Appointment procedure skewed in one party's favour can constitute de jure inability under Section 14 ACA

Update by Kriti

Published on 24 January 2020

Larsen and Toubro Construction Ltd. v. Public Works Department

Court: Delhi High Court | **Case Number**: OMP (T) (COMM.) 58 of 2018 | **Citation**: 2020 SCC OnLine Del 33 | **Bench**: Rajiv Shakdher J | **Date**: 09 January 2020

A. The background

Larsen and Toubro Ltd. ("L&T") and the Public Works Department of the Government of NCT of Delhi ("PWD") had a contract concerning the construction of a hospital. Disputes arose. L&T first exhausted the mandatory pre-arbitral dispute resolution mechanism and then commenced arbitration under Clause 25 of the General Conditions of Contract (GCC).[1] PWD appointed as arbitrator one Mr. Verma, a retired Special Director of the Central Public Works Department (CPWD).[2] This was despite L&T's objections that the procedure of appointment of the arbitral tribunal under Clause 25 of the GCC had become invalid because of the 2015 Amendments to the Arbitration and Conciliation Act, 1996 ("ACA").[3] L&T filed an application under Section 11 and Section 14 of the ACA seeking an order terminating the arbitrator's mandate and his substitution.

B. The court's decision[4]

B1. Was Mr. Verma ineligible for appointment under Section 12(5) ACA[5] read with Entry 1 of the Seventh Schedule[6]?

Ineligibility under the Seventh Schedule leads to termination of mandate under Section 14(1)(a) ACA, notwithstanding an agreement to the contrary. But Mr. Verma was not ineligible because: –

(a) He is a retired Special Director of the CPWD. He is neither an employee nor a consultant, nor an advisor of the PWD.

(b) He had been appointed as an arbitrator by the PWD in the past but has no past or present business relationship with the PWD.

B2. Even if Mr. Verma's appointment is contrary to Entry 31 of the Fifth Schedule,[7] can it be terminated without following the challenge procedure under Sections 12 and 13 ACA?

[1] This clause has not been reproduced in the judgment.
[2] A body which comes under the Central Government. The respondent PWD is a body under the State Government.
[3] With introduction of provisions relating to neutrality of arbitrators.
[4] First, the court considered a preliminary issue and held that the 2015 Amendments applied.
[5] Section 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.
[6] Entry 1 of the Seventh Schedule: The arbitrator is an employee, consultant, advisor or has any other past or present business relationship with a party.
[7] Entry 31 of the Fourth Schedule: The arbitrator had been associated within the past three years with a party or an affiliate of one of the parties in a professional capacity, such as a former employee or partner.

No, the grounds of challenging the appointment of the arbitrator are prescribed in Section 12(3). Even if the appointment is contrary to Entry 31 of the Fifth Schedule , the available remedy is under Sections 12 and 13 ACA.[8]

B3. Did Mr. Verma become *de jure* ineligible under Section 14(1)(a) ACA because the appointment procedure is skewed in favour of PWD? If so, by what process can he be substituted? Can the court make an appointment in his stead under Section 11 ACA?

The court concluded: yes, the procedure is skewed in favour of PWD. Mr. Verma was appointed *via* the same skewed process. He should be substituted but cannot be substituted under the same procedure. The court has the power to make an appointment. These were the court's reasons: –

(a) The procedure is skewed; it constitutes inability under Section 14(1)(a) ACA.

Firstly, the court noted that there is a mandatory pre-arbitration dispute resolution mechanism ("it is a term of contract that each party invoking arbitration must exhaust the aforesaid mechanism of settlement of claims/disputes prior to invoking arbitration"). It also noted that under that process, the Principal Chief Engineer is the first appellate authority, and also the authority for appointing an arbitrator, thus, wearing two hats. The court said his roles are such that there is every likelihood of his appointee not being perceived as impartial.

Secondly, the court commented on the "procrastination by the Principal Chief Engineer" in not disposing of L&T's appeal[9] within the prescribed period. The court observed it lent credence to the charge that appointment made by him was neither fair nor impartial. At times, the court said, not rendering a decision is worse than rendering a decision in the matter.

