OPENING THE PANDORA'S BOX: AN ANALYSIS OF THE SUPREME COURT'S DECISION IN *S.B.P.* V. *PATEL ENGINEERING*[1]

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Criticizing the controversial Supreme Court ruling that the power of the court to appoint an arbitrator is a judicial power, the author believes that the decision is an incorrect reading of section 11 of the Arbitration and Conciliation Act, 1996 and amounts to judicial legislation. This ruling amplifies the need for judicial and legislative clarification on the power of the court to appoint an arbitrator, so as to fulfil the objectives of the Arbitration and Conciliation Act.

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I. INTRODUCTION

In a momentous Seven Judge Constitution Bench decision in *SBP* v. *Patel Engineering Ltd.*[2] the Supreme Court has clarified and explained the operation of section 11(6) of the Arbitration and Conciliation Act, 1996 [hereinafter the "Act"] dealing with the appointment of arbitrators by the Chief Justice. The Court explained that such an appointment is an exercise of judicial power and not an administrative decision. This has far-reaching consequences for the future conduct of arbitral proceedings in India and more importantly for the signal that this

[1] A.I.R. 2006 S.C. 450.

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[2] *Id.*

sends out about the scope of judicial interference in alternative methods of dispute resolution.

Numerous commentators have criticized the decision in *SBP* v. *Patel Engineering Ltd.* as going beyond the expected role of a judicial forum in a party chosen dispute resolution mechanism. Be that as it may, it is submitted that this case raises a more fundamental concern, a concern that has been overlooked in the diatribe against judicial interference in arbitration. More significantly, it is to be rued that the decision has virtually re-written the statutory language in section 11(6). In a legal system that prides itself on a rule of law premised upon a tripartite system of governance, this decision goes way beyond the intention of the legislature that was clearly discernable in the express words of the statute. This has opened a Pandora's box. It is in this context that the article analyses the far-reaching implications of this decision.

Part II of this article discusses the relevant legal provisions and the earlier case law relating to the default powers of the Chief Justice, thus setting the stage for understanding the decision of the Supreme Court. Part III examines this decision of the Supreme Court in detail and discusses both the majority opinion as well as the dissent. Part IV advances arguments disagreeing with the decision. It lays down the proper role of the Court keeping in view the true spirit of the UNCITRAL Model Law [hereinafter the 'Model Law'] and the underlying grundnorm of legislative supremacy.

II. Setting the Stage - Background

The Act, under section 12(2), provides full freedom to the parties to agree upon a procedure for the appointment of the arbitrator(s). Usually, the parties provide for the appointment of a named arbitrator, or in the case of an institutional arbitration, a designee institution. If such procedure for appointment of the arbitrators is left for future agreement between the parties, it is not uncommon that for frustrating the arbitration, one of the parties refuses to appoint an arbitrator. Similarly, it is not hard to imagine situations where both the party-appointed arbitrators are unable to reach any agreement as to their choice of a common third arbitrator. In such situations, where the parties are not able to agree on the procedure, or the arbitrators are unable to agree upon the third arbitrator, or the designee institution is unable to perform its functions related to the procedure of appointment of the arbitral tribunal, section 11(6) of the Act provides,

> ...in the absence of any other means for securing the appointment provided in the agreement on the appointment procedure, [such]

> appointment shall be made, upon request of a party, by the Chief Justice or any person or institution designated by him.
>
> The next sub-section further provides
>
> [this] decision of the Chief Justice or any person or institution designated by him shall be final.

Thus to appoint or secure appointment of the sole arbitrator or the third arbitrator, the default power under all these provisions vests in the Chief Justice or any person or institution designated by him. The pertinent questions therefore are: What is the nature of this function? Is it judicial? Is it administrative or neither? Or is it a statutory power? The Supreme Court has been vexed with these questions since the enactment of the Act.

