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# THE SCOPE OF PUBLIC POLICY UNDER THE ARBITRATION AND CONCILIATION ACT, 1996

O.P. Malhotra\*

*In this paper, the author examines the true meaning of the term “public policy” under the Arbitration and Conciliation Act, 1996, for the purpose of setting aside arbitral awards. The author surveys contrasting judicial decisions and defends the much-maligned decision of the Supreme Court of India in ONGC v. Saw Pipes.*

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## I. INTRODUCTION

Public policy is a ground for setting aside an arbitral award under section 34 of the Arbitration and Conciliation Act, 1996.<sup>1</sup> The provision mirrors the

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<sup>1</sup> Hereinafter “the Act.” § 34 further explains that without prejudice to the *generality of the public policy of India* “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.”

UNCITRAL Model Law on International Commercial Arbitration. Section 48 of the Act also states that a foreign arbitral award may be set aside if it is in opposition to the public policy of India.

The term “public policy”, is of course, a nebulous one and incapable of any precise definition. Public policy has been described as ‘a principle of judicial legislation or interpretation founded on the current needs of the community’ When courts perform this function undoubtedly they legislate judicially. That is however, a kind of legislation implicitly delegated to them to further the object of the legislation and to promote the goals of society. *A priori* it is variable in nature. However, the rationale for the doctrine of public policy remains that while it is in general desirable that parties have autonomy to enter into contracts, when that autonomy is outweighed by public interest, a court will refuse to enforce the contract. The reasoning that applies for having public policy as a ground to set aside an arbitral award is the same.

The rationale behind this paper is to examine what the meaning of the term “public policy” should be, in the context of setting aside arbitral awards. Two landmark and contrasting decisions of the Supreme Court, in this regard, are analysed.

## II. THE *RENUSAGAR* CASE: THE NARROW VIEW OF PUBLIC POLICY

In the landmark decision in *Renusagar Power Co Ltd v. General Electric Co*,<sup>2</sup> dealing with the Foreign Awards (Recognition and Enforcement) Act 1961 section 7(1)(b)(ii), the Supreme Court stated the law:

“Since the Foreign Awards Act is concerned with recognition and enforcement of foreign awards which are governed by the principles of private international law, the expression “public policy” in section 7(1)(b)(ii) of the Foreign Awards Act must necessarily be construed in the sense the doctrine of public policy is applied in the field of private international law. Applying these criteria it must be held that the enforcement of a foreign award would be refused on the ground that it is contrary to public policy if such enforcement would be contrary to (i) fundamental policy of Indian law; or (ii) the interests of India; or (iii) justice or morality.”<sup>3</sup>

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<sup>2</sup> 1994 Supp (1) S.C.C. 644.

<sup>3</sup> These points were based on CHESHIRE & NORTH, PRIVATE INTERNATIONAL LAW 131 (1992) which classified four grounds on which English courts would refuse to enforce a

Though this statement of law was made in the context of enforcement of a foreign (New York Convention) award, it has been held to be relevant for setting aside arbitral awards under section 34(2)(b)(ii) on the ground that the award is in conflict with the public policy of India as well.<sup>4</sup> The implication of this decision is that an award with a patent illegality can be enforced, as long as that illegality itself is not contrary to the public policy of India.

### III. THE *ONGC* CASE: A BROADER VIEW OF PUBLIC POLICY

The decision of the Supreme Court in *ONGC v. SAW Pipes Ltd*<sup>5</sup> has provoked considerable adverse comment.<sup>6</sup> Particularly the comments of the Law Commission of India in its 176th Report and the comments of Arden LJ in an illuminating lecture<sup>7</sup> are noteworthy. The crux of all the comments is that the *ONGC* case sets the clock back to the pre-1996 era when parties could challenge arbitral awards on the ground of error of law apparent on the face of the award. The purpose of the UNCITRAL Model Law and therefore, *a priori*, of the 1996 Act was to leave that era behind. The decision of the Supreme Court in *Renusagar* gives “public policy of India” a narrow meaning by confining judicial intervention in an arbitral award only to the three grounds set forth in it, which are exhaustive and incapable of expansion. My deference to the authors of those comments does not prevent me offering a contrary view.

The facts of this case were as follows: the respondent company agreed to supply casing pipes to the appellant and placed an order for steel plates, i.e. the raw material required for their manufacture, with the appellant, an Italian supplier,

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foreign acquired right on the ground that its enforcement would affront some moral principle the maintenance of which admits of no possible compromise: (i) where the fundamental conceptions of English justice are disregarded; (ii) where English conceptions of morality are infringed; (iii) where a transaction prejudices the interests of the United Kingdom or its good relations with foreign powers; (iv) where a foreign law or statute offends English conceptions of human liberty and freedom of action.

<sup>4</sup> See *Municipal Corporation of Greater Mumbai v. Jyoti Construction Co.*, 2003 (3) Arb. L.R. 489.

<sup>5</sup> (2003) 5 S.C.C. 705, 709. See also *Jagmohan Singh Gujral v. Satish Ashok Sabnis*, 2004 (1) Arb. L.R. 212.

