Between the lines...

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Key Highlights

I. Supreme Court decides on appointment of employee of a party as arbitrator for arbitrations initiated prior to 2015 amendment

The Supreme Court of India in the case of ***Aravali Power Company Private Limited vs. M/s. Era Infra Engineering Limited*** (decided on September 12, 2017) held that if the appointed arbitrator is an employee of one party for an arbitration initiated prior to the Arbitration and Conciliation (Amendment) Act, 2015 (the **"2015 Amendment Act"**) coming into force, such appointment could not by itself, be rendered invalid and unenforceable.

Legal position before and after the amendment

It is pertinent to take note of the legal position in order to appreciate the facts of the case and the decision of the court. Prior to the Arbitration and Conciliation Act, 1996 (the **"Act"**) being amended by the 2015 Amendment Act, the position with respect to procedure for challenging the appointment of an arbitrator was that the appointment could be challenged within a time frame if circumstances existed that gave rise to justifiable doubts as to independence or impartiality of arbitrator. Precisely, before the amendment of the Act, merely because the appointed arbitrator was an employee of any party did not ipso facto render the appointment of such employee as arbitrator invalid.

However, after the amendment of the Act by the 2015 Amendment Act, 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 newly inserted Seventh Schedule is ineligible to be appointed as an arbitrator. This can be waived by the parties by an express agreement in writing subsequent to disputes having arisen between them. The Seventh Schedule contains, inter alia, list of various relationships between the arbitrator and the parties or counsel which includes that the arbitrator cannot be an employee, consultant, advisor or person having any other past or present business relationship with any party. In a nutshell, after the amendment of the Act, if the appointed arbitrator is an employee of any party, such appointment is ipso facto invalid. As noted by the court in this case, after the amendment, if the arbitration clause finds foul with the amended provisions, the appointment of the arbitrator even if apparently in conformity with the arbitration clause in

the agreement, would be illegal and court would be within its powers to appoint such arbitrator as may be permissible.

Facts

In the instant case, respondent was awarded construction work and contract was executed in 2009.The arbitration clause in the agreement provided for arbitration of disputes by project in-charge of the project or some other person appointed by the chairman and managing director.

Due to delays in completion of work by respondent, appellant cancelled remaining works. Respondent disputed the decision of appellant alleging that it was not to be blamed for the delays in completion of the project and invoked arbitration clause. Respondent wanted dispute to be arbitrated by a retired judge of the High Court. Appellant denied the allegations of respondent and appointed its Chief Executive Officer to arbitrate the disputes between the parties.

Arbitration proceedings commenced and no objection was raised before the arbitrator by respondent. However, after the 2015 Amendment Act came to be notified, respondent on January 12, 2016 challenged the appointment of arbitrator for the first time. The objection was rejected by the arbitrator on the ground that respondent participated in the arbitral proceedings without raising any protest. Respondent approached the Delhi High Court seeking termination of the mandate of the arbitrator. The Delhi High Court had set aside the appointment of arbitrator and directed appellant to provide name of three arbitrators from which respondent was to choose one as arbitrator. The Delhi High Court had observed, *"In the present case, no doubt, the invocation was on the basis of un-amended Act but still under Section 12 of the Act would give the similar indication. The sole Arbitrator appointed by the respondent admittedly is CEO and Executive of the respondent-Company who is also from the same office/department. In order to maintain the neutrality, or to avoid any doubt in the mind of the petitioner and the reasons given in the petition, it would be appropriate that independent sole Arbitrator should be appointed as ultimately neutral person has merely to decide the dispute between the parties. Even, the object and scope of the Act says so, that an arbitration procedure should be fair and unbiased. Thus, the appointment of Mr. S.K. Sinha, CEO of the respondent Company is terminated and once the Arbitrator's appointment is terminated, the Court can consider the prayer of the petitioner."*

This decision of the Delhi High Court was challenged before the apex court.

Arguments

Counsel for appellant submitted that the Delhi High Court should not have interfered with the appointment of arbitrator as the appointment was as per the arbitration clause agreed between the parties. Appellant referred to the law as it stood before the amendment of the Act which prescribed clearly the procedure to challenge the appointment of arbitrator.

Counsel for respondent, on the other hand, argued that a person who was associated with the project under

consideration or who was directly subordinate to any authority whose decision was in dispute could not be appointed as an arbitrator. Counsel relied upon several apex court decisions in support of the argument.

Observations of the Court

The court, at the outset, noted that the Act as it stood before the amendment was to govern the present dispute as the arbitration proceedings had commenced before October 23, 2015 which is the date on which the 2015 Amendment Act was deemed to have come into force.

