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ARBITRATION AND CONCILIATION

Bombay High Court Sets Aside Arbitral Award in Nayara Energy Dealership Dispute: Reaffirming Limits of Arbitral Powers in Commercial Contracts

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Introduction

The decision of the Bombay High Court in *Nayara Energy Ltd. v. M/s. Mahendra Sales Services* marks an important development in Indian arbitration jurisprudence concerning dealership agreements, determinable contracts, and the limits of arbitral intervention in private commercial arrangements. The judgment delivered by Justice Sharmila U. Deshmukh on 6th May 2026 revisits the scope of judicial review under Section 34 of the Arbitration and Conciliation Act, 1996 and clarifies that arbitral tribunals cannot import principles of equity and fairness into commercial contracts contrary to their express terms. The case arose from a petrol pump dealership dispute between Nayara Energy Ltd. (formerly Essar Oil Ltd.) and M/s. Mahendra Sales Services regarding termination of a franchise agreement and restoration of dealership rights. The Court ultimately quashed the arbitral award holding that it suffered from patent illegality and was contrary to substantive law.

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Factual Background

The dispute originated in 2005 when Nayara Energy appointed M/s. Mahendra Sales Services, a sole proprietorship concern of Mahendra Bagrecha, as a franchisee for operating a retail petroleum outlet in Rajasthan. A Lease Deed was executed on 21 October 2005 and a Franchise Agreement followed on 10 April 2006. The agreement imposed several obligations upon the franchisee, including bearing the costs of construction and operationalization of the retail outlet and achieving minimum monthly sales targets. Subsequently, on 1 May 2009, Smt. Nanita Jain expressed interest in replacing Mahendra Bagrecha as proprietor of the franchise concern. Thereafter, a declaration-cum-indemnity was executed, and Nayara Energy itself addressed a communication to the District Supply Officer recognizing Nanita Jain as the proprietor of M/s. Mahendra Sales Services. Petroleum products were also supplied to the outlet on 28 July 2009.

Despite these developments, the retail outlet allegedly failed to achieve the agreed sales targets. Nayara Energy issued multiple communications pointing out poor sales performance and eventually terminated the Franchise Agreement on 29 December 2010 under Clause 14(b) of the agreement. Nanita Jain challenged the termination and she alleged that substantial investments had been made pursuant to assurances and representations of the company. She further contended that the company stopped supplying petroleum products and terminated the agreement without notice or opportunity of hearing.

Arbitration Proceedings

The dispute was subsequently referred to arbitration through proceedings initiated under Section 11 of the Arbitration and Conciliation Act, 1996 for appointment of a sole arbitrator. During the arbitral proceedings, the claimant, M/s. Mahendra Sales Services through its proprietor Smt. Nanita Jain, raised extensive monetary claims aggregating to approximately Rs. 45 lakh. The claims primarily related to the alleged financial losses suffered by the claimant on account of the termination of the dealership arrangement and included reimbursement towards the purchase of land for the retail outlet, expenses incurred for machinery and petrol pump equipment, opportunity costs and loss of earnings arising from the non-operational status of the outlet, as well as lease rent and other consequential losses. The claimant contended that substantial investments had been made on the basis of assurances and representations of the company and that the dealership was illegally terminated without proper justification or opportunity of hearing.

Upon considering the pleadings and material placed on record, the learned Arbitral Tribunal arrived at the conclusion that a valid and subsisting contractual relationship existed between Nayara Energy Ltd. and M/s. Mahendra Sales Services represented by Smt. Nanita Jain, despite the absence of a freshly executed franchise agreement in her name. The tribunal relied upon the

conduct of the parties, including the recognition of Nanita Jain as proprietor and the supply of petroleum products to the outlet, to hold that the claimant had effectively stepped into the shoes of the earlier proprietor. The tribunal further held that the termination of the dealership agreement by Nayara Energy Ltd. on 29 December 2010 was illegal and violative of principles of natural justice, primarily on the ground that no prior notice or opportunity of hearing had been granted before terminating the dealership. Consequently, the tribunal awarded compensation of Rs. 4 lakh in favour of the claimant towards loss and depreciation of machinery and equipment installed at the retail outlet, along with interest at the rate of 6% per annum from 28 July 2009 till actual realization. In addition to the monetary compensation, the arbitral tribunal also directed restoration of the dealership in favour of M/s. Mahendra Sales Services and ordered that Smt. Nanita Jain be treated as the lawful proprietor of the dealership concern. However, while granting partial relief, the tribunal rejected the claimant's demands relating to reimbursement of land purchase cost, loss of future earnings, and lease rent, holding that those claims were either unsupported or not maintainable in the facts of the case.

