

**INDIA'S JUMBLED PUBLIC POLICY JURISPRUDENCE: STRETCH, DEMARCATÉ AND 'SAW
(PIPES)'**

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1. INTRODUCTION

The incorporation of arbitration clauses in commercial contracts has become a norm. By incorporating an arbitration clause, contracting parties promise to refer their future disputes not to a court of law but to an arbitral tribunal that may consist of one or more arbitrators.² The rationale behind waiving one's right of going to court is the efficacy of the arbitral process, as it aspires to be a quicker and cheaper alternative.³

Arbitration in India truly began with the enactment of the Arbitration Act, 1940 (hereinafter referred to as '*Act of 1940*').⁴ The Act of 1940 formalized the distinction between public and private adjudication of disputes. This stratification aimed to promote certainty and predictability in dispute resolution. Even though the Act of 1940 referred many kinds of disputes to arbitration, there were several issues that hampered its efficacy. These issues ranged from the lack of a provision prohibiting an arbitrator from resigning at any time during the course of arbitration to the lack of a proper procedure for substitution in the eventuality of the death of an arbitrator. Further, the Act of 1940 failed to recognize that the arbitration ought to fail in case of non-existence and invalidity of an agreement.⁵

Although the Act of 1940 codified Indian arbitration jurisprudence for the first time, the underlying issues plaguing the Act resulted in the practice of arbitration in India being jeopardised. It is not surprising that the legislature sought to replace the Act of 1940 with the Arbitration and Conciliation Act, 1996 (hereinafter referred to as '*the Act*'), in order to deal

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² DR. P. MARKANDA, NARESH MARKANDA & RAJESH MARKANDA, *LAW RELATING TO ARBITRATION AND CONCILIATION* (2016).

³ See, Steven Shavell, *The Level of Litigation: Private versus Social Optimality of Suit and of Settlement*, 19 INTL. REV. L. & ECON. 99 (1999).

⁴ The Arbitration Act, 1940, No. 10, Acts of Parliament, 1940 (India).

⁵ Tracy Work, *India Satisfies its Jones for Arbitration: New Arbitration Law in India*, 10 Transnat'l L. 217 (1997).

with these deficiencies.⁶ Based on the United Nations Commission on International Trade Law's Model Law on International Commercial Arbitration (UNCITRAL Model Law), the Act aimed to consolidate and amend the law relating to domestic arbitration, international commercial arbitration and enforcement of arbitral awards.⁷ The legislature's intention was to provide for speedy resolution of disputes whilst limiting judicial intervention. In order to give maximum autonomy to the arbitrators, an explicit non-obstante clause was incorporated in the Act to limit judicial intervention.⁸

Since the turn of the century, there has been a steep increase in the number of arbitrations throughout the country. One could point to the new Act providing the impetus required for fostering a good dispute resolution atmosphere. On the other hand, several new questions and issues have cropped up since the enactment of the Act.⁹ Many of these issues have had a drastic impact on shaping the Indian jurisprudence on domestic and international arbitration. This is not surprising if one considers that India is one of the first countries to have adopted the UNCITRAL Model Law. One such issue which has plagued the arbitration and judicial setting is the issue of public policy.¹⁰

*The doctrine of public policy is a channel through which public law enters private law and bars it from actualizing its normal legal consequences.*¹¹ Even though public policy is an old doctrine in common law, it is not clear which aspects of public law could enter the arena of private law and make it unenforceable. Despite the historical importance of the doctrine of public policy in contractual settings, there is still an unresolved tension at the heart of the intersection between private conflict resolution mechanisms and public policy.¹² Under the Act, the term 'public policy of India' has been used in three different sections which have been elaborated under three different chapters in the Act. It is first used under Section 34, i.e. 'Application of setting aside arbitral award' under Part I (Chapter VII), namely, 'Recourse

⁶ The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 (India).

⁷ See, United Nations Commission on International Trade Law, *UNCITRAL Model Law on International Commercial Arbitration, 1985 with Amendments as Adopted in 2008* (Vienna: United Nations, 2008).

⁸ The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 § 5 (India).

⁹ See generally, Sumeet Kachwaha, *The Arbitration Law of India: A Critical Analysis*, 1 *ASIAN INT'L ARB. J.* 105 (2005).

¹⁰ Arpan Gupta, *A New Dawn for India- Reducing Court Intervention in Enforcement of Foreign Awards*, 2 *INDIAN J. ARB. L.* 10 (2014).

¹¹ Farshad Ghodoosi, *The Concept of Public Policy in Law: Revisiting the Role of Public Policy Doctrine in the Enforcement of Private Legal Arrangements*, 94 *NEB. L. REV.* 685 (2015).

¹² Farshad Ghodoosi, *Arbitrating public policy: Why the buck should not stop at national courts*, 20(1) *LEWIS & CLARK. L. REV.* 237 (2016).

against arbitral award'.¹³ The next mention of this term has been made in section 48, titled 'Conditions for enforcement of foreign awards' under Part II (Chapter I), titled 'Enforcement of certain foreign awards: New York Convention Awards' (hereinafter referred to as '*New York Convention*').¹⁴ Lastly, the term has been used in Section 57, namely 'Conditions for Enforcement of Foreign Awards' under Part II (Chapter II), titled 'Enforcement of certain foreign awards: Geneva Convention Awards'.¹⁵ The paper focuses on setting aside an arbitral award on the grounds that it is in conflict with the public policy of India. However, the analysis has equally important consequences on the enforcement of foreign awards through the New York and Geneva Conventions in India. It would be quite manifest, at this point, that there needs to be a balance on the minimal judicial interference principle and the scope of public policy. What needs to be investigated is the optimality of the scope of public policy. Just to anticipate the questions: How has the jurisprudence in relation to the doctrine of public policy developed since the inception of the Act? How has it impacted the development of arbitration in India? An attempt has been made to answer the aforesaid and other related questions in this research. Nevertheless, it is essential to point out that the present paper is not a research into the viability of the doctrine of public policy and therefore, the viability aspect is studied only to the extent necessary to understand the concept of the doctrine itself.

In order to embark upon a holistic understanding of the issues at hand, it is essential, firstly, to understand the changing contours of the doctrine of public policy in the context of Indian arbitration jurisprudence. To this end, Chapter 2 provides a historical overview of the judicial and legislative approach towards the doctrine of public policy as applied in the domain of arbitration. It not only explores the varying scope of the term 'public policy' but also the approaches adopted towards its use as a ground for setting aside arbitral awards. The impact of these changing judicial and legislative approaches on the adjudication of arbitration petitions by the High Courts is dealt with in Chapter 3. This chapter attempts to showcase the practical fallout of the fluctuating interpretations dealt with in the previous chapter. Chapter 4 attempts to explore the different connotations of public policy and the kinds of contracts that would

¹³ The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 § 34(2)(b)(ii) (India).

¹⁴ The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 § 48(2)(b) (India).

¹⁵ The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 § 57(1)(e) (India).

represent a contravention of each connotation. As such, this Chapter seeks to explore the impact of the public policy doctrine on the performance and enforcement of contracts. Chapter 5 deals with the judicial cost arising from the issue of interpreting a vague terminology as well as the approaches adopted towards the minimization of the said costs. Further, it delves into the legislative and judicial preferences in relation to the interpretation of a vague term. Lastly, Chapter 6 investigates the reasons underlying the formulation of a particular law. An attempt has been made to resolve much of the confusion and retaliation surrounding the doctrine of public policy through the focal point approach elucidated in this chapter. The findings of the aforesaid chapters have been surmised in the concluding chapter, i.e. Chapter 7.

The correction of the fault-line with regard to the doctrine of public policy in Indian arbitration jurisprudence will hopefully contribute to the creation of a more conducive environment for alternative dispute resolution in India. The author emphasizes that the aim of this paper is to straighten out some of the wrinkles in the arbitration setting in India by providing a more nuanced analysis of the doctrine of public policy.

