IJAER/ September-October 2021 /Volume-10/Issue-2 ISSN: 2278-9677
International Journal of Arts & Education Research

ARBITRATION IN BANKING AND FINANCE DISPUTES: RECENT TRENDS

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1.1 INTRODUCTION

Arbitration, as an alternative dispute resolution mechanism, has gained significant traction in India over the past few decades. The country's economic growth, coupled with an increasing number of commercial transactions, both domestic and international, has led to a surge in disputes. The traditional court system, often criticised for its slow pace and backlog of cases, has prompted businesses and individuals to seek faster, more efficient means of resolving disputes. Arbitration has emerged as a preferred choice for many, offering a blend of flexibility, confidentiality and finality that the conventional judicial process may lack.

Arbitration is a separate contract by the separability principle as envisaged under section 16(1)(b) of the Arbitration and Conciliation Act, 1996. An assignment of a contract might result from a transfer either of the rights or of the obligations there under. As a result, obligations under a contract cannot be assigned except with the consent of the promisee and then it is a novation resulting in substitution of liabilities. On the other hand, rights under a contract are assignable unless a contract is personal in nature or the rights are incapable of being assigned. This view has been upheld in DLF Power Limited v. Mangalore Refinery & Petrochemicals Limited & Ors., 2016 SCC Online Bom 5069. The Bombay High Court in its judgment stated that the arbitration clause does not take away the right of assignment of a party to a contract if it is otherwise assignable. The Court noted that there is a clear distinction between assignment of rights under a contract by a party who has performed its obligations there under and the assignment of a claim.

Once the notice has been received, both parties will have to **appoint an arbitrator/s** as per the specifications mentioned in the arbitration clause or agreement. The parties to a dispute have the freedom to choose the number of arbitrators, as long as it's not an even number, but if a number is not specified in the arbitration clause or arbitration agreement, only one arbitrator will be appointed. Also, if parties choose to appoint three arbitrators but do not specify the procedure for their appointment, each party will choose one arbitrator and the two party-chosen arbitrators will choose the third arbitrator who will be on the panel. If one of the parties fails to appoint an arbitrator within the stipulated period, the other party can approach the designated Arbitral Institutions, as per the 2019 Amendment, seeking the appointment of an arbitrator.

1.2 ARBITRATION IN BANKING AND FINANCE DISPUTES: RECENT TRENDS

Financial services institutions have traditionally favoured litigation over arbitration as the forum of choice for dispute resolution. This is unlike other sectors, such as construction, shipping,

and energy where arbitration clauses have long been commonplace in those markets. However, since the mid-2000s there has been a marked increase in the number of banking and finance disputes being resolved by international arbitration; a trend that has continued in the major arbitral institutions over the last five years. The banking and finance sector has been in the top three of the industry sectors in the LCIA Annual Casework Reports for each of the last five years. The sector made up 32% of all cases in 2019, 20% in 2020, 26% in 2021 and 15% in 2022. The category of 'loan or other facility' has also been in the top three of the agreement types for LCIA disputes in three of the past five years. Similar observations can be made for other major arbitral institutions. For example, disputes in the banking and finance sector made up some 13.5% of all HKIAC cases in 2020, 16.2% in 2021 and 36.9% in 2022. Whilst the sector covers a diverse range of institutions and financial products and the decision to choose arbitration over litigation will often depend on the particular circumstances of each transaction, it is nonetheless possible to make some general remarks as to the reasons for the growth in popularity of arbitration.

1.3 FACTORS BEHIND THIS GROWTH

First, the increasing globalisation of finance transactions, and particularly the involvement of parties from emerging market jurisdictions means arbitration has become more attractive to financial institutions. The primary attraction in this context is the enforceability of arbitral awards. Under the New York Convention, which has c.170 countries as contracting states, there is a general obligation for the national courts of each to recognise arbitration awards as binding and to enforce them in accordance with their national rules of procedure (subject to certain exceptions). More patchwork regimes exist for national court judgments, and whilst the practical reality is that enforcing arbitral awards can be difficult, the New York Convention is a helping hand in a world where transactions, particularly in the derivatives and bonds markets for example, increasingly involve parties from a range of jurisdictions.

