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Setting Aside of Arbitral Awards on Public Policy Grounds: Evolving Jurisprudence Amidst the Conflict between Commercial and Sovereign Interests



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Setting Aside of Arbitral Award on Public Policy Grounds: Evolving Jurisprudence Amidst the Conflict between Commercial and Sovereign Interests

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Introduction

The Division Bench of the High Court of Delhi (High Court) has recently delivered a landmark decision in *Union of India v. Reliance Industries Ltd.*¹, which deals with the extraction of natural gas from the Krishna-Godavari basin situated on the coast of Andhra Pradesh. The High Court delves into the legality of the gas extraction efforts of Reliance given the allegations of gas migration from an adjacent block owned by the Oil and Natural Gas Corporation (ONGC) and the resulting unjust enrichment.

The judgment, at its core, deals with a challenge to an arbitral award and the fundamental principles of contractual interpretation juxtaposed with the doctrines of public trust² and unjust enrichment.³ In this article, we examine the facts of the case and

the findings of the High Court.

Background of the case

The dispute arose out of a Product Sharing Contract (PSC) dated 12-4-2000 entered between the Union of India (UOI), Reliance Industries Limited (RIL), and one Niko Limited (Niko). The PSC pertained to the extraction of hydrocarbons from Block KG-DWN-98/3, an offshore block in the Krishna-Godavari basin.

In terms of the PSC, RIL, being the lead contractor, held a participating interest of 90% while Niko held the remaining 10%. The disputes in the matter arose when ONGC, the contractor of an adjacent gas blocks (Block KG-OS-IG and Block KG-DWN-98/2), alleged that RIL unjustly enriched itself by extracting and commercially exploiting gas that had migrated from ONGC's block to RIL's block.

The claims of ONGC led to multiple rounds of litigation and arbitration proceedings. At first, ONGC approached the High Court with a writ petition⁴ claiming that since the gas reservoirs of RIL and ONGC were interconnected, RIL had been "unjustly enriched" by extracting and selling the gas that had migrated from the ONGC block.

To ascertain the extent to which the two gas blocks (i.e. the RIL gas block and the ONGC gas block) were connected, an independent study by experts was commissioned by the Directorate General of Hydrocarbons (DGH). The final report prepared by experts in 2015 (2015 Expert Report) confirmed the connectivity and continuity of the gas reservoirs across the blocks operated by RIL and ONGC.

On account of the findings rendered in the 2015 Expert Report and another report prepared by a Single-Member Committee of Justice (Retd.), A.P. Shah the UOI raised a demand notice for USD 1.5 billion, seeking the disgorgement of profits on the ground that RIL had been unjustly enriched by extracting hydrocarbons that had migrated from ONGC's adjacent block.

The issuance of the demand notice by the UOI led RIL to invoke the arbitration clause contained in Article 33 of the PSC.

The arbitration proceedings

Pursuant to RIL's invocation of the arbitration clause, an Arbitral Tribunal comprising of three arbitrators (Tribunal) was constituted, and arbitration proceedings were commenced under the Arbitration and Conciliation Act, 1996⁵ (Arbitration Act).

RIL's contention before the Tribunal was that the PSC enabled RIL to extract and sell any and all such hydrocarbons that were extracted from the contractually stipulated area, irrespective of the source of such hydrocarbons. Given this position, RIL claimed that

there was no legal basis for UOI to make out a case of purported unjust enrichment.

The UOI, on the other hand, contended that RIL had extracted natural resources which otherwise belonged to ONGC without any express authorisation. Thus, UOI argued that RIL violated the principles of equity, good faith, and public policy.

Upon hearing the parties, the Tribunal, in a 2:1 majority award, ruled in favour of RIL, holding that:

- (i) Although the 2015 Expert Report was highly unreliable, grossly inaccurate, and exaggerated, there was sufficient evidence to show that there existed some degree of connectivity.
- (ii) The PSC did not expressly prohibit/qualify the extraction of gas within the contract area.
- (iii) RIL, as the contractor, was permitted to extract all available gas within the contract area for the benefit of UOI, regardless of the source of the gas.

In view of the above, the majority of the Tribunal opined that RIL was not unjustly enriched.

The third arbitrator, in a “dissenting” award, sided with UOI’s claims. As per the third arbitrator, RIL had unlawfully benefited from the extraction of natural resources without appropriate permissions from the government authorities.