Challenge Before the Bombay High Court

Aggrieved by the arbitral award dated 18 January 2023, Nayara Energy Ltd. approached the Bombay High Court under Section 34 of the Arbitration and Conciliation Act, 1996 seeking to set aside the award on multiple grounds. The company primarily contended that there existed no formally executed Franchise Agreement between Nayara Energy Ltd. and Smt. Nanita Jain and therefore the arbitral tribunal erred in concluding that a valid contractual relationship subsisted between the parties. It was further argued that the learned Arbitrator had improperly imported principles of natural justice into a purely private commercial arrangement despite the Franchise Agreement expressly permitting termination for breach without any requirement of prior notice or hearing. Nayara Energy also challenged the award of compensation of Rs. 4 lakh towards machinery and equipment loss on the ground that the same was granted without any supporting pleadings, valuation documents, or evidentiary material establishing actual loss or depreciation. The company additionally submitted that the arbitral tribunal had acted contrary to settled principles of contract law by directing restoration of the dealership agreement, as such dealership contracts are determinable in nature and therefore incapable of specific performance under Section 14(1)(c) of the Specific Relief Act, 1963. On the other hand, the respondent strongly defended the arbitral award by arguing that the conduct of the parties, including recognition of Smt. Nanita Jain as proprietor and supply of petroleum products to the outlet, clearly established privity of contract between the parties. The respondent further contended that the arbitral award was based upon appreciation of evidence and contractual conduct and did not suffer from perversity, patent illegality, or violation of public policy warranting interference under Section 34 of the Arbitration Act.

Findings of the Bombay High Court

The Court first upheld the arbitrator's finding regarding existence of privity of contract. It observed that Nayara Energy had recognized Nanita Jain as proprietor, accepted her induction, and supplied products to the outlet. These acts clearly established contractual relations between the parties. However, the Court simultaneously held that Nanita Jain had stepped into the shoes of the earlier proprietor and therefore inherited all prior liabilities and defaults under the agreement. Since the minimum sales targets had admittedly not been achieved, the company was entitled to invoke the termination clause. The Court held that the arbitrator erred in importing principles of natural justice into the contractual framework. The arbitrator had set aside the termination solely on the basis that no hearing or prior notice had been granted before termination.

The Court held that the Franchise Agreement expressly permitted termination forthwith for breach and did not require issuance of prior notice. According to the Court, an arbitral tribunal cannot rewrite commercial contracts based on notions of fairness and equity unless parties expressly authorize adjudication on equitable principles under Section 28(2) of the Arbitration Act. Since the arbitrator ignored the contractual terms and relied exclusively on equitable considerations, the award violated substantive law and became vulnerable to challenge under Section 34. The Court further held that even assuming the termination was illegal, restoration of the dealership could not have been granted. The dealership agreement was determinable in nature and therefore incapable of specific performance under Section 14(1)(c) of the Specific Relief Act, 1963. The only permissible remedy in such cases would be damages.

The Court also found that the award of Rs. 4 lakh compensation was unsupported by pleadings and evidence. There was no valuation material, no proof regarding deterioration of machinery, and no evidence substantiating the quantum claimed. The arbitrator wrongly shifted the burden onto Nayara Energy to disprove the claim instead of requiring the claimant to establish damages.

Accordingly, the Bombay High Court quashed and set aside the entire arbitral award dated 18 January 2023.

Significance of the Judgment

This judgment is significant for several reasons.

1. First, it reinforces the principle that arbitral tribunals are bound by the terms of the contract and cannot substitute contractual obligations with equitable considerations. The decision reiterates that arbitral autonomy does not extend to rewriting private commercial bargains.
2. Second, the judgment provides clarity regarding determinable contracts such as dealership, distributorship, and franchise agreements. By relying upon the principle laid down in Indian Oil Corporation Ltd. v. Amritsar Gas Service, the Court reaffirmed that restoration or specific performance of such contracts is ordinarily barred.
3. Third, the ruling highlights the evidentiary burden in arbitration proceedings. Claims for damages cannot succeed merely because the opposing party failed to rebut them. Proper pleadings and evidence remain essential even in arbitral proceedings.
4. Fourth, the judgment demonstrates the contours of “patent illegality” under Section 34(2A). Awards contrary to contractual terms, unsupported by evidence, or violative of substantive law are liable to be interfered with by courts.

Finally, the case is a caution to arbitrators dealing with commercial disputes. While principles of fairness may appear attractive, arbitral tribunals must remain confined to the legal framework agreed upon by parties.

Conclusion

The Bombay High Court’s ruling in *Nayara Energy Ltd. v. M/s. Mahendra Sales Services* is an important reaffirmation of contractual sanctity in arbitration law. The judgment carefully balances minimal judicial interference with the need to prevent arbitral awards that disregard contractual provisions and substantive law. By setting aside the award, the Court clarified that arbitral tribunals cannot restore determinable commercial contracts or grant compensation unsupported by evidence. The decision will likely have substantial implications for future franchise, dealership, and distributorship disputes in India.

The matter was argued on behalf of the Petitioner, Nayara Energy Ltd., by Mr. Rohan Kelkar along with Ms. Aayushi Doshi and Ms. Surbhi Ahuja instructed by IndiaLaw LLP.

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