JUDICIAL REVIEW OF ARBITRAL AWARD:
A POLICY REVIEW ON DELIMITATION OF PATENT
ILLEGALITY IN INDIA

Kanya Saluja
IV Year B. Com LL. B (Hons.), Institute of Law, Nirma University, Ahmedabad

Amit Kumar Kashyap
Asst. Prof of Law, Institute of Law, Head Centre for Corporate Law Studies, Nirma University, Ahmedabad, India

In the legal interpretation of the grounds for setting aside arbitral awards, the ambiguity in the recourse against an arbitral award is an issue of genuine concern and relevance. The various amendments and judicial precedents made under Section 34 in the Arbitration and Conciliation Act 1996 have provided a near end to the definition of Public Policy. However, it is still an area that requires various changes to make the practice of setting aside Arbitral awards an exception rather than a regular exercise. One of the reasons for annulling or refusing to implement an arbitral judgment is “patent illegality,” which has generated intense debate among practitioners both in India and abroad. This research article discusses the nuances in highlighting the flaws and loopholes contributing to the execution and non-execution of arbitral awards. This research article discusses the jurisprudence and various precedents in the context of Patent Illegality under the Public Policy of India and how the Supreme Court of India, in multiple instances, contradicted its judgments and provided a vagueness in interpreting the setting aside of Arbitral Award in different scenarios.
INTRODUCTION

An act by the name of ‘The Arbitration and Conciliation Act, 1996’ (“Principal Act” or “the Act”) was enforced in India w.e.f. The 19th of August 1996. The Act provided the settlement of disputes by the most common form of alternate dispute resolution mechanism, i.e., Arbitration. To ensure justice, it was necessary that recourse against a decision passed through the process of Arbitration – called the Arbitral Award – exist. This was facilitated through Chapter VII of the Act. The sole section of this chapter – Section 34, has been revamped by the Arbitration and Conciliation Act (Amendment) Act, 2015 of the AC Act (“Amending Act”). This amendment was based on the recommendations given by the Law Commission in its 246th Report as a result of three landmark judgments, namely – ONGC vs. Saw Pipes (2003) 5 SCC 705, ONGC Ltd. v. Western Geco International Ltd. (2014) 9 SCC 263, and Associated Builders vs. DDA (2015) 3 SCC 49. However, the amendment seems to house multiple widely debated and conflicting points in the courts.

PATENT ILLEGALITY AND MEANING OF PUBLIC POLICY IN INDIA

The ground of ‘Patent Illegality’, amongst other groups, has been debated in the Court of India. In ONGC Vs. Saw Pipes, the Apex Court defined “patent illegality” in detail and brought it within the realm of Indian public policy for the first time. Before this interpretation, the unamended Act did not include the ground of ‘Patent Illegality’ to set aside an Arbitral Award. This was done by broadening the only existing foundation of ‘Public Policy of India’ or any enactment did not define this. The phrase was open to interpretation in an extensive sense, giving it the capacity to develop and evolve along with the dynamic law. Such evolution is visible upon reading the judgments pronounced in this regard.

In the case of Renusagar Power Co. Ltd vs. General Electric Co. 1994 SCC Supp (1) 644, in paragraphs 67 and 76, a Three-Judge Bench of the Apex Court interpreted the meaning of Public Policy of India about the Foreign Exchange and Regulation Act and the illegality of a foreign award under section 7(1)(b)(ii) of Foreign Awards Act. After examining the two regulations relating to Foreign Awards, it held that the purpose of the Acts was to protect the country’s economic interests, and hence any violation of such legislation would be against public policy.

