



SC PARTIALLY MODIFIES AWARD TO EXCLUDE REFUND OF BANK GUARANTEE

M.P. Power Generation Co. Ltd & Anr. v. Ansaldo Energia Spa & Anr.¹ (January 16, 2018)

INTRODUCTION

- 1) In an appeal to set aside an arbitral award on the grounds of patent illegality and conflict with public policy, the Supreme Court examined the conditional bank guarantees and determined whether the invocation was premature, wrongful, and illegal. While the award held that the claimant was entitled to the claim amount including the refund of the amounts encashed under the bank guarantees, the Supreme Court partially modified the award to exclude the claim for refund.

BACKGROUND

- 2) M.P. Power Generation Co. Ltd. ("**MPG**") issued a letter of intent dated 11 May 1999 in favor of Ansaldo Energia Spa and Anr. ("**Ansaldo**") to refurbish thermal power plants. MPG and Ansaldo entered into an Overall Coordination Agreement dated 24 August 1999 under which the parties entered into three contracts i.e. Offshore Supply Contract, Onshore Supply Contract, and Onshore Supply Contract (collectively referred to as "**Agreement**").
- 3) In accordance with the Agreement, Ansaldo furnished two conditional bank guarantees, towards the advance payment to be made to MPG ("**Bank Guarantees**"). An unconditional bank guarantee was also executed by ANZ Grindlays Bank Limited, on behalf of Ansaldo, towards the performance guarantee ("**Performance Guarantee**").
- 4) On 23 June 2001, MPG invoked the Bank Guarantees and the Performance Guarantee on the ground that Ansaldo breached its obligations under the Agreement. Disputes arose between the parties and Ansaldo invoked the arbitration clause in the Agreement. The tribunal passed an Award dated 23 September 2004, in favor of Ansaldo ("**Award**").
- 5) Through the Award, the tribunal, among other things, held MPG liable for (i) misrepresentation of the capacity of the plant and operating parameters; (ii) acting in breach of the Agreement by failing to furnish the letter of comfort; (iii) unlawful termination of the Agreement; and (iv) wrongful encashment of the Bank Guarantees. The Award directed MPG to refund the amounts under the Bank Guarantees and the Performance Guarantee to Ansaldo.
- 6) MPG filed an application under Section 34 of the Arbitration and Conciliation Act, 1996 ("**the Act**"), before the 7th Additional District Judge, Jabalpur ("**ADJ**") to set aside the Award. The ADJ partially set aside the Award through an order. The ADJ set aside that portion of the Award which related to- the encashment of the three guarantees, and the claim amount specified in the Award.
- 7) Ansaldo filed an appeal before the High Court to challenge the order passed by the ADJ. Upon examining the conditions in the Bank Guarantees, the High Court observed that '*non-fulfillment of contractual obligations*' was a precondition to invoking the Bank Guarantees. The High Court held that MPG was precluded from invoking the Bank Guarantees until MPG proved that Ansaldo breached its contractual obligations. The High Court set aside the decision of the ADJ and upheld the Award ("**Order**"). Aggrieved by the Order, MPG filed a special leave petition before the Supreme Court ("**SC**").

ANALYSIS OF THE SUPREME COURT

- 8) In the Civil Appeal before the apex court, MPG challenged the Award on the ground that (i) the Award suffered from fundamental flaws; (ii) the Award is perverse and vitiated due to patent illegality; (iii) the tribunal has failed to take a judicial approach; (iv) the finding of tribunal that MPG is liable for misrepresentation is incorrect; and that (iv) the finding that the invocation of the Bank Guarantees was wrongful is improper;
- 9) Relying upon *Renusagar Power*² and *ONGC*³, the SC reiterated that "*illegality must go to the root of the matter and incase the illegality is of trivial nature it cannot be held that the award is against public policy*" and that "*an award could also be set aside if it is so unfair and unreasonable that it shocks the conscience of the Court*".
- 10) The SC relied upon *Delhi Development Authority*⁴, and observed that the court can interfere with an award when "*it is contrary to (a) substantive provisions of law; or (b) provisions of the 1996 Act; or (c) against the terms of the respective contract; or (d)*

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

² *Renusagar Power Co, Ltd. v. General Electric Co.*, (1994) Supp. 1 SCC 644

³ *ONGC v. Saw Pipes*, (2003) 5 SCC 705

prejudicial to the rights of the parties”.

- 11) Relying upon its ruling in *Western Geco*⁵, the SC observed that *“the award of the Arbitral Tribunal is open to challenge when the arbitrators fail to draw an inference which ought to be drawn or if they had drawn an inference which on the face of it is untenable resulting in miscarriage of justice. The Court has the power to modify the offending part of the award in case it is severable from the rest...”.*


OBSERVATIONS

- 12) While the SC agreed with the findings in the Award regarding the issues of misrepresentation, breach of contract, and wrongful termination of contract, it diverged on the issue of whether Ansaldo was entitled to a refund of the amounts encashed under the bank guarantees.
- 13) Upon perusing the Award, the SC observed that *“In view of the finding of the finding of the Arbitral Tribunal the Board [MPG] committed a serious breach of contract and wrongfully terminated the contract, the Claimant [Ansaldo] was held to be entitled to return of the amounts for which the Bank Guarantees were given.”* The SC held that the tribunal *“failed to take notice of the fact that the other two Bank Guarantees were given for the amounts to be advanced by the Board [MPG]. In fact, the Board had advanced the said amounts to the Claimants”.*
- 14) The SC concluded that while Ansaldo is entitled to a refund of the amount given under the Performance Guarantee, it was not entitled to return of the amounts given under the Bank Guarantees. The SC held that the Award did not grant damages to Ansaldo and only directed return of the amounts spent by Ansaldo in actuals.

CONCLUSION

- 15) The SC partially modified the Award and set aside that part of the Award which granted Ansaldo refund of the amount encashed under the Bank Guarantees. The SC dismissed the appeal filed by MPG with the said modification.
- 16) Sub-section (2-A) in Section 34 of the amended Act, provides that an award arising out of arbitrations, other than international commercial arbitrations, may be set aside by the court if the court finds that the award is vitiated by patent illegality appearing on the face of the award. The proviso to sub-section (2-A) limits the interference by the courts and clarifies that an award shall not be set aside merely on the ground of an erroneous application of the law or by re-appreciation of evidence.
- 17) The apex court did not interfere with the findings of fact made in the Award. Therefore, the Supreme Court upheld the settled position of law that the court under Section 34(2) of the Act does not act as a court of appeal while applying the ground of ‘public policy’ to an award and consequently errors of fact cannot be corrected. An award can be challenged under Section 34 of the Act only on the limited grounds set out therein and cannot be used to re-examine evidence and re-agitate issues which have already been decided by the arbitrator.

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⁴ *Delhi Development Authority v. M/s. R.S. Sharma & Co.*, (2008) 13 SCC 80

⁵ *ONGC Ltd. v. Western Genco International Co. Ltd.*, (2014) 9 SCC 263