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The Need to Distinguish Supreme Court's Decision in Ellora Paper Mills

Blog

By Saurabh Mishra

The Need to Distinguish Supreme Court's Decision in *Ellora Paper Mills*

A *Blog* by Saurabh Mishra[1]

This is a Blog on the application of Section 12(5) Arbitration and Conciliation Act 1996 ("ACA") to arbitration proceedings that commenced *and* in which arbitrators were appointed before the Arbitration and Conciliation (Amendment) Act, 2015 came into force on 23 October 2015. A recent 2-judge bench decision of the Supreme Court of India in *Ellora Paper Mills Limited* v. *State of Madhya Pradesh*[2] (*Ellora*) has applied the said provision to terminate the mandate and substitute a tribunal constituted in the year 2000. This Blog argues that the decision in *Ellora* has the potential to adversely impact numerous pending arbitration proceedings as well as the setting aside of arbitral awards. Further, as this was not the purpose of Section 12 (5) ACA, arguments based on *Ellora* must be carefully considered and appropriately distinguished.

Independence and impartiality of employee arbitrators: the past and the present

Independence and impartiality of the arbitrators at the time of appointment, and its continuation throughout the arbitral proceedings, is accepted as an essential and indispensable part of the arbitration system.[3] Independence means "exemption from external control or support; freedom from subjection, or from the influence of others."[4] It "requires that there should be no such actual or past dependant relationship between the parties and the arbitrators which may or at best appear to affect the arbitrator's judgment."[5] Impartiality is "freedom from prejudice, bias."[6] The test applied is not proof of actual bias but the likelihood of bias.

When the ACA was enacted (following the Model Law and replacing the 1940 Act[7]), Section 12 ACA set forth a general test rather than a list of specific criteria to provide "national courts with a certain degree of flexibility and discretion."[8] An arbitrator could be challenged if circumstances existed that gave rise to justifiable doubts about his independence and impartiality.[9] Simultaneously, Section 11 (8) ACA also established criteria of independence and impartiality by providing that the appointing authority shall have due regard to considerations as are likely to secure the appointment of an independent and impartial tribunal.

Disputes relating to independence and impartiality of arbitrators have arisen often in contracts involving the state and state entities because of a common practice to provide for arbitration either by state's employee (a civil servant or an officer working in the contracting or another department) or a person appointed by an employee.

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[2] 2022 SCC OnLine SC 8.
[3] Under Section 34 (4) ACA, the court has the power to remand the matter back to the tribunal. So, a requirement of fresh disclosure under Section 12(1) ACA should apply at this stage. See International Bar Association, 'IBA Guidelines on Conflicts of Interest in International Arbitration 2014':<https://www.ibanet.org/MediaHandler?id=e2fe5e72-eb14-4bba-b10d-d33dafee8918, Part I (1)>.
[4] "independence, n." *OED Online*. Oxford University Press, December 2021. Web. 11 February 2022.
[5] Julian DM Lew, Loukas A Mistelis and Stefan M Kroll, *Comparative International Commercial Arbitration* (Wolters Kluwer 2003) 261.
[6] "impartiality, n." *OED Online*. Oxford University Press, December 2021. Web. 11 February 2022.
[7] For law on this issue under the Arbitration and Conciliation Act 1940, see e.g. *Govt of TN* v. *Munuswamy Mudaliar* 1988 Supp SCC 651.
[8] Howard M Holtzmann and Joseph E Neuhaus, *A Guide to the UNCITRAL Model Law on International Commercial Arbitration* (Wolters Kluwer 2015) 388.
[9] Under the doctrine of *competence competence*, the challenge lies with the arbitrator, and, if it fails the remedy is to raise the point at the set aside stage; Section 13 (5) ACA (1996), both *pre* and *post* 2015.

