# ONE STEP FORWARD, TWO STEPS BACK: STATE OF ARBITRATION IN INDIA

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**ABSTRACT**

*While repeated attempts are being made to establish India as a global arbitration hub, the recent Memorandum issued by the Ministry of Finance on "Guidelines for Arbitration and Mediation in Contracts of Domestic Public Procurement" dated 03.06.2024 has proven counterproductive. Though the Arbitration and Conciliation Act, of 1996 has been amended from time to enable India in becoming the international hub for arbitration, the present Memorandum would render all the earlier efforts made through amendments redundant. With the government being the largest litigant in India, compelling the counterparty to avail civil suits as the only legal remedy against the government would directly hamper the inflow of foreign investments in the country. The author critically analyses the rationale behind the issuance of the Memorandum and discusses whether the means justify the end. This article also delves further into the effect of adopting the pro-mediation approach in case of disputes with government entities. Finally, this article provides a probable solution to the concerns raised by the Ministry of Finance.*

## 1. INTRODUCTION

The Office Memorandum dated 03.06.2024,[1] issued by the Ministry of Finance on "*Guidelines for Arbitration and Mediation in Contracts of Domestic Public Procurement*" ("***Memorandum***") is a major setback to the process of dispute resolution in India. While efforts are being made by the legislature and the judiciary to make arbitration an effective tool in dispute resolution, the implementation of this Memorandum would set the clock back. Ultimately, this Memorandum will significantly increase the burden of the already overloaded courts and would make it impossible to get any

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1. Guidelines for Arbitration and Mediation in Contracts of Domestic Public Procurement 2024, F No FIN/22/2/2022-CDN (A&A).

significant relief in an expedited manner. The present article identifies and analyses the pros and cons of the Memorandum and its consequent impact on the dispute resolution system in India.

## 2. THE RATIONALE BEHIND THE ISSUANCE OF THE MEMORANDUM

The Memorandum sets out various peculiarities that come into the picture when the Government is a litigant and disadvantages of having arbitration as a mode of dispute resolution where the Government (including Government entity or agency such as a public sector undertaking) is a party. The peculiarities and disadvantages mentioned in the Memorandum are summarised below:

- Acceptance of an award without exhausting the challenge avenues is considered "improper" by various government authorities.
- Same practice has to be followed for all contractors in order to maintain fairness and non-arbitrariness which makes it difficult to accept arbitration awards if they vary from general practice.
- Government officers get transferred and it handicaps the Government from making an effective representation before the arbitrator.
- Arbitration is time-consuming and very expensive.
- Lack of standard selection process of arbitrators, apprehension of collusion and little accountability of the arbitrators for wrong decisions.
- The majority of arbitration awards are challenged before the courts, thereby increasing litigation.
- Commercial disputes can be amicably resolved and parties tend to raise inflated claims and counterclaims in arbitration proceedings.

## 3. PRO-MEDIATION APPROACH

The only positive takeaway from this Memorandum is the suggestion of adopting a pro-mediation approach to amicably settle the disputes. Most commercial disputes are capable of settlement without adjudication of the merits of the disputes with subject to the consent of the parties. The

Memorandum promotes mediation under the Mediation Act, of 2023,[2] the setting up of a high-level committee to oversee the mediation proceedings and, to ensure that the parties treat mediation on par with any judicial proceedings. However, the Memorandum fails to answer a crucial question – would the Government or its agencies abide by the outcome of the mediation proceedings?

Even before the introduction of the Mediation Act, of 2023, several Public Sector Undertakings ("***PSUs***") have introduced various alternate dispute mechanisms to settle disputes amicably. Various Dispute Resolution Boards/ Dispute Resolution Committees/ Resolution Redressal Committees have been formed by PSUs. For instance, the National Highway Authority of India ("***NHAI***") issued policy guidelines for the settlement of contractual disputes[3] to settle disputes under Part III of the Arbitration and Conciliation Act, of 1996 ("***Act***"),[4] before the invocation of arbitral proceedings. However, parties do not generally consent to the outcome of the pre-arbitral proceedings and proceed with the arbitral proceedings which have rendered these pre-arbitral mechanisms a mere useless formality. Therefore, in effect, the Memorandum makes initiation of a civil suit mandatory for all contractual disputes with the Government or its agencies.

## 4. IRRELEVANT CONSIDERATIONS

All the peculiarities identified in the Memorandum are rampant even in a civil suit and therefore, it does not justify the compelled approach to the civil courts.

The first peculiarity identified by the Memorandum is that arbitral awards cannot be accepted until all the available avenues to challenge the award are exhausted by the Government or its agencies. Even after the issuance of a decree by the Civil Court, if the Government or its agency do not challenge the decree, it will be considered "improper" by the relevant authorities. It is not the stand of the Government that it will adhere to the decree passed by a civil court without exhausting the appellate remedies available.

