

Risk allocation clause in a contract cannot interpreted liberally by Arbitrators

S Ravi Shankar¹

In a recent Judgment of Supreme Court of India in the matter of SOUTH EAST ASIA MARINE ENGINEERING² it was held that in order to mitigate the harsh consequences of frustration of contracts under S.56³ of the Contract Act and to uphold the sanctity of the contract, parties chose to mitigate the risk and allocate the risk in a certain manner by inserting *force majeure* clauses and the arbitrators are not permitted to expand the scope in the name of liberal interpretation.

The appellant was awarded a work order pursuant to a tender floated by the Respondent Government Company, the said contract was for the purpose of Well drilling and other auxiliary operations. During the subsistence of the contract, the price of high speed diesel, one of the essential materials for carrying out the drilling operations was increased by way of a government circular. The appellant raised a claim that increase in price of the said high speed diesel (HSD) triggered the change in law clause under the contract and the respondent became liable to reimburse the Appellant for that increase. But the respondent rejected the claim of the appellant. Hence the appellant initiated an arbitration proceeding and the arbitrators in their arbitration award applied the “liberal interpretation principles of contract” and held that the government circular increasing the price of high speed diesel can be treated as a change in law and hence the respondent is liable to pay the increased price of the high speed diesel as claimed by the appellant.

¹ Author is an arbitration lawyer and Senior Partner of Law Senate Law Firm.

² South East Asia Marine Engineering and Constructions Limited Vs Oil India Limited (2020) 5 SCC 164

³³ Indian Contract Act,1972



Aggrieved by the Above said award fast baby Passed by the arbitrators the respondent challenge the same under section 34 of the act⁴ before the District Judge concerned. The District Judge upheld the award and hence an appeal was preferred before the High Court. The High Court set aside the award holding that the arbitration award of the arbitrators is perverse and the arbitral tribunal cannot be allowed to rewrite the contract. Hence the appellant approached the Supreme Court of India by way of a Special Leave Petition.

The Clause interpreted by the Supreme Court of India is as follows:

Subsequently enacted laws:

Subsequent to the date of price of bid opening if there is a change in or an enactment of any law or interpretation of existing law, Which results in additional cost / reduction in cost to contractor on account of the operation under the contract the company / contractor shall reimburse / pay contractor/ company for such additional / reduced cost actually incurred.

Held: The Supreme Court of India held that the contract being a fixed rate contract and the party entered the contract after mitigating the risk of such an increase. It was further held that if the purpose of the contract was to limit risk of price variations , then the interpretation placed by the arbitral tribunal cannot be said to be a possible one and it would completely defeat the explicit wordings and purpose of the contract. It was further held that the interpretation of the arbitral tribunal to expand the meaning of the above said clause to include change in rate of high speed diesel is not a possible interpretation of this contract. Hence the arbitration award is perverse and High Court was correct in setting aside the award.

⁴ Arbitration and Conciliation Act,1996