

Supreme Court holds unilateral arbitrator appointments not permissible

19 November 2024

Partner: Mohit Rohatgi, Senior Associate: Samriddhi Shukla

This update covers:

1	Introduction	1
2	Background	1
3	Issues	3
4	Key aspects of the Supreme Court's ruling	3
5	Conclusion	5

1 Introduction

On 8 November 2024, a five-judge bench of the Supreme Court, in *Central Organisation for Railway Electrification v M/s ECI SPIC SMO MCML (JV)*, held that arbitration clauses: (i) mandating one party to unilaterally appoint the sole arbitrator, or (ii) in case of a three-member panel, mandating one party to select its nominee from a panel of arbitrators curated by the other party, violate the principles of equality under the Arbitration and Conciliation Act, 1996 (**Arbitration Act**). The Court also held that such unilateral appointment clauses in public-private contracts or public-sector undertaking (**PSU**) contracts violate the fundamental right to equality before the law under Article 14 of the Constitution. This decision necessitates contractual parties in India to reassess their arbitration clauses.

2 Background

The need for reference to a larger five-judge bench of the Supreme Court arose due to divergent views in several previous decisions of the Supreme Court on the validity of arbitration clauses where the appointment procedure was primarily controlled by one party through either unilateral appointment or selection of arbitrators from a panel exclusively curated by that party.

A five-judge bench of the Supreme Court of India upheld its previous decisions in TRF and Perkins and overruled its decisions in Voestalpine and CORE to hold that arbitration clauses: (i) mandating one party to unilaterally appoint the sole arbitrator, or (ii) in case of a three-member panel, mandating one party to select its nominee from a panel of arbitrators curated by the other party, are not permissible. The Supreme Court clarified that this decision applies to even public-private contracts or PSU contracts.

This question first became moot in *Voestalpine Schienen GmbH v Delhi Metro Rail Corporation Ltd. (DMRC)* (2017) (**Voestalpine**), where a two-judge bench of the Supreme Court determined the validity of an arbitration clause that required DMRC to select five names from a panel of engineers comprising serving or retired engineers of government departments or PSUs, who were to be then exclusively considered by each party for proposing their respective nominee arbitrator in a three-member tribunal. The Court held that:

- a. Section 12(5) (pertaining to ineligibility of an arbitrator) read with Seventh Schedule of the Arbitration Act does not bar retired government employees from serving as arbitrators and no bias or real likelihood of bias can be attributed to such experienced persons;
- b. the arbitration clause imposed several limitations on the private party so far as it was mandated to choose its nominee arbitrator from a five-member panel exclusively curated by DMRC;
- c. choice must be given to both parties to nominate any person from the entire panel of arbitrators; and
- d. in government contracts where the government has the authority to appoint an arbitrator, a ‘*broad-based panel*’ is imperative to secure the principles of independence and impartiality at the stage of appointment of arbitral tribunal.

In *TRF Ltd. v Energo Engineering Projects Ltd. (2017) (TRF)*, a three-judge bench of the Supreme Court decided a related question of whether the managing director of the respondent was eligible to nominate a sole arbitrator in view of Section 12(5) of the Arbitration Act. Relying upon the maxim of “*qui facit per alium facit per se*” (what one does through another is done by oneself), the Court held that a person who is statutorily ineligible to appoint an arbitrator under Section 12(5) of the Arbitration Act, cannot nominate another person as an arbitrator.

Subsequently, a two-judge bench of the Supreme Court in *Perkins Eastman Architects DPC v HSCC (India) Ltd. (2019) (Perkins)*, relied upon TRF to disregard an arbitration clause requiring HSCC to appoint the sole arbitrator on the basis that a person having interest in the dispute, or its outcome, ought not be given the power to unilaterally appoint a sole arbitrator.

In another significant ruling later that year, namely, *Central Organisation for Railway Electrification v ECI-SPIC-SMO-MCML (JV) A Joint Venture Company (2019) (CORE)*, a three-judge bench of the Supreme Court upheld the validity of an arbitration clause that provided for the following process for appointment of a three-member tribunal:

Step 1: Railways to prepare a list of at least four names of retired railway officers empanelled to work as railway arbitrators.

Step 2: Contractor to suggest at least two names from this panel.

Step 3: General Manager of Railways to appoint at least one of contractor’s suggestions as contractor’s nominee. Balance two arbitrators to be appointed from the panel or outside the panel.

The Court relied upon *Voestalpine* to observe that Section 12(5) of the Arbitration Act does not bar former employees of parties from being appointed as arbitrators. The Court also held that the findings in *TRF* and *Perkins* are not applicable as the General Manager of Railways’ right in formation of arbitral tribunal is “*counter-balanced*” by contractor’s power to choose any two names from the four names.

Another three-judge bench of the Supreme Court in *Union of India v Tania Constructions Limited (2021)* ruled upon the validity of an appointment procedure similar to the procedure contemplated in *CORE*. This bench, however, disagreed with the Supreme Court’s reasoning in *CORE* for the reason that once an appointing

authority is itself incapacitated, it cannot still validly appoint arbitrators, and referred the matter for consideration of the Chief Justice of India.

When the reference came up for hearing in 2023, the Attorney General of India intimated the Supreme Court that the issues raised in this reference would fall within the broad remit of the Expert Committee formed to reconsider the provisions of the Arbitration Act. As the government was yet to take any decision on the recommendations of this Committee, the Supreme Court, in April 2024, decided to take up the reference for final hearing.

