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Supreme Court of Pakistan endorsed the pro-enforcement bias of the New York Convention.

"Pakistan is one of the countries that have yet to develop jurisprudence on international commercial arbitration, and we must be cautious, and ought to adopt standards of practice in line with the international community."
2021 SCMR 1728

Introduction

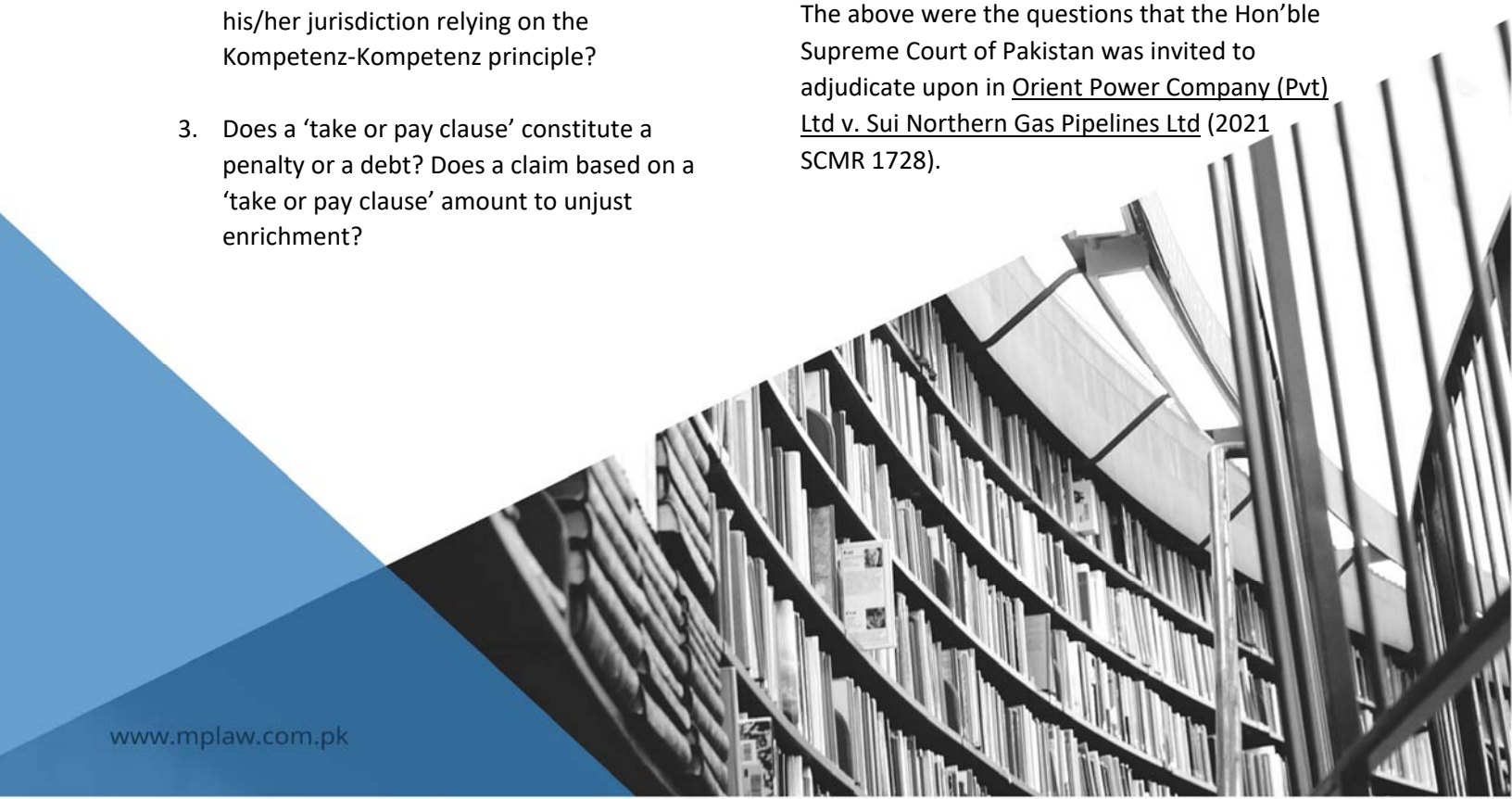
1. Can a dispute under the supplemental contact (that does not contain an arbitration clause) be submitted to international arbitration under the arbitration clause of the main contract?

