Master Guide to Arbitration in India

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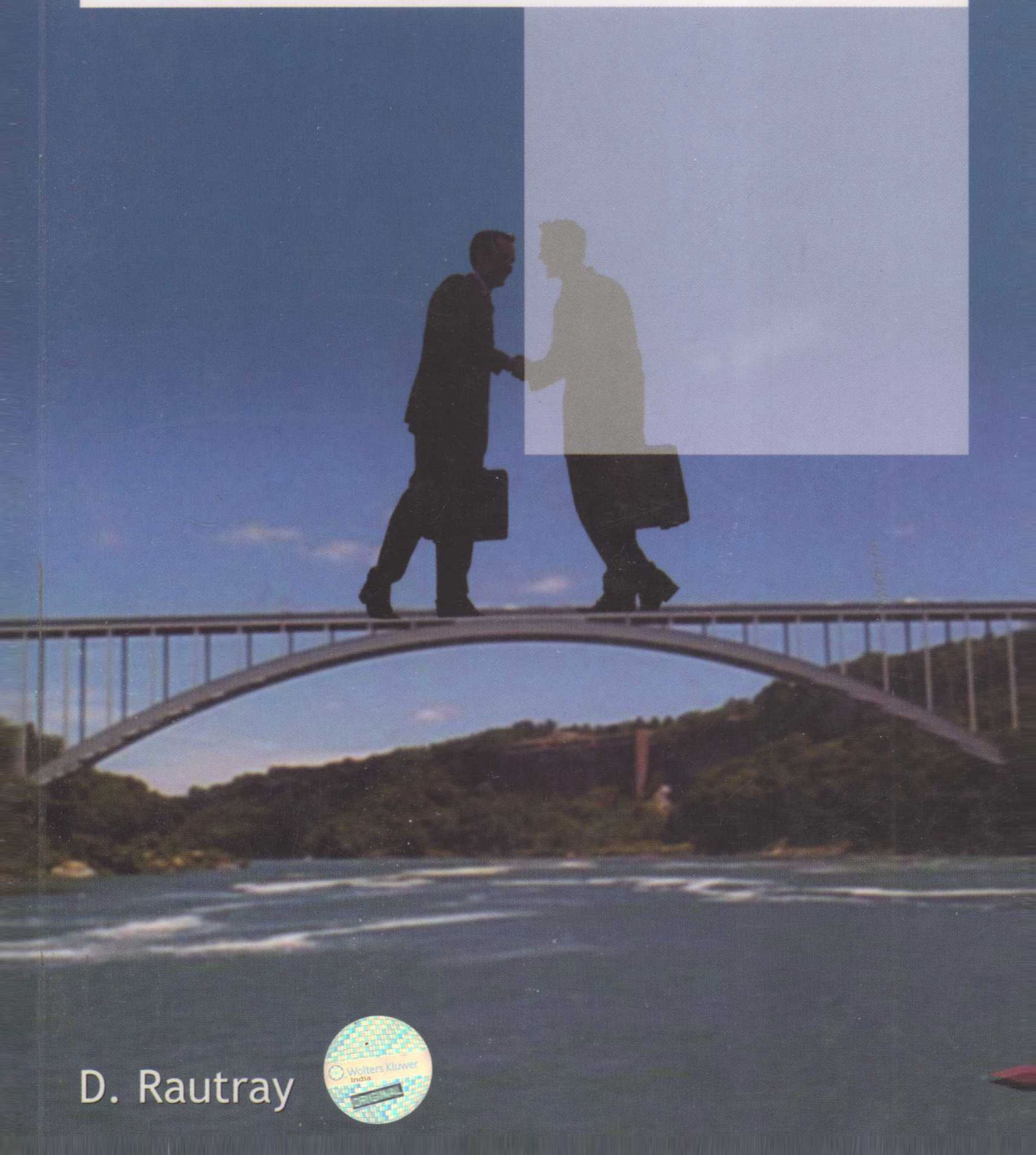

