Compass shift from arbitration?

7 August 2024

After years of government narrative about turning India into an arbitration hub, the ministry of Finance has reversed course, asking departments to seek other solutions. ***Freny Patel*** *reports*

A storm is brewing in India's legal landscape. New government guidelines prioritise mediation over arbitration for public sector disputes and have sparked controversy. This shift seemingly contradicts past efforts to promote India as an arbitration hub.

Arbitration was previously seen as a speedier and more convenient alternative to court battles in India. Chief Justice of India Dhananjaya Y Chandrachud championed arbitration as "the preferred method of seeking commercial justice", highlighting its growing popularity over traditional courts. Chief Justice Chandrachud made these remarks at the Supreme Court of the United Kingdom in early June, just days after the Ministry of Finance released its 3 June memorandum on Guidelines for Arbitration and Mediation in Contracts of Domestic Public Procurement.

The Indian government has been a major proponent of arbitration, particularly in infrastructure projects, aligning itself with the international norm where arbitration is standard practice for infrastructure and construction disputes. However, the June memorandum issued by the ministry's Department of Expenditure – Procurement Policy Division strongly conveys a preference for avoiding arbitration in government contracts. While acknowledging arbitration's advantages like speed and finality, the ministry expressed reservations about cost and delays, based on its own experience.

Minister of State for Finance Pankaj Chaudhary told the parliament that "more than 60% of arbitration awards are challenged in courts", compelling the government "to spend both on arbitration as well as on litigation".

Responding to the Arbitration Bar of India's questions about the rationale behind the revised guidelines, the minister cited litigation spending details drawn from a sample study involving the National Highway Authority of India and India's state-owned power generation company, NTPC. The study indicated a consistent increase in litigation costs in the past five financial years. For example, in financial year 2022-23, the government spent INR543.5 million (USD6.4 million) in legal fees, up from INR483.7 million the preceding financial year.

The ministry's six-page 3 June memo stated that "the process of arbitration itself takes a long time and is not as quick as envisaged, besides being very expensive". It emphasises caution, stating that appeals should only be pursued "when the case genuinely merits going for challenge/appeal and there are high chances of winning". The guidelines aim to tackle issues of cost, delay and lack of expertise in public sector disputes, but their efficacy and potential impacts raise significant concerns, legal experts warn.

"The shift towards litigation for government entities and limitations on arbitrable disputes is a setback for arbitration," Alok Jain, a Mumbai-based partner in the arbitration and dispute resolution practice at Economic Laws Practice (ELP) tells *India Business Law Journal*.

Agreement comes from Vyapak Desai, vice president of the Arbitration Bar of India and head of the international disputes and investigations team at Nishith Desai Associates in Mumbai. "With courts overburdened by over 50 million pending cases, arbitration needs strengthening, not abandonment," he says. Desai says both systems have issues but there's no question that India needs a well-functioning arbitration framework.

Nicholas Peacock, a London-based independent advocate and arbitrator, agrees that the potential advantages of arbitration are not always realised. "It is incumbent [on] arbitrators to do their utmost to optimise the efficient process that the parties intended by selecting arbitration as their dispute resolution option," he says.

There is significant speculation about the reasons behind the government's sudden shift. Several legal experts cite the case of *Delhi Metro Rail Corporation Ltd (DMRC) v Delhi Airport Metro Express Private Limited (DAMEPL)* – a high-stakes dispute where state-owned DMRC faced an INR80 billion arbitral award that favoured DAMEPL. It shook the finance ministry's trust in arbitration as a reliable method of resolving disputes.

Desai says the DMRC case "was not the trigger but perhaps acted as a catalyst" for the ministry's change in stance.

The award was later overturned by the Supreme Court, a decision that contradicts the purpose of the Arbitration and Conciliation (Amendment) Act, 2015, intended to reduce judicial intervention and position India as a favourable destination for arbitration.

New rules may hinder business

The new guidelines restrict arbitration for public sector contracts, instead favouring negotiation, mediation and high-level committees for complex disputes. They recommend excluding arbitration for claims under INR100 million. Experts warn these limitations could hinder both domestic and international businesses, with uncertainty surrounding the impact on ongoing projects.

Although the memo applies to government and the public sector, it does not bode well for the private sector, and both domestic and international companies.

