

Law of Arbitration in Pakistan

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[A Research Article]

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There are currently two main pieces of legislation dealing with arbitration in Pakistan: The Arbitration Act, 1940¹ and the Recognition and Enforcement (Arbitration Agreements and Foreign Arbitral Awards) Act, 2011². Although the Arbitration Act, 1940 (a pre-partition enactment, which still continues in force) is a very old act begging for modernity and alignment with other fast paced international jurisdictions, it still serves as a clear and well settled piece of legislation with consistent chain of judicial precedents backing the interpretational aspects shouldering the changing times particularly in trade and commercial matters. The Act provides for arbitration with the intervention of the court and arbitration without the intervention of the court. The main difference between these two types of arbitration pertains to whether or not both parties to a dispute are willing to resort to arbitration. Arbitration without the intervention of the court takes place where both parties are willing to resort to arbitration without seeking the court to appoint arbitrator(s). Arbitration with the intervention of the court occurs where one party is willing and the other is not so as to enable the willing party to ensure adherence to the pre-agreed arbitration by the unwilling party. The Foreign Awards Act is simply a ratification of the New York Convention, 1958 providing that foreign judgments and awards by or between the nationals of contracting states are to be enforced without questioning the validity of the same except on the grounds explicitly provided for in the Convention.

The Statute

The law of arbitration in Pakistan is contained in the Arbitration Act, 1940. Its main features are summarized as under:

The Act provides for three classes of arbitration:—

- (a) arbitration without court intervention (Chapter II, sections 3-19);
- (b) arbitration where no suit is pending, (but through court) (Chapter III, section 20) and
- (c) arbitration in suits (through court) (Chapter IV, sections 21-25).

The Act also contains further provisions, common to all the three types of arbitration (Chapter V, sections 26-38).

Arbitration Agreement

Whatever be the class of arbitrations there must be an arbitration agreement. As defined in the Arbitration Act, 1940, it means a written agreement to submit present or future differences to arbitration, whether an arbitrator is named therein or not [section 2 (2)].

Arbitrators

The number of arbitrators can be one, two, three or even more. In the case of an even number of arbitrators, an umpire is to be appointed according to the procedure given in the Act (First Schedule). Where the arbitration agreement does not specify the number, the arbitration shall be by a sole arbitrator (First Schedule).

An arbitrator may be named in the arbitration agreement or may be left to be appointed by a designated authority (First Schedule).

Where the arbitration agreement is silent about the mode of appointment of arbitrators and the parties cannot agree about the choice of the arbitrator, the Act gives power to the court to make

¹ <http://www.wipo.int/edocs/lexdocs/laws/en/pk/pk066en.pdf>

² <http://www.wipo.int/edocs/lexdocs/laws/en/pk/pk069en.pdf>

the appointment, after following the prescribed procedure (sections 8-10).

An arbitrator who does not diligently conduct the proceedings, or who is guilty of misconduct, can be removed by the court after due inquiry (section 11).

Death of a party does not terminate the arbitration proceedings, if the cause of action survives (section 6).

The arbitrator has got certain statutory powers, including the power to administer oaths to witnesses, power to “state a case” for the opinion of the court etc.

Court Intervention

If a party to an arbitration agreement refuses to go to arbitration, the other party can seek intervention of the court to compel a reference to arbitration (section 20).

Waiving rights under Arbitration clauses

An arbitration agreement may cease to apply if the parties agree on its termination. It may also be terminated as any other agreement, i.e. in accordance with general contract law principles. It may therefore be terminated or made ineffective simply by the conduct of the parties (impliedly or tacitly), partly or wholly. The parties may agree that the arbitration agreement shall not apply to a certain dispute or that it shall cease to apply entirely. A common example is that a plaintiff and a defendant (by not objecting) tacitly agree to submit a dispute to an ordinary court of law although an arbitration clause in a contract between the parties provides for arbitration. In such a case, the arbitration agreement is made ineffective in respect of the dispute at hand by the conduct of the parties.

Furthermore, and which is the subject matter of this article, pursuant to the general principles of law, a party may also *unilaterally* lose its right to rely on an arbitration agreement by *waiving* it, while the other party retains its right pursuant to the arbitration agreement. Having lost this right, a party may be in a difficult position if it intends to take legal action against the counterparty.

In general, if a party to an arbitration agreement commences proceedings in the courts in respect of a matter to which an arbitration agreement is applicable, this is likely to be treated as a breach of the arbitration agreement which will constitute a waiver of the right to arbitrate. Up until the point at which the defendant responds to the issue of proceedings it appears that the waiver is revocable. The potential breach of the agreement by the claimant would be repudiatory. A repudiatory breach requires the defendant to elect to accept the repudiation, and thereby discharge the agreement, or to affirm the agreement and require it to be observed. In the absence of any other correspondence, until the defendant responds to the court proceedings, it will neither yet have accepted the repudiation, thereby discharging the agreement to arbitrate, nor affirmed the agreement to arbitrate.

Therefore, in the absence of a response in the court proceedings from the defendant (or other relevant correspondence), the plaintiff, who had commenced court proceedings, could commence an arbitration. However, once the defendant has responded to the court proceedings, the plaintiff's waiver of its right to arbitrate will become either:

- (a) irrevocably waived, if the defendant takes a step in the proceedings to answer the substantive claim, thereby accepting the repudiation and waiving its own right to arbitrate by discharging the arbitration agreement; or
- (b) redundant, if the defendant makes a successful application under section 9 of the Arbitration Act 1996 to seek a stay of proceedings and have the matter referred to arbitration.

Policy

The foundations of Section 34 of the Arbitration Act, 1940 can be seen in Article 8 UNCITRAL Model Law³ and Article II New York Convention 1954⁴. Both of these operate to create an obligation upon a court in which proceedings have been commenced by a party, in breach of an arbitration agreement, to refer the parties to arbitration, if so requested by the other party, unless the court finds that the agreement is “null and void, inoperative or incapable of being performed” (Article 8 UNCITRAL Model Law and Article II New York Convention 1954). Section 9(4) of the Arbitration Act 1996 picks up this wording and imposes a mandatory stay on proceedings unless the court is satisfied that “the arbitration agreement is null and void, inoperative, or incapable of being performed”. It is therefore clear that the English courts, in line with the Model Law and New York Convention 1954, give great importance to what has been agreed between the parties and will do their utmost to give effect to an agreement to arbitrate.

