Proposed amendments to the Arbitration and Conciliation Act, 1996 – A critique

By:

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Introduction

Arbitration and Conciliation Act, 1996 came into being on 25th January 1996 and the Arbitration Act, 1940 stood repealed, except for such matters in which the parties had already invoked arbitration. It was expected that with the introduction of the Act of 1996 there would be minimal interference by the courts not only in the on-going arbitrations but awards passed under the said Act would get due honour and respect from the courts. Unfortunately, this was not to be. With the passage of time, due to the attitude and working of legal practitioners, arbitrators and court judgments, the ills of 1940 Act crept into the new Act also. Therefore, it became imperative on the part of the Parliament to re-visit certain provisions of the 1996 Act so as to ensure that the arbitral process was smoothly conducted with minimal interference by the courts and to remedy the wrong practices that had crept into the arbitral process. This was, incidentally, the avowed objective of the 1996 Act, as it was so mentioned in the "Statement of Objects and Reasons".

Court intervention despite legislation

Even though Section 5 of the 1996 Act provided in no uncertain terms that "Notwithstanding anything contained in any other law for the time being in force, in matters covered by this Part (i.e. Part I), no judicial authority shall intervene except where so provided in this Part". However, this illuminating principle was ignored with impunity with the passage of time. Through a number of judgments, courts started noticing certain lacunas in the provisions of the 1996 Act and went on to interpret the provisions in a way

which defeated the very purpose for which the Act had come into being. For example, provisions of the Sections 30 and 33 of the Arbitration Act, 1940, which provided for an in-depth investigation into the award, were brought back in their rigour, albeit through the back-door, vide a judgment in *Oil and Natural Gas Corporation Ltd. versus SAW Pipes Ltd., (2003)5 SCC 705*; Provisions of Sections 5 and 11 of the Act of 1940 which provided for removal of arbitrator during the course of proceedings was recalled through interpretation of Section 14 of the Act of 1996 [See *State of Arunachal Pradesh v. Subhash Projects & Marketing Ltd.,* 2007(1) Arb LR 564 (Gau) (DB); *Alcove Industries Ltd. v. Oriental Structural Engineers Ltd.,* 2008(1) Arb LR 393 (Del)]; Provisions of Section 20 of the 1940 Act, which provided for investigation into arbitrability of claims at the stage of appointment of arbitrator, were read into Section 11 of the Act of 1996 through the judgment of *SBP Ltd. versus Patel Engineering Ltd., (2005)8 SCC 618*.

Need for amendment

Considering the above judgments as well as the unwholesome practices followed by certain arbitrators in seeking huge fees and in prolonging arbitration proceedings endlessly, the Ministry of Law, Union of India, has proposed certain amendments to the Act of 1996. Through a Consultation Paper, they have invited comments from the General Public on the amendments proposed in relation to Sections 2(2), 11, 12, 28, 31(7)(b), 34 and 36 of the Act.

The major changes proposed by the said amendment are as follows:

- Insertion of an implied arbitration clause in every commercial contract with a consideration of specified value (Rs. 5 crore or more);
- Promotion of Institutional arbitrations, inasmuch as it is now mandatory for the High Courts/Supreme Court to refer the matters to arbitration institutions rather than appointing arbitrators themselves;

- Existing arbitration clauses too would be deemed to be amended so as to provide for Institutional arbitrations.
- Increasing the scope of declaration to be made by an arbitrator under Section 12 to ensure greater transparency in arbitration proceedings;
- Reduction of rate of interest from 18% to the "current rate of interest";
- Amending Sections 28 and 34 of the Act by providing for setting aside of awards if (a) the arbitrators do not take into account contractual provisions or trade usage or (b) if the award contains "patent and serious" illegalities or (c) it contains an erroneous decision on an application under Section 13(2) or Sections 16(2) or 16(3);
- Nullify the effect of the judgment of the Supreme Court in *Saw Pipes* case by limiting the explanation of "public policy of India";
- Amendment to Section 36 of the Act provides that an arbitration award shall not be automatically stayed merely on filing of an application for setting aside the award. The court can put the objecting party to terms before granting stay; and
- Establishment of Commercial Divisions in the High Courts (vide a separate Act) where the awards, appeals etc. would be filed. Thus jurisdiction of lower judiciary has been specifically excluded in respect to arbitration matters.
- Amendment of Section 2(2) limits applicability of Part-I of the Act only where the place of arbitration is in India.

