

INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

Volume 9 | Issue 2

2026

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Critical Analysis of Patent Illegality as a Ground for Setting Aside Domestic Awards in India

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ABSTRACT

Arbitration is one of the widely preferred forms of the Alternative Dispute Resolutions (ADRs) in India. Arbitration is predominantly based on party-autonomy, providing a flexible mechanism for an amicable settlement between the parties. The judicial intervention is restricted only to certain grounds ensuring the finality of arbitral awards. The Section 34 of the Arbitration and Conciliation Act, 1996 provides certain grounds for setting aside the arbitral awards passed in domestic arbitration. The concept of patent illegality was recognised as a ground by the Supreme Court in the year 2003 by giving a wider interpretation to the term 'Public Policy'. Further, the Amendment Act, 2015 provided patent illegality as a separate ground for challenging the arbitral award. This concept of patent illegality is unique to Indian Arbitration Law and sets a departure from international standards. Henceforth, its application is limited to awards passed in domestic arbitrations.

I. INTRODUCTION

Arbitration is one of the most widely preferred forms of Alternative Dispute Resolution in India. It provides a flexible mechanism through which parties may resolve their disputes amicably. Further, Arbitration has emerged as an effective means of resolving international commercial disputes in the past few decades. The United Nations Commission on International Trade Law (UNCITRAL) adopted the UNCITRAL Model Law on International Commercial Arbitration, 1985 and recognised the significance of arbitration as a means of settling disputes arising in international commercial relations.

India incorporated the principles of the UNCITRAL Model Law by enacting the Arbitration and Conciliation Act, 1996, which continues to govern domestic arbitration, international commercial arbitration and enforcement of foreign awards.

The Arbitration and Conciliation Act, 1996, is studied under three parts. The first part deals

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with domestic awards and second part provides for the enforcement of foreign awards. Further, the third part, which deals with Conciliation, is not relevant to the present study.

In India, Arbitration is widely preferred as an alternative forum to the conventional litigation. The voluntary choice of the parties is the basis for any Arbitration and thus, the principle of party-autonomy serves as the guiding spirit of the arbitral procedures.³The role of Courts is limited to the conditions provided under the Arbitration and Conciliation Act, 1996. In **Enercon (India) Ltd and Ors v. Enercon Gmbh and Anr**⁴, stressed the importance of limited court intrusion, which is reflected in **Section 5** of the Arbitration and Conciliation Act, 1996.⁵

The Judicial intervention is minimal at every stage of the arbitral process, ensuring the party-autonomy. An arbitral award is final, binding and enforceable. However, over the past few decades, setting aside of arbitral awards remains the most controversial form of judicial intervention.

The Courts may intervene and set aside a domestic award only on the grounds provided under **Section 34**⁶. These grounds are known as pigeon holes, as they ensure the balance between finality of awards and its reasonableness.

One of the frequently invoked grounds for setting aside a domestic award is the ground of 'Public policy of India'. This term 'Public Policy of India' is way too wide and thus, resulted in many ambiguities.

Furthermore, with the wide interpretation given to the ground of 'Public Policy of India', the doctrine of 'Patent illegality' has emerged as a distinct and independent ground for challenging a domestic award. This new ground of patent illegality is novel to Indian Jurisprudence and hence, it is considered as a deviation from international standards.

In recent judicial trends, it can be observed that the adoption of patent illegality as a ground has increased the scope for setting aside arbitral awards and thus, the finality of award is compromised. Hence, it is necessary to evaluate India's pro-enforcement stance of arbitral awards subsequent to the recognition of 'patent illegality' as ground for setting aside a domestic award.

³ Reforming India's Arbitration Framework: Addressing Patent Illegality in Award Enforcement; Alignment with the International Standards, - Arin Chatterjee & Arin Chatterjee, 2025 SCC OnLine Blog OpEd 110

⁴ (2014) 5 SCC 1

⁵ Patent Illegality in Arbitral Award - An Evolving Concept and Comparative International Jurisprudence - Sneha Gupta, JCLJ (2024) 620

⁶ The Arbitration and Conciliation Act, 1996

II. EVOLUTION OF GROUND OF PATENT ILLEGALITY

The ground of patent illegality has evolved with the expansion of the scope of public policy. Subsequently, patent illegality was recognised as a distinct and independent ground for challenging a domestic award. Hence, it is pertinent to trace-out its evolution through judicial interpretations and its subsequent statutory recognition.

A. Arbitral awards

An Arbitral award is the final determination rendered by the Arbitral Tribunal upon the dispute after hearing both the parties. It is defined as it includes an interim award.⁷ An award is final, binding and enforceable in accordance with law.

B. Kinds of Arbitral awards

Any award, which arises out of a domestic arbitration and an international commercial arbitration - seated in India, is referred as a domestic award. On the contrary, a foreign award is a result of Arbitration - seated in a foreign country. Thus, the seat of Arbitration determines the nature of award.

It is of significance that the validity of a foreign award cannot be challenged in India and only its execution can be resisted. The enforcement of a foreign award may be refused on the conditions provided under **Section 48**⁸, which is similar to the grounds enumerated under **Section 34**.⁹ In other words, a foreign award which is prevented from giving effect in India can be executed in other countries.