D. Rautray

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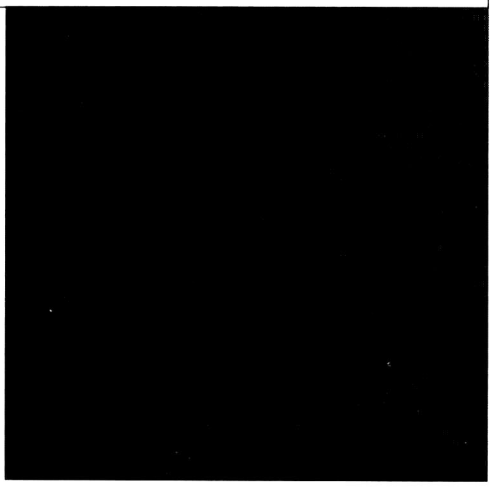

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Chapter 1 Legislative History

¶1-010 Arbitration in British India

Although the history of arbitration in India can be traced back to the origin of the settlement of disputes by village councils, better known as "panchayats", the legislative history dates back to the British administration of India. The East India Company under the power granted to it by the English Parliament framed numerous Regulations dealing with reference of disputes to arbitration. However, it was not until 1813 that disputes in relation to immovable properties ie, land, could be referred to arbitration as per the provisions of *Regulation VI of 1813*.

The Bengal Regulations

The Bengal Regulation I of 1772 and also *Regulation 1780* provided for reference of dispute by parties in relation to disputed accounts to arbitration by way of recommendation to the parties. It was thus, left to the parties to decide as to whether they wanted to accept such a recommendation or not. The award rendered became a decree of the court. *Regulation 1781* provided that:

> "the Judge do recommend, and so far as he can, without compulsion, prevail upon the parties to submit to the arbitration of one person, to be mutually agreed upon by the parties."

It also provided that:

> "no award of any arbitrator, or arbitrators be set aside except upon full proof made by oath of two credible witnesses that the arbitrators had been

guilty of gross corruption or partiality, in the cause in which they had made their award."

Under the *Regulation 1787*, suits could be referred to arbitration with the consent of the parties to the dispute. The *Bengal Regulation XVI of 1793* with a view to promote arbitration gave an option to the parties to the suit to give their consent to submit disputes to a mutually agreed arbitrator. On failure of the parties to appoint a mutually acceptable arbitrator, or the failure of the person nominated to act as an arbitrator, or refusal by him, the parties could give consent for appointment by the court. Disputes such as disputed accounts, partnerships, debts, doubtful or contested bargains, non-performance of contracts could be referred to arbitration under the said Regulation.

Regulation XXVII of 1814 removed the restriction on authorised vakils from acting as arbitrators and thereafter, under the *Bengal Regulation VII of 1822* rent and revenue disputes became referable to arbitration by revenue officers. Until *Regulation 1822* came into force, reference to arbitration could only be made by civil courts. Subsequently, even settlement officers were empowered to refer disputes to arbitrators under the provisions of the *Bengal Regulation IX of 1883*.

Code of Civil Procedure and arbitration

The Legislative Council for India codified the civil procedure and enacted the *Code of Civil Procedure* (*Act VIII of 1859*). The 1859 Code dealt with three kinds of arbitration:

- Sections 312 to 325 of the Code dealt with arbitration in pending suits and for an order of reference.
- Section 326 provided for an agreement for reference to be filed in court and thereupon for an order of reference being made.
- Reference to arbitration of a dispute without the intervention of the court was dealt with in s 327.

This distinction continued even under the *Arbitration Act, 1940*. Sections 312 to 327 of the 1859 Code were replaced with s 506 to 526 by the *Code of Civil Procedure, 1882*.

- Sections 506 to 526 dealt with orders for reference in a suit; whereas
- Sections 523 and 524 dealt with agreements for reference being filed in the court; and

- Sections 525 and 526 laid down provisions for filing of an award in the court.

