Dispute Resolution Hotline

March 03, 2017

SUPREME COURT UPHOLDS GOVERNMENT EMPLOYEES/EX-EMPLOYEES AS ARBITRATORS

The Supreme Court of India:

1. Acknowledges that retired/existing government employees may be appointed as arbitrators;
2. Directs public sector undertaking to broad base the panel of arbitrators to incorporate legal, accounting and technical expertise;
3. Partially strikes down procedure to appoint arbitral tribunal and ensures parties have access to full panel of potential arbitrators;

A two-judge bench of the Supreme Court of India (**"Court"**) in *Voestalpine Schienen GmbH* (**"Petitioner"**) *v. Delhi Metro Rail Corporation Ltd.* (**"Respondent"**)[1] upheld an arbitration agreement which required the Petitioner to choose from a panel of arbitrators maintained by the Respondent, consisting of serving or retired engineers either of the Government Department or Public Sector Undertakings.

However, in a step having far-reaching consequences, the Court, *inter alia*, went on to delete portions of the procedure for appointment of the arbitral tribunal and further, directed the Respondent to amend its existing panel and prepare a broad based panel consisting of (i) engineers of prominence and high repute from the private sector; (ii) persons with a legal background i.e. judges and lawyers; and (iii) persons having expertise in accountancy.

BRIEF FACTUAL BACKGROUND:

The Petitioner is an Austrian company engaged in the business of steel production *inter alia* manufacture, production and supply of rails and related products. The Respondent ("**Purchaser**"), a government owned corporation[2], which floated tenders for production and supply of steel rails. This contract was awarded to the Petitioner and the two parties entered into an agreement dated August 12, 2013 ("**Agreement**").

Disputes arose under the Agreement when the Respondent (i) withheld Euro 531,276 on the Petitioner's invoices; (ii) encashed performance bank guarantees amounting to Euro 783,200; (iii) imposed liquidated damages of Euro 400,129.39; and (iv) invoked the price variation clause to claim a deposit of Euro 487,830. There were claims and counter-claims between the parties arising out of the Agreement and on June 14, 2016, after attempts to amicably resolve the disputes were not successful, the Petitioner invoked arbitration under the Agreement.

The relevant portions of this arbitration agreement are reproduced below:

"ARBITRATION & RESOLUTION OF DISPUTES.

The Arbitration & Conciliation Act, 1996 of India shall be applicable. Purchaser and the supplier shall make every necessary effort to resolve amicably by direct and informal negotiation any disagreement or dispute arising between them under or in connection with contract.

Arbitration: If the efforts to resolve all if or any of the disputes through conciliation fails, then such disputes or differences whatsoever arising between the parties, arising out of or touching ……shall be referred to Arbitration in accordance with the following provisions:

1. *Matters to be arbitrated upon shall be referred to a sole Arbitrator where the total value of claims does not exceed Rs. 1.5 million. Beyond the claim limit of Rs. 1.5 million. Beyond the claim limit of Rs. 1.5 million, there shall be three Arbitrators.* ***For this purpose the Purchaser will make out a panel of engineers with the requisite qualifications and professional experience. This panel will be of serving or retired engineers "Government Departments or of Public Sector Undertakings;***
2. *For the disputes to be decided by a sole Arbitrator, a 'list of three engineers taken the aforesaid panel will be sent to the supplier by the Purchaser from which the supplier will choose one;*
3. ***For the disputes to be decided by three Arbitrators, the Purchaser will make out a list of five engineers from the aforesaid panel. The supplier and Purchaser shall choose one Arbitrator each, and the two so chosen shall choose the third Arbitrator from the said list, who shall act as the presiding Arbitrator****.*

……"

(emphasis supplied)

In their letter invoking arbitration, the Petitioner took the stand that appointment of the arbitral tribunal under the

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procedure specified in the Agreement would lead to the appointment of "*ineligible persons*" as arbitrators, in light of the requirements imposed by Section 12(5) read with Schedule 7 of the amended Arbitration & Conciliation Act, 1996 (**"Act"**). The Petitioner therefore nominated a retired Supreme Court judge as sole arbitrator and sought the consent of the Respondent. The Respondent replied on July 8, 2016, stating that the procedure in the arbitration agreement be followed and circulated a list of five potential arbitrators from the panel. The Respondent nominated a retired officer of the Indian Railway Services as its nominee arbitrator and called upon the Petitioner to appoint its nominee from the remaining four options.

