ARBITRATION AGREEMENT IN CONSTRUCTION CONTRACTS

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In construction contracts, certain questions are often reserved for the Engineer which, after they are decided by him, are either declared to be final or may be reviewable by the arbitral tribunal.[1]

Where such questions are reviewable by the arbitral tribunal, it is generally accepted that the arbitral tribunal is empowered to review both the findings of fact and law made by the Engineer.

However, wherein the contract states that the decision of the Engineer is final, two questions arise: (a) whether the Engineer functioned as an arbitrator or as an expert; and (b) assuming that the Engineer functioned as an expert, whether the Engineer's decision is reviewable by courts and if so, what is the scope of such review.

The issue of whether the Engineer functioned as an arbitrator or as an expert will depend upon the language of the clause that requires him to decide the questions. If the language is susceptible to the interpretation that reference to the Engineer is in the nature of "arbitration agreement", then his decision would be an arbitral award; otherwise it would be an 'expert decision'.

Thus, what constitutes 'arbitration agreement' is of particular significance in construction and infrastructure contracts. Unfortunately the judgments of Indian courts are not always consistent as to whether such a term would be an 'arbitration agreement' or not.

This lack of clarity could lead to avoidable loss of time and costs. It could also lead to injustice as a court might set aside the award after it has been rendered on lack of arbitrability. This is hardly a good scenario, particularly in the Indian context where construction and infrastructure building contracts are multiplying exponentially. Finally, it could hurt the cause of arbitration. The question, therefore, needs urgent resolution.

For example, in *State of Orissa v. Bhagyadhar Dash,*[2] the court summarized the existing case law and laid down some general guidelines to enable the parties to

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[1] Often, in modern times, the arbitral tribunal is empowered to review the Engineer's decision on facts and law. See for example clause 67 of FIDIC conditions of contract (now replaced by the NEC terms), or clause 66 of the ICE conditions of contract or relevant clause in the Frame Agreement under the JCT conditions of contract.

know if the clause concerned is arbitration clause or not. However, no consistent yardstick appears to exist among the cases cited.

An example of the decision of the Engineer acting pursuant to an "arbitration agreement" may be found in clauses such as the one found in Dash's case[3]:

"*Except where otherwise provided in the contract, all questions and disputes relating to the meaning of the specifications, designs, drawings and instructions hereinbefore mentioned and as to the quality of workmanship, or materials used on the work, or as to any other question, claim, right, matter or thing whatsoever, in any way arising out of or relating to the contract, designs, drawing, specifications, estimates, instructions, orders or these conditions, or otherwise concerning the work, or the execution, or failure to execute the same, whether arising during the progress of the work or after the completion or abandonment thereof shall be referred to the sole arbitration of a Superintending Engineer of the State Public Works Department unconnected with the work at any stage nominated by the Chief Engineer concerned. If there be no such Superintending Engineer, it should be referred to the sole arbitration of Chief Engineer concerned. It will be no objection to any such appointment that the arbitrator so appointed is a government servant. The award of the arbitrator so appointed shall be final, conclusive and binding on all parties to this Contract.*"

On the other hand, the example where some disputes are meant for the Engineer and some liable to be referred to arbitration is found in Suresh Chandra Panda's case[4]:

"*11. The Engineer-in-Chief shall have power to make any alterations or addition to the original specifications, drawings, designs and instructions that may appear to him to be necessary or advisable during the progress of the work, and the contractor shall be bound to carry out the work, in accordance with any instructions which may be given to him in writing signed by the Engineer-in-Charge, and such alteration shall not invalidate the contract and any additional work which the contractor may be directed to do in the manner above which is specified as part of the work, shall be carried out by the contractor on the same conditions in all respects on which he agreed to do the main work, and at the same rates as are specified in the tender for the main work.*

Provided always that if the contractor shall commence work, incur any expenditure in regard thereof before the rates shall have been determined as lastly hereinbefore mentioned, then and in such case, he shall only be entitled to be paid in respect of the work carried out or expenditure incurred by him prior to the date of the determination of the rate as aforesaid according to such rate or rates as shall be fixed by the Engineer-in-Charge. In the event of a dispute, the decision of the Superintending Engineer of the circle will be final.

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[2] (2011) 7 S.C.C. 406 (India).
[3] *Id.* at 419.
[4] Executive Engineer v. Suresh Chandra Panda (1999) 9 S.C.C. 92 (India).