3 Issues

The five-judge bench of the Supreme Court was, hence, called upon to determine the following issues in this reference:

- a. whether an appointment process which allows a party who has an interest in the dispute to unilaterally appoint a sole arbitrator, or curate a panel of arbitrators and mandate that the other party select their arbitrator from the panel is valid in law;
- b. whether the principle of equal treatment of parties applies at the stage of the appointment of arbitrators; and
- c. whether an appointment process in a public-private contract which allows a government entity to unilaterally appoint a sole arbitrator or majority of the arbitrators of the arbitral tribunal violates Article 14 of the Constitution.

4 Key aspects of the Supreme Court's ruling

a. *Principles underlying the Arbitration Act*

The Supreme Court first outlined the key principles that are essential to secure the status of arbitration as a *quasi-judicial* function and an alternate private dispute resolution mechanism:

- i. party autonomy,
- ii. independence and impartiality of arbitrators, and
- iii. equality in the arbitral proceedings.

The Court observed that these principles underpinning the scheme of the Arbitration Act are codified within its framework.

For instance, the Court observed that Section 12(5) of the Arbitration Act, inspired by the Orange and Red List of the International Bar Association Guidelines of Conflicts of Interest in International Arbitration, provides an extensive list of circumstances (relating to pecuniary, proprietary or cause-based interest in arbitration) which may give rise to justifiable doubts as to an arbitrator's independence or impartiality. The Court clarified that the proviso to Section 12(5) so far as it allows parties to waive the applicability of this section by way of an express agreement, reinforces the principle of party autonomy. The Court also observed that Section 18, on the other hand, encapsulates the principles of equal treatment of parties and the right to a fair hearing.

b. *Equality in the arbitral proceedings*

Drawing upon the above framework of the Arbitration Act, the Court held the principles of independence and impartiality of arbitral proceedings and equality of parties to be concomitant in nature. That is, independence and impartiality can be effectively enforced only if the parties can participate equally at all stages of an arbitral process. For these reasons, the Court extended the applicability of Section 18 housed in Chapter V – ‘*Conduct of Arbitral Proceedings*’ of the Arbitration Act to all stages of arbitration, including the stage of appointment of arbitrators.

In view of the above finding, the Court ruled that arbitration clauses in contracts allowing parties to unilaterally ‘*appoint*’ a sole arbitrator or ‘*control*’ the majority of arbitrators (by mandating counterparties to choose their arbitrators from the list exclusively curated by them) are against the principle of equal treatment entrenched under Section 18 of the Arbitration Act. The Court based its finding on the ‘*inherently exclusionary*’ nature of such mechanism that prevents both parties from equally participating in the process for appointment of arbitrators and disrupts the ‘*counter-balance*’ sought to be secured in their rights.

The Court carved out a very limited exception to the validity of clauses providing for unilateral appointment of arbitrators or majority control of arbitrators for cases where the other party expressly waives the applicability of Section 12(5) after the dispute has arisen.

c. *Public-private contracts under the Arbitration Act*

The Court extensively assessed the mechanism of public-private arbitrations and observed that the Arbitration Act does not distinguish between public-private arbitrations and private arbitrations, including on appointment of arbitrators, conduct of arbitral proceedings, setting aside and enforcement of arbitral awards. The Court also recognised the practice of PSUs in maintaining a ready pool of qualified professionals who have consented to act as potential arbitrators and took the view that the Arbitration Act does not prohibit PSUs from curating such panels. The Court, however, clarified that for the reasons mentioned above, a party ought not be forced to select its arbitrator from the panels curated by PSUs in public-private arbitrations.

d. *Equality under the Constitution and public policy*

Interestingly, the Court also relied on its previous decisions to hold that the Court can refuse to enforce an arbitration agreement if it is non-compliant with the provisions of the Constitution. In this context, the Court observed that since the actions of government authorities contracting with private parties have an element of ‘*public interest*’, the arbitration procedures including the appointment of arbitrators must be based on principles of equality and non-arbitrariness. Importing such principles, the Court held that clauses providing for unilateral appointment or control of arbitrators in public-private arbitrations also violate Article 14 of the Constitution by being arbitrary as the government can chart the course of arbitration proceedings to the prejudice of the other party.

Lastly, the Court referred to Section 34 of the Arbitration Act and observed that arbitral awards relating to unilateral appointment or control over a majority of arbitrators clauses in public-private contracts are also susceptible to challenge for violating the ‘*public policy of India*’.

e. *Prospective overruling*

In the process of reaching its conclusions, the Court upheld its earlier decisions in *TRF* and *Perkins* rendered in context of sole arbitrators and overruled its earlier decisions in *Voestalpine* and *CORE* rendered in the context of three-member arbitral tribunals. However, the Court noted that the overruling of these previous

decisions may possibly lead to nullification of several arbitral proceedings involving three-member tribunals and disturb the commercial bargains entered by the government and private entities.

Hence, the Court invoked its discretionary jurisdiction under Article 142 of the Constitution to give prospective effect to this ruling so far as it applied to appointment of three-member tribunals made after this ruling.

5 Conclusion

This decision of the five-judge bench of the Supreme Court will require contractual parties in India to reassess, and where required, amend their existing arbitration clauses, including in public-private contracts or PSU contracts, to ensure compliance. This ruling may also incentivise parties currently reluctant to adopt institutional rules, to embrace institutional arbitration for ease in the process of appointment of arbitrators possessing subject-matter expertise.

If you require any further information about the material contained in this newsletter, please get in touch with your Trilegal relationship partner or send an email to alerts@trilegal.com. The contents of this newsletter are intended for informational purposes only and are not in the nature of a legal opinion. Readers are encouraged to seek legal counsel prior to acting upon any of the information provided herein.