

# Dispute Resolution Hotline

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## WIDENED SCOPE OF "PUBLIC POLICY" LEAVES ARBITRAL AWARDS SUSCEPTIBLE TO FURTHER SCRUTINY BY COURTS

Supreme Court holds that:

- Arbitral Awards maybe set aside if they violate the fundamental policy of Indian law;
- Fundamental policy of Indian Law includes:
  - a. **Judicial Approach:** No Tribunal or court to act in an arbitrary, capricious or whimsical manner.
  - b. **Principles of Natural Justice:** Principles of natural justice to be followed and reasoned decisions to be made.
  - c. **Wednesbury's principle of reasonableness:** No decision should be perverse such that no reasonable person would arrive at it.
- If the above principles are not followed by an arbitral tribunal, the award passed would be open to challenge under Section 34(2)(b)(ii) of the Arbitration and Conciliation Act, 1996.

### BACKGROUND

The recent judgments of the apex court of the land clearly highlighted the recognition of the policy of least judicial intervention in arbitrations. However, the recent decision of the Hon'ble Supreme Court of India [**"Court"**], in the case Oil & Natural Gas Corporation Ltd. [**"Appellant"**] v. Western Geco international Ltd. [**"Respondent"**]<sup>1</sup>, appears to buck the trend. The Court has, in the decision, considered the ambit of "public policy" under **Section 34** of the Arbitration and Conciliation Act, 1996 [**"Act"**] which is a ground available to challenge an award or its enforcement. .

### FACTS

In mid - 2001 a tender was awarded to the Respondent for technical upgrade of a Seismic Survey Vessel [**"Vessel"**]. The Respondent had submitted a bid, which included equipping the Vessel with "Geopoint" Hydrophones of U.S. origin [**"US Hydrophones"**].

In due course, the Respondent was unable to fit the US Hydrophones, since it was unable to obtain the requisite license from the concerned authority in U.S.A. The Respondent accordingly requested the Appellant to consent to replace the US Hydrophones with those of Canadian origin. However, the Appellant insisted that US Hydrophones be used, and only when the application for US Hydrophones had been formally rejected by the concerned authority in U.S.A. the Appellant consented to the use of Canadian Hydrophones.

Owing to this issue the Vessel could not be returned to the Appellant on the stipulated date of July 9, 2001 and was eventually returned on May 6, 2002.

While making payments to the Respondent, the Appellant, *inter alia*, deducted amount towards excess engagement charges under the Contract. Disputes arose between the parties on account of the deductions, which were then adjudicated upon by an Arbitral Tribunal.

The Tribunal held that the excess engagement charges for the period from November 1, 2001 to March 22, 2002 deducted by the Appellant from the payments made to the Respondent were unjustified. The Tribunal held that this period of delay in delivery of Vessel could not be attributed to the Respondent - as it had by October 31, 2001, informed the Appellant of its inability to procure the requisite license and had provided the details regarding the alternate Canadian hydrophones.

The Appellant aggrieved by the award of the tribunal challenged the decision under **Section 34** of the Act.

It was contested by the Respondent that none of the grounds for setting aside an award under **Section 34** of the Act existed in the present case and therefore, the Court did not have the jurisdiction to set aside / interfere with the Award. It was also urged that the Court could not, in the absence of any compelling reason, interfere with the view taken by the Arbitrators as if it was sitting in appeal over the Award.

### JUDGMENT

The Court examined if the Award was in conflict with the "public policy of India", under Section **34(2)(b)(ii)** of the Act. Reliance was placed on the judgment in *ONGC Ltd. v. Saw Pipes Ltd.*<sup>2</sup> [**"Saw Pipes Case"**] while interpreting the phrase "public policy of India" wherein it has been held that an arbitral award should be "set aside if it is contrary to:

- fundamental policy of Indian law; or

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- the interest of India; or
- justice or morality, or
- in addition, if it is patently illegal.

### Interpretation of “fundamental policy of Indian law”

The Court observed that the phrase “fundamental policy of Indian law” had not been elaborated by the Court. Interpreting it in this case, the Court held that the phrase included, *inter alia*, the following three principles:

**a. Judicial Approach:** No Tribunal, court or other authority should act in an arbitrary, capricious or whimsical manner or be influenced by any extraneous consideration while making any determination which would affect the rights of citizens or have civil consequences.

**b. Principles of Natural Justice:** These principles should be followed by all courts and quasi – judicial authorities while determining the rights and obligations of parties. The parties to the dispute should be given the opportunity to be heard. The decision – makers should make reasoned decisions which reflects application of mind to the facts and circumstances of the case.

**c. Wednesbury’s principle of reasonableness:** Where a decision by a court or tribunal is so perverse or irrational that no reasonable person would have arrived at it [*the Wednesbury principle*], then such decision shall not be sustained in a court of law and maybe challenged.

The Court stated that the aforementioned principles were applicable to the awards passed in arbitrations.

### Application of principles to the facts in the case

The Court considered the facts of the case to determine if the excess engagement charges deducted by the Appellant were justified. The Court held that while on the one hand, the Appellant was held responsible for the delay as it did not act in right earnest, the same test was not applied to the Respondent.

In this regard, the period from November 1, 2001 to March 22, 2002 was considered.