2. THE EVOLUTION OF THE PUBLIC POLICY DOCTRINE IN INDIAN ARBITRATION JURISPRUDENCE

When considering the topic of judicial intervention in the arbitral process in India, the starting point would be the Supreme Court of India's judgment in *Renusagar Power Co. Ltd. v. General Electric Co.* (hereinafter referred to as '*Renusagar*') where the Court whilst construing the term 'public policy' in the context of a foreign award held that an award would be against the public policy of India if it is contrary to the (1) fundamental policy of India; (2) the interest of India and (3) justice or morality.¹⁶ Although the ratio in *Renusagar* was laid down in the year 1994, it laid the foundation of the public policy aspect of the Act of 1996. Implicitly, the decision confirmed the position that, only in exceptional circumstances should national courts interfere with the decisions of an arbitral tribunal. Furthermore, the Supreme Court held that the public policy exception cannot be used to adjudge the award on the merits of the case. This ratio was in conformity with the international practice in many developed nations at that point of time. However, the scenario changed drastically when the Supreme Court through *ONGC Ltd. v. Saw pipes Ltd.* (hereinafter referred to as '*Saw Pipes*') added another ground to the doctrine of public policy, namely that of patent illegality in order to set aside an award under Section 34 of the Act.¹⁷ Though the Supreme Court clarified that if the illegality is of a trivial nature it cannot be held that the award is against public policy, it still opened a Pandora's Box by mentioning that the award can be set aside if it is so unfair and unreasonable that it shocks the conscience of the court. The arbitral tribunal in *Saw Pipes* was of the opinion that the claimant i.e. ONGC Ltd. had to prove its loss to gain liquidated damages. However, the Supreme Court rejected this argument and stated that, as a matter of law, the claimant did not have to prove its losses to avail liquidated damages. The Court went on to state that an award which violated a law cannot be said to be in the interest of public policy because it was likely to adversely impact the administration of justice.¹⁸ The problem with this approach was the wider meaning imported to the term 'public policy' under Section 34. Consequently, the *Saw Pipes* judgment was criticized by several jurists; the bone of contention was that parties now had the option to

¹⁶ *Renusagar Power Co. Ltd. v. General Electric Co.*, (1994) Supp 1 SCC 644

¹⁷ *ONGC Ltd. v. Saw Pipes Ltd.*, (2003) 5 SCC 705

¹⁸ *Id.*

review the award on the merits, which was never the legislative intent underlying the Act.¹⁹ It is worth mentioning that seven years had passed since the inception of the Act when the Supreme Court laid down the ratio in *Saw Pipes*. Interestingly, the *Saw Pipes* decision was not to be applied for the enforcement of foreign awards under Section 48 of the Act, since the Act explicitly carves out a distinction between Parts I and II, which pertain to domestic and international arbitrations respectively.²⁰ Unfortunately, the scenario changed when the Supreme Court, through its decisions in *Bhatia International v. Bulk Trading S.A. and Anr.* (hereinafter referred to as '*Bhatia International*')²¹ and *Venture Global Engineering v. Satyam Computer Services Ltd.* (hereinafter referred to as '*Venture Global Engineering*')²² applied the *Saw Pipes* dictum to foreign awards.

A key role was subsequently played by the Government of India, which took corrective measures against this *misinterpretation* accorded by the judiciary by expanding the scope of public policy. Thus, in 2010, the Government of India released a consultation paper recommending changes to the Act, which would nullify the effects of the *Bhatia International*, *Venture Global Engineering* and *Saw Pipes* cases.²³ The major proposals were that Part I of the Act should be applicable only to arbitrations seated in India and that the ground of setting aside of awards on the basis of public policy should not include patent illegality within its ambit.²⁴ By this time, the *Saw Pipes* ratio had already trickled down to the High Courts, which had started to apply the patent illegality rule rather stringently. For instance, in the case of *Western Maharashtra Development Corporation Ltd. v. Bajaj Auto Ltd.* the Bombay High Court declared an award null and void as substantive provisions of the Companies Act, 1956 were not applied properly.²⁵ Even after the Government's consultation paper, the Supreme Court held firm and applied the 'patent illegality' standard under 'public policy of India' while examining the enforcement of foreign awards under Section 48(2)(b) of the Act. Through its

¹⁹ See, Manav Kapur, *Judicial Interference and Arbitral Autonomy: An Overview of Indian Arbitration Law*, 2 Contemp. Asia Arb. J. 325 (2009); Promod Nair, *Surveying a Decade of the 'New Law' of Arbitration in India*, 23 Arb. Int'l 699 (2007). *But see*, Sidharth Sharma, *Public Policy under the Indian Arbitration Act: In Defence of the Indian Supreme Court's Judgment in ONGC v. Saw Pipe*, 26 J. Int'l Arb. 133 (2009).

²⁰ The Arbitration and Conciliation Act, 1996, No. 26, Acts of Parliament, 1996 § 2(2) (India).

²¹ *Bhatia International v. Bulk Trading S.A. and Another*, (2004) 2 SCC 105.

²² *Venture Global Engineering v. Satyam Computer Services Ltd.*, (2008) 4 SCC 190

²³ Ministry of Law and Justice, Government of India, Proposed Amendments to the Arbitration & Conciliation Act, 1996: A Consultation Paper, (Apr., 2010).

²⁴ *Id.*

²⁵ *Western Maharashtra Development Corporation Ltd. v. Bajaj Auto Ltd.*, 2010 (154) Com Cases 593 Bom.

decision in *Phulchand Exports Ltd. v. OOO Patriot* (hereinafter referred to as '*Phulchand Exports Ltd.*'), the Supreme Court concluded that the enforcement of foreign awards must now meet the tests as applicable to domestic awards.²⁶

The Supreme Court's decision in *Phulchand Exports Ltd.* resulted in erasing the distinction of enforceability between foreign and domestic awards. Eventually, in the year 2014, the Supreme Court through its decision in *Shri Lal Mahal v. Progetto Grano Spa* decided that the expansive construction accorded to the term 'public policy' in the *Saw Pipes* decision cannot apply to the use of the term 'public policy of India' as far as foreign awards are concerned.²⁷ In the same year, the Law Commission of India opined that the legitimacy of judicial intervention in the case of a purely domestic award is far more than in cases where a court is examining the correctness of a foreign award.²⁸ Thus, it proposed that an amendment ought to be made to the Act, whereby the ground of public policy would be narrowed, *inter alia*, by amending Section 34 of the Act by removing the words 'interests of India' and enumerating that the said section only dealt with domestic awards which may be set aside by the Court, if the Court finds that such award is vitiated by 'patent illegality appearing on the face of the award'.²⁹ Clearly, the ground of 'patent illegality' put forward by the *Saw Pipes* judgement remained. However, the caveat was that in order to provide a balance and to avoid excessive intervention, a proviso was proposed that such an award shall not be set aside merely on the grounds of erroneous application of the law or re-appreciation of evidence.³⁰

A month after the Law Commission's Report, Supreme Court, in *ONGC Ltd. v. Western Geco International* (hereinafter referred to as '*Western Geco International*'), added three other grounds under the aspect of fundamental policy of India viz. judicial approach, principles of natural justice and rationality of the decision i.e. a decision by the tribunal cannot be so perverse or irrational that no reasonable person would have arrived at the same.³¹ If construed broadly,

²⁶ *Phulchand Exports Ltd. v. OOO Patriot*, (2011) 10 SCC 300.

²⁷ *Shri Lal Mahal v. Progetto Grano Spa.*, (2014) 2 SCC 433.

²⁸ Report No. 246 of the Law Commission of India, Amendments to the Arbitration and Conciliation Act, 1996 (Aug, 2014).

²⁹ *Id.*

³⁰ *Id.* at 55.

