Arbitration Clauses in Government Contracts: Arbitration, Accountability and Reform

Introduction

Arbitration in India has recently became one of the most preferred methods for resolving contractual disputes. Since many years, the changes made in arbitration through consistent support by judiciary has strengthened this mode of dispute resolution resulting in reduced interference by the court. The overall objective has always been to create a dispute resolution framework that is efficient and attracts the businesses operating in India.[1]

The government, however, holds a slightly different position when it comes to arbitration in India. It makes certain policies relating to arbitration, but it also enters into different contracts across the country. When it comes to public contracts, government departments and PSUs enter into agreements which involves large amount of public money.

Highlighting the same, on 3 June 2024, the Ministry of Finance issued "Guidelines for Arbitration in Contracts of Domestic Public Procurement".[2] These guidelines stated that arbitration should not be included in such contracts automatically when the dispute involves large amount of money. The government raised concerns as to delay and accountability when public money is involved. Now, this creates a gap when it comes to arbitration being efficient and business-friendly, and not being used when it comes to government contracts. The answer to this gap lies in creating a balance between party autonomy in arbitration and taking the responsibility to protect funds of the public.

Legal Position in India

Arbitration in government contracts is legally recognised under the Arbitration and Conciliation Act, 1996. The act does not restrict the state or its bodies to enter into arbitration agreements as once a valid

[1] SCC Times, '*Arbitration in Government Contracts: Party Autonomy Versus Public Policy*' (SCC Online Times, 27 January 2025) https://www.scconline.com/blog/post/2025/01/27/arbitration-in-government-contracts-party-autonomy-versus-public-policy/ accessed 23 February 2026.

[2] Ministry of Finance, Government of India, *Guidelines for Arbitration and Mediation in Contracts of Domestic Public Procurement* (3 June 2024).

arbitration clause or agreement comes into picture, the courts are required to respect the choice of the parties and has to limit the interference subject to specific statutory grounds.[3]

Government contracts despite the involvement of public authorities, are commercial in nature. However, because the public funds are involved, courts have always examined disputes in regards to such contracts through the eyes of public policy and constitutional accountability.[4]

Government Contracts and Arbitration

The government is usually hesitant about arbitration when it comes to public procurement contracts. Scholars have always pointed out that when the state enters into a contract, even though it acts like a private party, but it carries certain responsibilities towards public.[5] This, as already mentioned, creates a gap. Unlike private companies, the government has to answer to the auditors, the parliament, and ultimately to the people.

The Ministry of Finance in its guidelines mentioned above, observed that arbitration has often led to delay proceedings, heavy costs and repetitive challenges to arbitral awards.[6] Mostly, it has been followed by litigation. The government also mentions that there have been issues and difficulties when it comes to transparency and settlement decisions as large public funds are involved.

Arbitration is not unlawful, but it's application in public contracts, exposes the state to financial and administrative risks. The issue is as to accountability and money and not the existence of arbitration.

Critical Analysis

The hesitation of the government, when it comes to arbitration in public contracts is reasonable, but it also raises certain concerns. Arbitration has been promoted as an efficient alternative to lengthy the court proceedings. If the state restricts its use in government contracts, then it means that the disputes will return to civil courts. This increases the delay rather than reducing it. At the same time, the position

[3] Arbitration and Conciliation Act 1996, ss 7, 8, 34.
[4] S Deshpande, 'Court, Contract and Arbitration' (1984) 26 *Journal of the Indian Law Institute* 377 https://www.jstor.org/stable/43950942 accessed 23 February 2026.
[5] Ibid.
[6] Ministry of Finance, Guidelines for Arbitration and Mediation (n 2).

of the government is not entirely unreasonable. When large amount of public funds are involved, every decision is open to criticism at a later stage.

The real issue may not even lie in arbitration itself. Many disputes arise because of unclear contract drafting and exaggerated claims from both sides. Limiting arbitration would not solve these problems. What we need here is balance. A stronger system, better drafting, and reasonable decision making may address these concerns more effectively.

Conclusion

The discussion when it comes to arbitration and government contracts is about managing the balance between private dispute resolution and accountability towards public.

When the government enters into any commercial agreements, it does so in an environment which depends on trust and certainty. However, it will always remain answerable to public for how the money is being spent. Recent changes in the policies shows concerns about administrative risk and delay in resolving disputes. These issues deserve proper attention. Yet, restricting arbitration in such matters will only move the disputes back to already burdened courts. A more balanced approach lies in handling the process, carefully making accountability and efficiency supporting each other rather than competing with.