Interpretation of Contract v. Disregard of the terms of the Contract: Analysis of Section 28(3) of the Arbitration and Conciliation Act, 1996

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Introduction

1. The central force behind the creation of a valid contract, including an arbitration agreement, is the doctrine of 'party autonomy' which embodies the willingness of parties to determine their rights and interests, and to commit to fulfilling certain obligations therein.

2. In disputes involving contracts, inter *alia* work contracts, before the arbitral tribunals **(tribunal**), it has been established by the Supreme Court of India ("**Supreme Court"**) in ***Ssangyong Engineering & Construction Co. Ltd. v. National Highways Authority of India***, ***2019 15 SCC 131*** ("**Ssangyong**") at para 76 and ***PSA SICAL Terminals Pvt. Ltd. (SICAL) v. The Board of Trustees (Board),*** ***2021 SCC Online SC 508*** ("**PSA SICAL**") at para 82 - that tribunals do not have the power to alter or modify the terms of an agreement that could result in the creation of a new contract between the parties. Further, in February 2022, the Supreme Court in ***Indian Oil Corporation Ltd. (IOCL) v. M/s Shree Ganesh Petroleum Rajgurunagar (Ganesh Petroleum)***, ***2022 SCC OnLine SC 131*** ("**IOCL v. Shree Ganesh**") discussed the existing jurisprudence around the scope of arbitrators' powers in committing 'acceptable errors' and 'unacceptable errors' when delivering arbitral awards as far as interpreting terms of a contract are concerned.

3. By way of this article, the authors will discuss the historical jurisprudence under the Arbitration and Conciliation Act, 1996 on the issue of scope of the arbitrator's power to wander beyond the Contract. The same will begin with a discussion of the Judgment of the Supreme Court in ***Oil and Natural Gas Corporation v. SAW Pipes*** (***2003) 5 SCC 705*** ("**ONGC v. SAW Pipes**"), followed by the suggestions by the Law Commission in their 246th Report on the basis of which amendments were made to the Arbitration and Conciliation Act, 1996 in the year 2015. We shall thereafter see the changing stance taken by courts to give effect to these amendments.

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Thereafter, we shall analyse the two judgments of the Supreme Court in ***Ssangyong*** and ***PSA SICAL*** which discussed the restrictions on the power of the arbitral tribunal to make alterations to the Contract. Finally, the authors shall conclude the article by discussing the case of ***IOCL v. Shree Ganesh*** and analyse the scope of the powers of the arbitral tribunal as discussed in the case and compare with the dictum of the judgment of ***ONGC v. SAW Pipes.*** The comparison will help us state firmly the changes in law that have occurred regarding the scope of the arbitral tribunal to 'interpret' or disregard terms of the contract and how far the amendments of the Arbitration Act may have been neutralised by judicial pronouncements.

Jurisprudence Around Arbitrators' Powers to Alter or Modify a Contract

4. The law as it stood prior to the 2015 Amendment to Section 28(3) of the Arbitration Act, was established in the case of ***ONGC v. SAW Pipes***, wherein the arbitrator was restricted from making any changes to the terms of the contract on the reasoning that a tribunal was a creation of a contract and thus, even a reference to the common trade practices in the market did not allow the arbitrator to take a liberal approach in altering or modifying the terms of a contract.

5. Concurrent to the findings in ***ONGC v. SAW Pipes***, the Supreme Court in ***Bharat Coking Coal Ltd. v. Annapurna Construction, 2003 8 SCC 154*** ("**Annapurna Case**") distinguished between 'error within jurisdiction' and 'error outside jurisdiction' by underlining that an award can be set aside if the arbitrator has interpreted the terms of an agreement by travelling beyond the contract; however, if the interpretation has been made without travelling beyond the scope of the contract, then the award is not liable to be set aside. The former was construed as an arbitrator committing 'error without jurisdiction' and the latter as 'error within jurisdiction'.

6. The Supreme Court went ahead to clarify the legislative intent behind such a restrictive approach that was taken under Section 28(3) of the Arbitration Act, in the subsequent case of ***MD, Army Welfare Housing Organization v. Sumangal Services (P) Ltd, (2004) 9 SCC 619*** where it was observed that a tribunal, not being a court of law, its orders not being judicial orders, and its functions not being judicial functions, could not exercise its power *ex debito justitiae* i.e. 'as a matter of right'. Thus, the arbitrator's jurisdiction *"being confined to the four corners of the agreement, he can only pass such an order which may be the subject matter of reference*".