However, the obligation under the Arbitration Act to order a mandatory stay arises only if the party who has not commenced court proceedings (i.e. the defendant in the court proceedings) wishes the matter to be referred to arbitration. The defendant is free to allow the court proceedings to continue in disregard of the arbitration agreement.

Waiving Right to Arbitrate

The existence of an agreement to arbitrate will not prevent either party from commencing judicial proceedings in court. However, the issue of proceedings in court by one party will usually amount to a waiver of that party’s right to have the same dispute determined by arbitration if the defendant is content to have proceedings in court. This is also supported by section 34 of the Arbitration Act which provides that: “a party to an arbitration agreement against whom legal proceedings are brought (by way of claim or counterclaim) in respect of a matter, which under the agreement is to be referred to arbitration, may... apply to the court in which the proceedings have been brought to stay the proceedings so far as they concern that matter”. However, a party’s right to seek a stay is lost if that party takes a step in the proceedings to answer the substantive claim. To constitute ‘a step in the proceedings depriving a party of its right to arbitrate, the action of this party must be one which impliedly confirms the correctness of the proceedings and the willingness of the [party] to go along with a determination by the Courts of law instead of arbitration. Therefore, conduct which illustrates an intention to abandon the right to arbitration will be construed as taking a step in the proceedings, for example, filing a defense.

Legal Effect of Waiver

When a party waives its right to have a dispute determined by arbitration by initiating proceedings it waives this right in respect of all matters that can be properly brought before the court in relation to that particular dispute. Where the plaintiff commenced proceedings in court in breach of an arbitration agreement, and the defendant subsequently filed a written statement thereby waiving his right. Subsequently, the claimant received permission to amend the particulars of claim so as to include issues which were closely related to the action. The defendant contended that these additional issues should be referred to arbitration and applied for a stay of court proceedings in respect of these issues. The issue was whether the amendments to the particulars of claim formed part of dispute of which the court was already seized, or whether they were discrete matters in

³ https://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/07-86998_Ebook.pdf

⁴ <http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/New-York-Convention-E.pdf>

respect of which section 34 of the Arbitration Act entitled the defendant to apply for a stay of the proceedings, in respect of those issues, and insist that they be arbitrated. The Court held that the additional issues were in respect of the matter raised by the original proceedings in relation to which the defendant had already waived his right to apply for a stay of proceedings under section 34 by taking a number of steps in the proceedings.

Is the Waiver Irrevocable?

The waiver will only be irrevocable if the defendant in the court proceedings accepts the plaintiffs' repudiatory breach of the agreement to arbitrate by taking steps in the proceedings. The Lahore High Court considered an application by a plaintiff to stay its own suit, and the defendant's application, in favour of arbitration. The agreement between the parties contained a clause submitting all disputes to arbitration. When a dispute arose, the claimant sought an interim injunction compelling compliance with the agreement. The application was made in a part claim form rather than making an application for interim measures in support of arbitration. The application was refused. Some months later, the plaintiff served a notice of arbitration. The defendant responded by serving its defense and counterclaim in the court proceedings and challenging in correspondence the plaintiff's right to pursue arbitration. The plaintiff applied to stay its claim and the defendant's counterclaim. The court granted a stay of the counterclaim, and a stay of the suit. Although it was "highly arguable" that the issue of the part claim amounted to a breach of the arbitration agreement, the defendant had not done anything which would amount to an acceptance of that breach, so as to bring the arbitration agreement to an end. However, had the plaintiff's issue of the claim form been accepted by the defendant, this would have amounted to an acceptance of the plaintiff's repudiatory breach, and the plaintiff would therefore have lost the right to resort to arbitration. The Court held that assertions made by the defendant in correspondence prior to the commencement of court proceedings, that there was no contract between the parties, amounted to a repudiation of the agreement to arbitrate. Consequently, the plaintiff's subsequent commencement of proceedings amounted to an acceptance of this repudiatory breach thereby terminating the agreement to arbitrate. Therefore, it can be seen that law focuses less on the concept of waiver as such (and whether it could ever be revocable). Rather, law uses ordinary contract law principles to identify repudiation (repudiatory breach) of the agreement to arbitrate. Only if the repudiation is accepted will the parties both be discharged from further performance of the agreement to arbitrate. Acceptance of a repudiation is by that means irrevocable in its consequence. It can be undone only by both parties agreeing again to arbitrate.

Procedure

The Arbitration Act, 1940, is totally inadequate, in regard to matters of procedure. Of course the arbitrator must observe the essentials of natural justice, failing which, the arbitrator's award can be set aside for misconduct (section 30). But various stages of the process are not dealt with in the Act.

In practice, arbitration is conducted on the basis of (i) the pleadings (statement of claim and statement of defense), whereupon (ii) issues may be framed (if necessary), followed by (iii) affidavits, (iv) oral evidence, and (v) arguments.

The Award

The award must be pronounced within the time limits laid down in the arbitration agreement or (failing such agreement), within 4 months of the commencement of hearing. However, the time limit can be extended by the court in certain circumstances (section 28, and First Schedule).

The award has to be in writing and signed by the arbitrator. If there are more than one arbitrator, the majority view prevails. The Act itself does not provide that the arbitrator shall give reasons for the award. When the award is a non-speaking award, the scope for interference by the court with the award becomes somewhat limited.

Court control over the Award

An award cannot be enforced, by itself. Judgment of the court has to be obtained in terms of the award (section 17).

In the scheme of the Arbitration Act, 1940, the court may:—

- (a) pass judgment in terms of the award (section 17), or
- (b) modify or correct the award (section 15), or
- (c) remit the award (on any matter referred to arbitration), for re-consideration by the arbitrator or umpire (section 16), or
- (d) set aside the award (section 30).

In short, the court may (i) totally accept the award, or (ii) totally reject it, or (iii) adopt the intermediate course of modifying it or remitting it.

