

**PUBLIC POLICY A HURDLE UNDER THE INDIAN ARBITRATION  
LAW: CRITICAL ANALYSIS**

Author-Vishal Ranaware<sup>1</sup>

Co – Author Amol Shelar<sup>2</sup>

**ABSTRACT**

The traditional role of public policy was to limit the scope of foreign law, recognition, and enforcement of foreign judgments or awards. Sometimes domestic courts use this doctrine to strike down the foreign arbitral awards. Though the disputing parties are free to choose applicable laws in international commercial arbitration, when it comes to the recognition and enforcement of an award they rely on the domestic laws and courts. If the court thinks that an award before them deals with a matter violates public policy, the court may refuse to recognise and enforce it. There is no uniformity in public policy notion among the states, it has been interpreted in different ways in different jurisdictions so it becomes very difficult to say which award will be allowed and which will violate the principle. Therefore, it becomes a big hurdle in the way of international commercial arbitration. To deal with this issue Indian judiciary took a step to define it and limit the scope doctrine of public policy. Finally, in 2015 Indian Parliament amended the Arbitration and Conciliation Act, 1996, and clarified the term ‘public policy’.

**KEYWORDS**

Public Policy, International Commercial Arbitration, the Arbitration and Conciliation Act 1996, party autonomy, arbitral award, Renusagar.

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<sup>1</sup>Assistant Professor,Symbiosis Centre for Distance Learning, Pune(Email: adv.vishalranaware@gmail.com)

<sup>2</sup> Faculty of Law,Sinhgad Law College,Pune

## **INTRODUCTION**

Alternative dispute resolution mechanism brings hope for the disputing parties as it is flexible and informal compared to the judicial system, also have other advantages. Arbitration is one of the ways to resolve the dispute outside the court. It gives autonomy to the parties on certain aspects, like appointing arbitrators, deciding their qualification, place, date, and time, and most importantly finalising a set of procedural rules and laws applicable to the dispute. Also, the international and national laws provide for minimum intervention of the judiciary. In the arbitral proceedings, the judiciary can intervene only under the limited grounds provided by the Arbitration and Conciliation Act, 1996<sup>3</sup> (the Act). It is to protect the rights of the parties to resolve their dispute through arbitration, a recognised mode of dispute resolution, as per the agreement and this should not be hampered by unwelcome judicial intervention. However, this autonomy is not absolute, there are certain provisions that work as a limitation on the concept of party autonomy given by national and international law. Here, in this research paper researcher has discussed the concept of ‘public policy’ which works as a limitation on party autonomy. However, in 2015, Section 34<sup>4</sup> and 48<sup>5</sup> have amended to limit the scope of ‘public policy’.

## **FINALITY OF ARBITRAL AWARD**

As per the national and international laws, the decision of an arbitral tribunal is final and binding on parties and persons claiming under it. Judicial intervention is allowed in defined circumstances; therefore, if aggrieved party wants to set aside an arbitral award it can be done by the court ‘only’ on the grounds defined under Section 34, Part I of the Act. According to Section 34(2)(a), the party has to establish that:

- a. the party is under some incapacity,
- b. the arbitration agreement is invalid under the laws applicable,

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<sup>3</sup> The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 (India).

<sup>4</sup> The Arbitration and Conciliation Act, 1996, § 34, No. 26, Acts of Parliament, 1996 (India).

<sup>5</sup> The Arbitration and Conciliation Act, 1996, § 48, No. 26, Acts of Parliament, 1996 (India).

- c. the arbitrator has appointed without giving due notice to the party,
- d. the constitution of the arbitral tribunal is not as defined by parties, unless otherwise,
- e. the dispute or the matter covered by an arbitral award is not within the scope of arbitration according to the submission agreement,
- f. the arbitral tribunal has not followed the procedure defined by parties, unless otherwise.<sup>6</sup>

Apart from the above mentioned, there are two more grounds on which the court may set aside an arbitral award; arbitrability and public policy.<sup>7</sup> This provision is based on Article 34 of the UNCITRAL Model Law on International Commercial Arbitration, 1985 which is the first recourse against an award at the seat of arbitration.