246th Report of the Law Commission and the Amendments to the Act in 2015

7. The Law Commission of India in its **246th Report** had suggested for an amendment to Section 28(3) of the Arbitration and Conciliation Act, 1996 (**Arbitration Act**) in the following format:

> "(ii) In sub-section (3), after the words "tribunal shall decide" delete the words "in accordance with" and add the words "having regard to"", with the expression of its intention to "overrule the effect of ONGC Ltd. v. Saw Pipes Ltd., (2003) 5 SCC 705, where the Hon'ble Supreme Court held that any contravention of the terms of the contract would result in the award falling foul of Section 28 and consequently being against public policy."

8. The pre-amended Section 28(3) of the Arbitration Act stood as - "In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction." Amendment to Section 28(3) of the Arbitration Act was pursuant to the legislative recommendations that were expressed in the 246th Law Commission Report. The amended Section 28(3) of the Arbitration Act reads as: - "*While deciding and making an award, the arbitral tribunal shall, in all cases, take into account the terms of the contract and trade usages applicable to the transaction."*

9. Post the 2015 Amendment, several courts in India seem to have upheld the legislative intent as was expressed in the 246th Law Commission Report substantiated with reasoning for the same. In the recent case of ***Eastern Coalfields Ltd. v. Rungta Projects Ltd***., ***2018 SCC OnLine Cal 6555*** the Calcutta High Court praised the Ld. Arbitrator for taking a practical, commercial approach to the competing claims instead of giving a restrictive meaning to the terms of the contract. Following is the relevant para from the judgement

> "24. Instead of giving a restrictive meaning to the terms of the contract, the Ld Arbitrator took a practical, commercial approach to the competing claims. He could have shut his eyes to the ground realities in most cases of premature terminations, where the contractor is left high-and-dry and destined to clear the dirt; including settling claims of vendors, dismantling sheds, rid the site of equipment. In ploughing through the pleadings and evidence, the Ld Arbitrator meticulously weighed each of the claim against the actual expenses incurred in the context of the initial expectation of both parties that the contract would last for three years. In doing so, the Ld Arbitrator gave a correct construction to section 28 (3) of the Act; he took

> into account the trade usages and commercial practices prevalent in situations of this nature where a contractor is saddled with the burden of taking on expenses for paying off disgruntled third parties over and above the imminent monetary loss of the project altogether. In this Court's view, the extent of expenditure incurred under different heads and the quantum awarded under each head of claim by the learned arbitrator is a question of fact arrived at after proper evaluation of materials and a re-assessment of those facts can only be done if the assessment is found to be misdirected or perverse. The Award is in consonance with efficacious business practices applicable to commercial transactions where a contractor can apply for liquidated damages for the loss and damage suffered by it on account of premature termination of the contract."

10. The reasoning by the High Court appears to be based on the premise that no party to a contract can claim unjust benefits by putting another party in a disadvantageous position. Therefore, it is well within the rights of an arbitrator to interpret the terms of a commercial contract in light of the prevalent trade and business practices.

11. At this juncture, a very pertinent question could arise as to what the extent of the powers of an arbitrator is when adjudicating a contractual dispute in light of prevailing trade usages. Reference to the Delhi High Court's observations in the recent matter of ***Astonfield Renewables Pvt. Ltd. & Anr. v. Ravinder Raina, 2018 SCC OnLine Del 6665 (Astonfield Case)*** would be relevant here -

> "50. A reading of the above would show that the present is not a case where the Arbitrator has acted in ignorance of the terms of the Agreement, but is a case where the Arbitrator has interpreted the terms of the Agreement to reach a particular conclusion. This distinction is very relevant as construction of the terms of the contract is primarily for an Arbitrator to decide unless the Arbitrator construed the contract in such a way that it could be said to be something that no fair minded or reasonable person could do."

12. Therefore, it can be concluded that the developments around the amendment to Section 28(3) of the Arbitration Act always aimed at upholding the doctrine of party autonomy by giving due regard to the terms of a contract; but the only change has been in the transition from a

restrictive-to-liberal approach while interpreting the commercial viability of the terms the said contract.

Discussions regarding the amendments by the Supreme Court

13. Just prior to the 246th Law Commissions report and the amendments, the Supreme Court in ***Associate Builders v. Delhi Development Authority, 2015 3 SCC 49 (Associate Builders Case)***, held that an arbitrator is said to commit an 'error within jurisdiction' if he interprets the terms of the contract wrongly, but the same error would amount to 'error without jurisdiction' if he exercises powers which are not conferred on him. Essentially, the arbitrator is free to take into account the prevailing business practices as long as it is within the jurisdictional powers conferred on him, and such a reference must result in preserving the rights and interests of the parties to the contract.

14. Post the amendment, the Supreme Court in ***Ssangyong*** in para 76, while referring to ***Associate Builders,*** held that a Court can interfere with the award of an arbitrator only in exceptional circumstances including where it is evident that the course of conduct by an arbitrator is contrary to the fundamental principles of justice.

