Narrow Scope of Section 34 Reaffirmed: Arbitral Award Partially Modified

A. Introduction:

The Arbitration and the Conciliation Act, 1996 (the "**Act**") underwent a number of significant amendments in 2015 vide the Arbitration and Conciliation (Amendment) Act, 2015 (2015 Amendment). Under the 2015 Amendment, Section 34 (grounds on basis of which an arbitral award may be challenged) also underwent significant changes. For instance, the 2015 Amendment: (i) limited the definition of the term 'public policy', and (ii) introduced 'patent illegality' as an additional ground for challenging an award (under clause 2A).

Section 34 is based on the principle that courts should not interfere with the merits of an arbitral award and only look into the award on the basis of the specific grounds of challenge that have been provided under the said provisions. This principle has been repeatedly upheld in various cases wherein the courts have refrained to sit as a court of appeal on an arbitral award. The Supreme Court has further clarified the narrow scope of Section 34 in a recent case of *M.P. Power Generation Co. Ltd & Anr. v. Ansaldo Energia Spa & Anr* [1] ("Ansaldo Case") which has been discussed in detail in this article.

B. Case Analysis

(i) Facts

MP Power Generation Co. Ltd. ("the Board") awarded the tender for refurbishment of the Thermal Power Plants at Amarkantak to Ansaldo Energia Spa ("Ansaldo"). As per the terms of the contract, Ansaldo furnished the following bank guarantees for an amount of: (a) INR 29,20,000; (b) US $ 1,708,100- these two guarantees were used as security towards advance payments to be made by the Board; and (c) INR 18, 48,00,000 as a performance bank guarantee. However, within a year from the Zero Date of the Contract (i.e. March 9, 2000), Ansaldo informed the Board that they were suspending the contract as the Board had misrepresented to it and had also breached a fundamental condition of the contract.

The Board based on the Ansaldo's actions, invoked the three Bank Guarantees on June 23, 2001, issued a notice of default on August 29, 2001 to Ansaldo; and, finally terminated the contract.

An Arbitral Tribunal (constituted on the basis of the claim filed by Ansaldo) ruled in favour of Ansaldo, wherein it held that the Board had wrongfully terminated the contract and specifically directed that:-the three bank guarantees were wrongfully invoked and encashed by the Board.

Being aggrieved by the arbitral award the Board filed an application under Section 34 of the Act, challenging it before the District Court at Jabalpur. The District Court partially set aside the portion of the impugned award pertaining to the encashment of the Bank Guarantees, and the claim amount specified in the petition.

Thereafter, Ansaldo appealed against this judgment in the High Court of Madhya Pradesh, which

[1] (Civil Appeal No. 3804 of 2018, Arising out of S.L.P (Civil) No. 39067 of 2013

held that the lower court had overstepped its jurisdiction by interfering with the findings of an Arbitral Tribunal. It further affirmed the findings of the Tribunal that the Board had failed to prove breach of contractual obligations on part of Ansaldo before encashing the bank guarantees.

The Board aggrieved by the judgment of the High Court approached the Supreme Court.

(ii) Findings:

The Supreme Court dismissed the appeal of the Board, with modification. The Court discussed the scope of limited judicial interference under Section 34 of the Act in detail before arriving at this conclusion, which is summarized in the following paragraphs:

In the Ansaldo case, the Supreme Court heavily relied on the law as laid down in the case of *Associate Builders v Delhi Development Authority* [2] ("Associate Builder Case") and summarized its findings in the following manner. It is important to note that the Supreme Court in the Associate Builders case held that only the grounds specifically provided in Section 34 of the Act can be used for interfering with an arbitral award and held that merits of the award can be looked into only under the broad head of 'public policy'. Further, the court in the Associate Builder's case held that whether a particular arbitral award can be struck down on the ground of 'public policy' would depend on factors such as a) disregarding orders of superior courts; b) lack of judicial approach, or an arbitrary approach; c) lack of application of principles of natural justice; d) a decision is so perverse or so irrational that no reasonable person would have arrived at the same conclusion. In fact, the Court went to the extent of observing that an arbitrator is the sole judge with respect to quality and quantity of facts.

Further, as explained in the Associate Builder Case (which relied on the case of *Renusagar Co. Ltd. v General Electric Co.* [3] and *ONGC v Saw Pipes Ltd.*[4], the Court observed that award can be set aside if it is against justice and morality: which means that an award can be set aside "... if it is so unfair and unreasonable that it shocks the conscience of the Court." (*emphasis supplied*).

The Supreme Court in the Ansaldo case while citing the Associate Builders case, reaffirming *Delhi Development Authority v M/s R.S. Sharma & Co* [5] reiterated that an arbitral award can be set aside on grounds of patent illegality, which is based on whether there is: a) fraud or corruption; b) violation of substantive legal principles going to the root of the matter; c) error of law by the arbitrator; d) contravention of the Act itself; e) where the arbitrator fails to consider the terms of the contract; and f) if arbitrator fails to provide reasons which forms the basis of the award.

Based on all the principles cited above, the two judge bench in Ansaldo case affirmed the arbitral award substantively, and only modified the award to a limited extent that only one out of the three

[2] (2015) 3 SCC 49
[3] (1994) Supp. 1 SCC 644
[4] (2003) 5 SCC 705
[5] (2008) 13 SCC 80

guarantees (performance bank guarantee) shall be refunded, while the two bank guarantees against which the Board had already advanced requisite payments will not be refunded. This was based on the reasoning the Arbitral Tribunal had not awarded damages but had directed the Board to refund the amounts of the bank guarantees involving the amounts actually spent by Ansaldo.

Analysis:

An Arbitral Award is the preferred dispute resolution mechanism for most contractual arrangements. The sanctity and finality of an arbitral award is therefore critical to ensure that there is speedy resolution of commercial disputes, and ease of doing business within a particular jurisdiction is maintained. The review of this case is significant from this perspective.

The Ansaldo case has once again reaffirmed the principle that an arbitral award is sacrosanct unless it is challenged specifically on the grounds provided under Section 34 of the Act. This case highlights the astute application of the principle that arbitrator is the sole judge with respect to quality and quantity of facts: hence, the Supreme Court in this case did not differ from the findings of the Arbitral Tribunal or sit as a Court of Appeal by re-appreciating evidence.

In case of any queries or clarifications on this subject, please feel free to reach out Sayli Petiwale, Associate, Aureus Law Partners at http://sayli.petwale@aureuslaw.com. Views are personal.