Bar and Bench

# NPAC's Arbitration Review: Validity of unilateral Appointment of Arbitrators: Indian courts blow hot and cold

*The article enumerates the various judgments which interpret the method of appointment of arbitrators.*

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In recent times, there has been a spate of litigation in India concerning the validity of clauses allowing the unilateral appointment of an arbitrators by one party. While there are different variants of such clauses, (which we have discussed in some depth in this article), they essentially vest one party to an arbitration agreement with the sole right to appoint the arbitrator. These clauses typically feature in contracts with Government entities or public sector undertakings, empowering them to appoint one from among their ranks to arbitrate disputes involving them, thereby creating an *inherent bias* in the arbitration process.

The Arbitration and Conciliation (Amendment) Act, 2015 ("**Amendment Act**") introduced provisions to curb such bias through Section 12(5)[1] and the seventh schedule to the Arbitration and Conciliation Act, 1996 ("**the Act**"), which rendered certain categories of people ineligible to act as arbitrators.

In 2017, a 3 - judge bench of the Supreme Court ("**SC**") purposively interpreted these provisions and held in the case of *TRF Limited v Energo Engineering Projects Limited*[2] that an ineligible arbitrator under Section 12(5) read with the seventh schedule to the Act, was also barred from *nominating* an arbitrator. The court in *TRF* held that it was inconceivable in law that once a person had become statutorily disqualified from acting as an arbitrator, they should be permitted to appoint an arbitrator. As the court observed, '*once the infrastructure collapses, the superstructure is bound to collapse as well.'* Once the identity of the Managing Director as the sole arbitrator had been lost, his power to appoint an arbitrator was also obliterated.

This interpretation was upheld by the Supreme Court in the cases of *Perkins Eastman Architects DPC & Anr. V HSCC (India) Ltd*[3] and *Bharat Broadband Network Ltd. v United Telecoms Ltd*[4]. In *Perkins Eastman,* the court observed that the basis for the Managing Director being found to be ineligible to appoint an arbitrator in *TRF* was due to his interest in the outcome of the dispute. This interest in the dispute was the basis for the possibility of bias. Further, where only one party had the right to appoint a sole arbitrator, their choice would have the potential to chart out the course of the arbitration. The essence of the Amendment Act and the ruling in *TRF* was to prevent parties having an interest in the outcome of the dispute from having the sole right to appoint arbitrators.

However, the latest word on unilateral appointment of arbitrators from the SC has come in the case of *Central Organisation for Railway Electrification v M/S EVI-SPIC-SMO-MCML (JV)*[5], wherein the SC has upheld an arbitration clause allowing one party to nominate a panel of four arbitrators (comprising such party's employees), from which the counterparty would short list two nominees.

The general manager of the former would select one from this short list as the counterparty's nominee, as well as appoint the third and final arbitrator on the panel.

The *Railway Electrification* case seems to be a departure from the ratio in *TRF Limited* and the cases that followed, by vesting an ineligible party with the power to nominate an arbitrator. The SC in *Railway Electrification* also appears to have incorrectly interpreted the ratio of *Voestalpine Schinen Gmbh v Delhi Metro Rail Corporation Ltd*[6] in reaching its conclusion, as we will touch upon in this article.

In this article, we explore the nascent jurisprudence on unilateral appointment of arbitrators, by examining which types of appointments have been upheld, or struck down by the Indian courts, and certain ambiguities created by these precedents.

1. *Appointment of an ineligible arbitrator or its nominee*

This category of arbitration clauses seeks to appoint an ineligible individual as arbitrator, failing which, such individuals have the sole right to appoint another arbitrator.

For instance, the arbitration clause in *TRF Limited* prescribed that the Managing Director of one of the parties, or their nominee, was to act as the arbitrator. The arbitration clause in *Bharat Broadband* also prescribed that the Chairman and Managing Director ("**CMD**") of one of the parties was to act as sole arbitrator, and if they were unable or unwilling to act as the arbitrator, another person appointed by the CMD was to act as arbitrator.

Managing Directors are prohibited from acting as arbitrators under the seventh schedule to the Act, which disqualifies an arbitrator who is a '*manager, director or part of the management, or has a similar controlling influence in one of the parties.*'[7]

The SC in *TRF* held that once an arbitrator had become ineligible by operation of law, he could not nominate another as an arbitrator; such a situation was '*inconceivable in law*.'

The SC in *Bharat Broadband* relied upon *TRF* to hold that an appointment by an ineligible person was void *ab initio*, irrespective of any prior agreement between the parties. The court also underscored that when the appointing party was State authority, it was even more critical to appoint an independent and impartial arbitrator.

2. *Appointment of an ineligible arbitrator's nominee*

This category of arbitration clauses vests an ineligible arbitrator with the right to appoint a sole arbitrator to adjudicate disputes between parties.

This type of clause came up for consideration in *Perkins Eastman*, in which case the clause empowered the CMD of one of the parties to appoint an arbitrator, and prescribed that no person other than a person appointed by the CMD could act as an arbitrator.

