

Dispute

March 08, 2022

INTERIM PROTECTION AVAILABLE ONLY AGAINST THE “FRUITS” OF THE ARBITRAL AWARD

- Application for interim protection at the post arbitral award stage must be confined to only the “fruits” of the arbitral award;
- Complete consensus ad idem is required in all parts of a contract before specific performance can be directed;
- Granting a part entitlement to take measures for specific performance of a contract does not amount to directing specific performance of the contract itself.

Recently, the Delhi High Court (“**Delhi HC**”) in *Zostel Hospitality Private Ltd. v. Oravel Stays Private Ltd & Anr* held that a right to specific performance of the underlying agreement (under which the arbitration was invoked) in an arbitral award does not necessarily imply that specific performance is itself granted. It opined that the enforcement of such performance may still be subject to condition precedents and following the due process of law. The Delhi HC has also elaborated on the scope of an interim protection under Section 9 of the Arbitration and Conciliation Act, 1996 (“**Act**”) at the post-award stage and held that only the “fruit” of an arbitral award can be protected by way of interim measures.

BACKGROUND

Zostel Hospitality Pvt Ltd (“**Zostel**”) and one of its investor shareholders, Orios, entered into a contract with Oravel Stays Pvt Ltd (“**Oravel/OYO**”), whereunder, essentially, Zostel agreed to transfer its hotel business to OYO and Orios, against which OYO was required to transfer to Zostel, “*identified assets*” which included 7% of OYO’s shareholding. Pursuant to the commercial understanding, a term sheet (“**Term Sheet**”) was executed which stated that upon closing, Zostel’s shareholders would be entitled to acquire shares in OYO not exceeding 7% of Oravel’s diluted shareholding, and that upon completion of post-closing obligations, the founders would be entitled to a payout of US\$ 1 million. The Term Sheet also entailed that closing would require finalizing multiple definitive agreements regarding the exact terms of the transfer, which were to be negotiated subsequently by Zostel and Oravel.

Zostel began taking steps to fulfil its obligations¹ under the Term Sheet, however, when Zostel attempted to finalize the definitive agreements, Oravel delayed citing dissent from a particular shareholder of OYO. Subsequently, owing to alleged defaults on the part of OYO, Zostel was unable to acquire its assets, and initiated arbitration proceedings. The arbitral award (“**Arbitral Award**”) held that Zostel was entitled to specific performance of OYO’s obligations under the Term Sheet. Given that OYO was in the process of filing for an Initial Public Offer (IPO), Zostel filed a petition under Section 9 of the Act seeking a restraint on the IPO, so that the execution of the Arbitral Award in relation to the specific performance of the Term Sheet is not rendered unenforceable.

THE ARBITRAL AWARD

In the arbitration, the arbitrator (“**Arbitral Tribunal**”) had formulated multiple issues to adjudicate, including questions regarding bindingness of the Term Sheet, whether there was consensus ad idem between the parties regarding the definitive agreements, and whether the Zostel was entitled to a specific performance as per the terms of the Term Sheet.

The Arbitral Tribunal held that: **First**, on consideration of the Term Sheet as a whole, it could not be said to be a mere exploratory document. Even though the recital mentioned that the Term Sheet was not binding, clauses 4² and 7³ of the Term Sheet clarified that the definitive documents were not independent of the Term Sheet. **Second**, OYO’s acceptance of communication from Zostel regarding performance of acts mentioned in the Term Sheet also pointed towards its binding value.

Third, there could not have been complete consensus ad idem on the draft definitive agreements, on the premise that Zostel had forwarded multiple draft definitive agreements to OYO, and negotiations on the same were still underway. **Finally**, Zostel was entitled to specific performance of the Term Sheet, noting that Zostel had performed all its obligations under the Term Sheet successfully. However, as the definitive agreements were yet to be executed, the Arbitral Tribunal held that Zostel is entitled to file appropriate proceedings for specific performance and execution of definitive agreements as envisaged under the Term Sheet.

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First, as the Arbitral Tribunal had held that Zostel is entitled to specific performance of the Term Sheet, OYO's IPO should not be allowed as it would frustrate the enforcement of the award. **Second**, the arbitral tribunal had specifically found OYO to be in default and in breach of its obligations under the Term Sheet, by failing to execute definitive agreements and transfer 7% of its shares to Zostel. **Third**, the only hurdle in execution of the definitive agreements was the dissent of a particular shareholder of OYO, and but for that, the draft agreements were all but finalized. **Fourth**, the Term Sheet did not envision a situation where OYO did not transfer 7% of its share to Zostel, and hence claimed it to be a foregone inevitable conclusion. **Fifth**, the draft shareholders agreement between the parties granted Zostel the rights to 7% equity shares of OYO, resultantly, disqualifying OYO from issuing IPO under Regulation 5(2) of the SEBI (ICDR) Regulations.⁴

Sixth, the "proceedings for specific performance" mentioned in the Arbitral Award referred to the petition for enforcement of the arbitral award, as it is impossible to conclude that the Arbitral Tribunal would have intended Zostel to again seek specific performance of the Term Sheet separately.

Submissions for OYO

First, the Arbitral Award does not offer Zostel substantive rights, and contended that Zostel was relying on observations made within the Arbitral Award, while the operative part of the Award did not direct specific performance of the Term Sheet. There was no consensus ad idem between Zostel and OYO on the particulars of the Term Sheet, and hence, there remained no question of directing a specific performance.

Second, the draft agreements relied upon by Zostel, including the draft definitive agreements and shareholders agreement, were but drafts and could not be shown to be an indicator of consensus between the parties.

