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Government of India
Ministry of Finance
Department of Expenditure
Procurement Policy Division
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502, Lok Nayak Bhawan,
Khan Market, New Delhi
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OFFICE MEMORANDUM

Subject:- Guidelines for Arbitration and Mediation in Contracts of Domestic PublicProcurement – reg.

In recent decades, there has been an increasing resort to arbitration as a mean of alternative dispute resolution with a view to reducing litigation and achieving quick and efficient settlement of contractual disputes. Arbitration as a remedy is based on explicit provision in a contract and is not a judicial process. Arbitration can cover a whole range of contractual matters, including disputes between private sector parties where the Government or a public sector undertaking is not involved.

2. Arbitration is expected to provide several advantages compared to the process of litigation in the Courts:

(i) **Speed:** It is expected to result in quicker resolution of disputes.

(ii) **Convenience and Technical Expertise:** As it is not a judicial process, it provides greater convenience and less formality, enabling persons other than serving Judges (including technical experts) to act as Arbitrators. This may improve the quality of factual decision making, especially on technical issues.

(iii) **Finality:** Under the Arbitration and Conciliation Act, 1996, the decisions of the Arbitrators are final, and grounds for challenge in Courts are very limited. Hence, finality is an expected benefit of arbitration.

3. Recent developments, namely the enactment of the Mediation Act, 2023 and Court decisions, combined with the experience gained over many years have necessitated a re-examination of the Government's approach towards arbitration vis-à-vis other methods of dispute resolution, such as mediation and litigation.

4. The Government (or a Government entity or agency) as a disputant has certain peculiarities:

(i) The system of decision-making in Government involves accountability to Parliament. The law requires the Government to act fairly without

arbitrariness. There are multiple levels of scrutiny before and after decisions are taken. Acceptance of an adverse award when judicial avenues are not exhausted is often perceived to be improper by various authorities, despite the 'finality' envisaged in theory.

(ii) The necessity for fairness and non-arbitrariness makes it difficult to accept arbitration awards if they vary from the practice followed for other similarly-placed contractors who are not involved in the arbitration.

(iii) Officers in Government and its undertakings are transferrable and hence the personal knowledge of an officer involved in an arbitration matter may not be as deep as of the opposing private party. This handicaps the Government when presenting its case before arbitrators.

5. Notwithstanding the expected benefits of arbitration, the actual experience of arbitration in respect of contracts where the Government (or a Government entity or agency, such as a public sector enterprise) is a party have been, in many cases, unsatisfactory in meeting the expectations:

(i) The process of arbitration itself takes a long time and is not as quick as envisaged, besides being very expensive too.

(ii) The reduced formality, combined with the binding nature of decisions, has often led to wrong decisions on facts and improper application of the law. The arbitral process being contractual and intended to be final with very limited further recourse, is also exposed, particularly in matters of high financial value, to perceptions of wrong-doing including collusion. It is noteworthy that arbitrators are not necessarily subject to the high standards of selection which are applied to the judiciary and to judicial conduct. Further, proceedings are conducted behind closed doors and not in open court. There have been judicial decisions regarding impropriety on the part of arbitrators and there is little accountability for such wrong decisions, if taken by arbitrators.

(iii) The benefit of finality has also not been achieved. A large majority of arbitration decisions are being challenged in the Courts both by the Government (or its entity or agency) and by the opposite party, when the decision of the arbitrators is not to the satisfaction of either party. The expectation that challenge to arbitration award would be rare, has not been realised in practice. Therefore, instead of reducing litigation, it has become virtually an additional layer and source of more litigation, delaying final resolution. The objective of relieving the burden on Courts has generally not been achieved.

(iv) The intended finality, though often not realised in practice, also has a bearing on possible civil and criminal actions, attendant to the subject matter of the disputes.

(v) In many cases, a commercial and sensible practical approach if resorted to, may indeed amicably resolve the issues at the threshold, but the existence of an arbitration clause makes it easy for officers to avoid taking a decision by letting the dispute go to arbitration. Thereafter, in the adversarial process, realistic claims and counter-claims are often replaced by inflated claims, counter-claims or cross-claims and arbitral process many a time ends in concluding resolutions which are in-between or extreme in nature, when in reality, the intrinsic actual claims are far smaller.