Both these Codes have been viewed as not being exhaustive legislations on the law of arbitration. Mr Justice Birch observed that s 312 to 325 of the 1859 Code were enabling and were not intended to be restrictive or exclusive, and the parties who were sui juris were competent, before decree, to make any agreement as to the settlement of the suit[1]. There was nothing in the Code of 1859 to prevent parties who had suit pending in court from agreeing to submit the subject matter of that suit and other matters in dispute to arbitration under s 327[2]. Section 327 provided for a case where the matter had been referred to arbitration without the intervention of the court and an award had been made. The award might then be filed in the court and thereafter enforced as an award.

Pursuant to the provisions of ss 523 to 525 of the Code of 1877 parties to a suit could agree to refer matters in dispute between them to arbitration without the intervention of the court and could apply to have the agreement filed in the court and mere pendency of the suit with respect to the matters in dispute was not sufficient for the court to refuse the application for filing of the agreement[3]. None of the enactments or Regulations addressed the issue of reference of future disputes between the parties to arbitration but were confined to the reference of present disputes. This was considered to be a drawback inasmuch as there was no law enabling the parties in commercial transactions to provide for the reference of their future disputes to arbitrations. Section 21 of the *Specific Relief Act, 1877* provided that:

> "save as provided by the Code of Civil Procedure no contract to refer to arbitration shall be specifically enforced; but if any person, who has made such a contract, and has refused to perform it, sues in respect of any subject which he has contracted to refer, the existence of such contract shall bar the suit."

Enactment of *Arbitration Act, 1899*

To remedy the drawbacks of the earlier legislations on arbitration, the *Arbitration Act, 1899* was enacted which was based on the model of the

1 *Jogessur Banerjee v Kulyanee Churn Deo* [1875] 24 WR 41.
2 *Thakoor Doss Roy v Hurry Doss Roy* [1864] WR (Gap No) Misc. Rul. 21.
3 *Harivalabdas Kalliandas v Utamchand Manekchand* [1879] 4 Bom 1 (Sir Charles Sargent and Mr Justice Bayley).

English Arbitration Act, 1889. For the first time, the 1899 Act made provisions for reference of present and future disputes to arbitration without the intervention of the court. However, although the 1899 Act was in force throughout India, its actual application was limited to Presidency towns and a few more commercial towns. The 1899 Act extended the scope of arbitration and defined the word "submission" as a "written agreement to submit present and future differences to arbitration whether an arbitrator is named therein or not."

The *Indian Arbitration Act, 1899* was almost a verbatim reproduction of the *English Arbitration Act, 1889* except for those clauses in the English Act which dealt with reference under the order of the court with which the Indian Act did not deal.

The *Indian Arbitration Act, 1899* was intended only to apply to written submissions to afford machinery by which parties to written submissions might arbitrate and enforce awards. For the application of the provisions of the 1899 Act, two conditions were required to be fulfilled viz, (i) that there should not be a suit pending in respect thereof, and (ii) that the case must be one in respect of which, if either party wanted to bring a suit, the suit could be instituted in a Presidency Town[4]. The object of s 2 was merely to define the legal limits within which the machinery provided by the Act for arbitration, was applicable. The 1899 Act was thus, limited in its operation and also did not affect oral agreements for arbitration which were permitted by the common law[5]. Thus, it was still open to the parties to exercise their right under common law to refer disputes to arbitration by parol and to enforce awards made thereunder by the suits.

Section 4(b) of the 1899 Act defined the term "submission" as under:

> "(b) 'submission' means a written agreement to submit present or future differences to arbitration, whether an arbitrator is named or not."

To give arbitrators the jurisdiction to make an award, it was incumbent on the party claiming arbitration to show (a) that there are disputes between him and the opposing party arising out of or in relation to contracts entered into between them, and (b) that there is an agreement between them in writing to submit those disputes or differences to arbitration within the

4 Section 2 of 1899 Act.

5 Blackwell J *Mathuradas Maganlal v Maganlal Prabhudas* (1934) 36 Bom LR 47.

meaning of the term "submission" as defined in s 4(b) of the *Arbitration Act, 1899*, in order to give effect to the arbitration clause[6].

The Act of 1899 thus, dealt with arbitration by agreement without the intervention of the court and did not apply to disputes which were the subject matter of suits.

