Dispute Resolution Hotline

April 23, 2010

CHEER FOR ARBITRATION: CONSULTATION PAPER RELEASED

The Arbitration and Conciliation Act, 1996 ("**Arbitration Act**") was enacted to provide a pro arbitration regime with minimal judicial intervention. However, certain courts in India interpreted provisions of the Arbitration Act in a manner that led to an increase in judicial intervention and resulted in curtailment of party autonomy. These decisions, which have been discussed later, have resulted in considerable public debate and were widely criticized by jurists and practitioners.

Litigation in India is known to be a much prolonged process and arbitration offers an efficacious alternative for resolving disputes expeditiously. Owing to the complexities of the existing arbitration regime in India, a need was felt to introduce amendments in the Arbitration Act to bring it in conformity with international best practices.

Based on the recommendations of the 176th Report of the Law Commission of India, The Arbitration and Conciliation (Amendment) Bill, 2003 ("**Bill**") was introduced in the upper house of Parliament in December, 2003. In July, 2004 the Bill was referred for in-depth study to a committee chaired by Justice Dr. B.P. Saraf and later the Bill was referred for examination by the Departmental Relating Standing Committee on Personnel, Public Grievances, Law and Justice ("**Standing Committee**"). The Standing Committee was of the view that the provisions of the Bill still contained room for excessive intervention by Courts in arbitration proceedings. The Standing Committee further expressed the view that since many provisions of the Bill were contentious, the Bill may be withdrawn and a fresh legislation may be brought into effect after considering the recommendations of the Standing Committee. Accordingly, the Bill was withdrawn from Parliament.

The Union Ministry of Law and Justice ("**Ministry**") has now released a consultation paper proposing key amendments to the Arbitration Act. Though a much belated move, it is nevertheless a step in the right direction and provides hope that India would soon become an arbitration friendly jurisdiction.

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Background – Arbitration Act and current anomalies

Before discussing the key amendments proposed in the consultation paper, we would like to provide our readers a short summary of provisions of the Arbitration Act and the practical difficulties faced in its successful implementation.

The Arbitration Act is divided into four parts. **Part I** contains provisions that govern the conduct of arbitration proceedings and also provides for judicial intervention in arbitration proceedings in certain limited situations - (1) in the event the parties cannot reach a consensus on appointment of arbitrators; (2) where a party moves an application for interim measures of protection; (3) when a party seeks to enforce or set aside an arbitral award or (4) taking the assistance of the court in obtaining evidence.

Part II contains provisions for the enforcement in India of arbitral awards that are passed in reciprocating territories notified by the Government of India that are either a party to the New York Convention or the Geneva Convention.

Part III deals with conciliation while **Part IV** contains supplementary provisions.

Though the Arbitration Act was enacted to minimize the supervisory role of courts in arbitration proceedings, certain landmark judgments have expanded the scope of judicial intervention, which have also been discussed in this hotline. The current problems faced by parties in arbitration proceedings under the Arbitration Act are as follows:

1. **Applicability of Part 1 of the Arbitration Act** -.Section 2 (2) in Part 1 of the Arbitration Act provides – "*This Part shall apply where the place of arbitration is in India*." As a result of conflicting decisions of various courts in India, there has been considerable debate whether the provisions of Part 1 of the Act apply only to arbitrations held in India or also to arbitrations held outside India. In *Bhatia International v. Bulk Trading S.A., (2002) 4 SCC 105,* ("**Bhatia International**") the Supreme Court observed that since Part II of the Act is only applicable to awards granted in reciprocating territories, if Part 1 of the Act was held to be not applicable to arbitrations held outside India, then awards from non – reciprocating territories would be left uncovered by statute leaving the parties thereto remediless. The Court felt that this could not be the intention of the legislature and held that Part 1 is applicable to arbitrations that are held outside India, unless the parties expressly or impliedly agree to exclude its applicability. The Court also held that the absence of the word "only" in section 2 (2) of the Arbitration Act was deliberate and therefore Part 1 would apply to arbitrations held outside India. Accordingly, the Court granted interim measures with respect of disputes which the parties had agreed to submit for arbitration to the International Chamber of Commerce ("ICC") in Paris

   In *Venture Global Engineering v Satyam Computer Services Limited, (2008) 4 SCC 190* ("**Venture Global**"), the Supreme Court considered whether Part I of the Act applies to a foreign award. Following the decision in *Bhatia International*, the Supreme Court held that Part 1 of the Act does apply to foreign awards and parties may make an application under Section 34 contained in Part 1 of the Act to set aside such awards. Our hotline on the *Venture Global* decision can be found here.

