Law of Arbitration in India

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1 Introduction.

a. General.

India is a Union of States.[1] Its territories are divided among the Union territories and the State territories. There are 28 States and 7 Union territories.

The political set up of the federation is that power to legislate and govern is divided among the Union and the States in accordance with legislative lists given in the Seventh Schedule to the Constitution of India.

The judiciary, however, is common throughout India. It consists of the Supreme Court of India that functions from India's capital, New Delhi ; 22 High Courts that functions from capitals of different

States, some High Courts being common to States ; and subordinate courts having two tiers, functioning under the supervision of each High Court.

The judiciary is independent of the executive. The Constitution guarantees that once appointed, the judges of the High Courts and of the Supreme Court cannot be removed except by Parliament following the process of impeachment. So far no judge has been removed by impeachment. Also, during their tenure, their service conditions cannot be altered to their disadvantage. The judges of the subordinate courts function under and are accountable to the High Court and not under or to the executive.

The Constitution sanctions three types of enforceable adjudication : (a) adjudication by courts ; (b) adjudication by administrative agencies ; and, (c) adjudication by arbitration.

Adjudication by courts and the administrative agencies is sanctioned under the Constitution under Entry 11–A of List III of the Seventh Schedule to the Constitution. The Union and each State is empowered to enact a law that provides for adjudication of disputes by courts or administrative agencies on subjects within their competence.

Article 124 and article 214 of the Constitution create the Supreme Court of India and High Court for each State or a group of States.

Adjudication by arbitration is sanctioned under the Constitution under Entry 13 of List III to the Seventh Schedule to the Constitution. S. 28 of the Indian Contract Act, 1872, makes every contract that prohibits one of the parties from taking legal proceedings in a court to enforce his rights void, with further providing exception in case where the parties agreed to refer the disputes to arbitration.

b. Adjudication by courts.

By default, the courts provide the machinery for adjudication of disputes. The judges of the courts are appointed by methods sanctioned by law. Overall, the judges enjoy high reputation for competence and integrity.

Description of the method.

The judges apply common law and the statute law to decide cases.[2] The cases are initially lodged before the subordinate court having jurisdiction on the subject matter, place where the cause of action arises or the residence of the defendant. Of the two tiers of the subordinate courts, the action must be initiated, depending upon the valuation of the suit, in the appropriate court. In some cases of higher valuation, the High Court is the appropriate forum to initiate the action. The action in a court is often called 'suit' in India.

The method of proceedings in the court is prescribed by the Code of Civil Procedure, 1908 in case of civil disputes and the Code of Criminal Procedure, 1973 in case of criminal prosecutions. There

could be modifications in procedures in individual enactments.

Judicial structure.

The judicial structure is described briefly in the section “General” above to which the reader may refer.

Effectiveness of the method.

Considering the number of cases, the number of judges in India is small. In the US, for example, there are 107 judges per million of population, while in India there are only 11.

Also, there being four tiers of appeals, cases take considerable time before they are finally resolved. The following table illustrates the problem.[3]

Court	2001	2007
SC-cases decided	38,842	61,957
SC-fresh cases filed	39,419	69,109
HC(s)-cases decided	1,093,598	1,505,073
HC(s)-fresh cases filed	1,215,426	1,590,816

The courts are conscious of the problem and encourage resolution of disputes by arbitration.[4]

Administrative adjudication is another method to reduce the burden on courts.

c. Adjudication by administrative agencies.

Description of the method.

Individual enactments create agencies that resolve disputes arising in respect of the obligations created under the enactment.

The method adopted is that the law creates authorities having power to decide the rights of parties. These authorities are not judges in the technical sense, as they work under the government and are specifically empowered by law to decide the rights and obligations of the parties. Judges, as mentioned above, are entirely independent of the government and have the power to strike down a law or give directions to any official of the government, however high he or she may be placed.

Although the administrative authorities work under the government, their decisions given in respect of public’s rights are protected by law.

Tax adjudication.

For example, the Income-tax Act, 1961 creates an office of Income-tax Officer who discharges dual

function of collecting revenue as also to consider objectively the liability of the assessee to pay such revenue. His decision is subject to appeal before a higher authority whose sole function is to consider the objections to the decisions of the Income-tax Officer. There is a further appeal provided to the Income-tax Appellate Tribunal whose function is to consider the objections to the decisions of the higher authority. The law provides that the decisions on facts given by the Appellate Tribunal are final.

There are similar laws in respect of other taxes, such as excise duty on manufacture of goods and the customs duty on the import or export of goods.

