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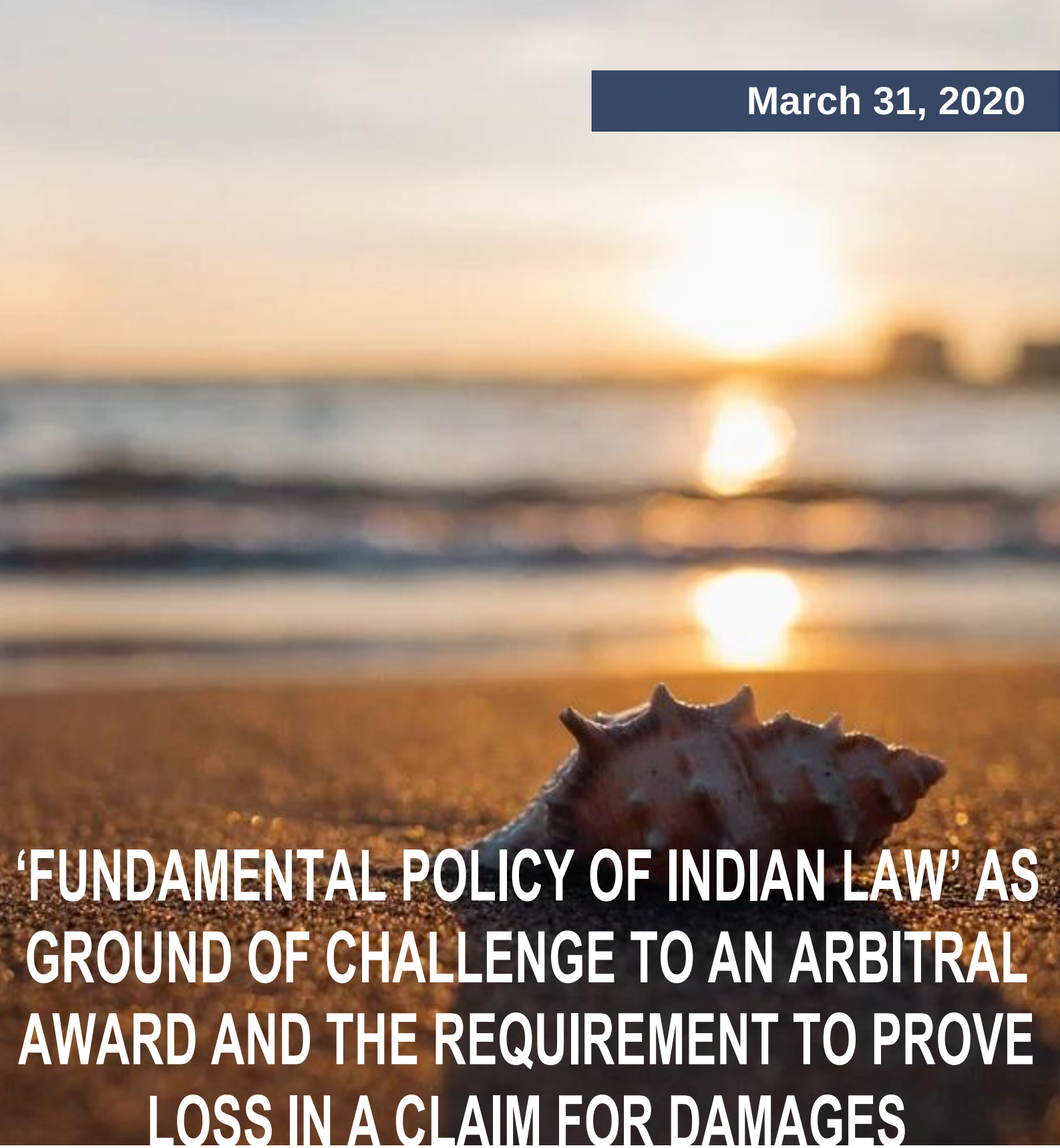

‘FUNDAMENTAL POLICY OF INDIAN LAW’ AS GROUND OF CHALLENGE TO AN ARBITRAL AWARD AND THE REQUIREMENT TO PROVE LOSS IN A CLAIM FOR DAMAGES

- A PERSPECTIVE THROUGH DEVELOPMENT OF LEGAL PRINCIPLES

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Introduction

An award passed by an arbitral tribunal can be set aside if the Court finds that the arbitral award is in conflict with the public policy of India.[1] Explanation 1 of Section 34(2) of the Arbitration and Conciliation Act, 1996 (hereinafter "**Act**") clarifies that an award is in conflict with the public policy of India, only if, -

(i) the making of the award was induced or affected by fraud or corruption or was in violation of section 75 or section 81; or
(ii) it is in contravention with the fundamental policy of Indian law; or
(iii) it is in conflict with the most basic notions of morality or justice.