Further, and importantly from a cultural point of view, arbitration offers what is often perceived to be a neutral venue for dispute resolution, which can be significant in circumstances where a counter-party resists the preferred choice of national court. This can be particularly important in transactions involving parties from emerging markets where the alternative to arbitration might be litigating before local courts unfamiliar with complex financial products, or litigating against nation-states before their own local courts.

Second, there have been various attempts to actively promote the use of arbitration for the resolution of disputes in the sector. Particular examples being:

- In 2013 the ISDA International Swaps and Derivatives Association ("ISDA") published the ISDA Arbitration Guide which provided, for the first time, arbitration templates to be inserted into the ISDA Master Agreement, together with general guidance on the arbitration process (the standard Master Agreement template providing for English or New York courts). This was partly driven by the increasing globalisation of finance transactions alluded to above. In 2018 ISDA published an updated guide (since updated in 2022) with further model clauses now covering a large number of seats and arbitral institutions as options along with updated guidance addressing developments in the

arbitration market since the previous edition. Whilst it is evidently hard to quantify, anecdotally, arbitration clauses appear to have been more frequently adopted in the market as a result, particularly over the last few years.

- In 2012 the Panel of Recognized International Market Experts in Finance ("PRIME Finance") was launched with the goal of utilising experts in financial markets in the resolution of complex financial disputes. The foundation provides access to a panel of expert arbitrators as well as a set of arbitral rules (last updated in January 2022) which are administered by the Permanent Court of Arbitration. At the time of writing there are yet to be any known arbitrations conducted under these rules, but PRIME Finance has undoubtedly increased the profile of arbitration in the market.

Third, a number of the major arbitral institutions have made changes to their rules in recent years that have made arbitration procedures more attractive for the enforcement of rights under financing contracts. For example, most major arbitral rules now offer an emergency arbitration procedure and some also provide for early dismissal; two areas in which court procedure has historically been regarded as more robust than arbitration. It should be noted that in practice, at least under the LCIA Rules, these provisions tend to be used infrequently. For example, in 2022 there were 13 applications for emergency arbitrators under the LCIA Rules and none were subsequently appointed. There were also a total of 15 applications for early determination, of which only one was granted (with six pending at the time of the LCIA Annual Casework Report's publication). That said, the perception that arbitral rules have adapted to align more closely to meet the needs of financial services institutions in some respects has been a factor in the growth of arbitration in the sector.

1.4 TYPES OF ARBITRATION IN INDIA

Ad Hoc Arbitration

Ad hoc arbitration is the most common form of arbitration in India. In this method, the arbitration tribunal decides on the issue based on rules established by either the parties involved or by the tribunal itself. This flexibility and the absence of a formal governing body make ad hoc arbitration a preferred choice for many disputing parties. However, the lack of a structured framework can sometimes lead to uncertainties and delays.

Institutional Arbitration

In contrast, institutional arbitration is conducted under the auspices of an established institution, such as the Indian Council of Arbitration (ICA) or the International Chamber of Commerce (ICC). These institutions provide a set of rules and administrative support, ensuring a more streamlined and professional arbitration process. Despite its advantages, institutional arbitration is less popular in India due to the limited number of well-established arbitration institutions and the higher costs associated with this method.

International Commercial Arbitration

The globalisation of the Indian economy has led to an increase in cross-border commercial transactions, making international commercial arbitration more relevant than ever. The Arbitration and Conciliation Act, 1996, applies to both domestic and international arbitrations, providing a cohesive legal framework for resolving international disputes.

1.5 The Role of Indian Courts in International Arbitration

Indian courts have a limited role in international arbitration, primarily confined to the enforcement of arbitral awards and the appointment of arbitrators in certain circumstances. The principle of minimal judicial intervention is even more pronounced in international arbitration, with Indian courts generally adopting a pro-arbitration stance.