23. Except where otherwise provided in the contract, all questions and disputes relating to the meaning of the specifications, designs, drawings and instructions hereinbefore mentioned and as to the quality of workmanship, or materials used on the work, or as to any other question, 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 work, or the execution, or failure to execute the same, whether arising during the progress of the work or after the completion or abandonment thereof shall be referred to the sole arbitration of a Superintending Engineer of the State Public Works Department unconnected with the work at any stage nominated by the Chief Engineer concerned. If there be no such Superintending Engineer, it should be referred to the sole arbitration of the Chief Engineer concerned. It will be no objection to any such appointment that the arbitrator so appointed is a government servant. The award of the arbitrator so appointed shall be final, conclusive and binding on all parties to this contract."

Does the Engineer function as arbitrator in such cases? What is the crucial element(s) that would help determine the answer. The chart below is a useful index of how the courts have approached the matter. The first column highlights the elements mentioned in the clause; the second gives the names of cases and the third indicates the result.

Elements	**Case Name**	**Citation**	**Whether it is an Arbitration Agreement?**
Clause contains terms 'final', and 'binding', but not 'reference' or 'dispute'	State of U.P. v. Tipper Chand	(1980) 2 S.C.C. 341 (India)	NOT arbitration agreement.
Clause contains—'final'	Rukmanibai Gupta v. Collr.	(1980) 4 S.C.C. 556 (India)	YES, arbitration agreement
Clause contains—'final'; 'binding'; but not—'dispute'; 'reference'	State of Orissa & Anr. v. Sri Damodar Das	(1996) 2 SCC 216 (India)	NOT arbitration agreement
Clause contains—'final'; 'binding'; but not—'dispute'; 'reference.	K.K. Modi v. K.N. Modi & Ors.	(1998) 3 S.C.C. 573 (India)	NOT arbitration agreement
Clause contains —'final'; 'binding'; but not —'dispute'; 'reference.	Bharat Bhushan Bhansal v. U.P. Small Industries Corporation Ltd. Kanpur	(1999) 2 S.C.C. 166 (India)	NOT arbitration agreement

Elements	**Case Name**	**Citation**	**Whether it is an Arbitration Agreement?**
Clause contains—'final', 'binding', for some claims—supdt engineer; for others reference to arbitration to Chief Engineers	Executive Engineer v. Suresh Chandra	(1999) 9 S.C.C. 92 (India)	NOT arbitration agreement
Clause contains—'reference', 'binding' 'final'	State of Bihar v. Encon	(2003) 7 S.C.C. 418 (India)	YES, arbitration agreement (but not given effect to because of 'real bias' of the Managing Director)s
Clause contains—'final', 'conclusive' 'binding'—superintending engineer	Mallikarjun v. Gulbarga	(2004) 1 S.C.C. 372 (India)	YES, arbitration agreement
Clause contains—'final', 'binding', for some claims—Superintendent engineer; for others reference to arbitration to Chief Engineers	State of Rajasthan v. Nav Bharat Construction	(2005) 11 S.C.C. 197 (India)	YES—arbitration agreement
Clause contains—'final', 'binding', 'reference' to superintending engineer	State of Punjab v. Dina Nath	(2007) 5 S.C.C. 28 (India)	YES, arbitration agreement
Clause contains 'dispute' but not 'reference' nor 'adjudication' nor 'binding'.	State of Orissa &Ors. v. Bhagyadhar Dash	(2011) 7 S.C.C. 406 (India)	NOT arbitration agreement

A careful study of these decisions reveals absence of consistency. The effect of a mistake in understanding whether the agreement relied upon is arbitration agreement could have serious consequences. In a large infrastructure contract, if the court finds that there is no arbitration clause the entire proceedings before the arbitrator and the award would become infructuous.

The 1996 Act does not permit either party to approach the court about the issue of existence of arbitration agreement until after the award.[5] Even when the issue is raised at the time of s. 11 applications, the court has no power to decide the question.[6] It is only after the award is made after prolonged proceedings, that the court has the power to examine whether the clause constituted "arbitration agreement" and whether the dispute in question was covered by the arbitration agreement.[7] In such cases the parties could end up losing very large and substantial sums, bringing them back to square one. This is undesirable.

Let us examine the clauses involved in the two or three of above cases and evaluate the reasoning of the courts.

(a) In the first of the cases listed above, *State of UP v. Tipper Chand,*[8] the relevant clause was as follows:

"Except where otherwise specified in the contract the decision of the Superintending Engineer for the time being shall be final, conclusive and binding on all parties to the contract upon all questions relating to the meaning of the specifications, design, drawing and instructions hereinbefore mentioned. The decision of such Engineer as to the quality of workmanship, or materials used on the work, or as to any other question, claim, right, matter or things whatsoever, in any way arising out of or relating to the contract, designs, drawing 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 the completion or abandonment of the contract by the contractor, shall also be final, conclusive and binding on the contractor."

