Critical analysis and Case study of [MMTC vs. Sterlite Industries Pvt. Ltd.] - Role Of Arbitrators

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Critical analysis and Case study of [MMTC vs. Sterlite Industries Pvt. Ltd.] following the IRAC Method
Supreme Court of India

M.M.T.C. Limited

- Versus-

Sterlite Industries (India) Ltd.

Decided on: 18 November, 1996

Equivalent citations: 1996 IXAD SC 25, 1997 AIHC 605, 1996 (2) ARBLR 705 SC

Bench: J Verma, B Kirpal

Facts

The agreement between the parties:

An agreement was entered into on 14th December, 1993 between the petitioner and the respondent by which the respondent appointed the petitioner as a consignment agent for the storage, handling and marketing of continuous cast copper rods manufactured by the respondent. The agreement provided, in so far as is material, that the petitioner will store, handle and market these copper rods produced by the respondent and received at various godowns of the petitioner from the respondent. Clause (I) A(iv) provided that the petitioner shall sell the aforesaid material belonging to the respondent on consignment basis "as per the policy and prices" of the respondent on the basis of the marked weight in the coils supplied by the respondent. By sub-clause (viii) of Clause (I)A, it was provided that the petitioner would collect the sale proceeds and the amount will be remitted on the following working day to the respondent after withholding the sales tax. Turnover tax and any other statutory cess, levy or tax. Besides the aforesaid deductions the petitioner would be entitled to deduct its service charges at the rate of Rs. 500/- per metric tonne. Rs. 500 per metric tonne then, was the remuneration to which the petitioner was entitled.
Under sub-clause (xi) of Clause (I)A, the petitioner was to provide for a copy of a statement of sales tax deposited with the sales tax authorities along with an 'F' Form in original and copies of challans and returns. Sub-clause (xiv) stipulated that the petitioner shall sell only against "100% advance financial arrangement to be made by the customer". The obligations of the respondent were specified in Clause (I)B of the Contract and these obligations included an obligation in sub-clause (i) to arrange for delivery of continuous cast copper rods to the godowns of the petitioner as intimated by the petitioner from time to time; an obligation under sub-clause (vii) to ensure quality and to redress customer complaints and under sub-clause (xi) not to appoint any selling agents or commission agents for sale in States agreed to with the petitioner. Under Clause (III) of the contract, it is provided that the products shall be of standard quality and the petitioner shall not give a guarantee or warranty save to the extent as mentioned by the respondent.

Provision was also made therein for the rectification and redressal of the customer grievances. Clause V provided that the agreement shall be deemed to have commenced on 14th December, 1993 and shall be valid for an initial period of three years. Either party could terminate the agreement by giving one month’s notice in writing.

There is no dispute about the fact that the agreement was not terminated. The contract between the parties contains a provision for arbitration and Clause VII provides in that regard that in the event of any question or dispute arising under or out of or relating to the construction, meaning and operation or effect of the agreement or breach thereof, the matter in dispute shall be referred to arbitration.

**Modified Payment Terms:**

The contract between the parties was initially varied on 6th January, 1994 in terms of a Memorandum of Understanding (MOU) which was arrived at between the parties. The MOU provided for a modification of the payment terms and the relevant part thereof were contested.

The MOU however, provided that it would be the "total responsibility" of the petitioner to ensure that the letters of credit which were established were bona fide in all respects and that payment for the principal along with interest would be made on the due date for supplies made against the particular letter of credit. Similarly, in the
case of a stand by letter of credit, it was provided that it would be the responsibility of
the petitioner to ensure that in case of the failure of the customer to make the
payment on the due date, the letter of credit would be negotiated timely and the
proceeds credited to the respondent both for the principal and the interest. Interest
was to be charged at the prevailing bank rate and the M.O.U. provided that the
prevailing rate was 18.25% per annum.

After the M.O.U. dated 5th January, 1994, a meeting took place between the parties
on 20th January, 1994 and the minutes of the meeting contain a further revision of
the agreed payment terms that were to govern the contractual relationship.