Modifying the Award

Modification of award by court

The Court may, by order, modify or correct an award: —

- (a) where it appears to the court that a part of the award is upon a matter not referred to arbitration and can be separated from the other and does not affect the decision on the matter referred, or
- (b) where the award is imperfect in form, or contains an obvious error which can be amended without affecting such decision, or
- (c) where an award contains a clerical mistake or an error arising from an accidental slip or omission (section 15).

Remitting the Award

The court may remit the award (or any matter referred to arbitration):

- (a) here the award has left undetermined certain matters or where it determines matters which are not referred to arbitration, and which cannot be separated from the rest or
- (b) where the award is so indefinite, as to be incapable of execution or
- (c) where an objection to the legality of the award is apparent on the face of it (section 16).

Setting aside the Award

The court can set aside the award, only on one or more of the following grounds, namely:—

- (a) that the arbitrator or umpire has misconducted himself or the proceedings;
- (b) that the award has been made after issue, by the court, of an order superseding the arbitration;
or
- (c) that an award has been improperly procured or is otherwise invalid (section 30).

Misconduct of the Arbitrator (Setting aside the Award)

One of the principal grounds for setting aside the award under the Act of 1940 is the ground of misconduct. Section 30 of the Act expresses it in rather cryptic terms by phrasing it in this manner "the arbitrator has misconducted himself or the proceedings". No exhaustive definition of "misconduct" in this context can be given because misconduct is as large as life itself.

Because of the endless variety of situations in life, treatment of the subject in an exhaustive manner is likely to degenerate into a mere catalogue of instances. It will be more useful if selected instances of misconduct are collected and are classified under a few convenient groups. In arranging the cases under such group, one should bear in mind the fact that misconduct may arise from the arbitrator's conduct of the case, the arbitrator's relations with the parties, the arbitrator's mode of arriving at the decision (in regard to the materials relied on by the arbitrator or the tests applied), and the arbitrator's mode of formulating his award.

Specific Heads of Misconduct

Here are some specific heads of misconduct which recur frequently in practice:—

- proceeding ex parte, without justification (and analogous acts);
- private inquiries by the arbitrator; absence of the arbitrator;
- delegation by the arbitrator, or the arbitrator associating strangers with the arbitration; use of wrong criteria by the arbitrator;
- use of wrong material (by the arbitrator); irregularities in the award;
- Proceeding ex parte and analogous acts are misconduct for an arbitrator: —
 - to hear only one party in the absence of the other; or
 - to fail to give notice of hearing; or
 - to amend the issues behind the back of the parties, thereby causing prejudice.

But it is not misconduct on his part to amend the issue at the time of writing an award, if no prejudice is caused to the parties.

Competent Court

The court competent to exercise various powers under the Arbitration Act, 1940, is the civil court, which would be competent to entertain a civil suit, if a suit were to be filed on the cause of action which forms the basis of the arbitration.

Private Inquiries

An arbitrator must decide on the evidence on record, and not on material obtained otherwise. It is misconduct on his part: —

- to import his personal knowledge into the decision;
- to hold a private conference with a party;
- to hold a private meeting behind the back of the party; to make a private inquiry behind the back of the party;
- to listen to confidential information, adverse to a party, even if the arbitration agreement gives him full latitude, (though the position may be different, if the parties had the opportunity of checking and contradicting the information so proposed to be utilized);
- to communicate with one party, behind the back of the other party.

Absence of Arbitrators

Where there are more than one arbitrator, they must all act together. The award is bad, if one arbitrator is absent. The position may be different if what was done during the absence of one arbitrator is done all over again by all the arbitrators, or if the act performed in the absence of one arbitrator is only ministerial, such as looking into an account book.

Joint Deliberations

All arbitrators must deliberate jointly. However, the parties may waive the irregularity. Delegation by arbitrator, or associating strangers with the arbitration. An arbitrator cannot delegate his functions to another person. It follows, that if the award is given by a person to whom the arbitrator delegates his functions, the award is a nullity. There is, however, an exception to this rule, where the delegation is: –

- (i) with the consent of all the parties, or
- (ii) a purely ministerial act.

An arbitrator cannot associate a third person with the decision-making process. Here again, there is no misconduct, if there was consent of all the parties, to such a course being adopted.

Use of Wrong Criterion by Arbitrator

Sometimes, an arbitrator, while not guilty of procedural lapses (as in the above categories of misconduct), employs a wrong criterion for coming to a conclusion. The award may then be set aside on that ground. Examples are:

- (i) assessment of damages for breach of contract, on the basis of rates prevailing in the black market (instead of the controlled rates);
- (ii) ignoring very material documents, at a stage when the evidence has not yet been closed.

Errors of Law

Questions of difficulty arise, when the arbitrator's decision is challenged, for an erroneous conclusion reached by the arbitrator on matters of law. The position appears to be a bit complex and cannot be stated with absolute certainty. However, broadly speaking, one can state the law on the subject in the form of the following propositions:–

- (a) where a question of law has been specifically referred to the arbitrator for his decision, then his ruling on that question, if bona fide and if not suffering from any other defect, is not open to challenge, merely because it is erroneous;
- (b) if a question of law has not been specifically referred to the arbitrator, his ruling on the point of law (if material to the result) may render the award void.

First as to situation (a) above. Where an arbitrator is called upon to decide the effect of the agreement, he has to really to decide a question of law, (i.e., in interpreting the agreement), and hence his decision on the point is not open to challenge.

In situation (b) above, the award of the arbitrator can be set aside on the ground of an error of law on the face of the award. However, for this purpose, the court cannot look into a document not referred to, in the award.

Generally, the question of error of law can arise only if reasons are given in the award. However, if the very relief granted by the award is illegal, the position is different. Thus, an arbitrator cannot grant specific performance of a contract of service. Nor can a contract for the sale of movable property be enforced specifically, save in exceptional cases.

Decision to be According to Legal Rights

An arbitrator must decide according to legal rights, and not according to his own notions of

fairness. There may, of course, be special situations where a different intention of the parties may be inferred and upheld judicially.

