

"Finance Companies Take Note: The Perils of Taking Arbitration Clause Easy"

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The treatment of arbitration proceedings by finance companies as a mere formality came under scanner of the High Court at Calcutta in the case of *Rasal Dilip Damodar v Srei Infrastructure Finance Limited and Anr.* In its order dated 14th May 2010, Hon'ble Justice Sanjib Banerjee in a very well worded judgment came down heavily upon the manner of conduct of entire arbitration proceedings by the finance company and the sole arbitrator and scornfully denounced the perfunctory, callous and unjust manner in which arbitration proceedings were carried out by the finance company with the aid of its 'pocket' arbitrator. It is noteworthy that leave was granted to the Respondents to initiate criminal action against the arbitrator, finance company and others.

Facts of the case:

Under an agreement dated 14-11-2000, the finance company made funds available to the hirer for acquiring a tractor with a trailer manufactured by Volvo India Limited. The tenure of agreement was 55 months commencing from January 2001 and ending July 2005. The agreement contained an "Arbitration clause" which contemplated reference of disputes to the sole arbitration of an arbitrator named therein. Incidentally, the name of the arbitrator was inserted in hand. The clause also provided arbitrator summary powers and stated that the arbitrator could be an employee or a person associated with the financier. The arbitrator was not required to give any reasons for his award and the arbitration was to be completed within four months of reference unless the parties agreed for extension.

On 18-11-2000, the tractor-trailer met with an accident. Insurance claim was processed and letters were exchanged between the parties. By its letter dated 18th February 2006, the finance company claimed a sum of Rs.61,24,000/-, and after giving credit to the payment of insurance claim, salvage value, sale proceeds of trailer and security deposit, the finance company claimed a net amount of Rs.18,67,150/-. The guarantor vide his letter dated 16-3-2006 responded to the aforesaid letter and disputed the claim.

It appears that the finance company referred the matter to arbitration on 25-1-2007. The arbitrator by letter dated 29-1-2007 forwarded a copy of the claim to the respondents directing them to file counter statements by 26-4-2007 and the hearing was fixed on 27-4-2007. Since the respondents did not appear, the hearing was adjourned to 20-9-2007. Once again no respondent appeared and the hearing was adjourned to 21-4-2008, which was further adjourned to 21-11-2008 and to 19-12-2008 and 12-2-2009. Ever since the commencement of arbitration proceedings, for the first time, one of the respondents (the guarantor) responded on 5-2-2009 by

filing his response. The proceedings continued and finally closed on 31-7-2009. The award was made on 9-9-2009 and served on the respondents.

It may be noted that the hirer never joined the arbitration proceedings and the guarantor joined the same only in February 2009, that is, two years after the arbitration commenced in January 2007.

Findings of the High Court:

The following findings of the High Court arrived at after detailed understanding of the facts deserves attention:

- (a) The Arbitrator regularly acted as an Arbitrator for various finance companies including the claimant-finance company.
- (b) The letter of claimant-finance Company, through its advocate, to the arbitrator referring the matter to arbitration was **not marked** to the respondents as well.
- (c) The first meeting of arbitration was fixed on 27th April 2007. The notice of this meeting was given on 29th January 2007. This notice also required the Respondents' to file their counter claims by 26th April 2007. Nobody appeared on 27th April 2007 and the matter was adjourned to 20th September 2007 by a letter dated 27th April 2007. **This letter and subsequent letters do not contain any reference to filing of counter statements by the Respondents.**
- (d) The minutes of the arbitration meeting held on 20th September 2007 recorded that the next arbitration meeting was on 21st April 2008 and the claimant was to serve notice upon the respondents by Registered post. **The High court noted that the Arbitrator delegated to the finance company the function of serving of notice to the Respondents in adversarial proceedings.**
- (e) The minutes of 21st April 2008 reveal that the claimant did not serve the notice of the meeting on the respondents through inadvertence. The claimant were once again required to serve the minutes of meeting held on 21st April on the Respondents and the minutes also recorded that no separate notice of meeting was required to be served on Respondents, and if they do not appear, the arbitration shall proceed ex-parte. **The High Court observed that the recordings betrayed the state of mind of the arbitrator since there was no corresponding warning to the claimant that the reference would stand dismissed upon the claimant's absence on the next date.**
- (f) The first hearing was purportedly on 27th April 2007, the next on 20th September 2007, that is, after about 5 months, and the next was on 21st April 2008, that is, after 7 months. **The High court observed generally Finance companies have no interest in dragging any arbitral reference where they are the claimants and do not allow defaulting**

hirers much breathing space. Unusual and abnormal hiatus was given in the present case.