<sup>6</sup> See D.R. Dhanuka, *A Critical Analysis of the Judgment ONGC v SAW Pipes Ltd.*, 2003 (2) Arb. L.R. 5 (SC) – *Plea for Consideration by Larger Bench*, 51(3) Arb. L.R. 1 (2003); S. Gupta, *Challenge to Arbitral Awards on Public Policy: A Comment on ONGC v. Saw Pipes Ltd.*, 52(3) Arb. L.R. 1 (2003).

<sup>7</sup> Delivered at the 2nd Conference on Dispute Resolution 2003 on Arbitration and the Courts, published in the journal of the International Centre for Alternative Dispute Resolution (ICADR).

within a certain time frame. As the flow of the supplies was impeded by a general strike of steel mill workers all over Europe, the respondent requested the appellant to extend the time limit for completion of the supplies. The appellant granted the request, subject to the condition that the amount of liquidated damages stipulated in the contract for delay in supply of pipes would be recovered from the respondent. The appellant accordingly deducted amounts towards liquidated damages as specified in the contract while making payment of the price.

In the arbitration proceedings that followed, the appellant did not prove that it had suffered any loss or damage because of the delay. The tribunal decided in favour of the respondent, holding that the amount of liquidated damages was wrongfully deducted. The Bombay High Court dismissed the petition for setting aside the award *inter alia* on the ground that the expression "in conflict with public policy of India" used in section 34(2)(b)(ii) could not be interpreted to mean that in case of violation of some provisions of law, without anything more, the court could set aside the award.

On appeal, on a review of the earlier dicta, the Supreme Court held that the phrase "public policy of India" used in the context of section 34, is required to be given a wider meaning than in *Renusagar*, because the concept of public policy connotes some matter which concerns public good and the public interest. What is for the public good or in the public interest or what would be injurious or harmful to the public good or public interest has varied from time to time. An award which, *prima facie* violates statutory provisions cannot be said to be in the public interest, because it is likely to adversely affect the administration of justice. Accordingly, in addition to the three heads set forth in *Renusagar*, an award can as well be annulled, being in conflict with public policy of India, if it is patently illegal.<sup>8</sup> The court however clarified that the illegality 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 public policy. An award could also be set aside if it were so unfair and unreasonable that it shocked the conscience of the court. Such an award must be adjudged void and opposed to the public policy of India.

On the facts, the Court held that the award on its face was erroneous and in violation of the terms of the contract and *a priori* violative of the provisions of section 28(3) of the Act. In other words, it was patently illegal and "a patently illegal award is required to be set at naught, otherwise it would promote injustice". Hence, if the award is erroneous on the basis of record with regard to the proposition of law or its application, the court will have jurisdiction to interfere. Therefore "giving limited jurisdiction to the court for having finality to the award and resolving the dispute by speedier method would be much more frustrated by

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<sup>8</sup> ONGC v. SAW Pipes Ltd., (2003) 5 S.C.C. 705, 727.

permitting a patently illegal award to operate". The question then is: What is an error of law apparent on the face of record that justifies annulment of an award or refusal to enforce a foreign award?

#### **IV. WHAT IS PATENT ILLEGALITY - ERROR OF LAW APPARENT ON THE FACE OF THE AWARD?**

In administrative law, 'error of law apparent on the face of the record' is one of the established grounds for quashing judicial or quasi-judicial orders or decisions on a writ of *certiorari*. In the United Kingdom a tribunal has now, in effect, no scope to decide any question of law incorrectly: an error of law would render its decision liable to be quashed as *ultra vires*. The court will, therefore, quash any decisive error, because all errors of law are now jurisdictional.<sup>9</sup> In India, however, an error of law apparent on the face of the record must be manifest on the face of the proceedings or the decisions. In other words, it must be a patently illegal error.<sup>10</sup> In all such cases, the impugned conclusion or decision should be so plainly inconsistent with the relevant statutory provisions that no difficulty is experienced by the reviewing court in holding that the error of law is apparent on the face of the record.<sup>11</sup> An error apparent on the face of the record must therefore be an obvious and patent mistake and not something which can be established by a long-drawn-out process of reasoning on points on which there may conceivably be two opinions. The error must be so blatant, so obvious, so manifest or so palpable that when attention is invited to it, no elaborate argument is needed to support the contention that the conclusion is erroneous.

Some instances of such blatant errors on face of the record or the decision which would vitiate an arbitral award are: where the award is inconsistent with: a constitutional provision; an Act of the Parliament or the State Legislature; the law declared by the Supreme Court of India or the High Court having jurisdiction. Such an award is vitiated by an error of law apparent on its face. In the context of arbitration, an award inconsistent with any provision of the Arbitration and Conciliation Act 1996 suffers by a patent error of law apparent on its face. Any decision or award suffering from such defects is a nullity without existence or effect in law. It is a nullity as expressed by various epithets as 'void', 'void *ab initio*', '*non est*' and '*coram non iudice*'. It is an affront to the law and stands self-

<sup>9</sup> WILLIAM WADE & CHRISTOPHER FORSYTH, ADMINISTRATIVE LAW 286 (2000).