Basis of Interference by Court

The logical basis on which the jurisdiction of the court to interfere for apparent error can be justified, needs first to be explained. The general principle is that an arbitrator is a final judge both of fact and of law. So far as questions of fact are concerned, this jurisdiction has been limited to decisions pronounced after serious procedural lapses, which reveal breach of natural justice or other technical misconduct. So far as errors of law are concerned, the jurisdiction of the court, (though not conferred in so many words by section 30), seems to have been based on the assumption that if the parties have not specifically referred a question for the decision of the arbitrator, then it is implied that the general power of the court to determine legal questions between the parties remains unimpaired. In theory, the jurisdiction can also be supported on the ground that the ultimate arbiters of questions of law should be the courts, so that uniformity is maintained.

Reasoned and Unreasoned Awards

Where the award is an unreasoned one, the court cannot interfere on the ground of an error therein. If the arbitrator chooses to give reasons, then the award can be set aside on the ground of error of law, although, in general, the reasonableness of the reasons themselves cannot be challenged.

Interpretation of Contracts

The same principle is also followed, regarding questions of interpretation of contract as determined in the award. Court can interfere only if the award is a speaking award. It is only if the line of interpretation is set out in the award that the court can interfere.

Breach of Natural Justice

Of course, the arbitrator would be guilty of misconduct, if there is a breach of natural justice. Thus, it is well established that the arbitrator cannot depend on personal knowledge or arrive at a conclusion behind the back of the parties.

But where the arbitrator decides a question of fact on the basis of the evidence and on the basis of answers given by the parties in response to queries from the arbitrator, the award cannot be said to be based on personal knowledge and cannot be set aside on that ground.

Arbitrator's award may be set aside, if it awards charges for extra work, escalation charges and damages claimed by the construction contractor without any supporting material.

The preceding Arbitration Act of 1940 that governs domestic arbitration in Pakistan has several deficiencies. Under the Act, the parties are relatively free to adopt procedures of their choice with little oversight. With no national arbitral institutions, there are no arbitral rules, except for some formulated by courts within the framework of the Act.

There are flaws in Arbitration Act 1940, namely: No interim power in the arbitrator, too many grounds for judicial intervention at all stages (pre-arbitral, during arbitration & post award), as a result it defeats the whole object of speedy and cost effective dispute resolution. A new Arbitration Act should be passed to implement the UNCITRAL Model Law on International Commercial Arbitration (the Model Law) into Pakistan. This will constitute a further step forward

in the efforts of the Government of Pakistan to build a framework for investor-friendly Dispute Resolution. Some landmark judgments on the Arbitration Act are worth reading.⁵

Pakistan Enacts a Statute to Implement the ICSID Convention

The Islamic Republic of Pakistan is not foreign to defending investment claims. In order to restore investors' confidence in its country, the Pakistani government enacted on April 28, 2011 a law to secure foreign investment. The International Investment Disputes Act (the "Act") had been qualified by the Pakistani president, Mr. Asif Ali Zardari, as "a giant leap forward" to create confidence amongst foreign investors.

The Act is Pakistan's answer to the Supreme Court of Pakistan's 2002 decision in the SGS v. Pakistan proceedings that the ICSID Convention, although ratified by Pakistan, having not been incorporated into the laws of Pakistan by implementing legislation, the domestic courts had no power to enforce the provisions of the Convention while ignoring the existing national statutes relating to arbitration. This case saw parallel arbitration proceedings in Pakistan and before ICSID, and the Supreme Court upheld the lower courts' decision not to stay the arbitration proceedings under the Pakistani Arbitration Act following the commencement of the ICSID arbitration.

Pakistan is a signatory to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 ("Convention") and after a long time the Convention has been made part of the domestic laws of Pakistan whereby foreign arbitral agreements and awards are now, enforceable without any questions asked except for rejecting the same on the grounds set forth in the Convention.

As per the Foreign Awards Act, a party to a foreign arbitration agreement against whom legal proceedings have been brought in respect of a matter which is covered by the arbitration agreement may, upon notice to the other party to the proceedings, apply to the court in which the proceedings have been brought to stay the proceedings in so far as they concern that matter. On such application being made, the court shall refer the parties to arbitration as per the foreign arbitration agreement unless the court finds that the arbitration agreement was null and void, inoperative or incapable of being performed in accordance with the Convention.

The above provision is a mammoth change of law in Pakistan whereby, prior to the Foreign Awards Act, the court before which legal proceedings were brought against a party to an (foreign) arbitration agreement had absolute discretion whether to stay the proceedings before it or refuse it in toto. All the grounds like forum non conveniens (most commonly used ground for refusal to stay legal proceedings in foreign arbitration agreements by domestic courts) have been set at naught and there does not appear to remain any domestic impediment in Pakistan to the enforcement of foreign arbitration agreements. In this regard, a very compelling principle has been upheld in a judgment vide a separate note recorded by Mr. Justice Ajmal Mian (the "Note"), which states that:

"I may observe that while dealing with an application under section 34 of the Arbitration Act in relation to a foreign arbitration clause like the one at issue, the Court's approach should be dynamic and it should bear in mind that unless there are some compelling reasons, such an arbitration clause should be honoured as generally the other party to such an

⁵ 2010 MLD 561, PLD 2010 KARACHI 390, 2010 YLR 611, 2010 CLC 258, 2010 MLD 421, 2010 CLC 1018, PLD 2010 LAHORE 443, 2011 SCMR 243, 2011 SCMR 1361, PLD 2011 ISLAMABAD 43, 2011 YLR 2413, 2011 MLD 502, 2011 CLC 863, PLD 2011 LAHORE 458, 2011 CLC 841, 2012 SCMR 1606, 2012 SCMR 402, PLD 2012 ISLAMABAD 21, 2012 CLD 796, PLD 2012 KARACHI 114, 2012 MLD 95, 2012 CLD 1380, PLD 2013 SUPREME COURT 641, 2013 MLD 1083, 2013 CLC 108, 2013 CLC 767, PLD 2013 KARACHI 254, 2013 CLC 1028, 2013 CLC 820, 2013 CLC 1518, 2014 CLD 824 SUPREME COURT, PLD 2014 SUPREME COURT 494, 2014 SCMR 1268, 2014 CLC 238, 2014 MLD 1100, PLD 2014 LAHORE 179, 2014 MLD 1795, 2014 CLC 1519.

