(2007) 10 AP CK 0002

Andhra Pradesh High Court

Case No: Arbitration Application No. 48 of 2007

Thermax Limited		APPELLANT
	Vs	
Arasmeta Captive Power Co. Pvt. Limited		RESPONDENT

Date of Decision: Oct. 23, 2007

Acts Referred:

- Arbitration and Conciliation Act, 1996 - Section 11, 11(1), 11(2), 11(3), 11(4)

Citation: (2008) 1 ALT 788

Hon'ble Judges: V.V.S. Rao, J

Bench: Single Bench

Advocate: Venkateswara Rao Gudapati, for the Appellant; Vilas V. Afzal Purkar, for M. Papa Reddy, for the Respondent

Final Decision: Dismissed

Judgement

@JUDGMENTTAG-ORDER

V.V.S. Rao, J.
This application is filed u/s 11(6) of Arbitration and Conciliation Act, 1996 (the Act, for brevity) read with Scheme of Appointment of Arbitrators, 1996, framed by Hon''ble the Chief Justice of Andhra Pradesh. The applicant, M/s. Thermax Limited, prays this Court to appoint second arbitrator in terms of Section 11(6) of the Act for the purpose of constituting Arbitral Tribunal to adjudicate the claims of the applicant.

2. The applicant is an incorporated company engaged in the business of design, engineering, procurement, supply of equipment and components constituting Boiler and Balance of Plant. The respondent company is also an incorporated entity. It is a Special Purpose Vehicle (SPV) formed for designing, developing, establishing and operating a 43 MW coal based power plant at Arasmeta, Janjgir-Champa District, District, Chattisgarh. The contract of designing, engineering, procuring, transportation, supplying the equipment and components for the project titled

"Boiler and Balance of Plant Agreement" was awarded by the respondent to the applicant. The supply agreement was entered into on 24-5-2005. Clause 27 of the agreement deals with dispute resolution and Clause 27.2 provided for arbitration " in case the parties are unable to resolve the dispute" by themselves, as per the redressal mechanism contained therein.

3. It is the case of the applicant that in terms of the supply agreement, the applicant delivered to the respondent equipment components and machinery constituting Boiler and Balance of Plant for the power plant. In November 2006, performance trials were allegedly conducted in accordance with the pre-approved performance test procedures, to the satisfaction of respondent. The respondent commenced the power plant but due to alleged mis-handling/improper use of equipment by the use, problems cropped up which were promptly rectified by the applicant as a gesture of goodwill. The power plant is fully operational and respondent never alleged any default/breach of performance under the supply agreement.

4. It is further case of the applicant that in spite of diligence and prompt performance of all obligations by the applicant, respondent committed the following breaches.

(i) Withdrawal of payable amounts including service tax to a tune of Rs. 10,36,000/-;

(ii) Non-payment of Rs. 86.00 lakhs with interest towards excess material at the project site, which was not allowed to be removed;

(iii) Payment of Rs. 21,24,200/- with interest thereon towards import duty benefit due to non-issuance of installation certificate of Boilers by the respondent;

(iv) Deviation of routing of transmission lines from specifications agreed by the parties;

(v) Payment of Rs. 3,03,530/- towards interest on certain supplies dispatched by the applicant prior to the letters of credit being operable; and

(vi) Failure of respondent to supply coal as per specifications provided in the supply agreement.

5. Apart from these, the applicant is entitled to fee towards operation and maintenance service in a sum of about Rs. 1,38,77,547A Rs. 3.00 lakhs towards compensation for re-designing of vibrating screens of coal handling system, Rs. 18.00 lakhs towards cost of steel and overheads for supply of additional tension towers. Besides claim for damages, applicant addressed letters/demand notices on 26-10-2006, 11-12-2006, 28-12-2006, 8-1 -2007,11 -1 -2007 and 28-2-2007 allegedly demanding resolution of issues by the respondent in accordance with Clause 27-1-1 of the supply agreement, in vain. As a result of inaction and failure to respond for resolution of issues, applicant nominated their arbitrator vide letter dated 2-5-2007 calling upon respondent to nominate another arbitrator so that parties'' arbitrators

can appoint a third arbitrator for resolving the dispute. In the meanwhile applicant also moved an application u/s 9 of the Act being O.P. No. 1 of 2007 on the file of the Court of Vacation Civil Judge, City Civil Court, Hyderabad, for appropriate interlocutroy orders against respondent. Thereafter present application is moved for appointment of second arbitrator to constitute arbitration tribunal.

