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Indian parties can choose a foreign seat of arbitration but can they also choose foreign law to govern their contract?: The end of a saga or the beginning of a new one!!

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The Supreme Court of India in its judgment in *PASL Wind Solutions Private Limited v. GE Power Conversion India Private Limited (Civil Appeal No. 1647 of 2021, judgment dated 20th April 2021)* has conclusively ruled that two Indian parties can choose a foreign seat of arbitration putting an end to years of controversy on the said subject matter. It has further ruled that should two Indian parties choose a foreign seat of arbitration, they would not be precluded from seeking reliefs under Section 9 of the Arbitration and Conciliation Act, 1996. Pertinently, the Court also seems to have held that there is no bar on Indian parties to agree to a foreign law governing their underlying contract. The authors in this article endeavor to trace the various points on which the Court gave its rulings whilst attempting to understand the reasoning for the same.

<u>Brief Facts:</u>

The matter had come up before Apex Court from an appeal against the judgment passed by the Single Judge of Gujarat High Court wherein the Court had whilst enforcing the foreign award obtained by two Indian parties in arbitration seated in Zurich, Switzerland, refused the winning parties' prayer for interim reliefs under Section 9 of the Arbitration.

The Indian Parties (being companies incorporated under the Companies Act, 1956) had entered into an agreement for supply of converters and after the said supply, disputes arose between the parties in relation to expiry of their warranty. For amicably resolving the issues which had arisen between the parties, they, entered into a Settlement Agreement. Clause 6 of the said Settlement Agreement provided for the dispute resolution clause stating that disputes arising out of the same would be resolved by (a) in an amicable manner within the period of 60 days, (b) after the expiry of 60 days, all disputes, controversies and differences would be referred to ***<u>arbitration</u>*** in ***<u>Zurich</u>*** in accordance with the ***<u>Rules of Conciliation and Arbitration and Arbitration of the International Chamber of Commerce.</u>*** Pertinently, in the facts of this case, the parties had agreed that the substantive law applicable to the Settlement Agreement would be Indian Law.

Disputes arose between the parties and request was made to refer the same to arbitration to the International Chamber of Commerce ("**ICC**"). A preliminary objection was taken regarding the arbitrator's jurisdiction on the ground that two Indian parties cannot agree to a foreign seat of arbitration. After considering the arguments from both sides, the Sole Arbitrator by a procedural order concluded that it indeed had the jurisdiction to adjudicate upon the dispute and confirmed that the seat of arbitration is Zurich. This procedural order remain unchallenged. Thereafter, in a case management hearing, the Sole Arbitrator decided to conduct the hearings in Mumbai. Subsequently, the final award came to be passed by holding that the seat of the arbitration of Zurich, Switzerland, the Claimants claim for breach and damages was

rejected and that it was directed to cough out sums to the Respondent and accumulated interest in accordance with the Indian Interest Act, 1978.

Thereafter, enforcement proceedings were initiated before the Gujarat High Court at which point it was urged that the seat was Mumbai and therefore it had filed a petition for challenging the award under Section 34 of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**"). An application for rejection of the said petition was rejected and simultaneously an application for execution of final award was also preferred.

Questions before the Court:

The questions have been identified very succinctly by the Court at Paragraph 2 of the judgment as below:

1. Whether two companies incorporated in India can choose a forum for arbitration outside India?

2. Whether an award made at such forum outside India, to which the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 applies, can be said to be a "foreign award" under Part II of the Arbitration Act and be enforceable as such?

3. Whether an application preferred under Section 9 of the Arbitration Act can be preferred by the Indian award holder in the said background?

Arguments:

The Appellant sought to impugn the judgment of the Gujarat High Court broadly on the following grounds:

1. Two Indian parties cannot agree to foreign seated arbitration as the same would foul of Section 23 of the Indian Contract Act, 1872 ("**Contract Act**") as well as Sections 28(1)(a) and Section 34(2A) of the Arbitration Act. In support of this submission, reliance was placed on provisions of Prohibition of Benami Property Transactions Act, 1988 ("**Benami Act**") by submitting that the same could be bypassed by Indians as such but by designating a foreign seat, parties may do the same which would be contrary to public policy of India;

2. A foreign Award under Part II of the Arbitration Act can only arise out of international commercial arbitrations as provided under Section 2(1)(f) of the same. The said provision states that the qualifying criterion for an "international commercial arbitration" would be the presence of a foreign element i.e. presence of atleast one foreign party;

3. The expression "unless the context otherwise requires" mentioned in Section 44 of the Arbitration Act contemplates only international commercial arbitrations and hence Part II of the Arbitration Act cannot be invoked *de horse* a foreign element;

4. The Arbitration Act is a self-contained code and lack of foreign element involved in a foreign seated award between two Indian Parties cannot be subject matter of challenge to either Part I of Part II of the Arbitration Act;

5. Section 10 of the Commercial Courts Act, 2015 recognizes only two categories of arbitrations being international commercial arbitrations and arbitrations other than international commercial arbitrations which is irreconcilable with Section 47 of the Arbitration Act and therefore the Commercial Act must prevail. Also, since it was not

an international commercial arbitration, only the district court would have the jurisdiction to adjudicate the same;

