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Arbitration and Conciliation (Amendment) Act, 2015: Arbitrators and Conflict of Interest

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Arbitration and Conciliation (Amendment) Act, 2015: Arbitrators and Conflict of Interest

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The advent of the year 2016 witnessed the passing of the Arbitration and Conciliation (Amendment) Act, 2015, amending the arbitration law – the Arbitration and Conciliation Act, 1996 – in India. It had earlier been promulgated as an ordinance in October 2015. Based on the recommendations of the 246th Report of the Law Commission of India, the Amendment sought to minimise interference of courts in arbitration proceedings, expedite the process, introduce safeguards to ensure greater fairness in the conduct of arbitration proceedings, bring the 1996 Act in conformity with international best practices, and thereby, enhance the overall effectiveness and efficiency of arbitration as the method for the resolution of business disputes. This paper provides an insight into the issue of arbitrators and conflict of interest, as under the 2015 Amendment Act.

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I. Introduction

Arbitration is a quasi-judicial process. Therefore, it is imperative that it is conducted in accordance with principles of natural justice. The impartiality and independence of the arbitral tribunal is vital to ensuring this. Section 12 of the Arbitration and Conciliation Act, 1996 ("Act") is primarily concerned with this aspect and the Arbitration and Conciliation (Amendment) Act, 2015 ("Amendment Act")[1] has introduced substantial changes in this regard. In this paper, I have attempted to evaluate the extent to which these will contribute towards achieving the objectives of the Amendment Act. This is done by *first*, examining the practical basis for the requirement of independence and impartiality in arbitration. *Secondly*, the Indian law on the subject matter before and after the amendment is laid out. *Thirdly*, the changes introduced by the amendment are analyzed in light of international best practices and the practical modalities of arbitration in India.

II. The Need for Neutrality

Arbitration, albeit lacking state sponsorship, is essentially an adjudicatory mechanism which has a bearing on the legal rights and liabilities of the parties involved. Therefore, it is essential that it is conducted in accordance with principles of fairness. The maxim – *nemo iudex in causa sua*, i.e. no man should be a judge in his own cause is one of the fundamental principles of natural justice. It posits that the dispute be adjudicated by a neutral third party. In addition, certain unique characteristics of commercial arbitration require that enhanced attention be paid to the neutrality of arbitrators. Arbitrators are not public officials and are most often chosen from among a small group of persons. Since they are paid only upon selection, there is an inherent incentive to favour parties that are likely to choose them in the future.[2] This is particularly true in major international disputes, where the pool consists of a few prominent barristers, senior law firm partners and law professors. The roles also display a great degree of reversibility – a party that is an arbitrator for one matter may be counsel for the other and *vice versa*.[3]

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[1] The Arbitration and Conciliation (Amendment) Act, 2015; No. 3 of 2016, dated December 31, 2015. Deemed to have come into force on the October 23, 2015.

[2] Dezalay, Y. & Garth, B.G., Dealing in Virtue: International Commercial Arbitration and the Construction of a Trans-National Legal Order, 50 (1996).

[3] *Id.*

However, this familiarity, while problematic from a neutrality perspective, also aids to improve the efficiency and effectiveness of the arbitral process and has contributed to making it an attractive form of business dispute resolution.[4] Therefore, the legal regime governing arbitral neutrality must account for this reality and attempt to strike a balance between considerations of fairness and efficiency that are unique to arbitration.

III. THE INDIAN LEGAL REGIME: BEFORE AND AFTER

Under the Act, the standard for neutrality is prescribed by Section 12 which provides that "*An arbitrator may be challenged only if (a) circumstances exist that give rise to justifiable doubts as to his independence or impartiality…*"[5] Thus, the test is not whether given the circumstances there is *actual* bias, for that would entail an onerous standard of proof but whether the circumstances create room for *justifiable apprehensions* of bias.

