STRIKING THE BALANCE: PATENT ILLEGALITY AND MINIMAL JUDICIAL INTERFERENCE UNDER THE INDIAN ARBITRATION JURISPRUDENCE

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ABSTRACT

The Arbitration and Conciliation Act, 1996 renders certain exhaustive grounds for extinguishing an arbitral award.[1] The rationale was not to lay down expansive grounds for extinguishing an arbitral award as it would ultimately amount to higher interference of the judicial authorities nullifying the aim of the 1996 Act. 'Patent illegality' wasn't one of the defences at hand pursuant to Section 34 for extinguishing an arbitral award until 2003, when it was brought within the realm of the 'public policy' shield as stipulated by Section 34(2)(b)(ii) of the 1996 Act by way of a momentous judicial decision by the Hon'ble Apex Court.[2] Finally, the defence of patent illegality to terminate an arbitral award gained legislative acknowledgement by way of the 2015 amendment which incorporated clause (2A) under Sec 34.[3] In this specific article, the author talks through the birth of the defence of patent illegality for extinguishing an arbitral award as well as the advancement and progress of the same with the aid of numerous notable judicial decisions and legislative materials. Finally, the article seeks to examine the possibility of increasing judicial intervention due to the employment of the ground of patent illegality for setting aside an arbitral award.

Keywords: Patent Illegality, Arbitral Award, Judicial interference, Public Policy.

[1] The Arbitration and Conciliation Act, 1996, §34, No. 26, Acts of Parliament, 1996 (India).
[2] Oil & Natural Gas Corporation Ltd v. Saw Pipes Ltd., (2003) 5 SCC 705.
[3] The Arbitration and Conciliation Act, 1996, §34(2A), No. 26, Acts of Parliament, 1996 (India).

INTRODUCTION

The legal framework on arbitration in nearly every country hub around two noteworthy facets of party autonomy[4] and finality of arbitral awards.[5] The fundamental concern that pops up is when the aforementioned facets are garbled by unrestricted judicial interference, consequently leading to non-achievement of the most crucial aim of the legal framework associated to arbitration. Unsurprisingly, the arbitration law of India i.e. The Arbitration and Conciliation Act, 1996 (henceforth stated as the 'Act') enthralled upon restricting court intervention and warranting finality of arbitral awards.[6] Therefore, the legislative intent was not to specify broad grounds for extinguishing arbitral awards rendered by an arbitral tribunal, as provided under Section 34 of the Act. In addition to the explicit basis for extinguishing an arbitral award, as entailed in Section 34 of the Act, Section 34(2A) was incorporated by the most momentous and talked about amendment in the Act in the year 2015 in consonance with the 246th Law Commission Report.[7] Section 34(2A) established an additional basis and defence pertaining to patent illegality wherein absolute domestic awards (domestic awards that don't arise from International Commercial Arbitration) may be extinguished, in case, there is any patent illegality emerging on the surface of the arbitral award in question.[8] Thus, the aforementioned Section widened the sphere of judicial review by supplementing one more defence to extinguish an absolute domestic arbitral award in addition to the grounds which were heretofore at hand under Section 34.

During the course of time, when the defence pertaining to public policy under Sec 34(2)(b)(ii) for extinguishing arbitral award started to be widespread, the patent illegality defence started to come into the spotlight.[9] Currently, patent illegality stands as an isolated defence for terminating an absolute domestic arbitral award under Sec 30(2A), distinct from the provision associated with the public policy defence.[10] It is actually of vital significance to know that the Act specifies the defence of patent illegality, however, it doesn't define the term anywhere in

[4] Vishal Ranaware & Amol Shelar, *Public Policy a Hurdle under the Indian Arbitration Law: Critical Analysis*, 4 IJLS 67, 69 (2018).
[5] Udechukwu Ojiako, *The Finality Principle in Arbitration: A Theoretical Exploration*, 15 J. LEG. AFF. DISPUTE RESOLUT. ENG. CONSTR. 04522038 (2023).
[6] LAW COMMISSION OF INDIA, *Amendments to the Arbitration and Conciliation Act 1996*, Report No. 246, 13 (August, 2014).
[7] The Arbitration and Conciliation Act, 1996, §34(2A), No. 26, Acts of Parliament, 1996 (India).
[8] *Id*.
[9] Deeksha Singh, *Patent Illegality as a Ground to Set Aside Domestic Arbitral Awards*, 2 JLRJS 328, 328-339 (2021).
[10] The Arbitration and Conciliation Act, 1996, §34, No. 26, Acts of Parliament, 1996 (India).