6. As per the closest connection test, the seat of arbitration can only be held to be Mumbai and hence, Part II would not apply though in the written submissions seems to not have been pressed;

The Respondents had preferred their own appeal against the finding that a Section 9 petition under the Arbitration Act is not maintainable. Save for the said finding, they supported the Gujarat High Court judgment as below;

1. The attempt to argue that the seat of the arbitration is Mumbai is antithetical to what was argued before the Sole Arbitrator in its preliminary challenge application and as such cannot be allowed;

2. Part I and Part II of the Arbitration Act are mutually exclusive and therefore the definition of "international commercial arbitrations" from Part cannot be imported in the appeal. Further, nationality, domicile or residence of parties are irrelevant of applicability of Part II of the Arbitration Act;

3. Two Indian parties can enter into an agreement for foreign seated arbitration and would culminate into a foreign award as per the prior decisions;

4. Parties from the same state can agree to have their disputes resolved in a foreign state and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958 ("**New York Convention**") would be available to apply and enforce the resultant foreign award;

5. Neither Section 23 nor Section 28 of the Contract Act forbid the choice of a foreign seat. Section 28 of the Contract Act rather provided for an exception for arbitral proceedings and the same supports party autonomy. The reference to "public policy" in Section 23 of the Contract Act is limited to "clear and incontestable cases of harm to the public";

6. Section 28(1)(a) of the Arbitration Act is available to only Part I. Grounds available for challenge to foreign award are waivable by parties which the parties have in this case;

7. Mumbai was only a convenient venue and not the seat of the arbitration;

8. The definition of international commercial arbitration provided under the Commercial Courts Act is not governed by the definition provided under the Arbitration Act but would refer to arbitrations not seated in India.

<u>Analysis:</u>

The Court kicked off it analysis of the arguments by closely inspecting the various provisions of the Arbitration Act in question.

The Court by placing reliance on *Mankastu Impex (P) Ltd. v. Airvisual Ltd., (2020) 5 SCC 399* wherein disputes were to be resolved by arbitration in "Hong Kong" and taking note of the dispute resolution clause and the procedural order passed by the Sole Arbitrator observed that the seat of the arbitration was Zurich. The argument pertaining to "closest connection test"

as propounded in *Enercon (India) Ltd. v. Enercon GmbH, (2014) 5 SCC 1* was rejected by the Court as in the said case "London" was the venue in the arbitration clause and not the seat. It was in that context, the Apex Court had observed that since that there was factor connecting the dispute or the parties to England, there was no requirement for designating "London" as the seat as it was the venue.

The Court further observed that Part I and Part II of the Arbitration Act are mutually exclusive. The Court observed that whilst Part I was applicable to domestic arbitrations, Part II was applicable only to enforcement proceedings save the exception provided in Section 45 of the Arbitration Act which pertains to referring parties to arbitration. Section 2 of the Foreign Awards Act, 1961 which is similar to Section 44 of the Arbitration Act. The Court took note of the fact that even as per the previous regime, domestic arbitrations were governed by Arbitration Act, 1940 whilst the foreign awards were governed by the Foreign Awards Act, 1961 and as such both parts were mutually exclusive.

The Court sought to uncover the reasons for which the proviso to Section 2(2) of the Arbitration Act which was included for the limited extent of granting powers to the Court for passing orders under Section 9, 27 and 37(1)(a) of the Arbitration Act. The Court took cognizance of the fact that the fact that the term "international commercial arbitration" was used in terms of arbitrations being outside India which resultantly means that the award is to be made at such a foreign place and enforced as per Part II of the Arbitration Act. Therefore, the Court held that the purport of the 'international commercial arbitration' as mentioned in Section 2(1)(f) is different to that in the proviso to Section 2(2) of the Arbitration Act insofar as whilst the former is party-centric, the latter is place-centric. In view of this, the Court held that the petition preferred under Section 9 of the Arbitration Act is maintainable.

There are four pre-requisites for an award to be a foreign award and the same are stated in Section 44 of the Arbitration Act being (a) the dispute being a commercial dispute as per Indian law, (b) the foreign award is made pursuant to an agreement in writing, (c) dispute must arise between persons and (d) the arbitral proceedings must take place in a country which is a New York convention signatory. The Court stressed on the fact that Section 44 is party-neutral and the emphasis is only on the place at which the award is made.

The Court relied upon its earlier pronouncement in *Atlas Export Industries v. Kotak & Co., (1999) 7 SCC 61,* wherein the disputes between two Indian parties were to be adjudicated in London in accordance with the arbitration rules of Grain and Food Trade Association Limited and the contract was also made under the terms and conditions effective at date of Grain and Food Trade Association Ltd., London and a challenge on the ground of Indian parties being unable to enforce a foreign award, thereby being hit by Section 23 and 28 of the Contract Act was rejected. The Court also rebuffed the reliance on *TDM Infrastructure (P) Ltd. v. UE Development India (P) Ltd., (2008) 14 SCC 271* as the same was considered to be binding precedent as it was passed by a Single Judge of the Apex Court in an application for appointing the arbitrator and case laws relying upon the same were overruled from various High Courts.