AMENDMENTS TO SECTION 12(1)

Two major amendments have been introduced to Section 12. First, a requirement of specific disclosures by an arbitrator at the stage of his possible appointment, concerning the presence of any relationship or interest that is likely to create justifiable doubts regarding his neutrality. For this purpose, Section 12(1) has been entirely replaced.[6] The amended sub-section provides as follows:

> "8. In Section 12 of the principal Act,—
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> (i) for sub-section (1), the following sub-section shall be substituted, namely:—

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[4] Sam Luttrell, BIAS CHALLENGES IN INTERNATIONAL COMMERCIAL ARBITRATION: THE NEED FOR A "REAL DANGER" TEST, INTERNATIONAL ARBITRATION LAW LIBRARY, Vol. 20, 7 (2009).

[5] Section 12(3), Arbitration and Conciliation Act, 1996: *Grounds for Challenge:*
(3) *An arbitrator may be challenged only if–*
(a) circumstances exist that give rise to justifiable doubts as to his independence or impartiality, or
(b) he does not possess the qualifications agreed to by the parties.

[6] Prior to the 2015 amendment, Section 12(1) of the Arbitration and Conciliation Act, 1996 was as follows:
"12. *Grounds for challenge.- (1) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose in writing any circumstances likely to give rise to justifiable doubts as to his independence or impartiality.*"

"(1) When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose in writing any circumstances,—

(a) such as the existence either direct or indirect, of any past or present relationship with or interest in any of the parties or in relation to the subject-matter in dispute, whether financial, business, professional or other kind, which is likely to give rise to justifiable doubts as to his independence or impartiality; and

(b) which are likely to affect his ability to devote sufficient time to the arbitration and in particular his ability to complete the entire arbitration within a period of twelve months.

Explanation 1.—The grounds stated in the Fifth Schedule shall guide in determining whether circumstances exist which give rise to justifiable doubts as to the independence or impartiality of an arbitrator.

Explanation 2.—The disclosure shall be made by such person in the form specified in the Sixth Schedule.[7]""

o The Fifth Schedule

Section 12(1) makes a reference to the Fifth Schedule which has also been introduced by the Amendment. The same has been drawn from the Red and Orange Lists of the Guidelines of the International Bar Association Guidelines of Conflict of Interest in International Arbitration (hereinafter "IBA Guidelines").[8] It lists 34 grounds, which give rise to justifiable doubts as to the independence or impartiality of arbitrators. These grounds have been classified under seven heads, which are as follows:

- Arbitrator's relationship with the parties or counsel
- Relationship of the arbitrator to the dispute
- Arbitrator's direct or indirect interest in the dispute
- Previous services for one of the parties or other involvement in the case

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[7] Section 8, The Arbitration and Conciliation Amendment (Ordinance), 2015.

[8] International Bar Association Guidelines on Conflicts of Interest in International Arbitration, Adopted by resolution of the IBA Council on October 23, 2014.

- Relationship between an arbitrator and another arbitrator or counsel
- Relationship between arbitrator and party and others involved in the arbitration, and
- Other circumstances.[9]

o THE SIXTH SCHEDULE

The disclosure referred to in Section 12(1) has to be made in the form specified in the Sixth Schedule. This requires providing the contact details of the prospective arbitrator, experience in general and experience with arbitrations in particular; the number of ongoing arbitrations that the arbitrator is conducting; list of circumstances related to conflict of interest, if any; and also list of all the circumstances which may have an effect on his working preventing him to finish the entire arbitration within a period of 12 months.

The language employed in the un-amended section "…*disclose in writing any circumstances likely to give rise to*…", without mention of any such circumstances, was highly subjective, relying primarily on the discretion and inner conscience of any arbitrator. Such an approach leads to confusion among both arbitrators and parties as to the exact scope of the disclosure requirements. In disputes involving transnational businesses and lawfirms, questions about disclosures and conflicts of interest becomes even more complex. The resulting uncertainty is exploited by both arbitrators and parties alike. Parties have more opportunities to use frivolous challenges to delay the arbitrations, or restrain the opposite party from appointing an arbitrator of its choice. On the other hand, arbitrators use vague standards to their advantage to make incomplete disclosures. This results in challenges at a later stage, including after the final award has been made.[10] It was therefore imperative to implement a standardised disclosure regime that balances the interests of the parties, their representatives, arbitrators and arbitral institutions.

