# Dispute Resolution Hotline

September 28, 2020

## DELHI HIGH COURT GIVES EXPRESSION TO 'EXPRESS AGREEMENT IN WRITING' IN SECTION 12(5) OF THE A&C ACT

- Clause authorising a party's Chairman to appoint the sole arbitrator renders the arbitrator de jure unable to continue with the proceedings under Section 12(5) read with Section 14(1)(a) of the A&C Act
- De jure inability results in automatic termination and does not require initiation of separate challenge proceedings
- Continuation of proceedings by the other party does not result in waiver of its right to object to termination of arbitrator mandate
- De jure inability of the arbitrator can be superseded only by an 'express agreement in writing' subsequent to the disputes

**FACTS:**

JMC Projects India Ltd. ("Petitioner / JMC") executed a work order with Indure Private Ltd. ("Respondent / Indure") on September 6, 2011. The Respondent is a major manufacturing company of the Desein Group.[1] The General Conditions of Contract in the work order contained an arbitration clause, stating, *"The arbitration will take place before a Sole Arbitrator who shall be nominated by Mr. N. P. Gupta, Chairman of Desein Private Limited."*

Disputes arose between the JMC and Indure (collectively "Parties") and Petitioner issued a notice of arbitration on July 1, 2016 and called upon nomination of an arbitrator through Mr. N.P. Gupta as per the arbitration clause. On July 26, 2016, Mr. N.P. Gupta nominated a retired judge of the High Court of Delhi ("Court") as the sole arbitrator. On November 11, 2016, the Petitioner filed its Statement of Claim. Proceedings continued, leading to two requests for extensions by Petitioner on January 6, 2020 and January 20, 2020 for filing of affidavit of evidence. Petitioner finally filed its evidence on January 27, 2020.

Petitioner filed an application before the Court under Section 14(1)(a) of the A&C Act seeking termination of the mandate of the arbitrator.

**CONTENTIONS OF PARTIES:**

The Petitioner contended that the arbitrator had become de jure incapable of performing his functions under the A&C Act owing to his ineligibility under Section 12(5) read with Schedule VII of the A&C Act.[2] The Petitioner relied on the first category in Schedule VII of the A&C Act wherein "employees, consultants, advisors, and persons who have any other past or present business relationship with either of the parties to the arbitration, are disqualified from arbitrating, vide S. No. 1 of the Seventh Schedule to the 1996 Act."

The Respondent argued that parties had waived the applicability of Section 12(5) and had expressly consented in writing to the functioning of the arbitrator by seeking two extensions in writing for the filing of evidence of its witnesses. It also relied on Section 13(4) of the A&C Act to state that the petition could not have been filed directly before the Court without raising a challenge before the arbitrator. Further, it stated that the proceedings were not maintainable before the Court as the agreement between the parties was not stamped.

**JUDGMENT:**

The Court held that by virtue of Section 12(5) of the A&C Act, the learned arbitrator appointed by Mr. N.P. Gupta, the Group Chairman, was rendered de jure incapable of continuing to function as arbitrator within the meaning of Section 14(1)(a) of the A&C Act. The Court allowed the petition and substituted the original arbitrator with a retired judge of the Court. The Court's analysis is briefly set out below.

The Court assessed the law in relation to Section 12(5) of the A&C Act read with category 1 in Schedule VII of the A&C Act. It analysed the position in *TRF Ltd. v. Energo Engineering Projects Ltd.*[3] ("**TRF case**") where the Supreme Court of India assessed an arbitration clause authorising the Managing Director of the Corporation to act as a sole arbitrator or appoint a nominee. The Court held that there was no doubt that by virtue of the Seventh Schedule, the Managing Director of the Corporation was ineligible by operation of law.

Further, the Court held that the arbitrator becomes ineligible as per prescription contained in Section 12(5). It is therefore inconceivable in law that a person who is statutorily ineligible to act as an arbitrator can nominate another person as an arbitrator. The Court also analysed *Perkins Eastman Architects DPC v. HSCC (India) Limited*[4] ("**Perkins case**") where the Supreme Court of India held that even the nominee of the managing director of the respondent could not competently function as the sole arbitrator on the basis of bias and interest in the outcome

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of the case.

In response to the Respondent's argument that the petitioner had waived the applicability of Section 12(5) by seeking written extensions, the Court stated that the only means to be free of the rigours of Section 12(5) was to have an express agreement in writing after disputes have arisen between the parties.

The agreement in writing must reflect awareness, on the parties, to the applicability of the said provision as well as the resultant invalidation of the arbitrator to arbitrate on the disputes, as well as a conscious intention to waive the applicability of Section 12(5). The express agreement in writing was an irreplaceable condition which could not be substituted by conduct, howsoever extensive or suggestive.

Accordingly, the extensions applications did not constitute an "agreement in writing" to waive the applicability of Section 12(5).