Explanation 2 of Section 34(2) of the Act further clarifies that the test as to whether there is a contravention with the fundamental policy of Indian law shall not entail a review on the merits of the dispute.[2]

Section 34 (2A) of the Act, as inserted by the Arbitration and Conciliation (Amendment) Act, 2015 (hereinafter "**2015 Amendment**") provides an additional ground of patent illegality for setting aside an award arising out of purely domestic arbitrations. The basis of challenge of an award on the ground of patent illegality must meet the standard set out by the Hon'ble Supreme Court of India in *ONGC Limited v. Saw Pipes Limited*[3].[4]

The amendments made in Section 34 of the Act recognized the fact that that domestic arbitrations and international commercial arbitrations having seat in India shall be treated differently in so far as grounds for setting aside of the award under Section 34 of the Act was concerned. The amendments were largely based on the 246th Report of the Law Commission of India which *inter alia* recommended that a mere violation of a law of India, even if such violation goes to the root of the matter, would not play foul of 'public policy of India' in cases of international commercial arbitrations.[5] Consequently, after the 2015 amendment, the ground of patent illegality is no longer available to a party challenging an award passed even in a domestically seated international commercial arbitration while it is available under Section 34 (2A) to a purely domestic arbitration.[6]

While the first part of this paper deals with the meaning of fundamental policy of Indian law and how this expression has been understood, interpreted and developed over the years by the courts in India; the second part explores the question: whether the requirement to prove loss in a claim for damages can be elevated to the status of fundamental policy of Indian law as evolved by the courts in India.

[1] Section 34(2)(b)(ii) of the Act. This statement consciously excludes the grounds of challenge to an arbitral award under Section 34(2)(a) and Section 34(2)(b)(i) of the Act which also do not deal with merits of the decision rendered by the arbitral tribunal.
[2] Inserted by Section 18(1) of the Arbitration and Conciliation (Amendment) Act, 2015
[3] (2003) 5 SCC 705
[4] Report No. 246, Amendments to the Arbitration and Conciliation Act, 1996, Law Commission of India, Government of India, August, 2014, ¶ 18. The basis of challenge to an award on the ground of patent illegality propounded in *ONGC Limited v. Saw Pipes* has been followed by the Supreme Court in *Mcdermott International Inc v. Burn Standard* (2006) 11 SCC 181; *DDA v. R.S.Sharma* (2008) 13 SCC 80; Associate Builders v. Delhi Development Authority (2015) 3 SCC 49
[5] *Ibid*, ¶ 35 – 37
[6] See *Ssyangyong Engineering and Construction Co. Ltd. v. National Highway Authority of India* (2019) 15 SCC 131; *Jumbo World Holdings Limited and Ors. v. Embassy Property Developments Private Limited* 2020 SCC OnLine Mad 61

What is Fundamental Policy of Indian Law

An award passed in an international commercial arbitration having its seat in India can be set aside on ground of it being against the public policy of India, albeit minus the "patent illegality" principle. As stated above, one of the constituents of public policy of India is the expression fundamental policy of Indian law. Explanation 2 of Section 34(2) of the Act further clarifies that the test as to whether there is a contravention with the fundamental policy of Indian law shall not entail a review on the merits of the dispute.

Thus, what is significant to note is that post the 2015 Amendment, while adjudicating whether an award is in conflict with the fundamental policy of Indian law, the courts cannot examine the award as if to conduct a review on merits of the dispute. With the amendment to the Act, a statutory safeguard has been put in place which is perhaps is one of the most significant change from the pre-amendment era where arbitral awards were routinely interfered with by the courts on a detailed review of the merits of the case.

Hence, the questions that essentially now arise are - what is fundamental policy of Indian law and to what extent the courts should interfere when an award is assailed as being in contravention to fundamental policy of Indian law post the 2015 Amendment?

