

# Dispute Resolution Hotline

January 19, 2012

## DENIAL OF APPOINTMENT OF ARBITRATOR AS PER TERMS OF CONTRACT ON GROUNDS OF BIAS AND IMPARTIALITY

### INTRODUCTION

The Supreme Court ("SC") in the case of Denel (Proprietary Limited) vs. Govt. of India, Ministry of Defence<sup>1</sup> exercising its powers under Section 11 (6) of the Arbitration and Conciliation Act, 1996 ("Act") reiterated that right to appointment of an Arbitrator does not get automatically forfeited after expiry of 30 days as prescribed under Section 11(4) & 11(5) of the Act unless petition is filed for appointment of Arbitrator under Section 11(6) of the Act prior to appointment by opposite party. The SC appointed an independent Sole Arbitrator due to apprehensions of bias and impartiality, contrary to the clauses of the contract necessitating appointment of DGOF or government servant, as the Sole Arbitrator.

### FACTS OF THE CASE

The parties entered into a contract for supply of 42,000 base bleed units. However, the quantity was later increased to 52,000 units as per clauses of the contract. Denel ("Petitioner") supplied substantial amount of the goods by January, 2005 though some were rejected by the Government ("Respondent").

The Petitioner was ready and willing to supply the remaining units however, received no response from the Respondent with regard to its dispatch leading to losses and damage being suffered by them. The Petitioner after a series of discussions with the Respondent later became aware that units rejected earlier were owing to usage of improper fuzes by the Respondent. Thereafter, the Respondent kept on hold all contracts and sent a notice seeking refund of amounts to the extent of US \$ 23,20,240. Non-refund of the said amounts led to dispute between the parties.

The parties failed to resolve their disputes through amicable settlement followed by the appointment of Mr. A K. Jain, Additional General Manager, Ordnance factory as the Arbitrator as per Clause 19(F) of the contract reproduced hereinbelow:-

*"All the disputes and difference arising out of or in any way touching or concerning the agreement (matters, for which the decision of a specific authority as specified in the contract shall be final under this agreement, shall not be subject to arbitration) shall be referred to the sole arbitration of the Director General, Ordnance Fys. Govt. of India for the time being or a Government servant appointed by him. The appointee shall not be a Govt. Servant who had dealt with the matters to which this agreement relates and that in the course of his duties as Govt. Servant has had not expressed views on all or any of the matter is in dispute or difference. In case the appointed Govt. Servant in place of the incumbents."*

The appointment of the said Arbitrator was objected to by the Petitioner on the grounds of apprehension of bias and terminated the appointment by Notification under Section 14 of the Act. The Arbitrator continued with the proceedings despite the passing of the said Notification dated January 23, 2009. The Petitioner filed application before the District Court, Chandrapur for termination of the mandate of the Arbitrator. The Hon'ble Court passed orders terminating mandate of the earlier Arbitrator and provided for appointment of Director General, Ordnance Factory ("DGOF") as the Arbitrator or any other government servant appointed by him, as per the terms of the contract.

The DGOF did not commence arbitration proceedings or appoint anyone else within 30 days of the passing of the abovementioned Order leading to the present petition being filed under Section 11 before the SC on March 2, 2011.

### DENEL'S SUBMISSIONS

The Petitioner claimed that orders passed by the District Court were void ab initio as it was not vested with the powers of appointment of Arbitrator and had exceeded its jurisdiction. Secondly, the Petitioner also questioned the authority of the DGOF to be appointed as the Arbitrator raising doubts on his impartiality and independence as the claims raised were against the Ministry of Defence and thereby he would be bound by the directions/instructions of his superior authorities and his previous actions including exchange of correspondences and direct involvement in the matter reflected lack of independence and impartiality. The Petitioner contended that by virtue of the DGOF failing to appoint an Arbitrator as per the orders of the District Court, the Respondent had forfeited their right towards appointment.

### MINISTRY OF DEFENCE'S SUBMISSIONS

The Government on the other hand questioned the maintainability of the petition and stated that new Arbitrator, Mr. Satyanarayana was appointed by DGOF on March 16, 2011 pursuant to order passed by the District Court, Chandrapur. The Petitioner was informed about the same by letter dated March 26, 2011. However, the Petitioner did

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not submit any response to the same. Further only upon receipt of letter dated April 8, 2011 with regard to taking forward the arbitration proceedings, the Petitioner later objected to the said appointment by their letter dated April 15, 2011.