arbitration clause is a foreign party. With the development and growth of international trade and commerce and due to modernization of communication/transport systems in the world, the contracts containing such an arbitration clause are very common nowadays. The bargain that follows from the sanctity which the Court attaches to contracts must be applied with more vigour to a contract containing a foreign arbitration clause. We should not overlook the fact that any breach of a term of such a contract to which a foreign company or person is a party, will tarnish the image of Pakistan in the comity of nations. A ground which could be a contemplation of party at the time of entering into the contract as a prudent man of business cannot furnish basis for refusal to stay the suit under section 34 of the Act. So the ground like, that it would be difficult to carry the voluminous evidence or numerous witnesses to a foreign country for arbitration proceedings or that it would be too expensive or that the subject-matter of the contract is in Pakistan or that the breach of the contract has taken place in Pakistan in my view cannot be a sound ground for refusal to stay a suit filed in Pakistan in breach of a foreign arbitration clause contained in contract of the nature referred to hereinabove. In order to deprive a foreign party to have arbitration in a foreign country in the manner provided for in the contract, the Court should come to the conclusion that the enforcement of such an arbitration clause would be unconscionable or would amount to forcing the Plaintiff to honour a different contract, which was not in contemplation of the parties and which could not have been in their contemplation as a prudent man of business." (emphasis added)

In another judgment by reference to the note, it was maintained that:

"...a party having entered into an agreement after having full knowledge of its consequences cannot be allowed to defeat the arbitration clause."

Moreover, while observing the principal laid down in the Note, a view was maintained in another judgment, which is

"...arguments regarding public policy and expensiveness of the arbitration taking place in London as ground for stay of suit are no longer tenable in light of the observations of the Supreme Court of Pakistan in the Hitachi case...There is no doubt some expense is involved in litigation but that is true anywhere in the world. In the present suit, the plaintiff has filed a suit for more than USD 1 m, and it is reasonable to expect to incur some expenses in the event of a dispute. Further, there is no restriction imposed by the State Bank of Pakistan on remittance of foreign exchange for any lawful purpose at any time and with the availability of modern devices such as teleconferencing facilities, evidence may be recorded easily anywhere in the World under the supervision of the arbitral body." Accordingly, the suit was stayed in this case.

Similarly, the foreign arbitral awards as per the Foreign Awards Act will be recognized and enforced in the same manner as a judgment or order of a court in Pakistan. The recognition and enforcement of foreign arbitral awards, now, cannot be refused except in accordance with the Convention.

While closing the subject of foreign arbitration agreements and awards, suffice here to state that the arbitration agreements and awards between Pakistani parties and foreign parties domiciled or incorporated in non- contracting states may be able to take advantage of the Arbitration Act and seek recognition and enforcement thereunder as if the same was a domestic arbitration agreement and award. In the Annex to this article, we provide a list of the case law concerning the Foreign Awards Act, which pertains only to the year.

However, the SGS v. Pakistan case had highlighted the need for national legislation in order to give full force and effect to the ICSID Convention. The enactment of this legislation, however, was not exempt of obstacles. The legislation was first promulgated by presidential ordinance in November 2006, but lapsed. Under the Constitution of Pakistan, presidential ordinances have a limited life of four months unless earlier repealed or enacted into a statute. A new presidential ordinance was promulgated in March 2007 followed by another in July 2007, but the state of

emergency was thereafter declared in Pakistan, which gave it permanent life. The permanent life however was cut short by a judgment of the Supreme Court which declared the emergency as illegal. This resulted in promulgation of another presidential ordinance in November 2009 followed by another in April 2010. The current Act is the result of a government sponsored bill introduced in Parliament in 2010.

The purpose of the Act is to implement the International Convention on the Settlement of Investment Disputes between States and Nationals of other States, with an aim to bringing transparency in the settlement of investment disputes. The Act attaches the ICSID Convention as a schedule.

Under the ICSID Convention, awards are insulated from review by national courts at the recognition and enforcement stage, but no such guarantees are offered when specific assets are targeted in execution of the award. Article 54(1) of the ICSID Convention provides that each contracting state shall “recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State”. Article 54(3) of the ICSID Convention provides that the execution of the award is governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought, and Article 55 emphasizes that “nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any State from execution”.

The Act leaves a great discretion to the Pakistan courts for the enforcement of ICSID awards. Article 4 provides that an award registered in Pakistan must “be of the same force and effect for the purposes of execution as if it had been a judgment of the High Court” and, if the award “relates to pecuniary obligations”, “proceedings may be taken on the award” and “the High Court shall have the same control over the execution of the award, as if the award had been a judgment of the High Court”. High Courts in Pakistan are generally courts of appeal, which are to be found in each province. The purpose of giving jurisdiction to a High Court is to ensure the quality of judicial expertise. With respect to its binding effect on the government itself, the Act provides that the principles set forth in Article 4 bind the government but “not so as to make an award enforceable against the Government in a manner in which a judgment would not be enforceable against the Government”. Moreover, the Act provides that these principles do not apply if the government is not a party to the award (Article 5).

In effect, therefore, the Act does not provide for a foolproof execution of ICSID awards in Pakistan. Execution of awards is subject to the review of the High Court and, if the award has been rendered against the Government, it can only be enforced if it were enforceable in the same circumstances if it were a judgment. In practice, the High Court will have the power to attach and sell assets, as long as such assets are not related to defense and national security. High Court decisions can be appealed. However, in execution matters, the grounds of appeal are very limited. The Act, however, removes a lacuna and one can hope that it will render the enforcement of ICSID awards in Pakistan easier. It has also the advantage of providing an effective reference for the execution of awards in Pakistan. In contrast, in many a state, the execution of ICSID awards is left to the civil procedure provisions applicable to the execution of judgments, which can lead to confusion and unsatisfactory decisions.

