Public Policy" A Double-Edged Sword under Sec. 34 of the Arbitration and Conciliation Act, 1996

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Abstract

The method of arbitration has evolved over the period of time to help the parties to speedily resolve their disputes through this process and in fact the Arbitration and Conciliation Act,1996 recognizes this aspect and has elaborate provisions to provide to the needs of speedy disposal of disputes. The object of the Act is to see that the proceedings come to finality without the intervention of the court, unless intervention by the court is warranted in a given case and the same is warranted by law.

The present paper is an attempt to analyze the importance of the term "public policy" under Sec. 34 of the Arbitration and Conciliation Act, 1996. The concept of public policy connotes some matter which concerns public good and the public interest. Sec. 34(2)(b) of the Act clearly explains as to what the legislature intended when it provides that an award deserves to be set aside when it is in conflict with public policy of India. Restrictions have also been put on the Courts/judicial authorities intervening during the course of arbitral proceedings. The main objectives of the 1996 Act, amongst others, are to make provision for an arbitral procedure which is fair, efficient and capable of meeting the needs of the specific arbitration; to provide that the arbitral tribunal gives reasons for its final award; to ensure that the tribunal remains within the limits of its jurisdiction; to minimize the supervisory role of the courts in the arbitral process; to provide that every final arbitral award is enforced in the same manner as if it were a decree of the court.

The courts cannot interfere with an award on issues concerning default, time being an essence, readiness, and willingness etc. because these are all issues of fact. Interference is permissible by the court only if the subject-matter of the dispute is not capable of settlement by arbitration or the arbitral award is in conflict with the public policy of India.

Thus this paper tries to highlight the extent of judicial intervention in arbitral process on the ground of "public policy" under Sec. 34 of the Act and attempts to make out how the judiciary has utilized this term as a groung for setting aside the arbitral award.

KEYWORDS: Public policy, Judiciary and arbitration, Judicial intervention, arbitration, arbitral process.

"The harsh truth is that we may be on our way to a society overrun by hordes of lawyers, hungry as locusts, and bridges of judges in numbers never before

contemplated. The notion that ordinary people want black robed judges, well-dressed lawyers, and fine paneled Court rooms as the setting to resolve their disputes, is not correct. People with legal problems like people with pain, want relief and they want it as quickly and inexpensively as possible".[1]

-Justice Warren Burger, former CJI of American Supreme Court

Disputes and differences in business dealings are common. The overburdened Courts and the judiciary in our country, is a proof of this. But a dispute must be resolved expeditiously. Unresolved disputes in business hinder its smooth flow and future growth, particularly in international trade. A dispute is normally resolved by way of litigation or through Alternative Dispute Resolution (ADR) mechanism.[2]

Alternative Dispute Resolution was conceived of, as a dispute resolution mechanism outside the courts of law, in this sense, ADR covers arbitration as also conciliation, mediation and all other forms of dispute resolution outside the courts of law. To be arbitrated disputes must arise out of legal relationship, whether contractual or otherwise. There should be no other exclusive forum created to resolve the dispute. In arbitration, there is final and binding award, whether the parties consent to it or not, but in other forms of ADR there would be no finality, except with the consent of the parties. The protagonists of ADR claimed that, whereas in arbitration one party may win and other may lose, or may be both may lose-as in a court case, in ADR it is a "win-win" situation because the parties would agree to a disposal of the matter on terms comfortable to each of them. In ADR, in this sense, it is not "dispute" or "difference" between the parties that is addressed, but the mindset of the parties, so that with gradual change in the mindset eventually both sides come to a meeting point.[3] However, it is to be noted that arbitration is participatory and the parties to the dispute have the privilege of getting their dispute resolved by the arbiters of their choice.

