ARBITRATION & ADR - INDIA

Judicial interference in arbitration: Section 34 saga

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AUTHORS

Nand Gopal Khaitan

Shounak Mitra

Rishav Dutt

Introduction

The topic of judicial interference in arbitration is replete with conundrums and it is easy to get bogged down in definitions and limitations – both conceptual and practical. This article focuses on certain notable cases and, consequently, a somewhat narrower field as regards the scope of judicial interference in domestic arbitration awards. The diversity of this topic primarily stems from the fact that arbitration continues to evolve rapidly in India. It is an area in which provocative ideas abound, with respect to which legal scholars and stakeholders tend to have more questions than answers. A key question in this regard concerns the acceptable level of judicial interference in arbitral awards (being a reflection of the minds of the arbitrators) and where the judiciary should draw the line.

Arbitration Act 1940

The first major consolidated law governing arbitration in India was the Arbitration Act 1940, which was based on the English and Welsh Arbitration Act 1934. Section 30 of the 1940 act provided for the setting aside of awards.(1) More often than not, awards were set aside and proceedings conducted under the act were subject to severe criticism. The Supreme Court was among the critics of the act, as seen in judgments such as *Guru Nanak Foundation v Rattan Singh*,(2) in which it observed that:

> *the way in which the proceedings under the Act are conducted and without exception challenged in Courts, has made Lawyers laugh and legal philosophers weep... Informal Forum chosen by the parties for expeditious disposal of their disputes has by the decisions of the Court been clothed with 'legalese' of unforeseeable complexity.*

Arbitration and Conciliation Act 1996

In 1992 India opened its economy, but it was apparent that it would never be a destination for developed nations unless it implemented a proper dispute mechanism. The legislature thus analysed the discrepancies in India's arbitration law and, recognising the importance of modernising its arbitration system, repealed previous statutes and enacted the Arbitration and Conciliation Act 1996, which came into effect on 25 January 1996.(3) The 1996 act was based on the United Nations Commission on International Trade Law Model Law on arbitration. One of the primary objectives of the 1996 act was to minimise court intervention in arbitral proceedings(4) and awards. Thus, Section 5 of the act provides that no judicial authority may intervene in arbitration except as provided for in the act.(5)

Section 34 (prior to 2015 amendment)

Section 34 of the 1996 act sets out the procedure and grounds for applying to set aside an arbitral award.(6) Section 34(2)(a)(7) provides certain grounds on which the courts can set aside an arbitral award, including that:

- a party was under some incapacity;
- the arbitration agreement is not valid in accordance with the law to which it was subjected by the parties to the agreement;
- proper notice of the arbitrator's appointment or the proceedings was not given;
- the dispute did not fall within the terms of those which could be submitted to arbitration or the award contains a decision beyond the scope of the arbitration; or
- the tribunal was not composed in accordance with the parties' agreement.

Under Section 34(2)(b) of the 1996 act,(8) the courts may also set aside an award if:

- the subject matter of the dispute cannot be settled by means of arbitration; or
- the arbitral award conflicts with the public policy of India.

The grounds in Section 34(2)(a) are precise, so the courts cannot widen their scope of interference with arbitral awards. The only open-ended expression which has left some ambiguity is Section 34(2)(b)'s 'public policy of India'. No other ground has been subject to such debate or the subject of so much judicial intervention.

Public policy – unruly horse

What constitutes being against public policy and thus grounds to set aside an award has raised questions for jurists. The term is not defined in the 1996 act(9) or any other law and is thus open to judicial scrutiny and various interpretations. Defining the concept of public policy(10) has thus been an arduous task, with Justice Burrough observing that it is a "very unruly horse and once you get astride it you never know where it will carry you".(11) The Indian courts have also dubbed it an 'unruly horse', thus giving the impression that it can never be defined.(12) However, some judges have attempted to give structure to the concept of public policy with respect to the setting aside of awards. In this regard, it is necessary to analyse the Supreme Court's landmark decisions in *Renusagar*(13) and *Saw Pipes*.(14)

Renusagar

Renusagar was one of the earliest Supreme Court judgments to consider the concept of public policy. In this decision, the Supreme Court held that an award which violates the Foreign Exchange Regulation Act 1973, being a statute enacted to safeguard national economic interest, will contravene the public policy of India and the fundamental policy of Indian law. The Supreme Court limited the scope of public policy to three grounds:

- the fundamental policy of Indian law;
- the interests of India; and
- justice or morality.

Saw Pipes

Saw Pipes stated that the term 'public policy' should be understood in a wider context and includes the concept of patent illegality. 'Patent illegality', as explained in this case, means any error of law on the face of an award. The judgment also held that an award can be set aside if it is so unfair and unreasonable that it shocks the conscience of the court.