Regarding the period from October 24, 2001 to November 26, 2001 (when the Appellant had failed to provide prompt directions for making application for the requisite license for the hydrophones) it was held that the Tribunal had rightly attributed the delay to the Appellant.

Thereafter, the period from November 26, 2001 (when the Appellant issued instructions for making of a formal request for the grant of license) to January 8, 2002 (when the application was actually made by the Respondent) was considered. This delay was attributed to the Respondent by the Court, for its lack of diligence in making a timely application. Since under the Award this delay was attributed to the Appellant instead of the Respondent, the Court held that the Tribunal had failed to appreciate the facts, leading to miscarriage of justice. It was held that the Tribunal had failed to apply consistently the test for determining the liability for the delays.

The delay for the period from January 8, 2002 to March 7, 2002 (time taken by US authority to process the application and reject the same) was attributed to the Appellant, as it was on their insistence that an application had been made.

Further, the delay from March 8, 2002 (when the application was rejected) to March 22, 2002 (when such rejection was conveyed by the Respondent to the Appellant) was attributed by the Court to the Respondent, contrary to the Tribunal’s finding.

The Court, conclusively, held that if arbitrators fail to draw an inference which ought to have been drawn; or if they draw an inference which is prima facie untenable, and results in miscarriage of justice then such an award is liable to be challenged cast away or modified, as necessitated.

In light of this, the Award was modified such that the Respondent was held liable for the delay for the periods being November 26, 2001 to January 8, 2002; and March 8, 2002 to March 22, 2002.

### ANALYSIS

In this case, the Court has, for the first time, defined, albeit non-exhaustively, the term “fundamental policy of Indian law” which is an ingredient of “public policy” under [Section 34](#) and [48](#) of the Act.<sup>3</sup> It is curious that the Court has not tested the award in the present case on the grounds of patent illegality, but has chosen to give a broad interpretation to “fundamental policy of Indian law”.

In the present case, the Court allowed the challenge to the award on the following basis:

- The arbitral tribunal failed to consistently apply the tests for determination of a dispute to both the parties; and
- The inference drawn by the tribunal from the proven facts was untenable resulting in miscarriage of justice.

The Court seems to have suggested that an award could be tested under the ambit of “fundamental policy of Indian law” on the aforesaid basis.

It is appreciable that the principles have been suggested to be applied to ensure that no award is passed without appreciating the facts and circumstances of a case and without consistent treatment to both the parties.

However, rendering the inferences drawn by a tribunal open to scrutiny of the courts based on the principles is a regressive step by the Court. While it is common for courts to ensure that an award is reasoned and has been passed after application of mind by the arbitrators, the courts do not usually adjudicate on the outcome of such application of mind. Such restraint is exercised to protect the independence of the arbitration process. The Court’s indication that a detailed scrutiny into the merits of the award may be undertaken may now liken the courts powers under [Section 34](#) and [48](#) of the Act to an appeal.

### Effect on Domestic and Foreign Awards

The *Saw Pipes case* prescribed four facets while elaborating on the meaning of the expression ‘public policy of India’ in context of [Section 34](#). Of the four facets of public policy prescribed in the *Saw Pipes case*, only the test of “patent illegality” is inapplicable to a challenge to enforcement of foreign awards under [Section 48](#) of the Act.<sup>4</sup>

Thus, the principles enunciated in the present case, being part of “fundamental policy of Indian law” are applicable to domestic and foreign awards alike.

Resultantly, the change has been brought about as follows, by the present judgment, in the ambit of “public policy” for setting aside a domestic award under **Section 34** of the Act and for refuting the enforcement of a foreign award under **Section 48**:

	Public Policy under Section 34 of the Act	Public Policy under Section 48 of the Act
Position before this judgment	Public Policy included:  1. Fundamental policy of Indian law;  2. The interest of India;  3. Justice or morality, or  4. Absence of patent illegality. <sup>5</sup>	Public Policy included:  1. Fundamental policy of Indian law;  2. The interest of India; or  3. Justice or morality
Position after this judgment	Public Policy now includes:  1. Fundamental policy of Indian law;  ■ Judicial Approach ■ Principles of Natural Justice ■ Wednesbury’s principle of reasonableness  2. The interest of India;  3. Justice or morality;  4. Patent illegality	Public Policy now includes:  1. Fundamental policy of Indian law;  ■ Judicial Approach ■ Principles of Natural Justice ■ Wednesbury’s principle of reasonableness  2. The interest of India;  3. Justice or morality.

– **Varuna Bhanrale, Ashish Kabra & Vyapak Desai**  
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<sup>1</sup> Civil Appeal No. 3415 of 2007  
<sup>2</sup> (2003) 5 SCC 705  
<sup>3</sup> The Court had for the first time in *Renusagar Power Co. Ltd v. General Electric Co.* [1994 SCC Supl. (1) 644] defined the term public policy to include (i) fundamental policy of Indian law; or (ii) the interests of India; or (iii) justice or morality.  
<sup>4</sup> As held by the Supreme Court in *Shri Lal Mahal Ltd. v. Progetto Grano Spa*, Civil Appeal No. 5085 of 2013 arising from SLP(c) No. 13721 of 2012  
<sup>5</sup> The ambit of “public policy” was widened in Saw Pipes case where “patent illegality” was also pronounced to be an aspect of public policy

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