Termination of Arbitrators: Judiciary Sets the Bar

1. Introduction

Fair adjudication of disputes is dependent on unbiased judges. In arbitrations where the parties nominate arbitrators, it is necessary to ensure that they are capable of passing awards in a fair manner. With this object, the Arbitration and Conciliation Act 1996 ("**Act**") was amended in 2015, when new provisions and grounds were added to determine if arbitrators have conflict of interest with the parties or subject-matter of dispute. The grounds are taken from the International Bar Association Guidelines on Conflict of Interest in International Arbitration ("**IBA Guidelines**") and are listed in the Fifth and Seventh Schedules. On August 31, 2017, the Supreme Court ("**SC**") delivered an important judgment in HRD Corporation ("**HRD**") vs. GAIL (India) Limited ("**GAIL**")[1] where the court analyzed the provisions of the Act in the light of IBA Guidelines and held that, the test for determining ineligibility is whether a reasonable third person knowing the facts of the dispute believes that the arbitrator is influenced by factors other than the merits of the case.

This newsletter summarizes the judgment of SC.

2. Factual Matrix

On April 1, 1999, HRD and GAIL entered into an agreement for the supply of wax generated at GAIL's plant at Uttar Pradesh. The agreement was for a period of 20 years. Disputes arose between the parties resulting in three arbitrations. For the first two arbitrations, the tribunal consisted of Justice A.B. Rohtagi (presiding arbitrator), Justice J.K. Mehra and Justice N.N. Goswamy. The parties proceeded with the same tribunal for the third arbitration, but Justice Goswamy expired during pendency of the proceedings and Justice T. Doabia was appointed in his place. Justice Rohtagi resigned and Justice. S.S. Chadha was appointed to fill the vacancy. The third arbitration culminated into two separate awards on the same day i.e. July 22, 2015.

A fourth arbitration was initiated in 2016, HRD initially nominated Justice K. Ramamoorthy, but he withdrew from the case and Justice Mukul Mudgal was nominated in his place. GAIL nominated Justice Doabia and the two arbitrators appointed Justice K.K. Lahoti to be the presiding arbitrator. Justice Lahoti disclosed after his appointment that he had previously given a legal opinion to GAIL in an unrelated matter. HRD filed two separate applications opposing the appointment of Justice Doabia and Justice Lahoti that was heard by the tribunal. This resulted in a divided opinion by the tribunal members as Justice Lahoti and Doabia held that they were entitled to continue hearing the dispute, and there was no conflict of interest. Justice Mudgal concurred with retaining only Justice Lahoti and held that Justice Doabia'a appointment was not in consonance with the Act. Thereafter, HRD filed a petition before Delhi High Court seeking termination of the appointment of Justice Doabia and Lahoti which the court dismissed. HRD challenged this decision in the SC and sought the termination of the mandate of the two arbitrators. The SC had to determine the procedure to be adopted in deciding petitions for termination of arbitrators.

1 2017 SCC OnLine SC 1024

2 Such disclosure has to be made in the form specified in the Sixth Schedule and in a reasonable time upon receipt of

3. Relevant Legal Provisions

Before delving into the parties' arguments and SC ruling, it is imperative to understand the legal provisions discussed in this case pertaining to conflict of interest. Section 12(1) of the Act requires possible arbitrators to disclose in writing, any kind of past interest or relationship with the parties or subject-matter of dispute and circumstances which will prevent them from completing the arbitration within 12 months.[2] Section 12(3)(a) provides that appointment of arbitrators can be challenged only if there is justifiable doubts as to their independence or impartiality which are to be tested on the grounds prescribed in the Fifth Schedule of the Act.[3] Section 12(5) prohibits appointment of possible individuals who are ineligible due to their association with the parties or if the subject matter of dispute falls within the grounds mentioned in the Seventh Schedule.[4] But, the parties can waive the applicability of this provision by a written agreement. Section 13 provides that the parties can agree on a procedure to challenge appointments before the tribunal. If they are unable to agree on the procedure, any party who intends to challenge should file an application within fifteen days from when they become aware of the constitution of tribunal or any circumstances that may create doubt as to the arbitrator's independence or impartiality. If the challenge is not successful, the tribunal can proceed with the arbitration and pass an award. Thereafter, parties can challenge the award in court under Section 34[5] of the Act. Section 14 stipulates that arbitrators shall be terminated if they become de jure ineligible to perform the functions. Under such situation, the parties may approach the court directly to decide on the termination.