The Supreme Court held that that agreement was not an arbitration agreement. In the case of *Governor General v. Simla Banking and Industrial Co. Ltd*[9] the clause was identical to the one before the Supreme Court. The Lahore High Court held that the clause did constitute an arbitration agreement.

The Supreme Court differed from the Lahore High Court and held that the clause cited above did not fulfil the requirements of an arbitration agreement. The reason given by the court was that the agreement should have either expressly stated that it was an arbitration agreement or at least there should have been a provision for making reference to enable the court to consider it to be an arbitration agreement.

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[5] The Arbitration and Conciliation Act, 1996, s.16.
[6] Indian Oil Corporation v. SPS Engineering (2011) 3 S.C.C. 507 (India).
[7] The 1996 Act, s. 34(29) (a) (iv).
[8] (1980) 2 S.C.C. 341 (India).
[9] A.I.R. 1947 (Lah.) 215.

As of end 2011, *Tipper Chand's*[10] case was followed in 8 other judgments.

(a) In *Rukmanibai Gupta v. Collector*,[11] the relevant clause was as follows: *"15. Whenever any doubt, difference or dispute shall hereafter arise touching the construction of these presents or anything herein contained or any matter or things connected with the said lands or the working or non-working thereof or the amount or payment of any rent or royalty reserved or made payable hereunder in the matter in difference shall be decided by the lessor whose decision shall be final."*

The Supreme Court held that the term of the contract constituted 'arbitration agreement'. The Court relied upon Russell on Arbitration[12] that stated that the arbitrator holds a 'judicial inquiry', and here the lessor is expected to hold such an inquiry (although the clause does not mention it). For that reason, the court held that the term constituted arbitration agreement.

It will be observed that the language of *Tipper Chand's* clause is essentially similar to that of *Rukamanibai's case*.[13] Neither uses the terms (i) arbitration agreement or (ii) reference or (iii) 'judicial inquiry'. However, in the two cases, coming only 8 months apart, the two benches took different views. In *Rukamanibai's case*,[14]*Tipper Chand's case*[15] was not cited.

In *State of Orissa v. Damodar Das,*[16] the relevant portion of the contract reads as follows:

"*25. Decision of Public Health Engineer to be final.— Except where otherwise specified in this contract, the decision of the Public Health Engineer for the time being shall be final, conclusive and binding on all parties to the contract upon all questions relating to the meaning of the specifications; drawings and instructions hereinbefore mentioned and as to the quality of workmanship or materials used on the work, or as to any other question, claim, right, matter or thing, whatsoever in any way arising out of, or relating to, the contract, 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 the completion or the sooner determination thereof of the contract.*"

The court held the clause not to be an arbitration agreement because "*the arbitration agreement must expressly or by implication be spelt out that there is an agreement to*

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[10] (1980) 2 S.C.C. 341 (India).
[11] (1980) 4 S.C.C. 556 (India).
[12] DAVID ST JOHN SUTTON, JUDITH GILL& MATTHEW GEARING, RUSSELL ON ARBITRATION (Sweet & Maxwell, London) (23rd ed. 2007)
[13] (1980) 4 SCC 556 (India).
[14] (1980) 4 SCC 556.
[15] (1980) 2 SCC 341.
[16] (1996) 2 SCC 216.

refer any dispute or difference for arbitration and the clause in the contract must contain such an agreement."[17]

The principle approved in this decision was that of the arbitration agreement to cover the Engineer's decision there must be an agreement to refer disputes to arbitration.

These illustrative decisions which held that the Engineer would not be acting as arbitrator in respect of the disputes referred to him may be contrasted with those decisions that have held the contrary.[18]

Some of the contrary decisions are: (i) *Bihar State v. Encon;*[19] *Mallikarjun v. Gulbarga*;[20] *State of Rajasthan v. Nav Bharat*;[21] and *State of Punjab v. Dina Nath.*[22] They all contain similar language and none of them contain anything that would make it crucial to hold them as arbitration agreement. One example should suffice.

In *Bihar State v. Encon,*[23] the relevant clause was: "*60. In case of any dispute arising out of the agreement, the matter shall be referred to the Managing Director, Bihar State Mineral Development Corporation Limited, Ranchi, whose decision shall be final and binding.*"

The court formulated the following test: *"The essential elements of an arbitration agreement are as follows:(1) There must be a present or a future difference in connection with some contemplated affair; (2) There must be the intention of the parties to settle such difference by a private tribunal; (3) The parties must agree in writing to be bound by the decision of such tribunal; (4) The parties must be ad idem".*

Having laid down a principle in the most general terms, the court then went on to say that it, having regard to the facts and circumstances, would "*proceed on the basis that the clause constituted an arbitration agreement".* In effect, thus, the court laid down no clear principle and went on to say that the clause constituted an arbitration agreement.

