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INEQUITY UNVEILED: CHALLENGES TO FAIR APPOINTMENT OF ARBITRATORS

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Introduction

Ensuring the impartiality and independence of arbitrators is paramount in arbitration proceedings, as it upholds the key tenets of natural justice. The foundation of the entire arbitration system hinges on the confidence parties placed in arbitrators entrusted with adjudicating their disputes. This confidence is essential in arbitration proceedings as parties themselves participate in the appointment of their arbitrators.[1]

In the Indian arbitration landscape, there are nuanced challenges in ensuring the independence and neutrality of arbitrators while upholding the binding nature of contracts and ensuring autonomy of parties in the appointment procedure. Therefore, this spirit of party autonomy at times overlooks the inherent unfairness in the appointment of arbitrators in certain situations, particularly when it comes to contracts with public sector undertakings and other statutory corporations. A big reason as to why such a trend is observed is that contracts with PSUs and other statutory corporations tend to give unilateral rights of arbitrator appointment to these entities which in turn gives rise to the question of bias.[2] In practice, there is a dearth of metrics to evaluate the independence and impartiality of these arbitrators, this has allowed state entities to nominate individuals which have some sort of designation linked with them to preside over their dispute. On that note, it is imperative to note that the practice of nominating serving employees as arbitrators in their dispute was not expressly prohibited in the now repealed Arbitration and Conciliation Act, 1940, ["**1940 Act**"] and subsequently under the Arbitration and Conciliation Act, 1996 ["**1996 Act**"] as well.

[1] Maria Nicole Cleis, *The independence and impartiality of ICSID Arbitrators* (Brill 2017).
[2] Vikram Hegde and Archana Vaidya, 'The challenges of Statute Mandated Arbitration under The National Highways Act, 1956' (*Live law*, 2 August 2023) < https://www.livelaw.in/articles/arbitration-act-statute-mandated-arbitration-challenges-national-highways-act-234175?infinitescroll=1> accessed 25 September 2023.

The court's first brush with this subject was documented in the case *Voestalpine Schienen GmBH v Delhi Metro Rail Corpn. Ltd* ["**Voestapline Schinen GmBH**"] [3] wherein the apex court examined the core tenets of arbitrator independence. However, the position held, did not offer a steady solution and left much more to be desired and it underscored the need for a more comprehensive understanding of judiciary's role in the appointment procedure.

The 2020 landmark judgment of the Supreme Court in *Perkins Eastman Architects DPC and Ors v HSCC (India) Ltd* ["**Perkins Eastman**"][4] altered the then-prevailing view on the disqualification of arbitrators. It held that "a person disqualified to ***act*** as an arbitrator is also disqualified to ***appoint*** an arbitrator". This has set in motion a flurry of resignations and termination petitions of arbitrators in various ongoing arbitrations and warrants critical examination. In the wake of the Perkins Eastman, it is necessary to understand the practical implications of this judgement and try to find out whether or not this position is in consonance with the legislative intent.

The 2015 amendment was a notable positive development in transforming the landscape governing arbitrator appointments, with the schedules demarcating criteria for arbitrator ineligibility and inclusion of party representation in the appointment process to ensure neutrality. The question, of whether the legislative changes actually translate to practical safeguards and adequately deal with the deficiencies in the pre-amendment framework still remains pertinent.

Navigating Party Autonomy and Procedural Fairness – Pre-2015 Amendment

Prior to the 2015 amendment, arbitration clauses or agreements that allowed one of the parties to nominate their own employee as an arbitrator were generally acceptable even though prima facie, it seems grossly violative of the principle of *nemo judex in causa sua.* This situation came about due to a legislative gap in clear disqualification criteria for arbitrators for want of independence and neutrality. This led to the dominant party always getting away with an arbitrator of their choice.