Third, the act of transferring 7% of OYO's shares to Zostel, which Zostel claimed OYO was in default of performing, was contingent upon the "closing" of the contract between the two parties, as envisioned in the Term Sheet.

Fourth, the issuing of IPO would not directly impact the agreement between Zostel and OYO, and submitted that the only relief Zostel might be able to claim is the difference in value of the 7% shareholding that OYO is to transfer to Zostel i.e., prior to and post the IPO.

JUDGMENT

The Delhi HC primarily relied on two rulings: *Dirk India Pvt Ltd v. Maharashtra State Power Generation Co. Ltd*⁵ ("**Dirk India**") in relation to the scope of an interim protection under Section 9 of the Act at a post-award stage; and *Mayawanti v. Kaushalya Devi*⁶ ("**Mayawanti**") in relation to the requirement of consensus ad idem as a necessary condition for specific performance of the contract.

Scope of Section 9 when invoked at post-award stage:

The Delhi HC re-affirmed the position of law set out by the Bombay High Court in *Dirk India*, which clarifies that if the petition is filed at the post-award stage, it only serves to protect the "fruits" of the arbitral award. The Delhi HC thereafter analysed what "fruits" can be derived from the Arbitral Award in question and observed that the Arbitral Award provided Zostel with a mere *entitlement* to specific performance of OYO's obligations under the Term Sheet, and nothing further. The Delhi HC further observed that the Arbitral Award did not direct OYO to immediately hand over the properties it was to transfer to Zostel on the closing of the Term Sheet, but merely directed Zostel to take steps towards making OYO fulfil its obligations as per the Term Sheet.

Requirement of complete consensus ad idem for specific performance:

The Delhi HC restated the position in *Mayawanti* regarding the requirement of complete consensus ad idem for securing the remedy of specific performance. The Supreme Court in *Mayawanti* had held that if the terms of an agreement are uncertain, and the parties are not at ad idem, the contract does not exist in the first place, and consequently, there can be no scope for claiming the remedy of specific performance. It observed that, contrary to Zostel's claim that the parties were on the cusp of agreement, in the present case the terms of the definitive agreements were clearly not agreed upon.

ANALYSIS

This is a well-reasoned and praise worthy judgment by the Delhi High Court. There are a few take away from the ruling, and they have been set out below.

First, contracting parties must take utmost care in drafting of term sheets. While the recital of the Term Sheet clarified that it is not binding⁷, the Arbitral Tribunal held that the Term Sheet could not be held to be an exploratory document basis the fact that it required Zostel to perform several "closing obligations" towards closing of the transaction, apart from the conditions mentioned in the definitive documents. The Arbitral Tribunal relied on the clauses of the Term Sheet and the actions taken by Zostel towards its fulfilment, and ultimately held that the parties acted upon it and it was a binding document. For the purposes of adjudication of the interim relief application, the Delhi HC assumed that the Arbitral Award is valid and binding, notwithstanding the challenge filed by OYO. Therefore, there is no finding on this aspect in the present judgment. However, such issues are likely to be discussed when the court hears the challenge to the Arbitral Award.

Summarily, although the recital may say that the term sheet is not binding, if the clauses set out in the main document create obligations, or links it with the definitive documents to be executed later, and if the parties take steps towards complying with such conditions, it can be later construed as a binding term sheet.

Second, an award passed by the Arbitral Tribunal must be thoroughly analysed to understand what exactly are the "fruits" of the Arbitration, especially given the development of legal jurisprudence in relation to protecting an asset in the post-award scenario. The Delhi HC at several places in the judgment has noted that "... *Zostel has not chosen to challenge the arbitral Award, possibly owing to its misconception that the Award directed specific performance of the Term Sheet...*".

Third, another important aspect emanating from the judgment is that while the scope of the interim protection

available prior to, or at the time of the arbitration extends to the subject matter of the arbitration agreement or the amount in dispute, only the “fruits” of the Arbitral Award can be protected at the post-award stage. Thus, the Delhi HC adopted a narrow approach vis-a-vis parties’ rights to seek interim protection under Section 9 of the Act at the post-award stage, as against a wider contour in the pre-award stage. Practically, this may impact the grant of interim protections where the arbitral awards are vaguely drafted and allow limited recourse to the parties to protect the assets against which enforcement may be sought, and which are at the risk of being dissipated.

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(The authors would like to acknowledge and thank for the contribution of Manav Sridharan, Vol intern with Nishith Desai Associates.)

You can direct your queries or comments to the authors

¹ Such as, (i) facilitating transfer of its employees, (ii) facilitating transfer of the properties in its network to OYO’s network, (iii) facilitating the process of consumer migration, (iv) facilitating the process of transfer of future bookings w.e.f. 31st December, 2015 and (v) providing the consumer data of OYO to Zostel.

² Clause 4 indicated that execution of the definitive documents was not independent of the Term Sheet.

³ Clause 7 of the Term Sheet stipulated that the execution of the definitive documents was “subject to the conditions set forth in the Term Sheet”.

⁴ Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

⁵ 2013 SCC OnLine Bom 481; also, Hindustan Construction Co v. Union of India, AIR 2020 SC 122

⁶ (1990) 3 SCC 1.

⁷ “...This TermSheet is non-binding and is intended solely as a summary of the current terms that are proposed by the parties provided that the paragraphs opposite the headings “Confidentiality”, “Approvals”, “Expenses”, “Exclusivity” and “Governing Law and Arbitration” shall be legally binding provisions The parties do not intend to be bound until they enter into Definitive Agreements regarding the subject matter of this TermSheet, and either party may, at any time prior to execution of such Definitive Agreements, unilaterally terminate all negotiations pursuant to this TermSheet without any liability to the other party...”

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