2. Can the foreign arbitrator adjudicate on his/her jurisdiction relying on the Kompetenz-Kompetenz principle?

3. Does a 'take or pay clause' constitute a penalty or a debt? Does a claim based on a 'take or pay clause' amount to unjust enrichment?

4. What is the scope of "public policy" ground under Article 5(2)(b) of the New York Convention? Can the enforcement of a foreign arbitral award based on a 'take or pay clause' be refused on the public policy ground?

The above were the questions that the Hon'ble Supreme Court of Pakistan was invited to adjudicate upon in Orient Power Company (Pvt) Ltd v. Sui Northern Gas Pipelines Ltd (2021 SCMR 1728).



Background

The matter originated from a Gas Supply Agreement (GSA) between a power generation company (appellant) and a natural gas utility company (respondent) that contained a 'take or pay clause'. The GSA provided for dispute resolution through expert determination and then international arbitration in London.

Certain disputes arose between the appellant and the respondent which were referred for expert determination under the GSA. The expert held the appellant liable to pay a certain amount to the respondent. Pursuant to the expert determination, the parties entered into a Payment Agreement (PA) that did not contain an arbitration clause.

Later, the appellant failed to pay certain invoices under the GSA as well as the amount outstanding under the PA. The respondent commenced international arbitration in London under the dispute resolution clause of the GSA. The international arbitration resulted in a foreign arbitral award in favor of the respondent.

The respondent commenced enforcement proceedings before the high court for enforcement of the foreign arbitral award under the New York Convention of 1958. The appellant contested the enforcement proceedings on multiple grounds.

The appellant argued that the foreign arbitral award in respect of the dispute regarding the outstanding payment under the PA was issued in the absence of an arbitration agreement between the parties. Hence its enforcement was liable to be refused under Article V(1)(a) of the New York Convention.

Likewise, in respect of the claim allowed by the arbitrator under the GSA, the appellant argued that the same was based on the 'take or pay clause' of the GSA which amounted to a penalty. That the arbitrator should have rejected the respondent's claim which amounted to unjust enrichment and a violation of Pakistani contract law that only allowed actual damages. The appellant argued that the enforcement of the foreign arbitral award by the high court would be against the public policy of Pakistan and should be refused under Article V(2)(b) of the New York Convention.

The high court rejected the above grounds and ordered the enforcement of the foreign arbitral award. The appellant instituted an intra-court appeal which met the same fate. The matter then came before the Supreme Court and the court was requested to decide the abovementioned four questions.

Ruling

The Supreme Court answered the **first question** in affirmative. The court held that the foreign arbitrator appointed under the GSA rightly exercised jurisdiction in respect of the disputes under the PA because "*the controversy arising out of [the PA was] a progeny of the GSA and cannot be divorced from the parent GSA*".