The courts too, supported such clauses in the name of 'party autonomy' and ignored the unequal bargaining power of the parties and the standard nature of these contracts with PSUs and statutory corporations. The only exception that was carved out by the Apex Court was in the case of *Indian Oil Corporation v Raja Transport Ltd.*[5] Here, it was held that such appointments would be invalid under section 12 if the arbitrator was in a position of control or was directly subordinate to the

[3] *Voestalpine Schienen GmBH v Delhi Metro Rail Corpn. Ltd* (2017) 4 SCC 665.
[4] *Perkins Eastman Architects DPC and Ors v HSCC (India) Ltd* (2020) 20 SCC 760.
[5] *Indian Oil Corporation v Raja Transport Ltd* (2009) 8 SCC 520.

officer whose actions constituted the subject matter of the dispute. This exception also found mention in the 246th Law Commission report which described it as inadequate.

The issue of arbitrator neutrality was taken up by the Law Commission of India which carried out a comprehensive examination of this deficiency in the working of the act in 2014. They came out with a comprehensive report, report no. 246.[6] This document served as the inspiration and source for major amendments to the 1996 Act, including the 2015 amendment. The amendment led to the addition of the fifth and seventh schedules, which focused on ensuring the independence and neutrality of arbitrators as they contain guidelines as to what constitutes justifiable doubts to the independence and impartiality of arbitrators. However, the issue has become a little complex with the courts subjectively interpreting section 12(5) of the 1996 Act, along with the fifth and seventh schedules, which has led to dissonance between judicial standpoints. The aforesaid section is produced below for reference and clarity-

> S. 12(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."*

The 246th Law Commission Report[7] was instrumental in bringing about the 2015 amendment.[8] It stressed the importance of minimum levels of arbitrator independence and impartiality notwithstanding any express agreements. It took the stance that the parties should not be made to waive their right to natural justice, especially when the state assumes the appointing authority. Among its recommendations were amendments to sections 11, 12, and 14 to introduce a "de jure" test of impartiality as opposed to the prevailing de facto disqualification criterion. Thus, it proposed to make potential arbitrators inherently ineligible if their relationships with the parties fell within categories specified in the fifth and seventh schedule. Moreover, the report also borrowed the concepts of orange and red lists from the "International Bar Association Guidelines on Conflicts of Interest in International Arbitration" to recommend a framework, capable of assessing doubts on an arbitrator's independence and neutrality.

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[6] Law Commission of India, '*Amendments to Arbitration and Conciliation Act, 1996'*, (Report No 246, 2014).
[7] Ibid.
[8] Arbitration and Conciliation (Amendment) Act, 2015.

Salient Features of the 2015 Amendment

Post amendment, section 12 makes it compulsory for the arbitrators to disclose any relationship or interests that could be construed as a justifiable doubt about their fairness using a designated format, found in the sixth schedule**.** We see the adoption of the aforementioned IBA guidelines in the fifth and the seventh schedules. The fifth schedule takes note of low-severity circumstances, considering de-facto grounds, equivalent to the ground listed in the orange list. The seventh schedule incorporates those disqualification grounds that are similar to those in the red list concerning the more serious, de-jure disqualifications for specific relationships, thereby enabling a comprehensive evaluation of an arbitrator's eligibility vis-à-vis the disqualifying criteria.[9]

Section 12(5) has a waiver clause now, allowing parties to evade this provision, however, it is not universal. The waiver must satisfy the conditions such as an express agreement in writing is compulsory, it should be made after the dispute has arisen, and also be open to judicial scrutiny to ensure no undue advantage is being exercised by one party as held in *Bharat Broadband Network Ltd v United Telecoms Ltd.* ["**Bharat Broadband Network Ltd.**"][10]

In the challenge procedure for appointments that are in contravention of the fifth schedule, a challenge is made to the arbitral tribunal itself u/s 13(2) and 12(3) of the 1996 Act. If the arbitral tribunal does not accept the challenge, it passes a non-appealable order, and the only option that remains with a party is a section 34 petition to set aside the award. In cases where the arbitrator is judged to be ineligible under the seventh schedule, it implies that the arbitrator inherently lacks the jurisdiction to conduct the proceedings. In such cases, the remedy is to file a termination application under section 14(2) of the 1996 Act. In cases where the arbitration clause or the arbitration agreement itself is of such nature that the appointment naturally results in a de-jure disqualification, then the parties have the remedy of approaching the court under section 11 for a fresh appointment of an arbitrator.