2. **Public Policy as a ground for setting aside arbitral awards –** In *Oil & Natural Gas Corporation v. Saw Pipes,* (2003*) 5 SCC 705* ("Saw Pipes") , the Supreme Court considered the grounds on which an arbitral award can be challenged. Section 34 (2) (b) (ii) of the Act provides that an award can be set aside on the ground that it in is conflict with the Public Policy of India. The Court opined that the meaning of the expression "Public Policy of India" should be given a broader meaning than the one ascribed in earlier decisions and accordingly held that an award that is patently illegal would be contrary to public policy and would be liable to be set aside. The Court also held that an award is patently illegal when it is contrary to the terms of substantive provisions of law or the provisions of the Arbitration Act or against the terms of the contract.

3. **Inapplicability of the Kompetenz – Kompetnz principle -** The *kompetenz-kompetenz* principle empowers arbitrators to rule on their own jurisdiction and to determine the validity and existence of the arbitration agreement. In India, the principle is set out in section 16 of the Arbitration Act.
Under the various provisions of Section 11 of the Arbitration Act, if parties to an arbitration agreement fail to appoint an arbitrator according to the terms contained in the arbitration agreement, then either party may approach the Chief Justice of the Supreme Court or his designate, in the case of international commercial arbitrations or the Chief Justice of the relevant High Court or his designate, in the case of domestic arbitrations, who will then appoint or designate an institution to appoint an arbitrator as per the provisions of the Arbitration Act. There has been considerable debate on whether an order appointing an arbitrator passed by a Chief Justice or his delegate is an administrative order or a judicial order. Previous cases held that such an order is an administrative order and accordingly the Chief Justice does not have the power to decide on the existence or validity of the arbitration agreement while considering an application made by a party under the provisions of the Arbitration Act for appointment of an arbitrator.

   However, in *SBP & Co. v. Patel Engineering, (2005) 8 SCC 618* ("**Patel Engineering**"), the Supreme Court overruled the earlier decisions and held that an order appointing an arbitrator by a Chief Justice is a judicial order and consequently, if a party raises an objection regarding the validity of the arbitration agreement, the Chief Justice is also required to determine the existence and validity of the arbitration agreement. The Supreme Court further held that the finding of the Chief Justice regarding the existence and validity of the arbitration agreement will be binding on the arbitral tribunal, thus negating the power conferred on the arbitral tribunal to determine the validity of the arbitration agreement under Section 16 of the Act. Our hotline on the *Patel Engineering* decision can be found here.

   The *Patel Engineering* decision had also held that the power of the Chief Justice of the Supreme Court or High Court as the case may be, can only be designated to a judge of the same court, although the Arbitration Act mentions that the power can be exercised by the Chief Justice or any person or institution designated by him.

Key amendments proposed in the consultation paper:

1. **Amendment in section 2 - Applicability of Part 1 of the Arbitration Act**: As noted earlier, there have been conflicting decisions regarding applicability of Part I of the Arbitration Act to arbitrations held outside India. In order to curtail intervention by Indian courts in arbitrations held outside India, the consultation paper proposes to amend section 2 (2) of the Arbitration Act, 1996 as follows:

   "(2) This part shall apply only where the place of arbitration is in India. Provided that provisions of section 9 and 27 shall also apply to international commercial arbitration where the place of arbitration is not in India, if an award made in such place is enforceable and recognized under Part II of this Act."