The IBA Guidelines are widely regarded as a representation of international best practices and are based on statutes, case law and juristic opinion from a cross-section of jurisdictions.[11] The wholesale adoption of these guidelines is definitely a positive step for the Indian regulatory framework.

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[9] Fifth Schedule, The Arbitration and Conciliation Act, 1996.
[10] IBA GUIDELINES, at 2.
[11] IBA GUIDELINES, at 2.

Amendments to Section 12(5)

The other change introduced by the Amendment Act is the addition of Section 12(5). It deems certain categories of persons ineligible for appointment as an arbitrator and reads as follows:

> "8. In Section 12 of the principal Act,—
>
> (ii) after sub-section (4), the following sub-section shall be inserted, namely:—
>
> "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."

The proviso allows parties to waive the requirements of Section 12(5) by an express agreement in writing after the disputes have arisen between them. This concession has been made to account for family arbitrations, where the objective is to minimize interference to promote harmony and quick resolution of disputes. It also acknowledges other situations where both parties demonstrate complete faith in the arbitrator, notwithstanding objective doubts as to his impartiality and independence.[12]

o The Seventh Schedule

Further details for theenforcement of this sub-section have been provided in the Seventh Schedule of the Act. This schedule is a sub-set of the Fifth Schedule and reflects the Red List of the IBA Guidelines. Thus, disclosures are required to be made in respect of a broad range of categories (both the red and orange lists of the IBA Guidelines), and a person is ineligible to act as an arbitrator only when a smaller and more serious set of situations is met (only the red list of the IBA guidelines).[13]

In the next part of the paper, I have discussed significant case law under Section 12 and its relationship with other provisions of the Act. This is done

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[12] Report No. 246, Law Commission of India, Amendments to The Arbitration and Conciliation Act, 1996, August, 2014 at 31, *available at* http://lawcommissionofindia.nic.in/reports/Report246.pdf; (Last visited on August 9, 2016.)

[13] *Id.*

with the objective of throwing some light on how the Amendment will actually be implemented, and some concerns brought up by it.

IV. In- House Arbitrators

Section 12, in its unamended form, has been subject to much litigation in the context of state undertakings appointing particular persons/designations related to the undertaking as a potential arbitrator. In a slew of decisions, the Indian Supreme Court has upheld the validity of such clauses.[14] In *Indian Oil Corpn. Ltd.* v *Raja Transport (P) Ltd.*[15] it succinctly summed up its stance on the issue. It observed that:

> "Arbitration is a binding voluntary alternative dispute resolution process by a private forum chosen by the parties. If a party, with open eyes and full knowledge and comprehension of the relevant provision enters into a contract with a Government/statutory corporation/public sector undertaking containing an arbitration agreement providing that one of its Secretaries/Directors shall be the arbitrator, he cannot subsequently turn around and contend that he is agreeable for settlement of the disputes by arbitration, but not by the named arbitrator who is an employee of the other part.
>
> …Senior officer/s (usually heads of department or equivalent) of a government/statutory corporation/ public sector undertaking, not associated with the contract, are considered to be independent and impartial and are not barred from functioning as Arbitrators merely because their employer is a party to the contract."