Aggrieved by the majority view of the Tribunal, the UOI challenged the arbitral award before the High Court under Section 34⁶ of the Arbitration Act. The Single Judge dismissed the challenge finding that the arbitral award was not perverse and that it fell within the scope of a “plausible view”.

Undeterred, the UOI approached the High Court in an appeal under Section 37⁷ of the Arbitration Act.

Issues of legal significance

The instant case raises important issues that emerge from the intersection of laws pertaining to contracts, arbitration, natural resources, and the overall public policy of India. These issues include:

- (i) Whether matters pertaining to the State’s sovereign control over natural resources and claims arising thereof are arbitrable?
- (ii) Would the commercial terms agreed upon amongst the parties be treated paramount on the grounds of contractual autonomy, even in matters pertaining to the exploitation of natural resources that otherwise have public interest considerations?

- (iii) Whether the public trust doctrine, which holds that natural resources cannot be arbitrarily alienated, have any role to play in the adjudication of commercial disputes?
- (iv) Can an Arbitral Tribunal determine issues pertaining to the State's failure to effectively regulate the exploitation of natural resources (in this case, gas from reservoirs)?
- (v) Whether the arbitration in the instant case fell within the scope of an "International Commercial Arbitration" in terms of Section 2(1)(f)⁸ of the Arbitration Act?

The Division Bench of the High Court, in its judgment, undertook a rigorous academic review of the applicable principles of law to navigate through the above issues.

High Court's reasoning and analysis

Scope of Section 37 under the Arbitration Act, patent illegality, and public policy of India

The High Court reiterated the long-standing legal position that a court acting under Section 37 of the Arbitration Act does not actually sit over an appeal over the award passed by the arbitrator(s). As per the High Court, a court acting under Section 37 of the Arbitration Act is guided by the same statutory limitations as prescribed under Section 34 of the Arbitration Act. Speaking on the limited leg-room for interfering with an arbitral award in proceedings under Section 37 of the Arbitration Act, the High Court cited a catena of decisions.⁹ Based on these decisions,¹⁰ the High Court observed that a court under Section 37 of the Arbitration Act cannot reappreciate and/or re-examine the evidence led by the parties before the Arbitral Tribunal.

After setting out the limited confines under which a court acting under Section 37 of the Arbitration Act could act, the High Court dealt with the expression patent illegality and what it meant in Indian arbitration jurisprudence. The High Court, in this regard, referred to multiple decisions.¹¹ More specifically, the High Court referred to the decision in *PSA Sical Terminals (P) Ltd. v. V.O. Chidambranar Port Trust*¹² and reaffirmed that an arbitral award shall be set aside if it fell in teeth of the public policy of India and/or the most basic notions of morality or justice.

Applying these grounds, the High Court linked public policy of India to the doctrine of public trust and Article 297 of the Constitution of India. Article 297 of the Constitution of India¹³ provides that all lands, minerals, and other valuable natural resources including petroleum and natural gas within the Indian territory vest in the Union of India. In this regard, the High Court cited the landmark decision in *M.C. Mehta v. Kamal Nath*¹⁴ to emphasise that natural resources such as air, water bodies, and forests are of great importance to the people as a whole. Thus, the State holds these natural resources in trust for the public at large. In other words, the sovereign right of the State over environmental resources are not "proprietary" but "fiduciary".

Notably, the High Court also relied on the decision in *Reliance Natural Resources Ltd. v. Reliance Industries Ltd.*¹⁵ to emphasise that with respect to the natural resources extracted and exploited in India, the Union would not allow a contractor or any other agency to extract resources without appropriate express permission. Such permission/authorisation may only be granted pursuant to a “rationally framed policy”.

Domestic or international commercial arbitration?

The Tribunal, while dealing with the issue of whether or not the present case constituted an international commercial arbitration, opined that RIL was the sole claimant in the arbitration. As such, Niko, the foreign entity having a 10% participating interest in terms of the PSC, was not a formal party to the arbitration proceedings. To further support its understanding, the Tribunal placed reliance on the terms of the PSC under which RIL was the only operator entitled to deal with UOI. Thus, the Tribunal ruled that the instant case concerned domestic arbitration.