Part II of the Act gives effect to the New York Convention 1958 (NY Convention), the Geneva Protocol 1923, and Geneva Convention 1927 which deals with the recognition and enforcement of foreign arbitral awards under the Act. Sub-section (1) and (2) of Section 48 of the Act based on Article V of the NY Convention define more or less similar grounds stated under Section 34 of the Act on which a local court where the recognition and enforcement sought may deny it.

Among all grounds, the principle of public policy gives scope for interpretation also works as a limitation on party autonomy.<sup>8</sup> Let's see how!

## **DOCTRINE OF PUBLIC POLICY**

The term 'public policy' has not been defined under the Act nor under any convention which makes it difficult to interpret and this gives an opportunity to judge to decide its course. It has been defined in different ways in different jurisdictions across the globe. The House of Lords in 1853 defined public policy as the legal principle which forbids the subject from doing something which is injurious to the public or against the public good.<sup>9</sup> It means the things which are injurious to the public, against the good morals or public good are not allowed to do in that particular jurisdiction. So, if an arbitral award deals with such matters, contrary to

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<sup>6</sup> The Arbitration and Conciliation Act, 1996, § 34(2)(a), No. 26, Acts of Parliament, 1996 (India).

<sup>7</sup> The Arbitration and Conciliation Act, 1996, § 34(2)(b), No. 26, Acts of Parliament, 1996 (India).

<sup>8</sup> The Arbitration and Conciliation Act, 1996, § 34 (2)(b)(ii), No. 26, Acts of Parliament, 1996 (India).

<sup>9</sup> Egerton v. Brownlow, (1853) 4 HLC 1.

laws or standards, violate the notion of morality and justice prevail in the court's jurisdiction such awards will be vacated by the domestic court. For example, there is a dispute between parties over casino profit. The disputing parties may resolve it through arbitration. Now, some states will consider it as a commercial dispute and will allow its enforcement. However, the states with strict rules against gambling may not be enforced on the ground of public policy as it is illegal in that particular jurisdiction. A similar approach has been adopted by the US Second Circuit Court of Appeals in *Parsons & Whittemore Overseas Co., Inc. v. Societe Generale de l'Industrie du Papier*<sup>10</sup> while affirming the arbitral award against an American Company. The court stated that the term public policy should be interpreted narrowly and the enforcement of foreign awards under the NY Convention may be denied if it goes against the basic idea of morality and justice.<sup>11</sup>

The Supreme Court of Korea stated that the basic tenet of the public policy principle is to protect the fundamental moral beliefs and social order of the country where recognition and enforcement are sought from being harmed.<sup>12</sup> Here, the Korean court gave a narrow interpretation and on the same note, the Swiss court in *K S AG v. CC SA*<sup>13</sup> upheld the constrained approach of the public policy principle. Apart from international commercial arbitration, in the US, courts from states like Ohio, South Carolina, and North Carolina consider that the binding arbitration agreements between parents to resolve child support disputes violates public policy.<sup>14</sup>

## **INDIAN LEGAL SYSTEM AND DOCTRINE OF PUBLIC POLICY**

Section 34(2)(b)(ii) and 48(2)(b) states that the court may set aside and refuse to enforce an arbitral award, respectively, if it contradicts with the notion of 'public policy' prevailed in the state.<sup>15</sup> The Act is silent on its meaning however, the judiciary has taken an initiative to

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<sup>10</sup> *Parsons & Whittemore Overseas Co., Inc. v. Societe Generale de l'Industrie du Papier*, 508 F.2d 969 (2d Cir. 1974).

<sup>11</sup> *Id.*

<sup>12</sup> *Adviso NV (Netherlands Antilles) v. Korea Overseas Construction Corp.*, XXI YBCA 612 (1996).

<sup>13</sup> *K S AG v. CC SA*, XX YBCA 762 (1995).

