

Dispute Resolution Hotline

September 25, 2017

SUPREME COURT UPHOLDS ARBITRAL CLAUSE PROVIDING FOR AN EMPLOYEE ARBITRATOR

- Appointment of employee as an Arbitrator is not invalid and unenforceable in arbitrations invoked prior to October 23, 2015;
- The terms of the arbitration agreement ought to be adhered to and/or given effect to as closely as possible;
- No automatic intervention by the Chief Justice of High Court for appointment of an arbitrator, without establishing cause.

INTRODUCTION

The Supreme Court of India (“**Court**”) in its recent ruling, *Aravalli Power Company Ltd. (“Appellant”) v. Era Infra Engineering Ltd., (“Respondent”),*¹ clarified that the provisions of the Arbitration and Conciliation (Amendment) Act, 2015 (“**Amendment Act**”) pertaining to arbitral appointments and challenge to such appointments would not be applicable to arbitrations invoked prior to October 23, 2015. The Court held that the employee named as an arbitrator in the arbitration clause should be given effect to in the absence of any justifiable apprehension of independence and impartiality.

BRIEF FACTS

The parties entered an agreement in 2009 for construction of permanent township for a thermal power project in Haryana. Due to certain delays in completion of work, the Appellant cancelled remaining works by their several letters issued in 2014-15. The Respondent refuted the claims and invoked arbitration under Clause 56 of the General Conditions of Contract (“**GCC**”) under the agreement. The relevant portion of the arbitration clause is reproduced below:

“.....*There will be no objections, if the Arbitrator so appointed is an employee of NTPC Limited (Formerly National Thermal Power Corporation Ltd) and that he had to deal with the matters to which the contract relates and that in the course of his duties as such he had expressed views on all or any of the matters in disputes or difference.....*”

| Date | Sequence of Events |
|-------------------|---|
| July 29, 2015 | The Respondent invoked arbitration and sought appointment of a retired High Court judge as the Sole Arbitrator for conducting arbitration proceedings. The Respondent in their letter requested a panel of independent arbitrators be made available to them for appointing the Sole Arbitrator or in the alternative were agreeable to constitution of an Arbitral Tribunal comprising of nominee of each party and they together appointing the Presiding Arbitrator. |
| August 19, 2015 | The Appellant rejected the request of the Respondent and appointed its Chief Executive Officer (“ CEO ”) as the Sole Arbitrator in terms of Clause 56, which envisaged the appointment of certain designated officers by the Appellant as the Arbitrator. |
| October 7, 2015 | Procedural hearing was conducted and parties were directed to complete pleadings and next hearing was scheduled for April 9, 2016. From the records, it appears that the Respondent did not raise any objection regarding continuation of the Arbitral proceedings. |
| October 23, 2015 | The Ordinance ² was promulgated and Fifth Schedule was inserted to the Act enumerating circumstances which give rise to justifiable doubts regarding the impartiality or independence of the arbitrator. Entry No.1 read as follows: if “ <i>The arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party</i> ”. |
| December 04, 2015 | Letter addressed by the Respondent seeking extension of time to file their Statement of Claim. |
| January 01, 2016 | Amendment Act was <i>gazetted</i> and was deemed to come into force from October 23, 2015; |
| January 12, 2016 | The Respondent sought to challenge the mandate of the Arbitrator and objected to the constitution of the Tribunal. Respondent expressed their intention to approach the Hon'ble Delhi High Court for appointment of an independent arbitral tribunal and sought stay on the arbitral proceedings. |
| January 22, 2016 | The Tribunal rejected the challenge as the Respondent participated in the Arbitral Proceedings. |

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The Respondent approached the Delhi High Court ("Delhi HC") seeking termination of the Arbitrator's mandate under Section 14 of the Arbitration & Conciliation Act, 1996 ("Act") and appointment of a Sole Arbitrator by the Chief Justice under Section 11(6) of the Act.