Although the proposed amendments have a laudable objective, however, it is felt that some more changes/amendments are required therein. The crucial aspects of the amendments, insofar as these relate to Sections 11, 12, 28, 34 and the provision with regard to deemed arbitration clause are discussed hereunder in the order of their importance, without making any comments whatsoever on the remaining proposed amendments:

Need for amendment to Section 11

After the coming into force of the 1996 Act, a huge amount of conflicting decisions were rendered in respect of appointment of arbitrators under Section 11. The trend in the first few years of the enactment of the Act was that the Chief Justice or his designate, while making appointment of an arbitrator, was performing an administrative act and hence, they should not enquire into the merits of the dispute or issues pertaining to jurisdiction etc. A series of judgments, viz., *Adur Samia (P) Ltd. v. Peekay Holdings Ltd.*, (1999)8 SCC 572 (a 2-judge bench); *Konkan Railway Corporation Ltd. v. Mehul Construction Co.*, (2000)7 SCC 201 (a 3-judge bench); and finally *Konkan Railway Construction Co. v. Rani Construction (P) Ltd.*, (2002)2 SCC 388 (a 5-judge bench) supported this view. The law was thereafter changed with the judgment of *SBP Co. v. Patel Engineering Ltd.*, (2005)8 SCC 618 (a 7-judge bench), which *inter alia* held that: (a) appointment of arbitrator by the Chief Justice or his designate was a judicial act; (b) while making the appointment, the Chief Justice or his designate would enquire into the arbitrability of the claims, jurisdictional issues etc.; (c) order of Chief Justice or his designate on such issues, i.e. jurisdiction etc. shall not be further subject to challenge before the arbitrator under Section 16 of the Act; (d) appointment would be made only by the Chief Justice or a High Court judge (in case of domestic arbitrations) and by the Chief Justice of India or a Supreme Court judge (in case of international arbitrations) and not by judges subordinate thereto.

In practice, it was observed that while making appointment of arbitrators, the High Courts and the Supreme Court were either: (i) appointing retired judges even when matters in dispute were highly technical; or (ii) re-investing the power to appoint the arbitrator back with the defaulting party, which had earlier failed to appoint the arbitrator, despite notice.

Charging of exorbitant fee by arbitrators

It was also observed that the appointed arbitrators were left free to determine their own fees. Unfortunately, this created a situation where the arbitrators started charging exorbitant fees. The very purpose of seeking resolution of disputes through arbitration is in danger of being defeated by this attitude. Such a trend was commented upon with disfavour even by the Supreme Court in *Union of India v. Singh Builders Syndicate*, (2009)4 SCC 523 in the following words:

> "When an arbitrator is appointed by court without indicating fees, either both parties or at least one party is at a disadvantage. Firstly, the parties feel constrained to agree to whatever fees is suggested by the arbitrator, even if it is high or beyond their capacity. Secondly, if a high fees is claimed by the arbitrator and one party agrees to pay such fee, the other party, which is unable to afford such fee or reluctant to pay such high fee, is put to an embarrassing position. He will not be able to express his reservation or objection to the high fee, owing to an apprehension that refusal by him to agree for the fee suggested by the arbitrator, may prejudice his case or create a bias in favour of the other party which readily agrees to pay the high fee."

At yet another place in the same judgment, the Supreme Court was constrained to observe:

> "The large number of sittings and charging of very high fee per sitting with add-ons, without any ceiling, have many a time resulted in the cost of arbitration approaching or even exceeding the amount involved in the dispute or the amount of the award. When an arbitrator is appointed by a court without indicating the fees, either both parties or at least one party is at a disadvantage."

Proposed changes to Section 11

To combat the above situations, proposals to amend a part of Section 11 of the Act of 1996 are as follows:

A) The word "Chief Justice" in the Act of 1996 has been replaced by the word "High Court".

