The Ever Expanding Scope of Public Policy

Introduction

An arbitration clause is a *sine qua non* for companies while executing commercial contracts. Arbitration is expected to provide an easy and cost effective option for dispute resolution and, as a consequence, the Indian parliament passed the Arbitration and Conciliation Act of 1996 (**"Act"**) replacing the old 1940 law on arbitration. One of the key objectives of the Act was to ensure that there is minimum judicial intervention and finality once an award is issued. However, the absence of finality has become a serious cause for concern for the disputing parties on account of the challenges to awards.

The Act is divided into two parts; the first part deals with arbitration proceedings conducted in India and their enforcement and the second part deals with foreign arbitration proceedings and its enforcement. The grounds of challenge to a domestic award are covered in section 34 of the Act and *public policy* is one such ground. The interpretation of the word *public policy* has been changing and expanding due to which companies have started to lose faith in the system as there is a failure to secure finality of an award. This newsletter focuses on the limited aspect of jurisprudential evolution in case of *public policy* as a ground of challenge for domestic awards.

The Relevant Law

Section 34 of the Act provides several grounds of challenge to an arbitration award. Amongst others, these include a party's incapacity, the arbitration agreement was not valid, the award is beyond the scope of submissions made to the arbitrator, and if the subject matter of dispute is not capable of settlement by arbitration under the law in force.

Section 34(2)(b)(ii) provides with the last ground of challenge i.e., the arbitral award is in conflict with the *public policy* of India. However, as noted, *public policy* has not been defined in the Act and has been left open to interpretation by the courts.

The Relevant Case Law

One of the first cases where the courts discussed the scope of *public policy* was Renusagar vs. General Electric Co. (**"Renusagar"**).[1] Although the case was of Foreign Awards (Recognition and Enforcement) Act, 1961[2], the interpretation of *public policy* was held valid for domestic awards too. In this case, there was a delay in payments as the Government of India refused to re-structure the payment plan as it would have led to massive outgo of foreign exchange. Due to this refusal, the installments to be made by Renusagar were late by 3 to 6 years. Therefore, General Electric invoked the arbitration clause.

The court differentiated between the two conflicting ways of understanding *public policy*. According to the "narrow view" no new heads of *public policy* can be created while the "broad

[1] (1984) 4 SCC 679

[2] The act has now been repealed and Part 2 of the Arbitration and Conciliation Act of 1996 deals with enforcement of foreign awards

view" suggests the court can broaden its scope. After a detailed consideration the court concluded that the underlying object of the Act was to facilitate international trade and commerce and giving *public policy* a broad view would defeat this very objective. Thus, in Renusagar the Supreme Court enunciated three well recognized heads of *public policy* i.e. fundamental policy of Indian law, interest of India, and the grounds of justice and morality. A noteworthy aspect of this ruling is, "*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*[3]."

Renusagar was considered a valid authority until 2003 when the judges in ONGC Ltd. v. SAW Pipes Ltd. (**"SAW Pipes"**)[4] distinguished between foreign awards and domestic awards. In this case, ONGC contracted SAW Pipes for delivery of off shore oiling equipment on or before a certain date. Due to general strike of steel mill workers in Europe, SAW Pipes failed to deliver the equipment. As a result, ONGC withheld the payments up to a certain amount as liquidated damages. This was challenged and the arbitral tribunal ruled that ONGC was wrong to withhold the payments as they could not prove any actual loss suffered by them. ONGC challenged this award on the basis that the terms of the contract did not require ONGC to prove that they suffered any loss and, thus, arbitrators' decision overlooked the terms of the contract and acted against *public policy*. In other words, the parties had expressly agreed that recovery for breach of the contract was to be by way of pre-estimated liquidated damages. The arbitral tribunal, however, held that the purchaser should establish actual loss. As the loss suffered was not proved, the arbitrator refused to award damages without assigning reasons.

A challenge was raised under section 34 and SAW Pipes contended that an erroneous decision by the arbitrator cannot be a valid ground for challenging the decision of the arbitrator as the court cannot go into the merits of the decision. The Supreme Court observed that the award can also be challenged on the grounds of wrong interpretation of law by the tribunal if the substantive law of the contract is Indian law, thereby considerably widening the scope of judicial review on the merits of the decision. The ratio established that as a fundamental principle any direction which is contrary to (a) fundamental policy of Indian law; (b) interest of India; (c) justice or morality and; (d) if it is patently illegal, then such direction has to be set aside considering it to be against public policy. The Supreme Court held that if the award is contrary to the substantive provisions of the Act and against the terms of the contract, it was patently illegal, and liable to be interfered with under section 34. Any award which is, on the face of it, patently in violation of statutory provisions cannot be said to be in public interest as such award was held likely to affect the administration of justice adversely. While adjudicating upon the matter, the Supreme Court further held that award could also be set aside if it is so unfair and unreasonable that it shocks the conscience of the court. In this case, the award was set aside.

