

DECODING PATENT ILLEGALITY: IN REFERENCE TO SECTION 34 OF THE ARBITRATION & CONCILIATION ACT,1996

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Introduction

Before the introduction of the Arbitration and Conciliation Act, of 1996, Section 30 of the Indian Arbitration Act, of 1940 stated certain broad grounds for setting aside an arbitral award. The term “set aside” means that a court has the power to set aside an award if it finds that the subject matter of the dispute cannot be settled by arbitration under the law for the time being in force or the arbitral award is in conflict with the public policy of India. No doubt the winds are changing, there is a trend seen that whenever an arbitral award goes against one of the parties, they seek ways to set aside the award. Under section 34 of the act, there are grounds provided that restrict challenging an award in the court. Prior to the 2015 amendment, Section 34 only dealt with setting aside domestic awards. However, this amendment brought in the concept of ‘patent illegality’ and standards of public policy which brought a significant change in the dynamic of setting aside an arbitral award.

Patent Illegality

In 2015, an amendment was initiated on the recommendation of the 246th report of the Law Commission through which “Public Policy” was made an exception to setting aside of the award. The following amendment has underlined the importance of judicial intervention in the setting aside of arbitral awards arising in arbitration other than international commercial arbitration².

The first case in which the Supreme Court laid down the standards of public policy was *Renusagar Power Co. Ltd v. General Electric Co*³. In this case, it was held that the court cannot scabble into the merits of the award but rather comment on its value in light of public policy. The court also laid down the standards of public policy while judging the validity of the award.

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² NLSBLR, <https://repository.nls.ac.in/cgi/viewcontent.cgi?article=1040&context=nlsblr> (last visited July 14, 2024).

³ *Renusagar Power Co. Ltd v. General Electric Co* 1994 Supp (1) SCC 644.

The amendment also brought in section 34(2A) clarifies that matters of arbitral award arising other than international commercial arbitration also be dealt with by the court if the court finds that such awards are vitiated by “patent illegality”. To provide a balance and avoid excessive intervention, the section also states that an award “shall not be set aside merely on the grounds of an erroneous application of the law or by re-appreciating the evidence”⁴.

The term “Patent Illegality” was explained by the Supreme Court for the first time in the case of *Oil & Natural Gas Corporation Ltd. versus SAW Pipes Ltd*⁵. The term “patent illegality” means an error of law that dives deep into the root of the matter. Such error of law means inconsistency with the common law, constitution and statutory provisions. In the above case, the primary issue addressed in this appeal was the ambit and scope of a court's jurisdiction under Section 34 of the Arbitration and Conciliation Act, 1996, particularly concerning the setting aside of an arbitral award. The court reviewed the relevant parts of Section 34, emphasising the conditions under which an arbitral award may be set aside. The court highlighted the importance of the arbitral procedure following the agreement of the parties and the Act. If the procedure or composition of the tribunal is not as agreed or mandated by the Act, the award can be set aside. The court clarified that an award is in conflict with public policy if it was induced or affected by fraud, corruption, or violation of certain sections of the Act. The court concluded that an arbitral award that contravenes the substantive provisions of the law or the terms of the contract can be set aside under Section 34. It held that procedural laws must provide relief when substantive law gives a right, reinforcing the principle that “there cannot be a wrong without a remedy”. Therefore, if an arbitral tribunal fails to follow mandatory procedures or makes an award contrary to the law or contract terms, such an award would be considered patently illegal and subject to being set aside by the court.

Through the years there have been several cases in the Supreme Court where the court has dissected the term “patent illegality” and discussed its stance. In *Ssangyong Engineering & Construction Company Limited v. National Highways Authority of India*⁶, the court delves into

⁴ SCC Online, https://www.scconline.com/blog/post/2022/03/23/decoding-the-public-policy-of-india-and-patent-illegality-on-the-fa-ce-of-an-award/#_ftn7 (last visited July 14, 2024).

⁵ Oil & Natural Gas Corporation Ltd. versus SAW Pipes Ltd (2003) 5 SCC 705.

