Unilateral Addition To Contract Violates The Most Basic Notions of Justice Under Section 34 of Arbitration And Conciliation Act 1996

written by Latha Shanmugam | May 25, 2019

The Supreme Court in its recent judgement in the case Ssangyong Engineering and Construction Company vs. National Highway Authority of India (NHAI)[1], has set aside an arbitral award on the grounds of it being in contravention with the most basic notions of justice system which in turn led to conflict in between public policy of India as per section 34(2)(b)(ii)(iii) of the Arbitration and Conciliation Act 1996. Also the Supreme Court stated that a unilateral addition or alteration of a contract can never be imposed upon an unwilling party. In addition to that, the Court also held that the award was liable to be set aside under Section 34(2)(a)(iii) on the finding that the party was rendered "unable to present his case".

FACTUAL BACKGROUND

The issue emerged out of a 2005 work contract between the National Highway Authority of India (NHAI) and Ssangyong Engineering and Construction Company, a Korean company. The contract had a price adjustment formula, which applied the Wholesale Price Index published by Union Government based on the year 1993-94.

From 2010 onwards, the Union Ministry started publishing WPI based on 2004-05.

The contractor raised the bills accordingly. In 2013, the NHAI issued a circular adopting a new formula applying a "linking factor" based on 2009-10 to the old formula and the circular expressly stated:

"Thus, payment on account of price adjustment may be made by adopting the above process subject to the condition that the contractors furnish undertaking / affidavit that this price adjustment is acceptable to them and they will not make any claim, whatsoever, on this account in future after this payment."

The contractor opposed the application of 2013 circular as a unilateral modification of the formula. The dispute was referred to arbitration. The arbitral tribunal by a 2:1 majority upheld the application of 2013 circular. While doing so, the majority award applied certain government guidelines of the Ministry of Commerce and Industry, which stated that the establishment of a linking factor to connect the Old Series with the New Series is necessary. The majority award further made it clear that these guidelines are available on the official website, though they were not on record in the proceedings. The dissenting arbitrator expressly stated that neither the Circular nor the guidelines could be applied as they were de hors the contract between the parties. The challenge made to the award under Section 34 before the Delhi High Court was not successful and the matter reached the Supreme Court at the instance of the Korean contractor.

ANALYSIS

APPLICABILITY OF THE
ARBITRATION AND CONCILIATION (AMENDMENT) ACT, 2015

As perceived by the supreme court, the important question that arise in this case was whether the parameters of review of arbitral award will be applicable to the present petition since the case was decided on 30.07.2016 and there was radical changes been made in the Arbitration and Conciliation (Amendment) Act, 2015 with effect from 23.10.2015 – in particular, in the "public policy of India" ground for challenge of arbitral awards. The question which arises is whether the amendments made in Section 34 are applicable to applications filed under Section 34 to set aside arbitral awards made after 23.10.2015.

This Court, in Board of Control for Cricket in India v. Kochi Cricket (P.) Ltd. and Ors.,[2] has held that the Amendment Act, 2015 would apply to Section 34 petitions that are made after this date. Further this court relying upon various judgements[3], concludes that a clarificatory amendment can only be retrospective, if it does not substantively change the law, but merely clarifies some doubt which has crept into the law. Further the court states we do not express any opinion on the aforesaid contention since the amendments made to Section 34 are not directly before us. It is enough to state that Section 26 of the Amendment Act makes it clear that the Amendment Act, as a whole, is prospective in nature. Thereafter, whether certain provisions are clarificatory, declaratory or procedural and, therefore, retrospective, is a separate and independent enquiry, which we are not required to undertake in the facts of the present cases, except to the extent indicated above, namely, the effect of the substituted Section 36 of the Amendment Act." Therefore, even in cases where, for avoidance of doubt, something is clarified by way of an amendment, such clarification cannot be retrospective if the earlier law has been changed substantively. But if it changes the law it is not presumed to be retrospective, irrespective of the fact that the phrases used are "it is declared" or "for the removal of doubts". Hence there is no doubt that in the present case, fundamental changes have been made in the law. The expansion of "public policy of India" in ONGC Ltd. v. Saw Pipes Ltd.,[4] and ONGC Ltd. v. Western Geco International Ltd.,[5] has been done away with, and a new ground of "patent illegality", with inbuilt exceptions, has been introduced. Given this, we declare that Section 34, as amended, will apply only to Section 34 applications that have been made to the Court on or after 23.10.2015, irrespective of the fact that the arbitration proceedings may have commenced prior to that date.