<sup>14</sup> *Cohoon v. Cohoon*, 770 N. E. 2d 885.

<sup>15</sup> The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 (India).

decode. It denotes the fundamental policy of law, justice, and morality.<sup>16</sup> The Supreme Court discussed this issue in a number of cases. In *Renusagar Power Co. Limited v. General Electric Company*<sup>17</sup> (Renusagar), the Apex Court interpreted the term ‘public policy’ defined as the ground for setting aside an award under the Foreign Awards (Recognition and Enforcement) Act, 1961<sup>18</sup>. The Court held that the term used in a very restricted sense, therefore an arbitral award cannot be barred under public policy principle merely on the ground of violation of Indian laws. The judges have to look for something more to apply the bar of public policy to foreign arbitral awards. It observed that to refuse the enforcement of foreign awards on the ground of public policy the court should find that award contrary to:

- (a) Fundamental policy of Indian Law; or
- (b) The interest if India; or
- (c) Justice or morality.

In furtherance of the above observation, the Indian judiciary has expanded the scope of the term ‘public policy’ by adding few more grounds to it. In 2003, in *Oil & Natural Gas Corporation Ltd. v. SAW Pipes Ltd*<sup>19</sup> (ONGC) the Supreme Court observed that the role of the court under Section 34 of the Act is appellate/revision court therefore, the vast powers are conferred by the Act. It stated that the ‘patent illegality’ could be a valid ground to set aside an arbitral award. As per the decision, to call an award ‘patently illegal’ has to disregard the substantive provisions of law or contradict the terms of the contract. If the given condition is satisfied, the court can intervene and pass an order under Section 34 of the Act. The court further added that the narrow approach would make some provisions of the Act insignificant, so an extensive interpretation is a prerequisite of the statute to vacate ‘patently illegal’ awards.<sup>20</sup>

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<sup>16</sup> *Bharti Airtel Limited v. Union of India*, 231 (2016) DLT 71.

<sup>17</sup> *Renusagar Power Co. Limited v. General Electric Company*, 1994 Supp (1) SCC 644.

<sup>18</sup> The Foreign Awards (Recognition and Enforcement) Act, 1961, § 7(1)(b)(ii), No. 45, Acts of Parliament, 1961 (India).

<sup>19</sup> *Oil & Natural Gas Corporation Ltd. v. SAW Pipes Ltd*, (2003) 5 SCC 705.

<sup>20</sup> *Id.*

There was a difference between *Renusagar*<sup>21</sup> and *ONGC*<sup>22</sup> as the earlier one was dealing with enforcement of an award under Section 7 of Foreign Awards (Recognition and Enforcement) Act, 1961<sup>23</sup> (since it is repealed Section 48 of the Act govern this field) and later with validity under Section 34 of the Act. However, it increases the burden of the Indian judiciary. Now, every award with an error of application of legal provisions could be challenged under Section 34 of the Act by virtue of newly added ground. Indian courts re-heard the awards on merits which defeated the very basic purpose of the arbitration.

In 2011, one more case related to the 'public policy' under Section 48 of the Act was filed before the Supreme Court. In *Phulchand Exports Ltd. v. OOO Patriot*<sup>24</sup> (*Phulchand*) the Supreme Court held that the test given in *ONGC*<sup>25</sup> must be followed for foreign awards as the expression 'public policy' under Section 34 and 48 of the Act are the same. The Supreme Court brought foreign awards and domestic awards on the same page without specifying reasons for ignoring the difference between these two drawn by the Act. It expands the meaning of the term 'public policy' in India.

However, *Phulchand*<sup>26</sup> ruling had a short span, it was overturned in *Shri Lal Mahal Ltd. v. Progetto Grano Spa*<sup>27</sup> ("*Lal Mahal*"). The Apex Court held that the term 'public policy', defined as ground under Section 48 of the Act, doesn't cover the 'patent illegality. This decision restored the position held in *Renusagar*<sup>28</sup> with respect to enforcement of the foreign award and ceased application of *ONGC*<sup>29</sup> to Section 48 cases. It ended strikes on the foreign awards on the ground of 'patent illegality' by narrowing down the scope of the term 'public policy' in India. The court observed that an application of the term 'public policy' under Section 48 of the Act is restricted to the arbitral awards contradicting the fundamental policy

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<sup>21</sup> *Renusagar Power Co. Limited v. General Electric Company*, 1994 Supp (1) SCC 644.