Indian Courts on Fundamental Policy of Indian law – *Renusagar to Vijay Karia*

One of the leading cases in the country where the term "public policy of India" and fundamental policy of Indian law was interpreted by the Supreme Court was in the year 1993 in the case of *Renusagar Power Company Limited v. General Electric Company*[7]. In *Renusagar*, the Supreme Court held that an award in violation of the Foreign Exchange Regulation Act, 1973 ("**FERA**"), being a statute enacted to safeguard the national economic interest, shall be contrary to the public policy of India and the fundamental policy of Indian law. In the same judgment, the Supreme Court observed that disregarding orders passed by superior courts would adversely affect the administration of justice and consequently an award passed in such disregard to orders of superior courts shall also be a violation of fundamental policy of Indian law.[8] Importantly, the Supreme Court further held that contravention of law alone would not attract the bar of public policy and something more than contravention of law was required.[9] The Supreme Court, however, did not delve into the question of what course of inquiry should the courts adopt to ascertain if the award was in breach of fundamental policy of Indian law but merely indicated couple of instances on the facts of the case before it.

Ten years later, the Supreme Court in *ONGC Limited v. Saw Pipes Limited*[10], after examining the grounds on which an award can be set aside under Section 34 of the Act, held that in addition to the narrower meaning given to the term "public policy" in *Renusagar*, the award could be set aside if it was patently illegal.[11] Although the Supreme Court in *Saw Pipes* sought to expand the scope of inquiry to set aside an award in purely domestic arbitrations by giving a wider interpretation to 'public policy', it had the unfortunate effect of being extended to apply equally to awards arising out of international commercial arbitrations as well as foreign awards, given the then statutory language of the Act.[12]

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[7] 1994 Supp (1) SCC 644
[8] *Ibid*, ¶ 76 & 85
[9] *Ibid*, ¶ 65
[10] (2003) 5 SCC 705
[11] *Ibid*, ¶ 31
[12] *Supra* note 4, ¶ 35

In order to do away with the unintended consequences of *Saw Pipes*, the Law Commission of India, in the year 2014, recommended the addition of Section 34 (2A) to the Act to deal with purely domestic awards, which may also be set aside if the Court finds that such award is vitiated by "patent illegality appearing on the face of the award."[13] The Law Commission of India further recommended the restriction of the scope of "public policy" to bring the definition in line with the definition propounded by the Supreme Court in *Renusagar*.

Before the recommendations of the Law Commission of India could be considered by the legislature, the term 'fundamental policy of Indian law' was construed widely by the Supreme Court in *ONGC v. Western Geco International Limited*[14] to include the Wednesbury principle of reasonableness[15]. In *Western Geco,* the Supreme Court without exhaustively enumerating the purport of the expression fundamental policy of Indian law referred to three juristic principles which, according to the Supreme Court, would necessarily be understood as a part and parcel of the fundamental policy of Indian law. These three well established juristic principles were: (i) adopting a judicial approach, (ii) following natural justice and (iii) absence of perversity or irrationality tested on the touchstone of Wednesbury principle of reasonableness. Thus, the Supreme Court *inter alia* incorporated the Wednesbury principle of reasonableness as a part of fundamental policy of Indian law.

Following *Western Geco*, the Supreme Court in the case of *Associate Builders v. Delhi Development Authority*[16] further fortified the concept of fundamental policy of Indian law to include - violation of FERA & disregard to superior courts (as explained in *Renusagar*) and the three juristic principles viz. judicial approach, natural justice and absence of perversity or irrationality (as explained in *Western Geco*). Of course, the aforesaid principles/instances were not exhaustive and were capable of further expansion.

As the Supreme Court's judgements in *Western Geco* and *Associate Builders* had the effect of expanding the power of courts rather than minimizing it (which would be contrary to international practice), the Law Commission of India believed that a clarification was needed in the amendments proposed by the Commission to ensure that the term fundamental policy of Indian law was narrowly construed.[17] The Law Commission believed that if such clarification was not incorporated, all amendments suggested by them in relation to construction of the term "public policy" and fundamental policy of Indian law will be rendered nugatory as the applicability of Wednesbury principle of reasonableness would permit a review of an arbitral award on merits. This would have opened the floodgates for challenges to arbitral awards on the ground of violation of fundamental policy of Indian law.[18] Eventually, the suggestions made by the Law Commission of India in the Supplementary Report were adopted and the Act was amended with effect from October 23, 2015.[19]

As fundamental changes were made in the law governing arbitrations in India, it was necessary for the highest court of the land to adopt, interpret, clarify and elucidate (wherever necessary) the

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[13] *Ibid*

[14] (2014) 9 SCC 263

[15] Wednesbury principle of reasonableness is a fundamental principle in administrative law which was propounded by the Court of Appeal in England and Wales in *Associated Provincial Picture Houses Ltd. v Wednesbury Corporation* [1948] 1 KB 223. The Wednesbury principle of reasonableness states that to have the right to intervene, the courts shall have to conclude: (i) in making the decision, the authority took into account factors that ought not to have been taken into account, or (ii) the authority failed to take into account factors that ought to have been taken into account, or (iii) the decision was so unreasonable that no reasonable authority would ever consider imposing it.

