

Grant Of Ad-Hoc Escalation Damages Without Pleadings Or Proof Is Patently Illegal: Delhi High Court

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Introduction

In a recent decision, the Delhi High Court has revisited two recurring themes in construction arbitration: the legal effect of a "*no-dues certificate*" issued at the stage of final bill settlement, and the permissibility of awarding escalation-related damages in the absence of pleadings and evidence. In ***Bharat Heavy Electrical Limited vs. Koneru Constructions*** [2025:DHC:10464], the High Court set aside an arbitral award to the limited extent that it granted escalation damages on an *ad-hoc* percentage basis, holding that the award suffered from patent illegality and was unreasoned on material issues.

Facts

BHEL awarded a civil works contract to Koneru Constructions in October 2006 for works relating to a 400/220 KV substation project in Tamil Nadu. The contract stipulated a completion period of fourteen months, with prices to remain firm and no escalation or price variation payable even during any extended period.

The works were completed only in June 2010, after a delay of over thirty months. Upon completion, the contractor raised its final bill. BHEL communicated the net payable amount and required, as a pre-condition for release of payment, a clear "*no-dues certificate*" in full and final settlement. The contractor furnished such a certificate in September 2011, expressly confirming that it had "*no due*" against the work order and had agreed to the net amount as full and final settlement. Payment was released shortly thereafter.

Subsequently, the contractor addressed letters alleging that the no-dues certificate had been furnished under financial hardship and economic duress. Arbitration was invoked, and multiple heads of damages were claimed. The arbitral tribunal rejected all claims except one, awarding the contractor ₹72.9 lakh towards "*loss suffered due to escalation of rates*", quantified at 10 per cent of the executed value, together with interest.

BHEL challenged the award under Section 34 of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**"), limited to the grant of escalation damages.

Arguments

On behalf of BHEL, it was contended that the award was contrary to the express terms of the contract, which categorically barred any escalation or price variation for the contractual as well as extended period. It was further argued that the

contractor had voluntarily issued a no-dues certificate without protest, resulting in accord and satisfaction, and that the arbitral tribunal failed to first determine whether the certificate was vitiated by coercion or duress before proceeding to adjudicate claims on merits.

BHEL also submitted that the escalation claim was unsupported by pleadings or evidence. No material was placed on record to show which items had escalated, the extent of escalation, or the methodology adopted to quantify the alleged loss. The award of a flat 10 per cent was therefore assailed as arbitrary and unreasoned.

The contractor, on the other hand, argued that the no-dues certificate had been obtained as a condition precedent for release of payment and could not bar genuine claims. It was contended that the delay was attributable to BHEL, particularly on account of delayed issuance of drawings, and that escalation damages were therefore justified notwithstanding the contractual bar. Reliance was placed on decisions recognising that escalation may be awarded as damages in appropriate cases of employer-caused delay.

Decision of the High Court

The High Court held that a no-dues certificate does not, by itself, automatically bar arbitration. However, the arbitral tribunal was required to return a clear finding on whether the certificate had been issued voluntarily or was vitiated by coercion, duress, or undue influence. The tribunal had merely cited precedent to state that signing a final bill is not an absolute bar, but failed to decide the factual controversy between the parties. This rendered the award unreasoned on a jurisdictionally significant issue.

The High Court also found the grant of escalation damages to be unsustainable. It noted that the contract contained an explicit prohibition on escalation "*whatsoever the reason may be*", and the arbitral tribunal had failed even to advert to this clause. While it may be open, in limited circumstances, to award escalation despite the absence of an escalation clause or even despite a prohibition, such a course necessarily requires engagement with the contractual provisions.

The High Court further emphasised that the escalation claim was wholly unsupported by pleadings, data, or calculations. There was no identification of escalated items, no quantification exercise, and no evidentiary foundation. The award of 10 per cent of the executed value was characterised as an *ad-hoc* and conclusory determination, falling foul of the requirement that damages must be proved and reasoned.

On these grounds, the Court set aside the award to the extent it granted escalation damages and the consequential interest, holding that the award suffered from patent illegality under Section 34 of the Arbitration Act.

Comment

The decision reinforces two important disciplines in construction arbitration. *First*, where final bills and no-dues certificates are in play, arbitral tribunals must squarely decide the issue of voluntariness and vitiation before proceeding to the merits. *Second*, delay-linked escalation claims cannot rest on intuition or broad percentages. Even where delay is established, escalation as damages must be pleaded, proved, and quantified with reference to evidence and contractual risk allocation. The judgment serves as a reminder that Courts acting under Section 34 of the Arbitration Act will not hesitate to intervene where tribunals ignore express contractual bars or award damages on an *ad-hoc* basis without reasons.

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