<sup>22</sup> *Oil & Natural Gas Corporation Ltd. v. SAW Pipes Ltd.*, (2003) 5 SCC 705.

<sup>23</sup> The Foreign Awards (Recognition and Enforcement) Act, 1961, § 7, No. 45, Acts of Parliament, 1961 (India).

<sup>24</sup> *Phulchand Exports Ltd. v. OOO Patriot*, (2011) 10 SCC 300.

<sup>25</sup> *Oil & Natural Gas Corporation Ltd. v. SAW Pipes Ltd.*, (2003) 5 SCC 705.

<sup>26</sup> *Phulchand Exports Ltd. v. OOO Patriot*, (2011) 10 SCC 300.

<sup>27</sup> *Shri Lal Mahal Ltd. v. Progetto Grano Spa*, (2014) 2 SCC 433.

<sup>28</sup> *Renusagar Power Co. Limited v. General Electric Company*, 1994 Supp (1) SCC 644.

<sup>29</sup> *Oil & Natural Gas Corporation Ltd. v. SAW Pipes Ltd.*, (2003) 5 SCC 705.

of India, the interest of India, and justice and morality. Section 48 of the Act doesn't give an opportunity to review the awards on the merits.

Further, it was expected from the highest judicial forum that *ONGC v. Western Geco International Ltd.*<sup>30</sup> (*Western Geco*) will review the explanation of the term 'public policy' under Section 34 of the Act and override the *ONGC*<sup>31</sup>. However the Apex Court broadened the scope of 'public policy' and observed that the term 'public policy' must include all such fundamental principles as providing a basis for the administration of justice and enforcement of law in this country. According to the court, the fundamental policy of Indian law includes three distinct and fundamental juristic principles, those are:

- a) the adjudicating authority must adopt a judicial approach while defining the rights of the citizens,
- b) the adjudicating authority must follow the principles of natural justice and consider relevant facts of the case to determine the rights and duties of parties,
- c) the court should not allow the enforcement of perverse or irrational awards.

These are the judgments that widened the scope of the expression 'public policy' referred under Sections 34 and 48 of the Act. To limit the scope of interpretation of the term 'public policy', the legislature added explanation to Section 34 and 48 through the Arbitration and Conciliation (Amendment) Act, 2015<sup>32</sup>.

### **THE 246<sup>TH</sup> LAW COMMISSION REPORT AND THE 2015 AMENDMENT**

The Law Commission of India (the Law Commission) responded to these judgments in February 2015 by issuing a supplement to the 246th Law Commission Report, published in August 2014. The Law Commission criticised the Supreme Court decisions in *ONGC*<sup>33</sup> and *Western Geco*<sup>34</sup> for broadening the scope of the term 'public policy' and "opening the

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<sup>30</sup> *ONGC v. Western Geco International Ltd.*, (2014) SLT 564.

<sup>31</sup> *Oil & Natural Gas Corporation Ltd. v. SAW Pipes Ltd.*, (2003) 5 SCC 705.

<sup>32</sup> The Arbitration and Conciliation (Amendment) Act, 2015, No. 3, Acts of Parliament, 2016 (India).

<sup>33</sup> *Oil & Natural Gas Corporation Ltd. v. SAW Pipes Ltd.*, (2003) 5 SCC 705.

<sup>34</sup> *ONGC v. Western Geco International Ltd.*, (2014) SLT 564.

floodgates”. The Law Commission highlighted that the exhaustive list of grounds defined under Section 34 and 48 of the Act are related to the procedural issues and the courts are not supposed to go into the substantive problem. The Law Commission recommended the definition of public policy given by the Supreme Court in *Renusagar*<sup>35</sup>.

