

FIDC

## Finance Industry Development Council

*(A Representative Body of NBFCs in India)*

101/103, Sunflower, 1<sup>st</sup> Floor, Rajawadi Road No.2, Ghatkopar (East), Mumbai – 400 077

Tel: 022 21029898/9820035553 • E-mail: [directorgeneral@fidcindia.org.in](mailto:directorgeneral@fidcindia.org.in)



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July 01, 2023

To  
The Secretary  
The Department of Legal Affairs  
Ministry of Law and Justice  
Government of India  
e-mail: [milind.mujumdar@gov.in](mailto:milind.mujumdar@gov.in), [ndiac-dla@gov.in](mailto:ndiac-dla@gov.in)

Madam/Sir,

**Sub: Request for comments from stakeholders on the working of Arbitration Law in the Country and need for reforms to the Arbitration and Conciliation Act, 1996 to improve the overall Arbitral ecosystem.**

**Ref: Notice dated 22/06/2023 from Department of Legal Affairs, Ministry of Law and Justice, Government of India inviting comments from stakeholders.**

With reference to the above subject, we wish to submit the following:

1. **Finance Industry Development Council (FIDC)** is a Representative Body of NBFCs registered with the Reserve Bank of India. FIDC was formed 18 years ago and is the recognized face of the NBFC sector. We have been engaged in regular interaction both with Reserve Bank of India and Govt. of India, which include pre-budget meetings and also important policy related meetings with RBI. Almost all the leading NBFCs and a large number of small and medium sized NBFCs are our members. FIDC's main aim is to aid, help and encourage the business of Non-Banking Financial Companies (NBFCs) engaged in the business of leasing, hire purchase, lending against mortgage/hypothecation of assets, loan securitization, investments, asset management services and to devise and formulate code of



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conduct and to set standard practices and systems for the NBFCs, to ensure sustainable growth in the sector. Our members play an important part in the economic progress of the country by providing last mile credit delivery to millions of MSMEs and self-employed for their business purposes.

2. We are given to understand that the Government of India has constituted an expert committee under the Chairpersonship of Dr. T.K. Viswanathan, Former Law Secretary, to examine the working of Arbitration Law in the Country and recommend reforms to the Arbitration and Conciliation Act, 1996 (Act) and we are happy that the Government has come up with a progressive initiative to refine and reform the process of Arbitration in India. As required under the notice under reference, we furnish the following suggestions:

### **A) APPOINTMENT OF ARBITRATOR:**

- i) We submit that the members of NBFCs are engaged predominantly in the business of extending retail and MSME loans to the deserving sections of the Society. The ticket size of the loan varies from Rs.50,000/- to few crores depending upon the profile and needs of the borrower. The recovery of the amounts from the defaulting borrower is predominantly through Arbitration process, as SARFAESI Act applies to NBFCs only for the loan of Rs.20.00 lakhs and above. Historically, the loan agreements of most of the NBFCs contain an Arbitration Clause whereunder all the disputes, differences and/or claim arising out of the agreement shall be settled by Arbitration by referring to the Sole Arbitration of an Arbitrator nominated by NBFC/its Managing Director/Director. The process of appointment of arbitrator in the above system is referred to as Unilateral appointment of Arbitrator by various courts. We have been following this process for a long time and have been successfully conducting the Arbitration through a Sole Arbitrator appointed under the above process even from the advent of 1940 Act which has been strictly in accordance with the principles of natural justice. In fact, the said process has been upheld by various courts



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including the Apex Court in *Datar Switchgear Ltd. Vs. TATA Finance Ltd.* and another reported in (2000) 8 SCC 151.