6. Respondent, through its Company Secretary and authorized signatory filed counter affidavit, opposing the application. An objection is raised with regard to maintainability of application u/s 11(6) of the Act. It is contention of respondent that applicant did not ever raise dispute nor followed dispute resolution procedure in Clause 27 of the ''Boilers and Balance Agreement'' dated 24-1-2005. It is further contention that applicant is under an obligation to serve a written notice on respondent if it had a genuine dispute of controversy and within twenty days from receipt of notice from the date of such notice there shall be meeting of parties with good faith to amicably resolve the dispute. If parties failed to resolve the dispute within sixty days of such notice, then the dispute shall be referred to arbitration under Clause 27.2. The applicant violated the terms of agreement and without resorting to dispute resolution procedure straightaway approached this Court with unclean hands for appointment of second arbitrator u/s 11(6) of the Act. It is further alleged that applicant issued notice to respondent vide letter dated 17-7-2007 alleging disputes for the first time, which itself establishes the fact that the applicant failed to comply with pre-arbitration redressal procedure prescribed under the agreement.

7. In addition to above objections for appointment of arbitrator, respondent has further made the following averments. Applicant entered into four different contracts with respondent. These are (1) Boiler and Balance Agreement dated 24-1-2005; (2) Erection and Commissioning agreement, dated 1 -2-2005; (3) Contract for Civil Works, dated 1-2-2005; and (4) Umbrella agreement, dated 8-2-2005. The sister concern of applicant, namely, M/s. Thermax Engineering Construction Company Limited (TECCL) signed erection and commissioning contract for civil works. Umbrella agreement was signed by applicant on 8-2-2005 and Clause 17 thereof provides quantum of liquidated damages that can be levied on the applicant on account of performance under each of four contracts. The applicant is bound by the said clause for performance of obligations under Umbrella agreement, for any failure or breach on the part of applicant or by its sister concerns. While reiterating workable aspects of Boiler and Balance agreement, respondent alleged that applicant abandoned project midway and respondent had to get the balance work done through other contractors for its project at a huge extra cost. The performance trials were conducted in November 2006 only in respect of equipments commissioned by the applicant. The Rotor Blade of the Turbine was damaged by applicant while conducting the erection carelessly. Respondent had to send Turbine to BHEL, Hyderabad, from Chattisgarh for repair by incurring an amount of Rs. 1.55 crores. Applicant failed to adhere to time schedule in supply of boilers and parts

used by applicant were not only defective but of substandard. There was regular correspondence by respond pointing out the failure in performance of applicant''s obligations. Applicant gave assurance that these will be sorted out. The allegation that respondent committed breach is denied. All other allegations and claims made by applicant are denied.

8. Learned Counsel for applicant submits that letters addressed by applicant, the details of which are given in Paragraph 12 at page 12 of statement annexed to arbitration application, would show that they were in compliance with Clause 27-1-1 and therefore applicant was well within its rights in nominating their arbitrator under Clause 27-2-1 read with 27-2-3. Alternatively he submits that even if applicant cannot be held to have availed pre-arbitration mechanism for redressal, still applicant can appoint an arbitrator in which event it is obligatory on the part of respondent to appoint their arbitrator under Clause 27-2-3.

9. Learned Senior Counsel appearing for respondent placed strong reliance on The Iron and Steel Company Limited Vs. Tiwari Road Lines, , Municipal Corporation, Jabalpur and Others Vs. Rajesh Construction Co., , and India Household and Healthcare Ltd. Vs. LG Household and Healthcare Ltd., , in support of the contention that a reference for arbitration shall not be maintainable unless the procedure and mechanism agreed to by and between the parties is complied with. He would urge that the applicant never invoked Clause 27-1-1 and various letters relied on by applicant are of no avail.

