

Dispute Resolution Hotline

February 22, 2019

COURTS HAVE NO FREEHAND IN SUBSTITUTING ARBITRATORS

- Arbitration agreement cannot be ignored in appointment of substitute arbitrators
- Conduct of parties may constitute waiver of objections
- Supreme Court exercises powers under Article 142 to set aside an arbitral award

The Supreme Court in an unprecedented case of *Rajasthan Small Industries Corporation Limited v. M/s Ganesh Containers Movers Syndicate*¹, set aside the arbitral award exercising powers under Article 142 of the Constitution of India. The Apex Court held that delay in passing the arbitral award does not entitle courts to replace the arbitrator who was an employee of one party, ignoring the arbitration agreement. Substitute arbitrators have to be appointed in accordance with the same arbitration agreement. The Court reaffirmed that Arbitration and Conciliation Act, 1996 ("**Arbitration Act**") as amended in 2015 would not apply to arbitrations commenced prior to amendment in 2015.

FACTUAL MATRIX

Rajasthan Small Industries Corporation Limited ("**RSICL / Appellant**") entered into an agreement with M/s Ganesh Containers Movers Syndicate ("**Respondent / Contractor**") on January 28, 2000 for transportation and handling of cargo at certain depots ("**Contract**"). Dispute arose between parties under the Contract and the Contractor requested for arbitration.

The Contract provided for settlement of disputes by arbitration. As per the clause 4.20.1, the arbitration was to be referred to a sole arbitrator which could either be Managing Director of RSICL himself or his nominee. One Mr. I. C. Shrivastava, IAS (Retd.) was appointed as the sole arbitrator in February 2005. However, due to slow progress of the arbitration, Mr. Shrivastava was removed in 2009 and Chairman-cum-Managing Director ("**CMD**") of RSICL was subsequently appointed as arbitrator by consent of both parties.

Initially, the Contractor protested and raised doubts on impartiality of CMD as the arbitrator. However, it finally gave its consent for CMD to arbitrate. Later on, the Contractor also declared its faith in the arbitrator and requested that the matter be decided expeditiously. However, the first arbitrator could not handover the record of arbitration to the subsequent arbitrator. As a result, Parties were directed to appear with complete records of claim and counter-claim. During such time, detailed discussions took place between parties and Contractor agreed to withdraw certain claims. Thereafter, during April and May 2011, the arbitrator sought clarifications from parties to finalise the award. However, in August 2011, the arbitral tribunal declared that chronological events need to be ascertained and the records will have to be reconstructed and no award was passed.

In 2013, the Contractor sent legal notices to RSICL claiming the amounts pursuant to earlier settlement along with interest. It stated that despite the settlement, no award was passed by the arbitrator. RSICL denied the settlement and also denied the amounts claimed.

Consequently, in December 2015, the Contractor filed an application under Section 11 of the Arbitration Act before the High Court of Rajasthan ("**High Court**") for appointment of an independent arbitrator to adjudicate the disputes. The Contractor requested that the arbitration proceedings be kept in abeyance till the High Court proceedings are concluded. However, the arbitral tribunal passed the final award on January 21, 2016 ("**Award**"). Subsequently, in April 2016 the High Court also passed the final order appointing a retired District Judge as the sole arbitrator to resolve the disputes between the parties. The said order was challenged by RSICL before the Hon'ble Supreme Court.

JUDGMENT

Contractor was not justified in filing an application under Section 11 of Arbitration Act

Supreme Court held that when parties consciously chose to refer their disputes to Managing Director himself or his nominee and having participated in the arbitral proceedings for some time, the Contractor could not turn around and seek for appointment of an independent arbitrator. In fact, the Contractor in one of his communications stated that it has full faith in the arbitrator.

The court noted that the Contractor has not placed on record any material to show that the arbitrator has not acted independently or impartially or is likely to not act independently or impartially. Accordingly, having participated in the arbitral proceedings, the Contractor was estopped from challenging the competence of the arbitrator.

CMD has not become ineligible to act as arbitrator as per Section 12(5) of Arbitration Act

In 2015, the Arbitration Act was amended and among other things, Section 12(5) and Seventh Schedule was inserted. Section 12(5) read with Seventh Schedule prohibits employees of one of the parties from being an arbitrator. The Contractor argued that by virtue of Section 12(5), CMD had become ineligible to act as arbitrator.