³¹ *ONGC Ltd. v. Western Geco International Ltd.*, (2014) 9 SCC 263.

then the decision that the tribunal has reached could be irrational even if it ignores vital evidence, which allows judicial interference with the merits of the award. As a result of the incongruity of the *Western Geco International* decision and the goal of minimal judicial intervention, the Supreme Court in *Associate Builders v. DDA*, clarified that the test for identifying whether there is any contravention with the fundamental policy of Indian Law shall not entail a review of the merits of the dispute.³² Additionally, the Legislature, through the Arbitration and Conciliation (Amendment) Act, 2015, clarified that section 34 (2) (b) (ii), which relates to setting aside of domestic awards, can be used by the Court only when it finds that the arbitral award is in conflict with the public policy of India.³³ To clarify what entails public policy of India, the law-makers inserted an explanation stating that an award is in conflict with public policy, only if, (i) the making of the award was induced or affected by fraud or corruption; 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. They went further to reiterate that under Section 34 (2A), a domestic award may also be set aside by the Court, if the Court finds that the award is vitiated by patent illegality appearing on the face of the award, provided that an award shall not be set aside merely on the ground of an erroneous application of law or re-appreciation of evidence.³⁴

In 2019, the Supreme Court of India, in the case of *Ssyangyong Engineering Construction Co. Ltd. v. National Highways Authority of India* (hereinafter referred to as '*Ssyangyong*'), analysed the amendment in its entirety and held that the term 'fundamental policy of Indian Law' would now correspond to the understanding of the expression in *Renusagar*. Furthermore, the approaches laid down in *Western Geco International*, except for natural justice would not apply. The ground for interference on the basis of the award being in conflict with justice and morality was to be understood as a conflict with the basic notions of morality or justice. This would mean that only such arbitral awards that shock the conscience of the Court could be set aside on this ground.³⁵ Recently, in the case of *Vijay Karia & Ors. v. Prysmian Cavi E Sistemi SRL & Ors.*, the court relied upon the *Ssyangyong* decision to state that, "*the foreign award must be read as a whole, fairly, and without nit-picking. If the said*

³² *Associate Builders v. DDA*, (2015) 3 SCC 49.

³³ The Arbitration and Conciliation (Amendment) Act (No. 3 of 2016) (2015) § 34(2)(b)(ii) (India).

³⁴ The Arbitration and Conciliation (Amendment) Act (No. 3 of 2016) (2015) § 34(2A) (India).

³⁵ *Ssyangyong Engineering and Construction Co. Ltd. v. National Highways Authority of India*, 2019 SCC OnLine SC 677.

award has addressed the basic issues raised by the parties and has, in substance, decided the claims and counter-claims of the parties then the enforcement must follow.”³⁶ That said, the court’s aim for making the *Ssyangyong* decision a panacea for all cases took a serious blow due to its decision in the case of *National Agricultural Cooperative Marketing Federation of India v. Alimenta S.A.*, where the court held that the award was *ex facie* illegal, and in contravention of the fundamental law of the country, as it violated a particular statute.³⁷

Even today, public policy remains a potent tool in the hands of the judiciary. Over the years, there has been an increase in judicial intervention insofar as setting aside of awards passed by the arbitral tribunal on the grounds of public policy is concerned. A pertinent question that emerges is the extent to which the *Renusagar* and *Saw Pipes* decisions have impacted the number of setting aside applications. The forthcoming chapter aims to answer this question. It proceeds to look at the judgements passed by the Bombay High Court and then analyses the number of successful and unsuccessful applications for setting aside of arbitral awards.

3. DATA ANALYSIS AND FINDINGS

3.1 Data Set and Research Methodology

This research uses Bombay High Court judgements on the setting aside of arbitral awards. At the outset, it is worth mentioning that in order to set aside an arbitral award under section 34 of the Act, a petitioner needs to file an Arbitration Petition.³⁸ These petitions can be filed either by the claimant or the respondent, depending on which party is aggrieved with the arbitral award. There may be exceptional cases where the petitions have been filed by both the parties i.e. the claimant and the respondent, which are normally clubbed together by the court as one petition. The data on these Arbitration Petitions has been collected through Supreme Court Cases Online (SCC). SCC Online is an online information database which makes reported case

³⁶ *Vijay Karia & Ors. v. Prysmian Cavi E Sistemi SRL & Ors.*, (2020) 11 SCC 1.

³⁷ *National Agricultural Cooperative Marketing Federation of India v. Alimenta S.A.*, (2020) SCC OnLine SC 381.

³⁸ See generally, Bombay High Court (Original Side) Rules, 1980, <https://bombayhighcourt.nic.in/libweb/rules/OSrules/bhcosrules.html> (last visited on 12th Aug. 2019).

law accessible in the electronic medium. The information database is a proven source for quick retrieval of case-law precedents of the Supreme Court of India and the High Courts of the country. To get the requisite judgements, the search included 'Arbitration and Conciliation Act, 1996 AND Section 34' and was further narrowed down to include 'Arbitration Petitions AND Public Policy'. Through this, a total of 306 reported cases in the Bombay High Court were found. Out of these 306 cases, several cases were appeals, company petitions and writ petitions, which are outside the purview of the current research and therefore do not form part of the final dataset. Thus, the final dataset contains a sample of 156 cases from the Bombay High Court, since 1998 to 2019, wherein the parties have used the argument of public policy in some form to set aside an arbitral award.

To showcase a basic descriptive statistic, three time periods have been used as a case. The first time period is from 1998 to 2003 (hereinafter referred to as the '*first period*'). This focuses on the number of applications that have been successful/ unsuccessful after the formulation of the Act until the judgment of the Supreme Court in *Saw Pipes*, which widened the scope of the application of the public policy doctrine in setting aside of arbitral awards. The second time period is from 2004 to 2015 (hereinafter referred to as the '*second period*'). Hereunder, the impact on the number of applications (successful/ unsuccessful) after the Supreme Court widened the scope of public policy through *Saw Pipes* can be seen. The final time period is from the year 2016 to 2019 (hereinafter referred to as the '*third period*'). This will capture the applications after the 2015 Amendment to the Act, which proceeded to narrow the scope of public policy and thereby, judicial intervention. To analyse the applications, a dummy variable is used to indicate the number of successful (0)/ unsuccessful (1) applications between the time periods (1998 to 2019).

3.2 Findings

Table I provides information on the first period where a total of 36 applications were disposed of wherein 13 were successful applications, i.e. 36.11 %, and 23 were unsuccessful applications, i.e. 63.89 %.

Application (Successful/ Unsuccessful)	Freq.	Percent	Cum.
0	13	36.11	36.11
1	23	63.89	100.00
Total	36	100.00	

Table I: Disposed of applications (Successful/ Unsuccessful) in the first period

Table II analyses the second time period wherein the total number of disposed of cases increased to 92. Out of 92 cases, there were 51 successful applications, i.e. 55.43 %, and 41 unsuccessful applications, i.e. 44.57 %.

Application (Successful/ Unsuccessful)	Freq.	Percent	Cum.
0	51	55.43	55.43
1	41	44.57	100.00
Total	92	100.00	

Table II: Disposed of applications (Successful/ Unsuccessful) in the second period

Table III analyses the third period, wherein the total number of disposed cases is 28. Out of these, there were 11 successful applications, i.e. 39.29 %, and 17 unsuccessful applications, i.e. 60.71 %.

Application (Successful/ Unsuccessful)	Freq.	Percent	Cum.
0	11	39.29	39.29
1	17	60.71	100.00
Total	28	100.00	

Table III: Disposed of applications (Successful/ Unsuccessful) in the third period

Table IV provides an overview of all three time periods based on the 156 disposed of applications which have been analysed. Out of 156 arbitration applications, 75 were successful whereas 81 were unsuccessful.