[16] (2015) 3 SCC 49

[17] "Public Policy" – Developments post – Report No. 246, Supplementary to Report No. 246 on Amendments to Arbitration and Conciliation Act, 1996, Law Commission of India, Government of India, February, 2015, ¶ 10.3

[18] *Ibid*, ¶ 10.5

[19] *See* Explanation 2 of Section 34 of the Act

scope of public policy ground for setting aside arbitral awards post amendments made by the 2015 Amendment.

The Supreme Court in the landmark judgement of *Ssyangyong Engineering and Construction Co. Ltd. v. National Highway Authority of India*[20], embarked on the journey of tracing the amendments based on the law commission report, the statement of objects and reasons of the 2015 Amendment and the judicial interpretations of the term fundamental policy of Indian law. In *Ssyangyong*, the Supreme Court held that the expression fundamental policy of Indian law would be relegated to the *Renusagar* understanding of the expression i.e. violation of provisions of FERA and disregard to judgements of superior courts. As stated above, ***Renusagar's*** expression of fundamental policy of Indian law was laid down on the facts of the case and was obviously not an exhaustive list of juristic principles guiding the term fundamental policy of Indian law.

The Supreme Court in *Ssyangyong* further observed that the expansive meaning of the term fundamental policy of Indian law incorporated in *Western Geco* would no longer sustain. This is because, under the guise of interfering with an award on the ground that the arbitrator did not adopt a judicial approach, the Court's intervention would be on the merits of the award, which is impermissible post the 2015 amendment.[21] Thus, in *Ssyangyong*, the Supreme Court relied on *Renusagar* for indicating the principles forming part of fundamental policy of Indian law and in a way lost an opportunity to lay down certain authoritative principles guiding the fundamental policy of Indian law.

Meanwhile, the Delhi High Court in the case of *Cruz City 1 Mauritius Holdings v. Unitech Limited*[22], while dealing with enforcement of a foreign award held that a contravention of any provision of an enactment shall not be synonymous to contravention of fundamental policy of Indian law and that the said expression would refer to the principles and the legislative policy on which Indian statutes and laws are founded. The Delhi High Court further went on to add that the expression "fundamental policy" connotes the basic and substratal rationale, values and principles which form the bedrock of laws in our country.[23] Perhaps one of the most crucial observations of the Delhi High Court was that the objections on the ground of public policy must be such that offend the core values of India's national policy and which it cannot be expected to compromise.[24]

Thus, the Delhi High Court, sought to provide a much more narrowed down definition of what would constitute a violation of fundamental policy of Indian law. It was clarified that mere contravention of an enactment/legislation shall not contravene the fundamental policy of Indian law and what would be required to establish is that the violation shall be such that would offend the core values of India's legislative policy which as a nation, the country cannot be expected to compromise.

Interestingly, in Cruz City, the Delhi High Court held that a simpliciter violation of any provision of Foreign Exchange Management Act, 1999 ("**FEMA**") (the successor of FERA) unlike a violation of a provision of FERA, shall not be considered synonymous to offending the fundamental policy of Indian law.[25] Thus, the scope of violation of a provision of FEMA being contrary to fundamental policy of Indian law was considerably mellowed down in the *Cruz City vis-à- vis* the violation of FERA as propounded in *Renusagar*.

The Delhi Court judgement of *Cruz City* was met with approval by the Supreme Court recently in the case of *Vijay Karia and Ors. v. Prysmian Cavi E Sistemi SRL and Ors.*[26], wherein the Supreme

[20] (2019) 15 SCC 131
[21] *Ibid*, ¶ 35
[22] (2017) 239 DLT 649
[23] *Ibid*, ¶ 97
[24] *Ibid*, ¶ 97, 98
[25] *Ibid*, ¶ 108
[26] 2020 SCC OnLine SC 177

Court on the scope of challenge to an award on the ground of violation of fundamental policy of India observed, as follows:

> "*The fundamental policy of Indian law, as has been held in Renusagar (supra), must amount to a breach of some legal principle or legislation which is so basic to Indian law that it is not susceptible of being compromised. "Fundamental Policy" refers to the core values of India's public policy as a nation, which may find expression not only in statutes but also time-honoured, hallowed principles which are followed by the Courts*." (emphasis supplied)