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However, in the present case the arbitration proceedings were commenced in 2009. Application for appointment of the arbitrator was also filed prior to 2015. Therefore, the Court held that the amended Arbitration Act would not be applicable. It opined that amended Arbitration Act cannot have retrospective operation unless the parties agreed.²

High Court was not right in terminating the mandated of CMD as arbitrator

The Contractor argued that the arbitrator failed to conclude the proceedings even after four years and therefore, appointment of substitute arbitrator was justified. To support this argument, it relied upon the judgment of Supreme Court in *Union of India & Ors. v. Uttar Pradesh State Bridge Corporation Limited*³ (“UPSB Case”). In this case, the arbitral tribunal was unable to proceed in the matter for almost four years without any justifiable reason despite specific orders of High Court to complete the proceedings within three months. Hence, it was held that the termination of mandate of the arbitral tribunal and appointment of substitute tribunal was justified.

The Supreme Court however, distinguished the present case with the UPSB Case. It held that in the present case, proceedings continued till August 2011. It was apparent that arbitration papers were incomplete and accordingly, chronological events needed to be ascertained and records had to be reconstructed. Owing to this, the Award could not be passed till 2013. The Contractor also never filed any application to expedite the proceedings nor did it file an application under Section 14 of the Arbitration Act for terminating the mandate of the arbitrator because of failing to act without undue delay.

Supreme Court held that mere neglect of an arbitrator to act or delay in passing the award by itself cannot be the ground to appoint another arbitrator disregarding the terms of arbitration agreement. Section 15 of Arbitration Act deals with termination and substitution of an arbitrator. As per Section 15(2), after the termination, the appointment of substitute arbitrator has to be in accordance with rules applicable to the appointment of arbitrator who was first appointed. The said rules also include contractual provisions for such appointment.⁴ Thus, even appointment of substitute arbitrator has to be done in accordance with the original agreement. In view of the above, the Supreme Court held that High Court was not right in appointing an independent arbitrator without giving due regard to the terms of the Contract.

Exercise of power under Article 142

Interestingly, the Supreme Court remarked that the arbitral tribunal should not have passed the Award when the High Court was seized of the matter. The proceedings were pending for a long time. The arbitrator hastily passed the Award after the proceedings in High Court were commenced. The record of arbitration had to be reconstructed and it is not clear whether it was done before the Award. The Contractor was also not given an opportunity to substantiate its claims. Hence, in order to do complete justice, the Supreme Court set aside the Award in exercise of its powers under Article 142 of the Constitution. The court held that it would also save parties much time if they were to challenge the Award by way of fresh proceedings under Section 34 of Arbitration Act.

CONCLUSION

The present judgment throws light on the termination and substitution of the arbitrators. It emphasizes the importance of terms of arbitration agreement which cannot be brushed aside by courts even when substituting the arbitrators under Section 15 of Arbitration Act. After the amendment in 2015, arbitration proceedings have to be concluded in a time bound manner (within twelve months with an extension of six months by consent of parties). Consequences such as reduction in fees and substitution of arbitrators are also now provided in case the tribunals are unable to meet the required timelines. The amended Arbitration Act also prohibits certain persons who are listed in the Seventh Schedule from acting as arbitrators, one category of them being “employees of one of the parties”. Accordingly, if a similar fact situation arose in the present day circumstances, the results could have been entirely different.

Interestingly, exercise of powers under Article 142 to set aside the Award also raises certain questions. The power was exercised only to save parties the trouble of filing fresh proceedings to challenge the Award under Arbitration Act. The court should therefore, have considered the thresholds provided under Section 34 to set aside the award. The question whether the Award was liable to be set aside because Contractor was actually unable to present its case, does not appear to have been dealt with. Accordingly, it is only but hoped that the present case is a one off exercise of power, given the peculiarity of the facts and will not be widely used as a precedent.

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You can direct your queries or comments to the authors

¹ Civil Appeal No. 1039 of 2019 arising out of SLP (C) No. 22809 of 2016
² *BCCI v. Kochi Cricket Private Limited & Ors.* (2018) 6 SCC 287
³ (2015) 2 SCC 52
⁴ *Yashwith Constructions (P) Ltd. v. Simplex Concrete Piles India & anr.*, (2006) 6 SCC 204

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