The Court relied on *Bharat Broadband Network Ltd. vs. United Telecoms Ltd.*[5] which contrasted the proviso to Section 12(5) with Section 4 of the A&C Act. Section 4 deals with cases of deemed waiver by conduct; whereas the proviso to Section 12(5) deals with waiver by express agreement in writing between the parties only if made subsequent to disputes having arisen between them. The expression "express agreement in writing" refers to an agreement made in words as opposed to an agreement which is to be inferred by conduct.

The Court also rejected the Respondent's argument that the petition could not be filed directly in Court without making a challenge before the arbitrator himself. With respect to the issue of stamping, the Court held that this contention was neither raised in the arbitration proceedings nor in the Respondent's reply to the petition before the Court. As such, it appeared to be an after-thought and a desperate attempt to wriggle out of the court proceedings. The Court refrained from making any finding on the issue.

**ANALYSIS:**

The Court has helpfully drawn a nuance in the type of clauses and capacities an employee can hold in relation to arbitral appointments. TRF Energo case provided that the Managing Director of a party, who is himself ineligible to be appointed as an arbitrator, cannot validly nominate another as an arbitrator in his stead. In TRF Energo, the Managing Director therefore held two capacities – either as an arbitrator, or nominating authority. The present case is distinct, in as much as the Group Chairman merely held the capacity of a nominating authority. The Court therefore relied on Perkins case to bring such situations under the rigors of ineligibility under Section 12(5). Where a party's employee only held the second capacity i.e. to nominate an arbitrator, his interest in the outcome of the case could continue into his capacity to nominate, forming the basis for bias. It is critical for parties to re-look and assess their arbitration clause with the above lens.

It would be relevant to analyse the distinction between cases where parties would need to file a separate application for challenge before the arbitrator, versus where the mandate of the arbitrator automatically terminates. Where doubts exists as to independence or impartiality of an arbitrator resulting from disclosure, the appointment can be challenged under Section 12(3) read with Section 13. However, where the arbitrator becomes de jure unable to perform his functions by virtue of ineligibility under Section 12(5), his or her mandate terminates automatically under Section 14(1)(a). In the latter case, the appointment cannot be challenged before an arbitrator. If any controversy arises as to whether the arbitrator is indeed de jure unable to continue with the proceedings, the Court would adjudicate upon such a question.

Further, the judgment provides expression and substantive interpretation to the words "express agreement in writing" under Section 12(5) of the A&C Act. The phrase would appear to be sufficiently clear. However, its analysis alongside Section 4 and 7 of the A&C Act, and the distinction drawn by the Court in the contours of waiver by implied conduct in Section 4, vis-a-vis "agreement in writing" under Section 7, versus a requirement of "express agreement in writing" under Section 12(5) offers clarity on the nuance that runs among these terms. It may not be simple for parties to escape the express requirement through indirect or implied means.

It is important to note that in the present case, the disputes arose after the enactment of the amendments to Section 12(5) in 2015 and the corresponding introduction of the Seventh Schedule to the A&C Act. This implies that the arbitrator was de jure unable to perform his functions by virtue of the ineligibility under Section 12(5) since his appointment in July 2016. However, it is surprising to note that despite settled law in this regard under Section 12(5) read with Schedule VII since 2015 and TRF Energo case in 2017, the Petitioner brought forth an application to terminate the mandate on the subject ground only in 2020 - four years after initiation of arbitral proceedings.

It is possible that without sufficient safeguards against such ignorance of the law (which cannot be an excuse), parties could abuse arbitration proceedings, where arbitrators are de jure unable, to their advantage upto a stage where they desire to substitute the arbitrator by taking aid of the de jure inability and lack of an express agreement in writing under Section 12(5) read with Section 14(1)(a). Conversely, a party that is ignorant of the automatic termination of an arbitrator's mandate under Section 14(1)(a) could continue with the arbitration proceedings resulting in an award that has no legal status and is amenable to a challenge. It is evident, and not novel, that a spectrum of issues could arise out of a brief, seemingly simple arbitration clause. Parties must closely look at their arbitration clauses and seek legal advice while drafting and contemplating initiation of arbitration proceedings.

– Kshama Loya Modani & Moazzam Khan
You can direct your queries or comments to the authors

[1] Not referred to in the judgment but available at https://www.desein.com/about/group-companies1.php accessed on September 16, 2020

[2] "12. Grounds for challenge.— (5) Notwithstanding any prior agreement to the contrary, any person whose relationship, with the parties or counsel or the subject matter of the dispute, falls under any of the categories specified in the Seventh Schedule shall be ineligible to be appointed as an arbitrator:
Provided that parties may, subsequent to disputes having arisen between them, waive the applicability of this sub-section by an express agreement in writing."
"The Seventh Schedule: Arbitrator's Relationship with the Parties or Counsel.
(1) The arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party."

[3] (2017) 8 SCC 377

[4] 2019 SCC OnLine SC 1517

[5] (2019) 5 SCC 755

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