Changing Nature of Unilateral Arbitrator Appointments: Judicial Trends

[9] Prerona Banerjee and Vishal Sinha, 'What goes around, comes around: The 2015 amendment on appointment of arbitrators in India' (*Bar and Bench*, 25 March 2023) <https://www.barandbench.com/columns/what-goes-around-comes-back-around-the-2015-amendment-on-appointment-of-arbitrators-in-india > accessed 26 September 2023.
[10] *Bharat Broadband Network Ltd v United Telecoms Ltd* (2019) 5 SCC 755.

During the introduction of the new schedules, a fair amount of objectivity was observed in the appointment procedure amendment. PSUs and other state entities could not nominate their existing employees, consultants, and advisors as arbitrators. However, there is no bar on them to appoint their retired and/or former employees as long as they have been retired for 3 years since their nomination date, as discussed by the Court in Voestapline Schinen GmBH.

Another aspect of arbitrator appointment that is relevant, is the appointment procedure itself, focusing on "who appoints the arbitrator". Now, these arbitration clauses, or agreements that give unilateral rights to one party, have come under judicial scanner; such arrangement prima facie indicates non-compliance with principles of party autonomy. While the seventh schedule lays down ineligibility criteria for a person to act as an arbitrator, it lays no such grounds for the 'appointing authority'. Therefore, the act in no way explicitly bars such unilateral appointments, what is mandated is merely the safeguard of the seventh schedule. If a person is not barred de jure, then the appointment is to be deemed valid, even if it is made unilaterally. At the very outset it seems like a gross violation of party autonomy, placing both parties at an unequal ground. Plenty of High Courts subscribed to this view before the landmark judgments of the Apex Courts, which will be covered below.

Analysis: Landmark Judgements post-2015 and the current positions of law

In the domain of unilateral arbitrator appointments, the courts have focused on a few specific types of appointment clauses –

i. " *Appointment of a disqualified person or nominee of disqualified person"*
ii. *"Appointment of nominee of one of the parties as sole arbitrator"*
iii. *"Appointment of arbitrator/s exclusively from a panel proposed or suggested by one of the parties"*

The first kind of appointment clause was the subject matter of the landmark case in *TRF Ltd v Energo Engg. Projects Ltdb.* ["**TRF case**"][11] The arbitration clause in the dispute nominated the Managing Director or a nominee of the MD. The court observed it to be a situation wherein the MD was acting vicariously by naming a nominee and the MD himself being de jure ineligible under section 12(5) (Amended section), he had also lost the power to nominate someone else.

This line of reasoning was also followed by the court in Bharat Broadband Network Limited. The appointment clause in question here was similar to the TRF case and it led to a challenge.

[11] *TRF Ltd v Energo Engg. Projects Ltd* (2017) 8 SCC 377.

Interestingly, the party that nominated the arbitrator itself was challenging the appointment. The court held, drawing from the TRF case, that de jure ineligibility of the arbitrator(s) renders the proceedings null and void, and no question of estoppel by conduct arose. In both these cases, the arbitration clause gave two powers to the parties that were disqualified: one to be the arbitrator themselves or appoint the arbitrator. These types of clauses were dealt with separately by the courts and clauses that did not confer these 'twin powers' were virtually facilitating unilateral appointments of a sole arbitrator. This is the second of the aforementioned category of appointment clauses. This was settled in the case of Perkin's Eastman.

The two judges' bench of the Apex Court in Perkins Eastman identified and rectified a very plausible ground of bias that plagued situations wherein one of the parties has the power to appoint sole arbitrators. The Supreme Court invalidated arbitration agreements with appointment clauses granting unilateral appointment rights declaring that -

"a person with an interest in the outcome of the dispute cannot have the power to appoint the sole arbitrator".