On the one hand, the law set out by the Supreme Court in *Saw Pipes* led many other courts to include any error of law within the scope of Section 34, including the subsequent decisions of the Supreme Court, thus opening the floodgates.(15) On the other hand, some of the subsequent benches acknowledged the criticism of *Saw Pipes* but also held that they were bound to observe it under the principle of *stare decisis*.(16) In *McDermott International Inc v Burn Standard Co Ltd*,(17) the court expressly noted that until a larger bench reconsidered the correctness of *Saw Pipes*, it was bound by the decision.

In *Saw Pipes,* the Supreme Court widened the scope of public policy. As such, the judgment was considered a step backwards as it allowed for greater judicial interference in arbitral awards and frustrated one of the objectives of the 1996 act (ie, discouraging interference in arbitral awards). At this stage, Indian law with regard to setting aside an award on the basis of public policy was indeed proving to be an unruly horse.

Run-up to 2015 amendment

246th Law Commission report

To deal with the jurisdictional expansion of the concept of public policy, in August 2014 the Law Commission provided a narrow interpretation of the term. It suggested substantial amendments to Section 34 of the 1996 act in an attempt to ensure that the *Renusagar* position applied to all foreign awards and all awards passed in international commercial arbitration. With respect to domestic arbitration, the Law Commission recommended that the patent illegality test be retained but construed more narrowly than under the *Saw Pipes* regime.(18) The Law Commission's 246th report suggested amendments to the 1996 act with the aim of

ensuring that terms such as 'fundamental policy of Indian law' and '[conflict with] most basic notions of morality or justice' were construed narrowly.(19)

ONGC v Western Geco

In September 2014, one month after the publication of the Law Commission's 246th report, a three-judge bench of the Supreme Court interpreted the 'fundamental policy of Indian law' (ie, the "first head" of public policy, as stated in *Renusagar*) to include perversity and irrationality (*ONGC v Western Geco*).(20) As per the Supreme Court, an award could therefore be set aside if it was perverse or irrational or if the arbitrators came to a finding at which "no reasonable [person] would have arrived". The perversity or irrationality of the decision was to be tested on the touchstone of the *Wednesbury* principle of reasonableness. In a way, *ONGC*:

- permitted the courts to review arbitral awards on their merits on the basis that they violated public policy; and
- expanded the courts' powers under Section 34 of the 1996 act rather than minimised them.

Associate Builders

ONGC was followed by *Associate Builders v Delhi Development Authority*,(21) in which the Supreme Court held, among other things, that the merits of an award can be examined only under the broad umbrella of public policy. The Supreme Court relied on landmark judgments such as *Renusagar, Saw Pipes, McDermott International* and *ONGC* and set out what would constitute the fundamental policy of India. The Supreme Court held that this term includes factors such as:

- disregarding orders of superior courts;
- judicial approach, which is the antithesis to arbitrary approach; and
- the principles of natural justice.

With reference to the ground of perversity, the Supreme Court held that an award will be perverse if:

- it is based on no evidence;
- the arbitral tribunal took into account something irrelevant to the decision at which it arrived; or
- the arbitral tribunal ignored vital evidence in arriving at its decision.

This ruling marked a significant step forward for the prior amendment regime and led to the numerous pro-arbitration decisions of the Supreme Court in recent years. However, the judgment left some room to set aside awards in limited cases where factual errors reflected that the arbitrator's approach was arbitrary and thus patently illegal.

Supplement to 246th report

The Law Commission considered that the negative consequences of *ONGC* and *Associate Builders* were:

- the further erosion of faith in arbitration proceedings among individuals and businesses in India and abroad;
- a reduction in India's popularity as a destination for international and domestic commercial arbitration;
- increased investor concern among domestic and foreign investors as to the efficacy and speed of dispute resolution and the potential for judicial interference; and
- an incidental increase in the judicial backlog.(22)

Thus, on 6 February 2015 the Law Commission issued a supplementary report reiterating the recommendations made in its 246th report and clarifying what constitutes the fundamental policy of Indian law.

Arbitration and Conciliation (Amendment) Act 2015

The Arbitration and Conciliation (Amendment) Act 2015 (effective from 23 October 2015) significantly amended the 1996 act (based on the Law Commission's reports) in order to reduce court intervention in arbitration. In particular, the 2015 amendment introduced certain amendments which narrowed the scope for setting aside awards.(23) In particular, the scope of 'public policy', as provided for in Section 34, has been narrowed so that awards can be set aside only if they:

- were induced or affected by fraud or corruption;
- contravene the fundamental policy of India; or
- conflict with the most basic notions of morality or justice.