Under the Arbitration Act of 1940, the resolution of disputes could not attain finality due the fact that arbitral awards were challenged invariably on various grounds. In M/s Guru Nanak Foundation v. M/s. Rattan Singh & Sons,[4] the Supreme Court observed, thus:-

> "Interminable, time consuming, complex and expensive court procedures impelled jurists to search for an alternative forum, less formal, more effective and speedy for resolution of disputes avoiding procedural claptrap and this led them to Arbitration Act, 1940. However, the way in which the proceedings under

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[1] Hon'ble Justice S. B. Sinha, "ADR and Access to Justice: Issues and Perspectives", cited by Abhinay Kapoor, 'Scope of Judicial Intervention in Arbitration and Conciliation Act, 1996', *Indian Council of Arbitration*, Vol. XLVII/ July-September 2010, edited by Ms. Shazia Usmani, p. 24

[2] Pawan Agarwal, 'Arbitration and Conciliation Act, *SEBI & Corporate Laws Magazine*, Vol. 56, 2004, p.61

[3] Sri. M. V. Shankar Bhat, 'An Appraisal of Alternative Dispute Resolution', *Legal Opus*, Mangalore Journal, p. 10.

[4] *AIR* 1981 SC 2075

> the Act are conducted and without an exception challenged in Courts, has made lawyers laugh and legal philosophers weep. Experience shows and law reports bear ample testimony that the proceedings under the Act have become highly technical accompanied by unending prolixity, at every stage providing a legal trap to the unwary. Informal forum chosen by the parties for expeditious disposal of their disputes has by the decisions of the Courts been clothed with 'legalese' of unforeseeable complexity."

This along with several other factors indicated the need for a comprehensive new legislation to remove the deficiencies and to make arbitration an effective ADR mechanism. Further, the Government of India realized that for effective implementation of its economic reforms it was necessary to recognize the demand of the business community in India and investors abroad for reforms in the law of arbitration in India. In Food Corporation of India v. Joginderpal Mohinderpal,[5]the Supreme Court also observed:

> "We should make the law of arbitration simple, less technical and more responsible to the actual realities of the situations but must be responsive to the canons of justice and fair play and make the arbitrator adhere to such process and norms which will create confidence not only by doing justice between the parties, but by creating sense that justice appears to have been done".[6]

As a result The Arbitration and Conciliation Act, 1996 was enacted by Parliament based on the United Nations Commission on International Trade Law (UNCITRAL) Model Law. Whenever a comprehensive new law is made repealing an old law, the object is to have a more efficient and effective law to serve the country. The shortcomings and lacunae found in implementing and operating the old law and the steps required to rectify such shortcomings become the basis for making the new law. But, it is to be noted that the 1996 Act is not based on the experience gained with reference to Arbitration Act, 1940, but based on the UNCITRAL Model Law with the object of having uniformity with International community in regard to law relating to arbitration.[7]

The main object of the 1996 Act is for early resolution of disputes once the arbitral tribunal enters upon reference. Procedural defects in the 1940 Act have been sought to be removed by 1996 Act. Restrictions have also been put on the Courts/judicial authorities intervening during the course of arbitral proceedings. The main objectives of the 1996 Act, amongst others, are to make provision for an arbitral procedure which is fair, efficient and capable of meeting the needs of the specific arbitration; to provide that the arbitral tribunal gives reasons for its final award; to ensure that the tribunal remains within the limits of its jurisdiction; to minimize the supervisory role of the courts in the

[5] *AIR* 1989 SC 1263

[6] J. S Verma, "International Arbitration", in P. C. Rao & William Sheffield, ed., *Alternative Dispute Resolution*, (Delhi: Universal Law Publishing Co. Pvt. Ltd., 1997) p. 15

[7] Justice R. V. Raveendran, 'What Ails Indian Arbitration', (2013) 1 *SCC* (J), p. J-56.

arbitral process; to provide that every final arbitral award is enforced in the same manner as if it were a decree of the court.[8]

