

Dispute Resolution Hotline

June 21, 2017

DELHI HIGH COURT CAUTIONS RAIL VIKAS NIGAM ON APPOINTMENT OF FORMER EMPLOYEES AS ARBITRATORS

- Former employees are not disqualified from being appointed as arbitrators, in a dispute involving the employer, but such appointment may give rise to apprehensions;
- It is paramount that all parties have full confidence in the arbitral process.
- Arbitrator may not be disqualified under Section 12 (5) read with 7th Schedule, yet his appointment can be challenged if there are reasons which give justifiable doubt as to his independence and impartiality;

Recently, the Delhi High Court ("**Court**") in *Afcons Infrastructure Ltd. ("Afcons") v. Rail Vikas Nigam Limited ("RVNL")*, interpreted Section 12 (5)¹ read with Entry 1² Schedule VII of the Arbitration and Conciliation Act ("**Act**") to hold that former employees of parties are not precluded from being appointed as arbitrators. However, this decision is subject to certain qualifications as discussed below.

BRIEF FACTS

Afcons and RVNL entered into a contract dated 12 December 2011 for construction of an infrastructure project ("**Agreement**"). A dispute arose between the parties and Afcons issued a notice of dissatisfaction and invoked arbitration, relying on the arbitration agreement. In the notice of dissatisfaction, Afcons nominated their arbitrator. RVNL disputed Afcons nomination terming it contrary to the arbitration agreement, and proposed a panel of five arbitrators, and called upon Afcons to select and nominate their nominee arbitrator from that list. Aggrieved by the same, Afcons preferred a petition under Section 11 of the Act before the Delhi High Court ("**Court**") for appointment of the arbitral tribunal.

The question which the Court had to decide was whether employees and former employees are disqualified from being appointed as arbitrators under Section 12 (5) of the Act.

The arbitration clause has been reproduced below:

(i) **Procedure for Appointment of Arbitrators:** The arbitrators shall be appointed as per following procedure:

- Employer will forward a panel of 5 names to the contractor and contractor will give his consent for any one name out of the panel to be appointed as one of the Arbitrators.
- Employer will decide the second Arbitrator out of the remaining four names in the panel as mentioned in Para (a) above.
- The third Arbitrator shall be chosen by the two Arbitrators so appointed by the parties and shall act as Presiding Arbitrator. In case of failure of the two Arbitrators appointed by the parties to reach upon consensus within a period of 30 days from the appointment of the Arbitrators subsequently appointed, then, upon the request of either or both parties, the presiding Arbitrator shall be appointed by the Managing Director, Rail Vikas Nigam Limited, New Delhi.

(ii) **Qualification and Experience of Arbitrators:** The arbitrators to be appointed shall have minimum qualification and experience as under:

- One member of the tribunal shall be necessarily a working (not below the rank of SAG) or a retired officer (retired not below the rank of SAG, age not exceeding 70 years and in reasonably good mental and physical fitness) of Indian Railway Accounts Service, having experience in financial matters related to construction contracts.
- One member shall be a technical person having degree in Engineering and may be working (not below the rank of SAG) or retired officer (retired not below the rank of SAG, age not exceeding 70 years and in reasonably good mental and physical fitness) of any Engineering service of Indian Railways or equivalent service in RVNL, and having knowledge and experience of the Railway working.
- The Presiding Arbitrator shall necessarily be a serving railway/RVNL officer and he shall have same minimum qualification and experience as specified above for either of the two arbitrators.
- Out of 3 Arbitrators not more than one shall be a retired officer.

(iii) No person other than the persons appointed as per above procedure and having above qualification and experience shall act as arbitrator.

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(iv) Neither party shall be permitted in the proceedings before such arbitrators to the evidence nor did arguments previously put before."

DECISION:

The Court allowed the petition, and directed RVNL to appoint any former judge of the Supreme Court as an arbitrator within 2 weeks.

The Court opined that:

- a. A person who is related to a party as an employee, consultant or an advisor, is disqualified to act as an arbitrator.
- b. An arbitrator which has "other" past or present business relationship with the party is also dis-qualified.
- c. The word "other" indicates a relationship other than that of an employee, consultant or an advisor. Therefore, the relationship of being a former employee would not come under the ambit of Section 12 (5) read with Entry 1 of the Seventh Schedule.
- d. The Court further clarified that the expression "*business relationship*" as used in Entry 1 of Seventh Schedule cannot be understood to include an employer-employee relationship.

Further, the Court held that the fact that the arbitrator is not disqualified under Section 12 (5) read with Seventh Schedule does not conclude that his appointment cannot be challenged if there are grounds which give rise to justifiable doubts as to his independence or impartiality.

The court relying on the Supreme Court of India's ("**Supreme Court**") judgment in *Voestalpine Schienen GMBH v. Delhi Metro Rail Corporation Limited*³ ("**Voestalpine**"), and Punjab and Haryana High Court's decision in *Reliance Infrastructure Ltd. v. Haryana Power Generation Corporation Ltd.*⁴ deviated from the arbitration clause provided in the Agreement to appoint an independent person to avoid even notional apprehensions of lack of independence or impartiality.

The Court opined that in the interest of securing the independence and neutrality of the arbitral tribunal, the process contemplated under clause 17.3 (ii) of the Agreement must be disregarded primarily because:

- a. The decision of the Supreme Court⁵ that parties choice to select one out of five persons suggested by the other party has "adverse consequences";
- b. RVNL suggested the names of former employees of Railways/RVNL for appointment of an arbitrator. All have part relationship with RVNL/Railways. Although this relationship may not fall within the prohibition stipulated under Section 12 (5) of the Act read with Seventh Schedule, it gives rise to apprehensions;

ANALYSIS

The decision affirms the intention of the judiciary to ensure impartial and independent arbitration proceedings. Specifically considering the 'adverse consequences' of allowing an arbitration clause that severely restricts the autonomy of Afcons in appointing arbitrators, the Court goes a step further, in line with the recent Supreme Court judgment to direct the parties to broad base their appointment of arbitrators.

The Court also expressed caution in upholding the validity of the appointment of former employees as arbitrators, and adds a caveat that mere validity of the appointment and the exclusion of former employees from Entry 1 of Schedule VII does not render the appointment immune of potential challenges. It has unequivocally frowned upon the restrictive appointment procedure laid down by the arbitration clause and recognized that such clause would do little to instill confidence among the arbitration regime laid down in the country, especially in light of the changes brought about by the recent Amendment Act. Such arbitration clauses are a common phenomenon in Government contracts, construction contracts, etc. This would prompt the Government and Public Sector Undertakings to be more mindful of the procedure for appointment and qualification of arbitrators in future.

One may however, question the precedential value of this ruling, in view of the Supreme Court's decision in *West Bengal vs Associated Contractors*⁶, wherein it was held that the decision of the Chief Justice or his designate in a Section 11 application, not being the decision of the Supreme Court or the High Court, as the case may be, has no precedential value, being a decision of a judicial authority which is not a court of record.

— **Mohammad Kamran, Alipak Banerjee & Moazzam Khan**
You can direct your queries or comments to the authors

¹ Section 12(5) of the Act– "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 Entry 1, Schedule VII of the Act– "The arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party"

³ AIR 2017 SC 939

⁴ 2016 (6) ArbLR 480 (P&H)

⁵ See *Voestalpine*

⁶(2015) 1 SCC 32

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