1.6 ADVANTAGES OF ARBITRATION IN INDIA

- **Speed and Efficiency:** One of the primary advantages of arbitration is its ability to resolve disputes relatively quickly compared to the traditional court system. The arbitration process is streamlined, with limited scope for appeals, leading to faster resolution of disputes.
- **Confidentiality:** Arbitration proceedings are private, allowing parties to maintain the confidentiality of sensitive information. This is particularly important in commercial disputes where protecting trade secrets and business strategies is crucial.
- **Flexibility:** Parties have the freedom to choose the rules governing the arbitration, the language of the proceedings, the venue and even the arbitrators. This flexibility allows for a more tailored dispute resolution process.
- **Expertise of Arbitrators:** Parties can select arbitrators with specific expertise relevant to their dispute, ensuring that the decision-makers have a deep understanding of the subject matter.
- **Enforceability of Awards:** India is a signatory to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. This means that arbitral awards made in India can be easily enforced in other signatory countries and vice versa.

1.7 CHALLENGES FACING ARBITRATION IN INDIA

Despite its advantages, arbitration in India is not without challenges. Some of the key issues include:

- **High Costs:** While arbitration is often perceived as a cost-effective alternative to litigation, the reality can be different.
- **Delays:** Although arbitration is designed to be faster than court proceedings, delays can occur due to various reasons, such as the unavailability of arbitrators, procedural complexities and parties seeking interim relief from courts.
- **Lack of Institutional Arbitration:** Most arbitrations in India are ad hoc, meaning they are not administered by an institution.
- **Judicial Intervention:** While the Arbitration and Conciliation Act aims to minimise judicial intervention, courts are often approached for interim measures or to challenge arbitral awards. This can sometimes lead to delays and increased costs.

The arbitrability of disputes undoubtedly represents the largest segment of litigations arising out of the Arbitration and Conciliation Act 1996. The primary reason behind the arbitrability of disputes being such a common issue in the courts is the Act's lack of classification of disputes as arbitrable or non-arbitrable. However, the judiciary has stepped in to fill the gaps that were laid bare by the legislature in respect of the arbitrability of disputes on several occasions.

1.8 ARBITRABILITY OF DISPUTES

The first such attempt to set out broad guidelines on whether an issue would be arbitrable was made by the Supreme Court in Booz Allen v SBI Home Finance Limited. In Booz Allen, the Court held that issues arising out of rights in personam and thus being of personal import and applicable to only the parties concerned would be arbitrable. On the other hand, issues pertaining to rights in rem and thus of general import and applicability to a wider section of the public would not be arbitrable. Following the landmark decision in Booz Allen, the case law in the field of the arbitrability of disputes was recently reaffirmed in Vidya Drolia v Durga Trading

Corporation. The Supreme Court has set out a rather extensive test to determine the arbitrability of a dispute.

In Vidya Drolia, the Supreme Court introduced a "four-fold" test to determine the "subject-matter arbitrability" of disputes. As per this test, a dispute will not be arbitrable if its subject-matter:

- relates to actions in rem that do not pertain to a subordinate right in personam;
- affects third-party rights;
- involves an inalienable sovereign function; or
- is non-arbitrable (expressly or by necessary implication) under mandatory statutes.

1.9 ARBITRABILITY OF DISPUTES UNDER INDIA'S DEBT RECOVERY LAWS

The Court applied this four-fold test to determine the arbitrability of disputes under India's debt recovery laws. The Court relied on the fourth principle of the test and held that such disputes are not arbitrable because banks and financial institutions have specific rights (including distinct modes of recovery) under such laws. Thus, India's debt recovery laws are deemed mandatory statutes, and by necessary implication, their derogation through contractual election of arbitration is impermissible.

In doing so, the Supreme Court overruled the Delhi High Court's judgment in HDFC Bank v Satpal Singh Bakshi.(4) It held that the Delhi High Court had correctly characterised disputes under debt recovery laws as actions in personam; however, that does not make them ipso facto arbitrable. As stated, the Supreme Court held that the debt recovery laws implicitly prohibit the arbitration of disputes. The Supreme Court reached this conclusion in two steps:

- first, elaborating on what is meant by "necessary implication of non-arbitrability under mandatory statutes"; and
- second, assessing the performance of debt recovery laws on the findings under the first step.