The Supreme Court's decision in *Indian Oil Corporation Limited and others* v. *Raja Transport Private Limited*[10] is possibly the best articulation of position before the 2015 Amendments. The court ruled that bias, partiality and lack of independence could not be presumed merely because an employee of one of the parties, which is a state entity, is an arbitrator.[11] However, the court added, there could be "justifiable apprehension about the independence or impartiality of an employee arbitrator, if such person was the controlling or dealing authority in regard to the subject contract or if he is a direct subordinate … to the officer whose decision is the subject matter of the dispute."[12]

The 2015 Amendments changed the law. Section 12(5) was added to provide that "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." Entry 1 Seventh Schedule prohibits, and automatically disqualifies, a relationship where the "*arbitrator is an employee*" of either the parties or counsel. This provision is a material departure from the earlier statutory scheme explained in *Raja* and other cases.

Applicability of the 2015 Amendments

Dispute relating to the applicability of the 2015 Amendments to proceedings commenced before arose in many cases. For example, in *BCCI* v. *Kochi Cricket (P) Ltd,*[13] the Supreme Court ruled that it applied (a) only to those arbitral proceedings which commenced on or after 23 October 2015, and (b) to all court proceedings commenced on or after that date (irrespective of commencement of arbitration). The court also ruled that the prospective nature of the amendments did not apply to a procedural amendment. Accordingly, in *Ssangyong Engineering and Construction Company Ltd* v. *National Highways Authority of India*,[14] the Supreme Court held that the amendments made to Section 34 ACA did not apply retrospectively because the amendment to that provision was substantive.[15]

Applicability of the 2015 Amendments to an application under Section 11 and 14 ACA came directly into question in *Aravalli Power Company Private Limited* v. *Era Infra Engineering Limited*.[16] Relying on the Raja Transport principle, the Supreme Court clearly ruled that under the position pre-2015 Amendments, no presumptive bias was associated with an employee of a state entity.

The decision of *SP Singla Constructions (P) Ltd* v. *State of HP*[17] is also significant. Relying on the law laid down in *BCCI* v. *Kochi* and subsequent decisions, the court held that the Amendment Act could not be invoked to disqualify the named arbitrator because the arbitration proceedings had commenced before the 2015 Amendments (in 2013).

Ellora's ruling: a short analysis

The conclusion drawn in *Ellora* is not consonant with the Supreme Court's consistent view. A dispute arose from a contract of supply of cream wove paper.[18] The arbitration agreement provided that the disputes were to be referred to arbitration by the Stationery Purchase Committee of the Government. The committee comprised of civil servants and other Government officers.

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[10] (2009) 8 SCC 520.
[11] ibid [34] (RV Raveendran & DK Jain JJ).
[12] *Raja* (n10) [34].
[13] (2018) 6 SCC 287.
[14] (2019) 15 SCC 131.
[15] This view has been reiterated by the court in subsequent decisions. See, e.g. *Union of India* v. *Parmar Construction Co* (2019) 15 SCC 682; *Hindustan Construction Company Ltd and another* v. *Union of India & others* 2019 SCC OnLine 1520.
[16] (2017) 15 SCC 32.
[17] (2019) 2 SCC 488.
[18] Paper having a cloth-like appearance when viewed by transmitted light.

Ellora had filed a recovery suit in 1998 in which the State applied under Section 8 ACA to refer the matter to arbitration. This application later succeeded in the High Court.[19] The referral was challenged in the Supreme Court but withdrawn without prejudice.[20] Then, the State constituted the tribunal and Ellora challenged the tribunal's jurisdiction under Section 13 ACA.[21] The tribunal rejected the challenge.

In 2001, Ellora challenged the tribunal's rejection order in the High Court. This was pending for sixteen years, with a stay on the arbitration, before being dismissed in 2017.[22]

In this broad background, Ellora applied to the High Court under Section 14 ACA read with Section 11 ACA to terminate the mandate of the Committee and substitute it with a court-appointed arbitrator.[23] Its central argument was that the tribunal members who had initiated the arbitration had lost their mandate post-2015 Amendments because of Section 12 (5) ACA. Also, they had retired and had to be substituted in any case. This time around, however, given the change in law, the Committee members could not be arbitrators.

