

# Dispute Resolution Hotline

March 20, 2013

## ENGLISH COURT APPLIES INDIAN LAW TO ARBITRATION AGREEMENTS TO SET ASIDE AN AWARD INTRODUCTION

The High Court of Justice, Queen’s Bench Division at London had recently in *Arsanovia Ltd. & Ors. v. Cruz City 1 Mauritius Holdings*<sup>1</sup>, set aside an arbitration award given in a London seated arbitration, governed by the London Court of International Arbitration (“LCIA”) Rules. The judgment gains importance from the perspective that the English court applied Indian laws to the arbitration agreements where the substantive law governing the agreement was Indian law and the seat of the arbitration was London.

### FACTS

A subsidiary of Unitech Limited (“Unitech”) being Arsanovia Limited (“Arsanovia”), a Cypriot company, had entered into a joint venture with Cruz City 1 Mauritius Holdings (“Cruz City”), a Mauritian company, for the purpose of slum development project in Mumbai. Accordingly, Arsanovia and Cruz City formed a joint venture company called Kerrush Investment Ltd. (“Kerrrush”). Arsanovia, Cruz City and Kerrush entered into a Shareholder’s Agreement (“SHA”) dated June 6, 2008.

Another subsidiary of Unitech, being Burley Holdings Limited (“Burley”), a Mauritian company, subscribed to certain specific clauses of the SHA by providing that: *“The undersigned hereby executes this Agreement to be bound by the direct obligations imposed upon them, under Clauses 3.9, 5.5.4, 5.6.2 and 15.3.4.”* Thus Burley while signing the SHA identified the specific obligations under the SHA that it was undertaking.

Unitech, Burley and Cruz City also executed an agreement dated 6 June 2008 (“Keepwell Agreement”), whereby Unitech agreed to cause Burley (as Burley is a subsidiary of Unitech) to comply with its obligations under the SHA which included making timely payments. Unitech had also agreed to ensure that Burley would have sufficient funds to timely meet any of its obligations under the SHA.

On July 14, 2010, Arsanovia served a Management Approval Termination Notice and a Buy-Out Notice on Cruz City on the grounds that a “Bankruptcy/Dissolution Event” (as defined in the SHA) had occurred in respect of the “Affiliate which controls Cruz City” (Lehman Brother Holdings Inc, which had filed for Chapter 11 Bankruptcy in the USA). On September 13, 2010 Cruz City purported to exercise a put option under the SHA on the basis that requirements for the start of the construction phase of the project had not been met, and required Arsanovia to buy Cruz City’s interest in Kerrush. The terms of the put option were much more favorable to Cruz City than the formula governing the Buy-Out Notice.

The question arose regarding the validity of the put option and the buy out notices leading to three arbitrations being:

Sr. No.	Claimant	Respondent	Claim/Counter-claim	Award
First Arbitration	Cruz City	Arsanovia and Burley	Damages and specific performance under the SHA whereby the respondents were required to comply with their obligations pertaining to the put option exercised by Cruz City.	Tribunal determined that it had jurisdiction and held that Cruz City had validly exercised the put option and that Unitech and Burley are required to the amounts due under the put option to Cruz City.
Second Arbitration	Cruz City	Unitech and Burley	Damages under the Keepwell Agreement as it was Unitech’s obligations to ensure that Burley complies with its obligations under the SHA and that Burley is kept in sufficient funds to meet such obligations.	
Third Arbitration and	Arsanovia	Cruz City and Burley	Declaration that the Buy Out notice was valid and damages and specific performance under the SHA Counterclaim which is similar to the claim under the Frist Arbitration made by Cruz City	Both claim and counterclaim were dismissed.

The awards were subsequently challenged by Unitech, Arsanovia and Burley (“Appellants”) before the Queens Bench on the ground that the tribunal did not have jurisdiction over the claims. It was contended by the Appellants in the court proceedings that the law applicable to the arbitration agreement under the SHA was Indian law and that as per Indian law Burley had not agreed to be bound by the arbitration clause found within the SHA. Accordingly, Burley could not have been made a party to the arbitration. Further, it was argued that under Indian law if the claim is brought against two parties only one of which is party to the arbitration agreement, the arbitration cannot be maintained and thus the tribunal did not have jurisdiction to decide the claims against Arsanovia either.