the Act. Consequently, there is an implied notion of looking at how the term has been construed by the judiciary in the absence of a legislative definition specified under the Act. Thus, it is understandable that reliance has to be sought on how the Apex Court and High Courts have construed the inherent meaning of the term 'patent illegality' and the scope of the same. In the Indian arbitration jurisprudence, patent illegality emerged as a defence for the very first instance in the momentous verdict of the Apex Court in the case of ***Saw Pipes***[11] in which wider interpretation and scope was given to the term 'public policy' defence to include patent illegality within its ambit. Although, the judicial connotation and purview of patent illegality as a shield will be deliberated in this article in a chronological manner, nonetheless, it is critical to get a preliminary understanding of the defence of patent illegality before going into depth, subsequently in the article. Henceforth, in case, an award infringes any 'substantive provisions of any law', 'the mandate of the 1996 Act', or 'the contractual stipulations', the patent illegality defence may come into the scene depending on the factual scenarios and judicial wisdom.[12]

PATENT ILLEGALITY: CARVING OUT FROM PUBLIC POLICY PRIOR TO THE 2015 AMENDMENT

Preceding the 2015 amendment, the defence associated to patent illegality took birth and sustained from the public policy ground as stipulated by Section 34(2)(b)(ii)[13] through numerous judicial decisions in the absence of the same being specified as a distinct ground under Section 34 of the Act which mentions the grounds for extinguishing an arbitral award.

In one of the oldest cases of ***Renusagar***[14], which was around 3 decades ago, the Apex Court restricted the purview of public policy[15] to 3 rationales i.e. 'fundamental policy of Indian law', 'interest of the country' or 'justice/morality'.

Around a decade later, the momentous ***Saw Pipes***[16] verdict is the first case in the Indian arbitration jurisprudence wherein the Apex Court introduced the defence of patent illegality by giving a wide interpretation to the phrase 'public policy of India'. This verdict undertook to

[11] Saw Pipes, *supra* note.
[12] Singh, *supra* note 328.
[13] The Arbitration and Conciliation Act, 1996, §34(2)(b)(ii), No. 26, Acts of Parliament, 1996 (India).
[14] Renusagar Power Co Ltd v. General Electric Co, (1994) Supp 1 SCC 644.
[15] Sunidhi Singh, *Patent Illegality In Setting Aside Arbitral Awards: Is India Becoming A Robust Seat For Arbitration?*, LIVE LAW (Feb. 13, 2023, 9:12 PM), https://www.livelaw.in/lawschoolcolumn/patent-illegality-in-setting-aside-arbitral-awards-is-india-becoming-a-robust-seat-for-arbitration-221421.
[16] Saw Pipes, *supra* note.

impair the attempt of the Apex Court in the Renusagar verdict which aimed to restrict the purview of public policy. In the discussed verdict, the Apex Court re-investigated Section 34(2)(b)(ii) and gave an expanded implication to the term 'public policy'. The court looked at public policy with regard to the core standards of the 1996 Arbitration Act, Indian Contract Act, 1872 and Constitutional standards. The court clarified on their stance that public policy is relevant not only to the policies framed/adopted by a specific government but also holistically, public virtues and public interest concerns. Furthermore, going at par with the aforementioned argument, a fourth ground associated to patent illegality was included by the Apex Court supplementing the already subsisting three other defence associated to public policy which were put forward by the same court in the Renusagar verdict along with the statutory ground of fraud or corruption or infringement of Sec 75/81 as stipulated under the head of explanation under Sec 34(2)(b)(ii). This essentially construed that an arbitral award may be extinguished due to it being patently void if the same infringed any 'substantive provisions of law' or 'the Act' or is 'contrary to any contractual stipulations'. However, the Court entailed a caveat that illegality should delve deep into the substance of the affair and when, it is of minimalistic character, then it shall not be declared that the award is contrary to public policy. The court further, entailed that an award may also be extinguished if it is so inequitable and irrational that startles the court's moral conscience. Henceforth, such an award is contrary to public policy and is therefore needed to be affirmed as void. The Saw Pipes verdict, by incorporating an additional defence of patent illegality along with the already subsisting grounds under public policy was subjected to a lot of condemnation as it widened the ambit of public policy so as to invite more potential court intervention which wasn't the focal point of the 1996 Act. This was portrayed as a major blow which could have a damaging impact halting the progress of the post 1996 Act arbitration legal framework in the country.