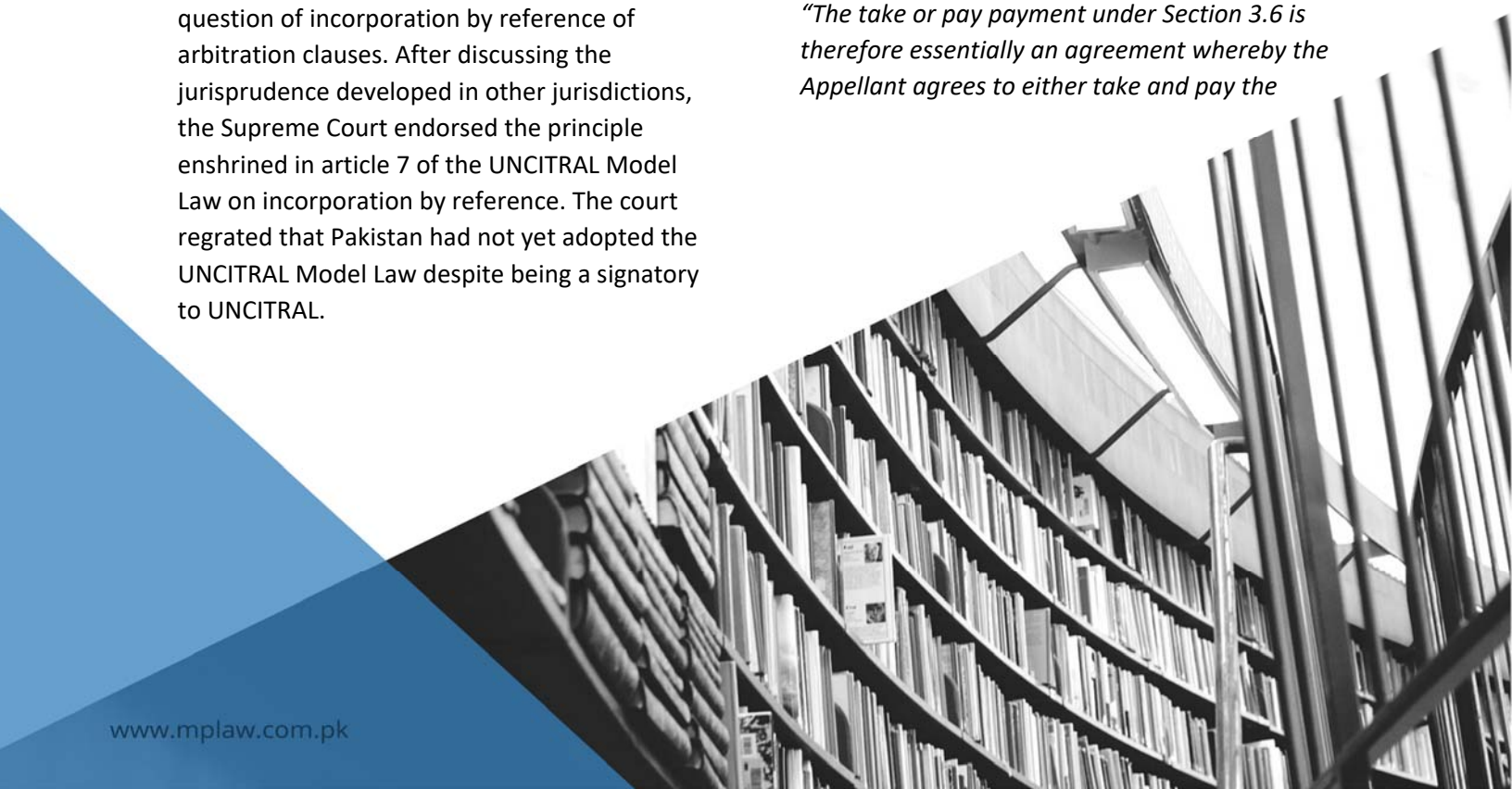
The Supreme Court discussed several judgments of the English, French, and Singaporean superior courts on this issue and observed that "*[t]he arbitration clause contained in the GSA would […] be the 'centre of gravity' and would be deemed to be anchored in the Payment Agreement which itself was merely an implementation of the GSA. The disputes 'arising out of' the GSA were thus wide enough to cover the Payment Agreement. We hold that it would neither be commercially sensible nor realistic to decide that both the Agreements were to be decided by separate forums.*"

The Supreme Court also dilated upon the question of incorporation by reference of arbitration clauses. After discussing the jurisprudence developed in other jurisdictions, the Supreme Court endorsed the principle enshrined in article 7 of the UNCITRAL Model Law on incorporation by reference. The court regrated that Pakistan had not yet adopted the UNCITRAL Model Law despite being a signatory to UNCITRAL.

The **second question** was also answered by the Supreme Court in the affirmative. The court held *"[u]nder the facts and circumstances of this case and in accordance with the doctrine of competence competence, the Sole Arbitrator was well within his rights to determine his own jurisdiction, and the learned counsel for Appellant has not been able to demonstrate that the tribunal lacked jurisdiction, or that assuming jurisdiction as regard the Payment Agreement, exceeded his mandate under Article V(1)(c) of the New York Convention.*"

In respect of the **third question** *i.e.,* whether the 'take or pay clause' constitutes a penalty, the Supreme Court held that the "take or pay clause" of the GSA did not amount to a penalty and that a claim based on it was maintainable, and was rightly allowed by the arbitral tribunal, and upheld by the high court. The Supreme Court interpreted the "take or pay clause" of the GSA as under:

