

## NAVIGATING THE EFFECT OF NO-CLAIMS CERTIFICATES IN CONSTRUCTION CONTRACTS

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### Introduction

In construction contracts, it is commonplace for employers to devise mechanisms to restrict the claims of contractors after the completion of works under the contract. These mechanisms may be clothed in the form of either express terms of the contract<sup>1</sup> or in the form of a separate agreement.<sup>2</sup> In as much as contractual clauses are concerned, works contracts may contain a clause that prohibits the contractor from claiming compensation for claims attributable to either the contractor, the employer or both parties.<sup>3</sup> Generally, these clauses stipulate that where extensions of time are granted due to delays, the contractor cannot seek any compensation on the ground of such delay, apart from time extension.<sup>4</sup> As far as the latter mechanism is concerned, employers may withhold the clearance of final bills unless the contractor submits a ‘no-demand’/ ‘no-claim’ certificate [“NCC”], a settlement agreement, or a discharge voucher signed by contractors.<sup>5</sup> This NCC is used by the employer as an instrument for preventing the contractor from pursuing future claims, predicated on the premise that the NCC serves as acceptance by contract in full accord and satisfaction of the parties to the contract.<sup>6</sup>

Interestingly, an NCC may not necessarily be for the final discharge of the entire contract. For example, a no-claims clause may provide that the contractor will not be entitled to payment of escalation during the contract period. However, if the contract period is extended due to delays not attributable to the contractor, this restriction or bar on pursuing a claim for escalation does

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<sup>1</sup> *State of Bihar v. Hanuman Mal Jan* (1997) 11 SCC 40.

<sup>2</sup> *M/s ONGC Mangalore Petrochemicals v. M/s Ans Constructions Limited* 2018 (3) SCC 373.

<sup>3</sup> *Oil and Natural Gas Corporation v. Wig Brothers Builders and Engineers Private Limited* (2010) SCC 377.

<sup>4</sup> *Ramnath International Construction (P) Ltd. v. Union of India* (2007) 2 SCC 453.

<sup>5</sup> *United India Insurance Company Limited v. Antique Art Exports Private Limited* (2019) 5 SCC 362.

<sup>6</sup> *P.K. Ramaiya & Co. v. Chairman and Managing Director, NTPC Ltd.* 1994 Supp (3) SCC 126.

not apply and the same can be disputed through arbitration/ litigation.<sup>7</sup> However, these terms or the agreement, as the case may be, are not infallible in their pursuit of putting a hiatus on the prospective claims of the contractor and the weightage that is to be given to such terms or agreement is a question that has vexed the courts and the stakeholders alike.

### **Impact of NCC on the arbitration clause**

A contract is generally discharged upon fulfilment of respective obligations by the parties under the contract. Alternatively, the parties may choose to substitute their existing obligations with a new set of obligations and the contract may be discharged by performance of such new set of obligations. The performance of the substituted obligations by the parties is referred to as discharge by accord and satisfaction. Section 63 of the Indian Contract Act is the legislative embodiment of the common law principle of discharge by accord and satisfaction. This accord and satisfaction can be in form of an NCC or a discharge certificate issued by the contractor to the employer.<sup>8</sup> Resultantly, the employers use the NCC as a tool to prevent the referral of the dispute to arbitration on the premise that issuance of NCC completely discharges the contract.

At this juncture, it is appurtenant to note that owing to the doctrine of separability, even in cases where there has been a valid discharge of the principal contract, the arbitration clause continues to survive. The doctrine of separability of arbitration clause, as propounded by the House of Lords in *Heyman v. Darwins*,<sup>9</sup> is premised on the principle that the nature and function of an arbitration clause are distinct from the substantive clauses of the contract. Unlike the other provisions of the contract, the arbitration clause does not deal with the substantive rights and obligations of the parties, instead it provides for the medium of resolution of disputes between the parties and thus, the discharge of the underlying contract does not *ipso facto* extinguish the arbitration agreement.

It therefore follows that even where the contract has allegedly been discharged by accord and satisfaction owing to signing of NCC or execution of a settlement agreement, as the case may be, the arbitration clause continues to survive and the parties are not discharged of their obligation to settle their disputes as per the arbitration agreement.<sup>10</sup> The dispute regarding full and final settlement of the contract, is thus, a dispute arising out of or in relation to the substantive contract and hence, is referable to arbitration.