   Section 9 deals with grant of interim reliefs by courts while section 27 deals with taking of assistance from court for obtaining evidence for the purpose of arbitration proceedings. Thus, the proposed amendment seeks to exclude the applicability of all other provisions of Part 1 of the Arbitration Act to arbitrations held outside India. This would be in step with the UNCITRAL model law on which the Arbitration Act is said to be based.

   From the reading of the provision it appears that Parties cannot contract out of this provision.Section 9 and 27, however, shall not apply in relation to arbitrations held in non-reciprocating countries. It is also unclear from the proposed amendment whether parties in arbitrations conducted in reciprocating countries would be entitled to appeal against an order granting or refusing to grant any measure under section 9. Such a ground for appeal is currently available under section 37 of Part 1, but in the absence of a specific provision in the proposed amendment it is ambiguous whether such a ground for appeal would be available in arbitrations held in reciprocating countries.

2. **Amendment in section 11 - Appointment of arbitrators by Court:** The proposed amendment seeks to give the Supreme Court (for international commercial arbitration) and the High Courts (for domestic arbitration) or any person or institution designated by them, the power to appoint arbitrators, where parties fail to reach a consensus on appointment of arbitrator(s). As noted earlier, under the current law the power is vested in the Chief Justice of the said courts and now the proposed amendment seeks to give the power to the Court itself. The proposed amendments also aim at encouraging institutional arbitration, by making it obligatory for Supreme Court or High Courts to refer appointment of arbitrators to an arbitration institution in respect of 'commercial dispute of specified value'. The expressions "commercial dispute" and "specified value" shall have the same meaning assigned to them under the Commercial Division of High Court Act, 2009 which is also yet to come into force. Our hotline on the Commercial Division of High Court Bill, 2009 can be found here.

   The proposed amendments also provide that:

   - appointment of arbitrators by the Supreme Court / High Court shall be made as expeditiously as possible and endeavour shall be made to dispose the matter within sixty days from the date of service of notice on the opposite party; and

- there will be no appeal from the orders of the courts under section 11.

3. **Amendment in section 12 - Disclosure of interest by the arbitrators**: Section 12 (1) currently provides that a person who is approached in connection with his possible appointment as arbitrator shall disclose in writing "…any circumstances likely to give justifiable doubts to his independence or impartiality". The proposed amendment seeks to make such disclosure more stringent and exhaustive on the lines of the 'International Bar Association Guidelines on Conflict of Interest in International Arbitration.'

4. **Amendment in section 28 - Terms of the contract** – Section 28 of the Arbitration Act deals with rules applicable to substance of the dispute. Section 28 (3) provides that "*In all cases, the Arbitral Tribunal shall decide in accordance with the terms of the contract and shall take into account the usages of the trade applicable to the transaction*". In *Saw Pipes*, the Supreme Court had held that an award that is contrary to the terms of the contract would be patently illegal and could be challenged under section 34. The paper proposes to amend section 28 (3) as follows – *"In all cases, the arbitral tribunal shall take into account the terms of the contract and trade usage applicable to the transaction*." Thus, the proposed amendment seeks to clarify that an arbitral tribunal only needs to take into account the terms of the contract. This should lead to less interference by courts on the ground that the award is against the terms of the contract.

5. **Amendment of section 31 - Rate of Interest** – Under the provisions of section 31 of the Arbitration Act, the arbitrator has the power to award interest for pre reference, pendte lie and post award periods. However, parties can contractually agree to exclude any award of interest for pre reference and pendte lie period. This position was also affirmed by the Supreme Court in *Sayed Ahmed v State of U.P*., our hotline on which can be found here. As currently stipulated in the Arbitration Act, the rate of interest is 18 % for post award period unless the tribunal otherwise directs. In order to reduce the rate of interest in light of the current economic scenario, the amendment seeks to fix this rate of interest at 1 % higher than current rate of interest fixed by the Reserve Bank of India.

