IN THE SUPREME COURT OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

In the matter of an Appeal in terms of Section 37 of the Arbitration Act No. 11 of 1995. Judgement dated 10.09.2017 in the Commercial High Court of the Western Province holden in Colombo.

SC Appeal 155/2023
SC HC LA 59/2020
HC/ARB/268/2013
HC/ARB/185/2014.
SLNAC 40-11-2011

Heladhanavi Limited
36, Bristol Street
Colombo 01

Claimant

Vs.

Ceylon Electricity Board
50, Chittampalam A. Gardiner
Mawatha, Colombo 02.

Respondent

AND NOW

Ceylon Electricity Board
50, Chittampalam A. Gardiner
Mawatha, Colombo 02.

Respondent-Petitioner-Appellant

Vs.

Heladhanavi Limited
36, Bristol Street
. Colombo 01

Claimant-Respondent-Respondent

Before	:	Jayantha Jayasuriya, PC, CJ Murdu N.B. Fernando , PC, J. E.A.G.R. Amarasekera, J.
Counsel	:	Milinda Gunatillake, PC. ASG for Respondent-Petitioner-Appellant Romesh De Silva, PC with F.N. Goonawardene, Vasanthakumar Niles and Prashanthi Vignanantha for Claimant-Respondent-Respondent.
Written Submissions	:	Claimant-Respondent –Respondent on 21.12.2023 and 11.06.2024 . Respondent-Petitioner-Appellant on 07.03.2024.
Argued on	:	14.03.2024 15.03.2024 and 05.04.2024
Decided on	:	12.11.2024

Jayantha Jayasuriya, PC, CJ.

The Respondent-Petitioner-Appellant - Ceylon Electricity Board - (hereinafter referred to as the "Appellant" or "CEB") impugns the Judgement of the High Court dated 19.06.2020. The impugned Judgement arises from two applications filed in the High Court, one by the Appellant and the other by the Claimant-Respondent-Respondent - Heladhanavi Limited - (hereinafter referred to as the "Respondent" or "the company"). Both those applications had been filed in the High Court in relation to an arbitral award dated 29th October 2013. The Respondent had invoked the jurisdiction of the High Court under Section 31 of the Arbitration Act No. 11 of 1995 ("the Act") to enforce the said arbitral award whilst the

Appellant had invoked the jurisdiction of the High Court under Section 32 of the Act to set aside the said arbitral order. Both those applications were consolidated and a single Judgement was delivered by the High Court. The Appellant sought an order to set aside the arbitral award on the ground that the "arbitral award is in conflict with the public policy of Sri Lanka" in terms of Section 32(1)(b)(ii) of the Act. The learned Judge of the High Court, while rejecting the Appellant's contention, entered the Judgement in favour of the Respondent.

This Court granted leave to appeal on the following three questions;

(i). Has the High Court erred in refusing to set aside the arbitral award on the grounds of it being in conflict with public policy as a result of having failed to apply its mind to the correct legal test, namely whether the award contained some element of illegality or the enforcement of the award would be wholly offensive to the ordinary responsible and fully informed members of the public on whose behalf the powers of the State exercised?

(ii). Has the High Court erred in refusing to set aside and proceeding to enforce the arbitral award notwithstanding the said award being in conflict with public policy as it was patently illegal in view of the Tribunal's findings contravening the substantive law of Sri Lanka including the provisions of the Inland Revenue Act and the Arbitration Act?

(iii). Would the two matters that are raised above amount to a re-agitation of the matters that had been already decided upon at the arbitration?

Taking into account the fact that the matter before this Court arises from a dispute between two parties who are engaged in an important commercial activity and with a view to facilitate an early resolution to this commercial dispute and minimise the possible adverse impact on the overall environment to conduct commercial activities, we proceeded to hear the submissions of the parties in the main appeal after granting leave to appeal as provided under the Supreme Court Rules with the consent of both parties.

The Appellant and the Respondent in 2003 had entered into a power purchase agreement where the Appellant purchased electrical energy that was generated in the Respondent's power plant. The practice between the two parties was for the Respondent to submit the

Appellant an invoice setting out the amounts due from the Appellant as per this agreement and the Appellant to honour by the full payment of such invoiced amounts. According to the agreement between the two parties, the Appellant while purchasing electrical energy from the Respondent was further obliged to pay any sums payable in respect of any "change in law event" as well as any "reimbursable taxes". The dispute that was referred for arbitration arose due to the Appellant refusing to make certain payments and / or taking steps to recover certain sums already paid to the Respondent, which sums the Respondent claims are due to be paid by the Appellant in view of a "change in law event" that occurred. The Appellant contends that the Respondent invoiced those questionable sums on the basis of "reimbursable taxes" and initially due to an inadvertence; the Appellant paid to the Respondent such sums. However, later having realised that the Respondent was not entitled to receive those sums, the Appellant took steps to withhold the value of such payments when making payments on subsequent invoices and thereafter refused to make further payment of such sums though the Respondent continued to invoice such sums. It is common ground that the sums in question correspond to the amounts that became liable to be paid as taxes by the Respondent, due to the changes that were brought in to the Inland Revenue Act by the Inland Revenue (Amendment) Act, No 12 of 2004.

