Dispute Resolution Hotline

May 27, 2008

DOMESTIC ARBITRATION AND FOREIGN LAW? NOT POSSIBLE: SC

Are you an Indian national or is your company incorporated in India? Are you entering into any commercial transaction with another Indian national or a company incorporated in India? Are you choosing the recourse to arbitration in the event of any dispute which may in the future? If the answer to all the questions is YES; have you given a proper thought as to what law will govern any dispute which may arise in the transaction in the future? Well there is no option.

RECENT SUPREME COURT (SC) CASE

On May 14, 2008 the apex court has laid down a landmark judgment in the case of TDM Infrastructure Pvt. Ltd. ("**TDM**") v. UE Development India Pvt. Ltd. ("**UED**"), wherein it is held that two Indian companies locked in a dispute cannot seek international commercial arbitration ("**ICA**") defined under the Indian Arbitration and Conciliation Act, 1996 ("**the Act**") as it tantamount's to condoning the home country's law. The Hon'ble Judge held that "the intention of the legislature appears to be clear that Indian nationals should not be permitted to derogate from Indian law. This is part of the public policy of the country."

FACTS OF THE CASE

In the abovementioned case, both the parties were companies incorporated under the Indian Companies Act, 1956. UED was awarded a project for rehabilitation and upgradation by the National Highway Authority of India. UED subcontracted some portion thereof to TDM. Disputes arose between the two companies and a consensus on a common arbitrator could not be reached between the parties. TDM approached the SC seeking the appointment of an arbitrator by virtue of Section 11(5) and 11(9) of the Act, under which the Chief Justice of India (CJI) or any person or institution designated by CJI could appoint an arbitrator. The reasoning of TDM in approaching the CJI was that since the control and management of TDM was in Malaysia, the dispute was an ICA. UED resisted this request, arguing that since TDM was incorporated and registered in India, the dispute does not fall under the purview of ICA and that the SC had no jurisdiction to pass an order for appointing an arbitrator. It insisted that TDM in law must be held to be situated in India notwithstanding that the directors are foreign nationals. The court was of the same view and rejected the applicability of Section 2(f)(iii) of the Act to the dispute.Section 2(f)(iii) of the Act defines ICA as "an arbitration relating to disputes arising out of legal relationships, whether contractual or not, considered as commercial under the law in force in India and where at least one of the parties is … a company or an association or a body of individuals whose central management and control is exercise in any country other than India."

JUDGMENT

SC has further laid down that no matter even if the control and management of a company is outside India; just by the virtue of having the entity registered in India makes it a domestic company and in the event of a dispute such a company cannot take recourse to foreign law as the governing law where the opposite party is also an Indian national or entity. The court in its dicta held that that if a company is registered in India, although having its director's based abroad, it would be an Indian unit for the purpose of Arbitration and Conciliation Act, 1996. When both the companies are incorporated in India, Clause (ii) of Section 2(1)(f) will apply and not the clause (iii) thereof.Further interpreting the law at hand, the SC has held that only in case where a body corporate which need not necessarily be a company registered and incorporated under the Indian Companies Act, as for example, an association or a body of individuals, the exercise of central management and control in any country other than India may have to be taken into consideration.The SC further explained that ICA meant arbitration between parties at least one of which is a body corporate which is incorporated in any country other than India. Court held that the incorporation in India was sufficient to determine the nationality of the Company. Therefore, it declined to nominate an arbitrator in the current judgment.Drawing attention to the fact that Indian Income Tax Act, 1961 contains a similar provision to Section 2(1)(f) of the Act; the court further observed that the tax statute and the Arbitration and Conciliation Act were not in pari materia, thereby concluding that taxation statue could not be used to interpret the Arbitration and Conciliation Act.

ANALYSIS

- This case law lays down the boundaries for determination of the nationality and domicile of the company. It clarifies the position of law that in case of any domestic arbitration, the arbitral tribunal shall determine the dispute in accordance with the substantive law of India in force at that time and restricts from using the law of any other country.
- In cases where both the parties are Indians and even if the subject matter of the transaction is based outside Indian

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borders e.g. technology related transactions; there might be a case that any other country's law if more favourable to the transaction instead of the Indian law, however, in light of this judgment the parties would not be able to refer to that law which plays as a hindrance over the parties choice. This seems not to be in consonance with the premise of arbitration mechanism that the 'party autonomy' is above all and central to a healthy business atmosphere.

Source: Judgment of the SC on the matter of TDM Infrastructure Pvt. Ltd. v. UE Development India Pvt. Ltd.dated May 14, 2008

- Sambhav Ranka & Vyapak Desai

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