Dispute Resolution Hotline

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SUPREME COURT CLARIFIES THE NARROW SCOPE OF 'PUBLIC POLICY' FOR CHALLENGE OF INDIAN AWARD

- Supreme Court provides guidance on the term 'public policy' under Section 34 of the Act and clarifies the extent of judicial intervention in a India seated arbitration;
- Supreme Court discusses the term 'morality' in a challenge under Section 34 of the Act;
- Supreme Court also draws a distinction between 'error of law' and 'error of fact' and the extent of interference permissible to that effect;
- Supreme Court further held that when a court is applying the "public policy" test to an arbitration award, it does not act as a court of appeal and consequently errors of fact cannot be corrected unless the arbitrators approach is arbitrary or capricious.

Recently, the Supreme Court of India **("Supreme Court")** in Associate Builders v. Delhi Development Authority,[1] has dealt with some of the key issues involving challenge of an arbitral award in an arbitration seated in India. The Supreme Court discussed and clarified some of the earlier rulings on the scope of 'public policy' in Section 34 of the Arbitration and Conciliation Act, 1996 **("Act")**, under several headings (viz. patent illegality, contrary to justice, contrary to morality, interest of India and fundamental policy of Indian law).

FACTS

Associate Builder **("Appellant")** was awarded a construction contract for 168 middle income group houses and 56 lower income group houses in trilok puri in the trans-yamuna area by the Delhi Development Authority **("DDA/Respondent")**. The understanding was that the contract will be completed in nine months for INR 87,66,678. However, the work came to be completed only after 34 months.

The Appellant alleged that the delay arose at the instance of the Respondent and subsequently made fifteen claims and consequently, Shri K.D. Bali was appointed as the sole arbitrator by the Delhi High Court to arbitrate the dispute **("Ld Arbitrator")**. Ld Arbitrator allowed four claims of the Appellant and further, scaled down two claims on the reasoning that DDA was responsible for the delay in the execution of the contract.

Thereafter, DDA moved an application before the single judge of the Delhi High Court under Section 34 of the Act to set aside the award, which was dismissed on April 3, 2006. Against this order, an appeal was filed under Section 37 of the Act before the Division Bench of the Delhi High Court **("Division Bench")** and vide an order dated February 8, 2012, the Division Bench found the arbitral award to be incorrect and rejected the four claims and further scaled down Claims 12 and 13 **("Impugned Judgment")**. Aggrieved by the Impugned Judgment, the Appellant approach the Supreme Court by way of a Special Leave Petition.

ISSUES

The primary issue before the Supreme Court was to decide the correctness of the Impugned Judgment. While deciding the same, the Supreme Court looked into the scope of 'public policy' as a ground for setting aside an award under Section 34(2)(b)(ii) of the Act. Supreme Court also considered the extent to which a court can replace the Ld Arbitrator's conclusion with its own conclusion by way of judicial interference.

CONTENTIONS

Appellant's submissions:

- The Division Bench has lost sight of the law laid down by the Supreme Court when it comes to challenges made to arbitral awards under Section 34 of the Act.
- The Division Bench has acted as a court of first appeal and taken into consideration facts which were neither pleaded nor proved before the Ld Arbitrator.
- The Division Bench has wrongfully interfered with the award as no error of law arises thereunder. Further, it has failed to appreciate the legal position that the arbitrator is the sole judge of the quality and quantity of evidence to arrive at a finding.

Respondent's Submissions:

- The Ld Arbitrator's award was in ignorance of the contractual provisions and that such an award amounts to a jurisdictional error by the Arbitrator and hence, the Division Bench has rightfully interfered with the award.

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The Supreme Court allowed the appeal and set aside the Impugned Judgment. In effect, the Supreme Court refused to interfere with the arbitral award with the following reasoning:

First, Supreme Court observed that the grounds for interfering with an arbitral award are limited to those mentioned in Section 34 of the Act and held that merits of the award can be looked into only under the broad head of 'public policy'. The Supreme Court relied on the landmark judgments like, *Renusagar*[2], *Saw Pipes*[3], *McDermott International*[4], *Western Geco International Ltd*[5]. and others, and laid down the heads under the ground of 'public policy' as:

- "Fundamental Policy of Indian law" would include factors such as a) disregarding orders of superior courts; b) judicial approach, which is an antithesis to an arbitrary approach; c) principles of natural justice; d) decision of arbitrators cannot be perverse and irrational in so far as no reasonable person would come to the same conclusion. Supreme Court held that an arbitrator is the sole judge with respect to quality and quantity of facts and therefore an award is not capable of being set aside solely on account of little evidence or if the quality of evidence is of inferior quality. Supreme Court further held that when a court is applying the "public policy" test to an arbitration award, it does not act as a court of appeal and consequently "errors of fact" cannot be corrected unless the arbitrators approach is arbitrary or capricious.
- Supreme Court described "Interest of India" as something which deals with India in world community and its relations with foreign nations. Notably, the Supreme Court did not illustrate this ground in detail as the same is a dynamic concept which needs to evolve on a case by case basis.
- Supreme Court held that the term "award is against justice and morality" would include the following: a) with regard to justice, the award should not be such that it shocks the conscience of the court; b) with regard to morality, there can be no universal standard however, Supreme Court observed that both the English and the Indian courts have restricted the scope of morality to "sexual immorality" only; c) With respect to an arbitration, it would be a valid ground when the contract is not illegal but against the mores of the day, however, held that this would only apply when it shocks the conscience of the court.
- Supreme Court further held that "Patent Illegality" would include: a) fraud or corruption; b) contravention of substantive law, which goes to the root of the matter; c) error of law by the arbitrator; d) contravention of the Act itself; e) where the arbitrator fails to consider the terms of the contract and usages of the trade as required under Section 28(3) of the Act; and f) if arbitrator does not give reasons for his decision.

Second, the Supreme Court held that the Division Bench has lost sight of the fact that it is not a first appellate court and cannot interfere with errors of fact.

ANALYSIS

This ruling marks an important step in the line with the pro arbitration decisions of the Supreme Court in the last couple of years. It is a welcome decision in so far as 'public policy' had been clarified in order to provide guidance on the level of interference sought to be made under Section 34 of the Act. This marks a rare occasion where Supreme Court has discussed "morality" in a challenge under Section 34 of the Act. Further, in *Western Geco International Ltd*[6], Supreme Court elaborated the scope of "fundamental policy of Indian law" for challenge of arbitral award, and consequently the legal community was skeptical, as it was felt that this would open flood gates of challenge to arbitration awards. Therefore, this judgment provides much needed assistance as it defines the narrow boundaries of challenge under Section 34 of the Act.

Supreme Court`s finding that an arbitral award cannot be set aside on the grounds of "error in facts", unless the arbitrators approach is arbitrary or capricious, is indeed praiseworthy as it would narrow judicial intervention. Another aspect which needs some attention is that the jurisprudence on 'public policy' laid down in this case would apply only to awards arising out of arbitrations seated in India, as Section 34 of the Act would only be applicable in such a situation.

– Alipak Banerjee, Moazzam Khan & Vyapak Desai
You can direct your queries or comments to the authors

[1] 2014 (4) ARBLR 307(SC)
[2] 1994 Supp (1) SCC 644
[3] 2003 (5) SCC 705
[4] 2006 (11) SCC 181
[5] 2014 (9) SCC 263
[6] *Ibid*

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