

ARBITRATOR'S DISCRETION: BALANCING CONTRACTUAL PROVISIONS WITH JUSTICE

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Introduction

Alternative Dispute Resolution [“ADR”] mechanisms have gained significant traction in India due to their efficiency, flexibility, and adaptability in resolving disputes. Amongst these, arbitration stands out as a preferred method, offering parties a way to resolve their disputes outside of traditional court litigation and by choosing subject matter experts to adjudicate over technical disputes. However, arbitrators being creatures of a contract, it has been a matter of debate as to whether an arbitrator can transcend beyond the mandate of a contract if the disputes require so, to do justice.

Arbitrations are required to operate within the framework of contractual provisions agreed upon by the parties involved. However, arbitrators have the liberty to employ equitable principles while interpreting contractual terms, albeit being the four corners of the contract. As such, while parties may establish the parameters of arbitration through contractual agreements, arbitrators possess expansive powers to interpret these provisions and ensure fairness, equity, and compliance with public policy, even if it means deviating from strict adherence to contractual terms. This flexibility allows arbitrators to address unforeseen circumstances, fill gaps in contracts (*though it does not imply rewriting of contract*), consider equitable principles, and craft remedies tailored to the specific needs of the dispute. Ultimately, the authority of arbitrators to transcend contractual provisions highlights their crucial role in delivering justice effectively within the ADR framework. This article through certain instances (*specifically pertaining to contractual limitation to claim damages*) explores the expansive scope of arbitrators' powers in India to adjudicate disputes pertaining to construction contracts. The article further explores the extent of authority and discretion vested in arbitrators to administer justice to the parties involved while respecting the contours within which they are expected to function.

Challenges in Construction Contracts and arbitrator's scope of discretion

An arbitrator's discretion to award damages in construction contracts is vital for ensuring fairness and effectiveness in resolving disputes, as a majority of the construction contracts are lumpsum turnkey contracts, plagued with delays and instances of unforeseen variations during execution. While construction contracts often include provisions outlining damages for delays, change of scope and escalation of prices, the arbitrators in this context have the flexibility to interpret these terms in a relevant factual context, wherein strict application of contractual provisions may have led to unjust outcomes, as will be detailed further in the subsequent paragraphs. Their discretion allows them to consider various factors, such as the reasons for the delay, the impact on the parties involved, and any extenuating circumstances. Moreover, arbitrators may also deviate from strict interpretation of contractual provisions by using equitable principles if the former would lead to an unjust outcome. The remedies that an arbitrator provides, as traced through evolving jurisprudence, include awarding damages beyond what is explicitly provided in the contract, taking into account the factual circumstances and factors. This discretion enables arbitrators to deliver comprehensive justice and maintain the integrity of the construction industry's dispute resolution process.

Change of contractor's scope of work vis-à-vis contractual limitations

Construction contracts usually contain specific provisions dealing with the allocation of risk regarding scope changes in lumpsum turnkey projects. In lumpsum contracts, the contractor undertakes to finish the project for a predetermined price. However, when there is an expansion in the scope of work, the question arises as to whether a contractor should be entitled to additional costs. This is where the discretion of an arbitrator assumes relevance. In the recent Delhi High Court judgment in *Dedicated Freight Corridor Corporation of India Ltd. v Tata Aldesa*,¹ ["**DFCCIL**"] a contractor incurred additional costs in a railway project due to an increase in the size of roads and bridges ["**RUB**"] related work. As per Clause 2.0 of part 2, volume 1 of the agreement signed between the parties, changes in the list of bridges and other structures shall be considered as 'variation'. Accordingly, the employer contended that this was a minor deviation in the lump sum contract, and not a variation entitling the contractor to additional costs. The arbitral tribunal ["**Tribunal**"] categorically rejected the employer's arguments on the grounds that the variation provision in the contract was broad enough to cover changes in the size of RUBs as well and was not limited to a variation of list of bridges and structures. Moreover, the Tribunal held that such modifications were beyond the contractor's ability to foresee or assess during the bidding process,

¹ *Dedicated Freight Corridor Corpn. of India Ltd. v Tata Aldesa JV* (2023) SCC OnLine Del 5242.

thereby rendering it unjust to expect bidders to account for costs subject to significant fluctuations that might arise from unpredictable increases in scope, type, and magnitude during execution. Consequently, it is inequitable to maintain the position that, in lumpsum contracts, the entirety of the risks associated with scope modifications are borne by the contractor. This judgement is a classic example of an arbitrator exercising its wisdom through the tools of equitable principles while being in the four corners of the contractual provision in order to ensure that the adjudication of a matter is done as a *wise man* who is not bound by the judicial knots.

Employer's delay and Arbitrator's remedial damages vis-à-vis contractual limitations

In construction contracts, when an employer's failure to meet its contractual obligations or delays due to reasons not attributable to the contractor impacts the work schedule, the arbitrator possesses the authority to award compensation to the contractor for the additional costs it incurred even if the contract provides an extension of time to be the sole remedy available to the contractor. The Supreme Court in the case of *K.N. Sathyapalan v State of Kerala and Anr.*² [**K.N. Sathyapalan**] held that,

“Ordinarily, the parties would be bound by the terms agreed upon in the contract, but in the event one of the parties to the contract is unable to fulfil its obligations under the contract which has a direct bearing on the work to be executed by the other party, the Arbitrator is vested with the authority to compensate the second party for the extra costs incurred by him as a result of failure of the first party to live up to its obligations”

In this case, the Court further determined that when the contractor encounters obstructions beyond its control, leading to an inability to fulfill its contractual obligations within the prescribed baseline schedule, strict adherence to the contractual terms must give way to a rather equitable interpretation of the contractual terms.