The High Court repelled this challenge by holding that the 2015 Amendments were prospective and could not be applied to arbitrations that commenced before 23 October 2015. The Supreme Court reversed this decision by terminating the Committee's mandate and substituting it with a court-appointed sole arbitrator given the amended law. While coming to the said conclusion, the court relied on the decisions in *TRF Limited* v. *Energo Engineering Projects Ltd*;[24] *Bharat Broadband Network Limited* v. *United Telecoms Limited*[25] and *Jaipur Zila Dugdh Utpadak Sangh Limited* v. *Ajay Sales & Supplies*.[26]

I will now analyse the court's findings.

Firstly, the fundamental weakness of the Supreme Court's decision is the question it framed. It asked:

> "whether, the Stationery Purchase Committee-Arbitral Tribunal consisting of the officers of the respondent has lost the mandate, considering Section 12 (5) read with Seventh Schedule of the Arbitration Act, 1996. If the answer is in the affirmative, in that case, whether a fresh arbitrator has to be appointed as per the Arbitration Act, 1996?"[27]

Ellora's case was based on the 2015 Amendments. Because the High Court had rejected the petition on the ground that the 2015 Amendments did not apply, and the tribunal's constitution was valid under the old law, the first and foremost question for the Supreme Court was: did the 2015 Amendments apply at all? This question, though raised, was not answered.

Secondly, assuming that Ellora had laid a foundation in its pleadings, the next question should have been whether, under the pre-2015 law, the tribunal's mandate could be terminated and substitution made? This question could have been examined given the law laid down in *Raja* as also (in particular) paras 17-19 of *Union of India* v. *UP State Bridge Corporation Ltd* (2015) 2 SCC 52.[28] If *Ellora* did not base its case on this argument, it was open for the court not to consider it.

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[19] *State of MP* v. *Ellora Paper Mills Limited* (Revision Petition No 1117 of 1999) (03 May 2000).
[20] Special Leave Petition No 13914 of 2000 (28 September 2000).
[21] The Supreme Court notes that the arbitral tribunal was constituted by the court. From the High Court's order of 03 May 2000, it appears that the court only referred the parties to arbitrate under the contract.
[22] *Ellora Paper Mills Limited* v. *State of MP* 2021 SCC OnLine MP 2796.
[23] In this blog, I have not examined whether the High Court has jurisdiction to consider an application for termination of mandate and substitution.
[24] (2017) 8 SCC 377.
[25] (2019) 5 SCC 755.
[26] 2021 SCC OnLine SC 730.
[27] *Ellora* (n2) [17].
[28] See also *State of Haryana* v. *GF Toll Road Pvt Ltd* (2019) 3 SCC 505.

Thirdly, Section 12(5) is substantive, leading to automatic disqualification of the categories specified in the Seventh Schedule. This regime did not exist earlier, and the court could not have applied the amended Section 12(5) read with Seventh Schedule to adjudge the eligibility of an arbitral tribunal because, as held in a clear line of authorities, the 2015 Amendment applies only to prospective appointments (but irrespective of the date of the agreement).

Fourthly, the court cited *Jaipur Zila* (MR Shah J's authored judgment) that had, in turn, relied on *Bharat Broadband*. But *Bharat Broadband's* decision is appropriately conscious of the applicability of the 2015 Amendments. The court had said that "there is no doubt in this case that disputes arose only after the introduction of Section 12 (5) into the statute book, and (the arbitrator) was appointed long after 23 October 2015."[29] In both *Bharat* and *TRF* the agreement was prior to 23 October 2015, but the disputes arose, and arbitration commenced after that date. This was the fact pattern in *Jaipur Zila* also, which invited an argument that the ineligibility was not attracted because the arbitration agreement was of a date before the 2015 Amendments. Of course, the argument was rejected.

Fifthly, a highly unconvincing feature of the judgment is that it notes all the authorities the State had cited to argue that the 2015 Amendments did not apply but discusses none of them. Similarly, it does not refer to Ellora's challenge before the tribunal and why were they rejected. It could have shed more light on the factual context for a better analysis.