On behalf of the Appellant, the learned Additional Solicitor-General submitted that the change in the law due to the said Amendment Act No 12 of 2004 did not bring in a new or additional financial burden on the Respondent. It is his contention that no change took place on the sums payable by the Respondent as part of his tax liability. The liability introduced through this amendment was on the shareholders based on their dividends earned from the Respondent company. It is his contention that the obligation on the Respondent company was to act as a mere collector and transmit to the Department of Inland Revenue the dividends tax the shareholders had to pay. Therefore, the amendment Act did not bring in an additional or new burden on the Respondent company affecting its financial status. Therefore, he contended that the Appellant did not have any responsibility to reimburse the sums in question – sums collected by the Respondent from funds paid to shareholders and transmitted to the Inland Revenue Department. It was further contended that the invoices that the Respondent tendered to the Appellant clearly reflect that the sums in question were claimed from the Appellant under the heading reimbursable taxes.

According to the material available to this Court it reveals, that the Appellant by his letter dated 19th August 2011 informed the Respondent that steps would be taken to recover in two instalments a total sum of Rupees 215,203,184/- paid to the Respondent from the year 2008 that was claimed under the heading reimbursable taxes. According to the invoices and the appendices, it is clear such taxes are described as "Dividend Tax". The learned Additional Solicitor General submitted that the Arbitral Tribunal gravely erred by reaching the conclusion that the Appellant is under the obligation to pay the Respondent, the sum in question. It is his contention that the learned High Court Judge erred when he held that he does not see any grounds to set aside the award in question. It is his contention that the facts and circumstances clearly fall within the ambit of section 32(1)(b)(ii) of the Act, where the High Court has the jurisdiction to set aside an arbitral award on the basis that the "arbitral award is in conflict with the public policy of Sri Lanka". He therefore moves this Court to set aside the impugned order of the High court.

In contradistinction to the above contention, the learned President's Counsel for the Respondent submits that the instant appeal should be dismissed on the basis that the examination of the issues raised by the Appellant before this Court amounts to a re-agitation of same issues that had already been determined by the Arbitral Tribunal. Hence engaging in such a process amounts to a total disregard of the concept of party autonomy, a prime foundation on which the whole process of arbitration is rested upon. It is his contention that setting aside of an arbitral award on the ground of "public policy" should be limited to extreme cases and any broader interpretation to the scope of this ground diametrically opposes the fundamental structure of the arbitration process as an alternate dispute resolution mechanism. Without prejudice to this contention the learned President's Counsel submitted that the examination of all material clearly reveal that the Arbitral Tribunal has correctly reached the conclusion recognising the rights of the Respondent to seek reimbursement of the sums paid as dividend taxes to the Inland Revenue Department, from the Appellant. The learned President's Counsel for the Respondent contended that the Appellant has no right to refuse the reimbursement of the dividend tax paid by the Respondent. Therefore, he moved that the appeal be dismissed and the impugned order of the High Court be affirmed.

When the arbitral proceedings are examined, they reveal that the Respondent by the Notice of Arbitration claimed that the Respondents correctly paid the sums in question and

that the Appellant had no right whatsoever to deduct such sums from monies payable to the former. The three disputes the Respondent claimed as arisen between the two parties are:

- Whether the sums of money paid to the Respondent under and in terms of the "Changes in Law" (Section 8.6) has been correctly paid.
- Whether the Appellant has the right in law to deduct the sum of Rupees 215,203,184/- or any sum paid to the Respondent.
- Whether the Appellant has the right to make the deductions set out in letter dated 19th August 2011.

After the Respondent filed his statement of claim and the Appellant filed his statement of defence, the arbitral proceedings commenced. There were five admissions, thirteen issues of the claimant and six issues of the Appellant. At the end of the hearing the arbitral award (the impugned award) was delivered in favour of the Respondent granting the following reliefs as prayed by the Respondent:

- Requiring and directing the Respondent (the Appellant in this Court) to pay to the Claimant (the Respondent in this Court) sums due and payable on account of the Change in Law Events with regard to the dividend tax in terms of the Agreement marked P2;
- Requiring and directing the Respondent that it is not entitled, in any way or manner, to deduct from monies due to the Claimant, the sum of Rs 215,203,184/= or any part of thereof referred to in letter dated 19/08/2011;
- Requiring and directing the Respondent that it is not entitled to, in any way or manner, deduct any sum of money already paid to the Claimant on account of the Change of Law Event with regard to dividend tax.

It is against this Award the Appellant invoked jurisdiction of the High Court. The Appellant sought an order to set aside the Award whilst the Respondent sought an order to enforce the Award.

The learned Judge of the High Court by his Judgement dated 19th June 2020 (the impugned Judgement) granted the relief prayed by the Respondent and dismissed the application of the Appellant. One of the grounds on which the Appellant made the application to set aside the arbitral award is that the impugned award is in conflict of the public policy of Sri Lanka, as stipulated in section 32(1)(b)(ii) of the Arbitration Act No.

