

# THE INDIAN LAW REPORTS

## PUNJAB SERIES

### LETTERS PATENT APPEAL.

*Before Bhandari, C. J. and Dulat, J.*

THE NEWZEALAND INSURANCE COMPANY, LTD,—  
*Appellant*

*versus*

M/s. THE NAGPAL HOSIERY FACTORY, AMRITSAR,—  
*Respondent.*

**Letters Patent Appeal No. 7 of 1951.**

*Arbitration Act (X of 1940)—Section 20—Arbitration agreement—Principles governing arbitration agreements stated—Insurance policy—Arbitration clause providing that only dispute regarding amount of damages to be referred to arbitration—Insurer repudiating liability under a clause of the policy—Whether can be compelled to resort to arbitration—Discretion—Exercise of, by lower Courts—When to be interfered with in appeal.*

1954

Sept., 9th

A fire insurance policy containing an arbitration clause declared that the insurance was not to cover any loss or damage occasioned by an explosion. The goods covered by the policy were destroyed but the company repudiated its liability to pay on the ground that the loss was caused not by fire but by an explosion, an excepted peril. The Court directed that the question of loss or damage should be referred to an arbitrator.

*Held*, that a party to an arbitration agreement should not be compelled to resort to arbitration when the matters in controversy between the parties fall outside the scope of the arbitration clause.

Held, that arbitration cases should be decided in the light of the following principles:--

- (1) that it is open to the parties to a contract to agree in advance that no right of action shall arise thereon until the matters in controversy have been referred to and ascertained by an arbitrator appointed in accordance with the terms of the contract;
- (2) that when the parties agree to submit their disputes to a domestic tribunal of their own choice, and when arbitration is made a condition precedent to an action being brought on the policy, it is *prima facie* the duty of the Court to give effect to the agreement unless the condition precedent has been removed under the powers conferred on the Court by the Arbitration Act or unless the Court comes to the conclusion that the right to arbitration has been waived;
- (3) that the right to arbitration like a right conferred by contract, may be waived by a party either by express agreement to do so, or by an express refusal to exercise it, or by a failure or neglect to arbitrate, or by participating without objection in a trial of the controversy on its merits, or by omitting to demand arbitration within a reasonable time, or by obstructing or delaying the arbitration proceedings, or by repudiating liability under the principal contract;
- (4) that if the dispute falls within the scope of the arbitration clause, the case must be referred to an arbitrator unless there are special reasons to the contrary; if, on the other hand, the dispute does not fall within the scope of the arbitration clause, the case must be decided by a court of Law unless there are special reasons to the contrary.

Held, that an insurance company can repudiate its liability under a policy in two different ways. It may

deny all liability under the policy by declaring that no binding contract is in existence. If liability is repudiated on grounds which go to the root of the contract and it is contended that the agreement is void, the company cannot insist on the observance of the arbitration clause. On the other hand the company while repudiating liability under the contract may accept the existence of the policy as a binding contract and may base its repudiation on the claim that a clause in it relieves the company from liability. In such a case the arbitration clause would be effective since the repudiation does not go to the root of the contract but on the contrary the company relies upon the terms of the contract to absolve it from liability.

*Held*, that where the arbitration clause requires the arbitrator merely to determine the dispute between the parties in regard to the quantum of loss or damage sustained by the assured and does not empower him to determine any other kind of dispute and the company repudiates its liability under a clause of the policy, the dispute that arises between the parties does not fall within the scope of the arbitration clause. In such a case it is not desirable to refer the smaller question of loss or damage to arbitration and to permit the larger question of liability to be agitated in a court of law. It is improper that the company should be compelled to obtain the arbitrator's award when it may well be found that the company is entitled to escape liability under one of the clauses of the policy, and it is inconvenient if a part of the dispute between the parties were to be litigated in Court and another part were to be decided by an arbitrator.

*Held*, that the Legislature has vested a discretion in the Court to permit or not to permit the filing of the arbitration agreement but this discretion, like other judicial discretions, must be exercised according to the rules which have been established by a long series of decisions. Where the lower Courts fail to exercise their discretion in accordance with those well-recognised rules, the appellate Court can interfere with that discretion in appeal.

*Macaura v. Northern Assurance (1), Jureidini v. National British and Irish Millers Insurance Company.*

Limited (1), *Heyman v. Darwins, Ltd.* (2), *Stebbing v. Liverpool and London and Globe Insurance Company, Limited* (3), *Woodall v. Pearl Assurance Co., Ltd.* (4) *Golding v. London and Edinburgh* (5), *Stevens and Sons v. Timber and General Accident Mutual Insurance Association* (6), *Kahn v. Traders* (7), *O'Connor v. Norwich Union Life and Fire Insurance Society* (8), and *Ives and Barker v. Willans* (9), relied on; *Viney v. Bignold* (10), distinguished.