The court relied upon the decision of the apex court in the case of ***Indian Oil Corporation Limited and Others vs. Raja Transport Private Limited*** [(2009) 8 SCC 520] in which it was held that just because an arbitrator was an employee of one of the parties was not a ground in itself to raise presumption of any bias. The court went on to observe that in the present case, there was no justifiable apprehension about the impartiality of the arbitrator and arbitrator in the present matter was neither the dealing authority in regard to the contract nor was directly sub-ordinate to the authority whose decision is the subject matter of the dispute. Further, the court pointed out that respondent participated in the arbitration and did not challenge the appointment within the prescribed time. The court held that in such circumstances, even though the arbitrator was an employee of one of the parties, the appointment could not be rendered invalid and unenforceable.

Decision

The court decided in favour of appellant and directed that the arbitration in the present matter should proceed in accordance with law.

VA View

In several commercial agreements, we generally find that one of the parties has weak bargaining power as the arbitration clause in such commercial agreement provides for appointment of an employee of the strong party as an arbitrator. In such cases, when disputes arise, the aggrieved party has no option but to get the dispute arbitrated by an employee of another party or challenge it in the courts of law as per the procedure under the Act. Further, possibility of bias is generally difficult to rule out and there is presumption of an unfair decision by the arbitrator. Such presumptions without any adequate findings/basis resulted into numerous cases pending before the higher judiciary and caused delay in justice delivery system.

However, this case before the apex court in relation to arbitration that commenced before the amendment to the Act came into force, has made the position very clear. The parties now, in respect of the arbitration proceedings commenced before the 2015 Amendment Act, cannot argue that arbitrator is not independent and is impartial merely because the employee of a party is an arbitrator. In the instant case, the Supreme Court chose to give effect to the agreed arbitration clause as the court felt that the there was no reasonable suspicion about the independence and impartiality of arbitrator. For arbitrations initiated before the amendment, such appointments are not ipso facto invalid and the courts will continue to decide the validity of such appointments as per the facts and circumstances of each case.

II. SARFAESI proceedings and arbitration proceedings can go hand in hand: Supreme Court

The Supreme Court of India decided an interesting case- ***M.D. Frozen Foods Exports Private Limited and Others vs. Hero Fincorp Limited*** on September 21, 2017. The Bench comprised of Hon'ble Mr. Justice Sanjay Kishan Kaul and Hon'ble Mr. Justice Rohinton Fali Nariman.

Facts

Appellant borrowed money from respondent against security of certain immoveable properties. On default in payment of monthly installment by appellant, respondent invoked the arbitration clause. Prior to the invocation of the clause, respondent was notified as a financial institution for the purpose of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (the **"SARFAESI Act"**). Respondent then issued a notice to appellant under Section 13(2) of the SARFAESI Act for one of the seven properties given as security. In parallel, the arbitration proceedings commenced and an interim order was passed restraining appellant from creating a third party charge on any of the properties in contention. Concerned about the proceedings under the SARFAESI Act, respondent filed an application to substitute the order of status quo qua parties with the name of appellant, which was allowed. This order was challenged by appellant before the Delhi High Court, and presently before the apex court. The Delhi High Court had dismissed the appeal.

The issues before the court were as under:

Issue 1: Whether the arbitration proceedings can continue simultaneously with the proceedings under the SARFAESI Act?

Issue 2: Whether Section 13(2) of the SARFAESI Act can be made applicable to debts arising out of a loan agreement/mortgage created prior to the applicability of the SARFAESI Act to respondent?

Issue 3: Whether respondent can invoke provisions of the SARFAESI Act when it has been notified as a financial institution after the account became a Non- Performing Asset (**"NPA"**)?

Arguments

Counsel for appellant contended that the remedy of arbitration was invoked after the provisions of the SARFAESI Act had been made applicable to respondent and therefore, respondent had elected its remedy and was precluded from seeking recourse under the SARFAESI Act. Further, it was contended that Section 13(2) of the SARFAESI Act was substantive law and thus, recourse to the SARFAESI Act's provisions after an account had been declared as NPA would amount to retrospective application of substantive law.

Counsel for respondent, on the other hand, argued that simultaneous proceedings could be initiated under the SARFAESI Act and the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (the **"RDDB Act"**). Similarly, the recourse of arbitration was only an alternative to the recourse under the RDDB Act. Section 37 of the SARFAESI Act made it clear that the provisions of the statute were in addition to and are not in derogation of any other law for the time being in force. It was further argued that the provisions of the SARFAESI Act can be used for recourse against

any live and actionable debt. The SARFAESI Act only provided the procedure to enforce rights which had already accrued to a lender without the interference of the courts. Counsel submitted, *"It is only a new remedy in terms of the manner of such recovery. The legislation itself is procedural in nature."*

Observations of the Court

Issue 1- The court traced the history and necessity for constituting debt recovery tribunals under the RDDB Act, as an alternative to civil proceedings for recovery of debts. The court drew analogies from the question of law with respect to simultaneous proceedings under the RDDB Act and SARFAESI Act. The said instance, being a settled question of law allowed for simultaneous proceedings under the SARFAESI Act and the RDDB Act because, (i) both the statutes were complementary to each other; and (ii) owing to the lack of inconsistency and repugnancy between the Acts, the doctrine of election of remedy had no application.