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<sup>7</sup> *Associated Construction v. Pawanhans Helicopters Pvt. Ltd.* (2008) 16 SCC 128.

<sup>8</sup> *Payana Keena Saminathan v. Pana Lana Palaniappa* (1913-14) 41 IA 142.

<sup>9</sup> *Heyman v. Darwins* (1942) A.C. 356.

<sup>10</sup> *SBI General Insurance Co. Ltd. v. Krish Spinning* 2024 SCC OnLine SC 1754.

This notion that there remains no dispute to be referred to arbitration pursuant to issuance of the NCC, also gained traction after the decision of the Supreme Court of India in *Nathani Steels Ltd. v. Associated Constructions*<sup>11</sup> wherein it was held that in the event of full and final settlement of any dispute by accord and satisfaction, there ceases to exist any arbitrable dispute and thus the arbitration clause cannot be invoked. Such a conclusion flows from the premise that “*a party cannot be permitted to “blow hot and cold”, “fast and loose” or “approbate and reprobate”. Where one knowingly accepts the benefits of a contract or conveyance or an order, is estopped to deny the validity or binding effect on him of such contract or conveyance or order.*”<sup>12</sup> However, there cannot be an omnibus conclusion that issuance of an NCC would *ipso facto* render any dispute arising out of the contract non-arbitrable, unless the parties expressly agree to do the same. In this regard, we may gainfully refer to the decision of the Apex Court in *National Insurance Company Limited v. Boghara Polyfab Private Limited*<sup>13</sup> wherein the following principles were laid down:

1. In a scenario where a claim is resolved through conciliation or pre-Lok Adalat leading to an accord and satisfaction, arbitration cannot be pursued.
2. Among the various claims of the claimant, if the admitted ones are settled, and negotiations resolve the remaining disputed claims through a written agreement, upon payment of the agreed amount and issuance of a discharge voucher/ no-claims certificate, any further reference to arbitration is precluded.
3. When a contractor completes the work and claims payment as per the contract, but the employer only partially admits the claim, demanding a discharge voucher/ NCC in a prescribed format for releasing the admitted amount. In such a case, the contractor might reluctantly sign the NCC to obtain at least the admitted payment. Such a discharge due to factors like economic pressure would not prevent arbitration.
4. An agreement/ “accord” provided by an insured, under the condition that the entire claim will be denied unless a full and final voucher for an amount lower than what was claimed is given, cannot be viewed as voluntary consent, and hence, would be arbitrable.
5. In a case where a contractor voluntarily reduces their claim amount to resolve disputes after the employer rejects their initial claims, and subsequently settles by signing a full and final discharge voucher, they cannot pursue future claims or arbitration. This holds true even if the

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<sup>11</sup> *Nathani Steels Ltd. v. Associated Constructions* 1995 Supp (3) SCC 324.

<sup>12</sup> *Cauvery Coffee Traders, Mangalore v. Hornor Resources (International) Company Limited* (2011) 10 SCC 420.

<sup>13</sup> *National Insurance Company Limited v. Boghara Polyfab Private Limited* (2009) 1 SCC 267.

contractor opted for the settlement due to financial or commercial pressures, as the choice to lower the claim was made willingly.

To sum up, the legal position on this matter stands crystallized to the effect that when a final settlement is reached amicably, even with adjustments, accepting payment as full and final, along with providing discharge vouchers/NCC, there remains no subsisting dispute. Subsequently, neither party can raise any further claims or demands against the other. The courts will also consider that the transaction was finalized between the parties not due to any inadvertent mistake but, in fact, after extensive bilateral discussions with the intention of resolving the dispute.<sup>14</sup> On the contrary, where the execution of discharge voucher is a pre-condition to the payment of claim, or where the settlement amount is offered to the contractor on a take it or a leave it basis, the dispute is arbitrable. In what has now come to be established as a norm in the construction sector, after issuing the NCC, contractors do seek to defy the legal validity of such no-claims/no-demand certificates on grounds of want of free consent.