However, issues of law arising out of the Tribunal's order are subject to judicial review by the High Court and the Supreme Court. This is done in order to ensure the rule of law.

Labor adjudication.

A number of laws regulate the rights of employees of industrial enterprises. They include the Minimum Wages Act, the Industrial Disputes Act, the Provident Funds Act, etc. These and other similar Acts provide for authorities who judge the respective contentions of the employees and the employers. The Acts provide for internal appeals and thereafter on issues of law the decisions are reviewable by courts. The review is generally confined to the questions of law.

d. Adjudication by arbitration.

Description of the method.

Modern system of arbitration is known to India for over two centuries. It was first introduced in India by the East India company. Its earlier use was not confined to commercial disputes but extended to settlement of family disputes and petty quarrels.

As economy grew, the law was modified to take those aspects into consideration and the law that prevailed immediately before the Arbitration and Conciliation Act, 1996, was the Indian Arbitration Act, 1940.

Briefly, the 1940 Act provided for appointment of an arbitrator that the parties had agreed to. The arbitrator was expected to take no sides and had to hear each party in the presence of the other.

The arbitrator had to have no specific qualifications. It was not necessary for him to give reasons for the award.

The arbitrations were for the most part ad hoc and as such the arbitrators tended to follow the court procedures. Like court procedures, the arbitration procedures were often time consuming. This led to delays in making of the award.

The courts generally respected the award. After giving opportunity to the objector to object to the

award, it could either confirm the award in which case the award would be executable ; or, it could remit, modify or set aside the award.

The courts interfered with the award only if the award disclosed “error of law apparent on the its face”. This was the standard that was laid down in an old judgment of the Privy Council, the then highest English court.[5] The standard has always been followed by the courts in India.[6]

Commercial disputes.

In 1947 when India became independent, it had no industry, except some textile mills. In virtual absence of international trade, it had no international experience.

After 1947, the government undertook industrialization on a rather large scale. It however did not encourage private industry. Even exports and imports of goods had to be done through governmental organizations. As a result the private businessmen had no experience of international trade.

In 1991−92, the government changed this policy and liberalized the economy so that private businessmen could engage in international trade.

As a result of this, the number of commercial disputes that went into arbitration were relatively small, both in value and complexity.

Other disputes

The other disputes that went to arbitration were petty disputes relating to division of family wealth and the like. They had no commercial impact.

2. Arbitration.

a. Position prior to the 1996 Act.

The 1940 Act.

As mentioned above, the 1940 Act dealt with relatively small claims and less complexity. As the arbitrations were generally ad hoc, the arbitrators had little choice other than to follow the court procedures. That delayed the matters, even though the 1940 Act provided time limit within which to make the award. It became the practice to extend the time of making of the award by agreement of the parties or by the court having jurisdiction.

The redeeming feature of the 1940 Act was that the courts uniformly followed the principle of not interfering with the award, unless it found that the “the award disclosed error of law apparent on the face of the award”[7] or that the arbitrator had misconducted himself or the proceedings.[8]

The 1961 Act.

After the New York Convention of 1958 on recognition and enforcement of foreign awards, India enacted the Foreign Awards (Recognition and Enforcement) Act, 1961 implementing the Convention.

The 1961 Act provided that when a suit is filed in India and the defendant produces an arbitration agreement that establishes that the arbitration is to take place outside India, the court is bound to send the dispute to the arbitral tribunal.

The said Act also provided that when a foreign award is brought before an Indian court for enforcement, the award would be enforced except in limited circumstances such as that under the applicable law the party was under some incapacity, or that the party complaining proves that it was not given proper notice, or that the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement between the parties and the like.[9]

The Act also provided that the court may decline to enforce an award that was "contrary to the public policy".[10]

In an important judgment, the Supreme Court of India held that that the scope of the expression 'public policy' includes : (a) the fundamental policy of the law of India ; (b) the interests of India ; and, (c) justice and morality. It therefore held that an award that merely violates the law of India would not be set aside on the ground that it violated public policy.[11]

b. Introduction of the 1996 Act.

As indicated above, India began liberalization of its economy from 1991–92. The foreign parties were encouraged to do business with India and investment in India.

There was demand from arbitration quarters in the world that India should change its legal structure to respond to the requirements of the times. It was suggested that it would be a good idea to follow the international practice by adopting the UNCITRAL Model Law that had been approved by the United Nations in 1985.