The Law Commission Report,

when it came to setting aside of domestic awards and recognition or enforcement
of foreign awards, prescribed certain changes to the 1996 Act as follows:
“SETTING ASIDE OF DOMESTIC
AWARDS AND RECOGNITION / ENFORCEMENT OF FOREIGN AWARDS
Once an arbitral award is made, an aggrieved party may apply for the setting aside of such award. Section 34 of the Act deals with setting aside a domestic award and a domestic award resulting from an international commercial arbitration whereas section 48 deals with conditions for enforcement of foreign awards. As the Act is currently drafted, the grounds for setting aside (under section 34) and conditions for refusal of enforcement (section 48) are in pari materia.
The Act, as it is presently drafted, therefore, treats all three types of awards – purely domestic award (i.e. domestic award not resulting from an international commercial arbitration), domestic award in an international commercial arbitration and a foreign award – as the same. The Commission believes that this has caused some problems. The legitimacy of judicial intervention in the case of a purely domestic award is far more than in cases where a court is examining the correctness of a foreign award or a domestic award in an international commercial arbitration.
It is for this reason that the Commission has recommended the addition of section 34 (2A) to deal with purely domestic awards, which may also be set aside by the Court if the Court finds that such award is vitiated by “patent illegality appearing on the face of the award.” In order to provide a balance and to avoid excessive intervention, it is clarified in the proposed proviso to the proposed section 34 (2A) that such “an award shall not be set aside merely on the ground of an erroneous application of the law or by re-appreciating evidence.”
The Commission believes that this will go a long way to assuage the fears of the judiciary as well as the other users of arbitration law who expect, and given the circumstances prevalent in our country, legitimately so, greater redress against purely domestic awards. This would also do away with the unintended consequences of the decision of the Supreme Court in ONGC vs. Saw Pipes Ltd,[6] which, although in the context of a purely domestic award, had the unfortunate effect of being extended to apply equally to both awards arising out of international commercial arbitrations as well as foreign awards, given the statutory language of the Act.
The amendment to section 28(3) has similarly been proposed solely in order to remove the basis for the decision of the Supreme Court in ONGC vs. Saw Pipes Ltd,[7] and in order that any contravention of a term of the contract by the tribunal should not ipso jure result in rendering the award becoming capable of being set aside. The Commission believes no similar amendment is necessary to section 28 (1) given the express restriction of the public policy ground.
WHEN
ARBITRAL TRIBUNAL COULD BE SAID TO HAVE GONE BEYOND THE AGREEMENT:
The appellant in this case had argued that Section 34(2)(a)(iv) of the 1996 Act was attracted to the facts of the case as the majority award contained decisions on matters beyond the scope of the submission to arbitration. However, the bench did not accept this argument referring to State of Goa v. Praveen Enterprises, the bench observed that "where an arbitral tribunal has

rendered an award which decides matters either beyond the scope of the arbitration agreement or beyond the disputes referred to the arbitral tribunal, the arbitral award could be said to have dealt with decisions on matters beyond the scope of submission to arbitration".

The bench further added the Section 34(2)(a)(iv) has to be construed narrowly and that it was not possible to say that the misinterpretation of contract by the tribunal would mean that it had gone beyond the scope of submission to arbitration "if otherwise the aforesaid misinterpretation (which would include going beyond the terms of the contract), could be said to have been fairly comprehended as "disputes" within the arbitration agreement"

Applying this to the facts, the bench observed the applicability of 2013 circular came within the ambit of disputes referred to the tribunal and held: "It is enough to state that the appellant argued before the arbitral tribunal that a new contract was being made by applying the formula outside what was prescribed, which was answered by the respondent, stating that it would not be possible to apply the old formula without a linking factor which would have to be introduced.