Sixthly, it weighed with the court that the arbitration proceedings had not "technically … commenced."[30] It is unclear if this was a reference to the concept of commencement as set out under Section 21 ACA. If it was, the observation is wrong because there is nothing such as technical and non-technical commencement under the ACA. The arbitral proceedings commence unless the parties have otherwise agreed once the other party receives a request under that provision. If the expression "commence" was a reference in the word's ordinary usage to mean the beginning of an action, the court was not correct in its approach. The proceedings had begun and could not go forward in the wake of Ellora's numerous litigations.[31]

Conclusion: distinguishing Ellora

There is no doubt that the 2015-Amendments lay norms of independence and impartiality that lend more legitimacy to the arbitration system. But legal reasoning requires a conceptual separation between a retrospective and a prospective law. A so-called "pro-arbitration" stance cannot be a justification to ignore this distinction. Moreover, it is not as if the norms were absent in the 1996 ACA before 2015, and Ellora could well have been considered under the old law subject to pleadings.

Consider the principal reasoning in *Ellora*. The court said that the officers constituting the Committee "*have become ineligible to become arbitrators and to continue as arbitrators*."[32] Further, "*it cannot be disputed that in the present case, the … Arbitral Tribunal comprising of officers of the respondent-State are all ineligible to become and/or to continue as arbitrators in view of the mandate of sub-section (5) of Section 12 read with Seventh Schedule*."[33]

A perpetuation of this view could lead to (a) termination of mandate in ongoing arbitrations and substitution of numerous tribunals appointed under the law before 2015 Amendments, and (ii) setting aside of awards made by such tribunals. *Ellora* itself is an example of the former. Based on *Ellora*, it is not difficult to imagine parties assailing arbitral awards made under even the law before the 2015 Amendments. In set-aside petitions involving awards made the present regime, the ground of

[29] *Bharat* (n 25) [18].
[30] Ellora (n2) [18].
[31] *Ellora* (n2) [18].
[32] *Ellora* (n2) [19].
[33] *Ellora* (n2) [19].

ineligibility of the tribunal is often invoked. For instance, in *JV Engineering Associate* v. *CORE*,[34] a post-2015 Amendment case, the award was set aside because the tribunal had been constituted in breach of Section 12 (5) ACA. Further, "an improper and impermissible appointment imperils any arbitral order or award, for it goes to the root of the matter," notes the Bombay High Court in an *ad interim* stage of a set-aside petition based on *Perkins*.[35] A similar argument was made but rejected by the Delhi High Court.[36]

Ellora is a decision *per incuriam*.[37] In cases not covered by the 2015 Amendments, it should be distinguished based on the following factors: one, the question of applicability of the 2015 Amendments was not directly considered or decided. Two, it weighed with the court that the arbitration proceedings had not commenced. Three, the tribunal was dysfunctional for twenty years.

[34] 2020 SCC OnLine Mad 4829.
[35] *Perkins Eastman Architects DPC* v. *HSCC (India) Ltd* 2019 SCC OnLine SC 1517.
[36] *Kanodia Infratech Limited* v. *Dalmia Cement (Bharat) Limited* 2021 SCC OnLine Del 4883.
[37] "per incuriam, adv." *OED Online*. Oxford University Press, December 2021. Web. 14 February 2022 : ('through carelessness. In later use: spec. (with reference to judicial decisions) through lack of regard to the facts of the law or of a legal case'). The doctrine of *per incuriam* is an exception to the doctrine of *stare decisis*. If court ignores a statutory provision or a binding precedent, it may be *per incuriam*, and not constitute a precedent.

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Saurabh Mishra, 'The Need to Distinguish the Supreme Court's Decision in Ellora Paper Mills' <https://www.nfral.in/blog/the-need-to-distinguish-supreme-courts-decision-in-ellora-paper-mills> accessed on 16 February 2022.