Arbitration Case *Insights*

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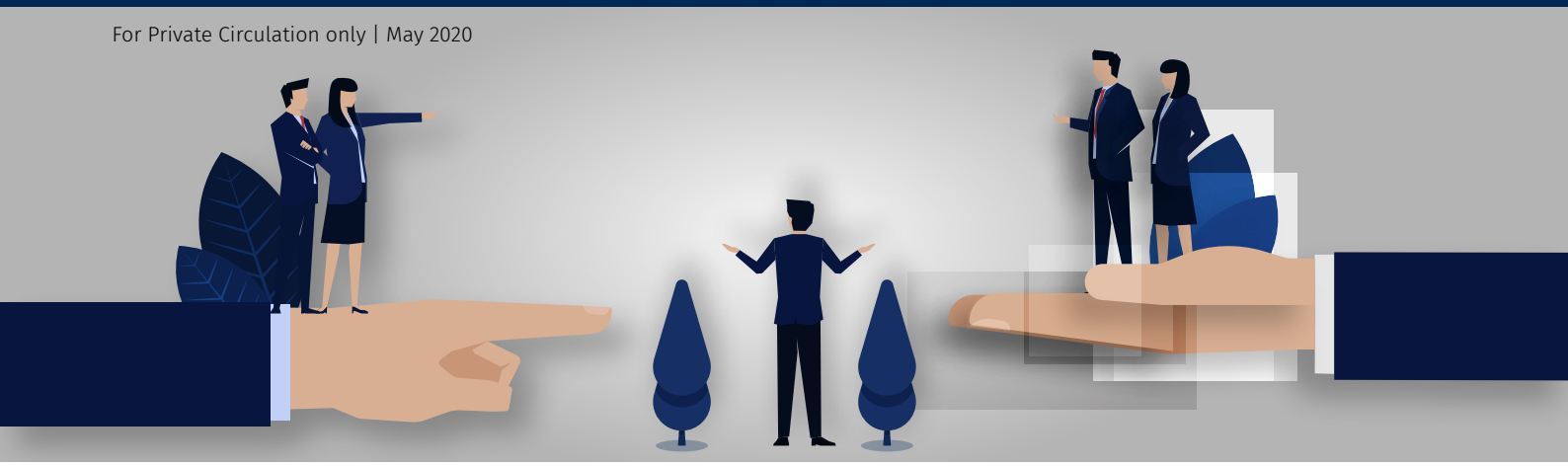
For Private Circulation only | May 2020



Supreme Court rules on perverse interpretation of clauses by arbitral tribunal[1]

Brief Facts

South East Asia Marine Engineering and Construction Ltd. ("**Appellant**"), who was awarded a work order for well drilling by Oil India Ltd. ("**Respondent**"), claimed reimbursement from the Respondent since the prices of High Speed Diesel ("**HSD**"), one of the essential materials for carrying out the drilling operations, had increased. The Appellant contended that the price increase triggered the "change in law" clause in the contract, i.e., Clause 23, ("**Clause 23**") justifying reimbursement from Respondent. The three-member arbitral tribunal ("**Tribunal**") issued the majority award ("**Award**") in favour of the Appellant and held that while an increase in HSD prices through a circular issued under the authority of the State or Union is not a "law", it has the "force of law" and thus, falls within the ambit of Clause 23. The minority award held that the executive orders do not come within the ambit of Clause 23.

The Respondent's challenge under Section 34 of the Arbitration and Conciliation Act, 1996 ("**Act**") failed as the District Judge held that the findings of the Tribunal were not against the public policy of India or patently illegal. The Respondent's challenge under Section 37 of the Act succeeded, with the Hon'ble Gauhati High Court ("**High Court**") setting aside the Award. The High Court held that the interpretation of the contract by the Tribunal was erroneous, was against the public policy of India and overlooked certain terms of the contract.

Issue

Whether the interpretation provided to the contract in the Award was reasonable enough to pass muster under Section 34 of the Act?