"The take or pay payment under Section 3.6 is therefore essentially an agreement whereby the Appellant agrees to either take and pay the



contract price for, a minimum contract quantity of Gas; or pay the applicable contract price for such Take or Pay Quantity if it is not taken. Thus, the Appellant's obligation may be described as being in the 'alternative' as it can be satisfied in either of the two ways. Therefore, even if the Appellant did not take up the Gas, but did pay for it, there would be no breach of contract. No penalty was attracted as a result of the Appellant not taking up the Gas, rather, conversely, under Section 3.6(c) of the GSA, the Appellant was allowed to 'make up' for the amount he had paid for. Thus, we are unable to agree with the contention of the Appellant that failure to take up the Gas had resulted in breach of contract."

While answering the **fourth question** regarding the scope of public policy ground under Article V(II)(b) of the New York Convention, the Supreme Court observed that "*Most courts world over have favoured a restrictive approach to public policy in international commercial arbitration. […] Pakistan is one of the countries that have yet to develop jurisprudence on international commercial arbitration, and we must be cautious, and ought to adopt standards of practice in line with the international community.*"

Accordingly, the Supreme Court held that "*the public policy defense is an exceptional one […] which demands heightened standards of proof that courts would normally require in order to refuse recognition and enforcement of a foreign arbitral award. […] This heightened standard of proof is compatible with the exceptional nature of the public policy defense as well as with the fact that Article V (2)(b) ibid; provides a mere facility to the courts and not an obligation.*"

The Supreme Court endorsed the pro-enforcement bias of the New York Convention and observed that "*[a] restrictive interpretation on challenge to enforcement of an award would, therefore, ensure finality of award at its last stage, giving greater certainty to parties after having gone through rigorous arbitrations. The New York Convention itself advocates for a 'pro-enforcement bias' and we are mindful of the same.*"

The Supreme Court also endorsed the following observation made by the High Court in the impugned judgment:

"*…[the] non-interference or the pro-enforcement policy is in itself a policy of Contracting States, which is not easily persuaded by the public policy exception argument… The public policy exception acts as a safeguard of fundamental notions of morality and justice, such that the enforcement of a*

foreign award may offend these fundamentals… [T]he public policy exception should not become a back door to review the merits of a foreign arbitral award or to create grounds which are not available under Article V of the Convention as this would negate the obligation to recognize and enforce foreign arbitral awards. Such kind of interference would essentially nullify the need for arbitration clauses as parties will be encouraged to challenge foreign awards on the public policy ground knowing that there is room to have the Court set aside the award."