11 of 1995. The learned High Court Judge was of the view that the *"arguments raised by the Respondent/Petitioner (the appellant in these proceedings) is baseless"*. He had reached this conclusion on the premise that the *"Respondent/Petitioner had failed to support on what grounds this award will affect the public policy of Sri Lanka".* The learned Judge has given his mind to the decisions of this Court in ***Kiran Atapattu v Janashakthi General Insurance Co. Ltd*** (SC Appeal 30-31/2005, SCM 22.02.2013) and ***Lightweight Armour Ltd v Sri Lanka Army*** (2007) 1 SLR 412-418 in expressing these views. It is also pertinent to note that the learned High Court Judge was of the view that the arbitrators "*.. have noted on a subsequent date the dividend taxes were imposed by law which became applicable to the Respondent/Petitioner (the respondent in these proceedings) . In the same event change in law event had been constituted. Therefore, at the time of entering the agreement with the Claimant/ respondent, the Respondent/Petitioner had to make payments in respect of the taxes for 'change in law event'. On that, the Claimant Respondent had invoiced the Respondent/Petitioner to pay the aforesaid sum*".

There is no doubt that the issues in these proceedings revolve around the content and scope of "change in law event" and "reimbursable taxes" as recognised and agreed upon by the two contesting parties in the power purchase agreement. Their scope and the exact content had been the focus at the arbitral proceedings. The examination of questions of law on which leave to appeal was granted may require revisiting some of these matters that had been on focus at arbitration proceedings. It is the validity of the very same process that is questioned by the learned President's Counsel for the Respondent. It is his contention that the Supreme Court embarking in such a process adversely impacts on one of the core concepts of arbitration process the "party autonomy" which is recognised under Section 5 of the Act. Furthermore, it was his contention that the absence of an appeal from an arbitral award further fortifies and strengthens the party autonomy recognised in the arbitration process.

However, it is noteworthy to observe at this stage, that the re-examination of some of the facts, circumstances and issues by the High Court or by this Court *per se* cannot be construed as a process that undermines the party autonomy in arbitral proceedings. The Act which governs the conduct of arbitration proceedings itself recognises the jurisdiction of the High Court to set aside an arbitral award on the ground "that the arbitral award is in

conflict with the public policy of Sri Lanka". In exercising this jurisdiction, the High Court and / or the Supreme Court may have to examine certain issues that had already been determined by the Arbitral Tribunal. Such examination will have to be limited to the extent that is necessary to determine the issue whether the award is in conflict with public policy. However, when exercising the jurisdiction in such an instance it is important to be mindful that the law does not make provision for a judicial review of the arbitral award, by way of exercising the appellate or revisionary jurisdiction of the court. The examination should be limited to the extent necessary to determine whether the award is in conflict with the public policy of Sri Lanka. The Court has no jurisdiction to set aside the arbitral award merely on the ground that the Arbitral Tribunal has committed errors of fact and / or law in making the award.

According to the Power Purchase Agreement between the Appellant and the Respondent, "Change in Law" is defined as *"..subsequent to the date hereof, a change in or in the binding interpretation of or adoption, promulgation, amendment, modification or repeal of any Laws of Sri Lanka or the introduction, amendment or modification of any of the terms and conditions applicable to the project by any Government Instrumentality of Sri Lanka in connection with the issuance or renewal of any Governmental Approvals not arising however from any action or inaction by the Company"*. Section 8.6 describes as to what a "Change in Law Event" is. Section 8.6(a)(iv) and 8.6(a)(v) respectively reads as:
"The Capacity Charge and Energy Charge reflect the Company's cost of financing, developing, designing, engineering, constructing, commissioning, operating, maintaining and owning the Facility based on the Laws of Sri Lanka at the date of this Agreement. A change in Law after that date shall constitute a change in law event (a "Change in Law Event") if such change in Law:

- *Relates to the concessions, benefits, exemptions and privileges granted to the company under the Board of Investment Law;*
- *Relates to taxes (including income tax, dividend taxes, capital gains taxes and withholding taxes) other than Taxes.*

In the agreement between the Appellant and the Respondent "Taxes" is defined as "any and all Reimbursable Taxes, Sales Taxes and Input Sales Taxes".

Section 8.6(a) further provides that *"For the avoidance of any doubt it is clarified that any change relating to Reimbursable Taxes, Sales Taxes or Input Sales Taxes shall not constitute a Change in Law Event.*" According to Section 8.6 (b)(i) *"if any Change in Law Event results in a material increase or decrease in the Company's cost of financing, developing designing, engineering, constructing, commissioning, operating, maintaining and owning the Facility there shall be an equitable adjustment of the Tariff and / or the making of other appropriate payments and / or amendment to the other appropriate terms of this Agreement, to correct such material increase or decrease as the case may be, so that subject to section 8.6(b)(ii), the Company shall be in no less or no more favourable financial position than the Company was prior to such Change in Law Event"*.

It is also pertinent to consider what "Reimbursable Taxes" are, as defined in the Agreement. According to the definition of "Reimbursable Taxes" such taxes means *"expenses directly necessarily and actually borne by the Company for the performance of its obligations under this Agreement in relation to the Project on account of any and all taxes, including gross receipts, business turnover, use, consumption, property, franchise, occupational, excise duties, customs duties, defence levy, however imposed, withheld, levied or assessed in relation to the Company's business in the project, by the Government of Sri Lanka or any Governmental Instrumentality of Sri Lanka or any other taxation Authority of Sri Lanka, but excluding Input Sales Taxes, Sales Taxes, Stamp Duty and all taxes, imposts duties or levies of whatever kind or nature however imposed that the Company may become liable to due to the sole default of the Company in maintaining the tax concessions available to the Company under the BOI Agreement or in respect of which the Company is entitled to a credit or receives an input credit"*.

