Finality of Arbitral Award – Has it Hit an Iceberg?

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Advocate K. Vaitheeswaran

Advocate D.S. Vipula

Arbitration as an alternate dispute mechanism is preferred as it is quick, effective and has a degree of finality. There are only specific grounds specified in Section 34 of the Arbitration and Conciliation Act, 1996 ("the Act") on which a Court of law can intervene and set aside an arbitral award. Section 34 of the Act read with Section 5 of the Act, makes it clear that an arbitration award that is governed by Part I of the Act can be set aside only on grounds mentioned under sub-section (2) and (2A) of Section 34 of the Act, and not otherwise.

Conflict with Public policy of India and Patent Illegality

When it comes to understanding what would constitute an 'arbitral award that would be in conflict with the public policy of India', there are certain landmark judicial pronouncements of the Hon'ble Supreme Court of India, that constitute the crux of the jurisprudence relating to the interpretation of 'public policy of India' and 'patent illegality' as used in Section 34(2)(b)(ii) of the Act and sub-section (2A) of Section 34, respectively.

The earliest such landmark judgment was in***Renusagar Power Co. Ltd. Vs. General Electric Co.***, where the Apex Court laid down that 'fundamental policy of Indian law'; 'interests of India'; and 'justice or morality' to be the three tests to be applied in order to determine if an award would be contrary to 'public policy' as per Section 7(1)(*b*)(*ii*) of the Foreign Awards (Recognition and Enforcement) Act, 1961. Subsequently, in ***ONGC Vs. Saw Pipes,*** the Supreme Court added yet another element to be considered to decide whether or not an arbitral award would be contrary to the public policy of India. The fourth element was 'patent illegality'.

Principles that form part of fundamental policy of Indian Law

In the case of***ONGC Vs. Western Geco International Ltd.,*** the Supreme Court explained the meaning of 'fundamental policy of India' and in the course of explanation, laid down three distinct and fundamental juristic principles that must necessarily be understood as a part and parcel of the fundamental policy of Indian law.

(i) The Court or authority concerned is bound to adopt a 'judicial approach'.

(ii) A Court or a quasi-judicial authority must, while determining the rights and obligations of parties before it, do so in accordance with the principles of natural justice.

(iii) Perversity or irrationality tested based on Wednesbury's Principle of Reasonableness.

After ***Western Geco*** came the Division Bench judgment in the case of***Associate Builders Vs. Delhi Development Authority*** wherein Justice R.F. Nariman in his judgement, had elaborated on the concepts of 'fundamental policy of Indian law'; 'interest of India'; 'justice or morality'; and 'patent illegality'. Firstly, in explaining the concept of 'fundamental policy of Indian law', the following four basic principles were laid down:

(i) disregarding orders of superior courts;

(ii) fair, reasonable and objective, as against an arbitrary or whimsical approach;

(iii) principles of natural justice; and

(iv) perversity and irrationality by the standards of a reasonable person who would have arrived at the decision.

Secondly, the concept of 'interest of India' was very briefly explained to be something that is relevant to India as a member of the world community in its relations with other foreign nations. Thirdly, for the concepts of 'justice and morality', the Justice R.F. Nariman explained that an award could be said to be against justice and morality if it shocks the conscience of the Courts. Finally, it was explained that the concept of 'patent illegality' would include three subheads:

(i) contravention of a substantive law of India, the illegality of which should go to the root of the matter and cannot be trivial in nature;

(ii) contravention of the Arbitration and Conciliation Act, itself;

(iii) contravention of Section 28(3) of the Act.

The relevant portion of the judgement is given below

"*An Arbitral Tribunal must decide in accordance with the terms of the contract, but if an arbitrator construes a term of the contract in a reasonable manner, it will not mean that the award can be set aside on this ground. Construction of the terms of a contract is primarily for an arbitrator to decide unless the arbitrator construes the contract in such a way that it could be said to be something that no fair-minded or reasonable person could do.*"

Arbitration and Conciliation (Amendment) Act, 2016.

In an attempt to put to rest the interpretations given to the concepts of 'public policy of India' and 'patent illegality', certain changes were suggested by the 246th Report of the Law Commission to amend the law. After taking into consideration the changes suggested by the Law Commission, the Parliament had enacted the Arbitration and Conciliation (Amendment) Act, 2016. Section 18 of the Amendment Act, 2016 introduced Explanation 1 to Section 34(2)(b), to explain when an award is in conflict with the public policy of India, and also included a new sub-section (2A) to statutorily include patent illegality as one of the grounds on which an arbitral award could be challenged under Section 34 of the Act.

Explanation to Section 34(2)(b) reads as under:

"*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,--*

.....

(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"

The newly inserted sub-section (2A) reads as under:

"*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 re-appreciation of evidence."