<sup>10</sup> Prem Singh v. Deputy Custodian General, A.I.R. 1957 S.C. 804 at 809; Parry & Co Ltd v. P.C. Pal, (1970) 2 L.L.J. 429 (SC), Bijili Cotton Mills Pvt. Ltd. v. Industrial Tribunal, 1972 Lab I.C. 1122 (SC); West Coast Motors v. District Magistrate, (1963) 1 L.L.J. 196.

<sup>11</sup> Syed Yakooob v. Radhakrishnan, A.I.R. 1964 S.C. 477, 480.

condemned. It bears a **brand of invalidity** on its forehead.<sup>12</sup> It is incapable of being enforced. Even though there is no ground in section 34(2) authorizing the court to set aside such an award, its **enforcement** under section 36 may be resisted by anyone against whom the award is made.

Section 38 of the Code of Civil Procedure 1908 provides 'a decree may be executed ... by the court to which it is sent for execution'. Now, the law is well settled that an executing court cannot go behind the decree. Nor can it question its legality or correctness. It must take the decree as it stands.<sup>13</sup> But there is one exception to this general rule and that is that, where the decree sought to be executed is a nullity for lack of inherent jurisdiction in the court passing it, its invalidity can be set up in an execution proceeding. If the court which passed the decree had no jurisdiction, the decree is a nullity incapable of execution and its invalidity can be set up in the execution proceedings.<sup>14</sup>

## V. CAN *ONGC* BE FAULTED?

I am of the opinion that the *ONGC* case cannot be faulted by critics for the following reasons:

### **A. Public Policy is not Immutable**

There is unanimity of English and Indian authorities that the concept of public policy is not immutable. The rules on which the public policies of a nation are founded at a particular time, on proper occasion, are capable of expansion and modification. In modern progressive society with fast-changing social norms and concepts, it is more and more imperative to evolve new heads of public policy. The courts have responded to this challenge in the past by minting new heads and when the exigencies of justice require they will do so again.

In light of this position of law, *ONGC* was justified in adding a fourth imperative head to the three set forth in *Renusagar*. It is relevant to note here that the three heads set out in *Renusagar* were stated by the court for the first time. Before that, the parameters of the scope of public policy of India had not been defined. Therefore, if one bench of the Supreme Court could list the three heads of the public policy of India in *Renusagar*, there is no justifiable reason to fault *ONGC* merely because another bench has added one more head to the three already existing. It is rather surprising, however, that in this of all areas the courts should be expected to surrender their function of developing the law.

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<sup>12</sup> Phrase coined by Lord Radcliffe in *Smith v. East Elloe*, [1956] 1 All E.R. 855 (HL).

<sup>13</sup> *Bank of Behar v. Saranghaidhai Singh*, A.I.R. 1949 P.C. 8.

<sup>14</sup> *Jnanendra Mohan v. Rabindra Nath*, A.I.R. 1933 P.C. 61.

### **B. Fundamental Policy of Indian Law**

Even assuming that the head, 'patent illegality' of the award which goes to the root of the matter or shocks the conscience of the court, could not be added to the three heads already existing, such patent illegality is comprehended in the very first head set out in *Renusagar*, "fundamental policy of Indian law" itself. For instance, an award inconsistent with a constitutional provision; or an Act of Parliament, particularly the Arbitration Act; a judgment of the Supreme Court or a High Court having jurisdiction over the arbitration, will evidently be patently illegal and contrary to the "fundamental policy of Indian law". And an award which does not state "the reasons upon which it is based" will be patently illegal, being inconsistent with section 31(3) of the Act. All such awards will be patently illegal and inconsistent with the "fundamental policy of Indian law".

### **C. Unenforceability of the Award**

A patently illegal award, where its illegality goes to the root of the matter or is so unfair and unreasonable that it shocks the conscience of the court, will be void *ab initio* and a nullity. In view of the law laid down by the Supreme Court in *Sunder Dass*, it will be incapable of enforcement under section 36. Its enforcement, therefore, under section 38 and Order XXI of the Code of Civil Procedure 1908 may be successfully resisted, because it will cause substantial injustice to the applicant.

### **D. Recommendations of the Law Commission of India**

It is relevant to note here that in its 176th Report the Law Commission of India itself has recommended insertion of a new section 34(A) proposing that two more additional grounds of attack to be included in the application under section 34(1). These two additional grounds are (i) that there is an error which is apparent on the face of the arbitral award giving rise to a substantial question of law, and (ii) that the award has not given reasons though it was an award which was required to contain reasons, not being one by way of settlement or one where the agreement provided that reasons need not be given.

## **VI. CONCLUSION**

A survey of the contemporary English and Indian law, therefore, reveals no justification to fault *ONGC*, which only modifies and expands the scope of public policy of India as delimited in *Renusagar*. It adds one more head – patent illegality of the award – provided that the illegality goes to the root of the matter or is so unfair and unreasonable that it shocks the conscience of the court. Contrarily, if the court had not so modified the law it would have failed in its duty to prevent subversion of societal goals and endangering the public good.