However, despite such strong critical views against the verdict given in the Saw Pipes case, the supreme court followed and applied the aforementioned precedent in the verdict of ***McDermott International***[17]. Emphasis was drawn that the defence of patent illegality had somewhat impaired the ethos of the 1996 Act. It can be perceived that, it is nearly the same as keeping the defence for challenge that subsisted under Section of the 1940 Arbitration Act. On top of that, a prudent scrutiny of the 1996 Act demonstrates that the two requirements for extinguishing an arbitral award on the rationale of patent illegality as stipulated in the Saw

[17] Mcdermott International Inc vs Burn Standard Co. Ltd. & Ors., (2006) 11 SCC 211.

Pipes verdict i.e. opposed to the explicit contractual terms or substantive law are hitherto there under clause (iv) and (v) of Section 34(2)(a). The former aforementioned discussed clause pertains to extinguishing an arbitral award in case it relates to a dispute not falling within the sphere of the reference of submission to arbitration. The later discussed clause pertains to extinguishment of arbitral award if the formation of the arbitral tribunal or the arbitral mechanism wasn't in consonance with the agreement entered into amidst the parties. Henceforth, the view taken to include patent illegality as an additional shield under the ambit of public policy was potentially not required as it further increased the ambit of judicial review to extinguish an arbitral award. This will lead to more judicial intervention and question the focal point of finality of arbitral awards which are the two most noteworthy aims of the 1996 Act.[18]

The Apex Court delved deep into the purview of patent illegality after some years in the verdict of ***Associate Builders case***[19] which was around a decade, post the Saw Pipes verdict. The court in the Associate Builders verdict critically dealt with the three facets of public policy as deliberated upon and settled in the Renusagar case and confirmed in the Saw Pipes case along with the fourth additional ground pertaining to patent illegality that took birth in the Saw Pipes case. Consequently, the Court, in the Associate Builders verdict, evaluated all the four facets of public policy in detail. While deliberating on the first rationale of 'fundamental policy of Indian Law', the Court counted on the ***Western Geco***[20] verdict where the Court supplemented three foundational and distinguished juristic principles that shall be appreciated as a cornerstone of the 'fundamental policy of Indian law' that incorporates core principles like complying the statutory terms, taking resort to the standard of stare decisis, proceeding with a judicial perspective, and complying with the well set out benchmark of natural justice and the Wednesbury principles. The court then talked over the other two heads in public policy i.e. 'interest of India' and 'justice/morality' respectively before delving into the most awaited analysis of the fourth head which is the shield of patent illegality. The court underpinned three facets of the patent illegality ground. firstly, an infringement of the substantive provisions of Indian law would lead to destruction of an arbitral award. Nonetheless, this shall be comprehended with the stance that such illegality should delve deep into the affair and must

[18] Garima Budhiraja Arya & Tania Sebastian, *Critical Appraisal of Patent Illegality as a Ground for Setting Aside an Arbitral Award in India*, 24 BOND L. REV. 157, 161 (2012).
[19] Associate Builders v. Delhi Development Authority, (2014) SCC Online SC 937.
[20] Oil & Natural Gas Corporation Ltd v. Western Geco International Ltd., (2014) 9 SCC 263.