C. Grounds of challenging a domestic award

The only recourse available against a domestic award is under **Section 34**¹⁰, which provides for challenging the validity of a domestic award. However, unlike an appeal, the Courts cannot decide upon the merits of the dispute and has only limited jurisdiction to review the award while considering an application for setting a domestic award under **Section 34**¹¹.

The validity of a domestic award can be challenged only on the grounds provided under **Section 34**¹², which includes both substantive and procedural grounds.

⁷ Sec 2(1)(c) of the Arbitration and Conciliation Act, 1966

⁸ The Arbitration and Conciliation Act, 1996

⁹ *Ibid.*,

¹⁰ *Ibid.*,

¹¹ *Ibid.*,

¹² *Ibid.*,

D. Ground of public policy

“Public Policy is an unruly horse where once you stride on it you do not know where it’s going to take you.”¹³

The term ‘public policy’ is way too wide and always depends on the nature of transactions and the statutes.

The ground of ‘public policy of India’ is one of the controversial and commonly invoked grounds to challenge the validity of an arbitral award. It is pertinent to note that the Arbitration and Conciliation Act, 1996, failed to define the term ‘public policy of India’, and thus, diverging opinions arose from the judgments of the Supreme Court.

For the purpose of avoiding confusions, the Amendment Act, 2015, defined the term ‘public policy of India’. The **Explanation 1 to Section 34(2)**¹⁴ provides that

An award contravenes public policy of India, only if the

1. Award was induced by fraud or corruption or contravenes **Section 75**¹⁵ or **Section 81**¹⁶
2. Award contravenes fundamental policy of Indian law; or
3. Award contravenes basic notions of morality or justice.

It is to be noted that the Courts rendered contrasting views on its scope of ‘Public policy of India’ and opened doors for countless litigations and debates.

E. **Renusagar Power Company Ltd v. General Electric Co.**¹⁷ - Narrow Interpretation of Public Policy

It is one of the pioneer decisions by a three- judge bench of the Supreme Court, which shaped the laws relating to challenging the validity of arbitral awards in India.

In the above- judgment, the Supreme Court dealt with the interpretation of public policy under **Section 7(1)(b)(ii) of the Foreign Awards (Recognition and Enforcement) Act, 1961**.

The Court held that **the Foreign Awards Act, 1961** deals with the recognition and enforcement of foreign awards and further governed by the principles of private international law. Hence, the term public policy must be construed as being applied in the field of private international law.

¹³ Richardson v. Mellish, 1824 All ER 258

¹⁴ The Arbitration and Conciliation Act, 1996

¹⁵ *Ibid.*,

¹⁶ *Ibid.*,

¹⁷ 1994 2 SCC 647

Applying the above-said principles, the court held that the enforcement of a foreign award can be refused on the ground that is contrary to public policy, if such enforcement would be contrary to

- i. fundamental policy of Indian law; or
- ii. the interests of India; or
- iii. justice or morality.

The above parameters were introduced by the Supreme Court to determine contravention of public policy of India, for the very first time. Further, the Court held that the test of public policy must be confined only to the public policy of India and does not relate to public policy of any other country.

However, the Court failed to elaborate the each of the above parameters. For instance, the Court did not explain on the aspects constituting the term ‘fundamental policy of India’ but observed that it includes all such fundamental principles that provide a basis for administration of justice and enforcement of law in this country. Further, the Court cited examples as to when fundamental policy of India is violated. The Court in the above case held that any violation of provisions of the Foreign Exchange Regulation Act, 1961 results in the violation of Fundamental policy of India, as the above Act is enacted in pursuant to national economic interest. Further, the Court observed that any blatant disregard of the orders passed by the Superior Courts will also contravene fundamental policy of India. However, the recovery of compound interest on interest, which is said to violate only a particular legislation, does not affect fundamental policy of India.

The Amendment Act, 2015 clarified that Court cannot re-appreciate the dispute on merits, while deciding as to contravention of fundamental policy of India.¹⁸

F. Oil & Natural Gas Corporation Ltd. v. Saw Pipes Ltd.¹⁹ – wider view of ‘Public Policy’ and evolution of ‘Patent Illegality’

In this judgment, the Division Bench of the Supreme Court deviated from its earlier decision in **Renusagar v. Electric General Co.**²⁰, with respect to the scope of ‘public policy of India’. The test for determining the scope of ‘public policy of India’ was widely expanded, resulting in several controversies. Further, the Court added another new ground called ‘Patent illegality’ for challenging domestic awards. Thus, the test of patent illegality was recognised as a ground for

¹⁸ Explanation 2 to Section 34 of the Arbitration and Conciliation Act, 1996

¹⁹ 2003 5 SCC 705

²⁰ Supra at 11

setting aside a domestic award for the first time.