In relation to the public policy as mentioned in Section 23 of the Contract Act, the Court observed that the same is a "*relative concept capable of modification in tune with the strides made by mankind in science and law*". Relying on a plethora of judgments on the said issue, the Court observed that "*freedom of contract needs to be balanced with clear and undeniable harm to the public, even if the facts of a particular case do not fall within the crystallised principles enumerated in well-established 'heads' of public policy.*"

On the argument that Indian parties cannot opt out of the substantive law of India basis Sections 28(1)(a) and 34(2)(a) of the Arbitration Act, the Court critically observed that such a bar arises only when the arbitration is not an international commercial arbitration seated in India. Further giving an illustration of adjudication of a dispute between an Indian resident and a non-habitual Indian resident wherein the same would attract Section 2(1)(f) and Section 28(1)(b) of the Arbitration Act, the Court noted that the said situation would allow the parties to designate foreign law central to their dispute and there is no bar on the same. Thereafter, the Court relying on its pronouncement in *Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc., (2012) 9 SCC 552* which was in turn relied upon by the Madhya Pradesh High Court in *Sasan Power Limited v. North American Coal Corporation (India) Pvt. Ltd., 2015 SCC OnLine MP 7417* noted that Section 28(1)(a) of the Arbitration Act has no application where the seat of arbitration is outside India and in such a scenario, the rules of conflict of law of the country in which the arbitration is seated would be applicable. With respect to the argument pertaining to the Benami Act, the Court held that even in a scenario wherein the substantive law governing the dispute is not specified (which for the avoidance of doubt in the present case was specified to be Indian law), it is open for the arbitrator to apply to Indian law in accordance with the rules for conflict of laws of the seat of the arbitration. The Court recognized that should Indian law prohibit a specific act, the arbitrator is likely to apply the rules of conflict of law and on the grounds of international comity between the India and country where the arbitral proceedings are seated. Further, the Court also stated an attempt to dodge Indian substantive law, may also be looked into whilst enforcement of the said foreign award under Section 48 of the Arbitration Act, specifically on the ground of the foreign award being contrary to India's public policy (which now has been defined in the Explanation to Section 48(2)).

The Court held that In the quandary between freedom of contract and clear and undeniable harm to the public, preference is to be given to freedom of contract as the as such there is no clear and undeniable harm in permitting Indian nationals to avail challenge procedure available in the seat country and waive that what is provided under Section 34 of the Arbitration Act.

Another issue raised in relation to Section 10 read with Section 21 of the Commercial Courts Act wherein it was argued that arbitrations other than international commercial arbitrations were to be disposed of by a commercial court having jurisdiction and not the High Court as mentioned in Section 47 of the Arbitration Act was answered by the Court in favour of the Respondents. The Court stated that there was no conflict *per se* both the provisions and that the purport of international commercial arbitral in the Commercial Courts Act different for foreign awards and domestic awards and there is no clash between the provisions. The Court relied on its judgment in *BGS SGS SOMA JV v. NHPC, (2020) 4 SCC 234* to re-iterate that substantive law to arbitral proceedings would be governed by the Arbitration Act whilst the procedure is laid down in the Commercial Courts Act, 2015.

The Court sustained party autonomy in Indian parties designating foreign seat of arbitration.

<u>Takeaways and ramifications:</u>

The key takeaway from the judgment is that the Court upheld party autonomy in designation of foreign seat of arbitration and also held that there is no bar on the parties to prefer an application under Section 9 of Arbitration Act.

Significantly, it would seem that the Court has opened the doorways for Indian parties to even elect for having foreign law applicable to their underlying dispute. The Court has also observed any machination to subterfuge Indian Law can be looked into by the Court at the stage of enforcement of the foreign award. Further, the Court has also shown the pathway for such

issues by empowering the arbitrator to apply the conflict of law rules available in the country of the foreign seat.

The above ruling could be momentous as it is likely to be a shot in the arm for the Indian parties seeking to elect for established legal regimes with an available body of law for adjudication of the dispute and the arbitral proceedings. The Court appears to have harmonized the needs of all stakeholders by providing necessary safeguards at each and every step. It is likely to have an effect on the costs incurred and the time spent by parties in dispute resolution proceedings as they may not have to delve on a dual systems governing their contract and their dispute resolution clause.

Conclusion:

This pronouncement is further to long range of pronouncements passed by the Apex Court is furthering its pro-arbitration and pro-enforcement stance and brings it on par with the enforcement mechanism available in other New York Convention countries. One can only hope that this endeavor of the judiciary is supplemented by the legislature to bring in laws to iron off creases if any.

<u>About the authors:</u>

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Amitava Majumdar (Raja) is the founding Managing Partner of Bose & Mitra & Co. He has consistently been rated as a Band-1/foremost lawyer in shipping by reputed organisations such as Chambers & Partners, Legal 500, India Business Law Journal etc. and Bose & Mitra & Co. under his helm has consistently been rated as a Tier-1 Law Firm in shipping for both Chambers & Partners and Legal 500.

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