Judgment

The Supreme Court upheld the setting aside of the Award, observing that the Tribunal's interpretation of Clause 23 of the contract was an impossible view. The Tribunal had arrived at its conclusion on the strength of beneficial construction as a rule of interpretation, which provides that a word which makes an interpretation inconsistent with the document as a whole, should be avoided. While the Supreme Court agreed with this rule of interpretation, it concluded that the Tribunal's ultimate conclusion rendered Clause 23 inconsistent with other clauses of the contract. The other contractual terms inferably made the contract a fixed-rate contract, requiring the rates to be in force until the completion or abandonment of the last well being drilled. The Supreme Court also referred to another clause in the contract, which indicated that the fuel would be supplied by the contractor at its expense. The Supreme Court observed that prudent contractors usually take such commercial price fluctuations into margin and such price fluctuations could not be brought under Clause 23 unless specific language points to the inclusion.

Although the Award was set aside by the Supreme Court, it did not agree with the High Court's reasoning to grant the same relief. The High Court had observed that Clause 23 was akin to a *force majeure* clause and was inserted in the contract to meet uncertain and unforeseen eventualities, and not for revising a fixed rate of contract. The High Court was of the view that under Clause 23, rights and obligations of both parties were saved due to any change in law keeping in mind the "doctrine of frustration" under Section 56 of the Indian Contract Act, 1872. The Supreme Court was quick to dismiss this view because the parties, in a distinct clause, had agreed for payment of a *force majeure* rate to tide over any *force majeure* event.

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Analysis

The judgment of the Supreme Court opines on various aspects of contractual interpretation and scope of judicial interference under Section 34 of the Act. The Supreme Court duly expressed mindfulness of its limited role in interfering in arbitral awards by placing reliance on the three-judge bench decision of the Supreme Court in ***Dyna Technologies Pvt. Ltd. v. Crompton Greaves Ltd.***[2] However, ultimately the perversity of the Award, in the Court's opinion, merited judicial interference. Undoubtedly with this judgment, the ground of perverse interpretation of clauses by an arbitral tribunal has obtained fresh vigour and widened the public policy and patent illegality grounds in Section 34 of the Act. This decision is bound to fly in the teeth of the much relied upon Supreme Court's decision in ***Associate Builders v. DDA***,[3] recently affirmed in ***Ssangyong Engg. & Construction Co. Ltd. v. National Highways Authority of India***.[4] Both these decisions have categorically narrowed the confines of Section 34 while *inter alia* holding that interpretation of the terms of a contract is primarily the prerogative of an arbitrator and the award can only be disturbed if such interpretation is impossible to arrive at by any reasonable person. It is important to note that in this case, while the Tribunal interpreted the import and meaning of individual words of the Clause, the Supreme Court checked the consistency of the Clause with other clauses to arrive at its conclusion.

The Supreme Court unreservedly indicated that "beneficial" construction of a clause does not mean "liberal" interpretation of a clause, and the acceptable test for interpretation of such a clause is to check its consistency with other terms of the contract. With its observations on factoring common price fluctuations by contractors, the Supreme Court may have debilitated clauses that mitigate the risks of price fluctuations. The judgment may have also given significant leeway to the argument that foreseeable price variations can escape the restraints of price variation clauses. The judgment will undoubtedly serve as an important precedent on the issue of interpretation of contracts by arbitrators, and more specifically, will have an effect on price variation clauses in fixed-rate contracts.

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1 Authored by Tejas Karia, Partner & Head-Arbitration, Gauhar Mirza, Principal Associate and Hiral Gupta, Associate; *South East Asia Marine Engineering and Constructions Ltd. (SEAMEC Ltd.) v. Oil India Ltd.*, Civil Appeal No. 673 of 2012, Supreme Court, 2020 SCC OnLine SC 451, judgment dated 11 May 2020.
Coram: N.V. Ramana, Mohan M. Shantanagoudar and Ajay Rastogi, JJ.

2 2019 SCC OnLine SC 1656.

3 (2015) 3 SCC 49.

4 (2019) 15 SCC 131.

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