*Letters Patent Appeal under clause 10 of the Letters Patent of the High Court against the judgment of Hon'ble Mr. Justice Kapur, dated the 4th October, 1950, passed in F.A.O. No. 70 of 1949, who affirmed that of Shri Mani Ram, Senior Sub-Judge, Amritsar, dated the 3rd August, 1949, holding that the question of loss or damage arising out of the policy shall first be referred to the arbitrators.*

*Application under section 20, Indian Arbitration Act.*

K. L. GOSAIN, for Appellant.

A. N. GROVER, for Respondent.

#### JUDGMENT

Bhandari, C.J. BHANDARI, C. J. This appeal raises the question whether a party to an arbitration agreement should be compelled to resort to arbitration even though the matters in the controversy between the parties fall outside the scope of the arbitration clause.

The facts of the case are simple. On the 11th February, 1946 the Nagpal Hosiery Factory at

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- (1) 1915 A.C. 499  
 (2) 1942 A.C. 356  
 (3) (1917) 2 K.B. 433  
 (4) (1919) 1 K.B. 593  
 (5) (1932) 43 Ll. L. Rep. 487  
 (6) (1933) 102 L.J. K.B. 337  
 (7) (1893) 4 Wy. 419  
 (8) (1894) 2 A.R. 723  
 (9) (1894) 2 Ch. 478, 490  
 (10) (1887) 20 Q.B.D. 172

Amritsar took out a fire insurance policy with the New Zealand Insurance Company Limited in respect of the building, machinery and stock-in-trade belonging to the said factory for a sum of Rs. 20,000 which was subsequently extended to Rs. 50,000. The risk was covered up to the 11th December, 1946 in the first instance but was later extended to the 11th December, 1948. Clause 7 (h) of the conditions declared that the insurance was not to cover any loss or damage occasioned by or through or in consequence of explosion. Clause 18 of the conditions was in the following terms :—

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“And it is hereby expressly stipulated and declared that it shall be a condition precedent to any right of action or suit upon this policy that the award by such arbitrator, arbitrators or umpire of the amount of the loss or damage, if disputed, shall be first obtained.”

On the 6th July, 1948, the premises of the factory and goods thereon are alleged to have been destroyed by fire and notice of the loss was given forthwith to the Company. On the 31st August, 1948 the Company informed the assured that the loss of the building, machinery and stock-in-trade was the result of an explosion, that there was no fire either before or after the explosion, and that the loss or damage caused by an explosion was an excepted peril under the policy. The Company repudiated liability on the above-mentioned grounds and expressed its inability to entertain the claim.

On the 29th November, 1948, the assured presented an application under section 20 of the Arbitration Act in which he prayed that the agreement to refer the dispute to arbitration contained in the policy be filed in Court. On the 3rd August, 1949, the learned Senior Subordinate Judge, in exercise

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of the discretion vested in him by the said section directed that the question of loss or damage arising out of the policy should be referred to an arbitrator in accordance with the terms of the policy and this decision was upheld by a learned Single Judge of this Court. The Company has come to this Court under clause 10 of the Letters Patent and the question for this Court is whether the discretion exercised by the Courts below has been exercised in accordance with recognised judicial principles.

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It is an accepted principle of law that it is open to the parties to a contract to agree in advance that no right of action shall arise thereon until the matters in controversy have been referred to and ascertained by an arbitrator appointed in accordance with the terms of the contract. It is equally clear that when the parties agree to submit their disputes to a domestic tribunal of their own choice, and when arbitration is made a condition precedent to an action being brought on the policy, it is *prima facie* the duty of the Court to give effect to the agreement unless the condition precedent has been removed under the powers conferred on the Court by the Arbitration Act or unless the Court comes to the conclusion that the right to arbitration has been waived. Now the right to arbitration like a right conferred by contract, may be waived by a party either by express agreement to do so, or by an express refusal to exercise it, or by a failure or neglect to arbitrate, or by participating without objection in a trial of the controversy on its merits, or by omitting to demand arbitration within a reasonable time, or by obstructing or delaying the arbitration proceedings, or by repudiating liability under the principal contract.

