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Setting Aside of Arbitral Award Due to Improper Constitution of the Tribunal

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This article discusses the successful challenge of a unanimous arbitral award on the grounds that the arbitral tribunal was improperly constituted due to the bias of one of the three arbitrators. The challenge was successful before the Higher Regional Court of Munich (Decision of Feb. 2nd 2014, Case 34 Sch 7/13). The German Supreme Court, *Bundesgerichtshof*, dealing with the appeal of this decision strongly backed the decision of the Higher Regional Court.

The German Arbitration Law is based on the UNCITRAL Model Law and provides that an arbitral award may be set aside in the Courts of the lex arbitri if the composition of the arbitral tribunal or the arbitral procedure was not in accordance with a provision of this Book or with an admissible agreement of the parties and this presumably affected the award (Section 1059(2)(d) of the German Code of Civil Procedure, *Zivilprozessordnung*). This provision mirrors Article 34 of the UNCITRAL Model Law on International Commercial Arbitration and its correct application can be understood from the decision given by the German Federal Supreme Court, *Bundesgerichtshof* in December 2014, in the Case of I ZB 23/14.

The case involved a dispute in relation to a lease agreement for a thermal bath that was concluded in 1986 and contained an arbitration clause for settlement of disputes by a three member Tribunal seated in Germany. In 2010, when disputes arose between the parties, the matter was referred to ad-hoc arbitration in accordance with the agreement. Each Party appointed an arbitrator, and subsequently the two Party-appointed arbitrators appointed the Chairperson of the Tribunal.

One of the Parties (hereinafter referred to as “the Complainant”) lodged an application against the appointment of the chairperson to disqualify him on the grounds of bias. The application was heard by the Tribunal and the challenge was dismissed. Subsequently, the Complainant appealed the decision of the Tribunal in the Higher Regional Court.

The tribunal continued with the proceedings while the appeal was pending before Court and rendered an award in April 2013 against the Complainant. However, the challenge of the chairperson was only decided by the Court in January 2014 and it was in decided favour of the Complainant. The Court found the challenge in its decision of Jan. 3rd, 2014 (Case 34 SchH 7/13), justified because the chairperson was not able to thoroughly destroy the lodged reasonable doubts regarding her independence and impartiality in a responding statement. Irrespective of an actual existence of bias, the Court found these circumstances to constitute objective reasons for a justified disqualification of the Chairperson since objectively incorrect statements as the one given by the

Chairperson are also apt to raise doubts regarding an arbitrator's due diligence.

Armed with this incontestable decision in accordance with Section 1065 (1) s. 2 of the German Code of Civil Procedure, the Complainant then applied to the Court to set aside the award rendered by the Tribunal on the grounds that the constitution of the Tribunal was not in accordance with law or the agreement of the Parties as the Chairperson had been found to be biased. Au contraire, the adverse party argued the decision of the Tribunal had been unanimous and therefore, the bias of the Chairperson had no impact on the award.

The question thus arose as to whether a unanimous award could be set aside if the appointment of one of the three arbitrators was successfully challenged. The primary point of contention was the difference between Section 1059(2)(d) and Article 34 to the extent that the former provided that the improper composition should presumably affect the award.

The two party-appointed arbitrators submitted a statement arguing that the award was valid as the bias of the Chairperson had no impact on the decision of the Tribunal and even if the Tribunal were re-constituted, the same award would be rendered as the two party-appointed arbitrators would retain the majority vote.

The Court, however, did not accept this line of reasoning and set aside the award. In examining the degree to which the bias of one arbitrator affected a unanimous award, the Court opined that the standard for determining the same should not be very high. In fact, whether or not the award was unanimous has no bearing on a finding under Section 1059(2)(d). Similarly, the Court held that the statement given by the two party-appointed arbitrators that a re-constituted Tribunal would also reach the same decision, had no probative value. The biased arbitrator was an inherent part of the Tribunal and participated in the arbitral proceedings. His bias could potentially have influenced the other arbitrators through his participation in meetings and deliberations. Thus, as his mere presence on the Tribunal presumably affected the award, it was not necessary to substantiate with evidence or a specific finding the causal link between the improper constitution of the Tribunal and the impugned award. On a side-note the Court emphasized that the statement given by the two party-appointed was suitable to raise doubts regarding the impartiality and the qualification of the two arbitrators.

This judgement of the Court is a well-reasoned decision and reflects upon an important aspect, the inter-dependence of arbitral proceedings on the Courts of the lex arbitri. Had the decision of the Court been handed down in time, the Chairperson would have had to recuse himself and the Tribunal may have reached a different decision. The fact that the Court reached a decision regarding the challenge of the Chairperson after a unanimous award had been rendered, cannot lead to a situation wherein the protection of Section 1059(2)(d) is nullified. However, it would be interesting to see how this matter proceeds now since the German law is silent on whether or not the re-constituted Tribunal shall commence proceedings from the beginning. In this regard even the UNCITRAL Model law does not provide any guidance unlike Rules of certain arbitral institution like the ICC which provide that the arbitral tribunal, on re-constitution shall determine if and to what extent prior proceedings shall be repeated. Ultimately, the parties will have to reach an agreement on how to proceed in this matter.

Ideally, the two party-appointed arbitrators should recuse themselves altogether from the proceedings in the light of the statement submitted by them in Court during the setting aside proceedings since the given statement is able to raise doubts regarding the arbitrators' impartiality

and as this has been explicitly emphasized by the Court. Failing this, the Complainant may attempt to challenge the two party-appointed arbitrators on this basis. Assuming that the parties have not agreed on a procedure for the recusal, the legal obstacle for him to overcome is the two week time limit for an application for recusal which is provided in Section 1037 (2) in the German Code of Civil Procedure. In favour of the Complainant, it can be argued that the two week time limit would start from the date of composition of the new Tribunal, i.e. the appointment of the new Chairperson by the two Party-appointed arbitrators. Because only then the Complainant gains knowledge of the actual cast of the new Tribunal. The fact that he knew the names of the challenged arbitrators before is innocuous since the time limit for a challenge of the new Tribunal otherwise would have elapsed even before its constitution (see Musielak/Voit, ZPO, Commentary on the German Code of Civil Procedure (12th Ed. 2015), Section 1037 recital 3). If the Tribunal again rejects the application, the Complainant can again approach the Court. It is clear that this last step would most certainly destroy the remaining credibility of the two Party-appointed arbitrators. At least, the decision is an explicit advice to future arbitrators in a similar situation to desist from giving such a statement in view of the principle of confidentiality of deliberation (emphasizing this as well Weyer, IBR Law Journal, 2015, vol. 7, p. 2795).

Furthermore, this case is also an example of instances, where in retrospect, it can be argued that the Tribunal should have suspended the proceedings till the Court decided on the Complainant's challenge petition. Either way, this judgement is relevant for all jurisdictions which follow the UNCITRAL Model Law.

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