The Appellant's position before the Arbitral Tribunal was that the Respondent through their invoices claimed the disputed sums under "reimbursable taxes" and not as a "change in law event". It is his contention that the invoiced disputed sums do not fall within the definition of reimbursable taxes and hence the steps to recover back the amounts initially paid to the Respondent and refusal to pay thereafter is not in conflict with the agreement. Furthermore, it was the contention of the Appellant, that the responsibility of the Respondent under the Amendment to the Inland Revenue Act was to recover the taxes payable by the shareholders on the dividends declared by the Respondent company and receivable by them and remitting to the Inland Revenue department. Therefore, it is

contended that there is no additional cost incurred by the Respondent in relation to the production of electricity due to the change that took place following the amendment to the Inland Revenue Act and fails to meet the requirement under Section 8.6 (b)(i) of the agreement. Hence the Respondent is not entitled to claim the disputed sum under the "change in law event".

The Respondent disputed this contention. It is his contention that the disputed amounts reflect the responsibility of the Respondent due to the amendment to the aforesaid amendment to the Inland Revenue Act, as it falls within the income tax liability of the Respondent on the dividends declared and negates the exemptions that existed at the time of agreement. Furthermore, it has been contended that the conduct of the Appellant is in violation of Section 4.3 (d) of the agreement which requires the invoiced party to inform the invoicing party if the former disputes any amount specified in an invoice and if no such step is taken it is deemed to be undisputed by the parties.

The Arbitral Tribunal has considered these competing positions taken up by the two parties and the evidence of the sole witness who was presented at the hearing, namely the accountant of the Respondent, in making its award.

The Tribunal having considered the evidence of the accountant, the format of the appendix to the invoice and the letter dated 19th August 2011 signed by the Deputy General Manager of the Appellant informing the Respondent that the Appellant would recover the invoiced amounts under Dividend Tax, that were already paid, and the fact that the Appellant's attempt to reclaim from the Respondent took place three years after the payments were made honouring the invoices held as follows:

- The Appellant has not made allowance for the entering of any amount becoming due in the event of there being a "Change in Law" in preparing the format of the invoice;
- The entry relating to the Dividend Taxes has been recorded in the appendix as a separate item;
- There were discussions between the lawyers and the Appellant before the Appellant made the payments in relating to the invoiced amount including the Dividend Tax claimed;

- Submission on behalf of the Appellant that the first paragraph of the letter sent in 2011 namely "Under the change in Law clause in PPA entered with you, we have reimbursed Rs.215,203,184/-as dividend tax paid by your company since 2008" was an error, is untenable;
- The Appellant knew all along that the Respondent was claiming income tax paid on dividends and reimbursement was sought in terms of Section 4.3(b)(v) of the agreement – Change in Law event;
- No dispute was raised by the Appellants under Section 4.3 (d) of the Agreement;
- The Appellants forced the Respondent to refer the matter for arbitration without raising a dispute on the invoices in accordance with the provisions of the agreement;
- It is too late in the day to raise a dispute since the amount in question has been paid by the Appellant satisfying itself that the Respondent was entitled to it, three years prior to the letter sent in 2011;

When these findings of the Tribunal are considered, it is apparent that all these decisions had been reached based on the material presented before it by both parties, including the evidence of the sole witness. The Tribunal has noted that her evidence on some of the matters had not been refuted by the Appellant. These findings are mainly on facts and even if the Tribunal has erred on them, it is not possible to claim a "patent illegality".

It is pertinent to note that the Tribunal in the course of its findings has reached the following conclusion too:

- Amendment to Section 11 of the Inland Revenue Law deprived the Respondent of an exemption from paying income tax on dividends paid by the Respondent;

The Appellant and the Respondent took up diametrically opposing positions on this issue. Whilst the Respondent's contention is in line with the decision of the Arbitral Tribunal, the Appellant took up the position that the amendment did not introduce a new tax burden on the Respondent and the responsibility on the Respondent was to act in terms of Section 65 of the Inland Revenue Act No. 10 of 2006 where any company who distributed dividends was required to withhold 10 percent of the gross dividends payable to any shareholder as tax and remit the same to the Department of Inland Revenue. Prima facie this is a question of law involving the interpretation and a decision on this requires closer scrutiny of the provisions of the Inland Revenue Law including the relevant amendments.

The Respondent in its statement of claim has averred that there was a Change in Law in respect of dividend taxes and the Appellant was obliged to pay the Respondent the said sum due in respect of the change relating to the dividend tax. In the witness statement of the sole witness – the accountant of the Respondent – it is stated that there was a Change in Law in respect of dividend tax which was brought about by Section 5 of the Inland Revenue (Amendment) Act No. 12 of 2004 and the effect of such change was that such companies which were hitherto entitled to pay dividends exempt from income tax – (under Inland Revenue Act No. 38 of 2000) - became liable to pay dividend tax. In the written submissions of the Respondent filed before the Tribunal in its capacity the Claimant also has taken up the same position. It is claimed that the change took place from 01st April 2004, obliged the Respondent to pay dividend tax. It is on this premise the Respondent claimed their right to seek a reimbursement from the Appellant under the agreement.