IN THE FIRST STEP, THE SUPREME COURT HELD AS FOLLOWS:

> Implied legislative intention to exclude arbitration can be seen if it appears that the statute creates a special right or a liability and provides for determination of the right and liability to be dealt with by the specified courts or the tribunals specially constituted in that behalf and further lays down that all questions about the said right and liability shall be determined by the court or tribunals so empowered and vested with exclusive jurisdiction. Therefore, mere creation of a specific forum as a substitute for civil court or specifying the civil court, may not be enough to accept the inference of implicit non- arbitrability. Conferment of jurisdiction on a specific court or creation of a public forum though eminently significant, may not be the decisive test to answer and decide whether arbitrability is impliedly barred.

Criticism of Supreme Court's position on arbitrability of disputes under debt recovery laws

Thus, the position on the arbitrability of disputes under the debt recovery laws is clear. However, the application of the four-fold test of arbitrability on the debt recovery laws in Vidya Drolia has received a lot of criticism. Some of the common critiques are set out below.

First, the Supreme Court concluded that the debt recovery laws necessarily imply the exclusion of arbitration without much evidence to that effect. The focus must lie on the text of the statute, its legislative history or any inherent conflict between arbitration and the statute's underlying purpose. However, no such conflicts were materially explored in Vidya Drolia. Moreover, the Debt Recovery Act came into existence before the Arbitration & Conciliation Act 1996, and therefore the legislature could not have intended to include any provision that could possibly imply its exclusion. Further, the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, which came after the Arbitration Act, contains no such exclusions either.

Second, the basis of the Supreme Court's determination was that, if arbitration is permitted, it would deprive banks and financial institutions of the benefits under the debt recovery laws. However, that does not mean that the laws are automatically non-derogable. Banks and financial institutions have regularly used arbitration to avail a lot of the same remedies as the DRT. Moreover, lenders must be permitted to elect arbitration over the debt recovery laws if they prefer the benefits of arbitration over the different modes of recovery under the debt recovery laws.

Third, the mandatory nature of these laws is not sufficiently proved, especially with regard to private law issues without any welfare implications. In Vidya Drolia, the Supreme Court itself noted that the creation of a special tribunal to merely substitute the functioning of civil courts does not imply non-arbitrability of the matters within its subject matter jurisdiction. Given the most important aspect of the debt recovery laws was to divert the case burden on civil courts, the election of arbitration should also be permissible.

1.10 CONCLUSION

The scope of arbitration in banking industry has expanded significantly over the years, offering a viable alternative to traditional litigation for resolving commercial disputes. In banking sector, The legal framework has evolved to support both domestic and international arbitration, with a focus on minimising judicial intervention and ensuring the efficiency of the arbitration process. While challenges remain, the future of arbitration in India is bright, with the potential to become a preferred destination for arbitration in the global arena, this will also be a milstone for banking sector as well as policy makers. Therefore, Indian courts may have taken the view that assignment in arbitration is permissible.

In 2005 and 2019 there were amendments made to the Principal Act in order to improve the arbitration process in India and make it speedy and expeditious which in turn would reduce costs and wastage of time. The amendments also solidified the impartiality and independence of an arbitrator and makes him responsible for any delay in the arbitration proceedings in an attempt to imbibe in them characteristics of self-discipline and accountability. Further, with the establishment of the Arbitration Council of India (ACI) by the 2019 Amending Act, there is now an institution to ensure that uniform and professional standards are maintained during the arbitration procedure in India.

Thus, the creation of special statutory rights and obligations, as well as a specific forum with exclusive jurisdiction to deal with such rights and obligations, is required to prove legislatively intended and implied non-arbitrability of disputes. The Supreme Court found these requirements for non-arbitrability to have been satisfied in respect of the debt recovery laws. The condition of special statutory rights and obligations was seen to be satisfied in respect of the different modes of recovery under the debt recovery laws, as well as their self-contained structure. Moreover, the Court held that creation of a specific debt recovery tribunal (DRT) to exclusively give effect to such statutory rights of recovery shows that these disputes are non-arbitrable by necessary implication.

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