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## DISCLAIMER

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## *ABOUT US*

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With this thought, we hereby present to you

**WHITE BLACK LEGAL: THE LAW JOURNAL**

# ANALYSIS AND SCOPE OF PUBLIC POLICY UNDER SECTION 34 of ARBITRATION & CONCILIATION ACT, 1996

(Submitted by- Mandeep Singh)

## INTRODUCTION

With the emergence of global village, by virtue of Globalization, the world has become too small. There has been exchange of ideas, culture, trade etc. Business trade has been had its best and there is extensive transaction between the nations. With the significance increase International trade, there has been increase in commercial disputes between the countries too. India has been one of those countries too which are going through this global economic change. Globalisation has led to economic growth in the country and this means caseload of commercial disputes in the Indian courts, which are already overburden with several other cases, leading to difficulty in speedy disposal of cases. Therefore with this lacuna in litigation process, the alternative dispute mechanisms are preferred by the business groups and one of these alternative dispute resolutions is the arbitration process between the parties.

It is a clear Rule of Law to challenge the decision of a tribunal or court by a party, it is against the party. It has been contended that, the challenging of an award passed by the Arbitration Tribunal is necessary in order to prevent the arbitrator from going beyond the scope of arbitration clause and check the arbitrators powers, but however there has also been criticism that a party cannot challenge an award passed, as the parties have themselves come to an agreement and appointed an arbitrator and challenging the tribunals award itself will lead to interference of Court in arbitration proceedings and this itself will be against the concept of arbitration. To balance these views, Section 34 is enacted. Section 30 of Indian Arbitration act, 1940, contained very broad grounds for challenging and setting aside the award passed by an arbitration tribunal. To protect the institution arbitration and to have less interference of court in arbitration proceedings, Section 34 of the Arbitration and Conciliation act, 1996 (1996 Act), provides for the parties to challenge the arbitration award passed by the Arbitration tribunal.

The Courts in India have themselves tried to protect the institution of arbitration, like it has been held that Court cannot reassess the evidence, even if arbitrator committed error.[1] The

[1] *National Electric Supply and Trading Corporation Pvt. Ltd. v. Punjab State* (AIR 1963 Punj 56)

Court has no jurisdiction to substitute its own valuation of conclusion on law/fact.[2] It cannot sit in appeal over the conclusion of arbitrators and re-examine the evidence which have already been considered by arbitrator.[3]

This research paper will examine the concept of "Public Policy" under Section 34 of 1996, Act; the term has been not defined in the Act. Public Policy in general may be defined[4] as set of principles in accordance with which communities need to be regulated to achieve the good of the entire community or public.

The Supreme Court and High Courts of India have been severely criticized for broadly interpreting "public policy" as a ground for setting aside the awards. It has been argued that this stand of Indian Courts has caused a huge loss in commercial business India, as many of the foreign countries would refuse to do their business with Indian parties, due to the picture of India no being arbitration friendly.

This research paper will mainly examine the ground for this criticism and will scrutinise them, through various decisions of the Indian Courts. The main question before this research paper is, whether the Indian Courts have interpreted "Public Policy", under section 34 of 1996 Act, in a broad manner and have failed the concept of arbitration in India.

## ARBITRATION IN INDIA

Prior to 1996, the Arbitration India was governed under two statutes; they are the Indian Arbitration act, 1940(1940 Act), which governed the domestic arbitration and the Foreign Awards (Recognition and Regulation) Act, 1961, which regulated the enforcement of foreign awards under the New York Convention

The 1940 Act was enacted based on the English Arbitration Act, 1934. Under the 1940 Act, throughout the proceedings the judicial intervention was needed, for example to set arbitral proceedings in motion, to determine the existence of a valid arbitration agreement and arbitral dispute, to extend the period of time permitted for making an award, and to enforce an arbitral tribunal award.[5] This led to serious criticism against the legislation contending that it defeats

[2] *Francis Klien Pvt. Ltd. v. Union of India* (1995 2 Arb LR 298).
[3] *State of Mishra v. R.N Mishra*,(AIR 1984 Ori 42)
[4] Padmanabhan Aishwarya. "*Analysis of Section 34 of the Arbitration and Conciliation Act*" http://manupatra.com/roundup/326/Articles/Arbitration.pdf
[5] Rendeiro Ameria. Texas Law Review."Indian Arbitration and public policy".http://www.texaslrev.com/wp-content/uploads/Rendeiro-89-TLR-699.pdf

the very purpose of arbitration and instead of disposing the arbitration cases in speedy manner they were being delayed due to the intervention of Courts.

