

Dispute Resolution Hotline

February 05, 2011

NO REASONS RECORDED BY ARBITRATOR - AWARD INVALID!

The Supreme Court of India ("**Supreme Court**"), in pronouncing its ruling on January 4, 2011, in the case of the *State of U.P. and Ors ("Appellant") v. Ms Combined Chemicals Company Private Limited ("CCCPL")*¹, set aside the order of the Allahabad High Court and held that the arbitrator is bound to assign reasons for his award, and failure to do so, renders the award invalid.

BRIEF FACTS

In 1985, the Directorate of Industries, Uttar Pradesh ("**Directorate**"), invited bids for the supply of zinc sulphate to the State Agricultural department. The tender form issued at the time of the bid contained a provision stating disputes arising out of the arrangement between the parties shall be referred to arbitration. Of the bids received, CCCPL's offer was found to be lowest and accepted. Accordingly, the Directorate issued an acceptance letter to CCCPL for the supply of zinc sulphate ("**Acceptance Letter**").

Disputes arose between the parties when the Directorate subsequently received another offer lower than CCCPL's offer and as a result, deferred the arrangement with CCCPL. CCCPL invoked arbitration (under the old Arbitration Act of 1940) based on the clause in the tender form. The Arbitrator appointed to settle the matter passed an award in favor of CCCPL by directing the Appellant to compensate CCCPL ("**Award**").

The Appellant challenged the Award in the Allahabad High Court which dismissed its objections.

The Appellant, thereafter, filed an appeal before the Supreme Court, where the following questions came up for consideration:

1. Whether the Acceptance Letter constituted a contract between the parties and accordingly, whether the arbitration clause in the tender form could be invoked,
2. Whether there was a violation of the rules of natural justice by declining the Appellant's prayer for adjournment and passing of the Award, and
3. Whether the Award is vitiated by patent error of law, *inter-alia*, on the ground that it was passed without assigning any reason or without recording a finding.

RULING

After considering the facts of this case, relying upon judicial precedents and relevant provisions of the Sale of Goods Act, 1930, the Supreme Court concluded that the issuance of the Acceptance Letter by the Appellant was sufficient to conclude that a contract existed between the parties and the fact that the Appellant did not sign a formal agreement sent by CCCPL cannot lead to an inference that the contract has not been executed. Therefore, CCCPL was entitled to invoke the arbitration clause as provided in the tender form.

On the issue of violating the rules of natural justice, the Supreme Court concluded that at one stage, the Arbitrator accepted the request made by the Appellant to adjourn the arbitration proceedings in view of the appeal proceedings pending, however, as there was no stay of the appeal proceedings obtained by the Appellant, the Arbitrator had every reason to proceed with the matter and pass the Award ex-parte since the Appellant did not bother to participate in the arbitration proceedings. Therefore, the Appellant could not have raised the issue of denial of reasonable opportunity of hearing.

The Supreme Court, however, did find merit in the Appellant's contention and on a perusal of the Award, observed that the Arbitrator had passed the Award in a casual manner, without awarding any reasons thereto and without taking into consideration the relevant materials in order to record its findings. The Supreme Court, relying on past precedents, held that the Arbitrator was bound to examine the tenability of the claim made by CCCPL under different heads and decide the same by assigning some reasons, howsoever briefly. Failure to do so did render the award invalid and this ground alone sufficed for setting aside the award. The Supreme Court ordered recommencement of the arbitration proceedings between the parties and directed the Arbitrator to decide on the issues and pass an award only after providing due opportunity to and accumulating adequate evidence from the parties.

ANALYSIS

The old Arbitration Act of 1940 did not include provisions to state that an arbitral award must be supported by reasons. The provisions of the Arbitration and Conciliation Act, 1996 ("**New Act**"), though, now stipulate the form and contents of an arbitral award, and amongst the requirements, categorically provide for an arbitral award to state reasons upon which such award is based. The only exceptions to this requirement are in instances when, (i) the parties to the arbitration have agreed that no reasons are to be accorded, and (ii) the award is passed based on the parties consenting to a settlement of the dispute.

With prior judgments having tilted both ways – that an arbitral award need not necessarily be supported by reasons,

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and in other instances that it must include reasons - this ruling, in an effort to be consistent with the requirements under the New Act, re-emphasizes the fact that arbitrators must, in all fairness, set out reasons while passing an arbitral award unless otherwise agreed by the parties and ensure adherence to the provisions under law.

As an added measure, while drafting an arbitration clause in an agreement, it may be prudent to also specify that the award passed by the arbitrator will set out detailed reasons. Particularly, this will be useful in instances where parties decide to resort to ad-hoc arbitration.

Khushboo Baxi & Vyapak Desai

1 Civil Appeal No. 5236 of 2007

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