The court distinguished between the first category of cases (i.e., the *TRF* category), and the present category of cases, wherein a managing director was not empowered to act as arbitrator himself, but empowered to appoint an arbitrator. The SC held that *reason* for the ineligibility of a managing director (i.e., interest in the dispute) would apply equally to both categories of cases. The court relied upon *TRF* and held that if a person was ineligible himself, such a person should also not '*have any role in charting out any course to the dispute resolution by having the power to appoint an arbitrator...*'

A similar clause came up for consideration before the High Court of Bombay in the case of *Lite Bite Foods Pvt Ltd. v. Airports Authority of India*[8] which empowered one of the parties, the Airports Authority of India, to appoint a sole arbitrator to adjudicate disputes. The court held that the clause was clearly covered by the *Perkins Eastman* category of cases, and held that it violated Section 12(5) read with the Seventh Schedule to the Act.

3. *Appointment from a panel of arbitrators*

This category of clause finds its roots in a confusing exception to the principles set out in the first two categories of cases by a division bench of the SC in the *Voestalpine* case.

Let us first revisit the facts of *Voestalpine*- One of the parties in *Voestalpine* was the Delhi Metro Rail Corporation ("**DMRC**"), a public-sector company that operated the Delhi Metro rail service. The arbitration clause in the *Voestalpine* case contemplated a panel of three arbitrators to adjudicate disputes. The DMRC would nominate a panel of five serving or retired engineers of the DMRC, Government departments or public sector undertakings. From this panel, both parties were to select one arbitrator each, and the two selected arbitrators were to appoint the third and final arbitrator from the remaining nominees. However, thereafter, the DMRC forwarded a list of 31 names to the petitioner to select its nominee. This list *excluded* serving or retired employees of the DMRC, but contained names of retired officers from the Indian railways, as well as other government bodies.

The SC in *Voestalpine* struck down the procedure originally contained in the arbitration clause, holding that it gave a very limited choice to the counterparty, and created room for suspicion that the DMRC would select its own favorites.

However, the SC upheld the process of selection from a wider list of 31 nominees. The court noted that none of the nominees in the list were employees or ex-employees of DMRC, and the seventh schedule did not proscribe government/ex-government employees from acting as arbitrators. However, the court also directed that engineers from the private sector, accountants, as well as judges and lawyers also be included in the pool for selection.

Relying upon *Voestalpine*, the SC in *Railway Electrification* upheld the arbitration clause in that case. However, arguably, the courts reliance on *Voestalpine* was misplaced as: (i) the clause in *Railway Electrification* contemplated a panel of arbitrators comprising of retired railway officers, (i.e., retired employees of one of the parties), which was specifically struck down by the court in *Voestalpine*; (ii) the panel in *Railway Electrification* was limited to this category of individuals, and was not broad-based like the list of 31 nominees in *Voestalpine* (ii) the number of nominees in *Railway Electrification* was only five, which was held to be too narrow a selection in *Voestalpine.*

Therefore, the ruling in *Railway Electrification* appears to be on a shaky foundation, and appears to have diluted the principles enshrined in the first two categories of cases.

***Status of Unilateral Appointment Clauses today: Clear as Mud***

Both the *Voestalpine* and *Railway Electrification* decisions appear to be a deviation from the *TRF* and *Perkins Eastman* category of cases. The courts in the former have diluted these rulings by empowering a disqualified entity to nominate *several* arbitrators from which the panel of arbitrators is ultimately selected. Arguably, if a disqualified party is proscribed from nominating *one* arbitrator, such a party should also be prohibited from nominating *a list* of arbitrators.

It also cannot be said that the power of such party to nominate a list of arbitrators, is counter balanced by the power of a counterparty to select their nominee from that list. As we have seen, in cases such as *Railway Electrification,* the options provided to the counterparty may be limited to just a few ex-employees of the former.

The 'list' exception created by *Voestalpine* and *Railway Electrification* may thus be susceptible to being exploited by unscrupulous parties seeking to appoint arbitrators of their choice, and therefore go against the spirit and purport of the Amendment Act. These cases appear to have derailed a steady line of precedents seeking to eradicate all bias in the arbitrator – selection process.

It is also apt to note that in case of conflict, *TRF,* being a case determined by a three-judge bench, would overrule both *Voestalpine,* (which was decided by a division bench of the SC), and *Railway Electrification* (which was decided by a single judge).

This issue is once again pending before the Supreme Court in the case of *Bhayana Builders Pvt. Ltd. v Oriental Structural Engineers Pvt. Ltd.* [9]. Hopefully, the SC will put this matter to rest by prohibiting *all* types of unilateral appointments.

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[1]Section 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.

[2](2017) 8 SCC 377

[3] (2019) SCC OnLine SC 1517

[4] Civil Appeal Nos. 3972 of 2019 arising out of SLP (C) No. 1550 of 2018

[5] Civil Appeal No. 9486-9487 of 2019 arising out of SLP (C) No. 24173-74 of 2019

[6] Arbitration Petition (C) No. 50 of 2016

[7] Schedule 7, Section 12

[8] Comm Arbitration Application (L) No. 495 of 2019

[9] SLP (C) No. 007161 of 2018