The 1996 Act, was enacted based on the UNICITRAL Model Law and Rules in order to harmonize India's arbitration laws in the lines of other nations, provided for a free and fair arbitration process and minimize the interference of Courts in the arbitral proceedings. The Statement of object and reason in Act, stated as follows[6]:

"The 1940 Act has become outdated in light of economic reforms of present time and these reforms could not become fully effective if the law dealing with settlement of both domestic and international commercial disputes remained out of tune with such reforms."

The 1996 Act has two parts – Part I provides for any arbitration conducted in India and enforcement of awards. Part II provides for enforcement of foreign awards. The enforcement of any foreign award to which the New York Convention or the Geneva Convention applies, is governed by Part II of the 1996 Act.

The 1996 Act, contains two features that differed from the UNCITRAL Model Law. First, while the UNICITRAL Model Law is applied only to international commercial arbitrations, the 1996 Act applies both, to international and domestic arbitrations. Second, the 1996 Act goes beyond the UNICITRAL Model Law in the area of minimizing judicial intervention.

In year 2003, the Law Commission of India prepared a report on the 1996 Act and suggested a number of amendments. Based on the Law Commission's report, the Arbitration and Conciliation (Amendment) Bill was submitted to Parliament in December 2003. The 2003 Amendments clarified the public policy grounds for setting aside an award by adding a section allowing an award to be set aside "on the additional ground that there is an error which is apparent on the face of the arbitral award giving rise to a substantial question of law."[7] However, at the present moment the amendment to the legislature is yet to be taken into consideration.

"The onward march in the field of foreign investment encouraging the private sector cannot be easily brushed aside. But the hurdles for such continuous development are always from within. The delay in bureaucratic actions, arbitration proceedings and court procedure are some of the hurdles which forbid development."

[6] *Ibid* Para 5.

[7] *Ibid* Para 5.

There are another set of scholars who are in minority, with regard to the view that it is necessary for the Courts to interfere in arbitral proceedings, in order to protect the interest of the Indian parties. There argument is based on the idea that the Courts need to protect the interest of the Indian parties, as the parties from the developed nations, would use their power over Indian parties and take advantage over them.

The view that Indian policy should be made so as to attract foreign investors is not valid and indeed, this clearly evident from Foreign Direct Investment Confidence Index, were India ranks third in the world in attractiveness to foreign investors, behind only China and the United States, based on a survey assessing the sentiments of senior executives at the world's largest companies. If India's primary goal in promulgating arbitration policy is to attract foreign investors, it appears that India has been successful. Indeed, almost 70% of American multinational corporations surveyed are highly satisfied with their experiences doing business in India.[8]

## MEANING AND CONTENT OF PUBLIC POLICY

An arbitral award may be set aside if the court finds that the arbitral is in conflict with the public policy of India. Without prejudice to the generality of clause 34(ii)(b), it is hereby declared, for the avoidance of any doubt, that an award is in conflict with the public policy of India if the making of the award was induced or affected by fraud or corruption or was in violation of section 75 or section 81.[9] An award against public policy cannot be enforced.