Ssangyong Engineering

The most recent judgment interpreting the concept of 'arbitral award that would be in conflict with the public policy of India', notably after the Amendment of 2016, is in the case of ***Ssangyong Engineering and Construction Co. Ltd. Vs. National Highways Authority of India*** which was interestingly, again authored by his Justice R.F. Nariman. In light of the amendments introduced by the Amendment Act, 2016, Justice R.F. Nariman has done away with certain aspects of his own judgment in the case of ***Associate Builders*** while upholding and maintaining certain other positions as mentioned in the earlier case.

The position of law in so far as 'public policy of India' and 'patent illegality' could be summarised in a nutshell as below:

(i) Interpretation of 'public policy of India' would now be constricted to 'fundamental policy of Indian law', 'basic notions of justice or morality', as were interpreted in ***Associated Builders.***

(ii) The ground of mere 'contravention of a substantive law of India' would no longer be a factor in testing whether or not an arbitral award would be in contravention of the public policy of India, as held in ***Associate Builders.***

(iii) 'Patent illegality' would not include:

(a) a contravention of a statute not linked to public policy or public interest; or

(b) reappreciation of evidence, which what an appellate court would do.

(iv) 'Patent illegality' would include:

(a) An arbitral award not being reasoned and in contravention of Section 31(3) of the Act; or

(b) a finding based on no evidence at all or an award which ignores vital evidence; or

(c) the arbitrator commits an error of jurisdiction.

Applicability of the Amendment Act

It is important to bear in mind that the Hon'ble Supreme Court in the case of ***BCCI Vs. Kochi Cricket Pvt. Ltd.*** as well as in the ***Ssangyong*** case, has held that the Amendment Act, 2016 would apply to only those petitions filed under Section 34 of the Act, made after 23.10.2015, i.e., the date on which the Amendment Act came into effect.

Patel Engineering vs. North Eastern Electric Power Corporation

A three-judge bench of the Hon'ble Supreme Court in the case of ***Patel Engineering vs. North Eastern Electric Power Corporation*** vide its judgment dated 22.05.2020 has reiterated the position of law in relation to 'patent illegality' by stating that 'patent illegality' is a ground available under the statute for setting aside a domestic award if:

(i) the arbitral award is found to be perverse, or, so irrational that no reasonable person would have arrived at the same; or,

(ii) the construction of the contract is such that no fair or reasonable person would take; or

(iii) the view of the arbitrator is not even a possible view.

SEAMEC Engineering

The smooth sailing of the arbitral award seems to have a hit an iceberg on account of the recent 3 member decision of the Supreme Court in the case of ***South East Asia Marine Engineering & Constructions Ltd. Vs. Oil India Ltd.***, through which the jurisprudence developed for exercise of powers by courts under Section 34 of the Arbitration and Conciliation Act, 1996 seems to be altered.

Facts

South East Asia Marine Engineering & Constructions Ltd. ("the Appellant") and Oil India Ltd. ("the Respondent") entered into a contract ("the Contract") for the purpose of well drilling and other auxiliary operations in Assam. During the subsistence of the Contract, the price of High Speed Diesel which was an essential element of the contract, had increased. The Appellant claimed that the increase in price triggered Clause 23 of the Contract which provided for the Appellant to be reimbursed *if there is a change in or enactment of any law or interpretation of existing law, which results in additional cost/reduction in cost to* the Appellant. However, the Respondent had rejected the claims several times which led to the Appellant invoking the arbitration clause. Finally, the Arbitral Tribunal ("the Tribunal") had to decide whether change in price of HSD by way of circulars issued under the authority of State or Union amounted to 'change in law'. The Tribunal ruled that even though the HSD prices were increased by way of circulars issued under the authority of State or Union *is not a "law" in the literal sense, but has the "force of law" and thus falls within the ambit of Clause 23* and consequentially allowed the claim of the Appellant and awarded a sum of Rs.98,89,564.33 with interest at 10% per annum from the date of the award till the recovery of award money. The amount was subsequently revised to Rs.1,32,32,126.36 on 11.03.2005.

Aggrieved by the Arbitral Award, the Respondent challenged it under Section 34 of the Act before the District Judge, who in turn upheld the Arbitral Award and held that *the findings of the tribunal were not without basis or against the public policy of India or patently illegal and did not warrant judicial interference*. Subsequently, the Respondent had appealed against this order under Section 37 of the Act, before the High Court. The High Court allowed the appeal and set aside the award passed by the Arbitral Tribunal while holding that the interpretation of the terms of the contract by the Arbitral Tribunal was erroneous and against the public policy of India. On the scope of judicial review under Section 37 of the Act, the High Court held that the Court had the power to set aside the award as it was passed overlooking the terms and conditions of the contract. Aggrieved by the order of the High Court, the Appellant filed a Civil Appeal before the Hon'ble Supreme Court.