The apex court, in all its wisdom, thus declared such clauses invalid. The story of unilateral appointments, however, is far from over; the third category of clauses is appointment from a panel(s) chosen by one of the parties.[12]

The court, having invalidated unilateral appointments in a series of cases shown above, took a contradictory stance in the case of *Central Organisation for Railway Electrification v ECI-SPIC-SMO-MCML (JV)* ["**Central Organisation**"].[13] In the Central Organisation case, the arbitration clause provided for a panel maintained by one of the parties. The Court recalled the position laid down in the Voestalpine Schienen in which a similar arbitration clause was held valid when the party maintaining the panel increased the number of names and provided more options than just its former employees as it became a broad-based panel**.** Coming back to the Central Organisation case, we see non-conformity with the broad-based panel principle. The arbitration clause authorised Indian Railways to appoint three arbitrators from a panel composed of its retired employees. The other party was allowed to choose two names from the four available potential arbitrators, with the Managing Director ["**MD**"] of the railways having the authority to nominate the arbitrator out of the two. Additionally, the MD also possessed the authority to nominate the other two arbitrators. Surprisingly enough, the Apex Court considered this a broad-based panel,

[12] R. Sudhindher, 'Perkins- Critical Analysis', (*Argus Partners*, 2 May 2020) <https://www.argus-p.com/papers-publications/thought-paper/perkins-a-critical-analysis/> accessed 26 September 2023.
[13] *Central Organisation for Railway Electrification v ECI-SPIC-SMO-MCML (JV)* (2020) 14 SCC 712.

which is quite disconcerting as in the Voestalpine Schienen case, the court specifically noted the absence of former employees of DMRC from the proposed list, which was absent in the Central Organisation case.

Following the principles laid down by the TRF judgment and then the Perkins Eastman case, functional neutrality is achieved only when parties have equal power over the appointment procedure. The court did not take into account that when a panel is maintained by only one party, they are not on equal footing. If a party is not allowed to unilaterally appoint a sole arbitrator, then logically, they should not be allowed the corpus of available arbitrators, restricting the choices of the other party. All the more so in matters like Central Organisation, wherein the panel maintained was not broad-based either. This tears away at the semblance of neutrality that was achieved in the Voestalpine case, and takes away incentives from the PSUs and other such entities to have broad-based panels. The Supreme Court has recently upheld the correctness of the Perkins Eastman, emphasising that a person interested in the outcome of a dispute cannot be allowed to unilaterally appoint a sole arbitrator. In striking down an arbitration clause that allowed the Ministry of Law and Justice to appoint on its own officers as the sole arbitrator on behalf of the Union of India on the as the officer is an employee of the Union, making him ineligible for appointment under schedule VII read with Section 12(5).[14] The court also observed that the Central Railways case had been challenged and referred to a larger bench in *Union of India v Tantia Constructions* ["**Tantia Constructions**"][15] and *JWS Steel Limited v Southern Railways* ["**JWS Steel Ltd**"].[16]

The Way Forward

The Central Organisation case has brought out the issue of law that is not yet lucid and is negatively affecting arbitration proceedings across India due to its soft approval of certain unfair appointment clauses. The current position of law is being debated by a three-judge bench of the Supreme Court in Tantia Constructions, wherein the bench has cast aspersion on the position held in Central Organisation. A larger bench is yet to be constituted. Meanwhile, this deadlock and the order passed by the new bench in Tantia Constructions has become a ground for a stay on arbitral awards where the appointment of the arbitrators has been unilateral via a panel controlled by one of the parties. The correctness of the Central Railways Judgment is being debated in the matter of JWS Steel Ltd as well. Thus there remains the hope of reversion back to the principle of a broad-based

[14] *M/S Glock Asia-Pacific Limited v Union of India* 2023 SCC ONLINE SC 644.
[15] *Union of India v Tantia Constructions* SLP No. 12670/2020.
[16] *JWS Steel Limited v Southern Railways* SLP No. 9462/2022.

panel as per the Voestalpine Schienen case so as to promote utmost fairness, impartiality, and neutrality in the appointment procedure of arbitrators.

Conclusion

The Arbitration space in India is growing rapidly, and has succeeded in providing objectivity in terms of appointment of arbitrators, but the battle is only half won by now. The lack of a uniform approach in dealing with unilateral appointments is apparent, and there is a pressing need to tie up all loose ends. It is imperative to foster transparency, and parties should rethink unilateral appointment clauses in their arbitration agreements. The judicial solution of broad-based panels is a welcome reform and upholds the principles of natural justice, from which the mechanism of arbitration derives its legitimacy. Another solution to address the woes in the appointment procedures is a systemic and long term fix, which is fostering the growth of institutionalized arbitration in India, having a robust framework to take care of the rapidly growing number of commercial disputes in India.