10. Two questions would fall for consideration. These are: (1) Whether covenanted mechanism for redressal of disputes is mandatory obligation and is a condition precedent for invoking arbitration clause; and (2) Whether applicant has availed the procedure and mechanism agreed to by and between the parties for pre-arbitration resolution of issues.

11. The National Law on arbitration and conciliation is essentially structured drawing and incorporating core aspects of Model Law on International Commercial Arbitration, which was adopted by the United Nations Commission on International Trade Law (UNCITRAL). There is no dispute that UNCITRAL Model Law provides for appointment of a third arbitrator if both the parties fail to reach a consensus thereon. But when once the arbitration procedure or arbitration agreement provides for the procedure for appointing arbitrator(s), which is agreed upon by the parties to the agreement, failure in such direction does not confer any power on the designated authority like Chief Justice or the institution/person authorized by him to usurp jurisdiction and appoint arbitrator thereby dragging the parties to arbitration even though they fail to comply with agreed procedure for appointment of arbitrator. These principles are adumbrated in Section 11 of the Act.

12. Section 11(1) to (6) of the Act, which are relevant for the purpose, read as under.

11. Appointment of arbitrators

(1) A person of any nationality may be an arbitrator, unless otherwise agreed the parties.

(2) Subject t 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-sections (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 or 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 to 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 the a party, by the chief Justice or any persons 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 a necessary measure, unless the agreement on the appointment procedure provides other means for securing the appointment.

13. Sub-section (2) of Section 11 of the Act enables the parties to agree on a procedure for appointment of arbitrator. This sub-section is subject to Sub-section (6) of Section 11. Reading Sub-section (2) and Sub-section (6) of Section 11, in one go, means that only when the party tails to act as required under the procedure agreed upon the Chief Justice or person designated by him can appoint an arbitrator. The parties therefore must attempt to seek redressal for the grievance by following procedure under the agreement and reach a conclusion that such attempts failed. These are condition precedent for invoking Section 11(6) of the Act. In the absence of compliance with the procedure agreed upon by any of the parties,

the Court cannot appoint arbitrator(s). This position is well settled.

14. In The Iron and Steel Company Limited Vs. Tiwari Road Lines, , Rajesh Construction Company; respondent therein; which was awarded contract for construction of a road, filed application u/s 11(6)(c) of the Act for appointment of arbitrator to adjudicate the dispute. A learned single Judge of Madhya Pradesh High Court allowed the application. This was assailed before the Supreme Court, it was submitted for the Corporation that it was not open to High Court to appoint arbitrator without the party complying with Clause 29 of the Contract. The said clause inter alia, provided that all questions and disputes relating to contract shall have to be referred to Chief City Engineer (CCE) within a period of thirty days of such occurrence whereupon CCE was required to issue instructions; within sixty clays of such request. If the CCE fails to do so, the party was given a remedy of appeal to Municipal Corporation within thirty days, which was required to be decided within ninety days, if the party is not satisfied with such decision, the matter can be referred to arbitration. The submission of the Corporation was accepted by Supreme Court and it was laid down as under.

Clause 29 specifically stipulates, as indicated herein earlier, that if any dispute arises between the parties, the party seeking invocation of the arbitration clause, shall first approach the Chief Engineer and on his failure to arbitrate the dispute, the party aggrieved may file an appeal to MPL Commissioner failing which, the Corporation shall constitute an Arbitration Board to resolve the disputes in the manner indicated in Clause 29. However, before doing so, the party invoking arbitration clause is required to furnish security of a sum to be determined by the Corporation.

In this case, admittedly, the security has not been furnished by the respondent to the Corporation, We, in fact, asked Mr. Sharma, appearing on behalf of the respondent to ascertain on the date of the hearing of the appeal, whether the security deposit was made or not. On instruction, Mr. Sharma informed us that such security has not yet been deposited. Such being the position even today, we hold that the obligation of the Corporation to constitute an Arbitration Board to resolve disputes between the parties could not arise under 29(d) of the contract. Therefore, we are of the opinion, that on account of non-furnishing of security by the respondent, the question of constituting an Arbitration Board by the Corporation could not arise at all. Accordingly, we hold that the High Court was not justified in appointing a retired Chief Justice of a High Court as Arbitrator by the impugned order.