B) Introduction of a new sub-section 11(7) which provides that the decision of the High Court or Institution under Section 11 shall be final and "no appeal including a letter patent appeal shall lie against such decision."

C) Introduction of a new sub-section 11(13) providing in mandatory terms that the High Court shall refer Commercial Disputes of a specified value to an Institution, which shall constitute the arbitral tribunal for adjudication.

D) High Court or its designate would take steps to dispose off the matter "as expeditiously as possible and endeavour shall be made to dispose of the matter within sixty days from the date of service of notice on the opposite party."

The above proposals have a great deal of merit, inasmuch as they ratify the judgment rendered in *SBP's case* and make appointment of an arbitrator a judicial act and not an administrative one. Similarly, by preferring Institutional Arbitration to *ad hoc* arbitration, the emphasis seems to be on making arbitrators follow certain rules, including limit on the fee charged. However, there are inherent dangers in the aforementioned proposed amendments some of which are brought out below:

i) The term "Commercial Dispute" referred to in the proposed Section 11(13) has been defined in the Commercial Division of High Court Act, 2009. The definition does not seem to include disputes arising out of "Works Contracts." This needs to be remedied by specifically adding the term "Works Contracts" to the definition provided in the Act of 2009.

ii) The largest single category of arbitration cases emanate from works contracts and call for specialists to be appointed as arbitrators. By leaving out Works Contracts from the purview of appointment by an

arbitral institution, once again the age-old practice of appointing non-experts would continue.

iii) Whereas proposed Section 11(13) uses the term “Commercial Dispute”, on page 36 of the Consultation Paper the term used is “Commercial Contract”. The definition given to Commercial Contract on page 37 of the Consultation paper is different from the definition of Commercial Dispute in the Act of 2009.

iv) To avoid confusion it should be specified whether the dispute has to be of the ‘specified value’ or the contract itself has to be of the ‘specified value’ to enable a person to approach the High Court.

v) The term “commercial contracts” and/or “commercial dispute” should be defined as “all contracts involving a pecuniary consideration”.

vi) Section 11 (as proposed to be amended) would empower the “High Court or person or Institution designated by it” to appoint an arbitrator. It is advisable to delete word “person” since the emphasis now is on Institutional arbitrations and the word “person” thus appears to be superfluous;

vii) It is not clear whether the High Court or the arbitral institution would adjudicate upon arbitrability of disputes, jurisdictional issues etc. before appointing an arbitrator.

viii) Proposed Section 11(7) providing that no appeal shall lie against a decision under Section 11 ought to be amended to allow for an appeal to the Supreme Court. This is necessary since the High Court or an Institution may err while deciding upon a jurisdictional issue or upon arbitrability of a claim.

ix) Proposed Section 11(14) providing for appointment by the High Court or its designate within 60 days should be made mandatory rather than discretionary, as the wording of the proposed clause indicates. This provision is contrary to the mandatory language employed in Clause (iv) on page 37 of the Consultation Paper which provides for appointment to be made within 30 days of the reference.

x) Section 11(6) of the 1996 Act does not provide a time limit within which a party can approach the Court for appointment of an arbitrator in the event of delay by the other party in appointment of an arbitrator. To overcome this flaw, the Supreme Court in *Datar Switchgears Ltd. v. Tata Finance Ltd.*, (2000)8 SCC 151 and *Punj Lloyd's Ltd. v. Pertronet MHB Ltd.*, (2006)2 SCC 638 cases fixed the said time limit as 30 days (minimum) from the date of service of notice seeking arbitration. This time limit should be formalized through an amendment to Section 11(6) of the Act.

Lastly, it is essential that strict guidelines should be prescribed for the Institution(s) to whom matters are to be referred, i.e. it should be ensured that these Institutions are capable of handling the deluge of litigation that would flow their way as a result of the amendments.