Enactment of the *Code of Civil Procedure, 1908*

With the enactment of the *Code of Civil Procedure, 1908* the Indian *Arbitration Act, 1899* and the 1908 Code together governed the entire field of arbitration proceedings in British India. A parol submission was still valid and enforceable by a suit though not as per the procedure prescribed by Sch 2 of the 1908 Code or the *Arbitration Act, 1899*[7].

The Code of 1908, instead of consisting entirely of sections, consisted partly of sections and partly of schedules which were brought into operation by various sections in the Code itself. Schedule 2 of the Code dealt with arbitration. Some express provision had to be inserted in the sections or body of the Code in order to bring the schedules into operation. Section 89 of the Code of 1908 provided as follows:

"(1) Save in so far as is otherwise provided by the Indian Arbitration Act, 1899 or by any other law for the time being in force, all references to arbitration whether by an order in a suit or otherwise, and all proceedings thereunder, shall be governed by the provisions contained in Schedule 2.

(2) The provisions of Schedule 2 shall not affect any arbitration pending at the commencement of this Code, but shall apply to any arbitration after that date under any agreement or reference made before the commencement of this Code."

Thus, s 89 directed all references to be governed by the provisions of Sch 2 which stated as follows:

> "Where in any suit all the parties interested agree that any matter in difference between them shall be referred to arbitration they may at any time before the judgment is pronounced, apply to the Court for an order of reference."

6 *Mahomed Haji Hamed v Pirojshaw R Vakharia & Co* (1932) 34 Bom LR 697.

7 *Ponnamma v Kotamma* AIR 1932 Mad 745.

Thus, Sch 2 of the Code of 1908 contained provisions that dealt with:

(i) arbitration in respect of the subject matter of suits; and

(ii) where the parties to dispute might file their arbitration agreements before the court, which would then refer the matter to arbitration; and

(iii) for arbitration without the intervention of court.

Importantly, the Indian Evidence Act did not apply to arbitration proceedings.

Prior to the enactment of the *Arbitration Act, 1940* the law of arbitration was contained in two separate enactments. However, the enactments in the *Code of Civil Procedure, 1908* and the *Indian Arbitration Act, 1899* could not completely do away with its shortcomings and hence, the need was felt to consolidate the law of arbitration into one legislative enactment.

¶1-020 Approach of the court to an award under the Act of 1899 and the 1908 Code

Misconduct by the arbitrator

The ground of misconduct to set aside an arbitral award did not necessarily involve any moral turpitude or dishonesty on the part of the arbitrator. Misconduct must be in the judicial sense of the word, meaning erroneous breach of duty on the part of the arbitrator, however honest, which causes miscarriage of justice. It should have entailed a substantial miscarriage of justice[8]. If a material piece of evidence was tendered by a party during the proceedings and the same was rejected, it may amount to misconduct entitling the petitioner to set aside the award[9]. Mere procedural irregularities such as award not being in a proper form by the arbitrator, proceedings not conducted as regularly and as methodically as should have been etc were held not amounting to misconduct[10]. Although, the Indian Evidence Act did not apply and the arbitrator was not bound by the technical and strict rules of evidence, he still could not disregard the rules of evidence founded on the fundamental principles of justice and public policy. The approach of the courts towards an arbitration award can therefore, be

8 Atkin J *Williams v Wallis and Cox* [1914] 2 KB 478.

9 *Williams v Wallis and Cox* [1914] 2 KB 478.

10 *Amir Begam v Badmddin Husaini* (1914) 16 Bom LR 413 (PC).

succinctly put down quoting Cockburn CJ *in re, Hopper* (1867) LR 2 QB 367 (p. 375):

> "I would observe that we must not be over ready to set aside awards where the parties have agreed to abide by the decision of a tribunal of their own selection, unless we see that there has been something radically wrong and vicious in the proceeding,[11]..."