India agreed to amend its law accordingly and enacted the 1996 Act, first as an Ordinance and later as a law. The President is empowered to issue an Ordinance when "immediate action" is required. Thus, without there being Parliamentary debate the Arbitration and Conciliation Ordinance came into force on January 26, 1996.

It later became Act, when Parliament, after a desultory debate, approved it.

The significant feature of the 1996 Act was that the UNCITRAL Model Law was made applicable to all arbitrations held in India, whether domestic or international. This was not in accordance with article 1 of the Model Law which specified that the Model Law was meant for international commercial arbitration.

3. The 1996 Act.

a. Structure of the Act

The Arbitration and Conciliation Act, 1996 consists of four Parts.

Part I is based on the UNCITRAL Model Law.[12] It is intended to apply where the place of arbitration is in India.[13]

Two themes underlie the Model Law : one, party autonomy ; and two, minimization of judicial oversight. Being a Model Law, its terms are not binding on any State. Part I of the Act, therefore, follows the model of the Model Law, but makes some changes. Some changes went beyond the Model Law in minimizing the judicial oversight.

Part II repealed the 1961 Act, but also re-enacted the same, substantially. Thus, the law implementing the New York Convention continued without interruption. Being a Convention, its terms were in the main repeated in Part II.

Part III deals with Conciliation. Discussion on that Part is outside the scope of this Paper.

Part IV deals with supplementary provisions that are of no consequence for the purposes of this Paper.

Evaluation of the 1996 Act.

The Model Law itself was a result of a compromise. The Law Reforms Commission of Hong Kong stated : "*We were also aware that the Model Law was the product of the work of arbitration experts from many countries, that to some extent it represented a compromise between the differing views represented by differing legal systems, and that there might be respects in which it could be* improved."[14] For example, as the UK Note before the UNCITRAL showed, the concept of 'public policy' in common law differs from that in the civil law.[15]

Lord Mustill, the leader of UK delegation before the UNCITRAL, an expert on arbitration law and a former judge of the highest English court said in the course of his key note speech at an ICCA Congress that the framers of the Model Law were unaware that in many parts of the world arbitrations were *ad hoc*.[16]

The importance of institutional arbitrations cannot be underestimated. When parties do not know each other and depend upon a resolution system independent of courts of their countries, it is necessary that such a system has all the necessary control and oversight mechanisms. Without such mechanisms, the arbitrators will remain unaccountable. Institutions supply rules, supervision, and oversight to the arbitration proceedings.[17]

Until recently, private enterprise in India had little opportunity to engage in international trade and

investment. As a result, no institution of international standard came up.

The framers of the 1996 Act appear to be aware that the Act would succeed only if there is at least one world class arbitration center in India. An institution called International Centre of Alternate Dispute Resolution (ICADR) was established in 1996 with the then Law Minister of India as its Chairman. (He continues to be the Law Minister and the Chairman). Unfortunately, it does not seem to have succeeded so far.

By providing that the Act would apply to both to international and domestic arbitrations the difficulties increased. It is well known that courts are less inclined to tolerate illegal awards in purely domestic arbitrations, although usually are more accommodating when faced with international awards. A well–known treatise states : "... [*In domestic arbitrations*] *some control* (*and even 'supervision'*) *of the arbitral process by the local courts was considered desirable. . . . Many States, including Belgium, Brazil, Colombia, France, Hong Kong, Nigeria, Singapore, Switzerland, etc. have adopted a separate legal regime to govern international commercial arbitrations-recognizing that different considerations may apply to such arbitrations*.[18]"

The above difficulties led the Law Commission of India to examine the suitability of the Act. It prepared a report recommending several amendments to the Act in 2001, one of which was to provide for different grounds for challenge to domestic and to international award. The government introduced a Bill proposing the amendments in Parliament in 2003.

However, before Parliament could take up the Bill, the present government came into power due to elections. The government withdrew the Bill. It has yet to introduce changes in the Act.

Case 1–Bhatia International v. Bulk Traders. (2002) 4 SCC 105.

The facts of the case, briefly, were : (a) the parties had an arbitration clause in the contract ; (b) accordingly, when disputes arose, the arbitration commenced with its seat in Paris, France ; (c) the foreign party applied to an Indian court under s. 9 of the 1996 Act requesting that the business assets of the Indian party be preserved pending arbitration. (d) the Indian party opposed it on the ground that application under s. 9 was misconceived as s. 9 fell in Part I which applied only when the arbitration was in India ; (e) the court rejected that argument.

