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Need for Overhaul of the Costs Regime in Indian Arbitration Law

Badrinath Srinivasan · Tuesday, March 5th, 2019

A legal regime which asks the victim of a frivolous legal proceeding to subsidise the costs of the perpetrator is unjust and is bound to provide incentives for more frivolous proceedings. For a long time, Indian arbitration law had been providing such incentives for a party to make frivolous objections to the arbitration agreement or the arbitral award. The Law Commission of India sought to change this state of affairs through its 246th report and recommended certain changes to the Arbitration and Conciliation Act, 1996 ("1996 Act"). Pursuant to the recommendations, the Indian legislature enacted the Arbitration and Conciliation (Amendment) Act, 2015 ("2015 Act") attempting to update the law on costs in line with the best international practices.

This post argues that even after the 2015 amendments, there has not been a marked change in the way in which courts award costs following best international practices such as the principle that costs follow the event.

Statutory Provisions on Costs in Arbitration

Section 31(8) of the 1996 Act as originally enacted dealt with costs in arbitration proceedings. Precedents that evolved therefrom led to a dissatisfied state of affairs regarding the regime on costs allocation in arbitration and arbitration related court proceedings (See, Ernst & Young LLP, Emerging Trends in Arbitration in India, p. 20). The chief complaint was that the provision was too open textured and allowed unnecessarily enormous discretion in awarding of costs. In most cases, tribunals and courts failed to award costs and provide reasons for their decision. An empirical survey suggested that in about 90% of the arbitrations, the parties had to bear either their own costs or half of the total arbitration costs, irrespective of the outcome of the arbitration.

Consequently, the winning party lost substantial money towards costs incurred due to the arbitral proceedings and was not compensated for considerable expenses incurred in arbitration related court proceedings such as proceedings relating to appointment of arbitrators, application for interim measures, and so on. Frequent judicial interference in arbitration also provided incentives for a party to delay or frustrate efficient settlement of disputes. A party so delaying or frustrating the proceedings was not made to bear the costs expended by the winning party and the winning party was not fully compensated for the costs incurred owing to the censurable conduct of the

losing party.

This state of affairs was incongruent with best international arbitration practices. After numerous calls for reforms, the Law Commission of India in its 246th Report sought an overhaul of the existing provision on costs.

Law Commission's Recommendations on Costs

The Law Commission of India submitted its 246th report, where it specifically pointed out the need for amending the law on costs. The Commission noted the potential for significant increase in costs in arbitration proceedings, which, according to the Commission necessitated the law on allocation of costs to be clear and predictable. For these reasons, the Commission recommended that the loser-pays principle should be normally followed by tribunals and courts hearing arbitration related court proceedings while allocating costs.

Primarily, two justifications were offered for by the Commission for this recommendation: One, it is only just that the losing party which dragged the other party to court/ arbitration or which set up unjust defences compensates the winning party for the losses incurred in resolving the issue in courts or before the tribunal. The second justification offered by the Commission was that from an economic point of view, the loser-pays principle provided an "*efficient deterrence against frivolous conduct and furthers compliance with contractual obligations*." (Para 23)

Further thereto, the Law Commission recommended insertion of Section 6A to the 1996 Act containing a detailed provision on costs. Thus, it would appear that the objective of the Law Commission's recommendations on costs was to introduce a "costs follow the event" regime and that in all arbitration related proceedings, the tribunal or the court, as the case may be, should ordinarily adhere to this principle. However, the manner in which Section 6A is a cause for concern (as will be seen in the later part of this post).

Section 31A of the 1996 Act (as amended in 2015)

Based on the recommendation of the Law Commission and an ordinance, the Indian Parliament enacted the Arbitration and Conciliation (Amendment) Act, 2015, and the same was brought into force with effect from 23 October 2015.