In ONGC Vs. Saw Pipes, a Two-Judge Bench of the Apex Court, considered the opinion as mentioned earlier but opined that interpretation of the expression “public policy of India” must be done in the context of the jurisdiction of Courts where the validity of an Award is challenged, unlike in a proceeding for the enforcement of a foreign award as done in Renusagar case. Under Paras 15, 20, 22, 28, and 31, it was held that, on the principle that no narrow meaning should be given to the expression “public policy of India” in the case where an award that is challenged as materially different from a proceeding where a foreign recognition is sought to be enforced. It was concluded that a domestic arbitral award could be set aside as “patently illegal” if it violates substantive provisions of an Indian Law, the Principal Act (AC Act), or the contract terms between the parties.

Again, in the case of McDermott International Inc. v. Burn Standard Co. Ltd., a slight change in the notion of what would be “public policy” was noticed in the previous two cases. In addition, the Court held that the scope of the expression would change based on the case and the nature of the transaction in such case but also held their ground in being bound by the decision in the case of ONGC. 

5 Supra 4.
Similarly, the Court, in the case of Centrotrade Minerals & Metals Inc. v. Hindustan Copper Ltd., followed its precedents and held that violation of “public policy” should be considered as a valid ground to set the arbitral award aside. However, it also pointed out that such patent illegality must be found at the core of the matter and should be, without doubt, not fair or reasonable. Thus, if the Arbitrator has not protected such ground, it would be liable to be challenged under Section 34.

Further, a three-judge bench in ONGC Ltd. v. Western Geco International Ltd. in Paras 34, 35, 38 and 39 not only acknowledged the validity of the dicta in Saw Pipes but also further held that the expression of the fundamental policy of Indian law is a comprehensive concept with multiple aspects included such as the judicial approach that the Arbitrator must be following, the Principles of Natural Justice the fundamental Wednesbury Principles that are perversity and irrationality. These aspects are to be kept in mind when it comes to adjudicating the validity of an arbitral award.

A two-judge bench in Associate Builders Vs. Delhi Development Authority further added to the existing interpretation that a disregard of a decision of a Superior Court is violative of the fundamental policy of Indian law in Para 18 to 26. Thus, the heading of “patent illegality” was divided into three subheads through this judgment as follows:

- Contravention of the substantive law of India referable to section 28(1)(a) of the Principal Act;
- Contravention of the Arbitration Act;
- Contravention of Section 28(3) of the Arbitration Act, i.e., adherence to terms of the contract.

NEW DEVELOPMENTS:
ANALYSIS

Newer judgments have also identified multiple factors that would be considered ‘Patent Illegality’, thus becoming a valid ground to set aside an arbitral award. However, there still seems to be an ambiguity in what exactly would be reasonable to be construed as ‘Patent Illegality’. In the recent judgment of I-Pay Clearing Services Private Limited v. ICICI Bank Limited, the Supreme Court stated that there must be a finding on the issue under contention, not mere reasoning. The rationale was that, without any finding, reasoning alone could not cure a defect in the award. The Court would then be unable to exercise its power under Section 34(4) as the record seems prima facie patently illegal.

In another recent judgment, while setting aside the award in the case of World Sport Group (India), Private Ltd v Board of Control for Cricket in India, Justice BP Colabawalla noted that challenging an arbitral award was not the same as filing an appeal, one of the grounds for challenging a domestic arbitral award, even after the Act’s amendment in 2015, was that it had patent illegality.

Also, from another point of view, the recent judgment restores the limited extent of involvement that courts have under Section 34 of the Act. The Division Bench’s observations mirrored its approach to adjudicating an appeal, similar to that of a civil court. Moreover, The Supreme Court also reaffirmed the limited elements of patent illegality and Indian public policy, demonstrating the counter posture maintained to support the arbitral process rather than undermine faith in it. Significantly, an arbitral award arising from a construction dispute is often hindered by the debtor’s propen-

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7 (2014) 9 SCC 263.
sity to file a motion to set aside the award. During this time, the genuine award-holder may face cash flow problems, which could have a cascading effect on its participation in additional projects. As a result, courts must consider these variables and make every effort to resolve such conflicts quickly.