It is clear that the Supreme Court was of the opinion that there is no need to adopt a narrow view of *public policy* in domestic arbitrations as *public policy* is ever expanding and its interpretation cannot be limited to specific heads. On the basis of this reasoning the court added "patent illegality" as another dimension of challenge. It is clear that through this

[3] Supra at 1
[4] (2003) 5 SCC 705

judgment, parties looking to prevent enforcement got a wider canvas on which to raise challenges thereby allowing courts to delve into the merits of a case which, in fact, is completely contrary to the spirit of speedy dispute resolution.

The next major expansion in the scope of *public policy* was done in ONGC Ltd. v. Western Geco International (**"Geco"**).[5] Briefly, ONGC contracted Western Geco for supply of hydrophones for upgrading their vessels. Western Geco agreed to supply US made hydrophones but due to inability to obtain a license there was a delay of 9 months and 28 days. As per the contract, ONGC deducted liquidated damages while making the payments but Western Geco challenged and argued that the damages and period of delay is extremely exaggerated. The question arose who was responsible for this delay and how should the deductions be made. The arbitral tribunal held Western Geco responsible only for a delay of 4 months and 22 days and the rest was attributed to ONGC which led to a reduction in damages. Western Geco challenged this award and eventually approached the Supreme Court who examined the scope of *public policy*. They considered the established principles in SAW Pipes and concluded that the earlier decisions made by the court do not elaborate enough on the principles of fundamental policy of India. As a result, the court laid down three distinct principles within the ambit of fundamental policy of India and stated that (a) the judiciary should not rule on a whimsical basis, (b) decisions taken by courts and competent authorities should be based on principles of natural justice and (c) no decision taken by the court should be so perverse or irrational that no reasonable person would have made it.

These principles provided the Supreme Court with such wide powers to examine awards that it may do more harm than the test of patent illegality laid down in SAW Pipes. Based on these principles, the court went into the facts of the case and reduced the delay to only 56 days. The decision was, yet again, a retrograde step in the ability of the judiciary to re-open well-reasoned awards.

In Associate Builders v. Delhi Development Authority (**"Builders"**)[6] the pro judicial intervention stand taken by the Supreme Court continues. A works contract was executed for construction of houses in Delhi. The project was to be completed in a certain time frame but there was a delay of 25 months which, according to the sole arbitrator, was attributed to DDA and they were asked to pay damages. DDA challenged this decision in the High Court which was dismissed. Finally, the case came to the Supreme Court who upheld the principles laid down in SAW Pipes and Geco. The court also expanded on all the four principles of *public policy* but, as a result, made an already vague term even more unclear.

They decided that in order to determine fundamental policy the judge should act in a fair, reasonable and objective matter. This is such a subjective test that it would allow an appellant to challenge almost anything as it has not been made clear enough what really would be the test of fairness, reasonableness and objectiveness. The court did not elaborate much on what should construe as interest of India and justice and morality, but clarified the position on the test of patent illegality which would include any award that goes against any substantive law of India, against the Act in itself or against the terms of the contract. The Supreme Court also

[5] (2004) 9 SCC 263
[6] (2005) 3 SCC 49

clarified again that such illegality should go to the root of the matter and should not be trivial in nature. But, the question that arises is if this test of triviality is enough?

Conclusion

The Parliament enacted the Act on the basis of the UNCITRAL model law with an intention to make arbitration an effective and efficacious means of dispute resolution. However, the evolution in the interpretation of *public policy* from Renusagar to Builders appears to have negated some of the efforts. Justice Burrough described *public policy* as, *"a very unruly horse, and when once you get astride it you never know where you are going."*[7] It appears that Renusagar followed this principle and ensured that a narrow view of *public policy* is adopted. Lord Denning said, "W*ith a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles*."[8] Over the years, the judiciary has been expanding the meaning of the word *public policy* but, has failed to keep in control this unruly horse. In conclusion, judicial intervention in well-reasoned awards should be kept to the minimum the enforcing courts should not be permitted to examine the merits of the case or not. The court should not be question the opinion of the arbitrator(s) if they have given reasons. The judiciary should ensure that they alleviate the concerns of the business and minimize the scope of judicial intervention.

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[7] Richardson v. Mellish (1824) 2 Bing 229
[8] Enderby Town Football Club Ltd. v. Football Assn. Ltd. (1971) Ch. 591