The Dispute:

The dispute in the present case arises out of supplies which were admittedly effected
by the respondent to the petitioner at the godowns of the petitioner. These goods
came to be sold by the petitioner as consignment agent on behalf of the respondent.
The claim relates to the period after April 1995. The case of the respondent is that
payments have not been made over to the respondent by the petitioner in respect of
the consignments of continuous cast copper rods which were supplied by the
respondent to the petitioner and which were admittedly sold by the petitioner to
various purchasers. Admittedly, and on this there is no dispute between the parties,
in respect of these consignments which were sold, the petitioner has charged its
service charges at the rate of Rs. 500/- per metric tonne. Similarly, there is no
dispute between the parties and, there was none before the arbitrators, that letters of
credit as required by the agreement between the parties were duly opened in favour
of the petitioner by the purchasers. The case of the respondent in the arbitration
proceeding was that under the original agreement dated 14th December, 1993, the
petitioner was to make delivery to the purchaser only against a 100% advance
payment. This clause was amended subsequently so as to permit the grant of credit
by the petitioner to purchasers subject to the purchaser opening a letter of credit as
specified in the memorandum of understanding dated 5th January, 1994. The
contention of the respondent is that the petitioner was responsible under the
contract to ensure that the letter of credit was bona fide and that payment was made.
The petitioner has admittedly received supplies from the respondent and sold them
but payment has not been made to the respondent.
The Arbitral Award:

The dispute between the parties came to be referred to the arbitration of three arbitrators Mr. Justice M.H. Kania, Mr. Justice M.N. Chandurkar and Mr. Justice S.N. Sapra. The parties led evidence before the arbitrators. By the Arbitral Award made on 27th June, 2001 two of the arbitrators, Mr. Justice M.H. Kania and Mr. Justice M.N. Chandurkar concerned in holding that the petitioner shall pay to the respondent a sum of Rs. 15,73,77,296/- with interest thereon at 14% per annum from 5th February, 1997 till the date of the Award and at 18% per annum thereafter; that the petitioner shall pay to the respondent an amount of Rs. 2.25 crores as interest on overdue payments upto 5th February, 1997. Besides these two operative directions of the learned arbitrators, the petitioner has been directed to furnish to the respondent, within a period of four weeks of the date of the Award, 'F' Forms which are required for the purposes of sales tax and which the petitioner has failed to furnish to the respondent. The arbitrators directed that in the event of the petitioner failing to do so, and the respondent being subjected to any liability on account of sales tax, the petitioner shall make good to the respondent the said liability with interest thereon at 18% per annum from the date such liability is discharged by the respondent till payment or realization. Costs of the arbitration were awarded to the respondent. Mr. Justice S.N. Sapra has delivered a dissenting Award.

Issues

Whether there is anything in the New Act to make such an agreement unenforceable?

Whether there was an independent agreement of the issues which were framed by the arbitrators?
Rules Applied, Cases Cited & Provisions of Law discussed briefly:

Three submissions have been urged on behalf of the petitioner to challenge the Arbitral Award. The learned Counsel urged that:

(i) The obligation of the petitioner to pay off the outstanding amount which the respondent is seeking to enforce in respect of one particular purchaser Hindustan Transmission Products Ltd. ("H.T.P."), arises out of an independent contract entered into between the petitioner and the respondent and it is, therefore, not covered by the terms of the arbitration agreement contained in the contractual document dated 14th December, 1993. Consequently, the arbitrators did not have the jurisdiction to entertain the dispute and acted outside the field of their jurisdiction. This ground of challenge is under section 34(2)(a)(iv).

(ii) The Award is contrary to the public policy of India, in that H.T.P., the third party purchaser, has instituted a civil suit against both the petitioner and the respondent in this Court, which is pending. Reliance was sought to be placed on the provisions of Order 21, Rule 29 of the Code of Civil Procedure, 1908 and on the decision of the Supreme Court in Krishna Singh v. Mathura Ahir, the learned Counsel urged that the petitioner would be entitled to take out a third party notice in the suit which has been instituted by H.T.P. and to invoke an indemnity against the respondent.

(iii) The dispute in respect of 'F' forms, which the award has directed the petitioner to furnish to the respondent, was not within the terms of reference to arbitration. Each of the three submissions can now be considered. The submissions which have been made for and on behalf of the respondent will be duly noted while considering and assessing the correctness of the submissions which are raised on behalf of the petitioner.

The contention of the learned Attorney General on behalf of the appellant is that an arbitration agreement providing for the appointment of an even number of arbitrators is not a valid agreement because of Section 10(1) of the New Act; and, therefore, the only remedy in such a case is by a suit and not by arbitration.