15. In ***PSA SICAL***, the Court clarified that an arbitrator cannot unilaterally amend the terms of a contract unless it is apparent from the evidence on record (such as documents, contractual terms, letters/exhibits exchanged, etc.) that the parties consent to the same. Further, it was iterated that it must be noted that in the facts of this case, the documents on record proved that when the change in Ministry's notification was received and a subsequent change was suggested by SICAL, the Board never consented to the same. Further, the Court has remarked that the change suggested by SICAL was not necessary as nothing on record suggested that the old revenue model would not have continued to function efficiently under the Ministry's Notification. In essence, it can be construed from the above observations: that if there is a change in the trade practices, it must have relevance to the terms of the contracts for the arbitrator to go ahead and incorporate the same during the construction of the contracts; and, that parties' consent plays a key role in determining their agreement to be subjected to a change in the contractual terms.

16. Although the Court has made the scope of the arbitrator's powers to interpret the terms of the contract crystal clear, there is ambiguity regarding the following: whether an arbitrator's powers will override the parties disagreement to an amendment in an event where the arbitrator has found the trade practices relevant to the construction of the contracts? If the parties were aware of the prevailing trade practices before the dispute came before the arbitrator and one of them expressed disagreement to incorporating the changes, does the arbitrator still have the power to modify and alter the terms? And, whether the award by the arbitrator in the *PSA Sical case* was an error within the jurisdiction or an error outside the jurisdiction?

IOCL v. Ganesh Petroleum - Arbitrator going beyond the terms of the Contract

17. The intention however behind the 2015 Amendment to Section 28(3) of the Arbitration Act has been established which entails-

    a. That a tribunal is empowered to take a more liberal approach when interpreting agreements by considering the prevalent significant trade practices and developments in the market; and
    b. That such an interpretation by a tribunal would not necessarily qualify as a valid ground to challenge its award.

18. However, there are still multiple interpretations as to what extent, and under what circumstances, can an arbitrator/tribunal exercise its powers under Section 28(3) of the Arbitration Act. The subsequent paragraphs will attempt to discern whether the recent ruling by the Court in the matter of ***IOCL v. Shree Ganesh Petroleum*** has continued to uphold and extend the legislative intent behind the 246th Law Commission Report or has taken a detour to the defunct laws by silently reinstating the legislatively overruled judgement of ***ONGC v SAW Pipes***.

19. Ganesh Petroleum leased a plot of land to IOCL, for a term of 29 years with further renewal by mutual consent and a lease rent of Rs. 1750/- per month, to set up a retail outlet for the sale of its petroleum products (**lease agreement**). Ganesh Petroleum and IOCL are together referred to as "the parties". IOCL was permitted to assign, transfer, sublet, underlet, or part with the possession of the premises or any part thereof to any person without the consent of Ganesh Petroleum.

20. Additionally, a dealership agreement was entered between the parties whereby Ganesh Petroleum was appointed as the dealer of the retail outlet which was set up by IOCL in the leased premises. The dealership agreement was for a term of 15 years and was to continue thereafter for successive years of one year each until either party determined to terminate the agreement by giving three months' notice in writing to the other of its intention to terminate the said agreement.

21. The arbitrator, while delivering the award on the disputes concerning the dealership agreement, increased the monthly lease rent under the lease agreement for IOCL from Rs.1750/- per month to Rs.10,000/- per month with 20% increase after every three years. Hence, the present appeal by IOCL.

22. By allowing the appeal against the judgment of the Bombay High Court (**BHC**) and simultaneously setting aside the award of the Arbitrator for increasing the lease rent from Rs.1750/- per month to Rs.10,000/- per month, the Court ruled that the arbitral award (**award**) was liable to be set aside under Section 34(2)(a)(iv) of the Arbitration Act as it concerned with the dispute of lease rent that did not fall within the arbitration clause in the dealership agreement and was thus patently beyond the scope of the submission to the arbitration, that a tribunal being a creature of contract, is bound to act in terms of the contract under which it is constituted, that a High Court or Supreme Court does not sit in appeal to an award and such courts can interfere with the award only if any of the following conditions are fulfilled:

> (i When an award is, on its face, in patent violation of a statutory provision.
>
> (ii)When the Arbitrator/Arbitral Tribunal has failed to adopt a judicial approach in deciding the dispute.
>
> (iii)When an award is in violation of the principles of natural justice.
>
> (iv)When an award is unreasonable or perverse.
>
> (v) When an award is patently illegal, which would include an award in patent contravention of any substantive law of India or in patent breach of the Arbitration Act.
>
> (vi)When an award is contrary to the interest of India, or against justice or morality, in the sense that it shocks the conscience of the Court.