Considering the recommendations of the Law Commission on this particular issue, the Parliament amended the Act through the Arbitration and Conciliation (Amendment) Act, 2015<sup>36</sup>. It adds explanation to the Section 34 and 48 of the Act. According to the amended provision, the court may set aside an arbitral award or deny enforcement if it conflicts with the public policy of India, only if:

1. The making of the award was induced or affected by fraud or corruption or was in violation of section 75<sup>37</sup> or section 81<sup>38</sup>; or
2. It is in contravention with the fundamental policy of Indian law; or
3. It conflicts with the most basic notions of morality or justice.

This amendment limits the scope of ‘public policy’ and reduced the scope of judicial intervention.

## CONCLUSION

Arbitration is one of the ways of alternative dispute resolution. It has been preferred by the parties for commercial disputes especially international because of its unique features, like, party autonomy and minimal court intervention. Parties to an arbitration agreement are permitted to select the applicable laws to the subject matter of dispute as well as procedural aspects of the arbitration. However, the doctrine of ‘public policy’ limits the party autonomy as ultimately the finality and enforcement of the arbitral award depend on the laws prevailing at the seat of arbitration and place the party seeking enforcement. Interpretation of the term ‘public policy’ varies from state to state, time to time as stated by the Supreme Court in *Murlidhar Agarwal and another v. State of U.P. and others*<sup>39</sup>. It was observed by the court that

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<sup>35</sup> *Renusagar Power Co. Limited v. General Electric Company*, 1994 Supp (1) SCC 644.

<sup>36</sup> The Arbitration and Conciliation (Amendment) Act, 2015, No. 3, Acts of Parliament, 2016 (India).

<sup>37</sup> The Arbitration and Conciliation Act, 1996, § 75, No. 26, Acts of Parliament, 1996 (India).

<sup>38</sup> The Arbitration and Conciliation Act, 1996, § 81, No. 26, Acts of Parliament, 1996 (India).

<sup>39</sup> *Murlidhar Agarwal and another v. State of U.P. and others*, 1974 (2) SCC 472.



the notion of public policy changes with time, generation, community, and state. Even in one generation, it may change its course. It never remains the same or static. It became useless if it didn't change or remain in fixed moulds. So, an award finalised in one state may be denied its enforcement at another. The term 'public policy' gives power to the court to decide its future course and the same was observed in India since *Renusagar*<sup>40</sup> to *Western Geco*<sup>41</sup>.

This issue has been resolved by the Arbitration and Conciliation (Amendment) Act, 2015 which is giving a positive result. Since the amendment, the courts have refused to examine the Section 34 and 48 cases on the merits, act as an appellate authority, or give a wide interpretation to expression 'public policy'. In *Venture Global Engineering LLC and Ors v. Tech Mahindra Ltd. and Ors*<sup>42</sup>, the Hon'ble Supreme Court held that the grounds specified under Section 34 of the Act are the 'only' grounds on which the court can set aside the awards. While dealing with Section 34 cases the court should not act like an appellate court, they are not supposed to examine the legality of an award on merits of claims by entering into a factual arena.<sup>43</sup> The same approach has been adopted by the judiciary in other cases like *Sutlej Construction v. The Union Territory of Chandigarh*<sup>44</sup>. Now, the courts are realising that they have to intervene in the arbitral process 'only' in specified conditions and grounds defined by the Act and give some free-way so an arbitration can achieve its intended objectives.

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<sup>40</sup> *Renusagar Power Co. Limited v. General Electric Company*, 1994 Supp (1) SCC 644.

<sup>41</sup> *ONGC v. Western Geco International Ltd.*, (2014) SLT 564.

<sup>42</sup> *Venture Global Engineering LLC and Ors v. Tech Mahindra Ltd. and Ors*, (2018) 1 SCC 656.

<sup>43</sup> *Id.*

<sup>44</sup> *Sutlej Construction v. The Union Territory of Chandigarh*, (2017) 14 SCALE 240 (SC).