⁶ Ssangyong Engineering & Construction Company Limited v. National Highways Authority of India (2019) 15 SCC 131.

the issue of "patent illegality" in arbitral awards. The judgment reaffirmed several principles regarding what constitutes patent illegality and its implications for setting aside arbitral awards under Section 34 of the Arbitration and Conciliation Act, 1996. The court referenced several precedents, including *ONGC Ltd. v. Saw Pipes Ltd.* and *McDermott International Inc. v. Burn Standard Co. Ltd.*⁷, to illustrate how the principle of patent illegality has been applied historically. The Saw Pipes case, in particular, broadened the scope of "public policy" to include patent illegality and set the precedent that an award could be set aside if it was so unfair and unreasonable that it shocked the conscience of the court. The court scrutinised whether the arbitral tribunal had gone contrary to or beyond the expressed law of the contract or granted relief in matters, not in dispute, which would fall under the purview of patent illegality. The award must align with the terms of the contract and the substantive law governing the parties; otherwise, it could be set aside for being patently illegal⁸.

In 2021, in *Delhi Airport Metro Express Pvt. Ltd. v. Delhi Metro Rail Corporation Ltd.*⁹, the court established the extent and scope of perversity or patent illegality as a ground for annulling an arbitral tribunal's award. The court made an observation that the Arbitral Tribunal had failed to determine the existence of certain defects. The Supreme Court observed that the Arbitral Tribunal's findings suggested that the existence of certain defects after the cure period implied that the defects were not rectified, and no effective measures were taken to cure the defects. However, the Supreme Court opined that the presence of defects at the end of the cure period addressed only one aspect of the termination clause — the incomplete rectification of defects. It still did not clarify whether effective steps were initiated within the cure period. Essentially, the Arbitral Tribunal viewed ongoing actions of DMRC that had not yet resulted in fully rectified defects as not constituting "effective steps" to prevent termination. This approach equated the completion of defect rectification with the effectiveness of the steps taken, disregarding the distinction between "curing defects" and "taking effective steps to cure defects".

Under the statute, the ground of patent illegality allows for setting aside a domestic award if the arbitrator's decision is perverse, irrational to the point that no reasonable person would have

⁷ *McDermott International Inc. v. Burn Standard Co. Ltd.*, (2006) 11 SCC 181.

⁸ Livelaw,

<https://www.livelaw.in/lawschoolcolumn/patent-illegality-in-setting-aside-arbitral-awards-is-india-becoming-a-robust-seat-for-arbitration-221421> (last visited July 14, 2024).

⁹ *Delhi Airport Metro Express Pvt. Ltd. v. Delhi Metro Rail Corporation Ltd.*, 2024 INSC 292

made the same decision, involves a contract interpretation that no fair or reasonable person would adopt, or if the arbitrator's view is not even a possible one. Originating from public policy, patent illegality has evolved into a distinct and self-sufficient basis for challenging domestic awards under Section 34 of the Arbitration and Conciliation Act. To successfully challenge an arbitral award, it must be demonstrated that the arbitrator's award suffered from perversity, an error of law, or that the arbitrator has otherwise misconducted themselves. Simply showing that there is another reasonable interpretation or possible view based on the record is insufficient for court interference¹⁰.

CONCLUSION

Indian jurisprudence stands witness in the development of the jurisprudence dealing with the validity of the arbitral award, which in a long time have affected several stakeholders. From the addition of public policy standards to the development of the patent illegality concept, a significant change can be seen. The latest legislative amendments and judicial precedence have improved the paradigm of the adjudicatory mechanism by reducing the reliance on the parties taken post-arbitration proceedings. These stringent policies made sure that the sanctity of arbitration is maintained and there is no repetition of proceeding after a resolution is arrived.

¹⁰ Livelaw, <https://www.livelaw.in/lawschoolcolumn/patent-illegality-in-setting-aside-arbitral-awards-is-india-becoming-a-robust-seat-for-arbitration-221421> (last visited July 14, 2024).