23. The Supreme Court while deciding to set aside the award in the case of *IOCL v. Ganesh Petroleum*, made a reference to the *Associate Builders Case*, wherein it observed that a tribunal cannot wander outside the scope of an agreement and alter its terms and conditions on the ground that such an act is to prevent injustice to a party when the parties had clearly entered into the agreement earlier with their eyes open. With subsequent reference to para 40 of ***Ssangyong*** the Court tried to draw a distinction between an error within the jurisdiction and an error outside the jurisdiction in light of when a tribunal can make reference to the prevailing trade usages in the market under Section 28(3) of the Arbitration Act. Further, the Hon'ble Supreme Court of India in the ***Ssangyong*** has held in **para 76,** that an Arbitral Tribunal, or for that matter, the Court cannot alter the terms and conditions of a valid contract executed between the parties. This view seems eerily similar to the *ONGC v. SAW Pipes* ruling which was legislatively overruled by the 2015 amendment.

24. In the present case of *IOCL v Ganesh Petroleum*, the Court observed that the dealership agreement and the lease agreement were two separate agreements, which had clearly outlined the manner in which disputes central to each of the agreements would be settled. It is already established from the facts in the case that the dispute had arisen pursuant to the termination of the dealership agreement. However, the arbitrator went ahead to pass an award in light of a matter (i.e. increase of the lease rent) that was central to the lease agreement and was not under the scope of the arbitration in the present case. Such an act of the arbitrator is clearly an error outside its jurisdiction because the issue was not under the scope of the agreement which was in dispute before it.

Analysis

25. Based on the aforesaid discussion and background the authors are of the opinion that if the matter has fallen within the scope of the agreement in dispute, the power of the arbitrator to still disregard the terms of the contract would have to be heavily backed by statutory provisions which disallow certain types of terms in the contract to be overlooked in case they are onerous or one-sided or if it had been apparent that such terms were unilaterally imposed and thus the consent was not freely given by the other party. If the arbitral tribunal provides specific reasons for the disregard of the terms of the contract the same may still be upheld as opposed to the earlier regime wherein the slightest wandering outside the terms of the contract would have

meant automatic setting aside under the *ONGC v. SAW Pipes* jurisprudence. For example, if the terms of the contract state that no damages would be payable for a breach of the contract and if such terms are to be strictly followed then no damages should be payable for the breach. But such a clause of the contract would clearly be in violation of the principles of contract law enshrined in the Indian Contract Act, 1872. Most often when terms of the contract are disregarded it is because the arbitral tribunal tries to impose the supremacy of the Contract Act.

26. The authors believe that the amendment to Section 28(3) of the Arbitration and Conciliation Act, 1996 is not necessarily regarding the trade usages being used by the arbitral tribunal to disregard the terms of the Contract but rather to allow the freedom to the arbitral tribunal to decide whether certain terms of the contract which are being relied upon by the parties are onerous and not in the spirit of the Contract Act, 1872. Further, the arbitral tribunal may also have the liberty, although very limited, to decide on the basis of adequate pleadings, that the terms being relied on disallowing the relief claimed by the plaintiff were not freely consented to and may be disregarded in light of the provisions of the Contract Act, 1872 which support the case of the plaintiff / claimant. This decision of the arbitral tribunal cannot be automatic, i.e. not all terms of the contract which are not in consonance with the Contract Act, 1872 may be disregarded as the principles of statutory interpretation and autonomy of parties to waive entitlements under a statute may play a role. The Supreme Court in ***National Insurance v. Boghara Polyfab (2009) 1 SCC 267*** has held that the presumption always has to be that the parties have entered into the contract with equal bargaining power and free consent, and only if the plaintiff is able to discharge its burden that the terms which restrict their entitlement are onerous or did not consent or the entitlements and protections under the Contract Act were not willingly waived, should the arbitral tribunal have the rights to disregard such terms of the contract and award the protection of the Contract Act to the plaintiff and the consequent reliefs.

27. In arguendo, if a tribunal were to decide a matter which was not within the scope of the arbitration submissions before it, then it would implicitly empower every arbitrator to espouse the power to interfere with any arbitration agreement, whether or not the parties to such agreement consented to submit to his jurisdiction. However, such a scenario is unrealistic given the nature of the creation of the arbitral tribunal and the role of party autonomy in the creation of an arbitration agreement. Hence, we can be rest assured that the Courts have NOT attempted

to re-instate the *ONGC v. SAW Pipes* jurisprudence of awards being set aside as being beyond the terms of the Contract. The arbitration matter in IOCL v. Shree Ganesh was rather a case of the jurisdiction not being available with the arbitrator and the award being set aside under Section 34(2)(a)(iv) and not being set aside under Section 34(2A) for being patently illegal.