The Act unequivocally indicates the limits of intervention of the Court with arbitral process to the minimum and it is certainly not the legislative intent that each and every order passed by an authority under the Act would be a subject matter of judicial scrutiny by the Court of law. Under the 1996 Act, the grounds on which an arbitral award could be challenged before the court have been severely cut down and such challenge is now permitted on the basis of invalidity of the agreement, want of jurisdiction on the part of the arbitrator or want of proper notice to a party of the appointment of arbitrator or of arbitral proceedings.[9]

GROUNDS FOR SETTING ASIDE OF AWARD

An aggrieved party can take recourse to the Court by filing an application challenging the award under Sec. 34 of the 1996 Act. It is a sort of an appeal against the award though Sec. 34 does not refer the term 'appeal' but the aim and object of this section is to give party a forum to challenge the award. Section 34(1) gives jurisdiction to entertain the challenge to an award to a Court as defined in c[10]. This section gives power and jurisdiction to set aside the award if the contingency and case is made out by the party as contemplated under Sec. 34(2) of the Act.

The old Arbitration Act, 1940 enabled a party aggrieved by an award to challenge it on the ground of errors apparent on the face of the award or on the ground that the arbitrator has misconduct himself or the proceedings or on the ground that it is invalid. The new Act does not have similar grounds for setting aside the awards. As a result, even if there were patently illegal awards, there was no way to set aside such awards. [11]

Application for Setting Aside Award:

Sub-section 1 of Sec. 34 deals with application for setting aside arbitral award and provides that recourse to a Court against an arbitral award may be made only by an application for setting aside award in accordance with sub-sec (2) and sub-sec (3). It is thus clear that if a party desires to challenge the award, it has necessarily to file an application in the competent Court for setting aside the award.

The objections filed under Sec. 34 of the 1996 Act have to be first tested on the touchstone of the provisions of the Sec. 34 of the Act itself; and only when the Court finds that the objections raised in the petition are covered by any of the grounds

[8] Dr. P. C. Markanda and et al., *Law relating to Arbitration and Conciliation*, (18th Edn., Lexis Nexis Butterworths Wadhwa, Nagpur 2013), p. 17

[9] *Ibid*, p. 18

[10] Sec. 2(1)(e)- "Court" means- (i) in the case of an arbitration other than international commercial arbitration, the principal Civil Court of original jurisdiction in a district, and includes the High Court in exercise of its ordinary original civil jurisdiction having jurisdiction to decide the questions forming the subject –matter of a suit, but does not include any Civil Court of a grade inferior to such principal Civil Court, or any Court of Small Causes;
(ii) in the case of international commercial arbitration, the High Court in exercise of its ordinary original civil jurisdiction, having jurisdiction to decide the questions forming the subject-matter of the arbitration if the same had been the subject-matter of a suit, and in other cases, a High Court having jurisdiction to hear appeals from decrees of Courts subordinate to that High Court.

[11] *Supra Note* (7), p. J-57

mentioned therein, the Court may consider the same and proceed to dispose them of on merits. The 1996 Act has reduced and limited the scope for challenging the award to such an extent that recourse to a Court against an award is open only in following eventualities:

(i) If the party challenging the award furnishes proof that he was under some incapacity;
(ii) That the agreement was not valid under the law;
(iii) That he was not given a proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case;
(iv) That the award deals with a dispute not referred to or not falling within the terms of the agreement;
(v) If the award contains decisions on matters beyond the scope of the submission to arbitration, only when if the decisions on matters submitted to arbitration can be separated from those not so submitted and in that case only the severable part is liable to be set aside;
(vi) If the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties;
(vii) If the subject matter of the dispute is found in the opinion of the Court not capable of settlement by arbitration under the law;
(viii) If the arbitral award is in conflict with the public policy of India.