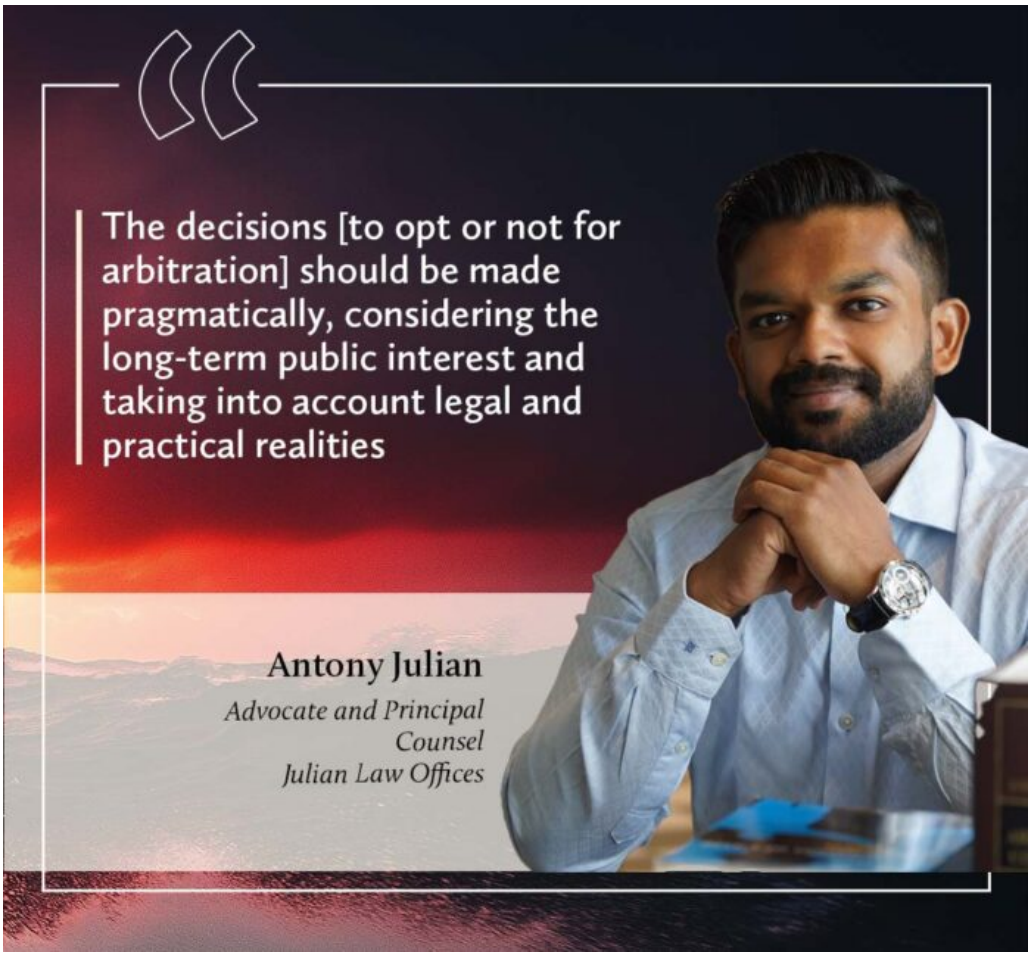
The guidelines primarily affect government entities and do not directly "dissuade international arbitration between private parties", says Naresh Thacker, partner and head of the litigation, arbitration and dispute resolution practice at ELP in Mumbai. However, he cautions that it "may not be reassuring to foreign investment in various sectors, especially infrastructure".

"No one saw this coming," says Dhruv Suri, a New Delhi-based partner with PSA. His firm has been flooded with questions from overseas clients, "asking whether this government memo will impact their future contracts, and if Indian courts can conduct day-to-day virtual cross-examinations should government contracts opt for litigation".

The unexpected government directive has caused confusion, uncertainty and anxiety as clients rush to understand the effects and consequences. "Government disputes need to be decided through arbitration because it avoids judicial burden, delays and uncertainties that are attached to litigation," says Kshama Loya, a Mumbai-based partner at Dentons Link Legal's dispute resolution practice. She agrees that strengthening the arbitration framework is crucial to ensuring that its promised efficiencies in time and cost are actually delivered.

While the new guidelines impose restrictions on arbitration, they encourage parties of public sector contracts to opt for mediation or negotiated settlements.

"The decisions should be made pragmatically, considering the long-term public interest and taking into account legal and practical realities," says Antony Julian, a Chennai-based advocate and principal counsel at Julian Law Offices. "It's important not to avoid responsibility or deny the genuine claims of the other party." Although good in theory, Julian thinks it is doubtful this will be put into practice.



The suggested use of a "high-level committee" to ensure probity in settlement negotiations and mediation is a good idea. However, Julian fears "the sheer number of commercial disputes of high value involving the government and its agencies would mean that this is effectively reduced to a perfunctory exercise, where the committee has little time to give due consideration to each dispute".

The mediation gamble

The government's push for mediation is aimed at faster and cheaper dispute resolution. However, doubts linger about its effectiveness in complex cases and the enforceability of settlements.

Strengthening the arbitration framework, as some experts suggest, might be a more sustainable solution.

Delhi-based construction consultant and mediator Amit Kathpalia is a strong proponent of mediation. He applauds its ability to foster collaboration and avoids "forcing [solutions] down the throat" of parties.

"Successful mediation settlements can't be appealed since they're voluntary agreements," says Kathpalia. He highlights the cost benefits in India, with mediation fees based on success and a percentage of the settled claim. Additionally, the process is faster due to the six-month time limit.

Vivek Narayan Sharma, an advocate-on-record and accredited Supreme Court mediator, echoes these sentiments. "Mediation is generally faster and less costly ... encourages collaborative problem solving and helps maintain business relationships, which is particularly beneficial in ongoing government contracts," he says.