In *P.M. Paul v Union of India*,³ [**P.M. Paul**] the dispute before the arbitrator was in relation to the claim of the contractor towards escalation price. The arbitrator was seized of the issues pertaining to the delay in the completion of project and the corresponding escalation of prices, wherein the contractual provisions were limited to extension of time being the sole remedy. The arbitrator rendered its finding on delay causation and held that there was a corresponding escalation of cost and price in the additional time that resulted in the contractor incurring additional costs for execution. Thus, the arbitrator concluded that it was reasonable to allow 20% of the compensation under the claim. Accordingly, the arbitrator allowed the same, exercising its discretion in employing

² *K.N. Sathyapalan v State of Kerala* (2007) 13 SCC 43.

³ *P.M. Paul v Union of India* 1989 Supp (1) SCC 368.

equitable tools for interpreting the contract. The Supreme Court, while dealing with the objection to the jurisdiction and scope of the arbitrator's power in travelling beyond the contours of the contract, observed as follows while upholding the decision of the arbitrator:

“Escalation is a normal incident arising out of gap of time in this inflationary age in performing any contract. The arbitrator has held that there was delay, and he has further referred to this aspect in his award. The arbitrator has noted that Claim I related to the losses caused due to increase in prices of materials and cost of labour and transport during the extended period of contract from 9-5-1980 for the work under phase I, and from 9-11-1980 for the work under phase II. The total amount shown was Rs 5,47,618.50. After discussing the evidence and the submissions the arbitrator found that it was evident that there was escalation and, therefore, he came to the conclusion that it was reasonable to allow 20 per cent of the compensation under Claim I, he has accordingly allowed the same. This was a matter which was within the jurisdiction of the arbitrator and, hence, the arbitrator had not misconducted himself in awarding the amount as he has done.”

Likewise, in a recent ruling of the Delhi High Court, the court emphasized upon the arbitral tribunal's power to recognize a contractor's entitlement to compensation regardless of contractual provision limiting extension of time to be the sole remedy. The Court in *Ircon International Ltd. v Delhi Metro Rail Corp.*⁴ [**“Ircon International”**] while dealing with a dispute concerning a railways construction project, affirmed the arbitrator's finding which recognized that the delay of 18 months in the completion of the project was on account of the employer's site handover issues. It further upheld the arbitrator's award saying that in such cases, despite the contract providing for an extension of time [**“EOT”**] for such delays to be the sole remedy, the contractor's claim to compensation irrespective of the contractual prescription can be allowed. The Delhi High Court as the Court dealing with objection to the award in terms of Section 34 of the Arbitration and Conciliation Act, 1996, found that through the EOT letters, the contractor has also notified the employer of such additional costs incurred.

In *Asian Tech Ltd. v Union of India*,⁵ [**“Asian Tech”**] the Supreme Court held that a provision disallowing compensation for delays caused by the employer does not preclude an arbitrator from granting damages to the contractor, particularly in circumstances where the employer had given assurances to the contractor regarding the resolution of rates through negotiation. Once again, the arbitrator's approach of looking beyond the veil of contractual provisions through the lens of equitable principles was considered appropriate and within its scope.

⁴ *Ircon International Ltd. v DMRC* (2023) SCC OnLine Del 6368.

⁵ *Asian Tech Limited v Union of India* (2009) 10 SCC 354.

Final analysis

In the realm of dispute resolution, the role of an arbitrator is often likened to that of a wise sage rather than a strict judge. In this context, the Supreme Court in the decision of *Associate Builders v Delhi Development Authority*⁶ [**Associated Builders**] observed as follows:

“Thus, an award based on little evidence or on evidence which does not measure up in quality to a trained mind would not be invalid on this score [Very often an arbitrator is a lay person not necessarily trained in law. Lord Mansfield, a famous English Judge, once advised a high military officer in Jamaica who needed to act as Judge as follows: “General, you have a sound head, and a good head, and a good heart; take courage and you will do very well, in your occupation, in a court of equity. My advice is, to make your decrees as your head and heart dictate, to hear both sides patiently, to decide with firmness in the best manner you can, but be careful not to assign your reasons, since your determination may be substantially right, although your reasons may be very bad, or essentially wrong”. It is very important to bear this in mind when awards of lay arbitrators are challenged.]”

The above-mentioned discussion is an attempt to highlight that in arbitration, contractual provisions do not serve as absolute constraints, as the arbitrator possesses considerable latitude to adjudicate based on factual circumstances and merits of the case. When wielded judiciously, arbitration exhibits a broad and sagacious scope, offering flexibility to address the complexities inherent in disputes. The rationale for opting arbitration as a mode of ADR includes its expeditious resolution and maintaining confidentiality among other factors. Nonetheless, parties ultimately seek justice, a concept not always achievable through rigid procedures, necessitating flexibility. Through this paper, the authors have utilized a nuanced illustration of construction arbitrations to demonstrate how the application of equitable principles by arbitrators can lead to a more justifiable administration of justice. The arbitrator while adjudicating a matter must respect the ethos of ADR i.e., flexibility and adaptability. Hence, the arbitrators while embracing their role as wise arbiters, must ensure that they uphold the integrity of the process, promote fairness, and maintain the delicate balance between honoring contractual confines and dispensing just and fair reliefs to the aggrieved party.

⁶ *Associate Builders v Delhi Development Authority* (2015) 3 SCC 49.