The Petitioner proceeded to file a petition before the Court under Section 11 of the Act, for appointment of an independent and impartial tribunal.

ARGUMENTS ADVANCED:

The Petitioner argued that any arbitrator that it nominates from within a list circulated by the Respondent would not qualify as an independent or impartial arbitrator in accordance with recently amended Section 12 of the Act read with Schedule 7 of the Act, which incorporates the IBA Guidelines on Conflict of Interest in International Arbitration. The Respondent is a public sector undertaking having all the trappings of the Government and therefore appointing an any person who was a serving or retired engineer of Government departments or public sector undertaking would defy the neutrality aspect as they had direct or indirect nexus/privity with the Respondent and the Petitioner had reasonable apprehension of bias against such persons.

The Respondent argued that the persons on the proposed list were neither serving nor ex-employees of the Respondent. They were ex-officers of other public bodies. The Respondent had also sent a fresh list containing thirty one names for the Petitioner to consider and appoint its nominee. The other names on the list were retired officers from the Indian Railways who retired from high positions and had a high degree of technical qualifications and experience. Merely because these persons may have served in railways or other government departments would not, by itself, impinge on their impartiality.

DECISION:

The Supreme Court held that this was not a fit case for them to exercise jurisdiction and constitute the arbitral tribunal.

The Court referred to the Law Commission's recommendations in its 246th Report proposing amendments to the Arbitration & Conciliation Act, 1996 and stated that the focus of Section 12 read with Schedule 7 lay in determining the neutrality of arbitrators viz. their independence and impartiality, which was critical to the entire process. The Law Commission had reiterated that the test in question was not whether there was any actual bias but, in fact, whether the circumstances in question give rise to any justifiable apprehension of bias.

The Court went on to hold that merely because the persons proposed were government employees or ex-government employees (and in no way connected to the Respondent), that by itself would not make them ineligible to act as arbitrators. Had it been the intention of legislature to cover such persons, it would have been provided for in the Seventh Schedule. The Court also stated that bias or even real likelihood of bias cannot be attributed to such highly qualified and experienced persons, simply on the ground that they served the Central government or public sector undertakings, where they had no connection with the Respondent. Pursuant to the amendment, there is an embargo on a person to act as an arbitrator if he has been either an employee or consultant or advisor or had any past or present business relations with the parties, which was not the case.

In an interesting step, the Court analyzed the procedure for appointment of the tribunal and noted that there existed two adverse consequences arising from the fact that the discretion lay with the Respondent to choose and propose options for arbitrators to the counterparty. The first being that the choice given to the counterparty was limited to the names proposed by the Respondent (as against the entire panel of the Respondent) and the second being that with the discretion that was given to the Respondent, room for suspicion was created that the Respondent may have picked its own favorites. This situation was countenanced and the Court stated that this part of the procedure required to be deleted and instead, parties should have the choice to nominate any person from the entire panel.

The Court also went on to express the need and direct the Respondent to amend its panel in a time bound manner to include (i) engineers of prominence and high repute from the private sector; (ii) persons with a legal background i.e. judges and lawyers; and (iii) persons having expertise in accountancy.

The Court also stated that it was time to send positive signals to the international business community in order to create a healthy arbitration environment and conducive culture in India. There should be no misapprehension that the principle of impartiality and independence would be discarded at any stage of the proceedings. This duty was only more onerous in contracts where the state was party.

ANALYSIS:

The Court's observation on the limited expertise demonstrated on the panel and the consequent direction to broad base the panel maintained by the Respondent takes into account the numerous kinds of disputes that may arise out of a given contract and is a welcome step. This step will enable parties to appoint a tribunal to having necessary expertise to deal with the subject matter of the dispute.

On the ever-controversial practice of government employees being appointed as arbitrators, the Court chose to uphold the practice (subject to the checks and balances built into the Act) and appreciate that the reasons for empaneling such highly qualified and experienced persons was to ensure the technical aspects of the dispute are suitably resolved. It may be felt in certain corridors that the Court lost an opportunity to once and for all strike down this practice insofar as it related to public sector undertakings.

Upholding party autonomy and the intention to arbitrate, the Court chose to limit the use of its discretion and instead, struck down parts of the agreed procedure which it felt required correction in the interest of removing adverse consequences. It thereby permitted access of parties to the entire, broad-based panel of potential arbitrators, which will be set up in due course.

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You can direct your queries or comments to the authors

[1] Arbitration Petition (Civil) No. 50 of 2016;

[2] Joint Venture between the Government of India and the Government of NCT, Delhi;