

Dispute Resolution Hotline

October 31, 2011

ENFORCEMENT OF AWARDS- ERASING THE DISTINCTION BETWEEN DOMESTIC AND FOREIGN AWARD

The Supreme Court ("SC") in its judgment dated October 12, 2011 in the matter of *Phulchand Exports*

Ltd. ("Appellant/Seller") vs. *OOO Patriot* ("Respondent/Buyer")¹ held that "patent illegality" under the term "public policy of India" needs to be looked into even while examining the enforcement of a foreign award under Section 48 (2) (b) of the Arbitration and Conciliation Act, 1996 ("Act"). Enforcement of foreign awards under Part II of the Act are now required to meet the tests as applicable for domestic awards thereby erasing the distinction of enforceability between domestic and foreign awards in India.

FACTS

In the present case, the parties entered into a Cost Insurance Freight ("CIF") contract for sale of certain goods at a fixed price to be delivered to Novorossiysk. The Buyer provided an open irrevocable letter of credit for the total value of the contract. Due to the delay of 16 days by the Seller in shipping the goods, the vessel left the port of loading (Kandla) 38 days later than the scheduled time of departure.

The goods never reached the port of destination owing to the occurrence of an engine failure. The vessel was rescued in Turkey and the entire cargo was sold out towards compensating the cost of the rescue. The Buyer preferred their claims before United India Insurance Company Limited for non-delivery of goods to Novorossiysk. The liability was denied by the insurers on the ground that the risk of detention was not covered within its policy. As a result, the Buyer brought its claims of USD 285,569.53 before the International Court of Commercial Arbitration at the Chamber of Commerce and Industry of the Russian Federation ("Arbitral Tribunal"). The Appellant/Seller contended that all risks in the goods and the property were transferred to the Buyer upon shipment of the goods and relief could be obtained by approaching the insurers. Further, the delay caused in the shipment of the goods, was acquiesced by the Buyer as the contract was not repudiated by them at any stage.

The Arbitral Tribunal after hearing both the parties held that non-delivery of the shipment and refusal of the Seller to reimburse clearly amounted to breach of the terms of the contract. However, due to the delay on the part of the Buyer to act in accordance with the provisions of the contract towards demanding reimbursement within 180 days of the receipt of moneys, the Arbitral Tribunal split the amount of losses and ordered the Seller to pay half the amounts along with interest and legal expenses to the Buyer. The Respondent/Buyer filed an arbitration petition for enforcement of the award before the Bombay High Court ("Bombay HC"). The Appellant/Seller contended that the award passed was against the public policy of India and thereby unenforceable in India.

The Single Judge of the Bombay High Court rejecting the objections held that the said award could be enforced as a decree of the Court. The same was appealed before the Division Bench. Relying on the judgment of *Renusagar Power Co. Ltd vs. General Electric Co.*² ("Renusagar"), the Division Bench dismissed the appeal by holding that no public policy was involved in the said matter, leading to the Special Leave Petition before the SC. The matter was undefended before the SC.

ISSUE

The sole issue in the instant case for consideration before the SC was regarding enforceability of foreign awards if "patently illegal" and against the public policy of India.

ARGUMENTS

CONTENTIONS OF THE APPELLANT

- The test concerning public policy as adopted in the Renusagar judgment is flawed. A broader and expanded meaning of "public policy of India" was adopted in a subsequent judgment of *Oil and Natural Gas Corporation Limited vs. Saw Pipes*³ ("Saw Pipes") under Section 34 of the Act and the same is applicable under Section 48 (2) (b) of the Act for foreign awards.
- The contract entered between the parties being a CIF contract, the risk in goods was passed on to the buyers upon shipment of the goods and the property documents were also transferred. As, a result no liability vested with the Sellers. The Appellant relying on Section 26 of the Sale of Goods Act, 1930 ("Goods Act") stated that the goods remain at the seller's risk only till the property in the goods is transferred to the buyer.
- The insertion of clause 4 in the CIF contract stating reimbursement of entire amounts to the buyer on non-arrival of goods within 180 days from the date of the payment is penal in nature under Section 74 and void under Section 23 of the Indian Contract Act, 1872 ("Contract Act"). Thereby, enforcement of such an award is against the public policy of India.

JUDGMENT

Firstly, with regard to the contention of risk being transferred to the buyers, the SC interpreting the provisions of the

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Goods Act held that the goods remain at the seller's risk until the property in the goods is transferred to the buyer. However, the proviso to Section 26 of the Goods Act clearly states that in case of delay in delivery of goods due to fault of either party, the goods are at the risk of the defaulting party. The Appellant/Seller not only delayed in the shipment of goods but also having shipped the goods in a vessel with no firm commitment to reach Novorossiysk as the first port of discharge clearly breached the terms of the contract and is liable to compensate the loss as per the provisions of the Goods Act. The Respondent/Buyer was entitled to invoke the contractual clauses for reimbursement.

Secondly, with regard to the said contractual clause being penal in nature and void are also untenable as award of liquidated damages is no way illegal under the provisions of the Contract Act. The stipulation for reimbursement in the contract is not in the nature of penalty; the clause is neither *in terrorem* and cannot be regarded as damages. Determination of public policy in a contract depends upon the nature of the transaction. The said clause cannot be held to be void under Section 23 of the Contract Act as the object/consideration is neither forbidden/fraudulent nor immoral or against the public policy. In the instant case, the award is not patently illegal or contrary to public policy of India as the clause for reimbursement or repayment is neither unreasonable nor unjust and only half of the price paid was required to be paid by the Respondent.

The SC relying on the decision of *Saw Pipes Ltd.*⁴ held that the expression '*public policy of India*' used in Section 48 (2)(b) has to be given wider meaning and the award could be set aside, '*if it is patently illegal*'.

ANALYSIS

It is not the decision but the thought process adopted by the SC that assumes significance in the present case. The same could lead to floodgates of "set aside" proceedings causing impediments in the enforcement of foreign arbitral awards in India.

The analogy accepted by the SC between Renusagar and Saw Pipes is flawed at the inception. The SC had explicitly stated that the expression "public policy" with regards to a foreign award does not cover the field covered by the words "laws of India". By examining the validity of a foreign award under the laws of India, the SC has struck heavy blow on the very narrow construction, which Renusagar sought to propagate.

- **Prateek Bagaria, Payel Chatterjee & Vyapak Desai**

1 Civil Appeal No. 3343 of 2005

2 AIR 1994 SC 100%

3 (2003) 5 SCC 705

4 ibid

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