

Dispute Resolution Hotline

September 03, 2009

YOUR EMPLOYEE AS YOUR ARBITRATOR? MAYBE!

The Hon'ble Supreme Court of India ("Court") has, by its order dated August 24, 2009, in the matter of *Indian Oil Corporation Ltd. & Ors. ("Appellants") Vs. Ms. Raja Transport (P) Ltd. ("Respondent")*¹, once again upheld that the Court must give full effect and meaning to the appointment procedure set by the parties in the arbitration agreement before appointing arbitrator of their choice.

BRIEF FACTS OF THE CASE:

The Appellant and Respondent entered into an agreement dated February 28, 2005 ("Agreement"), where under, the Respondent was appointed as the dealer of the Appellant for the retail sale of petroleum products. Clause 69² of the Agreement provided for settlement of disputes by arbitration where the Director, Marketing of the Appellant, or a person appointed by him, was to act as the sole arbitrator.

On August 06, 2005, the Appellant terminated the dealership. The Respondent filed suit in the Civil Court, Dehradun, seeking (1) a declaration that the order of termination of dealership was illegal and void and (2) for a permanent injunction restraining the Appellant from stopping the supply of petroleum products to the retail outlet of the Appellant. In this same suit, the Appellant filed an application under Section 8 of the Arbitration and Conciliation Act, 1996 ("the Act"), praying that the suit be rejected and the matter be referred to arbitration in terms of Section 69 of the Agreement. The Ld. Judge allowed the Appellant's application and directed the parties to refer the matter to arbitration within two months and also directed the Appellant not to stop supplies to the Respondent for a period of two months.

Both parties challenged the said order before the District Court, Dehradun. The Respondent also filed an application under Section 9 of the Act seeking an interim injunction against the Appellant. Both appeals and the Section 9 application were disposed off by a common order dated January 20, 2006, whereby, both appeals were dismissed and the Section 9 application was allowed, retraining the Appellant from interrupting the supply of petroleum products to the Respondent for two months as well as directing the parties to refer the matter to arbitration as per the agreement, within the said period of two months.

While the appeals were pending, the Respondent issued letter dated January 04, 2006, through their counsel, wherein, the Respondent, referring to the Appellant's insistence that only its Director, Marketing could be appointed as the Arbitrator, *inter alia* alleged that it (the Respondent) did not expect fair treatment or justice if the Director, Marketing or any other employee of the Appellant was appointed as the Arbitrator and called upon the Respondent to have a joint meeting so as to enable the parties to mutually agree on an independent arbitrator. This request was not accepted by the Appellant.

Thereafter, the Respondent filed an application before the Chief Justice of the Uttaranchal High Court under Section 11(6) of the Act for appointment of an independent arbitrator to decide the dispute. This application⁷ was allowed and a retired High Court Judge was appointed as the Sole Arbitrator to decide the dispute. The Ld. Chief Justice *inter alia* assigned the following two reasons to appoint a retired Judge as an Arbitrator instead of the persons as named in the arbitration agreement.

(i) The Director (Marketing) of the Appellant, being its employee, should be presumed not to act independently or impartially.

(ii) The Respondent had taken steps in accordance with the agreed appointment procedure contained in the arbitration agreement and directions of the civil court by issuing notice dated January 04, 2006, calling upon the Appellant to appoint an arbitrator. After receipt of the said notice, the Appellant had to refer the matter to its Director, Marketing, which it did not do, nor did it take any steps for the appointment of an Arbitrator. The Appellant had, thus, failed to act as required under the agreed procedure.

Aggrieved by the said order, the Appellant preferred an appeal before the Court.

JUDGMENT:

The facts and circumstances of this case raised three issues for the Court to consider:

1) Whether the Ld. Chief Justice of the Uttaranchal High Court was justified in assuming that when an employee of one of the parties to the dispute is appointed as an arbitrator, he will not act independently or impartially.

On this issue, the Court *inter alia* noted as under:

- Arbitration is a binding and voluntary dispute resolution process by a private forum so chosen by the parties.

- Where a party, with open eyes and full knowledge and comprehension of the said provision enters into a contract

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with a government/statutory corporation/public sector enterprise, where such arbitration agreements providing for settlement of disputes where the arbitrator will be one of its senior officers, were common, such party cannot subsequently turn around and contend otherwise unless performance of that part of the arbitration agreement is impossible, or is void being contrary to the provisions of the Act.