<u>Incorporation of deemed arbitration clause</u>:

A path-breaking amendment has been proposed in the form of a deemed arbitration clause in every commercial contract having a consideration of Rs. 5 crore or more. It has been proposed as follows:

(i) Unless parties expressly and in writing agree otherwise, every commercial contract with a consideration of specified value (Rs. 5 crore or more) shall be deemed to have in writing specified arbitration agreement.

(ii) Specified Arbitration Agreement as referred to in clause (i) shall contain following clause:

"All disputes except (here specify the excepted disputes, if any) arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of (here specify the name of the approved arbitral institution) by one or more arbitrators appointed in accordance with the said Rules"

(iii) Any arbitration agreement that differs from the said clause will stand modified along the lines of the specified arbitration agreement."

A bare reading of the above clauses leads to an irresistible conclusion that with the introduction of the proposed amendments, parties will have no power whatsoever to constitute their own tribunal even with consent (where the consideration for the contract is over Rs. 5 crore). In other words, *ad hoc* arbitration has been dispensed with and from now onwards all future arbitrations shall be Institutional arbitrations. This does not appear to be correct as it takes away the power of choice from the parties. It needs to be made clear in the draft proposal that *ad hoc* arbitration would be permissible where the parties agree to constitute such a tribunal. Parties should not be forced to take recourse to institutional arbitrations against their will. It is, therefore, suggested that sub-clause (iii) mentioned above, should be either deleted or suitably modified so as to allow parties' choice to prevail.

After listing the above changes, in the concluding paragraphs of the Consultation Paper it has been mentioned that "many provisions of the Act including Section 7 (which deals with arbitration agreement), Section 8, Section 2(1)(b) have to be amended." However, what the changes are going to be have not been spelt out. It is suggested that such changes should also be spelt out so as to harmonize with all the proposed changes. Similarly, on page 35 (paragraph marked 'I') it has been stated that Section 2(1)(e) would be amended but the exact scope of amendment has not been made known.

It is not clear from a reading of the proposed amendments as to what would be the law governing cases having consideration below Rs. 5 crores. It appears that such cases would be disposed off through *ad hoc* arbitration and the proceedings arising out of these arbitrations, including awards would be dealt with by the lower judiciary in accordance with the present Section 2(1)(e). This does not seem to be a practical solution to the problem.

Time limit to be fixed for concluding arbitration proceedings:

In Schedule I Rule 3 of the Arbitration Act, 1940 an arbitrator was required to make an award within 4 months of entering upon reference. A provision also existed for extension of time with the mutual consent of the parties, failing which any of the parties or the arbitrators could approach the court for extension of time. This period of 4 months was not realistic and the recalcitrant party would often refuse to grant extension to the arbitrator thereby forcing the other party or the arbitrator to approach the court. It then used to take a year or two before an order granting an extension of another 4 months was passed by the court. In the meantime, the arbitral proceedings came to a grinding halt.

To overcome this mischief, the Act of 1996 did not provide any time limit for conclusion of arbitral proceedings. Regrettably, this led to various types of malpractices, and recalcitrant parties found ways and means to delay proceedings. Similarly, advocates, and in some cases arbitrators, who are paid on daily basis, deliberately caused arbitration proceedings to prolong endlessly. It is usually observed in arbitrations nowadays that: (a) sittings are held in luxury star hotels and that too for only 2-3 hours; (b) lawyers who represent the parties only make themselves available in the evenings, i.e. after court hours; (c) oral evidence is prolonged, sometimes to a number of years; (d) hearings are not fixed for months on end since either the lawyers or the arbitrators do not have time or are busy elsewhere; (e) adjournments are allowed too liberally; (f) frivolous applications are filed; (g) challenges under Section 13 (bias) or Section 16 (jurisdiction) are made simply to prolong the proceedings; (h) Court rulings allowing intervention of courts under Section 14 of the Act are now opening the doors for further delay. This is leading to a situation where instead of the slogan “arbitrate – don’t litigate”, the cry among the business houses and ordinary litigants is “Honest men dread arbitration more than law suits”. Unfortunately, the proposed legislation does not address any of the above woes. Merely providing for

Institutional arbitrations would not make above maladies vanish. It has been observed that Institutional arbitrations are as prone to delay on the above grounds as *ad hoc* arbitrations.