Closing remarks

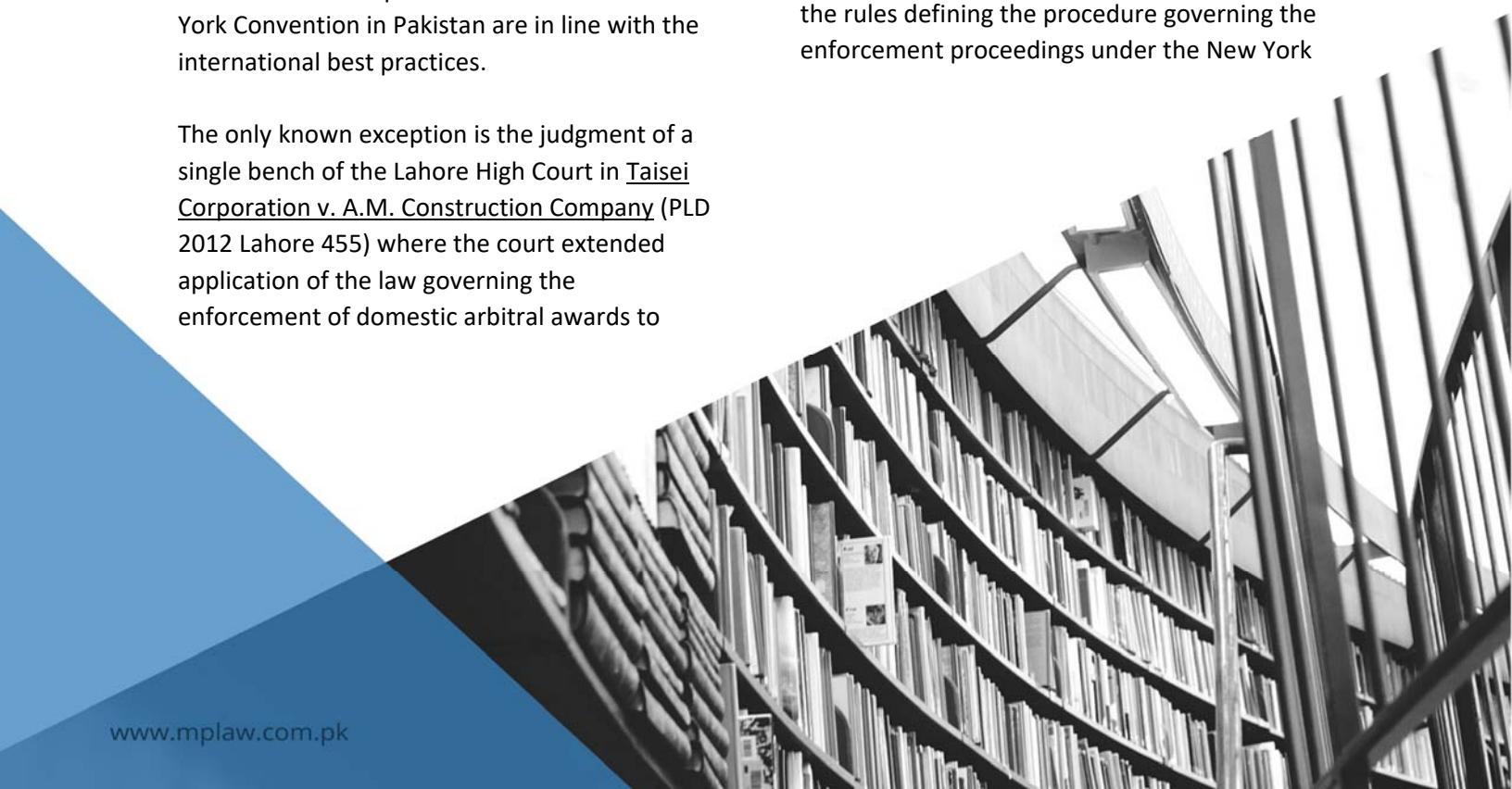
This is indeed a landmark judgment by Pakistan's apex court that has set the guiding principles for the high courts on how they should handle objections to the enforcement of the foreign arbitral awards under the New York Convention.

As a matter of fact, an overwhelming majority of the judgments rendered by the Pakistani courts after the implementation of the New York Convention in Pakistan are in line with the international best practices.

The only known exception is the judgment of a single bench of the Lahore High Court in Taisei Corporation v. A.M. Construction Company (PLD 2012 Lahore 455) where the court extended application of the law governing the enforcement of domestic arbitral awards to foreign arbitral awards covered under the New York Convention. However, this is not a celebrated judgment and has been impliedly overruled by a division bench of the same high court.

The real hurdle in the enforcement of foreign arbitral awards in Pakistan is caused by inordinate delays during the enforcement proceedings which, at times, take many years to conclude. These delays not only add to the frustration of the applicants but also increase the cost of enforcing foreign arbitral awards in Pakistan. The frequent adjournments granted by the court without any significant penal consequences and the applicability of century-old outdated procedural rules to the enforcement proceedings are mainly to blame for such delays.

Pakistan ratified the New York Convention and implemented it through enabling domestic legislation back in 2005. More than fifteen years have passed since then, yet the Government of Pakistan (GOP) has remained unable to frame the rules defining the procedure governing the enforcement proceedings under the New York



Convention which continue to be governed by, as stated above, century-old outdated procedural rules from the British era.

What is needed to improve Pakistan's image and standing in the international arbitration community is for the GOP to follow the recent judgment of the Supreme Court in its true letter and spirit. The GOP must frame rules defining the procedures governing the foreign award enforcement proceedings that are modern, efficient, and in line with international best practices.

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