

Dispute Resolution Hotline

September 07, 2012

BHATIA INTERNATIONAL AND VENTURE GLOBAL OVERRULED, BUT PROSPECTIVELY!

The Constitutional Bench of the Supreme Court ("**Court**") on September 6, 2012 in its decision in Bharat Aluminum Co. ("**Appellant**") v Kaiser Aluminum Technical Service, Inc. ("**Respondent**"), after laudable consideration of jurisprudence laid down by various Indian & foreign judgments and writings of renowned international commercial arbitration authors, ruled that findings by the Court in its judgment in Bhatia International v Bulk Trading S.A & Anr¹ ("**Bhatia International**") and Venture Global Engineering v Satyam Computer Services Ltd and Anr² ("**Venture Global**") were incorrect. It concluded that Part I of the Arbitration and Conciliation Act, 1996³ ("**Act**") had no application to arbitrations which were seated outside India, irrespective of the fact whether parties chose to apply the Act or not. Hence getting Indian law in line, with the well settled principle recognized internationally that "the seat of arbitration is intended to be its center of gravity".

But this welcome overruling by the Court of its previous decisions will provide no relief to the parties who have executed their arbitration agreements prior to the current judgment as the Court, right at the end of its judgment, directed that the overruling was merely prospective and the laws laid down therein apply only to arbitration agreements made after September 6, 2012.

BRIEF FACTS

The appeal filed by *Bharat Aluminum Co.* before the Division Bench was placed for hearing before a three Judge Bench as one of the judges in the Division Bench found that judgment in *Bhatia International and Venture Global* was unsound and the other judge disagreed with that observation. Subsequently it was directed to be placed before the Constitution Bench on January 10, 2012 along with other similar matters.

RELEVANT ISSUES DEALT BY THE COURT

The Court was unable to support the conclusions recorded by it in its previous decisions in *Bhatia International and Venture Global*. It concluded that the Act has adopted the territorial principle unequivocally accepted by the UNCITRAL Model Law, thereby limiting the applicability of Part I to arbitrations, which take place in India. It further stated that the territoriality principle of the Act precludes Part I from being applicable to a foreign seated arbitration, **even if the agreement purports to provide that the Arbitration proceedings will be governed by the Act (emphasis supplied).**

1. Interpretation of Section 2(2) of the Act

The pertinent issue for consideration before the Court was whether absence of the word "*only*" in Section 2(2) makes Part I of the Act applicable to all arbitrations, including arbitrations seated outside India. The previous judgments including *Bhatia International and Venture Global* clearly held that Part I would apply to all arbitrations including those held out of India, unless the parties by agreement, express or implied, exclude all or any of its provisions.

The primary contention put forth by the Appellant was that absence of the word "*only*" in Section 2(2) of the Act permits applicability of Part I of the Act to arbitrations held outside India, there being a conscious deviation from Article 1(2) of UNCITRAL Model Law. Further, restricting the applicability of this provision would lead to conflict with the rest of the provisions of the Act.

The Court following the principles of literal interpretation and in regard of the legislative intention held that applicability of Part I of the Act is limited only to arbitrations held in India and omission of the word "*only*" from Section 2(2) has no relevance. It further observed that the present wording of the Act does not deviate from the territoriality principle as accepted under Model Law and absence of "*only*" in the said provision does not change the content/intention of the legislation. It was observed that it is not permissible for the court while construing a provision to reconstruct the provision. The Court cannot produce a new jacket, while ironing out the creases of the old one.

2. No conflict with Section 2(4) and 2(5) of the Act

The Court dealt with the aspect whether the above interpretation of Section 2(2) of the Act would be in conflict with Sections 2(4) & 2(5). The Appellant contended that the language of Sections 2(4) & 2(5) makes Part I applicable to every arbitration, whether in India or outside.

The Court categorically held that there exists no conflict among the said provisions as Section 2(4) is applicable to "every arbitration under any other enactment for the time being in force" *covered by Part I (emphasis supplied)* and for the purposes of this section "*enactment*" would mean only an Act made by the Indian Parliament. Section 2(5) is merely an extension to Section 2(4) to deal with all proceedings in relation to

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arbitration with the exception of statutory or compulsory arbitrations in case of inconsistency and "all arbitrations" includes only those to which Part I is applicable. Thus, by virtue of the above provisions, Part I of the Act applies to all arbitrations held in India in accordance with the provisions of any Indian enactments unless inconsistent with the provisions of the Act .

3. Award under Section 2(7) of the Act is a "domestic award"

The scheme of the Act indicates that Part I applies to domestic arbitrations as well as international arbitrations conducted in India. International Commercial Arbitration included within Part I contemplate arbitrations between two foreign parties under foreign law with seat in India. Therefore, domestic awards made within Part I of the Act includes within its scope both, award rendered in an international arbitration held in India as well as arbitration between two domestic parties and not awards rendered in arbitration held outside India.

he object of Section 2(7) is to differentiate between domestic and foreign awards as covered under Part II of the Act. There is no overlapping between the two parts of the Act as the latter deals only with arbitrations held outside India, thereby categorizing them as foreign awards. The Court held that Act being based on the territoriality principle excludes applicability of Part I to foreign seated arbitrations even if the agreement is governed by the provisions of the Act.