Section 7:

Arbitration agreement-(1) In this part, "arbitration agreement" means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or
which may arise between them in respect of a defined legal relationship, whether contractual or not.

(2) An arbitration agreement may be in the form of an arbitration clause in a contract or in the form of a separate agreement.

(3) An arbitration agreement shall be in writing.

(4) An arbitration agreement is in writing if it is contained in

(a) A document signed by the parties;

(b) an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement; or

(c) an exchange of statements of claim and defence in which the existence of the agreement is alleged by one party and not denied by the other.

(5) The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement if the contract is in writing and the reference is such as to make that arbitration clause part of the contract.

Section 10:

Number of arbitrators -(1) The parties are free to determine the number of arbitrators, provided that such number shall not be an even number.

(2) Failing the determination referred to in Sub-section (1), the arbitral tribunal shall consist of a sole arbitrator.

Section 11:

11. Appointment of arbitrators. -(1) A person of any nationality may be an arbitrator, unless otherwise agreed by the parties.

(2) Subject to Sub-section (6), the parties are free to agree on a procedure for appointing the arbitrator or arbitrators.
(3) Failing any agreement referred to in Sub-section (2), in an arbitration with three arbitrators, each party shall appoint one arbitrator, and the two appointed arbitrators shall appoint the third arbitrator who shall act as the presiding arbitrator.

(4) If the appointment procedure in Sub-section (3) applies and

(a) A party fails to appoint an arbitrator within thirty days from the receipt of a request to do so from the other party; or

(b) The two appointed arbitrators fail to agree on the third arbitrator within thirty days from the date of their appointment,

the appointment shall be made, upon request of a party, by the Chief Justice or any person or institution designated by him.

(5) Failing any agreement referred to in Sub-section (2), in an arbitration with a sole arbitrator, if the parties fail to agree on the arbitrator within thirty days from receipt of a request by one party from the other party to so agree the appointment shall be made, upon request of a party, by the Chief Justice or any person or institution designated by him.

(6) Where, under an appointment procedure agreed upon by the parties,

(a) A party fails to act as required under that procedure; or

(b) The parties, or the two appointed arbitrators, fail to reach an agreement expected of them under that procedure; or

(c) a person, including an institution, fails to perform any function entrusted to him or it under that procedure,

a party may request the Chief Justice or any person or institution designated by him to take the necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

(7) A decision on a matter entrusted by Sub-section (4) or Sub-section (5) or Sub-section (6) to the Chief Justice or the person or institution designated by him is final.

8. Chapter II of the New Act contains Sections 7 to 9 under the heading "Arbitration Agreement". Chapter III under the heading "Composition of Arbitral Tribunal" contains Sections 10 to 15.
9. Sub-section (3) of Section 7 requires an arbitration agreement to be in writing and Sub-section (4) describes the kind of that writing. There is nothing in Section 7 to indicate the requirement of the number of arbitrators as a part of the arbitration agreement. Thus the validity of an arbitration agreement does not depend on the number of arbitrators specified therein. The number of arbitrators is dealt with separately in Section 10 which is a part of machinery provision for the working of the arbitration agreement. It is, therefore, clear that an arbitration agreement specifying an even number of arbitrators cannot be a ground to render the arbitration agreement invalid under the New Act as contended by the learned Attorney General.

10. Section 10 deals with the number of arbitrators. Sub-section (1) says that the parties are free to determine the number of arbitrators, provided that such number shall not be an even number. Sub-section (2) then says that failing the determination referred to in Sub-section (1), the arbitral tribunal shall consist of a sole arbitrator. Section 11 provides for appointment of arbitrators. This is how arbitral tribunal is constituted.

11. The arbitration clause provides that each party shall nominate one arbitrator and the two arbitrators shall then appoint an umpire before proceeding with the reference. The arbitration agreement is valid as it satisfies the requirement of Section 7 of the New Act. Section 11(3) requires the two arbitrators to appoint the third arbitrator or the umpire. There can be no doubt that the arbitration agreement in the present case accords with the implied condition contained in para 2 of the First Schedule to the Arbitration Act, 1940 requiring the two arbitrators, one each appointed by the two sides, to appoint an umpire not later than one month from the latest date of their respective appointment.