#### **Free consent vis-à-vis a no-claims certificate : How determined?**

A principle of contract law that is more settled than any other is that there can be no enforceable contract sans *consensus ad idem* of the parties.<sup>15</sup> The legislative exposition of this principle may be traced to Section 14 of the Indian Contract Act, 1872. The provision stipulates that consent is said to be free when it is not induced by coercion, undue influence or fraud. In the modern world of large corporations, extensive infrastructure, and the involvement of state instrumentalities in various industries, unequal bargaining power may often lead to unfair and unreasonable agreements.<sup>16</sup> In cases, where the bargain is found to be unconscionable, the courts have repeatedly refused to enforce such unreasonable agreements.<sup>17</sup>

In this regard, the Supreme Court while relying on the maxim '*necessitas non habet legem*' has held that "a person may sometimes have to succumb to the pressure of the other party to the bargain who is in a stronger position."<sup>18</sup> The court has further addressed the power difference among contracting parties in *Central Inland Water Transport Corpn. Ltd.*<sup>19</sup> and asserted that "the courts will not enforce and will, when

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<sup>14</sup> R.L. Kalathia & Co. v. State of Gujarat (2011) 2 SCC 400.

<sup>15</sup> Brij Mohan & Ors. v. Sugra Begum & Ors. 1990 SCR (3) 413.

<sup>16</sup> Central Inland Water Transport Corporation Ltd., v. Brojo Nath Ganguly (1986) 3 SCC 156.

<sup>17</sup> Dicitex Furnishing Ltd. v. Oriental Insurance Co. Ltd 2015 SCC OnLine Bom 5055.

<sup>18</sup> Chairman and Managing Director NTPC Ltd. v. Reshmi Constructions Builders and Contractors [2004] 2 SCC 663.

<sup>19</sup> Brojo Nath Ganguly (n 16).

*called upon to do so, strike down an unfair and unreasonable contract, or an unfair and unreasonable clause in a contract, entered into between parties who are not equal in bargaining power.”*

*(emphasis supplied)*

In certain works contracts, unless a discharge certificate is given in advance, payment of bills are generally delayed.<sup>20</sup> It is also common practice in some sectors to obtain undated receipts of advance payment.<sup>21</sup> This situation exemplifies instances where contractors are compelled to sign an NCC without proper consideration, with such no-claim certificates routinely demanded and accepted without thoughtful evaluation, sometimes for a sum which is smaller than the claim in full and final settlement of all claims. The courts have thus ruled that the existence of such a clause requiring a no-claim certificate in the agreement cannot absolutely prevent the contractor from raising claims which are genuine.<sup>22</sup> Inasmuch as it is common that unless a discharge certificate is given in advance by the contractor, payment of bills are generally delayed, hence, such a clause in the contract would not be an absolute bar to a contractor raising claims which are genuine at a later date even after submission of such ‘no-claim certificate’.<sup>23</sup>

However, a mere allegation that the NCC was an offspring of coercion/ undue influence will not be, a plea sufficient enough to invalidate the NCC.<sup>24</sup> In cases where a claimant sets up a plea that a no-claim certificate was acquired through fraud, coercion, undue influence and the other party contests its correctness, the courts have ruled that there is no fixed rule to determine the same and the court must look into this aspect to find out, *prima facie*, whether or not the dispute is bona fide.<sup>25</sup> It has been categorically held by courts that “*a bald plea of fraud, coercion, duress or undue influence is not enough and the party who sets such a plea must prima facie establish the same by placing material before the Chief Justice/ his designate.*”<sup>26</sup> In the subsequent section, with the help of judicial precedents, the author will analyse the aspects that must be factored in while determining the value that is to be attached to an NCC.

## **Judicial precedents on the validity of NCC**

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<sup>20</sup> *Ambica Construction v. Union of India* (2006) 13 SCC 475.

<sup>21</sup> *Bogbara Polyfab Private Limited* (n 13).

<sup>22</sup> *M/s Associated Construction v. Pawan Hans Helicopters* Appeal (Civil) 3376-3377 of 2008.

<sup>23</sup> *R.L. Kalathia* (n 14).

<sup>24</sup> *Oriental Insurance Co. Ltd* (n 17).

<sup>25</sup> *Union of India vs. Master Construction Co.* (2011) 12 SCC 349.