Grounds for setting aside the award have been laid down in sub-sec (2) of Sec. 34. Section 34 (2) makes it very clear that an award can be set aside, only if the party challenging the award furnishes proof in respect of any of the grounds listed in sub-sec. 2(a)(i) to (v) or if the Court finds that situation mentioned in sub-sec 2(b)(i) or (ii) exists. The Courts have consistently held that an award can be challenged only on grounds listed in Sec. 34.[12]

Under Sec. 34(2)(b), an arbitral award can be challenged on the vague ground that it is in conflict with "public policy of India". Otherwise the other grounds mentioned in Sec. 34 are very concrete. The gamut of arbitral awards landing up before the law Courts by way of challenge depends upon how this expression "public policy of India" is interpreted.[13]

Clause (b)(ii) is the most important part of Sec. 34 since a number of awards are likely to be set aside mainly on this ground of public policy. For obvious reasons, the 1996 Act, does not define the term 'public policy of India', though it does clarify that an award is in conflict with the public policy of India if it was induced by fraud or corruption or was in violation of Secs. 75 or 81. The Supreme Court in RenuSagar Power Co. Ltd. v. General Electric Co.[14]has defined the public policy as:

(a) Fundamental Policy of Indian law; or
(b) The interest of India; or

[12] *Supra Note* (8), p. 461
[13] Dr. Chidananda Reddy S. Patil, 'Arbitral Award on Slippery Slope of 'Public Policy', *Kare Law Journal*, August 2006, p. 66
[14] (1994) Supp. 1 *SCC* 644

(c) Justice or morality

Scope of public policy was enlarged in a later judgment of the Supreme Court in ONGC v. Saw Pipes Ltd.[15]in which an additional ground of 'patent illegality' was added. As the very wording of this ground suggests and as already clarified in the judgment itself, a simple violation of law would not fall within the enlarged definition of public policy. Thus whether an award contains a patent illegality or a mere contravention of law is going to remain a debatable point. While addition of this ground appears-to be quite justified, its interpretation would certainly involve controversies. In the case of ONGC, the Supreme Court also held that award against the express provisions of the contract amounts to patent illegality and hence against the public policy as well as violation of Sec. 28(3)[16] and hence hit by Sec. 34 2(a)(v).[17]

The decision of the Supreme Court in ONGC, has been subjected to repeated criticism on the ground that it virtually gives appellate or revision powers to Courts examining the validity of arbitral awards and frustrates the very scheme of the Act, in particular Section 5 and 34 of the Act, and that it dilutes Section 34 to an extent that applications under Section 34 of the Act have virtually become first appeals against awards. But others argue that such criticism does not take note of the reality of Indian arbitration and that the decision in ONGC is not the problem; and that it merely attempts a solution in regard to the problem of illogical and illegal awards which shock the judicial conscience of Courts. They point out that whenever a provision of law is impractical, inadequate or vague; Courts attempt to respire logic into it by interpreting the provision. When such an interpretation is adopted to make the provision logical, there will always be perceptional differences as to whether such interpretation by the Court is for the better or for the worse.

The case of ONGC makes a significant indentation in the jurisprudence of arbitration law in India. The judgment has come in for some intelligent criticism. Eminent jurist and lawyer Mr. F.S. Nariman minced no words when he said that the judgment has virtually set at naught the entire Arbitration and Conciliation Act of 1996.

To have introduced by judicial innovation a fresh ground of challenge and placed it under the head of 'Public Policy', was first contrary to the established doctrine of precedent the decision of a Bench of three Judges being binding on a Bench of two Judges. It was also contrary to the plain intent of the new 1996 Law— viz., the need for finality in alternate methods of dispute resolution without Court interference.

If courts continue to hold that they have the last word on facts and on law notwithstanding consensual agreements to refer matters necessarily involving facts and law to adjudication by arbitration the 1996 Act might as well be defeated. The Division Bench decision of the two Judges of the Court has altered the entire roadmap of

[15] (2003) 5 *SCC* 705
[16] Sec. 28(3) While deciding and making an award, the arbitral tribunal shall, in all cases, take into account the terms of the contract and trade usages applicable to the transaction.
[17] *Supra Note* (8), p. 462

Arbitration Law and put the clock back to where it started under the old 1940 Act. The ONGC judgment twists the delicate balance, carefully crafted by the Model Law (and enshrined in Section 34), between finality of arbitral awards on one hand and permissible judicial review on the other.