The term 'Public Policy of India' is not defined in the Act, though it is used in sections 34(2)(b)(ii) and 48(2)(b) of the Act. The expression refers to the principles and standards constituting the general or fundamental policy of the State established by the Constitution and the existing laws of the country, and the principles of justice and morality.[10] Public policy can be confined to those heads which a writ court can entertain while exercising extraordinary jurisdiction under Article 227 of the Constitution. An award which is in violation of the principles of natural justice is violating the public policy of India. A plea of limitation would be a ground based on the public policy.[11]

Illegality in an award must go to the root of the matter and if the illegality is of a trivial nature, it cannot be held that the award is against the public policy. An award can also be set aside if

[8] *Ibid* Para 5.
[9] *Olympus Superstructures Pvt Ltd. v Meena Vijay Khaitan* , (AIR 1999 SC 2012)
[10] *Rail India Technical and Economic Services Ltd v. Ravi Constructions*, ( AIR 2002 NOC)
[11] *Jagmohan Singh Gujral v. Satish Ashok Sabnis*, (2004 (2) RAJ 67)

it is so unfair and unreasonable that it shocks the conscience of the court. Such an award is opposed to public policy and is required to be adjudged void. An award which is patently in violation of the statutory provision cannot be said to be in public interest. An award can be set aside on the ground of being against public policy if it is contrary to:

(i) Fundamental policy of Indian law; or
(ii) The interest of India; or
(iii) Justice or morality; or
(iv) In addition, if it patently illegal.[12]

Where the arbitrator is directly interested in the subject matter of the litigation, the award would be said to be improperly procured.[13] Corruption on the part of the arbitrator is a good ground for setting aside the award, but where corruption, fraud, partiality or wrong doing is charged against the arbitrators, it has got to be established beyond doubt. Where the arbitrators stayed at the house of one of the parties, the court can refuse to accept the award.

An award may be set aside if it has been improperly procured or is otherwise invalid. Where an award has been obtained by fraud or by corrupt inducements, it is improper. The expression "otherwise improper" would include cases where the award is suffering from an apparent mark of invalidity such as an error of law apparent on the face of it. An award is liable to be set aside if it is opposed to public policy of India. Though it is a general ground, Section 34 says in particular that an award shall be deemed to be opposed to public policy if it was induced or affected by fraud or corruption.



## PUBLIC POLICY AND PATENT ILLEGALITY IN INDIA

The legislature has not incorporated exhaustive grounds for challenging arbitral awards or the grounds on which appeal against an order of the court would be maintainable. But in S. 34(2) (b) the phrase "public policy of India" is not required to be given a narrower meaning. Hence, the award which is passed in contravention of S 24, 28 or 31 could be set aside. Moreover, Sec 13 (5) and 16 enable a party to challenge the constitution of the Arbitral Tribunal or the arbitral award under S. 34. In any case, it is for the Parliament to provide for limited or wider jurisdiction to the court in cases, there is no reason to give narrower meaning to the term "public policy of India". Giving a limited jurisdiction to the court for giving finality to the award and resolving the dispute by speedier method would be frustrated by permitting patently illegal

[12] Markanda P.C. 2001. *Arbitration Step by Step*. Nagpur: Lexis Nexis.
[13] *Yusuf Khan v. Riyasat Ali*, (AIR 1926 Oudh 307 (DB)

award to operate. Patently illegal award is required to be set at naught, otherwise it would promote injustice.

Therefore the phrase "public policy of India" used in S.34 in context is require to be given a wider meaning. The concept of public policy connotes some matter which concerns public good and public interest. What is for public good or in public interest or what would be injurious or harmful to public good or public interest has varied from time to time. An award which is, on the face of it, patently in violation of statutory provisions cannot be said to be in public interest. Such award/judgment/decision is likely to adversely affect the administration of justice. Hence, in addition to the narrower meaning given to the term "public policy" in *Renusagar case*[14]. It has to be held that the award could be set aside if it is patently illegal.

## REDUCTION OF CORRUPTION AND BIAS-

The 1996 Act tries to ensure that there should be an impartial, incorrupt, bias free arbitration. The Model law commitment towards a bias and corruption free arbitration is seen clearly. Section 18 of the 1996 Act declares that the parties should ensure equality, at time and place should be fixed for hearing and notice should be given to the parties accordingly. The failure of an arbitrator to give to a party, a proper opportunity to matters right entitles the party to set aside and remission. This entails that the arbitral tribunal shall not treat one of the parties in a more advantageous fashion than the other and that each party is given the opportunity of being heard. In simple, the arbitral tribunal shall be impartial and fair.[15]



R.A Sharma argues that 1996 Act does not give enough opportunity or scope to challenge arbitral awards. In cases of contract involving government and private party, the private party uses adequate incentives to safeguard their interests. Arbitration has become a lucrative business in India after independence; the private parties try to exempt contractual liability. The Act does not provide any mechanism for preventing such massive frauds in the public exchequer.