On the aspect of provisions of FEMA being a fundamental policy of Indian law was negated by the Supreme Court and it was *inter alia* clarified that a rectifiable breach under FEMA can never be held to be a violation of the fundamental policy of Indian law especially in view of the drastic change in India's foreign policy from FERA to FEMA.[27]

The Supreme Court in *Vijay Karia* reaffirmed the principle that for a violation of fundamental policy of Indian law that there shall be a breach of a legal principle or legislation that is so basic to Indian law that the same can't be compromised. Implicit to this finding is that mere violation of any enactment shall not be a breach of fundamental policy of Indian law unless the same comprises of the most basic substratal values and principles forming the bedrock of laws in the country. While propounding the law, the Supreme Court in *Vijay Karia* has presumably created a narrow opening to include not only legislations/enactments that can be said to be an integral part of the policy of India but also *time- honored hallowed principles* which are consistently followed by the courts in India.

What are "Time–honored Hallowed Principles" forming Core Value of National Policy

The question then is - what are such *time-honored hallowed principles followed by the Courts* which may be considered as core values of India's public policy as a nation. The Supreme Court does not specifically answer this question, atleast in *Vijay Karia*. Arguably, the answer to this question may not be capable of an all-encompassing definition and may need to be answered on a case to case basis.

One such time-honored principle which is not codified by law and is consistently followed by the Courts is the acceptance of binding orders passed by superior courts. Any deviation from this legal principle by way of an arbitral award may certainly be a violation of fundamental policy of Indian law and susceptible to challenge under Section 34 of the Act. Thus, in a case where binding effect of a judgment of a superior court is disregarded by the arbitral tribunal, the same shall be ground for challenge of the award as a breach of fundamental policy of Indian policy.[28]

Some of the other illustrations (not exhaustive) which may play foul of fundamental policy of Indian law may include, i) an award which proceeds on a void contract; ii) upholding a transaction that is rendered void by a statute; iii) granting specific performance without any proof at all of readiness and willingness.[29] On the other hand, the Delhi High Court has held there is no such fundamental policy in Indian law that the arbitral tribunal should mandatorily render decision on jurisdictional issues before hearing the matter on merits.[30]

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[27] *Ibid*, ¶ 91

[28] See also *Ram Chander v. Union of India*, O.M.P. (COMM) 5/2015 and IA No. 20103/2015, decided on August 28, 2017 (Delhi HC); *Creative Engineers v. Union of India*, Arbitration Petition No. 610 of 2016, decided on November 29, 2018 (Bombay HC); *Union of India v. Recon*, Arbitration Petition (L) No. 1293 of 2019, decided on February 13, 2020 (Bom HC)

[29] *Union of India v. Recon*, Arbitration Petition (L) No. 1293 of 2019, decided on February 13, 2020 (Bom HC)

[30] *Glencore International AG v. Indian Potash Limited and Anr.* (2019) 263 DLT 663

While disregard to orders passed by superior courts or passing an award on the basis of a void contract or upholding a transaction rendered void by a statute may be illustrations of some of the legal principles which are incapable of being compromised, it is extremely difficult, if not impossible to segregate legal principles into categories which can be compromised and others which cannot. It shall, more often than not, depend on the ideology of the courts which are adjudicating a challenge on the ground of breach of fundamental policy of India. Also, while embarking into the journey as to whether a basic legal principle which is not susceptible to compromise is breached or not, there is always a possibility that the courts may have to make some inquiry on the merits of the dispute. This obviously is impermissible after the 2015 Amendment.

Requirement to prove Loss or Damage in a Claim for Damages in the Background of Fundamental Policy of Indian Law

Another *time honored hallowed legal principle* which may well be treated as a fundamental policy of Indian law is the requirement to prove loss or damage in a case where damages are claimed by a party for the breach of a contract. The basic principle of award of damages, as has been well settled by courts in India, is that compensation can only be given for damage or loss suffered. If damage or loss is not suffered, the law does not provide for a windfall.[31] However, proving loss or damage and the assessment & calculation thereof is more often than not a matter of evidence. The Act is now unequivocal that a challenge to the award shall not entail a review on the merits of the dispute. Thus, the lines can get a little blurred when the courts embark on the issue as to whether an award of damages is granted after following the well settled principles of proof of actual loss or damage. While on one hand, the courts shall have to consider that the arbitral tribunal passes its award after considering the well-established principles of proof of loss or damage, on the other hand, the courts shall have to exercise restraint considering the limited scope of inquiry available on the question of fundamental policy of Indian law.