The judgment is quite contrary to both the letter and spirit of arbitration law in India. The judgment is especially unsuitable for India, where Courts are bogged down with enormous workload. In such a situation, to open the door to challenge on merits howsoever guardedly is to undermine the efficacy of this dispute resolution mechanism.[18]

It is in this background the decision in ONGC is to be understood by interpreting the words "in conflict with the public policy of India", used in Sec. 34(2)(b)(ii) of the Act. The decision in ONGC, gave an opportunity to courts exercising jurisdiction under Sec. 34 of the Act, to have a closer and deeper scrutiny of awards, so that shockingly unreasonable awards could be interfered with. It has, in fact, to a certain extent, brought certain amount of discipline and restraint in arbitral awards.

ONGC has found statutory justification, through the amendment and insertion of Sec.34 (2-A) to the following effect[19]:

> (2-A) An Arbitral award arising out of arbitration other than international commercial arbitrations, may also 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:
>
> Provided 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.

No doubt the complaint regarding excessive intervention of courts will remain. But if patent and serious illegalities in awards resulting in substantial injustice are permitted to remain uncorrected, that will discredit the process of arbitration itself. Absence of a provision to interfere on the ground of patent illegality will be a tempting license to unscrupulous arbitrators to make shocking awards. On the other hand, a provision for intervention on the ground of patent illegality will act as a deterrent to unreasonable and unjust awards.

Those who complain about excessive intervention often overlook the reasons for intervention by Courts. Whenever there is an excessive intervention, the remedy is to remove or rectify the causes which necessitate such intervention, and also ensure that the interventions do not unduly delay the arbitration proceedings. Amending the law to prevent intervention, without removing the causes which invited the intervention, will lead to disastrous results. If there are bad awards or illegal awards and that led to courts

[18] Sumeet Kachwaha, 'The Arbitration Law of India: A Critical Analysis', *Asia International Arbitrational Journal*, Volume 1, Number 2, p.120

[19] Inserted by Act 3 of 2016, Sec.18 (w.e.f. 23-10-2015)

entertaining challenges thereto, it cannot be said that there is excessive intervention. A "cure" should not be barred on the ground that it is "strong". Allowing illegal and bad awards to stand undisturbed will affect the economy and will destroy arbitration.

The decision in ONGC, if properly understood and strictly applied, will not lead to excessive interference. Courts exercising jurisdiction under Section 34 of the Act, while taking note of the ratio that "patent illegality" would be a ground for interference, should also take note of the further requirement that the patent illegality should go to the root of the matter and trivial illegalities should not be grounds for interference. Courts should start with an assumption that arbitral awards are valid and should not interfere merely because a different view is possible.

It is not that courts are keen on intervention. Courts cannot obviously say that they will not interfere, if patent irregularities and illegalities are brought to their notice. It would be more proper to say that interventions by courts are not excessive, but whenever there is intervention, it involves considerable delay.[20]

CONCLUSION

The scheme of the Arbitration and Conciliation Act, 1996 is very clear to minimize court interference in the arbitral process and to ensure speedy enforcement of arbitral awards without the intervention of courts on unlimited grounds and aforementioned judgments have adopted a very edgy interpretation of the Act. In such a situation to allow an expansive reading of 'public policy' would nullify the entire purpose. Finality being the most attractive and unique feature of arbitration has been struck at its very roots by the expansive interpretation of the term 'public policy' by Supreme Court in the ONGC case, as a result of which arbitration as it now stands in India is just another step in the appeal process. To sum up, it can be said: "Public Policy can be a 'double-edged sword' in arbitration- 'helpful as a tool, dangerous as a weapon'." Now that an additional ground of challenge is also added to the section through an amendment, courts should chalk out an appropriate path, using restraint against uncalled for interventions and keeping the expeditious settlement of disputes finally through arbitration in mind.

[20] *Supra Note* (6), pp. J-59-61