In addition to this Act, Pakistan has also prepared the enactment of two statutes relating to international arbitration. First, a law to enforce the New York Convention has been passed by the Parliament National Ass, a new Arbitration Act, based on the UNCITRAL Model Law, is pending before the National Assembly.

A New Legislation Proposed

The Arbitration Bill, 2009 (the Bill) was introduced into the Pakistan National Assembly on 24

April 2009, which still has not been passed⁶. The preceding Arbitration Act of 1940 that governs domestic arbitration in Pakistan has several deficiencies. Under the Act, the parties are relatively free to adopt procedures of their choice with little oversight. With no national arbitral institutions, there are no arbitral rules, except for some formulated by courts within the framework of the Act. In its preamble the Bill aspires to implement the UNCITRAL Model Law on International Commercial Arbitration (the Model Law) into Pakistan. The Bill, once promulgated into law, will constitute a further step forward in the efforts of the Government of Pakistan to build a framework for investor-friendly Dispute Resolution.

Although it purports to implement the Model law, the Bill is in fact a modified version of the Indian Arbitration Act 1996 (the Indian Act). Although it is still very much in draft form its initiation is a positive sign for international commercial arbitration in Pakistan. It is hoped that the Bill is passed through the Parliament shortly and that note is taken of the changes proposed in this article. This author's concerns, in particular, arise from the problems faced in India in respect of the implementation of the Indian Act.

The Bill is intended to supersede and build on the Recognition and Enforcement (Arbitration Agreements and Foreign Arbitral Awards) Ordinance, 2007 (REAO) which implemented the United Nation's Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (NY Convention) into Pakistani law⁷. It is a holistic piece of legislation that covers the use of arbitration, conciliation and alternative dispute resolution within and outside Pakistan, including re-promulgating a domestic law implementing the International Convention on the Settlement of Investment Disputes (ICSID) between States and Nationals of Other States (the Washington Convention)⁸. The Bill also proposes to establish an Arbitration and Conciliation Centre in Pakistan.

This article analyzes the pros and cons of the Bill for international arbitration in Pakistan and also seek to highlight some of the challenges for international investors that it may pose.

A Good Move

The Bill builds on the progress made in the REAO in providing for NY Convention-compliant provisions and reproduces the REAO in its Part III. Consequently, the REAO's pro-enforcement provisions regarding arbitration agreements and awards are preserved by the Bill.

The REAO's failure in laying out a criterion for when an award can be characterized as domestic or foreign has been addressed in the Bill. The Bill moves towards a territorial approach on this issue and implements nearly identical grounds for challenging both types of awards⁹.

⁶ <https://international-arbitration-attorney.com/wp-content/uploads/2016/10/Pakistan-Arbitration-Law.pdf>

⁷ Task Force on National rules of procedure for recognition and enforcement of foreign arbitral awards pursuant to the New York Convention of 1958 which was Co-chaired by Geoffroy Lyonnet (France) and David P. Roney (Canada), In view of the 50th anniversary of the New York Convention in 2008, the Commission on Arbitration has created this task force.

The objectives of the task force are:

- to identify the countries to be covered by the work of the task force;
- to determine, for each country so identified, the national rules of procedure for recognition and enforcement of foreign arbitral awards, with reference to articles III and IV of the New York Convention;
- to compile all such national rules of procedure for recognition and enforcement of foreign arbitral awards on a country-by-country basis in one user-friendly document;
- to draft an introduction to and a summary of such compilation.

The Task Force is composed of over 150 registered members from 70 different countries.

⁸ Pakistan originally implemented the Washington Convention into its domestic law by promulgating the Arbitration (International Investment Disputes) Ordinance 2006.

⁹ In respect of foreign awards, section 50 of the Bill states that:

Accordingly, awards rendered within Pakistan are seen as domestic awards capable of being enforced or set-aside (as appropriate) by a Pakistani court while awards rendered outside Pakistan and in a state that is party to the NY Convention are enforceable in accordance with the terms of the NY Convention. Awards rendered in countries that are parties to the Geneva Protocol on Arbitration Clauses of 1923 and the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927¹⁰ continue to be enforceable in Pakistan under the Arbitration (Protocol and Convention) Act 1937 (the APC Act).

It is important to note that, under the REAO, there was a residual risk that awards rendered in a NY Convention country that applied Pakistani substantive law might have been characterized as a domestic award and so be subject to the enforcement provisions of the Pakistan Arbitration Act 1940. This residual risk arose as a result of the reasoning of the Supreme Court of Pakistan in *Hitachi Ltd v Rupali Polyester*,¹¹ where the Supreme Court tacitly affirmed (while commenting that it seemed impractical) the theory of "concurrent jurisdiction" expounded by the Indian Supreme Court in *National Thermal Power Corporation v The Singer Company*¹². Both Singer and Hitachi were concerned with the interpretation of S.9 (b) of the APC Act (the 'savings clause'¹³) which made the substantive law applicable to an award a determining factor¹⁴.

Since both the REAO and the Bill specifically omit the savings clause, a strong argument can be made that the legislature has consciously altered the criteria of character determination away from the choice of substantive law and towards a more territorial approach. This argument has also been used in India where the Indian Arbitration Act 1996 replaced a similar savings clause

"The recognition and enforcement of a foreign arbitral award shall not be refused except in accordance with Article V of the [NY] Convention."

In respect of domestic awards, section 34(2) of the Bill lays down the following grounds for set aside:

"(a) the party making the application furnishes proof that —

(i) a party to the arbitration agreement was under some incapacity, or

(ii) the arbitration agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law for the time being in force; or

(iii) the party making the application was not given proper notice of the appointment of an arbitrator or of the arbitral proceedings or was otherwise unable to present his case; or

(iv) the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration:

Provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the arbitral award which contains decisions on matters not submitted to arbitration may be set aside; or

(v) the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties, unless such agreement was in conflict with a provision of this Part from which the parties cannot derogate, or, failing such agreement, was not in accordance with this Part; or

(b) the Court finds that —

(i) the subject-matter of the dispute is not capable of settlement by arbitration under the law for the time being in force, or

(ii) the arbitral award is in conflict with the public policy of Pakistan.