not be of minimalistic nature. Comparing with the statute, the Court portrayed that this is an infringement of Section 28(1)(a) of the Act. Secondly, an infringement of the 1996 Act, all together, would be deemed to construe patent illegality. For instance, when an arbitrator doesn't provide for reasons, an award under Section 31(3) of the Act, such an award may be extinguished. Thirdly, the last facet of patent illegality is an infringement of Section 28(3) of the 1996 Act, when the arbitrator doesn't take note of the 'contractual terms' and 'usages of trade' as obligated under Section 28(3) of the 1996 Act. Nonetheless, the Court supplemented that the last discussed infringement shall be comprehended with a disclaimer. It is true that an arbitral tribunal shall resolve in consonance with the contractual stipulations, however, in case an arbitral tribunal construes a contractual stipulation in a fair and reasonable manner, it doesn't prime facie indicate that the award may be extinguished on this rationale. Deriving the contractual stipulation is fundamentally for the arbitral tribunal to apply the mind, and if the arbitrator comprehends the contractual stipulations in such a manner that it could be absolutely perceived that no rational or a prudent individual could do, then the patent illegality defence may be resorted to. Henceforth, the defence of patent illegality under this sub-head could potentially be relied upon, in case, the arbitral tribunal doesn't reasonably comprehend the contractual stipulations or when the contract has been comprehended irrationally.[21]

BIRTH OF PATENT ILLEGALITY AS A SEPARATE GROUND BY THE 2015 AMENDMENT

As discussed above, the defence of 'patent illegality' emerged and continued to grow from the public policy defence as stipulated by Section 34(2)(b)(ii) of the Act through the aforementioned momentous judicial decisions, for extinguishing an arbitral award in the absence of any legislative status of the same under the Act.[22] However, the 2015 amendment in the 1996 Act, which is the most notable and talked about amendments that brought a sea of alterations and additions in the Act gave legislative status to patent illegality as a distinct basis for extinguishing an arbitral award.[23] The Amendment Act in 2015 in consonance with the suggestions as rendered by the 246th Law Commission Report incorporated patent illegality as a distinct exception under Section 34(2A) of the 1996 Act, for extinguishing only pure domestic

[21] Abinash Agarwal & Shivangi Dubey, *Determining Patent Illegality for Setting Aside an Arbitral Award*, MCO LEGALS (Feb. 15, 2022,8:15 PM), https://www.mcolegals.in/kb/Determining_Patent_Illegality_for_setting_aside_an_Arbitral_Award.pdf.
[22] The Arbitration and Conciliation Act, 1996, §34(2)(b)(ii), No. 26, Acts of Parliament, 1996 (India).
[23] *Id*., §34(2A).

arbitral awards and not awards that are passed in pursuance of international commercial arbitration (Hereinafter referred to as 'ICA').[24] However, there is a caveat under Section 34(2A) which entails that that an award must not be extinguished solely due to the fact that law was applied inaccurately or by reproduction of evidence. This is basically the proviso under Section 34(2A) which portray the Law Commission's recommendatory remark that is to ensure balance and to get away with unrestrained interference of the Court.[25]

Pursuant to the suggestions as rendered by the 246th Law Commission Report, Section 34(2)(b) is altered and revised, providing a better version, which incorporates two explanations under the aforementioned Section and also provides a distinct head of 'patent illegality' by adding Section 34(2A) under the Act.[26] Under Section 34(2)(b), the Union Legislature has shed light in Explanation 1 as to what will determine an infringement of the country's public policy and has given legislative status to 2 out of 3 facets pertaining to public policy which were clarified in the Renusagar case i.e. basic policy of the country's law and morality/justice.[27] The Law Commission had suggested the insertion of section 34 (2A) pertaining to absolute domestic awards, that may be extinguished by the competent judicial authority if it is of the opinion that the award is induced by patent illegality visible ostensibly on the award. The rationale of the Commission for limiting the purview of patent illegality to absolute domestic awards and no other awards is primarily because the 1996 Act, prior to the discussed amendment failed to make a distinction amidst three kinds of awards i.e. absolute domestic awards (domestic awards that don't emerge from ICA), domestic awards emerging from ICA and foreign awards.[28] The Commission was of the opinion that this was severely concerning and had a destructive effect. The commission backed its arguments by clarifying that the lawfulness of judiciary interfering, in scenarios when absolute domestic awards are passed is significantly more, compared to instances, when a court is evaluating the legality of foreign awards or domestic awards passed in pursuance to ICA.[29] The commission also deliberated that restricting the ambit of the defence of patent illegality to solely absolute domestic awards would also nullify the detrimental effect of the verdict of the Apex Court in the Saw Pipes case, which was though in the setting of an