Applications Successful/ Unsuccessful	1	2	3	Total
0	13	51	11	75
1	23	41	17	81
Total	36	92	28	156

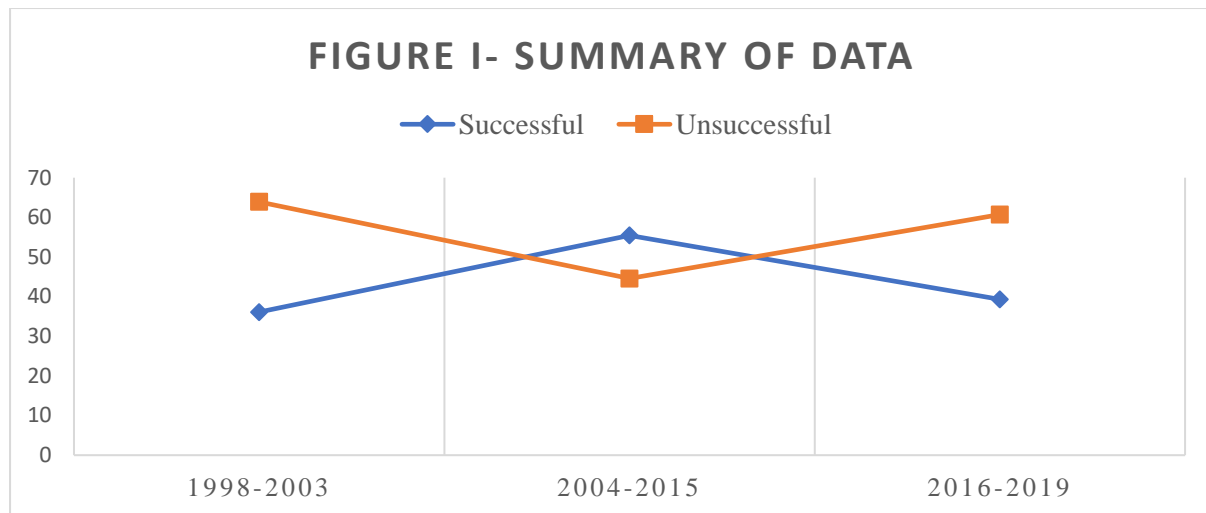
Table IV: Summary of disposed of applications (Successful/ Unsuccessful) since 1998 to 2019

It is clear that the three different time periods have massive fluctuations in the number of successful and unsuccessful applications. The findings pertaining to the first period show that the number of unsuccessful applications is considerably high as compared to successful ones. One could postulate that the Act was the reason behind a limited number of successful applications, keeping in mind the minimal judicial interference aspect enumerated under Section 5 of the Act.

On 17th April 2003, the Supreme Court laid down its decision in *Saw Pipes*, which widened the scope of public policy. This acted to catalyze the number of successful applications between 2004 and 2015. This is noticed through Table II wherein there is an increase in the successful applications as compared to the first period.

After the legislature came up with the 2015 Amendment to the Act of 1996, it may be seen that there is a substantial reduction in the number of successful applications wherein awards were

sought to be set aside on the ground of public policy. It is argued that this is the result of the legislature clarifying that the test of whether there is any contravention with the fundamental policy of Indian Law shall not entail a review on the merits of the dispute. The figure produced hereinafter summarizes the data in the foregoing table.



The differing principles, put forth in relation to the ground of public policy by the Supreme Court in a series of cases, have had severe implications on the number of applications as seen above. However, the analysis remains incomplete without exploring the various facets of public policy and the classification of contracts in relation to each notion. To this end, the next chapter carves out a distinction between public interest, public welfare and public security; all of which are essential facets of the doctrine.

4. PUBLIC POLICY AND THE VALIDITY OF CONTRACTS

4.1 Notions of Public Policy

All adjudicatory bodies including the public law courts are subject to criticism for erroneous decisions; arbitral tribunals are no exception to the same. These errors can stem from several

factors apart from public policy, which have been enumerated under Section 34 of the Act.³⁹ The provisions in Part I of the Act, which have been taken from the New York Convention, are rather exhaustive and violating them would imply violating the 'due process of law'.⁴⁰ The ambit of due process would include factors such as providing a procedural schedule, equal allocation of time for hearing and briefing, opportunity to confront evidence, disclosure of issues, selection of witnesses, party's right to appoint an arbitrator and the basic right of the parties to present a full case.⁴¹ Historically, following due process merely implied compliance with the law of the land. In the modern arbitral context, due process refers to the legal procedure that is owed to a party by the arbitral tribunal.⁴² By and large, countries which have ratified the New York Convention have had uniform jurisprudence on the 'due processes in arbitration'. However, the paranoia arises when the term public policy needs to be construed. There has been a lack of uniformity and, at times, divergence of opinions as to what entails public policy.⁴³ Besides the connotation of public policy expressed above, i.e. to bar the enforcement of judgments and awards, the term 'public policy' may also include rules that make the parties' contractual arrangements void. This makes it necessary to break public policy into different strands as the formation of various mandatory rules depends on these strands.⁴⁴ According to Ghodoosi, "...to better understand the concept of public policy, it needs to be divided into three distinct strands - public interest, public morality and public security - each with a separate pedigree and logic requiring a separate method for its analysis. The public interest category

³⁹ E.g., The Arbitration and Conciliation (Amendment) Act (No. 3 of 2016) (2015) § 34(2)(a)(i) (India). ('An arbitral award may be set aside by the Court only if-the party making the application furnishing proof that-a party was under some incapacity')

⁴⁰ See, U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Jun. 10, 1958, 330 U.N.T.S. 38 (1959); See also, Albert Jan van den Berg, *The New York Convention of 1958: An Overview*, ARB.-ICCA https://www.arbitration-icca.org/media/0/12125884227980/new_york_convention_of_1958_overview.pdf (last visited on 5th May 2020).

⁴¹ Klaus Berger & J. Ole. Jensen, *Due Process Paranoia and the Procedural Judgment rule: A safe harbour for procedural management decisions by International Arbitrators*, 32 ARB. INT'L 415 (2016).

⁴² Remy Gerbay, *Due Process Paranoia*, KLUWER ARBITRATION (Jun. 6, 2016) <http://arbitrationblog.kluwerarbitration.com/2016/06/06/due-process-paranoia/> (last visited on 5th June 2020).

⁴³ Bernard Hanotiau & Olivier Caprasse, *Arbitrability, Due Proces, and Public Policy under Article V of the New York Convention: Belgian and French Perspectives*, 25 J. INTL. ARB. 721 (2008). See also, Marike Paulsson, *The U.S. Courts and their Convention Public Policy Gloss Revisited: Hardy Exploration & Production (India) Inc. v. Government of India, Ministry of Petroleum & Natural Gas: Glossing with International Comity*, KLUWER ARBITRATION (Dec. 26, 2018) <http://arbitrationblog.kluwerarbitration.com/2018/12/26/the-us-courts-and-their-new-york-convention-public-policy-gloss-revisited-hardy-exploration-production-india-inc-v-government-of-india-ministry-of-petroleum-natural-gas-glossing-wi/> (last visited on 5th May 2020); Fali Nariman, *Judicial Dialogue on the New York Convention*, ICCA'S INTRODUCTION TO THE NEW YORK CONVENTION- CONVENTION AND SOVEREIGNTY (Nov. 23, 2013) https://www.arbitration-icca.org/media/2/13916005409590/nyc_roadshow_speech_23rd_nov_nariman.pdf. (last visited on 5th May 2020). Fali Nariman suggests that "independent sovereign States act too often like billiard balls, and do not co-operate."

⁴⁴ Alan Schwartz & Robert Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L. J. 541 (2003).

*refers to instances wherein the public policy exception can be determined by employing a cost-benefit analysis, weighing the interests of private parties against societal interest. The second strand, public morality, attempts to safeguard communal values by allowing the judiciary not to lend its enforcement apparatus to private legal arrangements that are injurious to common morality. Lastly, public security is structured around the exceptionalist logic of modern statehood, which aims to protect the State's survival interests...*⁴⁵

Based on these strands, we can analyse the need for a doctrine of public policy from the law and economics perspective. Law and economics scholars would argue that the sole purpose of entering into a contract is to effect an increase in wealth, social welfare and efficiency.⁴⁶ *Per contra*, any negative externalities that are caused through the contracts may be considered not contributing to social welfare. Therefore, one way to adjudge this is to consider the contract as inefficient when the net third party harm exceeds net third party benefits.⁴⁷ If the contracts cause third party harm, then the contracting parties can be directed to pay costs so as to maintain a status quo. An alternative approach to cost payment or the deterrence approach is the non-enforcement of such contracts. Thus, the contracts would be declared void by virtue of the public policy doctrine whenever there is a negative externality. This would inevitably force the contracting parties to evaluate third party effects before the agreement. This, in turn, would increase the information-acquiring cost and transaction cost of the parties, thereby resulting in over-deterrence. The Harvard Law Review, in its note on '*A Law and Economics look at contracts against public policy*', postulated that the consideration and the consequent performance is what causes negative externalities and not just entering into the contract.⁴⁸ On a purely legal basis, the act of entering into such an agreement may make the agreement *void ab initio*.⁴⁹ However, to analyse it from a law and economics perspective, the Harvard Law Review devised taxonomy of specific acts which may be against public policy. *Their opinion*

⁴⁵ Ghodoosi, *supra* note 10.