Explanation. — Without prejudice to the generality of expression public policy it also includes an arbitral award the making of which was induced or affected by fraud, misrepresentation or corruption and in violation of confidentiality."

¹⁰ 92 League of Nations Treaty Ser. 2302

¹¹ *Hitachi Ltd v Rupali Polyester* (1998 SCMR 1618).

¹² *Hitachi Ltd v Rupali Polyester* (1998 SCMR 1618).

¹³ APC Act s.9 (b) is a Savings clause that states: "Nothing in this Act shall.... (b) apply to any award made on an arbitration agreement governed by the law of Pakistan."

¹⁴ See these cases on Pakistan Law Site.

contained in the Indian Foreign Awards (Recognition and Enforcement) Act 1961 (FARE). Accordingly, it is likely that all awards rendered outside Pakistan will be recognised and enforced pursuant to, as applicable, the NY Convention or the Geneva Convention (^{15, 16}).

International commercial arbitrations¹⁷ taking place within Pakistan are also covered by the Bill. The Bill provides certain enabling provisions in respect of such arbitrations and gives supervisory powers over such arbitrations to Pakistani courts largely in accordance with the UNCITRAL Model law. Such provisions and powers include, amongst other things, giving the parties the power to obtain interim measures before or during arbitral proceedings¹⁸; the Chief Justice of Pakistan having powers to appoint arbitrators¹⁹; supervisory powers of Pakistani courts over the appointment and challenge of arbitrators²⁰; giving arbitral tribunals the power to rule on their own jurisdiction²¹; rules governing the conduct of arbitrations²²; court assistance in taking evidence²³; powers to arbitrators to decide *a case ex aequo et bono or as amiable compositeur* if authorized by the parties²⁴; and to apply the substantive law of any country chosen by the parties²⁵.

Problems Likely to Arise

The Bill copies, without substantive change, the Indian Act. Accordingly, there is a danger that it will import the same problems that the international arbitration community has faced in India following a number of decisions of the Indian Supreme Court. The Indian courts have, as a result, been heavily criticized for their extra-territorial interpretation of the Indian Act.

Though Pakistani courts have shown a willingness to independently evaluate Indian precedents that are cited before them²⁶, Indian judgments, along with judgments from other common law countries, still have persuasive value in Pakistani proceedings. Accordingly, it would be useful if the legislators in Pakistan would review the consequences of some of the Indian cases and try to incorporate (into the Act when passed) potential solutions for dealing with the problems faced

¹⁵ Compare the APC Act s.9(b) in fn. 8; s.9(b) of India's FARE was a savings clause identical to s. 9(b) of the Pakistan APC Act: "Nothing in this Act shall.... (b) apply to any award made on an arbitration agreement governed by the law of India."

¹⁶ In *Centrotrade Minerals and Metals Inc v. Hindustan Copper Ltd*, 2006(11) SCC 245, the Supreme Court of India held that an award from international commercial arbitration conducted in any NY Convention country would be a foreign award irrespective of the proper law governing the arbitration agreement. This case is also important as the Indian Supreme Court held that the phrase "or under the law of which that award was made" used in Article V (1)(e) of the NY Convention refers to the law of the country in which the arbitration had its seat rather than the country whose law governs the substantive contract. Additionally, *Vikramjit Sen J. in Bharti Televentures Ltd v DSS Enterprises Private Ltd CS (OS) No1769/2003* decided on August 17 2005, 2001 (3) RAJ 433 (Del) has stated in para [19] that "The deliberate decision not to incorporate s.9 (b) of FARE assumes great significances, and leads inexorably to the conclusion that the factum of Indian laws in the 1996 Arbitration regime, especially Part II thereof, venue/territoriality is all important."

¹⁸ Section 9 of the Bill.

¹⁹ Section 11 of the Bill

²⁰ Sections 11 to 15 of the Bill

²¹ Chapter IV of Part II of the Bill

²² Chapter V of Part II of the Bill

²³ Section 27 of the Bill

²⁴ Section 28 of the Bill

²⁵ Section 28 of the Bill

²⁶ For a good example of this, see *Hitachi Ltd v Rupali Polyester* (1998 SCMR 1618) where the Pakistani Supreme Court refused to follow the Indian Supreme Court's theory of concurrent jurisdiction set out in *National Thermal Power Corporation v The Singer Company*

under the Indian Act.

If Only

Confusingly, Part II of the Pakistani Bill is a reproduction (with minor modifications) of Part I of the Indian Act. Both these Parts include provisions that apply to arbitrations taking place inside the respective country to which they apply (e.g. the domestic courts' powers to order interim measures, to appoint arbitrators, set aside, etc.).

The principle problem with the Bill arises in Section 2(2) which is substantially identical to Section 2(2) of the Indian Act. Section 2(2) of the Bill states that:

"This Part and Part IV shall apply where the place of arbitration or conciliation is in Pakistan"

Section 2(2) of the Indian Act states that:

"This Part shall apply where the place of arbitration is in India"

In *Bhatia International v Bulk Trading S.A. and Another*²⁷ and, more recently, *Venture Global Engineering v Satyam Computer Services*²⁸, the Indian Supreme Court has interpreted the wording of Section 2(2) of the Indian Act to mean that Part I of the Indian Act would apply to all arbitrations whether conducted within or outside India.

The Indian Supreme Court's reasoning has been predicated largely on the fact that the word "only" is absent after the word "shall" in the Section.²⁹ In interpreting the consequences of this omission, the Indian Supreme Court reasoned in *Bhatia* that the Section mandatorily applied Part I of the Indian Act to arbitrations taking place within India, but did not prohibit Part I from applying to arbitrations taking place outside India. Recognizing that, as a general principle of Indian law, the jurisdiction of a court needs to be specifically excluded either by statute or by contract, the Indian Supreme Court reasoned that Part I would, therefore, apply to arbitrations conducted outside India unless the parties specifically agreed otherwise.

Consequently, the Indian Supreme Court in *Bhatia* allowed a party to obtain interim measures from an Indian court despite the arbitration taking place outside India and, more worryingly, in *Venture Global* it held that Indian courts can set aside foreign awards on the same grounds (e.g., patent illegality) as are applicable to domestic awards.