As mentioned before the sole witness who testified before the Tribunal was the accountant of the Respondent. In her testimony also she took up the same position as in the witness statement. She claimed that the change to the Inland Revenue Act introduced by amendment Act No. 12 of 2004, the status of the Respondent who enjoyed the exemption on dividend tax did change and had the responsibility to pay dividend tax henceforth. It is on this basis the witness claimed that invoices were prepared claiming the dividend tax the Respondent had to pay, from the Appellant due to the change in law. It was her position that *"Regarding Dividend Tax it is actually company's liability to pay the Dividend Tax. Actually CEB people and our lawyers also checked this position before paying the Dividend Tax so many times. Lawyers, even CEB people they have confirmed that according to change in law they are liable to pay this Dividend Tax and we paid".* However, her testimony reflects that there was an uncertainty as to exactly under which provision of the agreement that the Respondent is entitled to payment from the Appellant. It is not very clear as to exactly under which clause ie: clause relating to "reimbursable taxes" or clause relating to "change in law event" , that the Respondents had the right to claim this payment from the Appellant at the time of invoicing this sum. However, before the Arbitral Tribunal the Respondents claimed the payment on the basis of "change in law event".

The Appellant however, disputed the claim by the Respondent. It is their position that the payment of Dividend Tax by the Respondent as required by the 2004 Amendment does

not fall within the ambit of "reimbursable taxes" nor under "change in law event" under the agreement. It was contended that recovering the amounts paid to the Respondent on the basis of their claim in the invoices, is justified and is in accordance with the provisions of the agreement. In the Statement of Defence filed before the Tribunal, the Appellant contended that "dividend tax was not a tax expense incurred by the claimant company itself at all, but was only a tax paid by the claimant in terms of section 61 of the Inland Revenue Act No 10 of 2006 as amended by Act no 10 of 2007 and recovered by way of deduction, from the amount of gross dividend payable to the claimant's shareholder/s in terms of section 65 of the said Act". It was further contended "furthermore, this duty to recover Dividend Tax paid by a company from its shareholders was mandatory in terms of Section 65 of the said Act". It is on this basis the Appellant contested the Respondent's claim before the Arbitral Tribunal. The sole witness – the accountant of the Respondent company – had been cross examined extensively. Even though, the witness at one point conceded that the Respondent could not have claimed the payment under "reimbursable taxes", the witness has taken up the position that the payment of Dividend Tax was an expense incurred by the Respondent company. Furthermore, the witness had taken up the position that the change had an impact on the costs of the Respondent which had an impact on the tariff. However, this position was disputed by the Appellant. On behalf of the Appellant, it had been contended that the Respondent was not entitled to seek a payment based on the Dividend tax paid to the State. As such payment did not come within the purview of either "reimbursable taxes" or "change in law event" as stipulated by the agreement between the two parties. The Appellant has taken up the same position in the written submissions and has further elaborated its contention on the relevant issues raised before the Tribunal.

The Tribunal had to make its determination based on these competing claims of the two parties. It is apparent that the Tribunal had to examine several aspects in reaching its decision. Firstly, the exact nature and content of the relevant amendment/s to the Inland Revenue Act and the change that took place on the Respondent's obligations relating to payment of taxes. Secondly, whether the claim of the Respondent through the invoices does relate to such payment of taxes? Thirdly, whether the agreement entered into between the two parties recognises a right for the Respondent to seek a payment from the Appellant in relation to any such taxes paid by the former?

The findings of the Tribunal as enumerated hereinbefore, including the finding that "Amendment to Section 11 of the Inland Revenue Law deprived the Respondent of an exemption from paying income tax on dividends paid by the Respondent" reflects that the Tribunal has held in favour of the Respondent on all the aforementioned areas.

The contention of the Appellant before this Court is that the Tribunal had failed to comprehend the nature of the amendment introduced to the Inland Revenue Act and the statutory mechanism governing the payment of Dividend Tax as contemplated in the applicable law as amended and thereby erred in awarding the relief to the Respondent as they claimed. The learned Additional Solicitor General contended that such error of the Tribunal is a "patent error" that warrants the High Court setting aside the award under section 32(1)(b)(ii) of the Arbitration Act on the ground of "public policy". However, the learned President's Counsel for the Respondent strenuously contested this proposition on the basis that the facts of this matter do not fall within the ambit of "public policy" as provided under the Arbitration Act.

This Court in ***Light Weight Body Armour Ltd v Sri Lanka Army*** [2007] 1 SLR 411 observed that *"...error of law on the face of record is not a valid ground of challenge of an arbitral award under section 32 of the Arbitration Act"(at page 417).* Further explaining the scope of public policy requirement under section 32, the Court proceeded to observe that *"...Public policy is generally those moral, social or economic considerations which are applied by Courts as grounds for refusing enforcement of an arbitral award. The House of Lords in 1853 described the public policy as 'that principal of law which holds that no subject can lawfully do that which has the tendency to be injurious to the public or against public good'...It is generally understood that the term public policy which was used in 1958 New York Convention and many other treaties covered fundamental principles of law and justice in substantive as procedural aspects. Thus, instances such as corruption, bribery and fraud and similar serious cases would constitute a ground for setting aside..."* (at page 419).