6. **Amendment in section 34 - Scope of Public policy**: To nullify the effect of *Saw Pipes* noted above, the paper proposes to narrow the scope and meaning of public policy as a ground for setting aside awards. According to the proposed amendment, an award will only be considered to be in conflict with public policy when the award is contrary to fundamental policy of India, interests of India or justice and morality.

7. **Harmonising Section 34 with Section 13 and 16** - Under the provisions of section 13 of the Arbitration Act, parties are free to determine a procedure for challenge of arbitrators, and if the challenge is not successful the arbitral tribunal will continue proceedings and make an award. Sub section (5) of section 13 provides that a party which challenges appointment of arbitrator may file an application for setting aside such an award under section 34. However, this is not listed as a ground for challenging the award in section 34. Similarly, as provided in section 16, the arbitral tribunal may rule on its own jurisdiction. A plea that the tribunal does not have jurisdiction can be raised by the parties, and if the tribunal rejects the plea the

proceedings are continued and an award made. However, under sub-section (6) of section 16 party may make an application for setting aside such an award under section 34. There is however no such corresponding provision in section 34. To remove this ambiguity, the paper proposes to add the sub-clause (iii) in clause (b) of subsection (2) of section 34 –

"(iii) the application contains a plea questioning the decision of the arbitral tribunal rejecting –
(a) a challenge made by the applicant under sub section (2) of section 13
(b) a plea made under sub-section (2) or sub section (3) of section 16"

8. **Introduction of section 34 A - Additional ground of patent and serious illegality**: In order to provide recourse to a party aggrieved by a patent and serious illegality in the award, the paper proposes to introduce an additional challenge on the ground of patent and serious illegality of an arbitral award by introducing section 34 A in the Arbitration Act. However, this ground will not be available in case of international commercial arbitration and will apply only in case of domestic arbitration. The proposed amendment also provides that while considering such ground, the Court must be satisfied that the illegality identified by the applicant is patent and serious and has caused or is likely to cause substantial injustice to the parties.

   The proposed introduction of this additional ground creates an unwarranted distinction in ensuring finality of awards made in domestic arbitrations compared to awards passed in international commercial arbitrations that are held in India or outside India. Parties in domestic arbitrations, other than international commercial arbitrations would continue to approach courts in an attempt to second guess arbitral awards.

9. **Amendment in section 36 - Enforcement of Award**: Under section 36 of the Arbitration Act the enforcement is stayed when the other party files an application to set aside the award. However, this led to increased misuse of this provision where the party filing the application did so only for the purpose of delaying the execution of the award due to the automatic stay granted upon filing of the application. In order to ensure expeditious execution of awards, the paper proposes to amend section 36 and provide that filing of an application to set aside an award will not operate as an automatic stay on enforcement of award unless upon a separate application being made, the court agrees to grant stay of the operation of the award for reasons to be recorded in writing. The proposed amendment also provides that while granting stay of the operation of the award the court may also grant interim measures against parties to the award or even ad interim measures against third parties to protect the interests of the party in whose favor the award has been passed.

10. **Arbitration relating to Commercial Dispute of Specified Value** – The paper proposes that applications under section 34 and 36 and appeals under section 37 of the Arbitration Act in respect of commercial dispute of specified value, shall be heard by the commercial division as per the provisions of the Commercial Division of High Courts Bill, 2009 which is pending in Parliament. Our hotline on the Commercial Division of High Courts Bill, 2009 can be found here. Accordingly, the paper proposes to amend the definition of 'Court' in section 2 of the

Arbitration Act.

11. **Implied arbitration agreement in commercial contract of high consideration –** In order to promote institutional arbitration and avoid pleas regarding validity of arbitration agreements, the paper suggests introduction an amendment whereby every commercial contract of Rs 50 million or more shall be deemed, unless expressly agreed otherwise in writing by the parties, to contain an implied arbitration agreement that will provide for arbitration to be administered by an approved arbitral institution.

Conclusion

In conclusion, we reiterate that the consultation paper and most of the proposed amendments are a step in the right direction. Please write to us should you have any comments or suggestions on the consultation paper. We will consider them while forwarding our recommendations to the Ministry.

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