Only two narrow exceptions existed to this rule. *First*, when the arbitrator "was the controlling or dealing authority in regard to the subject contract or if he is a direct subordinate (as contrasted from an officer of an inferior rank in some other department) to the officer whose decision is the subject matter of the dispute." This was applied by the court in *Denel (Proprietary) Ltd.* v *Ministry of Defence.*[16] In this case, the Respondent was an enterprise under

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[14] See Executive Engineer v Gangaram Chhapolia, (1984) 3 SCC 627; Secy. to Govt., Transport. Deptt. v Munuswamy Mudaliar, 1988 Supp SCC 651; International Airports Authority v K.D. Bali, (1988) 2 SCC 360; *S.* Rajan v State of Kerala, (1992) 3 SCC 608; Indian Drugs & Pharmaceuticals Ltd. v Indo Swiss Synthetics Gem Mfg. *Co. Ltd.*, (1996) 1 SCC 54; Union of India v M.P. Gupta, (2004) 10 SCC 504; Ace Pipeline Contracts (P) Ltd. v Bharat Petroleum Corpn. Ltd., (2007) 5 SCC 304.

[15] Indian Oil Corpn. Ltd. v Raja Transport (P) Ltd., (2009) 8 SCC 520.

[16] Denel (Proprietary) Ltd. v Ministry of Defence, (2012) 2 SCC 759 : AIR 2012 SC 817.

Ministry of Defence of the Government of India. It didn't clear its dues pursuant to a direction issued by the Ministry of Defence due to which disputes arose between parties. The Court refused to enforce a clause for the appointment of the Managing Director of the Respondent as an arbitrator. It noted that the independence of the appointee couldn't be guaranteed because he was appointed and bound by directions of the Ministry and the disputes had arisen only because of the order of the Ministry.

Secondly, appointments have also been struck down in cases where an arbitrator displays impartiality in the matter, but these actions are not performed in official capacity. Thus, where a bureaucrat who had to act as an arbitrator in case of disputes relating to a government contract wrote letters which justified the imposition of damages in relation to that contract, he was held to be disqualified to act as an arbitrator.[17]

While admittedly, party autonomy is fundamental to arbitration and it is possible that clauses providing for in-house arbitrators are freely negotiated, this seldom happens in practice. Government tenders are highly coveted and fiercely bid for, leaving bidders with little bargaining power. Such clauses violate basic principles of natural justice and it is unfair to create a special exception for the state in this regard. In fact, when the state is involved, independence and impartiality should be ensured with even greater rigour, since the state enjoys inherent advantages *vis-a-vis* the other party by virtue of its status.[18] The Amendment Act seeks to address these concerns and in *Assignia-VIL JV* v *Rail Vikas Nigam Ltd*.[19] its effect on in-house arbitrators was discussed. As per the arbitration agreement between the parties, the tribunal would comprise of three members. One being a working or retired officer of the Indian Railways Accounts Service, the other being a working or retired officer of any engineering service of the Indian Railways and the presiding member being a serving railway/ RVNL officer. Placing reliance on Entry I of Schedule VII, the court declined to make the appointment in terms of the clause.

V. Arbitrators, Lawyers and Law Firms

Another area that has been subjected to some litigation is the relationship of arbitrators with the lawyers appearing in the arbitration process. The

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[17] BSNL v Motorola India (P) Ltd., (2009) 2 SCC 337 : (2008) 3 Arb LR 531.
[18] *Supra*, note 12.
[19] Assignia-VIL JV v Rail Vikas Nigam Ltd., 2016 SCC OnLine Del 2567.

decision in *Laker Airways Inc.* v *FLS Aerospace*[20] is considered to be the *locus classicus* on the subject. In this case, the court held that the involvement in an arbitration of two barristers from the same set of chambers, as arbitrator and counsel didn't taint the impartiality of the arbitrator. The court reasoned that there was no conflict of interest because barristers, even if they belonged to the same chambers, didn't share income and were self-employed. It was also noted that preventing barristers from appearing against, or in front of, one another would place severe constraints upon access to justice. In India, this issue was litigated in *Impex Corpn.* v *Elenjikal Aquamarine Exports Ltd.*[21] where the court was guided by a logic similar to the one applied in *Laker Airways*. In this case, the court held that where the lawyer for one of the parties was a junior in the chambers of the arbitrator, it didn't give any reason to suspect the neutrality of the arbitrator. In support of this decision, it has been pointed out that in the Indian context, it is routine for lawyers who shared the same set of offices, or were in a junior-senior set up, to subsequently start independent practice. In such situations, it is not possible to impute any bias on the arbitrator, actual or apparent by virtue of his past relationship.[22]