## ISSUES

§ Whether delay in appointment of an Arbitrator by the Respondent amounted to forfeiture of its rights?

§ Whether apprehensions of bias and appointment of Arbitrator by the Respondent in violation of the principles of natural justice?

## DECISION AND RATIONALE

The SC hearing both the parties held that the petition filed in the present case is maintainable as the same was filed prior to appointment of a new Arbitrator by the Respondent. The SC relying on the precedents of Datar Switchgears Ltd. vs. Tata Finance Limited<sup>2</sup> and Punj Lloyd Limited vs. Petronet MHB Ltd.<sup>3</sup> held that non-appointment of an Arbitrator within 30 days does not amount to forfeiture of rights under Section 11(6) of the Act. Unlike Section 11(4) and 11 (5) which prescribes a period of 30 days for appointment of an Arbitrator, there is no time limit for filing petition under Section 11 (6) of the Act. The right to appointment continues provided the same is made prior to the other party filing petition. In the instant case, the mandate of the earlier Arbitrator was terminated owing to him not acting in a fair and impartial manner but appointment of a new Arbitrator by the Respondent was delayed and not done prior to filing of the present petition. As a result, the Respondent's right was forfeited as they failed to appoint an Arbitrator prior to the filing of the petition.

With regard to the second issue on appointment of DGOF or a government servant as an Arbitrator, the SC relying on its previous ruling<sup>4</sup> held that it is 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. These officers are expected to act independently and impartially. Further, 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. **(please refer to our earlier hotline dated September 3, 2009)**<sup>5</sup>. However, the SC in the present case, declined to appoint an Arbitrator as per the terms of the contract as the apprehensions put forth by the Petitioner had merits as established through correspondences and attitude towards resolving the dispute. The same issue has been dealt earlier in the case of Denel (Proprietary) Limited v. Bharat Electronics Ltd & Anr.<sup>6</sup> **(please refer to our earlier hotline dated July 2, 2010)**.<sup>7</sup>

The SC held that under Section 11(6) of the Act, if the circumstances demand, an independent Arbitrator can be appointed as per Section 11(8) (b) contrary to the procedure provided under the terms of the contract. A new and independent Arbitrator was appointed considering the prior approach and attitude of the DGOF towards the dispute.

## CONCLUSION

This case lays down two clear principles with regard to appointment of Arbitrator under Section 11(6) of the Act. Firstly, failure to appoint an Arbitrator within 30 days as prescribed under Sections 11(4) and (5) of the Act do not amount to forfeiture of rights unless the opposite party has filed their petition under Section 11 (6) prior to the said appointment. Secondly, though it is a well established principle that appointment is required to be done as per the terms and conditions of the contract, however if circumstances exist an independent Arbitrator may be appointed as an exception to the general rule, if there is reasonable apprehension of bias and impartiality.

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You can direct your queries or comments to the authors

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<sup>1</sup> MANU/SC/0010/2012; Arbitration Petition No. 11 of 2011

<sup>2</sup> 2000 (8) SCC 151

<sup>3</sup> 2006 (2) SCC 638

<sup>4</sup> Indian Oil Corporation Limited & Ors. vs. Raja Transport Private Limited (2009) 8 SCC 520

<sup>5</sup> [http://www.nishithdesai.com/New\\_Hotline/Dispute/DISPUTE%20RESOLUTION%20HOTLINE\\_sep03.htm](http://www.nishithdesai.com/New_Hotline/Dispute/DISPUTE%20RESOLUTION%20HOTLINE_sep03.htm)

<sup>6</sup> Arbitration Petition No 16 of 2009

<sup>7</sup> [http://www.nishithdesai.com/New\\_Hotline/Dispute/DISPUTE%20RESOLUTION%20HOTLINE\\_July0210.htm](http://www.nishithdesai.com/New_Hotline/Dispute/DISPUTE%20RESOLUTION%20HOTLINE_July0210.htm)

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