The Appellant's primary contention was that the question of law decided by the Tribunal is beyond judicial review and thus the High Court could not have interfered with a reasoned award which was neither against public policy of India nor patently illegal. On the contrary, the main contention of the Respondent was that the Tribunal's award: (a) is perverse and unreasonable in as much as it is contrary to the terms of the Contract; (b) is violative of Section 28 of the Act as it overlooked the other terms of the Contract; (c) has rewritten the contract in the guise of interpretation and such interpretation being in conflict with the terms of the contract, is in conflict with the public policy of India.

Decision of the Hon'ble Supreme Court

The Supreme Court had to decide *whether the interpretation provided to the contract in the award of the Tribunal was reasonable and fair, so that the same passes the muster under Section 34 of the Arbitration and Conciliation Act, 1996*?

In the process of deciding the issue, Justice N.V. Ramana delivering the judgment on behalf of the other two judges, first discussed the ambit and scope of the Court's jurisdiction under Section 34 of the Act. In doing so, His Lordship observed that *it is a settled position that a Court can set aside the award only on the grounds as provided in the Arbitration Act as interpreted by the Courts*. Reference was also made to the decision in the case of ***Dyna Technologies Pvt. Ltd. Vs. Crompton Greaves*** wherein it was held *that arbitral awards should not be interfered with in a casual and cavalier manner, unless the Court comes to a conclusion that the perversity of the award goes to the root of the matter without there being a possibility of alternative interpretation which may sustain the arbitral award*.

Interestingly, His Lordship Justice N.V.Ramana while delivering the judgment, observes that *usually the Court is not required to examine the merits of the interpretation provided in the award by the arbitrator, if it comes to a conclusion that such an interpretation was reasonably possible*. The Court then examines the Arbitral Award and observes that the Tribunal in its majority award utilized the liberal interpretation rule to interpret Clause 23 of the Contract. Subsequently, the judgement examines the impugned order passed by the High Court wherein the latter had held that Clause 23 is akin to a *force majeure* clause. However, it is also observed that the Contract has an exclusive *force majeure* clause by virtue of which the parties had agreed for a payment of *force majeure* rate to tide over any *force majeure* event temporary in nature.

The Hon'ble Apex Court did not accept the Tribunal's wide interpretation of Clause 23 of the Contract, on the ground that the Tribunal had not followed the thumb rule of interpretation, i.e., a document forming a written contract should be read as a whole and so far as possible as mutually explanatory. The Hon'ble Court then went onto discuss in detail, the other terms of the Contract and concluded that the interpretation of the Arbitral Tribunal to expand the meaning of Clause 23 to include change in rate of High Speed Diesel, is not a possible interpretation of this contract, as the appellant did not introduce any evidence which proves the same. Finally, the Court dismissed the appeal without interfering with the impugned judgment and order of the High Court that set aside the Arbitral Award.

Analysis and Implication of the Judgment

While this decision is likely to have far reaching ramifications there are certain interesting aspects of the decision which would require some analysis. The Supreme Court does not elaborate on public policy or scope of Section 34 in the context of setting aside an award. However, the High Court had set aside the award on the ground that the interpretation of the terms of the contract was erroneous and against public policy. The Supreme Court has held that the arbitral tribunal ignored the basic

principle of interpretation that a written contract should be read as a whole and so far as possible as mutually explanatory.

The Supreme Court has not applied its own observation in the***Dyna Technologies*** casethat “the mandate under Section 34 is to respect the finality of the arbitral award and the party autonomy to get their dispute adjudicated by an alternative forum as provided under the law. If the Courts were to interfere with the arbitral award in the usual course on factual aspects, then the commercial wisdom behind opting for alternate dispute resolution would stand frustrated.”

One has to keep in mind the fact that the judgment in the***SEAMEC*** casehasbeen delivered by a three-judge Bench of the Hon’ble Apex Court as against the Division Bench judgments forming the crux of the jurisprudence relating to the interpretation of ‘public policy of India’ and ‘patent illegality’ as used in Section 34 of the Act. It is most important to keep in mind the applicability of the Amendments brought to Section 34. The Supreme Court had, in the ***BCCI*** case categorically held that the Amendment Act, 2016 would apply to those petitions under Section 34, that were filed after 23.10.2015, implying that any Section 34 petition pending as on 23.10.2015 would still have to be decided as per Section 34 as it stood prior to the Amendment Act, 2016. The proceedings in the ***SEAMEC*** case were initiated in as early as the year 2012. This would mean that the judgment would be the law of land in so far as Section 34 proceedings initiated prior to 23.10.2105, are concerned until a different view emerges from a Larger Bench. Therefore, given this judicial development pending applications under Section 34 are likely to get a fillip and the finality of an arbitral award or otherwise as an issue would be fully back before the Courts.