The Court in Patel Engineering\(^{14}\) noted that the amended section 34 provided an additional, albeit narrowly defined, ground of patent illegality for setting aside a domestic arbitration award. However, this ground did not apply to awards arising from international commercial arbitrations under Part-I of the 1996 Act. The Court cited Associated Builders, saying that drafting a contract’s provisions is essentially the Arbitrator’s responsibility. Furthermore, it was recognized that ‘patent illegality could not be asserted to fight enforcement in foreign awards under the New York Convention because it is not an eligible ground under section 48 therein.’ Only when the Arbitrator construes the contract in a way that no fair-minded or reasonable person would be considered patently illegal. The latter is covered under the ground of ‘patent illegality in amended section 34.

Furthermore, the Supreme Court in PSA SICAL Terminals Ltd. v. V.O. Chidambranar Port Trust\(^{15}\) ruled that the arbitral tribunal’s change of law decision was based on “no evidence” and “ignorance of key evidence,” rendering it irrational and subject to review.

**ANOMALIES UNDER THE AC (AMENDMENT) ACT, 2015 – PROSPECTIVE OR RETROSPECTIVE**

Section 26 of the Amending Act states that the Amending Act shall not apply retrospectively to any arbitral proceeding unless the parties agree to the contrary, i.e., it shall not use proceedings commenced before the commencement of the Amending Act. However, in its second part, it makes itself applicable to any proceeding concerning the arbitral proceeding commenced on or after the date of its commencement. Nevertheless, the proceedings would mean any such proceeding commenced under Section 21 of the Act. The question of the retrospective and prospective effect has often been a matter of debate, even amongst the judgments that have been pronounced in the matter.

In the case of BCCI vs. Kochi\(^{16}\), such prospective and retrospective application was interpreted in Para 5, 39, and 75. The Court observed that the section clearly distinguished between arbitral and related court proceedings. In its interpretation of the language of the Amending Act, it presented its opinion that in the first part, the arbitral proceedings are provided for; thus, the second part only refers to court proceedings that relate to the arbitral proceedings. Therefore, they have held that the scheme of the section is clear enough to indicate the prospective nature of the application. Through this judgment, the Apex Court made it clear that such ‘Retrospective effect’ will be only about the amended Section 36, which talks about the stay of the Arbitral Award and not the other amended provisions, including Section 34.

However, in the case of Ssangyong Engg. vs. Construction Co. Ltd.\(^{17}\), a Two-Judge bench gave an opposing observation on this point in Para 19. They noticed that through prior judgments, there was a change of ideology and that the courts sought to do away with the expansion of “public policy” and introduce the concept of “patent illegality”, which has certain inherent exceptions. Thus, they held that the amended Section 34 would apply to any application in relation to the award made post the amendment regardless of the date of commencement of the proceeding. So say, even if the proceeding had commenced and the award had been given on a date before the amending Act’s inception, the amendment would still apply as long the application seeking the setting aside of the award was filed post the amending Act commencing.

Such opposing views as presented in the Kochi Cricket Club Case and the Ssangyong Engg. The case upon the point of Section 34 and its applicability has presented an incoherent front and no clarity upon the section’s retrospective nature or lack thereof. This also makes matters of scope and jurisdiction a problem given the polar opposite


\(^{15}\) PSA SICAL Terminals (P) Ltd. v. V.O. Chidambranar Port Trust, 2021 SCC OnLine SC 508.

\(^{16}\) (2018) 6 SCC 287.

nature of the pre and post-amendment grounds of challenge available against an arbitral award.


Through these, the courts have consistently held that if a domestic arbitral award is contrary to either the substantive provision of substantive law or to conditions of the Arbitration Act or terms of the Act between the parties, then it is patently illegal and can be set aside. This view in the above cases was consistent through the levels of the Court with a minor addition that the binding effect of the judgment of a Superior Court being disregarded is also violative of the fundamental policy of Indian Law.