The decision of the Supreme Court in *KR Raveendranathan* v. *State of Kerala*[3] may be taken as a convenient starting point. A two Judge Bench of the Court referred to a larger Bench the question "whether the function of the Chief Justice or his designate, under sub-sections (4), (5) and (6), of section 11 to appoint an arbitrator or to secure the appointment of an arbitrator is of a judicial nature." Subsequently another two Judge Bench of the Court referred the same question to a larger Bench.[4] Later in *Sundaram Finance Ltd.* v. *NEPC India Ltd.*, another two Judge Bench of the court, as *obiter*, stated that "under the 1996 Act, appointment of arbitrator(s) is made as per the provisions of section 11, which does not require the Court (sic, actually Chief Justice) to pass a judicial order appointing [the] arbitrator(s)." This *obiter* was affirmed by another two Judge Bench in *Ador Samia Pvt Ltd.* v. *Peekay Holdings Ltd.*[5] which was affirmed by a three Judge Bench in *Konkan Railways Corpn* v. *Mehul Construction Co.*[6] The latter decision too was referred to a larger Bench by another two Judge Bench in *Konkan Railway Corporation* v. *Rani Construction (P) Ltd.*[7]

This is how the matter came up before a Constitution Bench of the Supreme Court. The Court cleared the air with a unanimous decision reported in *Konkan Railway Corpn Ltd.* v. *Rani Construction Pvt Ltd.*[8] where it affirmed the ruling in

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[3] (1996) 10 S.C.C. 35.

[4] (1998) 9 S.C.C. 728.

[5] (1998) 8 S.C.C. 572.

[6] (2000) 7 S.C.C. 201.

[7] (2000) 8 S.C.C. 159.

[8] (2002) 2 S.C.C. 388 (405), per Bharucha C.J. affirming the three judge bench decision in Konkan Railway Corp Ltd. v. Mehul Construction Co., (2000) 7 S.C.C. 201.

Mehul Construction Co. The Supreme Court ruled that the default power of the Chief Justice or 'any person or institution' designated by him under section 11 is not adjudicatory. On review of its earlier dicta the Court said that the only function of the Chief Justice or his designate under section 11 is to "fill the gap left" and appoint an arbitrator, so that the arbitral tribunal is expeditiously constituted and the arbitration proceedings are commenced. This function, according to the Court, has been advisedly left to the Chief Justice or his designate with a view to ensure that the appointment of the arbitrator is made by a person occupying a high judicial office to instill confidence in the appointment process. This would ensure that due care is taken to see that a competent, independent, and impartial arbitrator is appointed. Further, since the Chief Justice or his designate exercising the default power to appoint arbitrators is not a tribunal, therefore, such a decision cannot be made the subject of a petition for special leave to appeal under Article 136 of the Constitution.

III. Charting New Territory - *SBP* v. *Patel Engineering*

The Supreme Court in *SBP & Co* v. *Patel Engineering Ltd.* through a six-to-one majority has overturned the decision of the Constitution Bench in *Rani Construction.*[9]

Speaking through Balasubramanyan J, the Supreme Court held in no uncertain terms that the "the power exercised by the Chief Justice of the High Court or the Chief Justice of India under section 11(6) of the Act is not an administrative power. It is a judicial power." The implication of this is that the Court will appoint an arbitrator only if it satisfies itself that all the conditions precedent to the initiation of arbitration proceedings exist. Thus, it must go into the question of the validity of the arbitration agreement, the maintainability and arbitrability of the claim, the qualifications of the arbitrators and other jurisdictional matters. To rationalize this holding of the Court with the power of the arbitral tribunal to decide on its own jurisdiction in section 16, the Court was forced into a situation where it had to concede that the rule of *kompetenz-kompetenz* will operate only in respect of those arbitrations, where an arbitrator has not been appointed by the Court.

The other bit of "strained" construction which results from this decision is that the words in section 11(6) allowing for the Chief Justice or "any person or institution designated by him" to appoint an arbitrator, have been severely

[9] (2005) 8 S.C.C. 618.

mutilated. The words disclose a clear delegation. Surely, the legislature would have been aware that a judicial power cannot be delegated. To overcome this argument, the Supreme Court has held that here an "institution" can only mean a judge of the Supreme Court or any High Court.

Flowing from this conclusion arrived at by the Court are two very serious problems.

A. It Creates an Absurdity in the Law

The conclusion reached by the Court is something not envisaged within the scheme of the Act at all. To illustrate, even under section 45 of the Act, where the power of review of the arbitration agreement is given to the Court in specific terms,[10] the Court can only conduct a *prima facie* examination of the documents and materials on record.[11] To do otherwise will defeat the power of *kompetenz-kompetenz* under section 16 of the Act, lead to prolonged proceedings at the initial stage, as well as increase costs and uncertainty for the parties concerned.

