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Supreme Court Puts The Arbitration Process On A Back Foot

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This is unfortunately two steps backwards in the position of the Supreme Court which, in previous judgments, has been very pro-arbitration, Hiroo Advani, managing partner at Advani & Co., said. "The judges should simply not reinterpret contracts."

The Award

In 2003, the arbitral panel issued an award in favour of SEAMEC Ltd. against Oil India Ltd. During the subsistence of the contract for oil drilling, the prices for high-speed diesel went up. SEAMEC asked to be compensated for this increase in price saying this triggered the "change in law" clause under the contract. Any change in law that leads to an increase in cost for SEAMEC Ltd. would entitle it to a compensation, one of the clauses in the contract stated.

Oil India had argued that the increase in price was done by the Oil Price Committee and not by a law of Parliament or State legislature. And so, this clause could not be triggered. The arbitral tribunal dismissed this saying that at the time of signing the contract, Oil India knew that price increases were done by this committee on government's instruction. The rights granted to SEAMEC need to be construed broadly and price escalations will come within the ambit of this clause in the contract, the arbitral tribunal held.

On appeal, the district judge ruled that the findings of the tribunal were not without basis or against the public policy of India or patently illegal and did not warrant judicial interference. But the high court set aside the award and held it was passed overlooking the terms and conditions of the contract.

The Apex Court's View

The contract between SEAMEC and Oil India was a fixed rate contract, the Supreme Court noted. It pointed to the clauses of the contract which said: the rates, terms and conditions were to be in force until the completion or abandonment of the last well being drilled. Price fluctuations could not have been bought within the scope of the "change in law" clause, the bench concluded.

"If the purpose of the tender was to limit the risks of price variations, then the interpretation placed by the arbitral tribunal cannot be said to be possible one, as it would completely defeat the explicit wordings and purpose of the contract." – Supreme Court order in Oil India case

In saying so, the Supreme Court set aside the arbitral award. The arbitration law, under Section 34, lays down very narrow grounds for courts to interfere with awards and the court has to ask if the decision is so perverse that an award needs to be interfered with, Vyapak Desai, partner at Nishith Desai Associates, said.

"Unfortunately, the Supreme Court hasn't clarified how a different interpretation of the contract falls within the narrow scope of perversity for it to interfere with the award. This can be now be misused by parties on grounds that arbitral tribunal has applied an incorrect rule to read a contract."

Vyapak Desai, Partner, Nishith Desai Associates

You either interpret a clause in a contract widely or narrowly — it's neither perverse nor against public policy for any court to set aside an award, Desai said. Advani said interpretation of a contract is up to the arbitral tribunal and the Supreme Court has itself held so. This is a three-judge bench order — now a larger bench will need to find a way to narrow this down, he said.