Supreme Court's interpretation of arbitration clauses in Insurance Policies – An Analysis

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Introduction:

Recently, the Supreme Court in the case of Oriental Insurance Company Limited (**"Oriental Insurance / Insurer"**) v. M/s Narbheram Power and Steel Private Limited (**"NPSL / Company"**)[1] noted the peculiarity of dispute resolution clauses in insurance contracts and interpreted the language of an arbitration clause commonly found in insurance policies.

Facts

NPSL had entered into a Fire Industrial All Risk Policy (**"Policy"**) in respect of the factory situated in Odisha. In October 2013, a cyclone affected large parts of the state including NPSL's factory. The Company suffered damages estimated at INR 39,336,224. The Insurer was informed and a surveyor was appointed. Based on the surveyor's report, the Company requested the Insurer to settle its claim. Failing settlement, the Company issued a notice invoking arbitration as per the dispute resolution clause under the policy; reproduced below:

"13. If any dispute or difference shall arise as to the quantum to be paid under this policy (liability being otherwise admitted) such difference shall independently of all questions be referred to the decision of a sole arbitrator to be appointed in writing by the parties to or if they cannot agree upon a single arbitrator within 30 days of any party invoking arbitration, the same shall be referred to a panel of three arbitrator, comprising of two arbitrators, one to be appointed by each of the parties to the dispute/difference and the third arbitrator to be appointed by such two arbitrators and arbitration shall be conducted under and in accordance with the provisions of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as Part I for ease of reference).

It is clearly agreed and understood that no difference or dispute shall be referable to arbitration as hereinbefore provided, if the Company has disputed or not accepted liability under or in respect of this policy (hereinafter referred to as Part II).

It is hereby expressly stipulated and declared that it shall be a condition precedent to any right of action or suit upon this policy that the award by such arbitrator/arbitrators of the amount of the loss or damage shall be first obtained" (hereinafter referred to as Part III).

In reply, the Insurer repudiated the claim in entirety stating reasons[2] and declined to refer the disputes to arbitration. The Company approached the Calcutta High Court under Section 11(6)[3] of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**")
for appointment of an arbitrator.

The Contentious Dispute Resolution Clause

The dispute resolution clause in the present case can be divided into following three parts:

1. That dispute or difference on quantum of claim is to be determined by arbitration ("**Part I**");
2. That there shall be no arbitration if Insurer has completely denied the liability under the Policy ("**Part II**"); and
3. That obtaining an award on quantum is a necessary pre-condition to initiating any right of action or suit against the Insurer ("**Part III**").

A prima facie reading of the clause indicates incongruity and conflict. It would appear that an insurer can initiate arbitration only for dispute on quantum and not on denial of liability. On the other hand, the insurer cannot initiate any action or suit on denial of liability without obtaining an award on quantum. As such, one may say that the insured is remediless if the claim is completely denied by the insurer.

High Court's View

The High Court opined that the present arbitration clause was ambiguous. To make the clause workable, it contemplated a distinction between (1) loss suffered due to peril covered under the policy and (2) loss suffered due to peril not covered under the policy. It opined that it would be in the latter case (2) that Insurer could deny the liability completely and hold that such a claim is not arbitrable. If arbitrator could determine both such questions on whether loss was on account of peril covered under the policy and the quantum of such loss, then Part II and Part III will be incongruous; as such nothing much will be left for the suit court to determine. Without elucidating on applicability of this analysis to the present facts, the High Court held the dispute was referable to arbitration.

Supreme Court's View & Analysis

The Supreme Court overturned the Calcutta High Court's order. At the outset, the Court stated that insurance contracts are to be interpreted exactly in the words in which the contract is expressed. It held that High Court had proceeded under the assumption that Part II and Part III of the arbitration clause do not have harmony, and in fact, sound a discordant note. It stated that its judgment in Vulcan Insurance Co. Ltd. v. Maharaj Singh & anr[4], ("Vulcan Industries Case")was clear on this point and dispels any ambiguity in construing Part II and Part III of the arbitration clause.

Vulcan Industries dealt with a similar arbitration clause. In the said case, the insurer repudiated its liability to pay any amount claimed by the insured. The court opined that the dispute related to insurer's liability to pay any amount whatsoever. Therefore, dispute raised by the insured fell under Part I of the clause; it was therefore covered by the arbitration clause.

The court analysed Part II and III to hold that there is no incongruity in them. Clauses like Part III (making the award condition precedent to any right of action or suit) are known as **'Scott v. Avery Clauses'**[5]. These have been repeatedly held to be valid. It held that where policy is completely denied, no obligation lies on the insured to arbitrate the amount before commencing an action on policy– since the dispute itself was not covered by arbitration.

Relying upon various cases and reasons cited by the Insurer while repudiating liability, the Supreme Court opined that this was a case of denial of liability - not a dispute pertaining to quantum. While doing so, the Supreme Court made no comment on the distinction made by the High Court with respect to coverage or otherwise of a liability under the policy. It ruled that the arbitration clause clearly provided that *no difference or dispute shall be referable to arbitration if the Company has disputed or not accepted liability under the policy.* The remedy available to insured was to institute a civil suit for its grievances.

Conclusion

The High Court's view is based on reasons for repudiation of liability i.e. coverage or non-coverage of liability under a policy. However, the Supreme Court's view is based on a simple distinction of repudiation of liability and amount of loss, irrespective of reasons given for repudiation of liability.

The position now stands crystal clear. As soon as there is a rejection of claim but no dispute on amount of loss, the only remedy for the insured is to commence court proceedings for establishing insurer's liability. Once liability is established, a claimant may well resort to arbitration for determining the quantum of its claim. The present case reinforces the position in *Vulcan Industries*. One can argue that if the High Court had considered the decision in *Vulcan Industries*, its order might have been different.

On the other side, strict interpretation of such clauses could deprive the insurer of benefits of arbitration - being a faster and efficient option. It also opens doors for insurers to avoid arbitration by repudiating claims in entirety, considering that reasons for repudiation no longer hold water. Parties will therefore have to be aware of such arbitration clauses and ensure that their arbitration clause encompasses all disputes in relation to their insurance policies- if they would like to pursue arbitration both for questions of liability and quantum.

[1] Oriental Insurance Company Limited v. M/s Narbheram Power and Steel Private Limited, Civil Appeal No. 2268 of 2018, decided on May 02, 2018.

[2] The Insurer provided the following reasons :

> “1. Alleged loss of imported coal is clearly an inventory shortage.
>
> 2. There was no actual loss of stock in process.
>
> 3. The damage to the sponge iron is due to inherent vice.
>
> 4. The loss towards building/sheds etc. are exaggerated to cover insured maintenance.
>
> 5. As there is no material damage thus business interruption loss does not triggered.”

[3] Section 11(6) - \"Where, under an appointment procedure agreed upon by the parties -

(a) a party fails to act as required under that procedure; or

(b) the parties, or the two appointed arbitrators, fail to reach an agreement expected of them under that procedure; or

(c) a person, including an institution, fails to perform any function entrusted in him or it under that procedure;

a party may request the Supreme Court or, as the case may be, the High Court or any person or institution designated by such Court to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

[4] (1976) 1 SCC 943.

[5] Such clauses were first considered in the case of Scott v. Avery, 5 HLC 811: [1843–1860] All E.R. Rep. 1 HL.