⁴⁶ See generally, Steven Shavell, *Economic Analysis of Contract Law*, HARVARD LAW SCHOOL JOHN M. OLIN CENTER FOR LAW, ECONOMICS AND BUSINESS DISCUSSION PAPER SERIES (2003). <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.661.5864&rep=rep1&type=pdf> (last visited on 5th May 2020); C.f, Eric Posner, *Economic Analysis of Contract Law after Three Decades: Success or Failure?*, JOHN M. OLIN PROGRAM IN LAW AND ECONOMICS WORKING PAPER NO. 146 (2002).

⁴⁷ GREGORY KLASS, GEORGE LETSAS & PRINCE SAPRAI, *PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW* (2014).

⁴⁸ *A Law and Economics look at Contracts against Public Policy*, 119 HARV. L. REV. 1445 (2006).

⁴⁹ See, The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872, § 24.

was to create four categories which were (i) contracts to commit an act definitively against public policy, (ii) contracts to refrain from acts that further public policy, (iii) contracts to commit legal acts that themselves facilitate acts which are against public policy, and (iv) contract to commit acts of indeterminate legality.⁵⁰ Each category has been analyzed from an Indian perspective, taking Indian contract jurisprudence into account.

i. Contracts to Commit Acts Definitively Against Public Policy

The Indian Contract Act, 1872 does not define the terms 'public policy' or 'opposed to public policy'. Section 23 of the Indian Contract Act lays down certain conditions as to the lawfulness of the consideration and object of contracts.⁵¹ Under this section, unless a court terms the consideration to be unethical and against public policy, the agreement shall be enforceable by law. This section gives the court authority to repudiate the clauses that are against public policy and to declare them as *void ab initio*. Certain acts which attract penal provisions have been declared to be against public policy; these would come under the first category. Thus, a contract to commit such an act would be against public policy *per se*; however, it is possible that ambiguity may arise in exceptional cases. For instance, a case where A promises to superintend, on behalf of B, a legal manufacturer of indigo and an illegal traffic in other articles, and B promises to pay A, a salary of 10,000 Rupees per year.⁵² The agreement is void as the object of A's promise and the consideration for B's promise are, in part, unlawful.⁵³ The consideration in part being unlawful is on the basis that the legislature had anticipated that the act would create negative externalities. Let us presume that the illegal traffic of other articles is severed from the contract. In such a case, there is a welfare maximizing opportunity, which is lost. Taking the sample illustration further, A and B agree that A shall pay B 1,000 rupees, for which B shall afterwards deliver to A either rice or smuggled opium. This would then be a valid contract to deliver rice and a void agreement as to opium. *Thus, in cases where the negative externalities are not enough to justify complete deterrence, a blanket rule of non-enforcement is excessive.*⁵⁴ An argument for over-deterrence is that the court could address the aspect of over-deterrence by taking a cost-benefit analysis; however, this increases the cost of litigation.

⁵⁰ *Supra* note 47

⁵¹ *See*, The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872, § 23.

⁵² *See*, The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872, § 24.

⁵³ *Id.*

⁵⁴ *Supra* note 47

Additionally, in cases where one party alleges voidability of the contract, the Court will necessarily have to delve into the intention of the legislature in every case even when the provision itself is unambiguous. Thus, if there is over-deterrence in any way whatsoever, the judiciary must take the literal interpretation into account unless exceptional circumstances arise.⁵⁵

ii. Contracts to Refrain from Acts that Further Public Policy

The second category includes contracts to refrain from acts that further public policy. Under this, there is a possibility of the creation of a positive externality by the performance of the contract itself.⁵⁶ However, since the act contemplated by the performance itself is against the doctrine of public policy, the creation of a positive externality is barred.⁵⁷ Take, for instance, a post-employment restraint agreement between the employer and the employee. Let us assume that under this, the employee enters into an agreement with the employer whereby the employee cannot move to a more profitable position in another company, which sells the same product or service, where the employee's services could be put to use. *Post-employment restraints are said to monopolize the employment market because they limit the ability of the employees to sell their services to the highest bidder.*⁵⁸ Thus, at face value, one could term a long term employment contract to be anti-competitive. One could argue that there is a possibility that such agreements are against general contracting principles. Further, there is not only a loss to the employee's ability to earn a living but also the cost to society of losing the services of a productive individual. These would be substantial grounds for barring the contract as it goes against public policy. In *Affle Holdings Pte Ltd. v. Saurabh Singh*, the Delhi High Court was of the opinion that a negative covenant in the employment contract, which prohibits carrying on business beyond the tenure of the contract, is void and unenforceable.⁵⁹ The underlying reason behind invalidating post-employment restraints is that if such restraints are permitted, the employee would be unfairly restrained from using the skills and knowledge gained by him

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ Maureen Callahan, *Post Employment Restraint Agreements: A Reassessment*, 52 U.CHI L. REV. 703 (1985).

⁵⁹ *Affle Holdings Pte Ltd. v. Saurabh Singh and Ors.*, 2015 SCC OnLine Del 6765

or her to advance further in the industry. All of these arguments seem plausible to bar such contracts on the basis of violating public policy. On the other hand, Callahan, in her paper '*Post-Employment Restraint Agreements: A Reassessment*' was of the opinion that, "*post-employment contracts are not anti-competitive per se, and in many cases, foster competition by affording employers needed protection for confidential businesses or information in training.*"⁶⁰ Thus, the courts ought not to delve into the reasonableness of such contracts. If the employee breaches the post-employment restraint agreement, then there is a positive spillover, which is beneficial for the third parties employing the worker with the acquired skills. Courts should necessarily look at the contract and see whether the contract itself made the beneficial breach possible. If the contract was a factor that made beneficial breach possible, then it ought to be enforced. The approach used by the Supreme Court of India in *Percept D'Mark (India) Pvt. Ltd. v. Zaheer Khan & Another* seems to be the appropriate approach towards addressing concerns arising out of restricting covenants: "*Somewhere there must be a line between those contracts which are in restraint of trade and whose reasonableness can, therefore, be considered by the courts, and those contracts which merely regulate the normal commercial relations between the parties and are therefore, free from the doctrine...*"⁶¹ This would enable the judges to view the reasonableness of the contract and provide just enough incentive for the breachee to enter into the contract in the first place. Moreover, this would maximize social welfare by maximizing opportunities for beneficial breach.

iii. **Contracts to Commit Legal Acts That Themselves Facilitate Acts Against Public Policy**

*Certain activities do not require one or both the parties to engage in prohibited activities, but do facilitate such activities.*⁶² These activities would be under the third category, which includes contracts to commit legal acts that themselves facilitate acts against public policy. In this type of agreement, negative externality is more probabilistic in nature. Take, for instance, a case wherein A sells B an axe which was to be utilised for cutting trees. A knew that B did not have a proper license to cut trees in the forest. B, on the other hand, uses that axe to kill a person. The act of selling the axe did not result in any prohibited activity but facilitated the act

⁶⁰ Callahan, *Supra* note 57

⁶¹ *Percept D'Mark (India) Pvt. Ltd. v. Zaheer Khan & Anr.*, (2006) 4 SCC 227

⁶² *Supra* note 47

of murder. In such a case, one could argue that the intention of the contracting party needs to be judged to see if the contract could be enforced. Thus, on that basis, the contract ought not to be enforced had A known about the intention of B, whereas the contract should be enforced if A did not know about the intention of B. However, analysing the intention of the parties during contract is a costly affair and, therefore such contracts ought not to be enforced. This would inevitably lead to over-deterrence and lack of incentives for people to enter into contracts in which there is a minor illegality. This results in the loss of social welfare as the promisor would not want to indulge in such an activity due to non-enforcement on the ground of public policy. One option for the judiciary would be to analyse the cost and benefit; however, the trade-off here is that it raises the cost on the judiciary as the judges would have to analyse what would be construed as minor or major illegality. Thus, in my opinion, these types of contracts should be barred for being against public policy.

iv. Contracts to Commit Acts of Indeterminate Legality

*The fourth category deals with contracts with uncertain public policy effects. These contracts require a judicial determination as to whether the act is against public policy. At times, this may chill some legal activities and prevent welfare maximization.*⁶³ In such cases, the risk-taking ability of the parties is a determinative factor with regard to the actualisation of the contract. The chilling effect can be reduced by reducing the penalties associated with the act. This would increase the value of expected return. However, it can under-deter parties in relation to entering into contracts that will definitely violate the statute. The same is faced while analysing the public policy doctrine vis-à-vis the setting aside of arbitral awards.