The UNICTRAL law specially says that public policy not only includes French Notion of *ordre public* which consisted principles of procedural justice but also principles of law and justice in

[14] *Renusagar Power Co. v. General Electric Co*, (1994) 1 S.C.R. 22 (India).
[15] Malhotra O.P, Malhotra Indu. 2006. *The Law and Practices of Arbitration and Conciliation.* Lexis Nexis Butterworths.

substantive sense, instances being corruption, bribery, fraud.[16] It is not necessary in every case that the arbitrator has been bribed or is not acting ultra vires. A mere immorality found will eventually lead to the case violating the fundamental policy of India leading to biasness.

Today we see many arbitration proceedings involving multinational companies, investor's etc taking place fraudulently. One cannot misuse the corruption defence by arguing without any valid reason. Immortality has to be present which is affecting one of the parties directly or indirectly. Bias is not one of the grounds specified in Section 34 for setting aside an arbitral award by the court. Section 12(3) (a) provides that an arbitrator may be challenged if there are justifiable doubts as to his independence or impartiality. If the challenge is rejected by the Arbitral Tribunal and an award is made, an application for setting aside the award can be made on the ground that the challenge was wrongly rejected and the question of bias can be agitated in that proceeding. But if no challenge exists under Section 12(3) (a), the question of bias does not come and cannot be raised before the court.

## CONFIDENTIALITY-

Keeping confidentiality is very important because disclosure leads to unfairness in the arbitration process. The conciliator and the parties shall keep confidential all matters relating to the conciliation proceedings. One of the major issues or problem occurs when a consultant/expert witness concludes that its legal duty requires disclosure of such material, before making any such disclosure, it will give the parties to the arbitration notice of its intention to disclose material covered by this agreement. If the parties will not consent to the disclosure, the consultant/ expert witness and the parties will agree that the question of whether there is any applicable and overriding law and duty in relation to the material under consideration will be presented for decision to the arbitrator appointed under this agreement. The parties and the consultant/expert witness agree to be bound by the ruling of the arbitrator whose decision will be final and binding. However, many consultants and expert witnesses will refuse to enter into this kind of contractual commitment. An appropriate confidentiality agreement must address the legal duty of disclosure.[17] When a party gives information to the conciliator on the condition that it is kept confidential, the conciliator should not disclose that information to the other party. Confidentiality indirectly affects the arbitration proceedings and

[16] The Eighteenth Session.1985."UNCITRAL Report on the Working of its Eighteenth Session". Accessed August 24, 2017. http://www.uncitral.org/pdf/english/yearbooks/yb-1985-e/vol16-p3-46-e.pdf
[17] Varsha Rajora. 2011. "Confidentiality in Arbitration".http://ssrn.com/abstract=1572221

reasonable suspense of disclosure of information may lead to effect in the final award. This award can be challenged because disclosure leads to prejudice to one of the parties.

## LEGISLATIVE PERSPECTIVE-

Lord Mansfield in *Holman v. Johnson*[18] explained public policy as a concept where no court will lend its aid to a man who finds his cause of action upon immoral or illegal act. For good of the community and protecting the national interest public policy is important and can go to any extend. Under Indian Constitution the Fundamental Right in Right to Freedom article 19 (4) restrict the right of the individual if the any existing law in so far as it imposes, or prevent the State from making any law imposing, in the interests of the sovereignty and integrity of India or public order or morality, reasonable restrictions on the exercise of the right conferred by the said clause.[19]