The Memorandum notes that arbitration only adds an additional layer of litigation and delays final resolution and consequently, the object of reducing the burden of the courts has not been achieved. While there is

2. Mediation Act 2023 (32 of 2023).
3. National Highways Authority of India/Policy Guidelines/ Conciliation & Settlement of Contractual Disputes 2017, No 2.1.22.
4. Arbitration and Conciliation Act 1996 (26 of 1996), pt III.

a procedure to challenge an arbitral award, the scope of the challenge is narrower than that for a first or second appeal filed against decrees passed by civil courts. The narrow scope of challenging an arbitral award has already been settled by the Hon'ble Supreme Court in *Associate Builders v DDA*[5] *and Ssangyong Engg and Construction Co Ltd v NHAI*. Whereas, a first or second appeal against a decree requires the court to examine the merits of the disputes which significantly delays the adjudication process.

The second peculiarity identified in the Memorandum is that the Government or its agencies cannot accept awards that are against the general practice. This is applicable to other similarly placed contractors in order to maintain fairness and non-arbitrariness. The Memorandum fails to note that such an outcome is inevitable even if the civil courts are to be approached. There is no assurance that the civil courts will not deviate from the general practice adopted by a particular Government agency. Ultimately, an arbitral tribunal or a civil court decides the dispute based on the terms of the contract agreed by the parties, the conduct of the parties and how the parties understood the terms of the contract.[6] Therefore, this peculiarity identified in the Memorandum is an irrelevant consideration in making compulsory the need to approach a civil court when the attempt to amicably resolve the disputes through mediation fails.

The third peculiarity identified in the Memorandum is that Government officers get transferred which handicaps the Government when presenting its case before arbitrators. This problem persists not just in arbitrations, but in civil suits as well. Therefore, eradicating arbitration does not solve the problem. The Government has to take active steps in ensuring that the person with personal knowledge of the dispute is held accountable, and also make it mandatory that they would have to continue assisting during the dispute resolution. The Government must also be mindful of the fact that making the government officers to be present in civil suits is much more time-consuming since civil courts have multiple matters every day and it takes several days to complete the cross-examination of each witness. However, in arbitration proceedings, there is a lot more flexibility for fixing dedicated time slots that accommodate the witnesses' availability as well.

5. *Associate Builders v DDA* (2015) 3 SCC 49; *Ssangyong Engg and Construction Co Ltd v NHAI* (2019) 15 SCC 131.
6. *McDermott International Inc v Burn Standard Co Ltd* (2006) 11 SCC 181; *Pure Helium India (P) Ltd v Oil & Natural Gas Commission* (2003) 8 SCC 593 : AIR 2003 SC 4519.

## 5. ARBITRATION VS. CIVIL SUITS

### A. Time period

The Memorandum raises concerns about the time taken for the conclusion of arbitration proceedings and records that these proceedings are not conducted in the expedited manner as contemplated in the Act. While there could be some merit in this concern, it certainly does not warrant the blanket exclusion of arbitration as a dispute resolution process. The resolution of disputes arising out of and in connection with infrastructure/ construction projects in courts, which more often than not entails the perusal of voluminous documents, has proven to be extremely time-consuming primarily on account of the court systems being already overburdened.

In infrastructure/construction contract cases, both parties lead multiple witnesses to prove their case and the cross-examination will practically take more than a year and, in some instances, the determination is even more difficult owing to the technical nature of the dispute. Further, it will be difficult for the civil court to render a decision in an expedited manner considering it has to peruse thousands of documents and deal with highly technical aspects to arrive at a decision for each case. Whereas in an arbitration proceeding there will be a dedicated tribunal, which can also comprise technical experts depending on the nature of the dispute, who can peruse voluminous documents in relation to a particular case and render a decision within a reasonable timeframe. Furthermore, an arbitral tribunal is also not bound by the strict rules of procedure which makes it easy for the parties to conduct the arbitration proceedings.[7]

In fact, in the practical experience of the author, the trial in a commercial suit arising out of a construction contract took more than 2 years to be completed. This was due to the fact that the court has multiple cases in a day and it is difficult to accommodate the witnesses based on their availability. Civil courts in India are already overburdened with cases and this move from the Government will make it difficult not only for the courts but also for the litigants. The solution provided in the Memorandum for delay in the arbitration proceedings (i.e., switching to civil suits) is tantamount to switching from one process with delays to another one with an equal amount of, if not more delays, making the adjudication of disputes more difficult in the country. The move to eradicate arbitration from Government contracts will further delay the resolution of disputes and that makes it difficult to

7. Arbitration and Conciliation Act 1996 (26 of 1996), s 19.

attract investments from foreign countries. While many steps have been taken to make India an arbitration-friendly country, this Memorandum will negate all the efforts taken by the judiciary and the legislature.