The effect of public policy on contracts varies from case to case. This complicates the understanding of voidability of contracts on the grounds of public policy. This complexity is compounded in cases where the State acts as a paternalist to protect parties to the contracts. Thus, it is necessary not only to analyse the contracts on the basis of externalities it creates but also from a welfare perspective.

⁶³ *Id.*

5. A WELFARE PERSPECTIVE ON THE PUBLIC POLICY DOCTRINE

The main aim of any institution is to protect the parties to the contract. The author has analysed the contracts being barred as against public policy on the basis of the externalities they create. However, public policy can be used to protect the parties from the contract itself. In such cases, the institution may act in a paternalist manner to bar contracts against public policy. Parties to a contract should be on an equal footing; however, the stark reality is that parties are never on an equal footing. Unfair terms in a contract can be one of the arguments raised by the parties to point out unequal bargaining. The Supreme Court of India, in the case of *Indian Financial Assn. of Seven Day Adventists v. M.A. Unneerikutty*, was of the opinion that if any particular clause or clauses in a contract are unlawful and one-sided, then the contract would be void and against public policy.⁶⁴ Although unconscionability is not a ground under Section 23 of the Indian Contract Act, the Law Commission of India, in its 103rd Report on Unfair (Procedural and Substantive) Terms in Contract, has mentioned that unconscionable bargain could be brought under the ambit of public policy.⁶⁵ Interestingly, Epstein is of the opinion that it does not serve any function beyond the prohibition against fraud, duress and incompetence.⁶⁶ Thus, the doctrine is acceptable only in instances where there is some incapacity of a contracting party, which results in informational asymmetry for one of the parties. On the other hand, Ghodoosi states that the public policy argument can be used to set aside an arbitral award when serious asymmetry of information has caused harm to party.⁶⁷ Petitions for setting aside arbitral awards are normally heard by the High Courts of India. Thus, the arguments of serious informational asymmetry ought to be raised in the arbitral proceedings and not before the High Courts during the setting aside proceedings. Understandably, the courts do have the responsibility to protect the weaker party, if the party had been subject to any incapacity. However, if the party has been unable to prove economic duress of any sorts, then asymmetry of information, if any, ought not to be the reason for setting aside an award. Since, the arbitral tribunal has the power to check the voidability of the agreement and impliedly unreasonable clauses; the author's argument is not in consonance with Ghodoosi's argument of the onus being on the judiciary to set aside such awards on the grounds of public policy.⁶⁸ Epstein is right in concluding that unless there is some incapacity that is caused, unjust terms due to

⁶⁴ *Indian Financial Assn. of Seventh Day Adventists v. M.A. Unneerikutty*, (2006) 6 SCC 351

⁶⁵ L. COMM'N OF INDIA, 103RD REPORT ON UNFAIR TERMS IN CONTRACT (1984).

⁶⁶ Richard Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293 (1975).

⁶⁷ FARSHAD GHODOOSI, INTERNATIONAL DISPUTE RESOLUTION AND THE PUBLIC POLICY EXCEPTION (2018).

⁶⁸ *Id.*

unequal bargaining power cannot be termed to be against public policy.⁶⁹ Courts in India have tried to adopt a balanced approach. For instance, the Supreme Court, in the case of *Phulchand Exports Ltd. v O.O.O Patriot*, held that “when the commercial businessmen are involved in commercial contracts that are not of unequal bargaining power and have entered into a contract, then the agreed terms between them cannot be said to be unreasonable, unjust or unconscionable.”⁷⁰

From a welfare perspective, the State may act as a paternalist and draft laws to protect the weaker parties in the contract from certain incapacity. This is reasonable. However, the judicial institution should not interfere and have a balanced approach. Interference should happen only when there is a serious threat that the asymmetry has caused grave incapacity. Understandably, there is complexity in cases where the doctrine of public policy is applied. Thus, it is necessary to determine the costs of such vague statutory terms on the judiciary.

6. VAGUENESS OF ‘PUBLIC POLICY’ AND JUDICIAL COST MINIMIZATION

6.1 Optimal Interpretation of Public Policy to reduce judicial costs

The debate regarding the interpretation of public policy has been going on for years not just in the alternative dispute resolution setting but also in the contractual setting. In *Richardson v. Mellish*, Justice Burrough had termed public policy, “as an unruly horse; once you get astride of it, you never know where it will carry you.”⁷¹ Interestingly, this has been quoted on numerous occasions even by law and economics scholars whilst analysing the public policy usage in contracts and conflict resolutions.⁷² Until the late 1970’s, law and economics scholars were under the assumption that the statute had an unambiguous meaning once it had been drafted. However, Posner’s article on statutory interpretation provided a different approach to interpretation of statutes and the constitution.⁷³ His analysis of judicial independence from

⁶⁹ Epstein, *supra* note 65

⁷⁰ *Phulchand Exports v. O.O.O. Patriot*, (2011) 10 SCC 300

⁷¹ *Richardson v. Mellish*, (1824) 2 Bing 229

⁷² See, David Friedman, *Brining Order to Contracts against Public Policy*, 39 FLA. ST. U. L. REV. 563 (2012)

⁷³ Richard Posner, *Statutory Interpretation- in the Classroom and in the Courtroom*, 50 U.CHI L. REV. 800 (1983).

political control laid down the premise of courts acting as agents of the original draftsmen, rather than the current legislators.⁷⁴ Therefore, the role of the judiciary in interpreting vague laws is to determine the underlying public interest foundation which had been laid down by the enacting legislature.⁷⁵ Thus, in our case, that would be the meaning or ambit of the public policy doctrine. Public policy, as used in other contexts mentioned in the previous chapters, has been employed in a different sense under contractual and arbitral settings. One could argue that the usage of public policy is narrower in the arbitral setting than the contractual setting in the Indian scenario. It is impossible to define “public policy” considering its multi-dimensional character. Winfield is of the opinion that “*public policy is a principle of judicial legislation or interpretation founded on the current needs of the community.*”⁷⁶ This would not be counted as a full-proof definition; nonetheless, the essence of the public policy depending on the dynamic changes of the society has been captured. This makes it even more difficult for the judiciary, as an agent of the enacting body, to interpret this vague term. The judicial interpretation of vague terms from an economic perspective has been on the rise since the 1980s. An initial attempt to fill the gap and to provide an economic framework of alternative rules for judicial interpretation was made by Rizzo and Arnold in, ‘*An economic framework for Statutory Interpretation*’.⁷⁷ In their paper, they developed the economic theory of judicial interpretation which is one of *relative* interpretations wherein the framework suggests that the interpretation should be broader in some areas and narrower in others.⁷⁸ Their main aim was to minimize deviations of judicial decisions from those that would have been made by a costless legislature. The model is simple; there is a hypothetical ‘costless legislature’ and the statutory vagueness is assumed to be exogenous to the cost minimization problem. Their model to determine the total cost of judicial errors is:

$$C = \alpha O(I, V_0) + \beta U(I, V_0)$$

Here, V is the concept of statutory vagueness, I is the judicial interpretive stance, the over-inclusion and under-inclusion errors are O and U , respectively, and their relative costs are α

⁷⁴ William Landes & Richard Posner, *The Independent Judiciary in an Interest-Group Perspective*, 18 J. L. & ECON. 875 (1975)

⁷⁵ Posner, *Supra* note 72

⁷⁶ Percy Winfield, *Public Policy in the English Common Law*, 42 Harv. L. Rev. 76 (1928).