A learned single judge of the Bombay High Court in the case of *Punj Llyod Ltd. v. IOT Infrastructure and Energy Services Ltd.*[32] set aside an award of damages on the ground of it *inter alia* being in contravention of fundamental policy of Indian law wherein the arbitral tribunal granted a sum mentioned in the agreement as liquidated damages without evidence of any injury or loss suffered as a result of the breach of the contract.

Similarly, the Bombay High Court in *Home Care Retail Marts Pvt. Ltd. v. Haresh N. Sanghavi*[33] set aside the award of forfeiture of security deposit in the absence of proof of loss/damage by the party claiming damages on the ground of it being in contravention to fundamental policy of Indian law. In *Sandhaya Nayak v. Larsen and Toubro Infotech Ltd.,* the Bombay High Court set aside an award of liquidated damages where the employer didn't prove actual loss or damage in a case of termination of an employee for the breach of an employment contract.[34]

Thus, as is observed, the courts have set aside awards on the ground of fundamental policy of Indian law wherein damages were awarded without proof of loss or damage.[35] The courts have treated the requirement to prove damages as a time followed legal principle which is so basic to Indian law that it is not susceptible of being compromised. It can, however, be observed that in all the aforesaid cases, the party claiming damages had not led any evidence to prove loss or damage nor was there any pleading to the effect that it was difficult to ascertain actual loss in the facts of

[31] *Kailash Nath Associates v. Delhi Development Authority and Anr.* (2015) 4 SCC 136
[32] 2018 SCC OnLine Bom 19741
[33] 2019 SCC OnLine Bom 392
[34] 2019 SCC OnLine Bom 6665
[35] See also *Anila Gautam Jain v. Hindustan Petroleum Corporation Limited*, 2018 SCC OnLine Bom 917

the case. Hence, the Bombay High Court concluded that there was a violation of fundamental policy of Indian law.

However, when viewed from another perspective, it can also be questioned that while elevating the principles of proving loss or damage to the pedestal of public policy of India, has the Bombay High Court not erred in opening the floodgates for future challenges considering the largely factual nature of inquiry the courts have to undertake on the evidence led by a party to prove damages? Would it not entail a review on the merits of the dispute? Would the absence of proof of loss or damage be a mere breach of Section 73 and 74 of the Contract Act, 1872 (as the case may be) rather than a breach of fundamental policy of Indian law? The answer to all these questions may have to be appropriately answered by the Supreme Court soon.

Conclusion

The expression fundamental policy of Indian law contains in itself a broad set of principles which have been cultivated by the Supreme Court from *Renusagar* to *Vijay Karia.* The Supreme Court in *Vijay Karia* has identified the expression as a legal principle/enactment which is so basic to Indian law that it is not susceptible of being compromised. This seems to be now the standard on which an award where violation of fundamental policy of Indian law is alleged, has to be judged by courts in India. Whilst judging this, the courts shall have to be conscious of their limited role under the scheme of the Act.

As seen above, the Bombay High Court (for now) has treated the principle of proving of loss or damage in a claim for damages as a fundamental policy of Indian law. In other words, the court seems to be of the view that the principle that loss or damages is required to be proved is a core value which is so basic to the nation's policy that is not expected to be compromised. The Bombay High Court has lifted the general principles governing Section 73 and 74 of the Contract Act, 1872 (as the case may) to the pedestal of fundamental policy of Indian law. The consequence is that the absence of proof of loss or damage rather than being a mere breach of provisions of Contract Act, 1872, may also now be treated as breach of fundamental policy of Indian law. This shall lead to a more expansive meaning of the term fundamental policy of Indian law than intended by the legislature. This would also lead us back to the same position as it were prior to the 2015 Amendment. Also, the Bombay High Court while treating the principles of proving loss or damage to the pedestal of a fundamental policy of Indian law may have unintentionally opened the floodgates for future challenges on the somewhat abstract ground of proving damages. If the aspect whether loss or damage is actually proved by the party claiming damages is routinely analyzed by the courts, the same shall necessarily entail a review on the merits of the dispute, which is impermissible in law.

Thus, the courts in India need to adopt a narrow approach while setting aside awards on the ground of breach of the fundamental policy of Indian law to uphold the legislature's intention of ensuring minimal interference by courts,

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