Now an Insurance Company may repudiate its liability under a policy in two different ways. It may, for example, deny all liability under the

policy by declaring that no binding contract is in existence. If the liability is repudiated on grounds which go to the root of the contract and it is contended that the agreement is void the Company cannot insist on the observance of the arbitration clause, for, as pointed out by Lord Sumner in *Macaura v. Northern Assurance* (1), "the defendants could not both repudiate the contract *in toto* and require the performance of a part of it which only became performable when liability was admitted or established." The case *Jureidini v. National British and Irish Millers Insurance Company, Limited* (2), is a classic example of this kind of repudiation. In this case a claim was made for indemnity for the loss of goods by fire under a policy the conditions of which provided (1) that if the claim were fraudulent or if the loss were occasioned by the wilful act or with the connivance of the assured all benefits under the policy should be forfeited and (2) that if any difference should arise as to the amount of any loss or damage such difference should, independently of all other questions, be referred to arbitration and that it should be a condition precedent to any right of action upon the policy that the award of the arbitrator or umpire of the amount of the loss, if disputed, should be first obtained. The Insurance Company repudiated the claim *in toto* on the ground of fraud and arson. The House of Lords held that the repudiation of the claim on the ground going to the root of the contract precluded the Company from pleading the arbitration clause as a bar to an action to enforce the claim. In delivering the judgment in this case Lord Dunedin observed as follows :—

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"When the attitude was taken up by these parties..... that they repudiated the claim altogether and said that there

(1) 1925 A.C. 619, 631

(2) 1915 A.C. 499

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was no liability under the policy, that necessarily cut out the effect of clause 17 as creating a condition precedent."

This case came up for consideration in *Heyman v. Darwins Ltd.*, (1). Lord Wright considered it unfortunate that the exact grounds on which the House of Lords had come to the conclusion that the condition precedent was binding on the assured were not definitely expressed. It appears probable, however, that the order was made in favour of the assured on the ground that the arbitration clause, which was confined to differences touching the amount of loss or damage, could not be regarded as a bar to an action brought to determine whether the company was liable at all.

Different considerations, however, apply if the Company repudiating liability under the contract accepts the existence of the policy as a binding contract but bases its repudiation on the claim that a clause in it relieves the Company from liability. In such a case the arbitration clause would be effective since the repudiation does not go to the root of the contract but on the contrary the insurers rely upon the terms of the contract to absolve them from liability. Two outstanding examples of this kind of repudiation are *Stebbing v. Liverpool and London and Globe Insurance Company, Limited* (2), and *Woodall v. Pearl Assurance Co. Ltd.*, (3) In *Stebbing's* case a policy of insurance contained a clause referring to the decision of the arbitrator "all differences arising out of the policy." It also contained a recital that compliance with the conditions endorsed upon the policy should be a condition precedent to any claim and one of the conditions was that if any

(1) 1942 A.C. 356

(2) (1917) 2 K.B. 433

(3) (1919) 1 K.B. 593



false declaration was made or used in support of a claim all benefit under the policy should be forfeited. In answer to a claim by the assured the Company alleged that the assured had made untrue statements in the proposal form. The Court held that the Company was not seeking to avoid the policy but was relying on a condition that the truth of the answers in the proposal form should be the basis of the contract and consequently that the question whether the answers were true or not was within the scope of the reference, and the arbitration clause continued to be operative. Lord Reading, C. J., who pronounced the judgment of the Court observed as follows :—

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“But the phrase ‘avoiding the policy’ is loosely used in reference to the circumstances of this case. In truth the Company is relying upon a term of the policy which prevents the claimant recovering

.....

In the present case the Company are claiming the benefit of a clause in the contract when they say that the parties have agreed that the statements in question are material and that they induced the contract. If they succeed in escaping liability that is by reason of one of the clauses in the policy. In resisting the claim they are not avoiding the policy but relying on its terms. In my opinion, therefore, the question whether or not the statement is true is a question arising out of the policy.”

The principle propounded in *Stebbing's case* was endorsed in a number of cases in which it was held that the Company rely on the arbitration clause even if the ground of avoidance is the fraud

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of the assured, provided the terms of the arbitration clause are wide enough to cover such a dispute (*Heyman v. Darwins* (1), *Woodall v. Pearl Assurance Co., Ltd.* (2), *Golding v. London and Edinburgh*, (3), and *Stevens and Sons v. Timber and General Accident Mutual Insurance Association* (4).