The court reached its conclusion for several reasons, examination of which would take too much space. The reader, if interested, is invited to peruse the Paper written by this author published in a Law Journal for detailed discussion on the same.[19]

However, one of the reasons given by the court was that the language of s. 2(2) in Part I "This Part shall apply where the place of arbitration is in India" did not confine its application to India as s. 2(2) did not say that it would where "the place of arbitration is in India *only*".

In India, a foreign award is not enforceable per se. It is enforced because of India is a signatory to

the New York Convention, with the reservation that it would enforce only those awards that are rendered in a country that reciprocally would enforce awards made in India.

Case 2−Venture Global v. Satyam Computers. (2008) 4 SCC 190.

Bhatia's case was applied in this case. The facts were that parties, one of them from the US and the other from India, entered into two agreements. One for creating a joint venture, and the second for shareholding. The shareholding agreement contained an arbitration clause.

Following disputes, arbitrator made an award outside India. Satyam, the Indian company, had won and asked a US court to enforce the award. Pending consideration, Venture, the US company sued in India, relying on Bhatia and asking the court in India to set aside the award.

Satyam's objection that an award made outside India can be refused enforcement under Part II, but cannot be set aside by a court in India was rejected by the Supreme Court, relying upon Bhatia. As mentioned above, Bhatia had held that Part I of the 1996 Act would apply outside India as well. In Venture Global case, the court extended the principle to setting aside an award made outside India.

The court did not actually set aside the award, but remanded the matter to the trial court with the direction that it should consider the matter afresh keeping it in mind that if it agreed to the objection then it could set aside a foreign award.

This judgment, in this writer's opinion, is correct to the extent that the court was bound to follow Bhatia, but incorrect in that it did not consider it right to have the judgment in Bhatia reviewed by a larger bench. Bhatia's judgment makes the Act unworkable and is contrary to the basis on which the New York Convention and the Model Law were framed.

The international critics do not appear to have focused on Bhatia as the judgment enabled foreign parties to obtain interim measures even when arbitration was outside India. They however took notice of Venture Global case, which was the logical extension of Bhatia principle.

Thus, http : //www.whitecase.com/idq/spring_2008_4 opined as follows : "*The recent decision f the Supreme Court of India in Venture Global Engineering v. Satyam Computer Services Ltd has served another blow to the fledgling Indian arbitration regime and, in the process, sounded warning bells for those doing business in India*."

Again, the opinion expressed in http : //www.vinson−elkins.com/resources/pub_detail.aspx?id＝8244 is as follows.

"*The Supreme Court of India recently issued a decision of great importance to anyone who may seek to enforce an international arbitration award in India, or who may be drafting an arbitration provision in a contract with parties or assets located in India. The Court's decision allows arbitration awards to be challenged based on a standard approaching legal error*."

Actually, the error consisted in the counsel not seeking the review of Bhatia judgment. So long as

Bhatia judgment stands, it binds every court and judgments like the Venture Global are inevitable.

Case 3−ONGC v. Saw Pipes Ltd. (2003) 5 SCC

The facts of the case were as follows : (a) in a purely domestic contract, Saw Pipes Ltd agreed to supply pipes to ONGC by a specified date ; (b) it also agreed to pay damages of a specified amount if there was delay in supply of pipes to ONGC ; (c) there was delay in supply of pipes ; (d) the arbitral tribunal did not accept the explanation of Saw Pipes that the delay was due to *force mejeure* circumstances, that is, circumstances that are results of the elements of nature and not of human behavior ; and, (e) in spite of rejection of Saw Pipes' contention, the arbitral tribunal declined to give damages to ONGC as ONGC had not proved the actual loss.

ONGC appealed to the Supreme Court, which found that s. 28(3) of the 1996 Act reads as follows : "*In all cases, the arbitral tribunal shall decide in accordance with the terms of the contract*. . .".

According to the Supreme Court, as this provision made it mandatory for the arbitral tribunal to decide "all cases" "in accordance with the terms of the contract", the arbitral tribunal's reasoning, that ONGC must prove damages even where the contract provided for automatic damages, was inconsistent with its duty under s. 28(3).

The court held that s. 34 empowered it to set aside an award on the ground of public policy, which covered "patent illegality" of ignoring a mandatory provision of the 1996 Act.

This judgment was criticized on the ground that it expanded the scope of the term "public policy". Apart from the fact that the legal concept of public policy is one of the most difficult to pin down, there is also the issue of there being little debate on the question of what the court is to do when faced with a domestic award that violates a mandatory provision of the 1996 Act.