The above findings of the Supreme Court has been cited with approval in subsequent Judgements including ***Kiran Atapattu v Janashakthi General Insurance Co. Ltd*** (SC Appeal 30-31/2005, SCM 22.02.2013) and ***Spencer Services Limited v Mohomed Khan and another*** SC 200/2018 SCM 14.06.2024. In ***Spencer Services Limited*** (supra) the

Court considered the impact of alleged procedural irregularities committed by an Arbitral Tribunal in the context of the award being against the public policy and observed that: *"Every procedural violation does not give rise to a violation of public policy. It must be of a fundamental nature... Hence enforcement of an arbitral tribunal may be refused on the ground of public policy in the event that there has been a breach of the rules of natural justice or due process."* (at page 29).

Our Courts have consistently taken into account the core principles governing the arbitration proceedings including the concept of party autonomy in determining the scope of Section 32(1)(b)(ii) of the Arbitration Act. It is pertinent to note that the opportunity to set aside an arbitral award on the ground that the impugned award is in conflict with public policy of Sri Lanka should not lead to an abuse of the whole process by an unsuccessful party or the State at the final stage of arbitration process - the enforcement of the award. If such abuse takes place the credibility of the arbitration process itself would be at peril creating a serious impact on the efficient and effective alternate dispute resolution mechanism the commercial world has embraced. Hence, acting with caution in determining an issue on the enforcement of an arbitral award due to public policy concerns in the context of Section does not negate the effect of the statutory scheme of the Arbitration Act. On the other hand, no Court should hesitate to make an order setting aside an award in instances where such award is in conflict with public policy. The Supreme Court in ***Light Weight Body Armour Ltd*** (supra) recognised the jurisdiction of a Court to set aside an arbitral award in situations where patent and glaring error is a jurisdictional error or an error that renders the award contrary to public policy.

The learned Additional Solicitor General drew our attention to the decision of the Supreme Court of India in ***Oil and Natural Gas Corporation Ltd v Saw Pipes Ltd*** (2003) AIR SC 2629 in examining the scope of the similar provision in the Indian Act. He submitted that the Indian Supreme Court has recognised the jurisdiction of Court to set aside an arbitral award when such award is "patently illegal". The learned Additional Solicitor General impugns the award, on the premise that it is patently illegal and the above Judgement of the Indian Supreme Court lends support to his contention that such award could be set aside by Court on the basis that it is contrary to public policy. The Indian Supreme Court in ***Oil and Natural Gas Corporation Ltd*** (supra) has held that:

"The award could be set aside if it is against public policy of India, that is to say, if it is contrary to

(a) Fundamental policy of Indian Law;

(b) The interest of India; or

(c) Justice or morality; or

(d) It is patently illegal"

(at page 2656).

In reaching this decision the Indian Supreme Court had expressed the view that in the context of determining the issue of public policy in relation to an application to set aside an arbitral award a *"…wider meaning is required to be given so that the 'patently illegal award' passed by the Arbitral Tribunal could be set aside. If narrow meaning is given, some of the provisions of the Arbitration Act would become nugatory"* (at page 2641). It is on this basis that the Court identified the aforesaid four factors that could be considered in determining whether an arbitral award is contrary to public policy or not. It is also equally pertinent to note that the Supreme Court of India in reaching this decision, has exercised its jurisdiction similar to a situation where it exercises appellate or revisionary jurisdiction even though the subject matter before the Court was a challenge to an arbitral award based on "public policy". This is aptly reflected in the following observations of the Court:

"From the judgments discussed above, it can be held that the term 'public policy of India' is required to be interpreted in the context of the jurisdiction of the Court where the validity of the award is challenged before it becomes final and executable. The concept of enforcement of the award after it becomes final is different and the jurisdiction of the Court at that stage is could be limited. Similar is the position with regard to the execution of a decree. It is settle law as well as it is provided under the Code of Civil Procedure that once the decree has attained finality, in an execution proceeding, it may be challenged only on limited grounds such as the decree being without jurisdiction or nullity. But in a case where the judgment and decree is challenged before the appellate court or the court exercising revisional jurisdiction, the jurisdiction of such court would be wider. Therefore, in a case where the validity of award is challenged there is no necessity of giving a narrower meaning to the term 'public policy of India'" (at page 2641). Therefore, the Supreme Court of India has described that when an arbitral award is impugned on the

basis that it is contrary to the 'public policy of India', such challenge is made at a stage that the award has not become final and executable. On this premise the Indian Supreme Court has concluded that the Court could exercise its jurisdiction in such a situation as if the Court is exercising appellate or revisionary jurisdiction over a Judgement and decree which had not attained finality.