Accordingly, the following issues were framed by the court:

With respect to the award passed in the first arbitration:

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1. Whether Indian Law is applied to the Arbitration Agreement in the SHA or not?
2. Whether Burley became party to the Arbitration Agreement in the SHA or not?
3. Whether the Tribunal had the jurisdiction in the first arbitration to make the award against Arsanovia or not?

With respect to the award passed in the second arbitration:

4. Whether Indian Law is applicable to the Arbitration Agreement in the Keepwell Agreement or not?
5. Whether the claim of Cruz City in the Second Arbitration as upheld by the Tribunal was beyond the scope of the Tribunal's jurisdiction because it was premature or not?

## HELD

The first aspect that the court had to establish was the law which would be applicable to the arbitration agreement.

To determine the law governing the arbitration agreement the court applied the principles enunciated in the seminal judgment of *Sulamerica Cia nacional de Seguros SA and Ors. v. Enesa Engenharia SA and Ors.*<sup>2</sup> being:

- a. whether there was an express choice of parties with regards to the law applicable to the arbitration agreement.
- b. If there is no express choice, then whether an implied choice has been made by the parties.
- c. If there is no express and implied choice of the parties with regards to the law applicable then which law has the closest and most real connection with the arbitration agreement

It was held that the law governing the SHA was a strong indicator that the parties had made an implied choice that the law governing the arbitration agreement within the SHA shall also be Indian law. Further, under the arbitration clause the parties had specifically excluded the Part I of the (Indian) Arbitration and Conciliation Act, 1996 ("**Act**") from being applicable including that no interim reliefs would be available under Section 9 of the Act. This was seen to be a strong indicator of the intention of the parties that the arbitration agreement should be governed by Indian law. The only contrary indication with respect to the intention of the parties regarding the law applicable to the arbitration agreement was the choice of seat of the arbitration. Such contrary indication was not deemed to be sufficient to override the considerations in favour of coming to the conclusion of a choice of Indian law.

After concluding that the law applicable to the arbitration agreement found within the SHA was Indian law, the court then considered whether Burley became a party to the arbitration agreement within the SHA. It was observed that the arbitration clause did not fall within the specific clauses which Burley had agreed to be bound by while signing on the signature page. Further each of the clauses which Burley had signed on in confirmation included specific references to Burley. Lastly, the arbitration clause only referred to the term "the Parties" which did not include Burley within its fold. Thus, based on these factors the court concluded that Burley was never a party to the arbitration agreement. An interesting aspect here is that while considering the issue of whether Burley was a party to the arbitration agreement or not, the court relied on the principles of contractual interpretation under English law which required that an intention to enter into an arbitration clause must be clearly shown and is not readily inferred. The court then observed that the Indian law in this regard is similar to English laws and that there was no evidence before him to indicate to the contrary.

Thereafter, the court considered the question of whether an award can be made by the tribunal against Arsanovia in light of the fact that Burley was not a party to the arbitration agreement. The question arose as under Indian law, as per Supreme Court's ruling in *Sukanya Holdings Pvt. Ltd. v. Jayesh Pandya and arr.*<sup>3</sup>, bifurcation of cause of action is not permissible and therefore the court cannot bifurcate the cause of action between parties who are parties to the arbitration agreement and those who are not. However, the court then had to consider whether Sukanya Holdings case would be applicable to the present case as Sukanya Holdings dealt with Section 8 of the Act which deals with domestic arbitrations under part 1 of the Act, whereas the factual matrix on hand involved an international commercial arbitration. With respect to the question the court considered the recent Supreme Court decision in *Chloro Controls India Pvt. Ltd. v. Severn Trent Water Purification Inc. and Ors.*<sup>4</sup>, wherein it was argued that the proposition of law as laid down in the *Sukanya Holdings* case is not correct and should be set aside. However, in *Severn Trent*, the apex court did not provide an answer to the question and only provided that "Sukanya was a judgment of this court in a case arising under Section 8 Part 1 of the 1996 Act, while the present case relates to Section 45 Part II of the Act. As such the case may have no application to the present case....."