It is, therefore, necessary that:

(a) A reasonable time limit should be fixed for making an award. In the earlier bill of 2003, a time limit of 1 year (with a possible extension of another 6 months by the parties) had been provided. For further extension beyond the said period, provision had been made for approaching the Court. It is imperative that a similar provision should be made in the new legislation otherwise the very purpose of arbitrations, i.e. cheap and expeditious remedy would be lost.

(b) A cap should be fixed on the number of cases that an arbitrator can take up at any given time. In any case, it should not exceed 8 cases at a time.

(c) To ensure that the arbitrators finish the matter within a fixed time limit, it should be provided that fees would be payable only upon conclusion of the case. This, incidentally, would also save the parties incurring unnecessary expenditure upon an arbitrator who resigns/ otherwise vacates his office, without making the award.

(d) Periodical reports should be ensured from the arbitrators, either to the High Court or the Institution which appoints them, detailing the progress of cases entrusted to them.

Proposed amendments to Section 12 of the Act

The proposed amendment to Section 12 of the Act reads as under:

> "When a person is approached in connection with his possible appointment as an arbitrator, he shall disclose in writing any circumstances:-
>
> (i) such as the existence of any past or present relationship, either direct or indirect, with any of the parties or their counsel,

whether financial, business, professional, social or other kind or in relation to the subject matter in dispute, which are likely to give rise to justifiable doubts as to his independence or impartiality; and

(ii) such other circumstances as may be provided in the Rules made by the Central Government in this behalf."

The proposed amendment has far-reaching consequences and would present great difficulties in implementation to the courts as well as to the arbitrators. Some of the difficulties are listed out below:

a) Disclosure of relationship by an arbitrator, no matter how minor, could lead to objections and challenges by parties interested in delaying proceedings;

b) It could be employed as a means to embarrass the arbitrators and may be used as a tool to make the arbitrators withdraw themselves from the case;

c) Whereas desirability to disclose relationship with parties is understandable, the need for such disclosure in respect of counsel is debatable.

d) A person approached with a proposal to act as arbitrator may or may not know the name of the counsel at the said time. Thereafter, on appointment of counsel, he may be required to make another disclosure and even withdraw from the case. This would lead to delay.

e) While proposing the said amendment, reference has been made to International Bar Association (IBA) guidelines. These guidelines may not be very relevant to the local conditions prevailing in India.

f) The word "social" used in the proposed amendment is most objectionable. In India, it is customary to invite all known people to marriages or other social functions. If such persons are ultimately

appointed as arbitrators, acceptance of such invitations could then be used as a ground to challenge their impartiality.

g) A wrong or misleading declaration made in respect of "professional", "business" or "financial" relations can be verified at any point of time. However, closeness of "social" relations cannot be verified by any objective means. A mere meeting between an arbitrator with a counsel or a party at a gathering could lead to charges of "social" relationships. This word would then open up a Pandora's box of allegations and litigation.

h) The word "social" and its implications has been discussed in *Seddon v. Binions,* [1978]1 Lloyd's Rep. 381, wherein Roskill LJ stated as follows:

> "Inevitably where one has a phrase such as 'social domestic or pleasure purposes', used in a policy of insurance there will be cases which fall on one side of the line and cases which fall on the other side. For my part, however much claims managers might wish it otherwise, I do not believe it is possible to state any firm principle under which it can always be predicted which side of the line a particular case will fall. It must depend on the facts of the particular case, and the facts of the particular case will vary infinitely in their detail."

As per Webster's New World Dictionary, Third Edition, page 1272, the word "social" means:

> "having to do with human beings living together as a group in a situation in which their dealings with one another affect their common welfare; getting along well with others; of, for, or

involving friends, companionship, or sociability; living or association in groups or communities."

