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Indian Arbitration at a Crossroads

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India faces a choice, say Aloke Ray and Dipen Sabharwal at White & Case: revive the spirit of the 1996 act, or see a return of the 1940 law.

Anniversaries are apt occasions to reflect on the past and consider the future. 2006 saw the 10th anniversary of the Indian Arbitration and Conciliation Act 1996, presenting a timely opportunity to examine the state of arbitration in India.

Before the 1996 act, India's arbitration regime consisted of the Arbitration Act 1940, the Arbitration (Protocol and Convention) Act 1937, and the Foreign Awards (Recognition and Enforcement) Act 1961. The 1996 act replaced this framework, but was more than mere consolidating legislation. Not only did it implement the UNCITRAL Model Law on International Commercial Arbitration, it aimed to create a pro-arbitration legal regime in India.

Before the 1996 act, there was widespread discontent over excessive judicial intervention in arbitral proceedings with attendant delays and uncertainty. Section 30 of the 1940 act allowed courts to set aside an arbitral award where "the award [had] been improperly procured or [was] otherwise invalid".

Indian courts interpreted the phrase 'otherwise invalid' as a catch-all, which entitled them to substantively review the merits of an award and set it aside if it suffered from an "error of law apparent on the face of the award". As a result, the 1940 act became a vehicle for disgruntled parties on the losing end of arbitrations to challenge awards on the merits and retry, in effect, their case before Indian courts. Such abuse prompted the Supreme Court to declare that:

> "the way that the [arbitral] proceedings under the [1940] Act are conducted, and without exception challenged in the courts, has made lawyers laugh and legal philosophers weep in view of the unending prolixity, at every stage providing a legal trap to the unwary." *(M/s Gurunanak Foundation v. M/s Rattan Singh & Sons*, AIR 1981 SC 1075)

The 1996 act attempted to rectify the problem by limiting the basis on which awards could be challenged to a few narrow grounds (which mirrored those found in the UNCITRAL Model Law and the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards). The intention was to minimize the supervisory role of courts, ensure finality of arbitral awards, and expedite the arbitral process.

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Just as the proof of the pudding lies in the eating, the efficacy of any legislation must be judged by its implementation rather than its intentions. Unfortunately, in the case of the 1996 act, the reality has been far removed from the ideals professed by the legislation. Two decisions of the Supreme Court have in particular dealt body blows to the 1996 act: *Oil and Natural Gas Corporation v. SAW Pipes* (2003) 5 SCC 705, and *SBP & Co v. Patel Engineering* (2005) 8 SCC 618.

SAW Pipes addressed a challenge to an Indian arbitral award on the grounds that it was "in conflict with the public policy of India". Despite precedent suggesting that 'public policy' be interpreted in a restrictive manner and that a breach of public policy requires something more than a mere violation of Indian law *(Renusagar Power Co Ltd v. General Electric Co* 1994 Supp (1) SCC 644), the Supreme Court interpreted public policy in the broadest terms possible. It held that any arbitral award that violates Indian statutory provisions is "patently illegal" and contrary to "public policy". By equating 'patent illegality' to an 'error of law', the court paved the way for losing parties in the arbitral process to have their day in Indian courts on the basis of, in effect, any alleged contravention of Indian law, so resurrecting the near-limitless judicial review that the 1996 Act was designed to eliminate.

Taken alongside an earlier decision of the Supreme Court *(Bhatia International v. Bulk Trading SA* [2002] 1 LRI 703), the pitfalls posed by *SAW Pipes* are further exacerbated. Specifically, the Supreme Court held in *Bhatia* that the relevant part of the 1996 act addressed in *SAW Pipes* applies not only to domestic arbitral awards but also to foreign awards; so the excessive judicial intervention permitted by *SAW Pipes* may now be assumed to extend to the international arena. This takes the law on challenging awards far beyond the narrow grounds prescribed by the New York Convention and surely makes India's compliance with that treaty questionable.

More recently, in *Patel Engineering*, the Supreme Court permitted further court interventions in the arbitral process. The case concerned the appointment of an arbitrator by the chief justice of the Supreme Court in circumstances where the parties' chosen method for constituting the tribunal had failed. The court held that the chief justice, while discharging this function, is entitled to adjudicate on contentious preliminary issues such as the existence of a valid arbitration agreement. It rejected the argument that the chief justice's role be limited to a prima facie review of the facts while making such a determination and instead held that the chief justice was entitled to call for evidence to resolve jurisdictional issues. Significantly, the Supreme Court ruled that the chief justice's findings on these preliminary issues would be final and binding on the arbitral tribunal. This makes a mockery of the well-established principle of *Kompetenz Kompetenz*—the power of an arbitral tribunal to determine its own jurisdiction—enshrined in section 16 of the 1996 act. It also encourages parties to sabotage the appointment process of arbitrators, to make spurious arguments about preliminary issues, and to use evidentiary hearings in courts to delay arbitral proceedings.