The Amendment Act directly addresses the relationship between lawfirms, arbitrators and counsel. The Fifth and Seventh Schedule contain a clear embargo against the appointment of arbitrators in situations where they represent the lawyer or lawfirm acting as counsel/representing one of the parties while the dispute is ongoing.[23] When the arbitrator's lawfirm had a previous but terminated involvement in the matter without the arbitrator being involved himself or an ongoing commercial relationship with one of the parties/affiliate of one the parties, the possibility of bias may be inferred.[24] In addition, if the arbitrator was within the past three years a partner of, or otherwise affiliated with, another arbitrator or any of the counsel in the same arbitration, or a lawyer in the arbitrator's law firm is an arbitrator in another dispute involving the same party or parties or an affiliate of one of the parties, independence and impartiality will be jeopardized.[25]

Prima facie it seems that under the Amendment Act, these cases would be decided differently. However, the IBA Guidelines from which these schedules are drawn acknowledge the need for flexibility due to the growing size

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[20] Laker Airways Inc. v FLS Aerospace, (1999) 2 Lloyds Rep 45.
[21] Impex Corpn. v Elenjikal Aquamarine Exports Ltd., 2007 SCC OnLine Ker 125 : (2008) 2 Arb LR 560.
[22] Justice R.S. Bachawat's LAW OF ARBITRATION AND CONCILIATION, 981 (5th ed., 2005).
[23] Entries 3 and 4, Fifth and Seventh Schedule, The Arbitration and Conciliation Act, 1996.
[24] Entries 6 and 7, Fifth and Seventh Schedule, The Arbitration and Conciliation Act, 1996.
[25] Entries 26 and 27, Fifth Schedule, The Arbitration and Conciliation Act, 1996.

and diversity of practice in lawfirms. The nature, timing and scope of work must be considered. Further, it is recognised that a lawyers' chambers must not be equated with a lawfirm and disclosures and conflicts of interest in cases involving them must be evaluated on a case to case basis.

This calls for a more nuanced approach under which many of the arguments made in *Laker Airways* would still hold good. It is hoped that Indian judges will acknowledge the peculiarities of different fact situations and abstain from a straitjacket application of the rules to all situations. In cases which don't squarely fall within the entries, a thorough analysis of the relations between parties must be undertaken.

VI. CONFLICT BETWEEN SECTIONS 12(4) AND 12(5)

If a party to the arbitration has any apprehension about the neutrality of the arbitrator, the appointment of an arbitrator may be challenged as per Section 12(3).[26] Section 13 of the Act allows the challenge to be made within 15 days after becoming aware of the constitution of the Arbitral Tribunal or after becoming aware of the lack of any circumstance affecting neutrality.[27] Section 12(4) imposes a limitation in this regard, and allows a party to challenge an arbitrator appointed by him, or in whose appointment he has participated, only for reasons of which he becomes aware *after* the appointment has been made.

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[26] Section 12(3), Arbitration and Conciliation Act, 1996: *Grounds for Challenge:*

(3) *An arbitrator may be challenged only if-*

(a) circumstances exist that give rise to justifiable doubts as to his independence or impartiality, or

(b) *he does not possess the qualifications agreed to by the parties.*

[27] 13. Challenge procedure.- (1) Subject to sub-section (4), the parties are free to agree on a procedure for challenging an arbitrator.

(2) Failing any agreement referred to in sub-section (1), a party who intends to challenge an arbitrator shall, within fifteen days becoming aware of the constitution of the arbitral tribunal or after becoming aware of any circumstances referred to in sub-section (3) of section 12, send a written statement of the reasons for the challenge to the arbitral tribunal.