- ii) We submit that 2015 amendment to the Act has completely revamped the existing Arbitration process in India and Section 12 was amended by introducing Schedules V & VII. We submit that Schedule V enumerates few grounds giving rise to justifiable doubts as to the independence and impartiality of Arbitrators. Among them, the notable grounds under Clauses 22 & 24 give rise to various interpretations in so far as the grounds of challenge to appointment of the arbitrator are concerned. Clause 22 deals with the relationship of the arbitrators with the parties or counsel giving rise to doubts on the independence and impartiality of the Arbitrator when the Arbitrator has been appointed, within three years, as Arbitrator on two or more occasions by one of the parties or an affiliate of one of the parties. Clause 24 is about the justifiable doubts on the independence or impartiality of Arbitrator when the Arbitrator currently serves within the past three years as Arbitrator in Arbitration on a related issue involving one of the parties or an affiliate of one of the parties. However, explanation 3 to Schedule V gives an exemption to the fields like maritime or commodities Arbitration from the rigor of Schedule V for the reason that only small and specialized pool is available in these kinds of Arbitration. We further submit that Clauses 5 & 12 of Schedule VII make an Arbitrator ineligible if he/she is a Manager, Director or part of the management in one of the parties or in its affiliate. Here also, the Commodities and Maritime Arbitration are excluded from the purview of Article 7. Interestingly, nowhere the party autonomy in appointing Arbitrator by one of the parties is prohibited and in fact, Clause 22 of Schedule V permits appointment of the Arbitrator by one of the parties in one case over a three-year period.
- iii) We submit that our members being retail/MSME financiers deal with tens of thousands of disputes in a year and most disputes are resolved by Arbitration. Interestingly, if the cap for number of cases for an arbitrator is to be strictly



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followed, each company would require three times of the number of Arbitrators in their panel of Arbitrators. For example, if a Company initiates 10000 arbitration cases per year and in three years, they may initiate 30000 arbitration cases and if Schedule V is to be strictly followed, they will be forced to find a very large number of arbitrators in their panel to strictly comply with the terms of Article V which will be a futile exercise.

- iv) We are afraid that while incorporating Schedules V and VII in the Act, the legislature did not keep in mind the gravity of the retail arbitration in India. Therefore, it requires separate and simplified rules for the retail arbitrations in India keeping in mind the volume of cases and the quantum of claim in each case. As such, the party autonomy in appointment of the arbitrator by one of the parties is to be preserved as it was subject to the adherence of principles of natural justice by the arbitrator so appointed.
- v) We submit that series of decisions by Hon'ble Supreme Court from 2017 have made it clear that unilateral appointment of arbitrators by one of the parties to the arbitration is strictly prohibited and the proceedings by the unilaterally appointed arbitrator are declared void ab-initio which made the awards already obtained by NBFCs unenforceable.
- vi) We state that the NBFCs who are in retail business of lending have no other choice except to go for unilateral appointment of arbitrator for the following reasons:
  - a) There is no infrastructure for conducting the institutional arbitration in India much less the availability of Arbitral institutions itself in tier-II cities. It is an expensive and time-consuming affair for the parties to approach the High Court for appointment of arbitrator in each and every case as NBFC sector has tens of thousands of cases.



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- b) There is no express prohibition for unilateral appointment of arbitrator in 2015 amendment. Even Clauses 22 & 24 of Schedule V enumerate the grounds that give rise to justifiable doubt on the independence and impartiality of the arbitrator could be overcome by the arbitrator if he/she is able to prove that the proceedings were conducted in an independent and impartial manner. We reiterate that mere appointment of the same arbitrator more than once in three years by one of the parties may not itself render the arbitration proceedings void.
- c) Availability of the number of arbitrators is limited and if the clauses in Schedule V and VII are to be followed strictly, the arbitration mechanism will fail in India and the parties will be driven to the Court for their remedies which will choke the already burdened judicial system.
- vii) It is to be noted that under SARFAESI Act, the Banks & financial institutions are given full right and authority to proceed with the recovery action without intervention of court and the same is not termed as unilateral, of course with some checks and balances under the Act. Similar powers may be given to the finance companies for recovery of the debts due to them by allowing them to make unilateral appointment subject to the rigors of following the rules and regulations to be imposed upon.
- viii) We submit that since the NBFCs have obtained Lakhs of arbitral awards in the past 7 or 8 years and if the said awards are declared as unenforceable due to unilateral appointment, it will be a deadlock for the NBFCs for recovery of the amount in arbitration as limitation would have expired in most of the awards which will consequently have negative impact on the economy.
- ix) We submit that the arbitration mechanism in India will be seriously impacted if strict rules governing the appointment of arbitrator are followed in respect of the retail domestic arbitration given the non-



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practicality of the said rules. Arbitration is a softer means to settle disputes and therefore needs to be encouraged and simplified to prevent the legal system getting clogged and to reduce cost of litigation for both parties.

