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What Next for Indian Arbitration?

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Anniversaries are apt occasions to reflect on the past and consider the future. August 16, 2006 marked the tenth anniversary of the Indian Arbitration and Conciliation Act, 1996 and presents a timely opportunity to examine the state of arbitration in India.

The 1996 Act was designed primarily to implement the UNCITRAL Model Law on International Commercial Arbitration and create a pro-arbitration legal regime in India. Prior to its enactment, there was widespread discontent over the excessive judicial intervention allowed by its predecessor, the 1940 Act. The 1940 Act permitted courts to set aside an arbitral award where "the award [had] been improperly procured or [was] otherwise invalid." Indian courts interpreted this as a catch-all which allowed them to substantively review the merits of an award and set it aside if it suffered from an "error of law apparent on the face of the award." As a result, the 1940 Act became a vehicle for disgruntled parties on the losing end of an arbitration to challenge awards on the merits and effectively re-try their cases before Indian courts.

The 1996 Act attempted to rectify the problem by limiting the basis on which awards could be challenged to a few narrow grounds (which mirrored those found in the UNCITRAL Model Law and the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards). The intention was to minimise the supervisory role of courts, ensure finality of arbitral awards and expedite the arbitration process.

Just as the proof of the pudding lies in the eating, the efficacy of any legislation must

be judged by its implementation rather than its intentions. Unfortunately, insofar as the 1996 Act is concerned, the reality has been far removed from the ideals professed by the legislation. Two decisions of the Supreme Court have dealt body blows to the 1996 Act: *Oil & Natural Gas Corporation v SAW Pipes* (2003) 5 SCC 705 and *SBP & Co. v Patel Engineering* (2005) 8 SCC 618.

Briefly, *SAW Pipes* addressed a challenge to an Indian arbitral award on the ground that it was "in conflict with the public policy of India". Despite precedent suggesting that "public policy" be interpreted in a restrictive manner and that a breach of "public policy" involve something more than a mere violation of Indian law, the Court interpreted public policy in the broadest terms possible. The Court held that any arbitral award which violates Indian statutory provisions is "patently illegal" and contrary to "public policy". By equating "patent illegality" to an "error of law", the Court effectively paved the way for losing parties in the arbitral process to have their day in Indian courts on the basis of any alleged contraventions of Indian law, thereby resurrecting the potentially limitless judicial review which the 1996 Act was designed to eliminate.

More recently in *Patel Engineering*, the Supreme Court has sanctioned further court interventions in the arbitral process. The case concerned the appointment of an arbitrator by the Chief Justice in circumstances where the parties' chosen method for constituting the tribunal had failed. The Court held that the Chief Justice, while discharging this function, is entitled to adjudicate on contentious preliminary



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issues such as the existence of a valid arbitration agreement. The Court rejected the argument that the Chief Justice limit himself to a *prima facie* review of the facts while making this determination and held him entitled to call for evidence to resolve jurisdictional issues. Significantly, the Court that the Chief Justice's findings on these preliminary issues would be final and binding on the arbitral tribunal. This makes a mockery of the well-established principle of *Kompetenz Kompetenz* – the power of an arbitral tribunal to determine its own jurisdiction – enshrined in section 16 of the 1996 Act. It also encourages parties to sabotage the appointment process of arbitrators, make spurious arguments about preliminary issues and use evidentiary hearings in courts to delay arbitral proceedings.

The fact that Indian courts continue to not resist the temptation to intervene in arbitrations is harmful in two ways.

First, for a legal system which is plagued by endemic delays, a pro-arbitration stance would reduce the pressure on courts. Recent reports indicate that over 30 million cases are currently pending resolution in the Indian judiciary. There are only 13 judges for every million people in India compared to 51 in Britain and 107 in the United States. Clearly, Indian courts are struggling to cope with the huge case-load. Arbitration is not merely an attractive option for resolving disputes – it is absolutely essential to maintain the integrity of the Indian legal system. Encouraging parties to arbitrate, however, requires more than mere lip service harping on the merits of arbitration; it requires that the courts respect party autonomy and refrain from intervening in the arbitral process unnecessarily. If disputes are going to end up in courts anyway, there is scant incentive for parties to bother to arbitrate in the first instance.

Second, for a country seeking to attract foreign investment, it is imperative that its legal system provides efficient and predictable remedies to foreign investors. When commercial parties enter into transactions, they factor into their bargain the potential legal costs of enforcing their rights. If a legal system does not hold the promise of speed or certainty, a certain "risk premium" is added to the cost of the transaction which, if excessive, may make the transaction commercially unviable. Foreign investors have typically preferred arbitration and shied away from Indian courts due to prolonged delays in litigation caused by a backlog of cases. As a result of *SAW Pipes* and *Patel Engineering*, arbitration appears to have been reduced to a mere prelude to protracted

litigation in Indian courts, thereby increasing the "risk premium" associated with Indian transactions. This surely is not good news for the Indian economy. India attracted 5.5 billion dollars of foreign direct investment in 2005-06 but its potential to increase this inflow is not helped by an uncertain arbitration regime.

So, what has been the Indian policy response to *SAW Pipes* and *Patel Engineering*? Partial damage control, it appears. The Arbitration and Conciliation (Amendment) Bill, 2003, currently pending before the Indian Parliament, proposes to introduce a new section 34A which would allow an award to be set aside "where there is an error apparent on the face of the arbitration award giving rise to a substantial question of law". Although this new ground for challenge is narrower in definition than the *SAW Pipes* ruling, it still affords losing parties an opportunity to approach courts in an attempt to second-guess arbitral tribunals. This could lead to a position not dissimilar to that under the 1940 Act and complete a full circle for Indian arbitration. The Bill has not yet been enacted and there is still time to propose an amendment which would reverse *SAW Pipes* totally. As for *Patel Engineering*, although there has been no policy response thus far, this too could be addressed in revisions to the Bill which make clear the limits on the Chief Justice's role as an appointing authority.

The tenth anniversary of the 1996 Act finds Indian arbitration at a crossroads. The Indian legislature and judiciary have a fundamental choice to make – to respect party autonomy and finality of arbitral awards as envisaged by the 1996 Act or impose judicial supervision on arbitration and revert to the days of the 1940 Act. This choice will shape the course of Indian arbitration for the next decade and beyond.

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