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From Fluidity to Clarity? Pakistan's Arbitration Act of 2024 and the Future of Public Policy

Ali Shouzab (Hussain Zaman Associates) · Thursday, May 15th, 2025

Pakistani Courts typically employ an expansive interpretation of the term 'public policy' when determining arbitrability of an international dispute or the enforcement of foreign arbitral awards. As a consequence, in recent years, some of the awards (with political and monetary importance for Pakistan) from international arbitral tribunals have been denied enforcement by the Pakistani Courts. In other instances, some disputes have even been considered non-arbitrable at the pre-arbitral stage.

The New York Convention does not define the term 'public policy' and leaves it to the domestic laws of the states to define and interpret their own public policy. From a Pakistan perspective, it is noteworthy to remind ourselves as to why the courts had to play a crucial role in defining the term: the Arbitration Act, 1940 ("the 1940 Act"), Pakistan's domestic arbitration law which is still in force, is silent about the definition of the term public policy.

The new draft Arbitration Act of 2024 ("Draft Act"), expected to replace the Old Act after its entry in to force, is likely to limit expansive interpretation of 'public policy.' As discussed in a recent Kluwer Arbitration Blog post, the Draft Act is aimed to align Pakistan's arbitration law with international standards. Therefore, it is also expected to reduce instances where international awards are erroneously deemed unenforceable or non-arbitrable.

Whilst the Draft Act largely follows the New York Convention in terms of the principles of setting aside an award, and its recognition and enforcement, it goes further by helpfully defining 'public policy.' Keeping in view the evolution of the term over the decades, this blog post discusses what could be the effect of the Draft Act (once enacted) on the scope of 'public policy,' which has been a problematic area for Pakistan.

How Have Pakistani Courts Defined the Scope of Term 'Public Policy'?

Pakistani Courts have given the definition of the term public policy varying interpretations. For instance, in the case of Hub Power Company Limited (the "HUBCO Case") the Supreme Court of Pakistan ("SCP") found a dispute to have been non-arbitrable because the substantive agreement was tainted by corruption and therefore violated the State's public policy. Notably, a simple alleged 'fact' (that did not meet the required standard of proof as under Articles 117 and 119 of the

Qanoon e Shahadat Order 1984, Pakistan's Law of Evidence) was used to conclude *prima facie* that the underlying contract had been compromised by corruption. This rendered the whole dispute non-arbitrable.

Other precedents, such as *Maulana Abdul Haq Baloch v Govt of Balochistan* PLD 2013 SC 641 (famously known as the "Reko Diq Case"), have also addressed the broad scope of arbitrability during the early stages of a dispute. This case concerned mineral exploration in a resource-rich region of Pakistan. The court upheld the State's reliance on public policy grounds on the basis that there was 'alleged' corruption in the underlining contracts—yet again without offering any reasoning as to whether or not the standard of proof was met to prove the alleged fact. The court was of the view that when the object of a contract is unlawful and proper procedures for its formation are not followed, the contract is void *ab initio*. It further considered the contract to be contrary to the rights of the local citizens and, on that basis, the contract was declared to be against the public policy. This formed the basis for the court's conclusion that the dispute was non-arbitrable, as the agreement was *prima facie* a nullity in the eyes of law. An interesting aspect of this case emerged at enforcement, when in the *Presidential Reference No 2 of 2022* the scope of public policy was construed narrowly and the award was considered enforceable. In the author's view, the approach of Pakistani courts in the Reko Diq Case was arguably self-contradictory, in the sense that the scope of public policy was considered broad when rendering a decision about the arbitrability of the dispute and it was construed narrowly when determining if the award was enforceable.

Unsurprisingly, the broad interpretation of public policy in Pakistan had a negative impact on foreign investment. The inflows of the Foreign Direct Investment were substantially reduced—from 3 percent of GDP in 2007 to only 0.7 percent of GDP in 2014 (see World Bank), when the SCP handed down the judgment in the Reko Diq Case. This underscored the need to narrow the scope of public policy to allow parties seeking enforcement of arbitral awards against debtors in Pakistan to do so with greater ease, comparable to the experience in established jurisdictions such as the United Kingdom, the United States, and the EU Member States.