Considering that the parties were at issue on this, the dispute as to whether the linking factor applied, thanks to the Circular dated 15.02.2013, is clearly something raised and argued by the parties, and is certainly something which would fall within the arbitration clause or the reference to arbitration that governs the parties. This being the case, this argument would not obtain and Section 34(2)(a)(iv), as a result, would not be attracted."

PARTY UNABLE TO PRESENT CASE

The crucial point that the bench noted was that the government guidelines that were referred to and strongly relied upon by the majority award to arrive at the linking factor were never in evidence before the Tribunal. In fact, the Tribunal relied upon the said guidelines by itself and stated that they are to be found on a certain website. The respondent also agreed that these guidelines were never, in fact, disclosed in the arbitration proceedings. In this backdrop, the Court observed :"This being the case, and given the authorities cited hereinabove, it is clear that the appellant would be directly affected as it would otherwise be unable to present its case, not being allowed to comment on the applicability or interpretation of those guidelines.

For example, the appellant could have argued, without prejudice to the argument that linking is de hors the contract, that of the three methods for linking the New Series with the Old Series, either the second or the third method would be preferable to the first method, which the majority award has applied on its own. For this reason, the majority award needs to be set aside under Section34(2)(a)(iii)".

MOST BASIC NOTIONS OF JUSTICE VIOLATED

The

Court observed that the 2013 circular, which was unilaterally issued by the NHAI, could not bind the contractor without its consent. In fact the Circular itself expressly stipulated that it cannot apply unless the contractors furnish

an undertaking/affidavit that the price adjustment under the Circular is acceptable to them. "This being the case, it is clear that the majority award has created a new contract for the parties by applying the said

unilateral Circular and by substituting a workable formula under the agreement
by another formula de hors the agreement". This amounted to breaching the most basic notions of justice.
Based on the above arguments
and the authorities the SC set aside the judgments of the Single Judge and of the Division Bench of the Delhi High Court, but observed that under the Scheme
of Section 34 of the 1996 Act, the disputes that were decided by the majority award would have to be referred afresh to another arbitration and since this would cause considerable delay and will be contrary to one of the important objectives of the 1996 Act, i.e. speedy resolution of disputes by the arbitral
process invoked its power under Article 142 of the Constitution of India uphold
the minority award.
CONCLUSION:
As decided by SC in the above case when it comes to the public policy of India argument based upon “most basic notions of justice”, it is clear that this ground can be attracted only in very exceptional circumstances when the conscience of the Court is shocked by infraction of fundamental notions or principles of justice. Further, in order to apply a linking factor, a Circular, unilaterally issued by one party, cannot possibly bind the other party to the agreement without other party’s consent. Indeed, the Circular itself expressly stipulates that it cannot apply unless the contractors furnish an undertaking/affidavit that the price adjustment under the Circular is acceptable to them.
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Footnote
1. CIVIL APPEAL NO. 4779 OF 2019 (Arising
out of Special Leave Petition (Civil) No.19033 of 2017)
2. (2018) 6 SCC 287 [“BCCI”]
3. R. Rajagopal Reddy v. Padmini
Chandrasekharan [R. Rajagopal Reddy v. Padmini Chandrasekharan, (1995) 2 SCC 630], Fuerst Day Lawson Ltd. v. Jindal Exports Ltd. [Fuerst Day Lawson Ltd. v.
Jindal Exports Ltd., (2001) 6 SCC 356], SEDCO Forex International Drill Inc. v.
CIT [SEDCO Forex International Drill Inc. v. CIT, (2005) 12 SCC 717] and Bank of Baroda v. Anita Nandrajog [Bank of Baroda v. Anita Nandrajog, (2009) 9 SCC 462 : (2009) 2 SCC (L&S) 689]
4. (2003) 5 SCC 705 [“Saw Pipes”]
5. (2014) 9 SCC 263 [“Western Geco”]
6. ibid
7. ibid
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