Keeping in mind the legislative intent contained in the Amendment Act, as the current Arbitrator was the CEO of the Appellant and was previously involved in cases/ contract works similar to the present case, the Delhi HC allowed both petitions and asked the Appellant to furnish names of three panel arbitrators from different departments for selection by the Respondent. The Delhi HC also stated that in the event of failure by the Appellant, it would be open to the Respondent to revive the petitions in which case the Delhi HC would appoint a Sole Arbitrator from the list maintained by Delhi International Arbitration Centre.

The Appellant challenged the decision leading to the present appeal.

ISSUE

The Delhi HC had wrongly exercised jurisdiction and erred in applying the provisions of the Amendment Act, given that the arbitral proceedings were initiated prior to the amendments.

JUDGMENT

The Court clarified that since arbitration was invoked prior to October 23, 2015, the statutory provisions in force prior to the amendments would be applicable in the present case.

The named Arbitrator, being an employee of one of the parties, *ipso facto* would not render the appointment invalid and unenforceable under the erstwhile provisions of the Act. The Supreme Court held that doubts could arise if such person was the controlling or dealing authority with respect to the subject contract or if he is a direct subordinate to the officer whose decision is the subject matter of the dispute. Relying on *Indian Oil Corporation Ltd. and Others v. Raja Transport Private Ltd.*³ the Court held that the disputes should be referred to the named Arbitrator as a rule unless there exist justifiable apprehensions on his independence and impartiality.

The Court emphasized on the significance of giving effect to the terms of the agreement to the closest extent possible reiterating the law laid down in *Northern Railway Administration, Ministry of Railway, New Delhi v. Patel Engineering Company Ltd.*⁴ with respect to pre-amendment cases.

On arbitral appointment, the Supreme Court held that there could not be any automatic invocation of powers under Section 11(6) by the Chief Justice of High Court, without establishing that (i) a party fails to act as required under the appointment procedure; or (ii) the parties, or the two appointed arbitrators, fail to reach an agreement expected of them under that procedure; or (iii) a person, including an institution, fails to perform any function entrusted to him or it under the appointment procedure.

The Court specifically clarified that in case of arbitrations initiated post-amendments, if the arbitration clause is not in consonance with the amended provisions, the appointment of the Arbitrator even if apparently in conformity with the arbitration clause in the agreement, would be illegal and courts can exercise its powers under Section 11(6) to appoint arbitrators.

The Court went on to set aside the order of the Delhi HC and held that the arbitral proceedings under the CEO would continue in accordance with law.

ANALYSIS

Post the Amendment Act, several rulings have been passed by various High Courts applying the amended provisions retrospectively on a selective basis. This has created a lot of chaos and confusion on the interpretation of the provisions and its applicability to court proceedings emanating out of arbitrations.

The Court has clarified that the provisions of the Amendment Act insofar as they relate to the appointment of arbitrators, would not be applicable for arbitrations invoked prior to October 23, 2015. Moreover, the intervention of the courts in such arbitrations could only be sought on limited grounds i.e. by demonstrating justifiable doubts on independence or impartiality.

The Court has adopted a straight-jacket formula and demarcated pre-amendment and post-amendment application of provisions of the Act, not allowing parties to take advantage of the new provisions and derail ongoing proceedings. The Court chose to disregard the fact that the Sole Arbitrator in this case was, in fact, the CEO of the Appellant. It may be argued that in doing so, the Court lost an opportunity to once and for all put to rest the much criticized practice of appointment of employee-arbitrators. This is a practice that the Court itself has frowned upon several times and which was, in fact, severely criticized in the 246th Law Commission Report.

— **Siddharth Ratho, Payel Chatterjee & Sahil Kanuga**
You can direct your queries or comments to the authors

¹ Civil Appeal No. 12627-12628 OF 2017 (SPECIAL LEAVE PETITION (CIVIL) NOS.25206-25207 OF 2016)

² The Arbitration and Conciliation (Amendment) Ordinance was promulgated on October 23, 2015. Thereafter, on January 01, 2016, the Arbitration and Conciliation (Amendment) Act was gazetted and according to Section 1(2) therein, the Amendment Act was deemed to have come into force on October 23, 2015.

³ (2009) 8 SCC 520

⁴ (2008) 10 SCC 240

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September 22, 2024

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