

SUPREME COURT UPHOLDS COURT INTERVENTION TO RECTIFY ERRONEOUS CONTRACTUAL INTERPRETATION IN AN ARBITRAL AWARD¹

1. INTRODUCTION

A three-judge bench of the Supreme Court in its recent judgment in *South East Asia Marine Engineering and Constructions Limited v. Oil India Limited*² (the “**Judgment**”) upheld an order passed by the Gauhati High Court under Section 37 of the Arbitration and Conciliation Act, 1996 (the “**Arbitration Act**”) setting aside an arbitral award. The High Court reversed the decision under Section 34 of the Arbitration Act (whereby the challenge to the award was rejected) on the ground that the interpretation of the terms of the contract by the arbitral tribunal is erroneous and is against the public policy of India. The Judgment (upholding the High Court’s decision) is an interesting development as it marks an important checkpoint on the principle that an error of interpretation of contract is considered to be an error within the arbitral tribunal’s domain and thus not a ground to set aside an award. Before analyzing the Judgment, it is necessary to advert to a brief factual background, as set out hereunder.

2. FACTUAL BACKGROUND

Pursuant to a tender floated by the Respondent, the parties entered into a contract whereby the Appellant was engaged to carry out well drilling and other ancillary operations in the state of Assam. During the term of the contract, the price of high speed diesel (“**HSD**”), one of the essential materials for carrying out the operations contemplated in the contract, was increased by the Government through a circular. On account of rise in price of HSD, the Appellant sought certain reimbursements from the Respondent by relying on Clause 23 of the contract (“**Clause 23**”) which provided for reimbursement of cost in the event of change in prices of essential materials due to enactment of a new law or modification in an existing law. As the Respondent denied the reimbursements sought, the Appellant invoked arbitration claiming reimbursements on account of rise in price of HSD.

The arbitral tribunal passed an award dated December 19, 2003 (the “**Award**”) in favour of the Appellant. It took a view that Clause 23 ought to be interpreted liberally, in as much as it held that “*while an increase in HSD price through a circular issued under the authority of State or Union is not a “law” in the literal sense, but has the “force of law” and thus falls within the ambit of Clause 23.*”³ The tribunal held that this clause must be construed as ‘*Habendum Clause*’, thereby bringing price escalation of HSD within its purview.

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² Civil Appeal No. 673 of 2012.

³ Finding as noted in Para 4 of the Judgment.

The Respondent's application under Section 34 of the Arbitration Act for setting aside the award was dismissed by the district judge who took the view that the award was neither without basis nor against the public policy of India nor patently illegal and did not warrant interference. The decision of the district judge was further challenged before the Gauhati High Court in an appeal under Section 37 of the Arbitration Act which set aside the award on the ground that it was passed overlooking the terms of the contract between the parties. In its reasoning, the High Court took a view that Clause 23 is akin to a force majeure clause. Aggrieved by the decision of the High Court, the Appellant filed an appeal before the Supreme Court.

The main grounds of challenge before the Supreme Court were (a) that interpretation of contractual terms falls within the domain of the arbitral tribunal to decide and the High Court is conferred with only a supervisory role which cannot impart its own view with regard to interpretation of contractual terms between parties; and (b) as there exists no patent illegality in the Award, the questions of law decided by the arbitral tribunal were beyond the judicial review of the High Court under Section 34 of the Arbitration Act.

3. ISSUE FOR CONSIDERATION BEFORE THE SUPREME COURT

The key issue before the Supreme Court was the scope and ambit of the court's jurisdiction to scrutinize the award on matters of interpretation.

The Supreme Court referred to and relied upon its earlier judgment in *Dyna Technologies Pvt. Ltd. v. Crompton Greaves Limited*⁴ wherein it was held that if there are two plausible interpretations on fact and terms of contract, the court should defer to the view taken by the arbitral tribunal unless such view taken by the arbitral tribunal portrays perversity which is 'unpardonable'.

In light of the judgment in *Dyna Technologies (supra)*, the Supreme Court set out to determine – “Whether the interpretation provided to the contract in the award of the tribunal was reasonable and fair, so that the same passes muster under Section 34 of the Arbitration Act?”

4. DECISION OF THE SUPREME COURT

The Supreme Court delved into the reasons offered by both, the arbitral tribunal and the High Court. It did not subscribe to either⁵ and offered its own reasoning to uphold the setting aside of the Award.

The Supreme Court observed that the interpretation of Clause 23 by the arbitral tribunal is contrary to the thumb rule of interpretation of contract i.e., *a written contract should be read as a whole and so far as possible as mutually explanatory*. On examining the terms of the Letter of Intent and other clause of the contract, it reached the conclusion that as the contract was based on a fixed price, the Appellant had taken into account the risk of price variations before entering the tender process. Therefore, the purpose of the tender being to mitigate the risk of price variations, the interpretation of the arbitral tribunal that change in price of HSD is akin to change in law cannot be said to be a possible interpretation of Clause 23. The court also observed

⁴ (2019) 15 SCC 131.

⁵ Paragraphs 25 and 26 of the Judgment.

that the provision of change in law in Clause 23 cannot be stretched so far so as to include price fluctuations, which if intended by the parties, would have been specifically included in the contract.

The Supreme Court also laid emphasis on certain terms of the contract which specifically provided that (a) rates, terms and conditions under the contract were to continue in force until the completion and abandonment of the contract; and (b) fuel was to be supplied by the contractor at his expense as per the 'Consolidated Statement of Equipment and Services furnished by the Contractor' as provided in the contract. The court observed that such clauses clearly indicated that the prices stipulated in the contract were not open for modification and the interpretation of Clause 23 given by the arbitral tribunal was not possible. Hence, it was well within the scope of Section 34 of the Arbitration Act to set aside the Award.

To sum up, it held that the contractual interpretation of Clause 23 of the contract was not a possible interpretation of contract as (a) the arbitral tribunal ignored the thumb rule of contractual interpretation i.e., the contract shall be read as a whole, and ignored express terms in the contract which provided that rates agreed in the contract were not open to modification till completion or abandonment of the contract; and (b) price fluctuations of essential materials required for performance of the contract had been reasonably considered by the Appellant at the time of placing its bid for the contract and entering into the contract.

5. **INDUSLAW VIEW**

As elucidated in *Associate Builders v. Delhi Development Authority*⁶ and *McDermott International, Inc. v. Burn Standard Co. Ltd.*⁷, it is a settled law that matters of construction of contract primarily fall within the domain of the arbitrator and an error in interpretation does not warrant interference with the award. The Judgment does not deviate from that settled position, but is an example where the court, as a matter of exception, intervenes when the error of interpretation in the award is unpardonable and perverse.

It is pertinent to take note that the Supreme Court delved into the reasoning of the arbitral tribunal on the interpretation of the contractual terms and did not agree with the same. It also did not subscribe to the High Court's reasoning and in fact, replaced it with its own view on the interpretation of the contract in question and upheld the operative part of the High Court's decision i.e., to set aside the Award. The Judgment is a reminder that the 'hands off' approach of courts on errors of construction in the award does have its limits and in appropriate cases the courts may intervene and rectify the fallacious and impossible interpretation of the contract by the arbitral tribunal.

The Judgment does not provide a *carte blanche* mandate to courts to enter into issues of interpretation or sit in appeal over findings of the arbitral tribunals on matters of contractual interpretation, however, it does tend to widen the scope of scrutiny of awards on such matters. The ruling may have a bearing on the approach adopted by the courts in applying settled legal principles for considering challenge to arbitral awards.

⁶ (2015) 3 SCC 49.

⁷ (2006) 11 SCC 181.

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