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Patel Engineering presents another anomaly. Where either party to an arbitration is non-Indian, the arbitration is treated as an 'international commercial arbitration' under the 1996 act and the appointing authority under section 11 is the chief justice of the Supreme Court, from whom there is no right of appeal. Conversely, if both parties are Indian,

then the appointing authority is the chief justice of a High Court from whom, the court has held, there is a right to appeal (to the Supreme Court). Simply put, Indian parties get two bites at the cherry before Indian courts, whereas foreign parties get one. Although foreign parties may welcome having more limited exposure to the Indian judiciary, it remains troubling that post-*Patel Engineering* the power of a tribunal to determine its own jurisdiction can be usurped by the Supreme Court and that there is nothing a foreign party can do once the Supreme Court's determination has been made.

SAW Pipes and *Patel Engineering* have been criticised by commentators, and rightly so. Both judgments have severely undermined one of the principal features of the 1996 Act, namely enhancing party autonomy in arbitration. As Arden LJ has pointed out:

> "[T]he consequence of party autonomy is that the result will, save in restricted circumstances, be binding and that is part and parcel of the freedom to arbitrate. The courts have to respect the choice the parties have made and, though it may often be difficult for a court to resist this temptation, to decline to set aside an award if there is an error of law unless the law specifically permits the court to do so on that ground."

The Indian courts' failure to resist the temptation to intervene in arbitrations is harmful in two ways.

First, for a legal system plagued by endemic delays, a pro-arbitration stance would reduce the pressure on courts. Recent reports indicate that more than 30 million cases are pending resolution in the Indian judiciary. There are only 13 judges for every 1 million people in India compared with 51 in Britain and 107 in the United States: clearly, Indian courts are struggling to cope with the huge caseload. Arbitration is not, then, merely an attractive option for resolving disputes—it is essential to maintain the integrity of the Indian legal system. Encouraging parties to arbitrate, however, requires more than mere lip service to the merits of arbitration; it requires that the courts respect party autonomy and ensure the finality of resulting arbitral awards. If disputes are going to end up in courts anyway, there is scant incentive for parties to bother to arbitrate in the first instance.

Second, for a country seeking to attract foreign investment, it is imperative that its legal system provides efficient and predictable remedies to foreign investors. When commercial parties enter into transactions, they factor into their bargain the potential legal costs of enforcing their rights. If a legal system does not hold the promise of speed or certainty, a certain 'risk premium' is added to the cost of the transaction which, if excessive, may make the transaction commercially unviable. Foreign investors have typically preferred arbitration and shied away from Indian courts because of prolonged delays in litigation caused by a backlog of cases. As a result of *SAW Pipes* and *Patel Engineering*, arbitration appears to have been reduced to a mere prelude to protracted litigation in Indian courts, thereby increasing the risk premium associated with Indian transactions. This is bad news for the Indian economy. India attracted $5.5 billion of foreign direct investment in 2005 to 2006, yet its potential to increase this inflow is held back by an uncertain arbitration regime.

And what has been the Indian policy response to *SAW Pipes* and *Patel Engineering*? Partial damage control, it appears. The Arbitration and Conciliation (Amendment) Bill, 2003, which is pending before the Indian Parliament, aims to add a section allowing an award to be set aside "where there is an error apparent on the face of the arbitration award giving rise to a substantial question of law". Although this new ground for challenge is narrower in definition than the *SAW Pipes* ruling, it still affords losing parties an opportunity to approach courts in an attempt to second-guess arbitral tribunals. This could lead to a position similar to that under the 1940 act and complete a full circle for Indian arbitration.

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But the bill has yet to be enacted and there is still time to propose an amendment that would reverse *SAW Pipes* totally. As for *Patel Engineering*, although there has been no policy response so far, this too could be addressed in revisions that could be made to the bill, which clarify the limits on the chief justice's role as an appointing authority.

So, the 10th anniversary of the 1996 act finds Indian arbitration at a crossroads. The Indian legislature and judiciary have a fundamental choice to make: to respect party autonomy and finality of arbitral awards as envisaged by the 1996 act, or to impose judicial supervision on arbitration and revert to the days of the 1940 act. Their decision will shape the course of Indian arbitration for the next decade and beyond.

White & Case does not practice Indian law.

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