Thus fundamental right can also be restricting if the public policy is against the interest of the society or individual because it disturb and violates the sovereignty and integrity of a country.[20] So the policy must be made by seeing or needs the rights and duties of the individual and society. The section 23 says that the consideration or object of an agreement is lawful, unless- It is forbidden by law or is of such nature that, if permitted it would defeat the provisions of any law or is fraudulent, of involves or implies, injury to the person or property of another; or the Court regards it as immoral, or opposed to public policy.[21]



In many developed states the Antitrust or completion law, securities law and other public laws are arbitral. After the allocation of the award by the arbitral tribunal to deal with the claims, the next step is to determine the arbitral award's level of the judicial scrutiny with respect to the national law in case of both annulment and recognition actions. It is also important to determine the relevance of the public policy exception throughout the scrutiny. National courts, under the national law may be able to correctly review the arbitral award's merits in consideration with its disposition of the public policy and the compulsory law claims.

[18]Holman v Johnson **[1775] (Cowp) 341**
[19] Kerkatta Vivek. 2008 "Public Policy Setting Aside Award". http://www.legalindia.in/public-policy-setting-aside-arbitral-award/
[20] *Ibid* Para 26.
[21] *Ibid* Para 26.

## SCOPE OF PUBLIC POLICY IN FOREIGN ARBITRAL AWARDS

The first multilateral definition of public policy defence was found in formal rules governing international commercial arbitration in the 1927 Geneva Convention on the Execution of Foreign Arbitral Awards. Article I of the Convention provided for the recognition and enforcement of a foreign arbitral award only if the arbitral award was "not contrary to the public policy or to the principles of the law of the country in which it is sought to be relied.[22] The Arbitration and Conciliation Act, 1996 tries to gives different treatment to award made in India and those made outside India. Part I of the Act applies to "international arbitrations" which are seated in India and all "domestic arbitrations". In the case of a domestic award a 'challenge' to the award can be made under section 34 of the Act whereas no 'challenge' proceeding is contemplated for a foreign award. On the other hand a foreign award is one which is made in an arbitration proceedings seated outside India. Normally, the term "foreign award" gains significance only for the purposes of enforcement in a country other than its country of origin.[23]

The term "Public policy" in Article V (2) (b) of the New York Convention does not mean international public policy. The said expression means the doctrine of public policy as applied by the courts in which the foreign award is sought to be enforced. Consequently, the expression "public policy" means the doctrine of public policy as applied by the courts in India. The defence of public policy should be construed narrowly. According to the narrow view, courts cannot create new heads of public policy whereas the broad view countenances judicial law making in such areas. The enforcement of the foreign award must not be contrary to the public policy or the law of India. Since the expression "public policy" covers the field not covered by the words "and the law of India" which follow the said expression, contravention of law alone will not attract the bar of public policy and something more than contravention of law is required.[24]

The question of foreign arbitral awards against public policy comes into picture in the 2012 landmark case *Bharat Aluminium Company v. Kaiser Aluminium Technical Services Inc*[25] where the Court held that Part I of the Arbitration and Conciliation Act, 1996 would not be applicable to foreign arbitral awards. Therefore no interim relief lies available to a party in an arbitration seated outside India. Section 48 of the Act is akin to Article V of the New York

[22] "Public Policy defence" http://heinonline.org/HOL/Page?handle=hein.journals/calwi7&div=10&g_sent=1&collection=journals#237
[23] Rautray Jetley. "Enforcment of Foreign Arbitral Award in India". http://www.rautray.com/article4.pdf
[24] *Renusagar Power Co. Ltd. v. General Electric Co*, (1994 SCC 644).
[25] *Bharat Aluminium Company v. Kaiser Services Ltd*, (S.A(2002) 4 SCC)

Convention. An application for enforcement of a foreign award can be resisted by a party on limited grounds stipulated in section 48 of the Act. Thus, no 'challenge' proceedings or proceedings to annul the award can be brought against a foreign award in India under the Act notwithstanding the governing law of the contract is Indian law. Foreign awards sought to be enforced in India cannot be challenged on merits in Indian courts. In an enforcement proceeding, the court may refuse to enforce the foreign award on satisfactory 'proof' of any of the grounds mentioned in section 48(1), by the party resisting the enforcement of the award. The said section sets out the defence open to a party resisting enforcement of a foreign award.[26]

