challenge the validity of the binding nature of the settlement, the dispute cannot be left to the Arbitrator. The settlement would form an independent contract which can only be nullified in appropriate proceedings being taken by the respondent.

In support of the submissions, the learned counsel relied on ***Nathani Steels Ltd.*** *vs*. ***Associated Constructions***[1]. Mr.

[1] 1995 Supp (3) SCC 324

Kathpalia relied on the observations made in paragraph 3 of the judgment. The learned Counsel submits that the judgment of the High Court is erroneous and has to be set aside.

On the other hand, Mr. K. Swami, learned counsel appearing for the respondent submits that there is no "full and final settlement" of the amounts which were due to the respondent from the appellant. He further submits that the respondent had executed all the works which were entrusted to his client to the full satisfaction of the appellant. The claim and counter claim now made by the appellant is totally false and without any basis. The respondent is disputing each and every claim made by the appellant. Learned counsel further submitted that the alleged settlement dated 6-6-2003 is a unilateral document. There is no agreement between the parties for a final settlement. The document has been only received and the Manager has signed only to indicate that the letter has been received. There have been no negotiations between the parties prior to the issuance of letter dated 6-6-2003. He submits that the judgment relied upon by Mr. Kathpalia is not applicable in the facts of this case. In fact, according to him, the matter is squarely covered by the

judgment of this Court in ***National Insurance Company Limited*** vs. ***Boghara Polyfab Private Limited***[2]. Learned counsel has relied on paragraphs 33, 34 and 35 of the judgment. It is pointed out that in paragraph 33, this Court has considered the ratio of the judgment in ***Nathani Steels*** (supra) and distinguished the same. Relying upon the aforesaid judgment, the learned counsel submits that the appeal deserves to be dismissed.

Learned counsel further submitted that the receipt of a sum of Rs.16 lakhs subsequent to the letter dated 6-6-2003 does not signify the acceptance by the respondent of the aforesaid letter as a "full and final settlement". According to the learned counsel, in fact, the claim of the respondent was for over Rs.10,00,000/- and, therefore, the amounts which were received by the respondent were only in part payment of the amount due.

We have considered the submissions made by the learned Counsel for the parties.

In our opinion, the question as to whether letter dated 6-6-2003 would constitute a "full and final settlement" would

[2] (2009) 1 SCC 267

have to be determined on proper appreciation of the evidence led by the parties. It is, in our opinion, open to two interpretations. Which of the two interpretations is ultimately accepted will have to be decided by the appropriate forum. We are also not inclined to accept the submissions of Mr. Kathpalia that if the alleged settlement is to be doubted, it cannot be doubted before the Arbitrator. It must be remembered that the appellant is relying on the alleged settlement by way of defence. The respondent has not accepted the same. Nor has the respondent denied the execution of the document. The respondent has also not claimed that the full and final settlement was signed under coercion, undue influence, fraud, misrepresentation or mistake. Furthermore, the appellant had not made a claim on the basis of the settlement. It would have been different, if the appellant had made a claim on the basis of settlement which was denied by the respondent by one or more of the defences, as noticed above. In such circumstances, following the judgment in ***Nathani's case*** (supra), it would have to be held that the settlement can only be challenged in "proper proceedings". But these observations

would be applicable only if there was a clear cut acceptance by the parties that there was a "full and final settlement".

In fact, the matter would be squarely covered against the appellant by the ratio of the judgment in ***National Insurance Company Limited*** (supra) wherein this Court has considered the cases which were earlier considered in ***Nathani's Steel*** (supra) and observed as follows:-

> **"33. Nathani Steels related to a dispute on account of non-completion of the contract. The Court found that the said dispute was settled by and between the parties as per deed dated 20.12.1980 signed by both parties. The deed referred to the prior discussions between the parties and recorded the amicable settlement of the disputes and differences between the parties in the presence of the Architect on the terms and conditions set out in clauses 1 to 8 thereof. In view of it, the Court rejected the contention of the contractor that the settlement was liable to be set aside on the ground of mistake. A three-Judge Bench of this Court, after referring to the decisions in P.K. Ramaiah and Nay Bharat Builders, held thus: (SCC p.326, para 3)**
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> **"3……. that once the parties have arrived at a settlement in respect of any dispute or difference arising under a contract and that dispute or the difference is amicable settled by way of a final settlement by and between the parties, unless that settlement is set aside in proper proceedings, it cannot lie in the mouth of one of the parties to the settlement to spurn it on the ground that it was a mistake and proceed to invoke the Arbitration clause. If this is permitted the sanctity of contract, the settlement also being a contract, would be wholly lost and it would be open to one party to take the benefit under the settlement and then to question the same on the ground of mistake without having the settlement set**

aside. In the circumstances, we think that in the instant case since the dispute or difference was finally settled and payments were made as per the settlement, it was not open to the respondent unilaterally to treat the settlement as non est and proceed to invoke the Arbitration clause."

34. What requires to be noticed is that in Nav Bharat Builders and Nathani Steels, this Court on examination of facts, was satisfied that there were negotiations and voluntary settlement of all pending disputes, and the contract was discharged by accord and satisfaction. In P.K. Ramaiah, the Court was satisfied that there was a voluntary acceptance of the measurements and full and final payment of the amount found due, resulting in discharge of the contract, leaving no outstanding claim or pending dispute. In those circumstances, this Court held that after such voluntary accord and satisfaction or discharge of the contract, there could be no arbitrable disputes.

36. In Damodar Valley Corporation, the question that arose for consideration of this Court was as follows: (SCC p. 144 para 4)

> **''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 Sections 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."**

In that case the question arose with reference to a claim by the supplier. The purchaser required the supplier to furnish a full and final receipt. But the supplier did not give such a receipt. Even though there was no discharge voucher, the purchaser contended that the payments made by it were in full and final settlement of the bills. This Court rejected that contention and held that 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 which would mean that the arbitration clause operates. This Court held 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; and where there is an arbitration clause in a contract, notwithstanding the plea that there was a full and final settlement between the parties, that dispute can be referred to arbitration. It was also observed that mere claim of accord and satisfaction may not put an end to the arbitration clause. It is significant that neither P.K. Ramaiah nor Nathani Steels disagreed with the decision in Damodar Valley Corporation but only distinguished it on the ground that there was no full and final discharge voucher showing accord and satisfaction in that case."**

In our opinion, since there is no acceptance of the full and final settlement by the Respondent which has been relied upon by the appellant, the issue clearly had to be left to the Arbitrator to be adjudicated.

In view of the above, we find no merit in the appeal and the same is accordingly dismissed.

Before we part with this matter, we would request the learned Arbitrator to conclude the Arbitration Proceedings as expeditiously as possible since the matter was referred long back as this would be in the interest of justice.

.....
.....J.
(SURINDER SINGH NIJJAR)

.....J
(RANJANA PRAKASH DESAI)

NEW DELHI,
NOVEMBER 28, 2013.