4. Issues and Parties Arguments

The key question in this case concerned the manner in which the provisions of the Act are to be interpreted in a potential conflict of interest analysis of arbitrators, for determining their eligibility to continue with the arbitration.

4.1 HRD's arguments

(a) Appointment of Justice Doabia: HRD contended that the object of amending the Act is to appoint neutral arbitrators who are independent and fair in their decision-making. Justice Doabia had adjudicated in the third arbitration for GAIL. HRD argued that he was ineligible under three grounds of the Seventh Schedule. The first ground provided that, an arbitrator who is an employee, advisor or consultant or who has any business relationship with the parties is ineligible. According to HRD, Justice Doabia arbitrated their dispute in the past and this constituted a business relationship between him and the parties. They further stated that the Seventh Schedule also provides, the arbitrator should not have rendered legal advice or given expert opinion to the parties or be involved in any manner in the case. HRD stated since Justice Doabia had passed an award in the third arbitration, this constituted expert opinion and he was involved in the case.

2 Such disclosure has to be made in the form specified in the Sixth Schedule and in a reasonable time upon receipt of a nomination request. Before confirmation of the appointment the proposed nominee has to submit its disclosure

3 The Fifth Schedule to the Act contains 34 grounds which can cast doubt on the arbitrator's ability to act independently or impartially

4 The Seventh Schedule contains 19 grounds that make arbitrators de jure ineligible to continue as arbitrators

5 Section 34 contains the grounds based on which an application can be filed in the court for setting aside an arbitral award

Furthermore, he had not disclosed in writing circumstances which are likely to affect his ability to devote sufficient time for the arbitration, in accordance with Section 12(1)(b) of the Act.

(b) Appointment of Justice Lahoti: HRD also contended that the appointment of Justice Lahoti attracted three grounds of the Seventh Schedule and two new grounds of the Fifth Schedule. As with the case of Justice Doabia, HRD argued that rendering legal opinion or advice constituted a business relationship between potential arbitrator and parties. Further, as Justice Lahoti was on the panel of arbitrators of GAIL, HRD argued that this amounted to giving regular advice to GAIL and acting as their adviser within the last three years, thereby making him ineligible to proceed with the arbitration. Therefore, his appointment should be terminated.

HRD further contended that after the 2015 amendment, the scope of challenge to awards under Section 34 of the Act has been narrowed. Previously, the grounds for setting aside an arbitral award were quite broad. Any award could be challenged on varied statutory grounds, including one when the award was contrary to the public policy of India. This meant the award passed by biased arbitrators could theoretically be set aside by the court, if the party challenging it could prove that the arbitrators had conflict of interest which prevented them from passing a neutral award. The 2015 amendment has narrowed the grounds for challenge by removing the public policy ground and by limiting it to awards that are only against the fundamental policy of Indian law. By incorporating specific grounds in the two schedules of the Act, the legislature intended that the parties resolve disputes concerning potential conflict of interest of arbitrators, before the commencement of arbitration process. This will ensure that the awards passed are adhered to by the parties and they do not seek to set it aside.

4.2 GAIL's arguments

GAIL argued that neither Justice Lahoti nor Justice Doabia were ineligible to act as arbitrators and the grounds raised by HRD are not applicable to them, as they cover circumstances where the arbitrators have some business relationship with the parties or are continuously giving advice to them regarding the current or any other dispute. Giving a legal opinion or rendering an arbitral award does not make the arbitrators ineligible. Further, Justice Doabia had no previous involvement in the very dispute and had appeared in a different arbitration arising out of the same agreement. Moreover, the two Schedules are taken from the IBA Guidelines and are to be read in the light of the general principles contained in it. The IBA Guidelines consider arbitrators to be independent and impartial at the time of appointment unless clear circumstances indicate that they may not function without bias.