Thus the English court concluded on the basis of the above that, the Supreme Court had in *Severn Trent* not answered that whether the proposition laid down in *Sukanya Holdings* was correct or that whether the proposition laid down in the case of *Sukanya Holdings* is applicable to petitions under Section 45 of the Act. Thus, the court placed reliance of several other (Indian) high court judgments wherein Sukanya Holdings had been applied in context of Section 45 of the Act to hold that the principle enunciated in *Sukanya Holdings* case is not confined to applications for reference to arbitration, but to the concept of arbitrability and that it applies to international arbitrations as much as it does to domestic arbitrations.

Therefore, it was held that as under the First Arbitration as Burley could not have been made a party, Arsanovia could also not be subjected to arbitration as that would amount to bifurcation of cause of action which is not permitted under Indian law as held in the Sukanya Holdings case. The court thus set aside the award passed in the First Arbitration.

Further, the arbitration agreement within the Keepwell Agreement was also held to be governed by Indian Law on the same consideration as those in case of the SHA.

Thereafter, it was contended that the award passed in the Second Arbitration with respect to the Keepwell Agreement should also be set aside on the ground that the claim made therein is premature as the liability therein arises only once the claim is crystallised under the SHA. With respect to the same the English court agreed to the reasoning of the tribunal that:  
*"There is nothing conceptually difficult about a court or tribunal making a determination that a debt is due under another contract in order to determine whether relief should be granted under the contract before it."*

The court observed that the Tribunal needed to determine whether Burley was liable under the SHA in order to determine whether United was liable under the Keepwell Agreement, and that the question could be dealt with by the tribunal to resolve a "dispute arising out of or in connection with the provisions of the Keepwell Agreement". Thus the award passed under the Second Arbitration was upheld.

## ANALYSIS & CONCLUSION

The present case establishes the importance of clearly stipulating in international contracts, the law

which would be applicable to an arbitration clause. Failure to stipulate such law at the stage of drafting the clause may give rise to significant jurisdictional issues, at a later stage, as highlighted by the present judgment.

Further, in the present case the court had considered the express exclusion of Part 1 of the Act found within the arbitration clause as a factor which pointed towards the intention of the parties to apply Indian law. However, the express exclusion of Part 1 of the Act in an arbitration clause providing for a seat of arbitration outside India is a standard practice which has been adopted in relation to transactions which have an Indian link. This is due to the pivotal decision of *Bhatia International v Bulk Trading SA*.<sup>5</sup> wherein the court had held that Part 1 of the Act would be applicable to even foreign seated arbitrations unless they have been otherwise excluded, thereby giving Indian courts jurisdiction with respect to even foreign seated arbitrations. Though the decision in *Bhatia International* case has been overruled in *Bharat Aluminum Co. v. Kaiser Aluminum Technical Services*.<sup>6</sup>, it continues to be applicable to the agreements executed prior to September 6, 2012 and to that extent such an exclusion of Part 1 of the Act to limit interference of Indian courts in foreign seated arbitrations was a typical approach which is unlikely to reflect on the intention of the parties with respect to the law governing the arbitration agreement.

Further, the court had considered the recent Supreme Court judgment in the *Chloro Controls India Pvt. Ltd. v. Severn Trent Water Purification Inc. and Ors.*, from the perspective of whether it overrules the *Sukanya Holdings* case or limits the application of the proposition laid down in *Sukanaya Holdings* to domestic arbitrations. However, the court never applied the *Chloro Controls* judgment to the issue of whether *Burley* could have been made party to the arbitration irrespective of whether it had signed arbitration agreement or not. This may be in light of the fact that such an argument was never made before the judge as at the time of the hearing before the English court the Supreme Court ruling in *Chloro Controls* case had not come out. However it would have been interesting to see if the said judgment could have been applied to hold that *Burley* could have been made a party to the arbitration proceedings.

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You can direct your queries or comments to the authors

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<sup>1</sup> [2012] EWHC 3702 (Comm)

<sup>2</sup> [2012] EWCA Civ 638

<sup>3</sup> (2003) 5 SCC 531

<sup>4</sup> (2013) 1 SCC 641

<sup>5</sup> (2002) 4 SCC 105

<sup>6</sup> (2012) 9 SCC 552

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