The clear distinction restricted by Section 26 of the Amending Act was made incomprehensible and unclear by the contradictions that arose in the views of the Apex Court in the two cases, i.e., the Kochi Cricket Club case and the Ssangyong Engg. Case.

In a prior Judgement, it was implied that the laws would act only prospectively when it came to a matter of the appeal. In the case of Garikapatti Veeraya vs. N. Subbiah Choudhury the apex court held in para 23 that the appeals arising out of a suit instituted would form part of one legal proceeding and since the right to appeal was a substantive right. Such freedom is to be governed by laws existing at the time the suit was instituted rather than the time the appeal was filed. It also held that such a right could be taken away only by a subsequent enactment that, intending to take it away, expressly provides for such removal of the request. Thus, yet another contradiction arises as the second part of Section 26 of the Amending Act was held to imply retrospective application of the amendment. However, this judgment supports the principle that only procedural provisions can be given a retrospective effect, such as Section 36 of the principal Act.

Finally, another amendment in 2019, Section 87 of the principal Act, was amended to clarify the confusion regarding Section 34. The amended Section 87 provides that the Amending Act of 2015 will only have a future effect. That is to say; the amendment would apply to proceedings commenced after the amendment. It would not apply to the judicial proceedings commenced after the amendment if such proceeding is with respect to a suit commenced before the amendment of 2015.

POST AMENDMENT – ANOMALIES, INCONSISTENCIES, AND TINKERING WITH PRINCIPLES SET OUT IN EARLIER JUDGEMENTS

The decision in the Ssangyong Engg. Vs. Construction Co. Ltd. case did create multiple contradictions in the position of the law. However, it is pertinent to note that the unamended Act, including section 34, did apply in the case. Further, it is an established principle that the correctness of an Apex Court interpretation of the law would not be questioned. Thus, the dicta of the Associate Builders case was upheld in the Ssangyong case. It was held that the law violations or disregard for a binding judgment would be valid grounds to appeal against an award under Section 34. But there were also inherent inconsistencies in the opinion. In the same case of Ssangyong Engg., the Court held that specific observations of Associated Builders are no longer suitable in the eyes of the law.

More contradiction arose when the Court in Ssangyong Engg. Held that violation of substantive law would not be a ground for challenging the award post the amendment as it was devoid of consideration for the provision made by Sec-
tion 28(1)(a) of the Principal Act, which requires the Arbitral Tribunal to abide by the substantive law of India while deciding a dispute referred to it. Thus the idea that the Arbitrator had to follow the substantive law but any error or non-compliance would not be a valid ground to seek for such an award to be set aside.

The legislature did not intend to include “error of law” as a separate reason for setting aside domestic awards under Section 34(2)(b)(ii) of the Act. In reality, the Court’s view of public policy is so broad that it could lead to an avalanche of arbitral decisions being challenged in Indian courts. Section 34 of the Act and the associated UNCITRAL Model Law rules were arguably meant to restrict this judicial review of the merits of the case to ensure the finality of arbitral rulings on the merits. The ratio of the verdict does not correspond to the Act’s goal. Some authors advocate for a middle path. According to them, the so-called “mistake obvious on the face of record” test should be used as an “all-weather” solution. However, given the thorough scope of the justifications listed in Section 34, such a solution is redundant.

The contradictions continued to be a problem for the parties opting for Arbitration even in the post-amendment context. The Apex Court in DAME vs. DMRC, in paras 26 and 27 held the illegality must be in the core issue and not every error of law or the erroneous application thereof would constitute a ‘patent illegality. It further went on to say that such infringement should be against public policy or interest. It held, therefore, that unless the decision reached by the Arbitrator is so flawed, it cannot be made possible or is unreasonable, or there is an error of jurisdiction by the Arbitrator due to overstepping of the contract, there would be no ground to re-try the matter for the award. However, they also held that any decision for the arbitral award must be elucidated and should be based on consideration of all available evidence. In conclusion, they held that the award must be erroneous to the effect of “shocking the conscience of the court” or should be inherently immoral to be liable to be set aside.