Taking the above proposition further, in *Shri Lal Mahal Ltd. v. Progetto Grano*[27] the Supreme Court passed a seminal judgment, whereby it unmistakably established a difference between the scope of objections to the enforceability of a foreign award under Section 48 of the Act, challenges to set aside an award altogether under section 34 of the Act. As a consequence, the Supreme Court has substantially curtailed the scope of the expression 'public policy, which is a ground available to object to the enforcement of foreign arbitral awards in India and brought it in line with the New York Convention.[28]

In *Phulchand Exports Limited v. O.O.O. Patriot*, the Supreme Court expanded the meaning of the expression public policy, under Section 48 of the Act, and held that the scope and purport of the expression under section 34 and 48 are the same. Thus, even in a scenario where the award attains finality, upon an action for enforcement of the foreign award being instituted, the parties by virtue of the decision in *Phulchand* could apply the extremely broad standard of 'public policy' in *ONGC* and almost re-open the entire matter.[29]

The *Phulchand* case does not lay down the correct law and has been overruled by Lal Mahal case. Patent illegality is a ground which is limited to Section 34 of the Act where the issue is to set aside or not. So the expression 'public policy' found under Section 48 of the Act does not belong to a ground under patent illegality. *Lal Mahal* gave an understanding that public policy is comparatively limited in cases involving conflict of laws and matters involving a foreign element such as a foreign seated arbitration. The Supreme Court made it clear that

[26] *Ibid* Para 47.
[27] Civil Appeal No. 5085 of 2013 arising from SLP(c) No. 13721 of 2012
[28] "*Scope of public Policy in Foreign Arbitral Awards*", http://www.siac.org.sg
[29] *Ibid* para-32

Section 48 does not offer an opportunity to have a second look at the foreign award at the enforcement stage, or permit the award on merits.

From above we can see that Supreme Court has limited scope of public policy in Foreign Arbitral Awards. Foreign seated arbitrations is a global approach for speedy justice and transformation is needed. In order to establish India as an international commercial arbitration destination, Supreme Court needs to observe limited interference.

## CONCLUSION

The view that Indian policy should be made so as to attract foreign investors is not valid and indeed, this clearly evident from Foreign Direct Investment Confidence Index, were India ranks third in the world in attractiveness to foreign investors, behind only China and the United States, based on a survey assessing the sentiments of senior executives at the world's largest companies. Therefore it is clear from this fact that there has been no affect on International arbitration by the virtue of broad interpretation of "public policy" by the Supreme Court of India.

Public policy is still a very strong weapon to the parties to resist the enforcement of foreign arbitration award. The reason for such a loophole in the commercial arbitration is the absence of definition of "International Public Policy". But due to such absence there must be something done to govern the concept of public policy, to see to it that it is not being misused by the parties and at the same time the policies of a nation are not being effected by virtue of an award passed.

First thing would be that more international initiatives like that of the ILA (International Law Association) should be initiated so that more countries can come together to reach an agreement as to the parameters of the public policy defence. This will help in meaningfully defining the concept of Public Policy through consensus from all the parties, which will help the arbitration tribunals as well as the national Courts, to dispose the cases, without any delay and confusion.

There is a clear desire in India to attract the investors from foreign countries and to have a pro-arbitration nation, however at the same time India is bound to protect the interest of its parties and to disregard the award passed which transgress the Indian Parliamentary policies. Equitable dispute resolution and economic development are among the primary interests of the national government, and India has a legitimate stake in fostering the growth and development of both.

Therefore in order to attract the foreign investors, as well as to protect the interest of Indian parties, the best solution would be the creation of a special bench for arbitration cases; such a bench would have jurisdiction over foreign parties concerns regarding cost, efficiency, and finality, while increasing parties' access to the courts to challenge arbitral awards. Ancillary to the creation of such a bench, the Indian government could protect its pro-arbitration stand and increase India's attractiveness as a destination for foreign investment without compromising the interests of its people and businesses.