[24] LAW COMMISSION OF INDIA, *Amendments to the Arbitration and Conciliation Act 1996*, Report No. 246, 21 (August, 2014).
[25] The Arbitration and Conciliation Act, 1996, §34(2A), No. 26, Acts of Parliament, 1996 (India).
[26] *Id*., §34(2)(b) explanation I & II and §34(2A).
[27] Renusagar, *supra* note.
[28] LAW COMMISSION OF INDIA, *Amendments to the Arbitration and Conciliation Act 1996*, Report No. 246, 21 (August, 2014).
[29] *Id*.

absolute domestic award, had the misfortune of a wider application of the defence of patent illegality to both domestic awards made in pursuance to ICA in addition to foreign awards.[30]

PATENT ILLEGALITY POST THE 2015 AMENDMENT

In the 2019 case of ***Ssangyong Engineering***[31], the Hon'ble Apex Court firmly established that the 2015 Amendment will have a prospective effect. This essentially means that, it will have no effect on arbitrations which may have commenced prior to 2015. Rather, it will be concerned with section 34 petitions which are filed to the Court either on or post the date of October 23, 2015. The court in this case, while referring to the statutory mandate that patent illegality must be visible ostensibly on the award, clarified that the concerned illegality must delve into the root of the affair, however, that shouldn't be solely on the incorrect application of the law. This implies that, whatever isn't coming within the realm of 'the fundamental policy of Indian law' (this case nullified the judicial approach, Wednesbury standards of irrationality/perversity, that were perceived to be a part of the country's foundational policy as stated in the Western Geco verdict and reaffirmed the stance of what will fall under the country's foundational policy as settled in the Renusagar verdict i.e. infringement of an enactment associated to public policy/public interest) as confirmed in the Renusagar verdict i.e. specifically, infringement of an enactment associated to public policy/public interest, cannot be given indirect access by virtue of the defence of patent illegality to extinguish an award. The court also clarified that re-examination of evidence, that is one of the significant powers of the appellate court, shall not be exercised under the patent illegality ground.

The court in this case, shifting away from the rationale given in the Associate Builders case pertaining to patent illegality, specified that only an infringement of the country's substantive law, cannot be utilized as a defence for extinguishing an arbitral award. Nonetheless, when the award's reasoning isn't rendered by the arbitrator which explicitly infringes Section 31(3) of the Arbitration Act, the defence of patent illegality can be resorted to. The court, confirming the viewpoint taken in the Associate Builders case stipulated that the defence of patent illegality can also be resorted to, in situations of the arbitrator comprehending the contractual terms in a way that no just or reasonable individual would i.e. it wasn't possible for the arbitrator to resort to such viewpoint. The court, further supplemented this point, by adding that, when the

[30] *Id.*
[31] Ssangyong Engineering and Construction Company Limited v. National Highways Authority of India, (2019) 15 SCC 131.

arbitrator roams external to the contract and relates to affairs that aren't assigned to him, he engages in jurisdictional error. This defence will come under the purview of the latest head of patent illegality as incorporated under Section 34(2A). The Apex Court also stated that the defence of patent illegality can be resorted to in case when a perverse ruling is given by the arbitrator. The court supplemented that, a ruling constructed without taking into account any evidence whatsoever or where an award disregards crucial evidence in rendering a ruling would amount to perversity and is therefore apt to be extinguished due to it being patently void. The court didn't stop here and stated that, a ruling having its basis on documents taken, which the parties didn't refer to and weren't aware of, by the arbitrator would also amount to a ruling which isn't backed by any evidence as such a ruling is supported by evidence not rendered by any of the parties due to which it can be determined to be unreasonable.

In the verdict of ***Patel Engineering Ltd.***[32], the highest court of the nation settled that in case an arbitrator's ruling is observed to be unreasonable or irrational or his viewpoint is far from being just that any prudent individual would take, in such a state of event, the patent illegality defence can be resorted to. In this specific verdict, the reasonableness of an award from the lens of a prudent individual was evaluated.[33] The court relying on the Ssangyong case, re-affirmed that the facet of patent illegality is a shield at hand to parties for extinguishing an absolute domestic award, when the arbitrator's ruling is seen as so perverse/unreasonable that no prudent individual would have drawn such conclusion; or, the contractual stipulations are constructed is such a manner that no just or prudent individual would take; or, when the arbitrator resorts to an impossible stance.