Further, a new Section 2A was introduced, which states that an award may be set aside "if the Court finds that the award is vitiated by patent illegality appearing on the face of the award". In terms of this amended provision, an award cannot be set aside merely on the ground of erroneous application of the law or reappreciation of evidence. Thus, the amendment clearly demonstrates the legislature's intention for the public

policy exception to be interpreted restrictively.

Post-2015 amendment era

Ssangyong Engineering & Construction Co Ltd

The Supreme Court's decision in *Ssangyong Engineering & Construction Co Ltd v National Highways Authority of India*(24) led to some notable developments. The judgment sums up the position following the 2015 amendment as follows:

- The interpretation of the term 'public policy of India' was narrowed by the 2015 amendment and the amendments to Section 34 of the 1996 act, especially the removal of the wide interpretation of the term, were substantive in nature. Thus, the post-amendment position does not apply to applications relating to Section 34 which were instituted before the 2015 amendment, unless otherwise agreed by the parties.
- 'Public policy of India' now means the 'fundamental policy of Indian law', as explained in *Associate Builders* (ie, the *Renusagar* understanding of 'fundamental policy of Indian law' applies). This means that the law set out in *ONGC* no longer applies. However, the principles of natural justice, as contained in Sections 18(25) and 34(2)(a)(iii) of the 1996 act, remain grounds on which an award can be challenged, in keeping with *Associate Builders*.
- 'Public policy of India' is now constricted to mean that a domestic award must be:
  - contrary to the fundamental policy of Indian law, as understood in *Associate Builders*; or
  - against the basic notions of justice or morality, as understood in *Associate Builders*.
- Insofar as domestic awards are concerned, an additional ground is now available under Section 2A, which was added to Section 34 by the 2015 amendment act. For this ground to apply, there must be patent illegality appearing on the face of the award. Such illegality must go to the root of the matter and must not amount to mere erroneous application of the law. In short, the contravention of a statute which is not linked to public policy or public interest will not lead to the setting aside of an award on the ground of patent illegality.
- The Supreme Court explained the concept of patent illegality following the 2015 amendment and expanded its ambit through an interpretation of Section 28(3) of the 1996 act. If an arbitrator looks beyond the contract and deals with matters outside their jurisdiction, they will commit an error of jurisdiction. This ground of challenge falls within the new ground added under Section 34(2A).
- Reappreciation of evidence, which falls under the appellate courts' jurisdiction, is not permitted under the ground of patent illegality.
- While no longer a ground for challenge with respect to the public policy of India, if a decision is perverse, it will amount to patent illegality. Thus, a finding based on no evidence or an award which ignores vital evidence will be perverse and liable to be set aside on the ground of patent illegality.

Ssangyong throws much-needed light on the legal position regarding the setting aside of awards following the 2015 amendment. In its recent judgment *South East Asia Marine Engineering and Constructions Ltd v Oil India Limited*,(26) the Supreme Court set aside the award in question on the ground that the tribunal's interpretation of a contractual provision was not reasonably possible on reading the contract as a whole. This judgment dealt with the pre-2015 amendment situation and, while acknowledging the limited scope of Section 34, somewhat dealt with the merits of the case. In the later judgment *Patel Engineering v North Eastern Electric Power Corporation Limited*,**(27)** a three-judge bench of the Supreme Court dealt extensively with the history of patent illegality as a ground for setting aside a domestic award. Dealing with the position post-2015 and the latest judgments in this respect, including *Ssangyong* and *Associate Builders*, the Supreme Court noted that the ground of patent illegality is available to set aside a domestic award if the arbitrator's:

- decision is found to be perverse or so irrational that no reasonable person would have arrived at the same decision; or
- construction of the contract is such that no fair or reasonable person would make the same construction or the arbitrator's view is impossible.

Thus, *Patel Engineering* essentially reaffirmed the view that an arbitral award can be set aside under Section 34 of the 1996 act if it is patently illegal or perverse.

Comment

Stakeholders are undoubtedly propagating a regime under which there is less court interference with respect to setting aside an award, which should see 'arbitrate not litigate' become the norm. At the same time, arbitration's main objective is to ensure the delivery of a legitimate award in the interest of justice, which is why the law permits the courts to intervene in arbitral proceedings in certain cases. Further, the courts' hearing of Section 34 applications should not be reduced to mere endorsement which shies away from interference. A balanced approach is required by the courts to achieve the true objective of the 1996 act. The recent judgments

discussed above point in this direction, but further rulings which consider the post-2015 amendment scenario are required to clarify these issues further. The courts must decide where to draw the line to reduce judicial interference while simultaneously delivering justice in a way which upholds the spirit of Section 34 of the 1996 act.