The Court held that wide meaning must be given to the term ‘Public policy of India’. The concept of public policy denotes public good or public interest and varies over a period of time. Nevertheless, an award which patently violates the provisions of a Statute cannot be considered to be in public interest as it affects the administration of justice. Hence, an award must be set aside if it is patently illegal, in addition to the narrow view given to public policy in **Renusagar’s** case.²¹

Thus, an award could be set aside if it is contrary to: -

- i. fundamental policy of Indian law; or
- ii. the interest of India; or
- iii. justice or morality, or
- iv. if it is patently illegal.

This judgment was criticised by various authors for its wide interpretation and for its deviation from earlier and binding decision in **Renusagar**²² by a three-judge bench.

G. Ground of Patent illegality

The Arbitration and Conciliation Act, 1996 originally did not include Patent illegality as a ground for challenging domestic awards under **Section 34**.²³ Thereafter, the Supreme Court widely interpreted the term ‘Public Policy of India’ and Patent illegality was recognised as a ground for setting aside an arbitral award in 2003.

III. SCOPE OF PATENT ILLEGALITY

A. Definition of Patent Illegality

The term ‘Patent’ implies that the award must be unreasonable or illegal on the face of record. Such illegality must be grave and requires the intervention of the Courts.

The Supreme Court in **Oil & Natural Gas Corporation Ltd. v. Saw Pipes Ltd.**²⁴, observed that an award is patently illegal if it shocks the conscience of the Court. Illegality must go to the root of the matter and if the illegality is of trivial nature it cannot be held that award is against the public policy. An award which is patent illegal is required to be adjudged as void.

²¹ *Ibid.*,

²² *Ibid.*,

²³ The Arbitration and Conciliation Act ,1996

²⁴ Supra at 13

The instances enumerated in **Oil & Natural Gas Corporation Ltd. v. Saw Pipes Ltd**²⁵, for an award to be patent illegal include:

1. if the award is patently against the statutory provisions of substantive law which is in force in India
2. award was passed without giving an opportunity of hearing to the parties as provided under **Section 24**²⁶
3. non-reasoning of an award which violates **Section 31**²⁷

In the all above-mentioned scenarios, an award is void and therefore, requires to be set-aside on the ground of patent illegality.

B. Statutory Recognition

The wide interpretation rendered by the Supreme Court resulted in many ambiguities and attracted more litigations challenging the arbitral awards. For instance, the Supreme Court applied the test of patent illegality only to challenge of domestic awards. However, the statutory language of the Act extended its application to refusing the enforcement of foreign awards.

The **246th Report of Law Commission of India** recommended that the unintended consequences of applying patent illegality by the judgment of **Oil & Natural Gas Corporation Ltd. v. Saw Pipes Ltd**²⁸, must be cured.

Upon the recommendations of **246th Report of Law Commission of India**, the Amendment Act, 2015 was brought into effect. The Amendment Act, 2015 inserted **Section 34 2(A)**²⁹, which provides that any award, passed in an arbitration other than international commercial arbitrations, may be set aside if it is patently illegal appearing on the face of it.

In **Mcdermott International Inc v. Burn Standard Co. Ltd.**³⁰ the Supreme Court underscored the importance of minimal judicial intervention while deciding applications under **Section 34**.³¹ The Court held that for an award to be set aside, the illegality must go to the roots of the matter and shock the conscience of the Court.

Subsequently, in **Associate Builders v. Delhi Development Authority**³², the Supreme Court

²⁵ *Ibid.*,

²⁶ The Arbitration and Conciliation Act, 1996

²⁷ *Ibid.*,

²⁸ *Supra* at 13

²⁹ The Arbitration and Conciliation Act, 1996

³⁰ 2006 (11) SCC 181

³¹ The Arbitration and Conciliation Act, 1996

³² (2015) 3 SCC 49

held that the following situations would result to patent illegality;

1. Contravention of terms of contract, which violates **Section 28(3)**³³
2. Contravention of provisions of any substantive law
3. Contravention of **Section 31(3)**³⁴, which mandates a reasoned award

The Supreme Court in its notable decision in **Ssangyong Engineering and Construction Company Limited v. National Highways Authority of India**³⁵, noted that the Courts cannot deal with the merits of the dispute while deciding **Section 34**³⁶ applications. Further, the Supreme Court upheld that the foreign awards are excluded from the test of patent illegality for refusing its enforcement under **Section 48**³⁷.

IV. CONCLUSION

India's pro enforcement of arbitral awards is affected due to the loose interpretation of grounds of public policy of India and patent illegality. It is evident there are inconsistencies and diverging opinions with respect to the interpretations of public policy of India and patent illegality.

Further, the test of patent illegality is novel to India and hence, it is a departure from international standards. On the other hand, other countries tend to follow a restrictive approach with respect to interpreting public policy for setting aside arbitral awards.

Hence, it must be ensured that the test of patent illegality does not result in re-appreciating the facts of the dispute. The Courts only have a limited jurisdiction and cannot review the award on merits.

³³ The Arbitration and Conciliation Act, 1996

³⁴ *Ibid.*,

³⁵ (2019) 15 SCC 131

³⁶ The Arbitration and Conciliation Act, 1996

³⁷ *Ibid.*,