⁷⁷ Mario Rizzo & Frank Arnold, *An Economic Framework for Statutory Interpretation*, 50 J. L. & CONTEMP. PROBS. 165 (1988)

⁷⁸ *Id.* at 166

and β , respectively. According to them, *the total cost of judicial errors is at a minimum when the first order condition of the above objective function is set equal to zero*⁷⁹:

$$\alpha O_1 + \beta U_1 = 0$$

This implies that:

$$\alpha O_1 = -\beta U_1$$

*The above model showcases that the appropriate reach of the statute or the vague term results when, given a fixed degree of vagueness, the judiciary selects an interpretive stance so that the costs of marginal over-inclusions balance the costs of marginal under-inclusions.*⁸⁰

Taking the same model, in the public policy context, the author opines that if the vagueness of public policy, or terms therein, increase, two consequences follow. First, there will be an increase in the number of petitions for setting aside, which, according to the costless legislature, ought not to have been included. Therefore, a widened scope of public policy may over-include cases. Conversely, a narrower interpretive stance would have several under-inclusions. Rizzo and Arnold's function has to be considered subject to the utility function of the business community; in the public policy context, which will be U_x . This would consist of the contracts which will be negatively affected due to the increase in scope of public policy (Co). This would give more grounds for the awards and contracts to be declared void. Taking the utility function of the business community in the analysis of public policy is essential as the social costs of errors become higher when the judicial interpretation goes awry. This would be under the assumption that Act will enhance social welfare and is not a private interest statute. Hereunder, (A) stands for the decrease in the number of arbitrations due to lesser number of contracts and more judicial intervention.

$$U_x(I, V_0, Co, A) = \bar{U}$$

⁷⁹ *Id.* at 171

⁸⁰ *Id.* at 171

By taking the utility function, courts would minimize the social costs (inclusive of the judicial minimization of cost) as they perceive them, from deviating from the legislative intent of a statute.

7. PREFERENCES OF THE JUDICIARY IN INTERPRETING VAGUE TERMS

Statutory interpretation has been excessively concerned with the different canons of interpretation such as the golden rule and the literal rule.⁸¹ Thus, little attention has been paid to the preferences of the judiciary and the legislature.⁸² Legal theorists believe that the courts are concerned with following the basic rules of interpretation and applying the law to interpret terms as they are in a contract or statute.⁸³ However, this may not be entirely true. Take for instance, the arguments laid by positive political theorists that the courts are primarily concerned with reading their own preferences into statutes, to the extent that they can do so whilst avoiding unnecessary statutory overrides.⁸⁴ Judges do have policy preferences that influence their reading of a particular term. Whilst construing their preference, a judge will prefer to use instruments such as precedents and interpretation tools. However, traditional sources of legal interpretation often support more than one interpretation of a statute or term, giving the judges law-making discretion. *Thus, when the option arises, judges typically consider how a "reasonable" lawmaker might have intended the statute to be interpreted, including his own preferences and the preferences of the current legislature. This would be termed as the legislative signal.*⁸⁵ When the judges include their own preferences, there may be divergence with the legislature's preferences. In the case of public policy, the Supreme Court in *Muralidhar Agarwal v. State of U.P.*⁸⁶, was of the opinion that, "*Public Policy is a dynamic concept which varies from generation to generation. Going further, the difficulty of discovering what public policy is at given moment certainly does not absolve the judges from the duty of doing so. In conducting an enquiry, judges are not hide-bound by precedent. The*

⁸¹ JUSTICE G. P. SINGH, PRINCIPLES OF STATUTORY INTERPRETATION (2012).

⁸² Jonathan Macey & Geoffrey Miller, *The Canons of Statutory Construction and Judicial Preferences*, 45 VAND. L. REV. 647 (1992).

⁸³ Lawrence Solum, *The Interpretation-Construction Distinction*, 27 CONST. COMMENT. 95 (2010); *But see*, Patrick Kelley, *Theories of Legislation and Statutory Interpretation: Natural Law and the Intention of the Legislature*, 1 WASH. U. JUR. REV. 47 (2009)

⁸⁴ Klass, *supra* note 46

⁸⁵ William Eskridge, JR, *Post-enactment Legislative Signals*, 57 J. L. & CONTEMP. PROB. 75 (1994).

⁸⁶ Murlidhar Agarwal and Anr. v. State of U.P. and Anr., 1974 AIR 1924

judges must look beyond the narrow field of past precedents, though still leaves open the question, in which direction they must cast their gaze. The judges must base their decision on the opinions of the men of the world, as distinguished from opinions based on legal learning.”

Interestingly, Supreme Court placed reliance on this case to widen the scope of public policy in *Saw Pipes*. It is true that when the legislature enacts a particular statute, it cannot assume the judiciary’s preferences, which may or may not diverge from its own preferences.⁸⁷ However, in this case, there was a clear path provided by the judiciary under the *Renusagar* case. The judiciary, by going against the principles laid down in *Renusagar* gave rise to unnecessary sunk cost and a massive opportunity cost. Unfortunately, when the court reviews the law and widens the ambit, it raises further social cost. To curb the misgiving, the legislature updates its assessment of the preferences, which results in the additional cost of reiterating its own policy preferences in the statute through amendments.

This discussion should make clear the importance of optimal judicial interpretive stance in reducing costs and maintaining legislative preferences. The implication of not taking the enacting legislature’s preferences into account for analysing a vague term is an unnecessary dispute between the two arms, with each trying to put its own mark. Continuing on the same thought, the final chapter will try to identify the need for a focal point by the judiciary especially when the law, as in the case of public policy, is unclear. The author analyzes why the law is needed in the first place and what are the consequences when the law is unclear.

8. THE FOCAL POINT APPROACH AS A PANACEA TO THE PUBLIC POLICY CONUNDRUM

In the Indian context, the Supreme Court’s judgment is binding on all courts within the territory of India.⁸⁸ Thus, the Indian hierarchical structure would have the Supreme Court at the top of the pyramid followed by the High Courts in different States of the country. The ratio laid down by the Supreme Court is binding as a precedent on all the lower courts. As pointed out in the first chapter, the Supreme Court’s judgments in the *Renusagar* and *Saw Pipes* cases have binding precedential value on the lower courts. The basic reasoning behind the *Saw Pipes*

⁸⁷ See, *Klass supra* note 46

⁸⁸ INDIA CONST., art. 141

decision overrode the legislature's preferences. By adding the ground of patent illegality, the Supreme Court widened the scope of public policy considerably. This ratio trickled down to the High Courts of the country, which do not require any unanimity as far as appreciation of precedents are concerned. Let us assume that the Bombay High Court, staying within the limits of the *Saw Pipes* decision, interpreted public policy widely and further, construed the term patent illegality liberally. The consequence would be that more petitions of setting aside would be successful in the Bombay High Court. On the other hand, let us assume that the Madras High Court, staying within the limits of *Saw Pipes* decision, interpreted public policy narrowly, giving due consideration to the term 'patent illegality'. Consider that all the remaining High Courts in India interpret public policy and patent illegality anywhere between the scope defined by the High Courts of Bombay and Madras. Given this, multiple equilibria will be formed in relation to the scope of public policy, especially under a vague concept like patent illegality as put forward by the Supreme Court of India in the *Saw Pipes* decision. Clearly, the parties entering into contracts will be confused regarding the enforcement of arbitral awards, if there are any disputes that arise. Further, the parties would face the issue of analysing the contracts in the first place due to the lack of information regarding the doctrine of public policy and what constitutes patent illegality. In cases where there are multiple equilibria as in the hypothetical scenario mentioned above, where the High Courts throughout the country have more than one interpretation, the parties entering into contracts may be able to gauge which are the equilibrium outcomes. However, there is no sure-fire way for all of the said parties to converge on the same equilibrium. To further enunciate this concept, it is worth mentioning Basu's Island game. In this game, two people are left on an island with one opting to drive on the left and the other one opting to drive on the right. This may create two equal equilibria, vis-à-vis driving on the right equilibrium and driving on the left equilibrium. The result would be disastrous. The 'Island Game' analogy can be clearly applied to the case of High Court interpretations.⁸⁹ Interestingly, this is where Basu is of the opinion that the focal point can play a role.⁹⁰ According to him, "*the focal point is a concept that arises from psychological capacity, which enables people to guess what another person is likely to do when faced with the problem of choosing one from among several equilibria.*"⁹¹ To better understand the focal point approach, the author continues with the High Courts' example. Since there are 25 High Courts throughout

⁸⁹ Kaushik Basu, *The Republic of Beliefs*, World Bank Group- Policy Research Working Paper No. 7259 (2015).