(3) Unless the arbitrator challenged under sub-section (2) withdraws from his office or the other party agrees to the challenge, the arbitral tribunal shall decide on the challenge.

(4) If a challenge under any procedure agreed upon by the parties or under the procedure under sub-section (2) is not successful, the arbitral tribunal shall continue the arbitral proceedings and make an arbitral award.

(5) Where an arbitral award is made under sub-section (4), the party challenging the arbitrator may make an application for setting aside such an arbitral award in accordance with section 34.

(6) Where an arbitral award is set aside on an application made under sub-section (5), the Court may decide as to whether the arbitrator who is challenged is entitled to any fees.

Under Section 12(5), certain categories of persons are deemed *ineligible* for appointment. Thus, it would seem that their appointment could potentially be challenged at *any* stage including after the arbitral tribunal has been constituted, notwithstanding that a party was aware of the ineligibility. Unfortunately, the Amendment Act is silent on the consequences of an ineligible person being appointed as an arbitrator. This could result in confusion and litigation, delaying the arbitral processes. It is unfortunate that the recommendations of the Law Commission in this respect were not incorporated by the Amendment Act. It had recommend the addition of an explanation to Section 14 of the Act to declare that if a person who is ineligible for appointment under Section 12(5) is in fact appointed as an arbitrator, he shall *de jure* be incapable of performing his functions under Section 14 of the Act.[28] The inclusion of this proviso would have clarified that the appointment of an ineligible person as an arbitrator can be challenged at time since all actions taken by the tribunal would lack any force of law.

VII. CUT-OFF DATE FOR THE AMENDMENT

As per Section 26 of the Amendment Act, the changes contained in it apply only to arbitration proceedings commenced in accordance with Section 21 of the Act after the coming into force of the Amendment Act. The parties can choose to derogate from this provision.[29] Under Section 21 "commencement of arbitration proceedings" is deemed to take place on the date on which a request for the dispute to be referred to arbitration is received by the respondent. In *Panihati Rubber Ltd.* v *Northeast Frontier Railway*,[30] upon disputes arising between the parties, the petitioner had requested the respondent to refer the matter to arbitration in 2011 and subsequently due to the inaction of the respondents filed an application under Section 11 of the Act. The question before the court was whether the appointment of the arbitrator during the pendency of the petition was a valid one. In determining this question, the court placed reliance on the amended Section 12(5) to conclude that an interested party, as was in this case, couldn't be appointed as an arbitrator. In doing so, the court failed to take notice of Section 26 of the Amendment Act and created incorrect precedent. It is hoped that other High Courts do not err on this count.

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[28] *Supra*, note 12.
[29] Section 26, Arbitration and Conciliation (Amendment) Act, 2015.
[30] Panihati Rubber Ltd. v Northeast Frontier Railway, 2016 SCC OnLine Gau 69.

VIII. CONCLUSION

In this paper, I have attempted to provide a brief overview of the legal regime regulating the independence and impartiality of arbitrators after the Amendment Act. The changes introduced by the Amendment bring Indian law in line with international best practices–they seek to strike a balance between party autonomy and due process in arbitral proceedings. The subjectivity prevailing under the earlier regime is also countered with the inclusion of clear standards to indicate lack of neutrality. The changes will also end the unfortunate practice of appointing in-house arbitrators by the government through the abuse of its superior bargaining power. This will bring in more transparency into government procurement and tenders, thereby encouraging greater private investment in some core sectors of the economy.

However, the successful implementation of this regime requires a nuanced interpretation by courts. They must constantly endeavour to achieve the goals of the Amendment Act and account for the complexities of the relationships between different parties involved in commercial arbitrations. Else, there is a risk of jeopardizing the unique efficiency and effectiveness of the arbitral process, which has made it an attractive form of business dispute resolution.