Despite the Tribunal’s ruling, the Single Judge while dealing with the petition under Section 34 of the Arbitration Act, relied on the decision in *Reliance Industries Ltd. v. Union of India*¹⁶ to hold that the instant case pertained to an International Commercial Arbitration.

The Division Bench of the High Court disagreed with the findings of the Single Judge and opined that the reliance on the decision in *Reliance Industries Ltd. v. Union of India*¹⁷ was misplaced inasmuch as the decision in that case was rendered at the pre-adjudication stage under Section 11(6)¹⁸ of the Arbitration Act.

In the present case, RIL never challenged the finding of the Tribunal holding that RIL was the sole claimant in the arbitration. Hence, as per the Division Bench of the High Court, the Single Judge was bound to follow the findings of the Tribunal which remained unchallenged. To support its findings, the Division Bench of the High Court relied on the decision in *L&T-Scomi v. MMRDA*¹⁹ to hold that once both companies were found to be incorporated in India, the arbitration would not be an International Commercial Arbitration under Section 2(1)(f) of the Arbitration Act. Accordingly, the Division Bench of the High Court ruled that the present case constituted domestic arbitration and not international commercial arbitration under the Arbitration Act.

Central Government’s regulatory oversight and RIL’s disclosure obligations

In terms of Rule 28 of the Petroleum and Natural Gas Rules, 1959 (PNG Rules), the High Court observed that the Central Government was empowered to regulate the operations of a lessee/licensee in a field or area where the Government had reasons to believe that the deposits of petroleum extend beyond the boundary of the lease or licensed area. Similarly, the regulatory oversight of the State also stood affirmed under Rule 30 of the PNG Rules which requires lessees to notify the Central Government before suspending, abandoning, or resuming drilling and extraction activities.

In addition to the above, as per the terms contained in the PSC, RIL was required to keep the UOI informed of all developments taking place and divulge all data pertaining to the contract area during the course of the extraction operations.

As regards RIL's obligation to obtain prior consent/approvals from the UOI, the High Court adopted a textualist approach for interpreting the provisions of the PSC. The High Court held that the mere silence²⁰ of UOI and/or the other authorities concerned on the issue of migrated gas could not be considered as an approval to continue with the extraction.

The High Court found that RIL had prior knowledge of the connectivity of the gas reservoirs located across the ONGC block and the RIL block based on technical reports such as the 2003 DeGloyer & MacNaughton Report (D&M Report). However, the High Court noted that RIL's stance on the issue of connectivity was prevaricating as RIL categorically denied the existence of any connectivity in its counter to ONGC's writ petition in WP(C) No. 3054 of 2014²¹.

In view of the above, and upon reviewing the findings of the Tribunal in the majority award, the High Court opined that RIL had failed to disclose material particulars pertaining to its gas extraction operations and thus fell in breach of the PSC. The High Court particularly referred to RIL's non-disclosure of critical geological data which confirmed that there was migration of gas from ONGC's block to RIL's block.

Accordingly, the High Court opined that the Tribunal erred in downplaying the importance of RIL's non-disclosure as a minor procedural oversight when the same was a fundamental and material breach of the PSC. Furthermore, the High Court noted that there were no specific findings rendered on the shifting stance of RIL, which the UOI claimed to be an attempt to play fraud. On this count, the High Court opined that the underlying award was vitiated by patent illegality as it fell in teeth of the substantive laws of the land, the terms of the PSC, and other regulatory provisions such as the PNG Rules.

High Court's conclusion

In view of its discussion, the High Court, without advert to the merits of the case, opined that RIL had extracted the "migrated gas". However, the said extraction was not with the complete/express permission of the Union. Further, the High Court also opined that the extraction carried out by RIL could not be termed as the "most efficient manner for betterment of the Union" as required under the public policy of India. Thus, the Tribunal's view was held to be patently erroneous and set aside.

Comment

The High Court's verdict has far-reaching implications for the evolution of the Indian arbitration law regime, especially in matters concerning the interplay between commercial disputes and sovereign rights over natural resources.

A key takeaway from the judgment is the High Court's interpretation of the doctrine of public trust as a constitutional duty enshrined in Article 297 of the Constitution of India. The High Court has also attempted to integrate the State's fiduciary responsibility as custodian of natural resources into the broader public policy of India, ultimately forming one of the grounds for setting aside the arbitral award.