<sup>26</sup> *ibid.*

In *Ambica Construction*,<sup>27</sup> the Supreme Court examined the validity of a contractual clause that mandated the contractor to furnish a no-claim certificate specified by the Railways after the final measurement, and that further provided that the contractor would be prevented from challenging the accuracy of items covered by the certificate. The fact that at the time of issuance of the no-claim certificate the work was unfinished and final measurements had not been conducted, evidenced that the certificate was obtained under duress and coercion. The court held that such a prohibitory contract clause does not completely prevent a contractor from asserting claims that are genuine.

In some instances, the court may examine the conduct of the parties through correspondences/ communication exchanged to check the veracity of the claim of coercion/ undue influence. In the facts that led to the decision in *Reshmi Constructions*,<sup>28</sup> the employer cleared a final bill with a ‘no-demand certificate’ indicating no claims, which the contractor signed and submitted. However, the same day, the contractor sent a letter to the employer stating that the certificate was issued under a threat of non-payment until its execution. In this instance, the Supreme Court was convinced by the contractor’s argument that the no-demand certificate was *prima facie* obtained under coercion/ undue influence. The fact that the contractor’s initial final bill was rejected, but a subsequent final bill, accompanied by a ‘no-demand certificate’ was prepared and signed to ensure payment and went on to prove that the contractor’s claim of being under influence of coercion was not considered an afterthought.

Similarly in *Bansal Infratech*,<sup>29</sup> the arbitral tribunal reviewed the evidence presented by both parties. It found that after the claimant submitted the final bill, the employer issued a letter stating that specific documents, including an NCC and a Material Reconciliation Statement [“**MRS**”], were required for processing. Consequently, the tribunal determined that the claimant was economically pressured to provide the NCC and MRS.

Another crucial aspect to consider in navigating a no-claims clause is contingent on the acceptance and processing of the final payment by the contractor without raising any objections.<sup>30</sup> Such acceptance by conduct is also recognised under Section 8 of the Contract Act.<sup>31</sup> In this regard, the

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<sup>27</sup> *Ambica Construction* (n 20).

<sup>28</sup> *Reshmi Constructions* (n 18).

<sup>29</sup> *GAIL (India) Limited v. Bansal Infratech Synergies Limited* 2021 SCC OnLine Del 3628.

<sup>30</sup> *Union of India v. Onkar Nath Bhalla and Sons* (2009) 7 SCC 350.

<sup>31</sup> Section 8, Indian Contract Act, 1872.

court in *Bhagwati Prasad Pawan Kumar v. Union of India*<sup>32</sup> has ruled that keeping or encashing the cheques without any protest signifies complete and final settlement of the claim.

Thus, it is important for contractors to express any objections or non-acceptance before encashing the cheques. Further, thus, it is essential for contractors to present *prima facie* proof of coercion/undue influence in order to succeed in court for seeking reference to arbitration.<sup>33</sup> This action challenges the authenticity of the claim, ensuring that the claims remain eligible for arbitration.

## **Conclusion**

There exists no rule of universal application that discharge of contract by accord and satisfaction would render the dispute non-arbitrable. However, the issuance of an NCC is not a paper tiger in every case. If the parties have arrived at a settlement in respect of any dispute or difference arising under a contract and that dispute is amicably settled by way of a final settlement by and between the parties, 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.

The above referred body of cases firmly crystalize the principle that a contractor may not, as an afterthought, allege that the NCC was a result of fraud, coercion, duress or undue influence. Where the full and final satisfaction is acknowledged by the parties to the contract and the amount is received unconditionally, a subsequent allegation of coercion is viewed as a merely a devise by the contractor to get over the settlement of the claims. It is important to acknowledge that the purpose of a full and final settlement is to prevent future disputes between the parties involved. Consequently, the contractor should present compelling evidence to confirm the authenticity of the coercion allegations and refrain from using them to gain an advantage from the employer after receiving payment. A plain allegation of fraud or coercion without specific details proving circumstances that nullify consent will not benefit the contractor's case.

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<sup>32</sup> *Bhagwati Prasad Pawan Kumar v. Union of India* (2006) 5 SCC 311.

<sup>33</sup> *New India Association Co. Ltd. v. Genus Power Infrastructure Ltd.* (2015) 2 SCC 424.