6. Adjudication by the courts is a remedy which always exists wherever there is no arbitration clause. However, another alternative to arbitration is mediation, which is a process whereby parties attempt to reach an amicable settlement of their dispute with the assistance of a third person (mediator) who does not have the authority to impose a settlement upon the parties to a dispute. There are successful models of mediation/ conciliation being practiced in certain Government entities, for example in the oil and gas sector. Section 48 of the Mediation Act, 2023 allows the Government or any Government entity or agency to frame schemes or guidelines for resolution of disputes through mediation or conciliation, and in such cases, a mediation or conciliation may be conducted in accordance with such schemes or guidelines.

7. Keeping all these factors in view, the following guidelines are issued for contracts of domestic procurement by the Government and by its entities and agencies (including Central Public Sector Enterprises [CPSEs], Public Sector Banks [PSBs] etc. and Government companies):

(i) Arbitration as a method of dispute resolution should not be routinely or automatically included in procurement contracts/ tenders, especially in large contracts.

(ii) As a norm, arbitration (if included in contracts) may be restricted to disputes with a value less than Rs. 10 crore. This figure is with reference to the value of the dispute (not the value of the contract, which may be much higher). It may be specifically mentioned in the bid conditions/ conditions of contract that in all other cases, arbitration will not be a method of dispute resolution in the contract.

(iii) Inclusion of arbitration clauses covering disputes with a value exceeding the norm specified in sub-para (ii) above, should be based on careful application of mind and recording of reasons and with the approval of:

a. In respect of Government Ministries/ Departments, attached/ subordinate offices and autonomous bodies, the Secretary concerned or an officer (not below the level of Joint Secretary), to whom authority is delegated by the Secretary.

b. In respect of CPSEs/ PSBs/ Financial Institutions etc., the Managing Director.

(iv) In matters where arbitration is to be resorted to, institutional arbitration may be given preference (where appropriate, after considering reasonableness of the cost of arbitration relative to the value involved).

(v) In matters covered by arbitration/ court decisions, the guidance contained in General Instructions on Procurement and Project Management dated 29.10.2021 should be kept in mind. In cases where there is a decision against the government/ public sector enterprise, *the decision to challenge/ appeal should not be taken in a routine manner, but only when the case genuinely merits going for challenge/ appeal and there are high chances of winning in the court/ higher court.*

(vi) Government departments/ entities/ agencies should avoid and/ or amicably settle as many disputes as possible using mechanisms available in the contract. Decisions should be taken in a pragmatic manner in overall long-term public interest, keeping legal and practical realities in view, without shirking or avoiding responsibility or denying genuine claims of the other party.

(vii) Government departments/ entities/ agencies are encouraged to adopt mediation under the Mediation Act, 2023 and/ or negotiated amicable settlements for resolution of disputes. Where necessary, e.g. matters of high value, they may proceed in the manner discussed below:

a. Government departments/ undertakings may, where they consider appropriate e.g. in high value matters, constitute a High-Level Committee (HLC) for dispute resolution which may include:

i. A retired judge.
ii. A retired high-ranking officer and/ or technical expert.

This composition is purely indicative and not prescriptive.

b. In cases where a HLC is constituted, the Government department/ entity/ agency may either

i. negotiate directly with the other party and place a tentative proposed solution before the HLC; or

ii. conduct mediation through a mediator and then place the tentative mediated agreement before the HLC; or
iii. use the HLC itself as the mediator.

c. This will enable decisions taken for resolving disputes in appropriate matters to be scrutinized by a high-ranking body at arms-length from the regular decision-making structure, thereby promoting fair and sound decisions in public interest, with probity.

(viii) There may be rare situations in long duration works contracts where, due to unforeseen major events, public interest may be best served by a re-negotiation of the terms. In such circumstances, the terms of the tentative re-negotiated contract may be placed before a suitably constituted High Level Committee before approval.

(ix) Approval of the appropriate authority will need to be obtained for the final accepted solution. Section 49 of the Mediation Act, 2023 is also relevant in this regard.

(x) Mediation agreements need not be routinely or automatically included in procurement contracts/ tenders. The absence of a mediation agreement in the contract does not preclude pre-litigation mediation. Such a clause may be incorporated where it is consciously decided to do so.

(xi) Disputes not covered in an arbitration clause and where the methods outlined above are not successful, should be adjudicated by the courts.

8. General or case-specific modification in the application of the above guidelines may be authorised by the Secretary concerned (or an officer not below the level of Joint Secretary to whom the authority is delegated by him) in respect of Government Ministries/ Departments, attached/ subordinate offices and autonomous bodies, or the Managing Director in respect of Central Public Sector Enterprises including Banks and Financial Institutions etc.

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