Courts therefore, did not interfere with arbitral award unless there was substantial injustice[12]. If the misconduct was not of such a nature that called for setting aside the award, the courts had the power to remit the award to the arbitrator[13]. The courts were not bound under s 13 of the Indian Arbitration Act, to act only on the grounds mentioned in paragraph 14 of the Second Schedule to the Code[14]. The grounds for remitting an award were much wider than those for setting it aside, but the jurisdiction was statutory and could not be increased or decreased.

Section 14 of the 1899 Act empowered the court to set aside an award where an arbitrator or umpire had misconducted himself or an arbitration award had been improperly procured. An objection to an award on the ground of misconduct or irregularity on the part of the arbitrator was to be taken by motion to set aside the award, but that where it was alleged that the arbitrator had acted wholly without jurisdiction, the award could be questioned in a suit brought for that purpose[15].

Enforcing arbitral award

Under s 15 of the *Indian Arbitration Act, 1899*, unless the court remitted the award to the reconsideration of the arbitrator or umpire, or set it aside,

11 Relied upon in *Aboobaker Latiff v The Reception Committee of the 48th Indian National Congress* (1937) 39 Bom LR 476.

12 Scrutton LJ in *Olympia Oil and Cake Company and MacAndrew Moreland & Co, In re* (1918) 2 KB 771.

13 Section 13 of 1899 Act. Section 13 of the Act provided that the court may from time to time remit the award to the reconsideration of the arbitrator or umpire. Even under para 14 of Sch II to the Civil Procedure Code the court may remit the award or any matter referred to arbitration to the reconsideration of the same arbitrator upon such terms as the court thinks fit on the grounds mentioned therein.

14 *Aboobaker Latiff v The Reception Committee of the 48th Indian National Congress* (1937) 39 Bom LR 476.

15 *Matulal Dalmia v Ramkissen Das Madan Gopal* (1920) ILR 47 Cal 806; *Abdul Gani Sumar v The Reception Committee of the 48th Indian National Congress* (1936) 38 Bom LR 380.

the award when filed in the court was enforceable as if it were a decree of the court, and (unlike the provision in para 21, second schedule of the Code of Civil Procedure), the Act did not provide for making a decree on the award. A decree if passed was passed without jurisdiction and a nullity, and was incapable of execution qua decree. However, an application to execute such a decree was treated in substance as one for execution of the award[16]. A party was thus, entitled to enforce the arbitrator's award through the court in exactly the same way as if it was a decree.

Opinion of the court on arbitral award

Rule 11 of Sch II of the Code of Civil Procedure, provided that upon any reference by an order of the court, the arbitrator or umpire may, with the leave of the court, state the award as to the whole or any part thereof in the form of a special case for the opinion of the court, and the court shall deliver its opinion thereon and shall order such opinion to be added to and form part of the award. The arbitrators were given power to take the opinion of the court under s 10(b) of the Act, which provided that the arbitrator had power to state a special case for the opinion of the court on any question of law involved. The legislature in framing s 10(b) of the Indian Arbitration Act followed the wording of s 19 of the English Act and in framing r 11 of the Second Schedule of the Code of Civil Procedure followed the wording of s 7(b) of the English Act. The mere expression of opinion by the court as a special case was not an award[17].

Arbitration Act, 1940

The preamble of the *Arbitration Act, 1940* indicated that it was a consolidating and an amending act. The 1940 Act was also intended to be an exhaustive code on the law of arbitration in India[18]. However, the purpose of referring disputes to arbitration ie, speedy adjudication of disputes, got defeated owing to increasing court interventions in the proceedings, recourse to procedural technicalities and by objections raised during the arbitration proceedings and at the time of filing of the award in the court. Further delays were experienced by parties at the time of the enforcement of awards. The grounds of challenging the award got widened as a result of judicial interpretation of the provisions of the 1940 Act by the courts.

16 *Jnanendra Mohan Bhaduri v Rabindra Nath Chakravarty* (1933) 35 Bom LR 327.
17 *Purshotumdas Ramgopal v Ramgopal Hiralal* (1910) 12 Bom LR 852.
18 AIR 1967 Bom 347; AIR 1951 Mad 683.

