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Neutrality, Independence and Impartiality of the Arbitrators: the Past and the Present

Ellora Paper Mills Limited v. the State of Madhya Pradesh

Case No.	Civil Appeal No. 7697 of 2021
Date	04 January 2022
Court	Supreme Court of India
Coram	Hon'ble Mr. Justice M.R. Shah; and Hon'ble Mr. Justice B.V. Nagarathna

1. **FACTUAL MATRIX:**

- 1.1 At the heart of the controversy revolve around when, the State of Madhya Pradesh (**“Respondent”**) published a tender for the supply of cream weaved paper and duplicating paper for the 1993-1994. Ellora Paper Mills Limited (**“Ellora/Appellant”**) competed for the contract and was ultimately awarded it on 22.09.1993. Subsequently, a conflict emerged when the Respondent failed to pay for 90% of the paper delivered by Ellora in accordance with the contract's conditions and rejected certain consignments without offering justification.
- 1.2 The Respondent informed the Appellant through letter dated 15.11.1993, that the paper supplied did not meet the standards. In 1994, Appellant filed a legal suit in Bhopal's Civil Court seeking a permanent injunction against the Respondent prohibiting it from awarding the contract to a third business. The suit, however, was futile because the Respondent had already awarded the supply order to a third business.
- 1.3 Thereafter, the Appellant filed a second claim to recover Rs. 95,32,103/- (Rupees Ninety Three Lakhs Thirty Two Thousand One Hundred and Three Only). The Respondent filed an application under to Section 8 of the Arbitration and Conciliation Act, 1996 (**“Act”**), seeking a stay of the Civil Court proceedings, which was denied.
- 1.4 On reconsideration, the Madhya Pradesh High Court granted the application and referred the parties to arbitration before the Stationery Purchase Committee, which comprised of state officers [the Additional Secretary, Department of Revenue as President, (i) Deputy Secretary, Department of Revenue, (ii) Deputy Secretary, General Administration Department, (iii) Deputy Secretary, Department of Finance, and (iv) Deputy Secretary/Under Secretary, General Administration Department and (v) Senior Deputy Controller of Head Office, Printing as Members].
- 1.5 Before the Hon'ble High Court, the Appellant argued that because the nominated Arbitrators were all employees of the State, they were hit by the ineligibility in Entry 1 of the Seventh Schedule of the Act, which bars an Arbitrator from being an employee, consultant, advisor or having any other past or present business relationship with a party. By reason of their ineligibility, Appellant asserted that the ineligible Arbitrators could not appoint their replacement Arbitrators either. The Hon'ble High Court rejected Appellant's application.
- 1.6 It relied on the Hon'ble Supreme Court's decisions in *BCCI v. Kochi Cricket (P) Ltd.*¹ and *Union of India v. Parmar Construction Co.*², wherein the Court had ruled that provisions of the 2015 amendment will not apply to arbitral proceedings commenced before the 2015 amendment unless the parties otherwise agreed. In this case, the Hon'ble High Court ruled that the prohibition in Section 12(5) read with the Seventh Schedule—inserted by the 2015 amendment—preventing a party from appointing its own employees to an Arbitral Tribunal did not apply to the Arbitration, as it had commenced before the 2015 amendment.
- 1.7 The Appellant approached the Hon'ble High Court under Section 14 read with Sections 11 and 15 of the Act, seeking to terminate the mandate of the Tribunal as originally constituted and to appoint a new Arbitrator.

2. **ISSUE RAISED:**

¹ (2018) 6 SCC 287.

² 2019 SCC OnLine SC 442.

- 2.1 Whether Arbitral Tribunal constituted before 2015 Amendment can operate if it violates neutrality mandate under section 12(5) of the Act?