It is through this reasoning process the Supreme Court of India recognised 'patent illegality' as a factor that could be taken into account in determining whether an impugned arbitral award is challenged on the basis that such award is contrary to public policy of India. However, it is necessary to consider as to what extent this reasoning is in line with the jurisprudence of our Courts, if this Court is to act on the basis that the principles adopted in ***Oil and Natural Gas Corpn. Ltd*** (supra) has a persuasive value, when we determine the issue of 'public policy'. In this regard it is also pertinent to note the nature of the jurisdiction that the High Court is exercising when an award is challenged on the ground of "public policy".

Section 26 of the Arbitration Act recognises the finality of an arbitral award. According to this section, the "..award made by the arbitral tribunal shall be **final and binding** on the parties to the arbitration agreement". (emphasis added). Having recognised the finality of the award between the parties to the agreement, a limited room has been made for the intervention by Courts through the provisions in Part VII of the Act. Section 32 (1)(b)(ii) of the Act that recognises the jurisdiction of Court to set aside an Award on the basis the award is in conflict with the public policy of Sri Lanka is in Part VII. Therefore, when the Court examines an Arbitral Award on this ground it is not exercising the appellate or revisionary jurisdiction provided by the Constitution or any other Statute.

K.Kanag-Isvaran P.C. in "Some Fundamental Concepts and Principles in the Law of Arbitration" in "Arbitration Law in Sri Lanka", edited by K.Kanag-Isvaran PC and S.S. Wijeratne (3rd Ed – 2011) opines: *"It is therefore important to note that our Act does not empower a reviewing court before which an Award is sought to be set aside to undertake a review of the legal and factual conclusions contained in the arbitral award. In other words no challenge is permitted on the "merits" of the award – whether on a ground of law or on a ground of fact unlike in the exercise of an "appellate" jurisdiction where a*

"judgment" may be sought to be impeached both on questions of law as well as on 'questions of fact'. (pp 225-255 at 250).

Dr. Harsha Cabral P.C. in "Law and Practice of Commercial Arbitration in Sri Lanka" (ISBN 978-955-98598-4-0 published in 2018) opined that *"the grounds set down in section 32 are exhaustive., in that, arbitral awards cannot be challenged on any other ground than those set down in in Section 32. Another important factor to take note of is that, in an application to set aside the award there is no provision for the merits of the matter to be reviewed or revisited. An application made to the High Court under section 32 is different to an appeal made from a lower court to a higher court where the parties are free to revisit the facts and the law in detail. Thus, an arbitral award can be set aside only on the limited grounds set out in Section 32"* (at page 72).

In ***Kiran Atapattu*** (supra) this Court held that *"…our courts have adopted a more cautious approach and held that it is not every error of law but only a violation of a fundamental principle of law applicable in Sri Lanka that would be held to be contrary to public policy." (at page 8).*

This Court in ***Light Weight Body Armour Ltd***; (supra) *"As section 32 contains the sole grounds upon which an Award may be challenged or set aside, court to correct patent or glaring error of law in an Award unless the error can be established to be a jurisdictional error or can be shown to be of such nature as to render the Award contrary to public policy"* (at page 417). This Court in the same Judgement observed that *"The concept of public policy is not immutable. Rules which rest on foundation of public policy, not being rules of fixed customary law, are capable on proper occasion expansion or modification depending on the circumstances. Public policy is generally those moral, social, or economic considerations, which are applied by courts as grounds for refusing enforcement…..Whatever leads to the obstruction of justice or violation of a statute or is against good morals of a society can be deemed as being against public policy and therefore not susceptible to enforcement."* (at page 419)

Therefore, this Court having left the exact parameters of the concept of "public policy" open, adopted a cautious approach in determining the given facts of a particular matter warrants an order setting aside an award on the ground that such award is contrary to

public policy. In such situations the Court would refrain from exercising powers vested on it in situations where it exercises its "appellate" or "revisionary" jurisdiction. Therefore, the proper approach for the Court to adopt in determining the issue at hand is to continue following the approach adopted by our Courts without being influenced by the Indian jurisprudence. Hence, every error of law in an Award including an error on the interpretation of any statute should not *per se* lead to the setting aside of such award. Such a cautious approach will preserve and protect the unique character of Arbitration process in resolving commercial disputes while limiting intervention by Courts to protect interests of the State and preserve public good from ill effects of a decision relating to a dispute between two private parties who had voluntarily agreed to resolve their disputes through alternate dispute resolution mechanism.

The main basis on which the learned Additional Solicitor General urged that the impugned award is contrary to public policy is that the Tribunal erred when it decided that the Respondent had to pay dividend tax on dividends distributed to the shareholders of the Respondent due to the change that was brought in by the Inland Revenue (Amendment) Act No. 11 of 2004 and that such change fell within the purview of "change in law event" as set out in the agreement between the Appellant and the Respondent. The learned Additional Solicitor General contended that these findings of the Tribunal are "patently illegal" as the Tribunal erred in interpreting the provisions of the Inland Revenue (amendment) Act as well as the provisions of the agreement between the two parties. He contended that such errors go to the root of the matter before the Tribunal. Furthermore, it is contended that the award is perverse and irrational that no responsible Tribunal would have arrived at the decision arrived by the Tribunal.