Domain experts and arbitration enthusiasts are likely to debate this aspect extensively, i.e. whether broader public interest considerations can be imposed on contractual disputes that are otherwise commercial in nature. While public policy of India remains a recognised ground for judicial intervention in arbitration, its expanding scope in disputes involving natural resources may lead to further discussions on the limits of arbitrability.

It is also worth noting that the High Court did not engage in an extensive discussion on the overall arbitrability of similarly situated disputes. Instead, its decision hinged on findings of patent illegality and perversity in the impugned award on other counts. This leaves open the question of how future cases involving resource extraction, contractual autonomy, and sovereign rights will be adjudicated under India's arbitration regime.

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1. 2025 SCC OnLine Del 841.
2. The doctrine of public trust is a legal principle that mandates the State to act as a trustee of natural resources, ensuring their availability for public use rather than permitting their exploitation for private gains. It is based on the notion that certain resources such as air, water, and forests are so essential to public welfare that they should not be subject to private ownership except with the explicit permission of the State.
3. A contract-law principle rooted in the maxim *nemo debet locupletari ex aliena jactura* (no one should be enriched at expense of another), doctrine of unjust enrichment is a legal principle that prevents one party from unfairly benefiting at the expense of another without a valid legal reason. It applies when a person or entity receives a gain whether money, property, or services that rightfully belongs to someone else, and keeping that benefit would be unjust.
4. *ONGC v. Union of India*, Writ Petition Civil No. 3054 of 2014.
5. Arbitration and Conciliation Act, 1996.
6. Arbitration and Conciliation Act, 1996, S. 34.
7. Arbitration and Conciliation Act, 1996, S. 37.
8. Arbitration and Conciliation Act, 1996, S. 2(1)(f).

9. *DMRC Ltd. v. Delhi Airport Metro Express (P) Ltd.*, (2024) 6 SCC 357; *Punjab State Civil Supplies Corpn. Ltd. v. Sanman Rice Mills*, 2024 SCC OnLine SC 2632; and *MMTC Ltd. v. Vedanta Ltd.*, (2019) 4 SCC 163.
10. *DMRC Ltd. v. Delhi Airport Metro Express (P) Ltd.*, (2024) 6 SCC 357; *Punjab State Civil Supplies Corpn. Ltd. v. Sanman Rice Mills*, 2024 SCC OnLine SC 2632; and *MMTC Ltd. v. Vedanta Ltd.*, (2019) 4 SCC 163.
11. *ONGC Ltd. v. Saw Pipes Ltd.*, (2003) 5 SCC 705; *State of Chhattisgarh v. SAL Udyog (P) Ltd.*, (2022) 2 SCC 275; *Associate Builders v. DDA*, (2015) 3 SCC 49; *Ssangyong Engg. & Construction Co. Ltd. v. NHAI*, (2019) 15 SCC 131; and *Delhi Airport Metro Express (P) Ltd. v. DMRC Ltd.*, (2022) 1 SCC 131.
12. (2023) 15 SCC 781.
13. The relevant extract of Constitution of India, Art. 297 reads as:

297. *Things of value within territorial waters or continental shelf and resources of the exclusive economic zone to vest in the Union.*—(1) All lands, minerals and other things of value underlying the oceans within the territorial waters, or the continental shelf, or the exclusive economic zone, of India shall vest in the Union and be held for the purposes of the Union.
14. (1997) 1 SCC 388, 407. The relevant extract reads as:

25. The public trust doctrine primarily rests on the principle that certain resources like air, sea, waters and the forests have such a great importance to the people as a whole that it would be wholly unjustified to make them a subject of private ownership. The said resources being a gift of nature, they should be made freely available to everyone irrespective of the status in life. The doctrine enjoins upon the Government to protect the resources for the enjoyment of the general public rather than to permit their use for private ownership or commercial purposes.
15. (2010) 7 SCC 1.
16. (2014) 11 SCC 576.
17. (2014) 11 SCC 576.
18. Arbitration and Conciliation Act, 1996, S. 11(6).
19. (2019) 2 SCC 271.
20. On this aspect, the High Court cited the decision in *Reliance Natural Resources Ltd. v. Reliance Industries Ltd.*, (2010) 7 SCC 1.
21. *ONGC v. Union of India*, Writ Petition Civil No. 3054 of 2014.