The amended Act contains detailed provisions on costs in Section 31A, which is similar to Section 6A suggested by the Law Commission. Section 31A(1) empowers the court or arbitral tribunal, as the case may be, to award costs in relation to any proceeding under the 1996 Act. It reads:

> "*In relation to any arbitration proceeding or a proceeding under any of the provisions of this Act pertaining to the arbitration, the Court or arbitral tribunal, notwithstanding anything contained in the Code of Civil Procedure,1908, shall have the discretion to determine— (a) whether costs are payable by one party to another; (b) the amount of such costs; and (c) when such costs are to be paid…*"

The wordings of Section 31A(1) is a cause for concern. The use of the word "discretion" could be construed to mean that the Court or the tribunal has the option to choose not to pass any order on costs.

Similar is the case of Section 31A(2) as well. It reads:

> "*If the Court or arbitral tribunal decides to make an order as to payment of costs,— (a) the general rule is that the unsuccessful party shall be ordered to pay the costs of the successful party; or (b) the Court or arbitral tribunal may make a different order for reasons to be recorded in writing.*"

This sub-section begins with the term "if" as if to suggest that making an order as to payment of costs is a matter of choice of the Court or the arbitral tribunal, as the case may be. This construction is incongruent to the purpose for which the new regime on costs was introduced, as noted by the Law Commission.

A perusal of the decisions in the post-2015 suggest that there has not been a change, especially by the courts, in awarding of costs. This leads to the inference that the introduction of Section 31A was a pointless exercise.

The recent decision of Larsen and Toubro Limited Scomi Engineering BHD vs. Mumbai Metropolitan Region Development Authority (03.10.2018 – SC): MANU/SC/1151/2018 is a typical example where the court did not even deal with costs in a petition for constituting the tribunal. The petition was ultimately dismissed on the ground that the arbitration was not an international commercial arbitration warranting constitution of the arbitral tribunal by the apex court rather than by the relevant High Court.

Proposed Amendments

The Arbitration and Conciliation Bill, 2018, which is now under consideration in the Indian Parliament does not seek to address this issue.

Therefore, it is suggested that amendments to Section 31A should be made in the current round of reforms to provide the following:

- The Court or the tribunal shall make an order as to payment of costs.
- The general rule for the tribunal and the Court should be that the unsuccessful party should be ordered to pay costs of the successful party.
- The Court or the tribunal may depart from the above general rule for reasons to be recorded in writing.

Towards this end, a new sub-section in the form of Section 31A(1A) has to be introduced along the following lines: "*The Court or arbitral tribunal shall make an order as to payment of costs while making a determination under this Act: Provided that the Court or arbitral tribunal shall have the discretion to postpone the order as to payment of costs at the time end of the proceedings before it.*"

Consequently, the phrase "*If the Court or arbitral tribunal decides*" at the beginning of Section 31A(2) should be amended to read: "*Where the Court or arbitral tribunal decides*".

Closing Remarks

International practice suggests that arbitral tribunals and courts hearing arbitration related matters award reasonable costs in favour of the winning party. In some countries, courts award costs on indemnity basis in respect of unsuccessful challenges to arbitration agreements and arbitral awards and also in unsuccessful petitions for refusal to recognise or enforce awards. Indemnifying the winning party for costs incurred in such cases makes sense.

Unfortunately, Indian courts and tribunals not only fail to award indemnity costs in deserved cases but do not even award reasonable costs in favour of the winning party as provided under the statute book. Hence, it is important that the 2018 Amendment Bill clarifies the intent behind the enactment of Section 31A by amending the law as suggested above. This will ensure that the legal costs of the party initiating frivolous legal proceedings stalling the arbitration process is not subsidised by the victim of such proceedings.

In order for India to achieve the objective of becoming a prominent global centre for dispute resolution, it is of fundamental importance that courts and the arbitral tribunals allocate costs in accordance with best international practices.

This post is based on the ideas that were mooted in a paper presented at a conference in 2017 and can be accessed from here.

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