Thereafter, one of the key decisions that narrowed the scope of public policy was *Orient Power Company v Sui Northern Gas Pipelines* 2021 SCMR 1728 (SCP) (the "Orient Power Case"). This case marked a notable shift in the approach taken by Pakistani courts regarding the scope of public policy. The court held that enforcement of an arbitral award could only be refused on public policy grounds where the surrounding illegality was so serious that non-enforcement was the only viable option. This decision was welcomed by Pakistan's legal community because of the shift to a narrow construction of public policy.

The analysis above suggests that the approach taken by Pakistani courts in determining the scope of public policy has been inconsistent and marked by significant judicial discretion. Even the shift in Orient Power Case was not adequate enough to address the broader challenge to clearly define what constitutes public policy. Therefore, there was a need to define the scope of public policy in a clearer manner.

What Role Could the Draft Act Play to Define the Future Scope of 'Public Policy'?

Keeping in view the scenarios of expansive interpretation as discussed above, Section 39(3) of the

Draft Act narrows the scope of the term ‘public policy’ in a clearer manner:

> *“(3) An award is in conflict with the public policy of Pakistan only if—*
>
> *(a) the making of the award was induced or affected by fraud or corruption; or*
>
> *(b) a material breach of the rules of natural justice occurred—*
>
> *(i) during the arbitral proceedings; or*
>
> *(ii) in connection with the making of the award; or,*
>
> *(c) it is in conflict with the most fundamental norms of morality and justice.*
>
> *Explanation— A determination as to whether an award is in conflict with the public policy of Pakistan shall not entail a review on the merits of the dispute . . .”*

A positive move is the inclusion of the proviso “shall not entail a review on the merits of the dispute,” which would hopefully deter courts from re-adjudicating issues already decided through arbitration. This is a much-needed development, potentially resulting from lessons learnt from the Reko Diq Case, where the court had delved into the merits of the dispute even though the underlying agreements and treaties had prescribed arbitration as the dispute resolution mechanism. Whilst it is indeed common in contemporary international practice that awards tainted with “fraud or corruption” are not enforced, this provision would eventually be a positive move if the misconceived approaches—such as in the HUBCO case—are consigned to the past.

On the other hand, terms such as “a material breach of the rules of natural justice,” if not narrowly confined to instances of procedural irregularity, could prove to be problematic. This is because Pakistani courts may well apply a broad interpretation of “rules of natural justice” to encapsulate ‘any’ rule whatsoever. Vague terms like “the most fundamental norms of morality and justice” could also be problematic if they are interpreted without restraint.

The very purpose of this provision was to limit the scope of public policy, but it seems less likely in the presence of such wording. There could be two possible proposals for avoiding expansion. One is the exercise of restraint. This could be done by self-regulating judicial discretion on interpreting the provisions beyond the object and purpose of the Draft Act. However, this solution seems less likely to be successful in practice. Second, which might be a more viable solution, is to revise the provision to avoid the use of vague terms like natural justice or morality that could increase the likelihood of broad interpretations.

Conclusion

By codifying the scope of public policy, the Draft Act aims to mitigate judicial discretion and promote consistency in the interpretation of public policy. However, there is a possibility that the pre-existing problems regarding the broad scope of the term could persist. Whilst the new law intends to prescribe the parameters of public policy, it also contains vague and subjective terms that could enable courts to adopt an expansive approach. To ensure the Draft Act effectively

creates a pro-arbitration environment, it is imperative that either the language of the provision is revised to remove ambiguities or to encourage a disciplined judicial approach to its interpretation. Ultimately, defining the exact scope of the term rests first with the legislature, and then the superior courts, which should interpret the provisions cautiously to avoid unnecessary expansion.

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