3. CONTENTIONS OF THE APPELLANT:

- 3.1 Appellant contended that the Hon'ble High Court in its impugned judgement was contrary to the law established by the Supreme Court in *Jaipur Zila Dugdh Utpadak Sahkari Sangh Limited v. Ajay Sales & Suppliers*³. It was argued that continuing to have a Tribunal composed of State officers would defeat the purpose of the Amendment Act, 2015, which added sub-section (5) to Section 12 read with the Seventh Schedule to ensure the arbitrators' impartiality and neutrality.
- 3.2 Additionally, it was asserted that in *Jaipur Zila Dugdh Utpadak Sahkari Sangh Limited* (supra), the Hon'ble Apex Court rejected the argument that once a party engages in an arbitration procedure, the party cannot invoke Section 12(5) and seek appointment of a new Arbitral Tribunal. It was emphasised that an application claiming Section 12(5) would be maintainable in the absence of an express waiver. It was argued that the Tribunal was established in 2001 but did not convene until 2017, during which time a stay of proceedings was in effect. Additionally, other Tribunal officers retired over the course of two decades, but no action was done to establish a new Tribunal.

4. CONTENTIONS OF THE RESPONDENT:

- 4.1 Respondent stated that the Arbitral Tribunal was established in 2000 and that Section 12(5) read with the Seventh Schedule was added to the law on 23.10.2015. As a result, it would be inapplicable to the current fact circumstance, as held in the order.

5. JUDGEMENT OF SUPREME COURT:

- 5.1 The Supreme Court held that an arbitral tribunal established pursuant to an arbitration clause prior to the 2015 amendment to the Arbitration and Conciliation Act 1996 will forfeit its mandate if it violates the neutrality clause contained in Section 12(5) read with the Seventh Schedule, which was incorporated by the 2015 amendment.
- 5.2 The Court determined that an arbitration clause that requires the appointment of arbitrators in violation of the modified Section 12(5) of the Act cannot be enforced.
- 5.3 The Supreme Court Observed that, when an arbitration clause is deemed to be in conflict with the revised provision, the appointment of the arbitrator would fall beyond the scope of the arbitration agreement, authorising the Court to appoint the most permissive arbiter. That is the consequence of the non-obstante clause found in Section 12 sub-section (5), and the other party cannot insist on the arbitrator being appointed in accordance with the arbitration agreement's stipulations.
- 5.4 The Court stated that when Section 12(5) takes effect, an arbitral tribunal appointed pursuant to such an arbitration clause will lose its mandate.
- 5.5 Citing *Bharat Broadband Network Limited v. United Telecoms Limited*⁴, the Hon'ble Court noted that the stated judgement rejected the argument that a contractor who has engaged in arbitration proceedings cannot seek a new appointment of arbitrator under Section 12(5). The Hon'ble Court ruled that the Impugned Judgment violated the principals laid down in various judgments pronounced by the Hon'ble Apex Court

³ 2021 SCC OnLine SC 730.

⁴ (2019) 5 SCC 755.

in *TRF Limited v. Energo Engineering Projects Limited*⁵, *Bharat Broadband (supra)*, and *Jaipur Zila Dugdh Utpadak Sahkari Sangh Limited (supra)*.

- 5.6 Additionally, it found that the Tribunal, which was comprised of officers of the Respondent, had lost its mandate pursuant to Section 12(5) read with the Act Seventh Schedule. Rather than remanding the case back to the Hon'ble High Court, the Hon'ble Supreme Court chose to appoint Justice Abhay Manohar Sapre, a former Supreme Court judge, as the new Arbitrator to resolve the dispute arisen between the parties.

6. PSL OPINION:

- 6.1 The present judgment has emphasised how important it is to prohibit a party, particularly a government organisation, from violating the norm against bias by nominating an employee, consultant, or advisor, or anyone with a prior business relationship as an Arbitrator,. While this is a good improvement in Indian law, caution should be exercised to avoid upsetting previous Arbitrations.
- 6.2 Of course, the Court was attempting to rectify a historical error and galvanise a slow-moving arbitration in this case; but, this should not be interpreted to indicate that all pre-amendment arbitrations are now subject to the rigours of the 2015 amendment appointment criteria. A delicate balance must be maintained in this regard to ensure that these adjustments are implemented evenly.

⁵ (2017) 8 SCC 377.