From the above, it is evident that the term "social" has a very wide meaning. The implications of adding the said term to the proposed amendment is fraught with danger. It is proposed that the word "social" should be deleted or replaced by a term such as "relationship promoting each other's cause". In any case, further explanation to the term is essential and it should not be allowed to remain in the Act in its present form.

i) While expanding the scope of Section 12 to encompass various relationships between people, the issue of contracts, wherein the named arbitrator is an officer of the employer has not been addressed. In *Union of India v. Singh Builders Syndicate*, (2009)4 SCC 523, the Supreme Court had stated as follows:

> "We find that a provision for serving officers of one party being appointed as arbitrator(s) brings out considerably resistance from the other party, when disputes arise. Having regard to the emphasis on independence and impartiality in the new Act, Government, statutory authorities and government companies should think of phasing out arbitration clauses providing for serving officers and encourage professionalism in arbitration."

The proposed amendment should keep in mind the above recommendation of the Supreme Court and declare that where an arbitration clause provides for appointment of an employee or an interested party as an arbitrator, it would be void to that extent.

Proposed changes to Sections 28 and 34 of the Act:

The proposed legislation has added new provisions in Section 28 and Section 34A, which read as follows:

"28(3) In all cases, the arbitral tribunal shall take into account the terms of the contract and trade usage applicable to the transaction."

"34A Application for setting aside arbitral award on additional ground of patent and serious illegality:-

(1) Recourse to a court against an arbitral award made in an arbitration other than an international arbitration, can also be made by a party under sub-section (1) of Section 34 on the additional ground that there is a patent and serious illegality, which has caused or is likely to cause substantial injustice to the party.
(2) Where the ground referred to in sub-section (1) is invoked in an application filed under sub-section (1) of Section 34, while considering such grounds, the court must be satisfied that the illegality identified by the applicant is patent and serious and has caused or is likely to cause substantial injustice to the applicant."

The effect of the proposed amendments is far-reaching and would certainly bring back the ill-effects of Sections 30 and 33 of the Arbitration Act, 1940. The proposed amendments would, in effect, bring back the omnibus provision of the Act of 1940 providing for setting aside of awards "for any other reasons". The term "patent and serious" in Section 34A is open to different interpretations, it can be read in a restrictive sense or in a liberal manner. What may be patent and serious for one court may not be so for another. An illegality, patent or otherwise, is naturally a ground for setting aside an award. The proposed amendment to Section 28(3) as well as the existing provisions, i.e. Section 28(1) and 34(1) would cover any situation where an award can be termed as illegal. No useful purpose is thus to be served by introduction of Section 34(A), which is merely a repetition of what has been stated earlier and, in fact, could lead to confusion.

Our country needs legislation which protects arbitral awards and the proposed Section 34A does not in any way support the said purpose. Arbitral awards should be upheld except where they run counter to the grounds mentioned in Section 28(1) and 34(1) of the existing Act read with the proposed Section 28(3).

In practice, it has been observed that some arbitrators consider arbitration to be a business. Tainted and unconscionable awards are often rendered, which shake the conscience of all. In this situation, the words of wisdom of Harry R. Blyth [21 Green Bag, 224 – quoted in *J.S. Jadhav v. Mustafa Haji Mohamed Yusuf*, (1993)2 SCC 562], are extremely apt:

> "Great God! the hour has come when we must clear
> The legal fields from poison and from fear;
> We must remould our standards – build them higher,
> And clear the air as though by cleansing fire,
> Weed out the damning traitors to the law,
> Restore her to her ancient place of awe."

It is a matter of common knowledge that arbitrators perform a very pious duty. Parties to arbitration look to them for justice and redressal of grievances. It is, therefore, imperative that their conduct should be above-board. They must act like hermits who have neither any desire nor any aspiration. They must not pollute the arbitral system. Their job is to supply light and not heat. Their job is to apply balm on injured parts and not to inflict injuries to the system.

Conclusion

The above amendments to the Act of 1996 are very far-reaching and would have a great impact on the manner in which arbitrations would be conducted. Merely to avoid some ills that have crept into the situation, we are introducing basic changes and that too without proper public debate. It is hoped that the Government would invite greater public participation to the proposed amendments and conferences should be held to discuss the proposed amendments. Hurry could lead to greater problems at a later stage. By the proposed amendments, intention seems to be to get out of the muddle but in the process, we may be sinking deeper in the slush.