However, he acknowledges its limitations. "The challenge arises when mediation fails. Courts are overburdened, and arbitration hasn't alleviated this pressure as most awards are challenged in court. Both government and private parties frequently appeal unfavourable decisions."

Sharma says that the absence of a guaranteed fallback option like arbitration for high-value disputes, coupled with the "high costs and delays associated with court remedies", could hurt businesses in India.

Suri, at PSA, also expresses reservations about the practicality of mediation. "Mediation has the potential to be a highly effective dispute resolution mechanism, but it hinges on three key factors: transparency, justification and accountability," he says. For mediation to succeed, Suri says public sector undertakings should avoid rejecting reasonable settlements and incurring unnecessary legal expenses.

While mediation is ideal, Desai, at Nishith Desai Associates, does not find it practical "because government officials hesitate to make decisions on settlements". He cites the ineffectiveness of the government's Direct Tax Vivad Se Vishwas Rules, 2020, and other settlement policies promoting mediation.

"Settlements raise concerns of bias or corruption, leading to further audits. This discourages government officials from readily agreeing to settlements," says Desai.

Mediator Kathpalia says arbitration "is not cheaper, certainly not in India, where arbitrators were charging exorbitant amounts and parties had to pay for the respective lawyers as well as the arbitrators".

Although commending the focus on mediation, ELP's Jain expresses concerns that it might overshadow India's commitment to arbitration, potentially hurting its standing as a leading arbitration hub.

"To successfully encourage mediation would require more than the simple addition of a clause referring disputes to mediation," says Jain, pointing out that the government would have to empower its officials to actively consider settlements even if they negatively impact the government. "Government officials [are] loathe to attempt meaningful settlements due to the fear of a vigilance investigation."

However, having acknowledged cost and delay concerns in arbitration, Suri casts doubt about its suitability for complex construction disputes. He adds: "reducing arbitration volume may free up some arbitrators, but potential litigation backlogs could negate any savings."

Loya echoes this sentiment, highlighting efficient practices in leading jurisdictions like England and Singapore. This is possible by "devoting time to a limited number of arbitrations, which they can do justice," she says. "When the focus will be on quality over quantity, then efficiency will be a corollary."

The Arbitration and Conciliation Act, 1996, contains provisions for fast-track arbitration and timelines within which domestic arbitrations ought to be completed. The guidelines should direct that these provisions should be strictly

adhered to and the government should follow best practices in conducting an arbitration, says Jain.

Acknowledging the judiciary's current challenges, given that "the rate of incoming cases is far greater than the disposal rate", Loya proposes greater reliance on well-functioning arbitral institutions. This would not only enhance arbitration efficiency but also alleviate the burden on the court system.

Loya also advocates a collaborative model similar to that of Singapore, where arbitration courts and commercial courts work together to provide parties with effective and timely dispute resolution options.

Mediation v arbitration

In October 2016, Prime Minister Narendra Modi spoke of building a strong system for institutional arbitration as a national priority. Creating "a vibrant ecosystem for institutional arbitration [is] one of the foremost priorities of our government ... to promote India globally as an arbitration hub," he said

There appears to be a misalignment in government policy. Lawyers argue that the aims of the National Litigation Policy, aimed at streamlining court processes and reducing the rising caseload, may not be achieved if arbitration takes a back seat.

Many ask if the government's push for mediation has left arbitration in the cold. Both the Arbitration Bar of India and the Indian Arbitration Forum have urged the Ministry of Finance to reconsider the June memo. They point out its

contradiction to the goal of promoting arbitration, and that discouraging arbitration clauses in large contracts will undermine India's efforts to become an arbitration hub.

"The memo can do immeasurable damage to the country's ability to hold itself out as an investment-friendly destination," the two bodies said in a letter to the ministry.

Desai adds: "The solution isn't to abandon arbitration but to find a better model."

Finance Minister Chaudhary told parliament that "the guidelines are flexible and continue to permit arbitration for high-value disputes after application of mind by the [concerned] ministry".

Chaudhary emphatically stated that the guidelines would not have a detrimental impact on the existing arbitration infrastructure. He said a significant number of high-value disputes had already ended up in courts after arbitration, even before the guidelines were implemented. This strongly suggests that the backlog of court cases is unlikely to experience a major increase.

The road ahead

The true impact of the new guidelines remains to be seen. Their success hinges on implementation, a change in government mindset, and the response of the legal community and businesses.

The debate highlights the need for a balanced approach, potentially incorporating both mediation and a streamlined arbitration process. Ultimately, fostering a culture of transparency and collaboration will be crucial for a successful alternative dispute resolution system in India.

ELP's Thacker says that India's strides in international arbitration, marked by significant reforms in 2015 and 2019, and further advancements under former law secretary TK Vishwanathan's expert committee for introducing reforms to the arbitration law, should not be derailed by the counterproductive guidelines. "The National Litigation Policy, an awaited document, hopefully furthers this goal and not the intent of the guidelines," he says.