Case 4−Shin-Etsu Chemical Co. v. Aksh Optifibre

Briefly, the facts of this case were as follows. (i) the arbitration clause provided that the agreement was to be governed by the Japanese law ; (ii) all disputes were to be settled by arbitration ; (iii) the place of arbitration was to be Tokyo, Japan ; (iv) the arbitral tribunal had to make award in accordance with the ICC Rules.

The court formulated the issue before it thus : "*What is the standard of review that the judicial authority should adopt in relation to the arbitration agreement at the initial stage of section 45, viz., a prima facie finding or a final finding?*"

Although it was the Japanese party that had initiated under s. 8 the request for reference to arbitration, its counsel conceded that the applicable section was 45 and not 8. The difference between s. 45 and s. 8 is that the former was enacted to comply with the New York Convention, the latter is formulated pursuant to the UNCITRAL Model Law.

It is the difference between the two provisions that the court discussed to decide whether the decision should be *prima facie* or final.

The three judges gave separate judgments.

SABHARWAL, J. held as follows :

(a) Both provisions s. 8[20] and s. 45[21] are differently structured−the former meant for domestic arbitration, and the latter for international arbitration ;

(b) The mandatory nature of s. 45 requires that the issue of validity of agreement be decided finally, which would save costs ;

SRIKRISHNA, J. held that as s. 48[22] provides for challenge to the award on the ground of invalidity of arbitration agreement, the finding under s. 45 should be *prima facie* only.

DHARMADHIKARI, J. generally agreed with Srikrishna, J.

By conferring initial power on the arbitral tribunal to decide the issue of validity of arbitration agreement, the object of the Act is to minimize the court's role prior to arbitration. It would therefore be appropriate for the court to decide the issue *prima facie* and to leave it to first the arbitral tribunal and finally to the court to deal with the issue.

4. Conclusion.

The law of arbitration in India, both in its format and in execution, at present is in unsatisfactory state. Correction requires India to amend the law so as to separate the domestic arbitration from international commercial arbitration.

It is also necessary that institutional arbitration be encouraged. It would be useful if well known institutions from the world establish their presence in India and conduct some of the high value domestic and international arbitrations under its aegis. Indians have shown in the last 15 years that they are capable of international competition, and there is no reason to believe that they cannot establish and run good institutional arbitrations.

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1 The Constitution of India, article 1(1).

2 The Constitution of India, article 372 sanctions the use of the common law.

3 The statistics are taken from the speech delivered by the Chief Justice of India on November 26, 2008, which is the Law Day in India.

4 Executive Engineer v. N. C. Budhiraja (2001) 2 SCC 721 ; see also the 1996 Act, s. 30.

5 Champsey Bhara v Jivraj Baloo (1923) A C 480.

6 See for example, Bharat Coking Coal Ltd v. Annapoorna Constructions (2003) 8 SCC 154.

7 Champsey Bhara, supra.

8 The Indian Arbitration Act, 1940, s. 30.

9 The Foreign Awards (Recognition and Enforcement) Act, 1961, s. 7.
10 Ibid., s. 7(1)(b)(ii).
11 Renusagar Power Co. Ltd. v. General Electric (1994) Supp. 1 SCC 644.
12 See the Preamble to the Act.
13 The 1996 Act, s. 2(2).
14 The Law Reform Commission of Hong Kong, Report on the Adoption of UNCITRAL Model Law on Arbitration, paragraph 4.5.
15 See Broches, *Commentary on the UNCITRAL Model Law on International Commercial Arbitration* (Kluwer, 1990), at p. 191 ; and UN Doc. A/CN. 9/263 Add. 2, paras. 29–35.
16 Speech given at Bahrain ICCA Congress in 1993.
17 See Gary Born, on Arbitration, at http : //books.google.co.in/books?id＝hYEbA 8 mIzMsC&pg＝PA 44&dq＝institutional＋versus＋”ad＋hoc”＋arbitration&ei＝9 BlRScXtCKWQkATmrPla#PPA 44, M 1.
18 The Law and Practice of International Commercial Arbitration, Redfern and Hunter, 4th Edition, paragraph 1–22.
19 Bhatia International v Bulk Trading－a Critical Review by S K Dholakia, (2003) 5 SCC (Jour) 22.
20 Corresponding to article 8 of the Model Law.
21 Corresponding to article II(3) of the New York Convention of 1958.
22 Corresponding to Article V(1)(a) of the New York Convention of 1958.