*Heyman's case* (1), which was decided by the House of Lords in the year 1942 contains a masterly exposition of the effect of repudiation under a contract which contains an arbitration clause and of the consequences which flow from a disclaimer of liability. An arbitration clause in a contract provided "that if any dispute shall arise between the parties hereto in respect of this agreement or any of the provisions herein contained or anything arising hereout the same shall be referred for arbitration in accordance with the provisions of the Arbitration Act, 1889." A dispute having arisen between the parties, the appellants commenced an action against the respondents claiming (a) a declaration that the respondents had repudiated the contract and (b) damages. The respondents who admitted the existence of the contract and denied that they had repudiated it, applied to have the action stayed in order that it might be dealt with under the arbitration clause. The House of Lords held that the dispute fell within the terms of the arbitration clause and that the action ought to be stayed. It was held further that when an arbitration clause in a contract provides that any dispute or difference "in respect of" or "in regard to" or "under the contract" shall be referred to arbitration, and the parties are at one in asserting that they entered into a binding contract. the clause will apply; a stay will therefore be

(1) 1942 A.C. 358

(2) (1919) 1 K.B. 593

(3) (1932) 43 Ll. L. Rep. 487

(4) (1933) 102 L.J. K.B. 937

granted even if the dispute involves an assertion by one party that circumstances have arisen which have the effect of discharging one or both parties from all subsequent liability under the contract, such as repudiation of the contract by one party accepted by the other, or frustration of the contract. If, however, the point in dispute is whether the contract containing the clause was ever entered into at all, or was void *ab initio*, illegal, or obtained (for example) by fraud, duress or undue influence the clause does not apply and the stay will be refused.

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The case now under appeal partakes of the characteristics of both the classes of cases mentioned above. It is similar to *Stebbing's case* as the Company relying on one of the terms of the policy has denied its liability to pay. It has not repudiated the policy as void *ab initio*; on the other hand it has affirmed the policy as a subsisting contract by declaring that the loss caused by the explosion is an excepted peril. It has relied on one of the terms of the policy which entitled it to escape liability and taking advantage of that term it has rejected the claim. The case is similar also to *Jureidini's case* (1), as the arbitration clause is confined only to differences touching the amount of loss or damage and does not extend to differences concerning the liability of the Company. But it is different from the class of cases to which *Stebbing's case* belongs as far as the scope of the arbitration clause is concerned. In *Stebbing's case* the clause declared without any qualification that 'all differences arising out of this policy shall be referred to the decision of an arbitrator.' In *Woodall's case* (2), the clause provided that 'if any question shall arise touching this policy or the liability of the

(1) 1915 A.C. 499

(2) (1919) 1 K.B. 593

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Company thereunder or the extent or nature of such liability or otherwise howsoever in connection therewith, the assured may refer the same to arbitration.' The language used by the parties in those cases was as wide as can be conceived, for it empowered the arbitrator to assess not only the amount of loss or damage sustained by the assured but also to determine the extent or nature of the liability of the Company.

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The following facts stand out in bold relief as far as the present case is concerned :-

- (1) that both the parties admit the existence of a binding contract ;
- (2) that the company has not repudiated liability on the grounds which go to the root of the contract and has not stated either that the contract was never entered into, or that it was void or illegal or was vitiated by fraud etc ;
- (3) that the company relied on the terms of the contract to absolve it from liability;
- (4) that arbitration has been made a condition precedent ; and
- (5) that as the Company is disputing its liability to pay and as the arbitration clause is confined clearly to the ascertainment of loss or damage, the dispute falls outside the scope of the arbitration clause.

The parties to this litigation have entered into an agreement voluntarily and of their own accord and the assured is thus entitled to rely on the arbitration clause and to claim that the arbitration agreement be filed in Court. It has been held repeatedly that a Court should, if possible, endeavour to give effect to an agreement

for settlement of disputes by a domestic tribunal and to decline to entertain a suit by a party who fails without legal justification to comply with an arbitration agreement, particularly when the ascertainment of certain facts by arbitrators has been made a condition precedent to a right of action. In such cases a suit should not be entertained unless compliance with the conditions is excused for some good cause.

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The question now arises whether the Company has been able to show any good cause as to why the terms of the agreement should not be complied with and the agreement should not be filed. The answer is in my opinion clearly in the affirmative.

In the first place the dispute which has arisen between the parties is not within the scope of the arbitration agreement. I pointed out in an earlier paragraph of this judgment that the arbitration clause in the present case requires the arbitrator merely to determine the disputes between the parties in regard to the quantum of loss or damage sustained by the assured ; it does not empower him to determine any other kind of dispute. The dispute which has actually arisen in this case is not in regard to the amount of money which the Company is liable to pay to the assured for the loss or damage sustained by him but whether the Company is liable to pay anything at all. This dispute is clearly outside the scope of the arbitration clause. In *Kahn v. Traders* (1), it was held that as a rule where the amount of loss or damage is the only matter which the parties refer to arbitration, then, if the insurers repudiate any liability on the policy there is no obligation on the assured to arbitrate as to the amount before commencing an action on the policy. In *Jureidini's case* (2), the Court appears to have expressed the view that if