The failure of the 1940 Act to achieve the objective of an alternative dispute resolution mechanism augmented by the liberalisation of the Indian economy, the necessity of a new enactment was felt. The Supreme Court itself had adversely commented on the then prevailing judicial practices in *M/s Guru Nanak Foundation v M/s Ratan Singh & Sons*[19], wherein the court observed that:

> "Interminable, time consuming, complex and expensive court procedures impelled jurists to search for an alternative forum, less formal, more effective and speedy for resolution of disputes avoiding procedural claptrap and this led them to Arbitration Act, 1940. However, the way in which the proceedings under the Act are conducted and without an exception challenged in the courts has made lawyers laugh and legal philosophers weep. Experience shows and law reports bear ample testimony that the proceedings under the Act have become highly technical accompanied by unending prolixity, at every stage providing a legal trap to the unwary. Informal forum chosen by the parties for expeditious disposal of the disputes has by the decision of the courts been clothed with "legalese" of unforeseeable complexity".

It became evident that the 1940 Act had become outdated as a new era had begun with the economic reforms in the country. It was felt that the reforms would not be fully effective if the law dealing with settlement of both domestic and international commercial remained out of tune with the reforms. Ironically, although the 1940 Act was seen as a consolidating statute, the law on arbitration continued to be contained in three enactments ie, the *Arbitration Act, 1940*, the *Arbitration (Protocol and Convention) Act, 1937* and the *Foreign Awards (Recognition and Enforcement) Act, 1961.*

¶1-030 Legislative history of the *Arbitration and Conciliation Act, 1996*

With a view to facilitate international trade and commerce the necessity of a uniform legal regime was considered imperative. Foremost in the agenda was the need to have an uniform legal mechanism for dispute resolution. It is this felt need that led the United Nations Commission on International Trade Law (UNCITRAL), in consultations with all the member states, to suggest a Model Law which could be consistently adopted by the nations.

19 (1981) 4 SCC 634.

As a result, the United Nations Commission on International Trade Law, adopted in 1985 the Model Law on International Commercial Arbitration. The General Assembly of the United Nations has recommended the use of these Rules in cases where the disputes arise in the context of international commercial transactions and the parties seek amicable settlement of disputes by recourse to conciliation. India being a member state, the President on 16 January 1996, promulgated the *Arbitration and Conciliation Ordinance, 1996* .This was made effective from 25 January 1996. The second Ordinance came in its place on 26 March 1996 which was again replaced by the third Ordinance on 26 June 1996. These Ordinances were necessitated by the need for continuing the operation of the new law.

As a result, the Arbitration and Conciliation Bill was introduced in the Parliament to consolidate, define, and amend the law relating to domestic arbitration, international commercial arbitration, conciliation enforcement of foreign arbitral awards, in the lines of the UNCITRAL Model Law and Rules.

The Arbitration and Conciliation Ordinance, 1996 was originally promulgated by the President on 16 January 1996 and was made effective from 25 January 1996. The second Ordinance came in its place on 26 March 1996 which was again replaced by the third Ordinance on 26 June 1996. These Ordinances were necessitated by the circumstances for continuing the operation of the new law. The new Act 26 of 1996 received the President's assent on 16 August 1996 and was published in the Gazette of India (Extra) Part II Section I dated 19 August 1996[20]. It was observed by the Supreme Court as follows:

> "From the plain and literal reading of the said provision and the gazette notification, it is clear that the Act came into force on 22-8-1996. But the purposive reading would show that the Act came into force in continuation of the first Ordinance which was brought into force on 25-1-1996. This makes the position clear that although the Act came into force on 22-8-1996, for all practical and legal purposes it shall be deemed to have been effective from 25-1-1996 particularly when the provisions of the Ordinance and the Act are similar and there is nothing in the Act to the contrary so as to make the Ordinance ineffective as to either its coming into force on 25-1-1996 or its continuation up to 22-8-1996. Thus we conclude that the Act was brought into force with effect from 22-8-1996 vide Notification No.

20 *Fuerst Day Lawson Ltd v Jindal Exports Ltd* (2001) 6 SCC 356.