Section 11(6) by using the phrases "Chief Justice" and "appoint" describes this action of the Chief Justice, in terms indicating an even lesser degree of permissible intervention than section 45. Thus, at the very least, the same logic under section 45, applies to the case at hand. Section 11 merely provides for the "procedure" for the appointment of the arbitrators. Surely, the procedure adopted should not affect the jurisdiction of the arbitral tribunal to determine the validity of the arbitration agreement. This decision creates an absurdity in the law to that extent.

This also has serious consequences for the working of the arbitration system in India. It gives an incentive to the parties to indulge in dilatory tactics since a *prima facie* examination of an arbitration agreement can be done at one hearing, as opposed to a complete judicial adjudication, which may take several months. The jurisprudence of arbitration worldwide[12] is unanimous in rejecting the right

[10] § 45 deals with the power of judicial authorities to refer the parties to arbitration. It provides "Notwithstanding anything contained in Part I or in the Code of Civil Procedure, 1908 (5 of 1908), a judicial authority, when seized of an action in a matter in respect of which the parties have made an agreement referred to in § 44, shall, at the request of one of the parties or any person claiming through or under him, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."

[11] Shin-Etsu Chemical Co Ltd. v. Aksh Optifibre Ltd., 2005 (3) Arb. L.R. 1 (SC).

[12] It is only fair to point out that contradictory viewpoints do exist on whether a court should rule on the validity of the arbitration agreement. For instance in England, the power of the court while appointing an arbitral tribunal is recognized as 'judicial' as per § 18 of the Arbitration Act, 1996. However, this is so because the nature of the

of courts to interfere in the working of the arbitral process.[13] It can be put no better than the words of Lord Mustill who mused – "How much more reticence may be required when the parties have agreed that their disputes shall be resolved elsewhere?"[14]

B. It is an Exercise of "Judicial Legislation"

Be that as it may, the other regrettable and even more serious consequence of this decision is that in arriving at this conclusion the Court has strained the legislative language beyond permissible limits.

It is relevant to note here that the Parliament has departed from the text of Article 11 of the UNCITRAL Model Law, which vests the default power to appoint an arbitrator in the 'court'. The default power has specifically been vested by the Parliament in the 'Chief Justice' and to designate 'any person or institution'. This function was deliberately entrusted to the Chief Justice to ensure that the appointment is made by a person occupying the highest judicial office.

The fact that the Chief Justice is authorized to delegate his default power to appoint arbitrators to 'any person or institution' clearly indicates that this function is *not* a judicial function, because a judicial function cannot be delegated by the Chief Justice to 'any person or institution'.

Furthermore, the right to appoint the arbitrator or arbitrators basically is the right of the parties. If the parties fail to agree upon the appointment of an arbitrator or the party-nominated arbitrators fail to appoint the third arbitrator, the right by default passes to the Chief Justice, who is authorized by the statute to delegate his function to appoint the arbitrator or arbitrators to 'any person or institution'. The phrase 'any person or institution' is of wide amplitude. It cannot be tampered with by a judicial fiat.

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power has been specifically so prescribed by the English Arbitration Act, 1996. The Indian Parliament has specifically excluded this power from the courts at the initial stage and placed the power solely with the arbitral tribunal in consonance with the principle of *kompetenz-kompetenz*.

[13] Article 5 of UNCITRAL Model Law. *See also* "United Nations Commission on International Trade Law Model Law on International Commercial Arbitration", (1985) 24 I.L.M. 1302, 1331; O.P.C. Farms Inc. v. Conopco Inc., 154 F.3d 1047 (9th Cir. 1998); Private Company 'Triple V' Inc. Ltd. v. Star (Universal) Co. Ltd. and Sky Jade Enterprises Group Ltd., Case No. 109, CLOUT (Hong Kong Court of Appeal, 7th July, 1995); Pacific International Lines (Pte) Ltd v. Tsinliens Metals and Minerals Co (HK) Ltd., [1993] 2 H.K.L.R. 249.

[14] Lord Mustill in the foreword to O. P. MALHOTRA, THE LAW AND PRACTICE OF ARBITRATION viii (2006).

The majority opinion purports to change the language of the statute by replacing the words "the appointment shall be made... by the Chief Justice or any person or institution designated by him" with the court-coined language-

> The power under Section 11(6) of the Act, in its entirety, could be delegated, by the Chief Justice of the High Court only to another Judge of that Court and by the Chief Justice of India to another Judge of the Supreme Court.