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[17] *Id.* at 224.

[18] The question of how far the court would interfere with the discretion of the Engineer is a separate matter, examined below. The present analysis is on the assumption that the Engineer's decision is not reviewable by arbitral tribunal. In modern times, in international contracts, the arbitral tribunal is often empowered to review the Engineer's decision on facts and law. *See* for example clause 67 of FIDIC conditions of contract, or clause 66 of the ICE conditions of contract (now replaced by the NEC terms) or relevant clause in the Frame Agreement under the JCT conditions of contract.

[19] (2003) 7 S.C.C. 418 (India).

[20] (2004) 1 S.C.C. 772 (India).

[21] (2005) 11 S.C.C. 197 (India).

[22] (2007) 5 S.C.C. 28 (India).

[23] (2003) 7 S.C.C. 418 (India).

The group of clauses that contained the 'arbitration agreement' empowered the Managing Director to terminate the agreement if he thought it necessary to do so. The above clause empowered him to be the arbitrator. As the same person had the power to terminate as also to conduct the judicial proceedings in the form of arbitration, the court declined to allow the Managing Director to be arbitrator.

However, the *Encon case*[24] commenced in 1993 and ten years later, in 2003, the Supreme Court held that though the agreement was arbitration agreement, the arbitrator mentioned in the arbitration agreement was bound to be biased and hence the arbitration proceedings were inappropriate. The court did not mention what remedy the respondent could have pursued.

Thus, in several cases, there is no way to predict whether the court would hold a clause to be an arbitration agreement.

Different types of questions arise in respect of the remedy and its scope against the decision of the Engineer. For example:

(a) Some of the contracts provide that if a party is aggrieved the dispute can be taken to arbitration. In such a case, what is the scope of review of the Engineer's decision by the arbitral tribunal?

(b) Some contracts provide that such a challenge should be made before the arbitral tribunal within a specified time, failing which the arbitration would not lay. Does the time limit bind the party?

(c) Some contracts provide that the decision of the Engineer is final and binding and makes no reference to arbitration and either expressly or impliedly bars litigation. Is the aggrieved party without remedy?

(d) Some contracts declare the decision of the Engineer binding but do not state that his decision is final. Can the aggrieved party challenge the matter?

(e) Would the court allow a full trial or only seek to review the *errors* apparent in the decision of the Engineer?

With respect to (a) above, the only case decided by the Supreme Court on the issue is under the FIDIC condition no 67, which authorises the arbitral tribunal full review.[25] Clause 67.3 reads thus:

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[24] (2003) 7 S.C.C. 418 (India).
[25] NHAI v. Bumihiway (2006) 10 S.C.C. 763 (India).

"67.3. Any dispute in respect of which the recommendation(s), if any, of the Board has not become final and binding pursuant to sub-clause 67.1 shall be finally settled by arbitration as set forth below. The Arbitral Tribunal shall have full power to open-up, review and revise any decision, opinion, instruction, determination, certificate or valuation of the engineer and any recommendation(s) of the Board related to the dispute."

Regarding (b) above, generally speaking, if the decision is not challenged within a specific time limit agreed to between the parties, then the court or the arbitral tribunal will not entertain the challenge belatedly made.[26]

However, Keating on Building Contracts suggests the following ways to fight it:[27]

1. the matters fall within the express exception to the conclusive effect of the certificate, e.g. fraud;
2. the issue is not within the range of matters upon which the certificate is stated to be conclusive evidence;
3. technical irregularity in the giving of the final certificate e.g. it was not issued by the person named as the architect in the contract; and
4. the architect was disqualified at the time when he gave his certificate.

Regarding (c), (d), and (e), there are few case laws in India dealing with these questions and none from the Supreme Court.

In view of the increasing number of cases of construction and infrastructure contracts in India, it is necessary to have a legislation that deals with these aspects with clarity. It would be ideal if the Engineer's decision (and now Dispute Resolution Board's decision) is made mandatory condition before resorting to arbitration and also empower arbitral tribunals to judicially review the decisions, whenever necessary.

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[26] CHEUNG KWOK KIT, TIME LIMITS FOR CONSTRUCTING ARBITRATION IN CONSTRUCTION CONTRACTS (Aug 20, 2012); http://www.deaconslaw.com/eng/knowledge/knowledge_100.htm

[27] VIVIAN RAMSEY, KEATINGON BUILDING CONTRACTS (Sweet & Maxwell Ltd., London) (7th ed.2000)