For further information on this topic please contact Nand Gopal Khaitan, Shounak Mitra or Rishav Dutt at Khaitan & Co by telephone (+91 33 2248 7000) or email (ng.khaitan@khaitanco.com, shounak.mitra@khaitanco.com or rishav.dutt@khaitanco.com). The Khaitan & Co website can be accessed at www.khaitanco.com.

Endnotes

(1) Under Section 30, the grounds for setting aside an award are as follows:

> *An award shall not be set aside except on one or more of the following grounds, namely: -*
>
> *(a) that an arbitrator or umpire has misconducted [themselves] or the proceedings*
>
> *(b) that an award has been made after the issue of an order by the Court superseding the arbitration or after arbitration proceedings have become invalid under section 35;*
>
> *(c) that an award has been improperly procured or is other- wise invalid.*

(2) (1981) 4 SCC 634; also refer to *FCI v Joginderpal Mohinderpal* (1989) 2 SCC 347.

(3) The act sought to address complaints by foreign investors that despite its wealth of resources, the prospect of dispute settlement in India was too daunting. The model laws and rules were already being widely used internationally; thus, India joined the international consensus on their use.

(4) *P Anand Gajapathi Raju v PVG Raju* (2000) 4 SCC 539 at p541.

(5) Extent of judicial intervention: "Notwithstanding anything contained in any other law for the time being in force, in matters governed by this Part, no judicial authority shall intervene except so provided in this Part".

(6) *Indu Engineering and Textiles Ltd v Delhi Development Authority* (2001) 3 SCR 916.

(7) Prior to the 2015 amendment.

(8) Prior to the 2015 amendment.

(9) A contract against public policy under Section 23 of the Contract Act 1872. It was interpreted by the Supreme Court in *Gherulal Parakh v Mahadeo Das* (1959) Supp (2) SCR 206, which stated that public policy is an untrustworthy guide. It is also noteworthy that the United Kingdom protested against the inclusion of the term by writing a note pointing out the difference between civil and common law countries. However, the United Nations Commission on International Trade Law agreed to retain public policy as a ground of challenge.

(10) In *Holman v Johnson,* Lord Mansfield stated that the principle of public policy is *ex dolo malo non oritur actio*. No court of law will lend its aid to a party which acts immorally or illegally.

(11) *Richardson v Mellish* [1824] 2 Bligh 229, 242.

(12) *Oil & Natural Gas Corporation Ltd v Saw Pipes Ltd* (2003) 5 SCC 705.

(13) *Renusagar Power Co Ltd v General Electric Co* (1994) SCC Supl (1) 644.

(14) *Oil & Natural Gas Corporation Ltd, supra.*

(15) *ONGC Ltd v Garware Shipping Corporation Ltd*, 2007 (13) SCC 434; *Delhi Development Authority v RS Sharma*, 2008 (13) SCC 80; *Phulchand Exports Ltd v OOO Patriot* (2011) 11 SCALE 475.

(16) *Centrotrade Minerals & Metals Inc v Hindusthan Copper Limited* (2006) (2) ARBLR 547.

(17) (2006) 11 SCC.181.

(18) Supplementary Report to Report 246, government of India.

(19) *Ibid,* Paragraph 10.2.

(20) (2014) 9 SCC 263, Paragraphs 35, 38 and 39.

(21) (2015) 3 SCC 49.

(22) Supplementary Report to Report 246, *supra,* Paragraph 10.6.

(23) *Explanation to Section 34 (2) (b)*

> *Explanation 1.— For the avoidance of any doubt, it is clarified that an award is in conflict with the public policy of India, only if—*
>
> *i the making of the award was induced or affected by fraud or corruption or was in violation of section 75 or section 81; or*
>
> *ii it is in contravention with the fundamental policy of Indian law; or*
>
> *iii it is in conflict with the most basic notions of morality or justice.*
>
> *Explanation 2— For the avoidance of doubt, the test as to whether there is a contravention with the fundamental policy of Indian law shall not entail a review on the merits of the dispute.";*
>
> *(2A) An arbitral award arising out of arbitrations 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 reappreciation of evidence.*

(24) (2019) 3 SCC.

(25) Equal treatment of parties: "The parties shall be treated with equality and each party shall be given a full opportunity to present [their] case."

(26) Civil Appeal 673/2012.

(27) Special Leave Petition (C) 3584-85 of 2020 (*Patel Engineering Limited v North Eastern Power Corporation Limited*) Paragraph 22.