Thirdly, the court noted that the "more serious cause for concern" was how arbitrators are empanelled by the PWD. Empanelment, for example, required that the person must not have appeared against the Government. Mr. Verma was empanelled under the same procedure. This procedure, the court concluded, was skewed in PWD's favour and the persons empanelled are required to display trait or attributes that are antithetical to the appointment of an impartial and an independent arbitrator.

Finally, the court concluded that inability of an arbitrator under Section 14 (1) (a) ACA includes those aspects which lend support to the plea that the appointee-arbitrator would not be impartial and/or independent even if those matters don't fall under the Seventh Schedule.

(b) Appointment of substitute arbitrator—must it be via the original appointment process?

The court held that under Section 15(2) ACA, when the mandate of an arbitrator is terminated, the substitute arbitrator can be appointed only according to the rules applicable to the original appointment. But it said that principle would not apply here because: –

(i) Section 15(2) ACA is founded on the premise that rules of appointment ensure that the appointee-arbitrator has, in the very least, ostensible attributes of being fair and impartial.

(ii) Here, both the procedure for appointment[10] and the conditions of empanelment[11] are such that they are likely to create an impression that the appointee-arbitrator is neither fair nor independent nor impartial.

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[8] Section 12 ACA provides for the "Grounds for Challenge" and Section 13 ACA provides for the "Challenge Procedure."

[9] In the pre-arbitral dispute resolution process, L&T's 'petition' had eventually reached the Principal Chief Engineer.

[10] Referring to the Principal Chief Engineer being one of the adjudicators in the pre-arbitration dispute resolution process, as also having the power to appoint an arbitrator.

[11] Referring to conditions for empanelment ("the conditions … seek almost a declaration of allegiance to the Government).

The court also rejected the argument that in absence of the Chief Engineer that role could be fulfilled by the Additional Director General or Director General of Works.[12]

(c) What relief—asking the PWD to rejig the procedure?

The court then exercising its power under Section 11 ACA made an appointment. It said the other option was to persuade PWD to rejig its appointment procedure and broad base its panel of arbitrators following *M/S Voestalpine Schienen GMBH* v. *Delhi Metro Rail Corporation Limited*, (2017) 4 SCC 665. But "this is an exercise that can, perhaps, be carried out by the PWD with regard to future appointments". Appointment now would hasten the process.

The court said this power has been exercised by courts even prior to the 2015 Amendments in the interest of appointing an impartial and independent arbitrator by veering away from the procedure agreed to between the parties [referring to *Indian Oil Corporation Limited* v. *Raja Transport Pvt. Limited*, (2009) 8 SCC 520 and *Union of India* v. *U.P. State Bridge Corporation Limited*, (2015) 2 SCC 52), all of which the court said was cited with approval in *Voestalpine*].

(d) Reframing the GCC

The court suggested it would be in the interest of the PWD to reframe Clause 25 (i) of the GCC to the extent it confers the power of constituting an arbitral tribunal on the Chief Engineer who also acts as the first appellate authority in the mandatory pre-arbitration adjudicatory process.

The court also said the PWD also should revisit its empanelment applications and to broad base its panel to include not only retired government and public sector officials but judges, bureaucrats, lawyers etcetera having relevant domain expertise. Also, the PWD "would do well to follow the directions issued by the Supreme Court in *Voestalpine* in paragraph 29 at page 690."

[12] This argument was based on Clause 25 (ii) of the GCC which provided that if the Chief Engineer is available, then, the role of the appointing authority could be fulfilled by the Additional Director General of the concerned region of the CPWD and if no Additional Director General is available, then, the said obligation of appointing the sole arbitrator could be discharged by the Director General of Works, CPWD. Therefore, it was argued that even if the court were to terminate the mandate of Mr. Verma, it would have to allow PWD to appoint a substitute arbitrator. The court said, first, the post is not vacant, and second, both the Additional Director General and the Director General of Works would have the same panel available to them as it was to the Chief Engineer.