

Dispute Resolution Hotline

July 02, 2010

YOUR EMPLOYEE AS ARBITRATOR, MAY NOT BE FAIR: SUPREME COURT

As a general rule, the law of Arbitration tends to preserve the finality of appointment of an arbitrator chosen with the mutual consent of the parties to an arbitration agreement. Applying this basic principle, the Supreme Court of India had held in *Indian Oil Corporation Ltd. & Ors. Vs. M/s. Raja Transport (P) Ltd.*, that the parties to an arbitration agreement are free to appoint an employee of one of the parties as an arbitrator under the arbitration agreement.¹ However, the Supreme Court in its recent ruling of *Denel (Proprietary) Limited ("Petitioner") v. Bharat Electronics Ltd & Anr ("Respondent")*², has granted relief under the Arbitration Petition filed by the Petitioner, allowing appointment of an independent arbitrator, albeit the existence of a valid Arbitration clause providing for appointment of Respondent's Managing Director or his nominee as the arbitrator.

THE RULING:

The Petitioner is a company wholly owned by the Government of South Africa and the Respondent company is an enterprise under the Ministry of Defense of the Government of India. The Respondent placed certain purchase orders with the Petitioner. The purchase orders contained an arbitration clause providing for the Managing Director, or his nominee, to act as an arbitrator in case a dispute arising between the Petitioner and the Respondent pursuant to the purchase orders. The goods were delivered by the Petitioner to the Respondent. Subsequently, by a letter dated May 4, 2005 the Respondent informed the Petitioner that in light of a direction of Ministry of Defense under Government of India to withhold any payments to be made to the Petitioner, it could not settle the amounts due to the Petitioner under the purchase orders. The Petitioner by way of a notice dated May 30, 2009, requested the Respondent to refer the dispute to arbitration in accordance with the arbitration clause under the purchase order. It was stated in the notice that since the arbitration clause provided only for the appointment of the Managing Director of the Respondent or his nominee as the arbitrator, it was an invalid clause and further requested the Respondent for appointment of mutually agreed independent arbitrator. On refusal of the Respondent to appoint a mutually agreed person as the arbitrator, the Petitioner approached the Supreme Court of India by way of an Arbitration Petition for appointment of a sole arbitrator under section 11(6) of the Arbitration and Conciliation Act, 1996 ("Act"). Section 11(6) of the Act allows the parties to an arbitration agreement to apply to the Chief Justice of India for appointment of an arbitrator in case they fail to appoint an arbitrator as envisaged under the arbitration agreement.

The Petitioner contended that the Managing Director was appointed by the Central Government itself, he could not go against the order of the Ministry of Defense of Government of India. Hence the Petitioner genuinely apprehended that it may not get justice in the hands of the said Managing Director.

The Supreme Court observed that the validity of the arbitration clause was not under dispute. Further, the Supreme Court observed that it was settled law that courts cannot interpose and interdict the appointment of an arbitrator whom the parties have chosen under the terms of the contract except on grounds like legal misconduct of the arbitrator, fraud, disqualification etc. However, considering the peculiar facts of the case and acknowledging that the appointed arbitrator, who was the Managing Director of the Respondent, was bound by the order of the Ministry of Defense of the Government of India. Therefore, the Managing Director may not be in a position to independently decide the dispute referred to him. Acknowledging the peculiar facts of the case and in the interests of both the parties and to do complete justice, the Supreme Court appointed an independent arbitrator to adjudicate the dispute between the Petitioner and the Respondent.

ANALYSIS OF THE RULING:

The Supreme Court had held in *Indian Oil Corporation Ltd. Vs Raja Transport Private Limited*³, that parties to an arbitration agreement could appoint an employee of one of the parties as an arbitrator, which *ipso facto* is not a ground to raise a presumption of bias or lack of independence on the part of the chosen arbitrator. Further, it was held that court has discretion to refuse appointment of such employee of one party as the arbitrator to their dispute, if there exists a reasonable apprehension about his impartiality or independence. However, in the case at hand, the Supreme Court gave effect to the exception of the above principle and refused the appointment of chosen arbitrator on the grounds of independence.

As a take away from this judgment, parties to an arbitration agreement for International Commercial Arbitration should bear in mind that the appointment of an employee of one of the parties as the arbitrator to their dispute may suffer at the hands of the power to do complete justice of the Supreme Court.

It is pertinent to note that section 11 of the Act comes into play only where (i) either the parties fail to appoint a person as the arbitrator, or (ii) the two appointed arbitrators fail to choose a third one. In the case at hand, the parties had agreed upon appointment of Respondent's Managing Director as the arbitrator. Applying section 11 in cases where the parties had already agreed upon appointment of an arbitrator may not be in line with the spirit of the Act. It would be interesting to see the interpretation of the present case as taken by the various High Courts dealing with application for appointment of an independent arbitrator.

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2 Arbitration Petition No 16 of 2009

3 Civil Appeal No. 5760 of 2009 arising out of SLP (C) No. 26906 of 2008.

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