- It was settled law that arbitration agreements in government contracts providing that an employee of the department (usually a high official unconnected with the work or the contract) will be the arbitrator are neither void, nor unenforceable.

- Whilst the provisions relating to independence, impartiality and freedom from bias are implicit under the Arbitration Act, 1940, the same are made explicit in the Act.

- This position may differ where the person named as the arbitrator is an employee of a company/body/individual other than the state and its instrumentalities e.g. a Director of a private company who is party to the arbitration agreement. In such cases, there may be a valid and reasonable apprehension of bias in view of his position and interest. In such cases, the court has the discretion not to appoint such a person.

2) In what circumstances the Chief Justice or his designate can ignore the appointment procedure or the named arbitrator in the arbitration agreement to appoint an arbitrator of his choice.

On this issue, the Court *inter alia* noted as under:

- The court must first ensure that the terms of the agreement are adhered to or given effect to, as far as possible and those remedies, as provided for, are exhausted.

- It is not mandatory to appoint the named arbitrator but at the same time, due regard has to be given to the qualifications required by the agreement and other considerations. Referring the disputes to the named arbitrator shall be the rule. Ignoring the named arbitrator and nominating an independent arbitrator shall be the exception to the rule, which is to be resorted to for valid reasons.

Interestingly, the Court also proceeded to expound on the scope of Section 11 of the Act, which contains the scheme of appointment of arbitrators.

3) Whether the Respondent had taken the necessary steps for the appointment of an arbitrator in terms of the agreement, and the Appellant had failed to act in terms of the agreed procedure, by not referring the dispute to its Director, Marketing for arbitration.

On this issue, the Court *inter alia* noted as under:

- In view of the order dated January 20, 2006, the Respondent ought to have referred the dispute to the Director (Marketing) of the Appellant within two months from January 2006. The Respondent had not done so and in light thereof, it was the Respondent that had failed to act in terms of the agreed procedure and not the Appellant.

- As the Arbitrator was already identified, there was no need for the Respondent to ask the Appellant to act in accordance with the agreed procedure.

The Court proceeded to hold that the Chief Justice had erred in having proceeded on the basis that the Respondent had performed its duty under the agreement and that there was justification for appointment of an independent arbitrator.

The Court then proceeded to allow the appeal, set aside the impugned order and appointed the Director (Marketing) of the Appellant as the sole arbitrator to decide the disputes between the parties.

ANALYSIS:

By this decision, the Court has once again upheld that when a person enters into a contract with a government/statutory corporation/public sector enterprise having an arbitration agreement providing for settlement of disputes where the arbitrator will be one of its senior officers, such person cannot subsequently turn around and contend otherwise unless performance of that part of the arbitration agreement is impossible, or is void being contrary to the provisions of the Act. However, this position may differ where the person named as the arbitrator is an employee of a company/body/individual other than the state and its instrumentalities e.g. a Director of a private company who is party to the arbitration agreement.

Referring to its decision taken earlier in the matter of **Northern Railway Administration, Ministry of Railway, New Delhi Vs. Patel Engineering Company Ltd.** (please refer to our earlier hotline dated August 26, 2008) Court reiterated that it is important to first ensure that the terms of the arbitration agreement are adhered to or given effect to, as far as possible and those remedies, as provided for, are exhausted, before they intervene in any manner.

However, if circumstances exist, giving rise to justifiable doubts as to the independence and impartiality of the person nominated, or if other circumstances warrant appointment of an independent arbitrator by ignoring the procedure prescribed, the Chief Justice or his designate may, for reasons to be recorded ignore the designated arbitrator and appoint someone else.

- **Sahil Kanuga & Vyapak Desai**

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business

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¹ Civil Appeal No. 5760 of 2009 arising out of SLP (C) No. 26906 of 2008.

² "69. Any dispute or a difference of any nature whatsoever or regarding any right, liability, act, omission or account of any of the parties hereto arising out of or in relation to this Agreement shall be referred to the sole arbitration of the Director, Marketing of the Corporation or of some officer of the Corporation who may be nominated by the Director Marketing. The dealer will not be entitled to raise any objection to any such arbitrator on the ground that the arbitrator is an officer of the contract related or that in the course of his duties or differences.It shall also be a term of this contract that no other person other than the Director, Marketing or a person nominated by such Director, marketing of the Corporation as aforesaid shall act as arbitrator hereunder....."

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