### B. Costs

While there is some merit in the concern raised in the Memorandum regarding arbitration being expensive, the cited concern is again not compelling enough to exclude arbitration. The parties always have the option to regulate the fees paid to the arbitrators. Schedule IV of the Act sets out reasonable fees to be paid to the arbitrators. The Hon'ble Supreme Court has already issued 'Directives governing fees of arbitrators in ad hoc arbitrations' in *ONGC Ltd v Afcons Gunanusa JV*,[8] in order to regulate the fees paid to the arbitrators. It is relevant to note that the court fees for a commercial suit would be equivalent to or more than the fees contemplated under Schedule IV of the Act.

For example, the court fee for a civil suit for recovery of money or claim for compensation under Section 22 read with Article 1 of Schedule I of Tamil Nadu Court Fees and Suits Valuation Act, 1965 (as amended in 2017),[9] is 3% of the amount claimed in the dispute. If a party has a claim for Rs. 50 crores, the court fee payable would be Rs. 1.5 crores in a civil suit. However, the maximum fees payable to an arbitral tribunal under Schedule IV of the Act,[10] for a Rs. 50 crores claim would be Rs. 90 lakhs (assuming a three-member tribunal).

### C. Apprehension of Collusion in Arbitrations

A genuine concern raised in the Memorandum is that there is an apprehension of wrongdoing, including collusion in the conduct of the arbitration proceedings especially in high-stakes matters. Such apprehensions are less when the courts appoint the arbitrator under Section 11 of the Act. However, when the parties appoint the arbitrators, such apprehensions are high and this can be regulated by introducing certain qualifications and standards for appointment of arbitrators in ad-hoc arbitrations. Further, the Act also has sufficient safeguards to ensure the impartiality and independence of the arbitrators under Sections 12 to 15 read with Schedule V and VII.

8. *ONGC Ltd v Afcons Gunanusa JV* (2024) 4 SCC 481 : 2022 INSC 884.
9. Tamil Nadu Court-Fees and Suits Valuation (Amendment) Act 2017 (6 of 2017).
10. Arbitration and Conciliation Act 1996 (26 of 1996), sch 4.

While Schedule 8 of the Act[11] has been removed, broad-based guidelines for the appointment of an arbitrator may be introduced by the legislators to address this issue in ad-hoc arbitrations.

## 6. CONCLUDING REMARKS AND SUGGESTIONS

As elaborated above, none of the concerns raised in the Memorandum justify the exclusion of arbitration clauses from Government contracts. This move will lead to docket explosions in courts and consequently, dispute resolution will be significantly delayed in the country. This will further discourage foreign companies from investing in India. Through the introduction of the Vivad se Vishwas II scheme dated 29.05.2023[12] and 29.12.2023,[13] the Government in the past had already come up with a solution for tackling the problems identified in the Memorandum. This scheme allows the Government to settle the disputes based on the arbitral awards considering the genuine nature of the claims. Nothing in the memorandum prevents the Government from continuing this scheme and settling disputes under it. Further, the NHAI has also formed a committee to determine whether the arbitral award can be accepted or an appeal has to be made against such an award.[14] Reportedly, NHAI settled around 60 cases for around Rs. 4076 crores against the claimed amount of Rs. 14,590 during FY 2021-22. The Government and its agencies can adopt similar methods to ensure speedy resolution of disputes. Implementation of this Memorandum would result in a gradual eradication of arbitration in India since the Government is touted to be the biggest litigant in India.

11. Arbitration and Conciliation (Amendment) Act 2019, sch 8; Subsequently, the Schedule was removed through the Arbitration and Conciliation (Amendment) Act 2021 (31 of 2021).
12. Press Information Bureau, 'Government Launches a One-Time Settlement Scheme Vivad se Vishwas – II (Contractual Disputes) to Effectively Settle Pending Contractual Disputes, as Announced in the Union Budget 2023-24' (*Press Information Bureau* 2 August 2023) <https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1945072> accessed 10 September 2024.
13. Ministry of Finance, Government of India, Department of Expenditure and Procurement Public Division, Vivad se Vishwas – II (Contractual Disputes) 2023, No F 1/7/2022-PDD.
14. Ministry of Finance, Government of India, Department of Public Enterprises, General Instructions on Procurement and Project Management 2021, No F1/1/2021, F No DPE/7(4)/2017-Fin., 19.