⁹⁰ KAUSHIK BASU, *THE REPUBLIC OF BELIEFS: A NEW APPROACH TO LAW AND ECONOMICS* (2018).

⁹¹ *Id* at 38

the country, the author assumes that there are 25 focal points created. This is seen through the Squares Game below:

Game 1: Squares Game

Clearly, this game has 25 Equilibria. The author assumes that there are two contracting parties from Madras and Bombay respectively, who are unsure as to whether the contract they have entered into would be against the doctrine of public policy. The party from Bombay would not want to enter into a contract as the Bombay High Court has given a wide interpretation and thus, the contract could be void as against public policy. On the contrary, in an indeterminate legality regarding patent illegality, the contracting party from Madras would be willing to enter into this contract as the Madras High Court has given a narrower interpretation. On the assumption that there is no way to get any further information through a lawyer, which increases cost of transaction, the chances are that the parties will not want to enter into such a contract. This is where the parties get nothing. Assume that there are two contracts wherein one contract is signed by two parties from Madras and the other contract is signed by two parties from Bombay. Further, assume that both the contracts are of indeterminate legality under public policy and that neither violates any statute linked to public policy or public interest. However, assume that both violate minor regulations which have no bearing on public interest. If disputes arise in both contracts and the consequent arbitral awards are challenged on the grounds of violation of public policy, and if the challenge to the validity of both contracts reaches the Supreme Court, both the contracts would give the parties an expected income of

Rs. 40, which is equal to 1,000 multiplied by one-twenty-fifth, if the Supreme Court would choose the contract which they have entered into as valid. However, this probability is rather miniscule. This is understandably a game where the utility of the focal point comes into play. One way to create a focal equilibrium is to place a visible marker on any one of the squares. This would indicate to the parties that this is the focal point.⁹²

Basu gives an instance of meeting at the airport. He says that if we suppose that “*two people decided to meet at an airport at a certain time but have forgotten to mention a specific place. This will allow each player to then choose a place to go and wait. If they both choose the same place, they meet and are happy. If they choose different places, they are unhappy. The game is the same as the squares game which has multiple equilibria.*”⁹³ Basu then proposes a solution to this conundrum: “*the airport authorities can solve this by deliberately creating a focal point. They do this by simply choosing any visible place in the airport and putting up a sign, saying “Meeting Point”.*”⁹⁴ Since multiple equilibria are formed there is an inherent confusion in the minds of the parties. Whilst the law cannot change the options available to individuals, it can effect a change in individual beliefs about what others will do.⁹⁵ These can prompt individuals to behave differently and that is what can take society to a new equilibrium. In other words, the law is simply an instrument that gives salience to certain equilibria and certain kinds of behaviour. Thus, a new law, if it has to be effective, has to create a new focal point. In the case of public policy, the legislature narrows the scope of public policy with well-defined scope of what constitutes public policy. This, in turn, becomes the law of the land. Thus, the legislature directs the parties to a better equilibrium. It could happen that there may be a better outcome in the society and an equilibrium, which could not be realized by the law. Therefore, the law can be amended to realize this particular outcome as was done by the legislature with the amendment of the Act in 2015. This process goes on and on until the society reaches the optimal outcome. On the other hand, a cardinal mistake the Supreme Court made through the *Saw Pipes* decision by adding the ground of public policy was to not realize the limitation of the law and to try and overreach and direct the society to some outcome that is not the best equilibrium, and hence, not sustainable. The decision of the Supreme Court in *Saw Pipes* inevitably took

⁹² *Id* at 45

⁹³ *Id* at 44

⁹⁴ *Id* at 44

⁹⁵ *Id*; See also, Robert Lee, *Kaushik Basu: The Republic of Beliefs: A New Approach to Law and Economics*, 46 J. L. Soc’y 340 (2019)

the society to a downward equilibrium, and hence, the law was not sustainable. In such cases we end up with laws that are doomed to fail. Hadfield’s argument plays an important role here. He says “*It’s not that there are no formal legal rules and systems in poor and developing countries. Indeed, there are often so many rules and systems that no one could possibly comply with all*”⁹⁶

One could point to that fact that even the narrower scope of the doctrine of public policy is ambiguous and, thus, may lead parties astray. In this case, we use a focal curb. The law, as in our case, the doctrine of public policy ambit, directs the society to understand not a focal point but what may be called a “focal curb”. *A focal curb is a set of strategies open to each player, such that the ordered collection of these sets- one for each player- is closed under rational behaviour.*⁹⁷ Take for instance, the squares game dealt with earlier. In the game above, there were 25 equilibria considering there were 25 High Courts in the country, each with a degree of their understanding of patent illegality and public policy pursuant to the *Saw Pipes* decision. Now, if we take the 2015 Amendment, where the legislature reduced the scope of public policy considerably, the legislature may not have given the parties a focal point but has created a focal curb.

X	X	X	X
X			

Game 2: Focal Curb Squares Game

⁹⁶ GILLIAN HADFIELD, *RULES FOR A FLAT WORLD: WHY HUMANS INVENTED LAW AND HOW TO REINVENT IT FOR A COMPLEX GLOBAL ECONOMY* (2017).

⁹⁷ Basu, *supra* note 89

In the 2015 amendment, the legislature narrowed the scope of public policy considerably. Let us suppose that this new amendment by the legislature says that parties are now to consider only major illegality under public policy which violates public interest and public welfare. Under this, one could argue that despite the ambiguity of the terms 'major illegality' 'public interest and welfare', the term public policy has been narrowed down considerably as compared to *Saw Pipes* decision, which includes the abovementioned ambiguous terms and additional vague terms such as patent illegality, without a proper connotation. In this regard, the Amendment states that, while construing public policy, only the bottom five squares need to be taken into consideration. This law, thus, directs society not to a point but to a set of actions. The law, in this case, can be thought of not as creating a focal point but a focal curb. Now, the parties expected income through the contracts would be Rs. 200, which is equal to 1,000 multiplied by one-fifth, i.e. the probability that the Supreme Court would choose the contract which they have entered into as valid. Because of the inherent ambiguity in the doctrine of public policy, it is important to go beyond focal points to focal curbs. This creates the space essential to accommodate the inherent ambiguity of the term 'public policy'. However, the term cannot be ambiguous to such an extent that the parties do not have any idea where to converge as was the case in the *Saw Pipes* decision.

The idea behind the focal point approach to law is that it helps create richer models. It takes multiple players into account and recognizes their role played in the economy game. As holistic as this approach may be, it does have its own limitations. Nevertheless, using this approach to settle the issue of ambiguous laws may help India achieve set-valued target of being the future arbitration hub. For now, given the amendments carried out to the Act, a clear *jurisprudence constante* is being achieved.

9. CONCLUSION

In this thesis, several issues have been outlined regarding the Supreme Court's approach towards public policy doctrine in arbitral setting. Whenever a dispute is settled through arbitration, the procedural costs are much lower as compared to a suit that is filed. The relationship between a private forum such as arbitral tribunal and the judiciary has been volatile since the inception of the Act with continuous intervention. Understandably, the legislature has had to put forward its own preferences, forcefully at times. Despite the effort to be

comprehensive, the author has reconciled to the fact that the vagueness of the public policy doctrine will have open-ended questions in the future. Countries now have the incentive to show that they are business friendly by providing contractual rights and easy dispute settlement mechanism. India has been making its mark by consistently rising in ranks on the ease of doing business statistics.⁹⁸ There will always be cases where certainty and consistency will have to outweigh the desire to achieve justice in indeterminate legality cases. Courts must check the unruly horse, i.e. public policy, try to tame it and ensure that it pulls in the right direction. If left unchecked the coach may never arrive at its destination.

⁹⁸ See, The World Bank's Ease of Doing Business Score, 2019, <https://www.doingbusiness.org/en/data/exploreeconomies/india> (last visited on 12th Aug. 2020); Press Information Bureau, Government of India, *India improves rank by 23 positions in Ease of Doing Business- India at 77 Rank in World Bank's Doing Business Report* (Oct. 31. 2018) <http://pib.gov.in/newsite/PrintRelease.aspx?relid=184513> (last visited on 12th Aug. 2020).