(1) (1893) 4 WJ, 419

(2) 1915 A.C. 499

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the arbitration clause is confined merely to the ascertainment of the amount of loss or damage it cannot be pleaded as a bar to an action brought to determine whether the Company is liable at all. Commenting on this case in *Woodall's case* (1), Warrington, L. J., observed as follows:—

“That however was a totally different case. In the first place there was total repudiation of the contract. In the second place the arbitration clause did not extend to differences as to liability under the contract ; it only extended to a difference as to the amount payable under the policy. The consequence was that, if the contention of the Insurance Company in that case had prevailed, there would have been no means of deciding the question of the liability of the Company. According to their contention it could not have been decided by the Courts, and by the terms of the arbitration clauses it could not have been decided by arbitration.”

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In *O' Connor v. Norwich Union Life and Fire Insurance Society*, (2), where the arbitration clause dealt with questions of amount only and action was brought to determine the question of liability, the Court declared that if the subject-matter of the action falls outside the arbitration clause, as in the present case, there is no reason why a stay should be granted. (See also the cases collected under paragraph 56 of Halsbury's Laws of England Volume II. Arbitration, Third Edition).

As against this long array of authorities, the only decision in which a somewhat discordant note

(1) (1919) 1 K. B. 59  
(2) (1894) 2 I.R. 723

appears to have been struck is the case of *Viney v. The Newzealand Insurance Company, Ltd.* (1). In that case the defendant pleaded in an action on a fire policy that the policy was made subject to a condition that, if any difference should arise in the adjustment of a loss, the amount to be paid should be submitted to arbitration, and the insured should not be entitled to commence or maintain any action upon the policy until the amount of the loss should have been referred and determined as therein provided, and then only for the amount so determined, that a difference had arisen, and the amount had not been referred or determined. The Court held that the determination of the amount by arbitration was a condition precedent to the right to recover on the policy and the defence was an answer to the action. As the report of the case states merely that "a difference"—presumably in the adjustment of the loss—"had arisen, and that the amount had not been referred or determined" it does not indicate whether the Company had in fact repudiated liability on the policy. This decision cannot in my opinion be regarded as a good precedent.

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There is another reason also for holding that the arbitration agreement should not be filed. I am of the opinion that the Court would not be justified in referring the minor question of loss or damage to the arbitration and not taking any action whatever in regard to the major question of the liability of the Company. In *Ives and Barker v. Willans* (2), Lindlay, L. J., observed as follows :—

"But I quite see that if the matters agreed to be referred were not the main matters in dispute but were of a subordinate and trifling nature and if the matters not agreed to be referred were the

(1) (1887) 20 Q.B.D. 172

(2) (1894) 2 Ch. 478, 490

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in all matters in dispute, it would be very inconvenient, to say the least of it, to refer that small part and let the action go on as to the large part."

(See also the cases collected under paragraph 61 of Halsbury's Laws of England, Volume II. Arbitration, Third Edition).

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I am satisfied from a perusal of the record that the dispute which has arisen in the present case does not fall within the scope of the arbitration clause, that it would not be desirable to refer the smaller question of loss or damage to arbitration and to permit the larger question of liability to be agitated in a Court of Law, and that it would be extremely improper to compel the Company to obtain the arbitrator's award when it may well be found that the Company is entitled to escape liability under one of the clauses of the policy. Moreover, it would be extremely inconvenient if a part of the dispute between the parties were to be litigated in Court and another part were to be decided by an arbitrator. A rough and ready rule which may be adopted in such cases is that if the dispute falls within the scope of the arbitration clause, the case must be referred to an arbitrator unless there are special reasons to the contrary, if on the other hand the dispute does not fall within the scope of the arbitration clause the case must be decided by a Court of law, unless there are special reasons to the contrary.

It is contended on behalf of the assured that the discretion exercised by the Courts below should not be lightly interfered with and consequently that this appeal should be dismissed with costs. I regret I am unable to agree. It is true that the Legislature has vested a discretion in the Court



to permit or not to permit the filing of the arbitration agreement, but it must be remembered that this discretion, like other judicial discretions, must be exercised according to the rules which have been established by a long series of decisions. The Courts in the present case do not appear to have exercised their discretion in accordance with those well-recognised rules. I would accordingly allow the appeal, set aside the order of the learned Single Judge and direct that the agreement be not filed. In view of the peculiar circumstances of the case I would leave the parties to bear their own costs.

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DULAT, J. I agree.

Dulat, J.