- x) Interestingly, the amendments made in 2019 to Sec. 11 and the provisions relating to the constitution of Arbitration Council of India are yet to be notified. If the same are notified, few anomalies will be removed.

### **B. Challenge to Arbitral Award - Provision for Deposit of Award Amount:**

- i) Currently, in many cases where defaulting borrowers/parties fail to honour their payment obligations, the burden of making the payment to the Arbitrators often falls on the lenders. This situation creates an imbalance and places undue financial strain on the lenders, especially when the borrower later challenges the arbitral award.
- ii) To address this issue and to ensure effective enforcement of arbitration awards, a provision similar to Section 19 of the Micro, Small, and Medium Enterprises Development (MSMED) Act should be considered. (This provision mandates the deposit of 75% of the award amount by the party against whom the award is made before it can proceed with its application for setting aside an award passed against it). Implementing a similar provision in arbitration procedures would serve as an additional safeguard and enhance compliance with arbitration awards.

### **C. ONLINE DISPUTE RESOLUTION:**

We submit that the world is moving towards paperless litigation. Even the judicial system is actively advocating e-filing of cases and virtual hearings. New generation arbitrators and arbitral institutions do prefer resolution of disputes through online mode with state-of-the-art technology. If a state sponsored



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platform is created for conducting arbitration proceedings, it will help all the litigants.

### **D. RULES FOR ENFORCEMENT OF INTERIM MEASURES:**

We submit that 2015 amendment to the Act is revolutionary and more particularly, providing tooth to the provisions granting powers to the Arbitral Tribunal to pass interim measures was a pragmatic step for the development of arbitration in India. However, there is no clarity on enforcement of the orders passed by the Arbitral Tribunal as different courts interpret the provisions differently. As such, it is imperative that effective and efficient Rules be drafted for enforcement of interim orders (such as injunction, attachment of properties and appointment of receiver/commissioner) by the Arbitral Tribunal which will make the process uniform throughout the country. Technology may also be used in this area.

### **E. ESTABLISHMENT OF EXCLUSIVE COURTS FOR ENFORCEMENT OF ARBITRAL AWARDS FOR RECOVERY OF MONEY:**

We submit that financial institutions are the biggest drivers of the economy and they should be facilitated in bringing back the lost money into the economy. Conversion of bad debts into recovery will boost the economy of the country in a big way. Today, the agony of the creditor starts only after he gets a decree or arbitral award as the enforcement of the same takes decades to see their light since the same depends upon the overburdened judicial system. Execution of decrees or awards is stuck with the obsolete provisions of a century old Civil Procedure Code. If the lost money needs to be brought back into the economy in an expeditious manner, it requires the faster and simplified rules for enforcement of arbitral awards and specialized courts be established for Execution of money decrees/awards.



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3. In the above background, we make the following suggestions:

- i) ***To have separate simplified rules for domestic retail arbitration for recovery of money by the financial institutions upholding unilateral appointment of arbitrator by the Lenders.***
- ii) ***To minimize the intervention of the courts in dealing with petitions under Sec.34 of the Act by imposing a rule for a deposit of at least 50% of the arbitral award for filing such petitions.***
- iii) ***To draft and notify Rules for Online Dispute Resolution and create a platform for conducting the proceedings by the Arbitral Tribunals.***
- iv) ***To draft and notify uniform Rules for enforcement of interim measures granted by the Arbitral Tribunal.***
- v) ***To establish dedicated courts for enforcement of arbitral awards for recovery of money with simplified rules governing the same.***

Thanking you,

Regards

**For Finance Industry Development Council**

**MAHESH THAKKER  
DIRECTOR GENERAL**



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