The judgment in DAME upheld the Ssangyong Engg. Decision without thought denoted a very narrow meaning to the concept of “public policy of India”, which was again adopted by Renusagar with no consideration being given to the other judgments passed. Such a narrowed perspective that limited the grounds for appeal against the arbitral award was further continued as the settled proposition with no consideration given to the previous interpretations and ratios.

**CONCLUSION**

In light of the anomalies mentioned earlier, the judgment in Kochi Cricket Club interpreting section 26 of the amending Act in Para 5, 39 and 75 and a contrary opinion in Ssangyong Engg. (supra) in Para 19, which renders the first part of section 26 of the Amending Act otiose and redundant.

The judgment in Patel Engineering continues the emerging judicial trend of establishing a pro-enforcement Indian arbitration regime, which commenced with the decisions in Associated Builders and Ssangyong Engineering. Interestingly, while section 34 of the Act has been recently amended by the 2019 amendment, the legislature has not modified the sub-section(2A). It shows their intent to limit judicial intervention on the ground of ‘patent illegality, in cases of awards rendered in purely domestic arbitrations as 2015 amendments, along with the judicial precedents of Associated Builders and Ssangyong Engineering.

Furthermore, the Supreme Court in Delhi Airport Metro Express Private Limited vs. Delhi Metro Rail Corporation Limited upheld the arbitral tribunal’s findings, stating, “As the arbitrator is the sole judge of the quality as well as quantity of the evidence, the task of being a judge on the evidence before the Tribunal does not fall upon the court in the exercise of its jurisdiction under Section 34.” As a result, public authorities must now exercise caution. They should not hide behind the private partner’s mistakes, mutual waivers, or the signing of additional agreements. The tremendous legal and financial ramifications of public authority’s actions of omission and commission should be anticipated and envisioned from the start.

Moreover, from the case of PSA Sical and SEAMAN, it can be interpreted that the courts will be able to protect the principles of inherent equity constructively and sensibly, also in quasi-judicial actions such as arbitration law, with this extended purview. The insertion of the phrase “patent illegality” was, without a doubt, a significant step forward by the lawmakers. However, it’s worth noting that the reasoning doesn’t say whether a limited or broad interpretation would prompt the Court to intervene and overturn the arbitral verdict. Furthermore, regardless matter how little or comprehensive the contract’s understanding is, it will not result in a breach of public policy or perversity of the award. It is also important to note that the Court did not categorically specify which ground of Section 34 of the Act the impugned award is set aside on, as the Court set aside an award upon that pretense of a broad interpretation of clause 23, which is not possible, resulting in a legal infirmity in the judgment.

Now, recently in Haryana Urban Development Authority, Karnal v. M/s. Mehta Construction Company and Another, the SC held that aside from the grounds listed in Section 34(2)(b) of the Arbitration and Conciliation Act, 2013 (the “Act”), an arbitral award can only be overturned if it is vitiated by patent illegality, not by the erroneous application of law or misappreciation of facts.

The legislation states that the courts may only intervene with an arbitral award on the grounds outlined in Section 34 of the Arbitration Act. Furthermore, if two opposing viewpoints are available on a subject, the courts may not overturn the arbitral ruling simply because the opposite view appears to be more reasonable. To bring India’s arbitral regime up to par with other modern jurisdictions, Indian courts must understand the goals of Arbitration and display restraint in examining arbitral verdicts.

The courts have gone back and forth in their interpretation of this provision. A single “correct” interpretation is yet to emerge or be established from the plethora of judgments passed in this regard. There is much of a need to streamline the scope and meaning of patent illegality amidst the inconsistencies resulting from the interpretations’ multiple deviations.

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26 Civil Appeal No.5627/2021 (arising out of SLP (C) No. 4115/2019).


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