5. SC Analysis and Decision

After hearing both sides, SC had to decide whether to interpret the provisions of the Act broadly so that even a minute doubt as to the independence or impartiality of judges is to be considered as basis for ineligibility, or consider the facts and circumstances of each case individually before deciding about the termination of an arbitrator. In this regard, SC came to certain conclusions to guide it in the interpretation of provisions of the Act.

5.1 Separation of Fifth and Seventh Schedule

At the outset, SC held that the 2015 amendment had created a dichotomy between the grounds contained in the Fifth and the Seventh Schedule. The former lists circumstances that only give rise to justifiable doubts as to the independence or impartiality of arbitrators, while the latter lists circumstances which make arbitrators *per se* ineligible to further perform their functions. A challenge under the Fifth Schedule can be initially heard by the tribunal only and the challenge can be taken to court only after an award is passed. But, for challenges under the Seventh Schedule, the parties can directly approach the court, to decide whether the mandate of an arbitrator can be terminated. Hence in the present case, SC could hear only the challenges based on grounds contained in the Seventh Schedule.

5.2 IBA Guidelines

The SC agreed with HRD that the 2015 amendment was carried out with the goal of appointing neutral arbitrators and that the Fifth and Seventh Schedules, when read in consonance with Section 12, are used to determine ineligibility of arbitrators. However, the grounds in the schedules cannot be construed in an expansive manner such that the remotest likelihood of bias merits removal of arbitrators. This is not an acceptable standard of interpreting the schedules as this would defeat the very purpose of including specific grounds for termination of arbitrators introduced by the 2015 amendment. As both Schedules were lifted from the IBA Guidelines, the court felt it imperative to interpret the statutory provisions in the light of the general principles contained in it. According to these principles, if a third person with knowledge of the facts believes that the arbitrator is incapable of acting in an independent or impartial manner, the doubts about the arbitrator are justified. The test for determining eligibility of arbitrators requires taking a broad common-sense approach to the grounds of Fifth and Seventh Schedules. This would, therefore, require a fair construction of the words used therein, neither tending to enlarge nor restrict them unduly. SC adopted this approach in the case and applied this test individually to each ground of the Seventh Schedule, to analyze if a reasonable third person would believe that the two arbitrators were biased under the facts and circumstances of the case.

After due deliberations, the SC held as follows. Regarding Justice Lahoti's appointment, they were of the view that giving a legal opinion comes within the purview of professional relationship as it is considered as legal advice and not business advice, as outlined in the first ground of Fifth Schedule. The apex court categorically held that the other two grounds will not apply, as Justice Lahoti was not continuously giving advice to GAIL.

With respect to Justice Doabia's appointment, SC held that grounds of the Seventh Schedule was derived from para 2.1.2 of the IBA Guidelines which states "The Arbitrator had a prior involvement in the dispute." As such this ground of the Seventh Schedule only required that the arbitrator not be involved in the current dispute. Since heading to this ground reads as "Relationship of the arbitrator to the dispute". This indicates that the person should be involved in the dispute in any other capacity other than as an arbitrator. The fact that an arbitrator has previously decided a case is not enough to lead to a conclusion of apparent bias. Arbitrators are generally assumed to be trustworthy and honest and approach each case with an open mind unless facts exist that may show possibility of a preconceived notion. Accordingly, SC ruled that the appointment of Justice Doabia and Lahoti cannot be terminated.

6. Conclusion

The standard set by the ruling will, hopefully, serve as a reference point for any future disputes challenging appointment of arbitrators. It was necessary to set a common standard to prevent vexatious litigation by parties, even in the remotest instances of doubts concerning independence or impartiality of arbitrators. In order to further promote arbitration as an efficacious process, clearly there has to be a belief in their ability to be neutral and impartial. The fact that an arbitrator has been on a panel of an arbitral tribunal in a different dispute, but amongst the same parties, should not lead to an automatic assumption of bias against that arbitrator. The decision also highlights the importance given to international principles and guidelines in an endeavor to tighten the entire arbitral process.

Author
Bhavani Navaneedhan