**Judgement**

There is no dispute that the arbitral proceeding in the present case commenced after the New Act came into force and, therefore, the New Act applies. In view of the term in the arbitration agreement that the two arbitrators would appoint the umpire or the third arbitrator before proceeding with the reference, the requirement of Sub-section (1) of Section 10 is satisfied and Sub-section (2) thereof has no application. As earlier stated the agreement satisfies the requirement of Section 7 of the Act and, therefore, is a valid arbitration agreement. The appointment of arbitrators must, therefore, be governed by Section 11 of the New Act.
The fact that each of the two parties have appointed their own arbitrators, namely, Justice M.N. Chandurkar (Retd.) and Justice S.P. Sapra (Retd.), Section 11(3) was attracted and the two appointed arbitrators were required to appoint a third arbitrator to act as the presiding arbitrator, failing which the Chief Justice of the High Court or any person or institution designated by him would be required to appoint the third arbitrator as required by Section 11(4)(b) of the New Act. Since the procedure prescribed in Section 11(3) has not been followed the further consequence provided in Section 11 must follow.

Accordingly, it was directed that the chief Justice of the High Court was to appoint the third arbitrator under Section 11(4)(b) of the New Act in view of the failure of the two appointed arbitrators to appoint the third arbitrator within thirty days from the date of their appointments. Direction given by the Chief Justice of the High Court is substituted to this effect.

The appeal was disposed of accordingly. No costs.

HELD:

The validity of an arbitration agreement does not depend on the number of arbitrators specified therein. The number of arbitrators is dealt with separately in Section 10 of the Arbitration and Conciliation Act, 1996 which is a part of machinery provision for the working of the arbitration agreement. Therefore, an arbitration agreement specifying an even number of arbitrators cannot be a ground to render the arbitration agreement invalid under the new Act.
Analysis

The case concerned an arbitration clause contained in a contract entered into by the parties. The clause provided for the appointment of one arbitrator by each party and an umpire to be jointly appointed by those arbitrators.

The appellant sought to rely on the arbitration clause after a dispute arose between the parties. After the respondent claimed that the arbitration clause could not be resorted to, and, therefore, refused to name an arbitrator, the appellant brought an action in the High Court. The High Court rejected the respondent's contention that the arbitration clause was invalid in light of section 10 of the new 1996 Arbitration and Conciliation Act. The aforementioned provision in the Act states that parties are free to determine the number of arbitrators, provided that such number shall not be an even number. Special leave was given to appeal to the Supreme Court. The Supreme Court held that the relevant provision to determine the validity of an arbitration agreement is section 7 of the 1996 Act, which contains the writing requirement. As there is no reference to the number of arbitrators within this provision, the Supreme Court concluded that the validity of an arbitration clause does not depend on the number of arbitrators specified therein. The arbitration clause was therefore held to be valid.

Contractual relationships are much like marriages. In good times, anything goes, but in bad times, there is no issue small enough not to fight over. It is probably for this reason that something as simple as the law surrounding the appointment of an arbitrator has developed in the manner it has. Earlier, the appointment of an arbitrator in India was less complicated, where both parties would agree to listen to the decision of a respected elder, whom both trusted implicitly. Today, the law surrounding this seemingly innocuous aspect of an agreement has developed tremendously and parties argue vociferously to insert their choice of details including forum and arbitrator into the dispute resolution clause of a contract.

The law of arbitration in India is governed by the provisions of the Arbitration and Conciliation Act, 1996, (‘the Act’). The Act leaves parties free to decide on whether they wish to go in for institutional arbitration or ad hoc arbitration. In India,
institutional arbitration had, initially, failed to take off as expected and most parties preferred to go in for ad hoc arbitration. This was possibly due to the lack of enough institutional arbitration facilities. However, it must be said that in the light of the rapid development of the Indian industry and the creation of efficient facilities for institutional arbitration, both in India and globally, settlement of disputes by arbitral institutions is fast gaining popularity.

In this case, as discussed above in a brief manner, the said provision was tested where it was unsuccessfully argued that where each party thereto had agreed to appoint an arbitrator, and the two arbitrators so appointed were to jointly appoint a third arbitrator, the said arbitration agreement was invalid since technically the parties have appointed an even number of arbitrators, irrespective of the fact that the same agreement contemplates that the two arbitrators will appoint a third arbitrator. The Honourable Supreme Court (‘Supreme Court/Court’) also held that the validity of an arbitration agreement did not depend on the number of arbitrators specified in such agreement.