Analogously, in the present circumstance, the proceedings under the SARFAESI Act were in the nature of enforcement proceedings and arbitration was in the nature of adjudicatory proceedings. The court referred the case of ***Transcore vs. Union of India and Anr.*** [(2008) 1 SCC 125]which held that the SARFAESI Act is an additional remedy to the RDDB Act. Together they constitute one remedy and, therefore, the doctrine of election is not applicable. Referring to the above case, the court in the instant case held, *"The only twist in the present case is that, instead of the recovery process under the RDDB Act, we are concerned with an arbitration proceeding. It is trite to say that arbitration is an alternative to the civil proceedings. In fact, when a question was raised as to whether the matters which came within the scope and jurisdiction of the Debt Recovery Tribunal under the RDDB Act, could still be referred to arbitration when both parties have incorporated such a clause, the answer was given in the affirmative. That being the position, the appellants can hardly be permitted to contend that the initiation of arbitration proceedings would, in any manner, prejudice their rights to seek relief under the SARFAESI Act."* The court observed that remedy under the provisions of the SARFAESI Act was in addition to the remedy of arbitration.

Issue 2 and 3- The Court observed that the SARFAESI Act applied to all claims which were owing and live at the time when it came into force and the date on which the debt was declared as NPA had no impact.

Decision

The Court dismissed the appeal and noted that this was an attempt by appellant to prolong the recovery.

VA View

The judgment of the apex court noted that debt recovery processes were exceedingly slow due to the varied techniques employed by the borrowers in their endeavors to make the said proceedings 'cumbersome and time consuming.' The court observed that in the event the secured assets are insufficient to satisfy the debts, the secured creditor can proceed against other assets in execution against the debtor, after determination of the pending

outstanding amount by a competent forum. The court concluded that the appeal was completely devoid of merit, and was only an endeavour to prolong the ultimate "date of judgment" for appellants to meet their obligations.

The court has observed that the SARFAESI Act applies to claims which are live at the time when the statute came into force and that the remedy under the SARFAESI Act is in addition to remedy of arbitration.

III. CBDT takes a step forward towards easing the tax concern of global MNC's having regional headquarters in India

The concept of Place of Effective Management (**"POEM"**) is an internationally recognised test for determination of residence of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognises the concept of POEM for determination of residence of a company as a tie-breaker rule for avoidance of double taxation. The principle of POEM is recognized and accepted by Organization of Economic Cooperation and Development (OECD) also.

The Finance Act, 2015 also introduced this concept of POEM by amending the provisions of section 6(3) of the Income Tax Act, 1961 for determining the tax residency of a foreign company in India. POEM had been defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. These provisions have taken effect from 1st April, 2017.

The Central Board of Direct Taxes (**"CBDT"**) had issued guiding principles for determination of POEM by Circular No. 06/2017 dated 24th January, 2017 in which it was clarified that the POEM in case of a company engaged in Active Business Outside India shall be presumed to be outside India if the majority meetings of the Board of Directors (**"BoD"**) are held outside India. Further, if on the basis of facts and circumstances it is established that the BoD of the company are standing aside and not exercising their powers of management and such powers are being exercised by either the holding company or any other person (s) resident in India, then the POEM shall be considered to be in India.

Concerns were raised by various stakeholders wherein it was represented that, as per the CBDT guidelines, in cases of multinational companies with regional headquarter structure, POEM may be triggered merely on the ground that certain employees having multi-country responsibility or oversight over operations in other countries of the region are working from India leading to taxation in India of their income from operations outside India.

To nip this concern in the bud, the CBDT by its Circular no. 25/2017 dated 23rd October, 2017 has clarified that so long as the regional headquarter operates for group companies in a region within the general and objective principles of global policy of the group laid down by the parent entity in the field of pay roll functions, accounting, human resource functions, IT infrastructure and network platforms, supply chain functions, and routine banking operational procedures, which are per se not specific to any entity or group of entities, this in itself, would not

constitute a case of BoD of such group companies standing aside and consequently such activities of the regional headquarter in India alone will not be a basis for establishment of POEM for such group companies.

However, it has also been clarified that if the above clarification is found to be used for abusive or aggressive tax planning, then the provisions of General Anti-Avoidance Rules may come into play.

VA View

The above clarification has been welcomed by the multi-national corporations carrying on the specified activities through their regional headquarter in India. Such a regional headquarter would not constitute a POEM of the other group companies in India as long as it performs routine functions as described above in accordance with the general and objective principles of global policy of the group. However, for all other substantive operational functions, it would be imperative that the majority meetings of the BoD of companies engaged in active business outside India be carried out outside India so that the risk of establishing POEM of the group companies is mitigated. Overall, this seems to be a positive step towards elevating India to a preferred global business hub and aligning the tax reforms towards the government's avowed objective of ease of doing business in India.

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