It is submitted that this clearly goes beyond the delicate balance between the legislature and judiciary, for "it is for the Legislature to make a law applicable to certain situations contemplated by it and the judiciary has no power in entering into *legislative wisdom*."[15] While interpreting statutory provisions, it is not permissible for the court to replace the words of the statute with some other words. The Court cannot restrain or expand the operation of the legislation since "it has no power to legislate."[16]

The minority opinion recognizes this fact, and Thakker J minces no words when he says –

> No court of law much less the highest court of the country would interpret one provision of an Act of Parliament which would make another provision totally redundant, otiose and nugatory... It is not open to a court to ignore the legislative mandate by making artificial distinction between the power to be exercised by the Chief Justice or by his 'colleague' and the power to be exercised by other organs though legislature was quite clear on the exercise of power by the persons and authorities specified therein.

Rewriting the statute in the court-coined language is tantamount to impermissible judicial legislation. Though this decision, for the time being does prevail, its jurisprudential correctness is not free from doubt because it is nothing but a 'naked usurpation of the legislative function under the thin disguise of interpretation.'[17] If this holding is to prevail, the court will be acting in a legislative rather than a judicial capacity.[18] While purporting to interpret various enactments,

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[15] Per Thakker J, *supra* note 1, ¶ 111.

[16] State of Kerala v. Mathai Verghese, (1986) 4 S.C.C. 746 (749). *See also* Union of India v. Deoki Nandan Aggarwal, 1992 (Supp.) 1 S.C.C. 323; Crawford v. Spooner, [1846] 4 Moo Ind App 179 (P.C.).

[17] Magor & St Mellons RDC v. Newport Corpn, [1951] 2 All. E.R. 839 (841) (HL).

[18] Petron Engineering Construction Pvt Ltd v. Central Board of Direct Taxes, 1989 (Supp.) 2 S.C.C. 7. *See* also Padmasundara Rao v. State of Tamil Nadu, (2002) 3 S.C.C. 533; Unique Butyle Tube Industries (P) Ltd v. UP Financial Corporation,

this seven-judge decision is set to become a precedent for impermissible intervention in areas where the Parliament has been quite clear and unambiguous. This militates against the tripartite theory of the government.

IV. Law Reform – The Way Forward

In the light of these principles universally recognised by the English as well as Indian courts, the conclusions of the majority judgment in *Patel Engineering* are fundamentally flawed. The decision requires reconsideration by a still larger Bench of the Court. But even then the possibility of judicial division cannot be ruled out *ad infinitum*. It is, therefore, suggested that the Chief Justice of India may consider the advisability of recommending the issue to Parliament for a suitable amendment. A somewhat similar situation arose in *Associated Cement Cos. Ltd.* v. *Their Workmen*,[19] where a strong case was made before the Supreme Court for revision of the Full Bench Formula for payment of bonus. Rejecting the plea for revision of the formula, speaking for the court, Gajendragadkar J. stated:

> The plea for the revision of the formula raises an issue which affects all industries; and before any change is made in it, all industries and their workmen would have to be heard and their pleas carefully considered. It is obvious that, while dealing with the present group of appeals, it would be difficult, unreasonable, and inexpedient to attempt such a task.... If the Legislature feels that the claim for social and economic justice made by labour should be redefined on a clearer basis, it can step in and legislate in that behalf.

This resulted in enactment of the Bonus Act 1965. Likewise, the Supreme Court may recommend to the Parliament the need for amending section 11 by a legislative measure. This need is underscored by the fact that the operation of this decision and its prescribed procedure in arbitrations in India today not only serves as a hindrance to expeditious proceedings but sends out the wrong signal to parties keen on seeking alternate methods of dispute resolution. At a time when the trend worldwide points towards reduction of judicial interference, the Supreme Court has in *Patel Engineering* charted the opposite course, an approach not justified in principle as well as practice. It may, however, be borne in mind that as long as this decision is not overruled by a larger Bench or by a legislative amendment clarifying the law, it will prevail and the procedure prescribed in it has to be followed.

(2003) 2 S.C.C 455; Shiv Shakti Co-op Housing Society Nagpur v. Swaraj Developers, A.I.R. 2003 S.C. 2434.

[19] (1959) 1 L.L.J. 644.