To avoid Pakistani courts reaching a similar conclusion, it would be sensible to insert the word "only" into section 2(2) of the Bill, after the word "shall".

Public Policy:

Another problem arising out of the Indian Act comes from the reasoning of the Indian Supreme Court in *ONGC v Saw Pipes Ltd*³⁰ where an award rendered in India was not enforced on the grounds that it failed to correctly apply Indian substantive law.³¹ The Indian Supreme Court

²⁷ *Bhatia International v Bulk Trading S.A. and Another* (2002) 4 SCC 105)

²⁸ *Venture Global Engineering v Satyam Computer Services* (2008(1) ARBLR1 37 (SC))

²⁹ *Bhatia International v Bulk Trading S.A. and Another*, at paragraphs [21] and [27] the Indian Supreme Court made reference to the fact that Article 1(2) of UNCITRAL Model Law, on which Section 2(2) of the Indian Act is based, uses the word "only" and that this word was specifically omitted by the Indian legislature in drafting that Section.

³⁰ *ONGC v Saw Pipes Ltd* 2003 SOL Case No175

³¹ In *ONGC v Saw Pipes Ltd* 2003 SOL Case No175, the arbitrators had determined that a claim for liquidated damages under Indian law required the proof of some loss contrary to Sections 73 and 74 of the Indian Contract Act. The Indian Supreme Court reasoned that since the arbitrators had failed to consider these sections, they had misapplied Indian substantive law. The court felt that the phrase public policy of India meant that an award could be set aside if it contained an illegality. This is a very wide interpretation of that phrase and has been criticized heavily in international commercial arbitration circles

predicated its decision on Section 34 of the Indian Act, which allows a court to refuse to enforce an award if such an award is contrary to the public policy of India. Section 34 of the Indian Act has been reproduced with slight modification as Section 34 of the Bill. Accordingly, the Pakistani courts could follow a similar line of reasoning in interpreting this phrase in the

Pakistani Context:

Pakistani courts have, in the past, largely tried to give a restrictive construction to the term "public policy"³². Accordingly, the Pakistani courts will hopefully not try to use the vagueness of the term so as to imply a generalized supervisory interest in the application of Pakistani substantive law in arbitration proceedings involving foreign parties. Such a result would not be in line with the spirit of the NY Convention. (29)

The Bill does attempt to clarify the construction of the term public policy as applicable to arbitrations taking place within Pakistan, in the Explanation to sub-Section 34(2) of the Bill where public policy is to include: "an arbitral award the making of which was induced or affected by fraud, misrepresentation or corruption and in violation of confidentiality." These are broader grounds than that provided in the Explanation to Section 34(2) of the Indian Act. It is suggested that the inclusion of misrepresentation and violation of confidentiality in the Explanation are capable of immense interpretation and should be deleted, or more precisely framed.

Conclusion:

The legal system in Pakistan is inefficient/inadequate which has failed to give speedy remedy to litigants and it had not been delivering at all. Therefore, the author is a great proponent of alternate dispute resolution "ADR" mechanisms, including arbitration and its benefits, for resolution of disputes, however, it is suggested to bring a new Arbitration Act which would not be as antiquated as the existing Arbitration Act of 1940. The prevalent Arbitration law was a failed phenomenon because, once the arbitrators give an award the parties have to go to court again to have it implemented by making it as rule of the court or objected/appealed, which gives rise to another round of litigation. The four major benefits of Arbitration, namely: time efficiency, cost efficiency, confidentiality and integrity have not in fact materialized yet. Another problem with arbitration was that courts were very miserly in giving away their jurisdiction and were acting as adversaries in this respect.

The process for domestic arbitration is very much based on the more recognized common law jurisdiction albeit certainly needing modernity in the codified Arbitration Act to promote investor confidence in Pakistani legal system but the gap is being filled in by the superior courts through their precedents which are binding. International arbitration framework, Foreign Awards Act, is

³² In *Manzoor Hussain v Wali Muhammad*, PLD 1965 SC 425, the Pakistan Supreme Court in deciding whether a contract was contrary to public policy under section 23 of the Pakistan Contract Act 1872 stated that this section has to be construed strictly and that the court should not invent new categories or heads of public policy. Cf. *Ali Muhammad v Bashir Ahmad*, 1991 SCMR 1928 where the Pakistan Supreme Court affirmed the setting aside of an arbitration award because that award purported to decide a criminal matter and the arbitrability of such a matter would be against public policy. Also see *The Hub Power Company Ltd v Wapda* (PLD 2000 Supreme Court 841), where the Supreme Court of Pakistan refused to enforce an arbitral agreement between Hubco (a subsidiary of Britain's National Power set up with World Bank support) and the Pakistani government on the grounds that the underlying agreement had been procured as a result of fraud and corruption. Also see *Grosvenor Casino Limited v Abdul Malik Badruddin* (PLD 1998 Karachi 104) where Bhagwandas J refused to execute a judgment of the United Kingdom High Court of Justice Queen's Bench Division on the grounds that the judgment decided a matter in respect of gambling debts and that such contracts for wagering were void under Pakistani law and were also repugnant to principles of Shariah; and as such were contrary to the public policy of Pakistan. 2014 CLD KARACHI 337, PLD 2014 KARACHI 349, PLD 2014 KARACHI 427

already in line with the most commonly followed process.

In the proposed Arbitration Bill by clearly preventing the application of Part II of the Bill to arbitrations taking place outside of Pakistan, the Pakistani legislature is going to import the same problems faced by the international arbitral community in India.

The application of Part I of the Indian Act to arbitrations taking place outside India has resulted not only in interim measures being ordered by Indian courts in respect of such arbitrations (30) but has also led to the Indian Supreme Court ruling that an award rendered outside India is capable of being set aside by Indian courts (31).

Additionally, the term "public policy" is a precarious and unpredictable term and the uncertainty that results from it is only further exacerbated by the definition that the Bill provides in its Explanation to Section 34(2). These are problems that Pakistan should seek to avoid in introducing its new legislation on international commercial arbitration. It is hoped that these deficiencies in the Bill can be cured before the Bill becomes an Act of the Parliament.

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