- (g) Only subsequent to October 31, 2008, the postal records were maintained. There was nothing in the records of the arbitrator to show any attempt at service of any notice relating to the reference on the respondents to the reference prior to November 1, 2008. Insinuating that the documents produced by the arbitrator and finance company may be fabricated or ante-dated, the High court observed that reason for the same was to overcome limitation and to have a live claim to go to arbitration.

Decision of the High Court:

Finding gaping holes in every letter, minutes or documents which the arbitrator or the finance company produced in regard to the arbitration reference and dissecting every sentence of the Arbitration award to highlight its nonchalant and routine character, the High Court made some scathing and caustic observations which are noteworthy. No doubt an arbitration proceeding is an informal proceeding and is not bound by the shackles of technicalities, but in the instant case, the High Court was of the view that the level of informality was taken to such an absurd extent that it suggested that *“the arbitrator and claimant were, possibly, extension of each other.”*

The routine recordings in the award and its mechanical nature were highlighted in the following words:

“There is no discussion in the award as to the merits of the matter. In effect, there are no reasons furnished in support of the award that the 1996 Act commands an arbitrator to supply.....There is no reference to any material. There is no indication as to how the mind was applied to any fact to reach the conclusion. Reasons are the links between the facts and the conclusion that indicate as to how the mind was applied to the matters in hand. There is no analysis of any evidence. After all, this was no run of the mill default by the hirer in paying instalments; there was an accident to the asset almost at the factory gates of the dealer that resulted in the complete loss of the tractor and some damage to the appendage that was the trailer which was subsequently possessed by the financier after it was repaired and sold off.The award does not reveal that it dawned on the arbitrator that the hirer did not have any opportunity to enjoy the asset as it met with an accident within four days of the execution of the agreement, whether or not the accident occurred when the vehicle was in the constructive possession of the hirer. The award does not show that the arbitrator thought it fit to consider whether the terms of the agreement warranted the respondents to be foisted with the liability on account of the entire complement of instalments payable thereunder notwithstanding the said accident.”

On facts, the High Court almost concluded that the documents produced by the finance company were fabricated, may be with a view to survive the clutches of limitation. The observations made in this connection will have far reaching implications and will haunt finance companies and the arbitrators for long time to come –

“Once it is evident that there was no intimation to the hirer or the guarantor of the alleged commencement of the reference for a period of nearly 22 months after it

allegedly commenced, there is no need to look any further. But there was even more ghastly mischief afoot in the reference. There does not appear to have been any reference prior to October 31, 2008; **the records were concocted to give them an appearance of authenticity. To sustain this award by any quirk of law or the strained application of any legal principle would do violence to the rudimentary concept of justice, be opposed to public policy and a slur on the process of adjudication that an arbitral reference connotes.** (emphasis supplied)

In conclusion, in beautifully worded passage, Hon'ble Justice Sanjib Banerjee expressed the nature and scope of arbitration proceedings and duties cast on arbitrator. Exposing the bias frame of mind of and abuse of position by the arbitrator, he admonished the award as utterly unjust:

“..... There is a general duty cast on an arbitrator to act fairly and impartially as between the parties. In weighing the evidence as to this arbitrator's partiality, it has to be assessed whether the circumstances bearing on the allegation of partiality, or as things appear from the records, would lead a fair-minded and informed observer to conclude that there was a real possibility that the arbitrator was biased. The fact that the arbitrator has taken up many a previous reference relating to this finance company may not, by itself, amount to lack of independence which would have rendered him incapable of conducting the reference. The circumstances here reveal a fundamental abuse of his position by the arbitrator. A reference to arbitration is ordinarily an alternative to an action in court. Even though an arbitral reference is shorn of the technicalities and the level of formality that are associated with a court, the basic elements of fairness, impartiality and disconnection cannot be compromised for expedience or efficacy or some evil design. The misconduct on the part of this arbitrator involves personal turpitude on the part of the arbitrator amounting to subversion of the process of adjudication that has resulted in complete miscarriage of justice. The right to a fair adjudication is a natural right and inheres in every individual and juristic entity. The records of the arbitrator unmistakably point to the sabotage of the process of adjudication. The award is not only abhorrently bad and liable to be set aside, but it appears to be a vicious merchandise of criminal conduct reeking of collusion.”

Takeaway:

The Finance Companies should no longer consider Arbitration clause in the finance agreement as a mere formality and should invoke the same with great sense of responsibility. The arbitrator is in a position of a judge and should not pass awards only to the advantage of the finance company without going into the facts and circumstances of the case; he should maintain proper records of arbitration proceedings and his unbiased reasoning and application of mind should be manifest in his award unambiguously.