In this regard it is pertinent to note that it is common ground that no dividend tax was in force at the time the two parties entered into the agreement. Therefore, it is clear that the Tribunal had to consider the provisions in the Amendment Act along with the other provisions of the Inland Revenue Act when the Tribunal reached the finding that the "*Amendment to section 11 of the Inland Revenue Law deprived the respondent of an exemption from paying income tax on dividends paid by the respondent"*. One could argue that it is through the interpretation of the relevant provisions of the Inland Revenue Act as amended the Tribunal could have come to this conclusion. Hence, if the Tribunal erred in the interpretation of the provisions of the Inland Revenue Act could it be possible to claim

that the Award is patently illegal and the award is contrary to public policy?. In my view the facts before this Court does not lend support to answer this question in the affirmative. The Inland Revenue Act makes provision relating to one of the main sources of revenue to the State. Therefore, there is an obligation to ensure that the provisions of the Act are correctly interpreted and that the State would not be deprived or denied the collection of revenue it is lawfully entitled to. If the State is denied this opportunity due to an error in the interpretation of any of the provisions of the statute such denial would have a serious adverse impact on the State. Such an error would defeat the object of the relevant statute and would cause harm to the State as well as to the citizenry. An award with such an error could be termed as an award that is patently illegal and the enforcement of such an award would be contrary to public policy. It is reasonable to adopt such a test to determine whether an Award should be set aside on the ground that it is contrary to public policy due to an error of the Tribunal in its interpretation of any statutory provision. If the ill effects of an error on the interpretation of any statutory provision by the Tribunal impacts upon the State or any other third party, setting aside of such an award on the basis of public policy in my view falls within the ambit of Section 32(1)(b)(ii) of the Arbitration Act. Hence each and every error on interpreting a statute would not be a valid ground to set aside an arbitral award.

In the matter before us in this appeal, no such eventuality has occurred. It is common ground that the Amendment to the Inland Revenue Act brought in a responsibility on the Respondent to pay income tax based on the dividends declared. The finding of the Tribunal is not in conflict with this position. Hence, I am of the view that the Tribunal has not erred in interpreting the statutory provisions in the Inland Revenue Act as amended to the disadvantage of the State, defeating the object and purpose of the said Act.

The next question that warrants examination is whether the Tribunal has erred in interpreting provisions relating to "change in law event" and "reimbursable tax" as stipulated in the agreement. In my view, any error on the interpretation of any provision in the agreement which brings in ill effects to one of the parties *per se* could not be brought within the purview of Section 32(1)(b)(ii) of the Act. If not, any party against whom an award is made could invoke the jurisdiction of the High Court and move Court to set aside the award on each and every instance the Tribunal has erred in interpreting any provision

in the agreement. Such an eventuality would adversely impact on the core principles in the Arbitration process. It would defeat the Arbitral process by opening flood gates to challenge Arbitral Awards in Courts in every instance a Tribunal has erred in the interpretation of any provision of the agreement. Therefore, in my view even if the Tribunal has erred by holding that the Appellant has the duty to pay the Respondent the sums the Respondent has paid as dividend Tax and such error has occurred in interpreting the provisions relating to "change in law event" as stipulated in the agreement, the award cannot be set aside on the basis that the award is contrary to public policy. Such an instance does not fall within the ambit of Section 32(1)(b)(ii).

In view of my findings enumerated hereinbefore, I am of the view that the Appellant is not entitled for an order setting aside the impugned arbitral award under Section 32(1)(b)(ii) of the Arbitration Act, even though the Tribunal has erred in interpreting the Inland Revenue Act as amended and the provisions of the agreement entered into between the two parties.

The other ground on which the learned Additional Solicitor contended that the impugned award is contrary to public policy is that the Respondent would be unjustly enriched if the award is executed. His contention is that the legislative scheme under the Inland Revenue Act has made provision for a company who pays dividend tax based on the value of declared dividends such a company is entitled to recover such sum by deducting such some from declared dividends before being paid to the shareholders. Therefore, if the Appellant is directed to make this payment, the Respondent would be recovering double the value of dividend tax that had been paid to the State. However, no evidence has been presented before the Arbitral Tribunal to establish this proposition, other than drawing the attention to the relevant statutory provisions in the Inland Revenue Act. The best witness who could have provided evidence on this matter is the sole witness who testified at the hearing – the accountant of the Respondent. This witness had not been probed in the cross examination by the Appellant. The Appellant in its statement of defence stated that the Respondent has wrongfully and unlawfully claimed reimbursement from the Appellant on account of dividend tax. It is further stated that the Respondent was not entitled in law to invoice and claim from the Appellant , sums paid on account of dividend tax on the basis of it being a "reimbursable tax" since the said dividend tax did not fall within the

definition and ambit of "reimbursable taxes" as set out in the agreement. The witness had been cross examined on this basis but had not examined to demonstrate that in fact the Respondent earned double the value of the dividend tax paid. Therefore, the Tribunal was not presented with sufficient evidence to make a determination on this matter other than by raising it in the written submissions subsequently filed. Hence no error could be attributed to the Tribunal on the failure to make a determination on this specific issue.

In view of the findings enumerated hereinbefore, I answer the first two questions of law in the negative and dismiss the appeal. No order is made on costs.

Chief Justice

Murdu N.B. Fernando , PC.
I agree

Judge of the Supreme Court

E.A.G.R. Amarasekera,
I agree

Judge of the Supreme Court