(emphasis supplied)

15. In India Household and Healthcare Ltd. Vs. LG Household and Healthcare Ltd., , the above view was reiterated by the Supreme Court and it was held that, "an application for appointment of arbitrator is not maintainable unless the procedure and mechanism agreed to by and between the parties is complied with."

16. In the The Iron and Steel Company Limited Vs. Tiwari Road Lines, , the Supreme Court after referring to earlier case law reiterated the legal position and (aid down as under.

The legislative scheme of Section 11 is very clear. If the parties have agreed on a procedure for appointing the arbitrator or arbitrators as contemplated by Sub-section (2) thereof, then the dispute between the parties has to be decided in accordance with the said procedure and recourse to the Chief Justice or his designate cannot be taken straightaway. A party can approach the Chief Justice or his designate only if the parties have not agreed on a procedure for appointing the arbitrator as contemplated by Sub-section (2) of Section 11 of the Act or the various contingencies provided for in Sub-section (6) have arisen. Since the parties here had agreed on a procedure for appointing an arbitrator for setting the dispute by arbitration as contemplated by Sub-section (2) and there is no allegation that anyone of the contingencies enumerated in Clauses (1) or (b) or (c) of Sub-section (6) had arisen, the application moved by the respondent herein to the City Civil Court, Hyderabad, was clearly not maintainable and the said court had no jurisdiction to entertain such an application and pass any order. The order dated 27-12-2004, therefore, is not sustainable.

In the matter of settlement of dispute by arbitration, the agreement executed by the parties has to be given great importance and an agreed procedure for appointing the arbitrators has been placed on high pedestal and has to be given preference to any other mode for securing appointment of an arbitrator. It is for this reason that in Clause (1) of Sub-section (8) of Section 11 of the Act, it is specifically provided that the Chief Justice or the person or institution designated by him, in appointing an arbitrator, shall have due regard to any qualifications required of the arbitrator by the agreement of the parties.

17. Thus having regard to settled law and binding precedents, on point No. 1 it must be held in the absence of compliance with the procedure and mechanism agreed upon by the parties, the application u/s 11(6) of the Act would not lie.

18. In examining the second point for consideration it is to be seen whether at any time prior to filing the present application, applicant complied with or attempted to comply with Clause 27.1.1, to enable respondent to act in accordance with Clause 27.1.2. Applicant relies on various communications/notices issued by applicant on 26-10-2006, 11-12-2006, 28-12-2006, 8-1-2007, 11-1-2007 and 28-2-2007, which are enclosed to the application as Annexures-B to G. Be it noted that Annexure-B is a letter addressed by Sri M.L. Bindra (Head-EPC Operations, M/s. Thermax Limited) to Mr. K.A. Sastry of Arasmeta Captive Power Co. Pvt. Ltd. Annexures-C, D and G are letters addressed by R.V. Ramani (Head-Cogen Division). Annexures-E and F are addressed by A.K. Dhoke on behalf of TECCL with whom respondent entered into erection and commissioning agreement and contract for civil works. Be that as it is, none of these six documents referred to Clause 27.1.1 nor any notice of dispute was

given. Reference to these six documents cannot lead to a conclusion that pre-arbitration procedure and mechanism was complied with by applicant. Indeed on 17-5-2007, after filing the present application before this Court, TECCL addressed a letter to respondent giving notice of dispute as contemplated under the agreement. This would belie any contention of applicant that there was due compliance with pre-arbitration procedure and mechanism agreed upon. The submission that letter dated 17-7-2007 was addressed by TECCL has no relevance, cannot be accepted. Under the umbrella agreement dated 8-2-2005, applicant as well as its sister concern were burdened with certain obligations. It must be held that this application u/s 11(6) of the Act without complying with accepted pre-arbitration procedure and mechanism as provided for in Clauses 27.1.1 and 27.1.2 is not maintainable.

18.1 In the result, for the above reasons, this application is dismissed.