In ***Delhi Airport Metro Express Private Limited***[34] verdict, the Hon'ble Apex Court re-affirmed the instances where the defence of 'patent illegality' can be resorted to, as already settled in prior discussed verdicts which are -

- When the arbitrator resorts to an impossible stance or viewpoint.
- When the arbitrator comprehends a contractual stipulation by applying such mechanism that no just or prudent individual would, or when the arbitrator wrongly perceives a

[32] Patel Engineering Ltd. v. North Eastern Electric Power Corporation Ltd., (2020) SCC Online SC 466.
[33] Juhi Agarwal & Ashutosh Singh Charan, *Patent Illegality of Arbitration Award*, 6 INT'L JL MGMT. & HUMAN. 2410, 2413 (2023).
[34] Delhi Airport Metro Express Private Limited v. Delhi Metro Rail Corporation Limited, (2022) SCC Online SC 549.

jurisdiction by roaming external of the contract and concerning with affairs that are not assigned to them.

- When an arbitral award's ruling does not contain any reason which is a mandate.

- When the final ruling of the arbitrator isn't based on any kind of evidence or crucial evidences were ignored in order to finalize a ruling, then it is deemed to be unreasonable and therefore, the award can be extinguished by virtue of the rationale of patent illegality. Additionally, taking account of documents which the other party didn't receive as they weren't rendered to them is a subset of perversity coming under the ambit of 'patent illegality'.

In the verdict of ***Indian Oil Corporation Ltd***[35], the Apex Court while extinguishing an award affirmed the same to be plagued by the defect of patent illegality because of the fact that the Arbitral Tribunal didn't act in consonance with the contractual stipulations or hasn't taken into consideration the mutually agreed stipulations mentioned in the contract.

CONCLUSION

Thus, it can be concluded by inspecting the findings in this article that patent illegality didn't have a legislative status prior to the 2015 amendment. Prior to the aforementioned amendment, patent illegality emerged or rather took birth from the public policy shield mentioned under Section 34(2)(b)(ii) of the 1996 Act by way of judicial connotation. Before, the amendment the patent illegality shield was applicable to be resorted to in case of both domestic and foreign awards. Then, the 2015 amendment came into being which gave a legislative status to the shield of patent illegality by incorporating clause (2A) under Section 34 of the Act, where an absolute domestic award and not an award declared in pursuance of ICA could be extinguished by virtue of the same being patently void. The proviso to Section 34(2A) was a much needed addition as the legislature feared that the 'patently illegality' shield might be used on a frequent basis to extinguish an arbitral award which will impair the noteworthy focal points of arbitration law i.e. minimal interference of judicial authorities and finality of awards. Thus the proviso which states that the defence of patent illegality cannot be resorted to in case of flawed application of law or re-examination of evidence was added to strike the much needed balance. It is also

[35] Indian Oil Corporation Ltd. v. Shree Ganesh Petroleum Rajgurunagar (2022) SCC Online SC 131.

important to specify that the defence of patent illegality can be taken into consideration only in case of those Section 34 petitions that were filed post the 2015 amendment which is 23/10/2015 ensuring a prospective applicability of the same.

Patent illegality, as analyzed from numerous judicial decisions, portray and settles that illegality must delve deep into the substance of the affairs and illicitness of minimalistic character shouldn't be a shield to extinguish an award. The defence of patent illegality should only be resorted to when the award passed is so unjust and perverse that it startles the moral conscience of the court. The ground of patent illegality as have been rendered by the judicial pronouncements, which have been discussed like unreasonably comprehending a contractual stipulation or perversity, for instance in the form of an award ignoring momentous evidences, are according to the author the right determination of grounds to invoke the shield of patent illegality. The aim of the 1996 Act to lower judiciary's interference as much as possible, cannot support the fact that an award will be declared final without any scope of extinguishment, if the same is grossly illegal or unreasonable which startles the moral conscience of the judiciary. Thus, as long as the judicial trend of invoking the patent illegality shield is restricted to a high standard of the court's moral conscience, perversity/unreasonability and the court doesn't poke into events of minimalistic nature, the patent illegality defence will in no way impair the focal point of the 1996 Act of ensuring very less interference of the courts.