4. Party Autonomy

The Act permits the parties to decide the place of arbitration. The Court interpreting Section 20 of the Act pertaining to place/seat of arbitration has clarified that if seat of arbitration is India, parties are free to choose any place or venue within India for conducting the arbitration proceedings. However, the said provision is to be read with Section 2(2) of the Act to understand the applicability of principle of territoriality. In the absence of parties failing to specify law governing arbitration proceedings, the same would be governed as per the law of the country in which arbitration is held, having the closest connection with the proceedings.

The Court has distinguished the concept of "*seat*" and "*venue*" and explained their significance in arbitration proceedings. The distinction between seat and venue of arbitration assumes significance when foreign seat is assigned, with the Act as the curial law governing the arbitration proceedings. In such scenario, Part I would be inapplicable to the extent inconsistent with arbitration law of the seat.

Further, elaborating on the issue of choice of substantive law, the Court interpreting Section 28 of the Act held that arbitrations under Part I of the Act not being international commercial arbitration would be compulsorily governed by the Indian substantive law, to prevent domestic parties from resorting to arbitration with foreign governing law, whereas no such compulsion prevails in case of international commercial arbitration as defined under Section 2(1) (f) of the Act. The very objective of the Section is to segregate domestic and international arbitrations and convey the legislative intention of not providing extra-territorial applicability to Part I of the Act.

5. Application of Part II of the Act

The Court held that there is no overlapping of the provisions of Part I and Part II of the Act and Part II is not merely supplementary. There is complete segregation between both the parts as Part I deals with all four phases of arbitration-commencement, conduct, challenge and recognition and enforcement whereas Part II pertains only to recognition and enforcement of foreign awards. Further, the Court held that regulation of conduct of arbitration and challenge would be done by the Courts of the country in which arbitration is conducted, thereby application of Part I provisions to foreign awards would defeat the very object of the Act. Elaborating on the said issue, the Court has also clarified that approaching judicial authority under the non-obstante clause in Section 45 of the Act, does not make Part I applicable to foreign arbitrations held outside India.

6. Enforcement of Foreign Award under Section 48(1) & (2) though being under Part II construed as falling under Part I

No provision for annulment of foreign award is provided under the Act. Section 34 pertaining to challenge of awards being included within Part I clearly reflects the legislative intention to restrict its scope to domestic awards. Section 48 of the Act recognizes that Courts of two nations are competent to annul or suspend an award including the country in "which the award was made" and "*under the law of which the award was made*". Enforcement of foreign award in India would be refused only if the said award is set aside by Courts of either of the countries as specified above. The Appellant contended that Courts in both the countries have concurrent jurisdiction to annul the award.

The Court has clarified that the expression "under the law of which the award was made" refers to the procedural law/curial law of the country and has no reference to the substantive law of the contract between the parties. Rejecting the contrary views upheld in its previous judgments annulling foreign award on the basis of law governing the dispute, the Court held that awards passed in arbitrations conducted outside India cannot be annulled under the provisions of the Act.

7. Applicability of Section 9 to foreign seated arbitrations

The major contention of the Appellant for applicability of Section 9 relief to foreign awards was not to leave any party remediless and correct interpretation being adopted in *Bhatia International*. The applicability of Part I was extended only to the extent of granting interim reliefs and not annulment as the same would invite extra-territorial operations.

Section 9 of the Act acts in aid of the arbitration proceedings and provides interim reliefs before or during arbitration or at any time after the making of award but prior to the enforcement of the award under Section 36 of the Act. The Court held that Section 36 being applicable only to domestic awards, pertains only to arbitrations with Indian seat, thereby Section 9 cannot be made applicable to arbitrations held outside India in contravention of the territoriality principle established under Section 2(2) of the Act. It was further clarified that if parties voluntarily chose a foreign seat, it would be implied that consequences of such choice would be known to them and non-applicability of Section 9 would not render them remediless.

8. No relief for awards passed in Non-Convention Countries

Awards passed in non-convention countries are not included within the ambit of the Act. The Court held that non-inclusion of the same does not amount to a lacunae as the legislative intention needs to be understood from the language and aspects not included therein cannot be incorporated vide interpretation. The ability to remove such

defects is vested only with the Parliament and in its absence; applicability of the Act is limited to awards passed under the Act and in convention countries.

9. **Maintainability of suits for Interim Reliefs**

Existence of cause of action is the basis to maintainability of suits under the Code of Civil Procedure, 1908 ("Code"). Pendency of arbitration proceedings does not constitute sufficient ground for maintainability of a suit for interim relief. The Court has specified that no suit on the merits of the arbitration would be maintainable as the same would be subject to Sections 8 and 45 of the Act and relief if any would be purely to safeguard the property in dispute before the Arbitrator. No substantive reliefs on the merits of the arbitration could be claimed in the suit and in the event of a valid cause of action; no such suit would be maintainable. The relief claimed would be subject to future award that may be passed and contingent cause of action would not suffice to get proper reliefs. No provision of the Code or the Act vests powers to grant interim relief in suits in the absence of existence of a substantive suit, in pending arbitrations held outside India.

ANALYSIS

Due to the limited application of the present judgment to arbitration agreements executed post September 6, 2012, the Appellants in the present appeal are effectively on the losing side as their arbitration agreements were executed prior to the said period and hence the present judgment is not applicable to them. The judgment has several positive and negative elements that need to be considered :

Positives

The judgment has clarified several legal anomalies which had tarnished the image of Indian arbitration laws and judicial system. It has remedied the primary concern which foreign parties faced while arbitrating against an Indian party i.e. ensuring minimum interference by local courts in arbitrations seated outside India.

The judgment by further clarifying that no annulment proceedings would lie in India against an award made outside India has got the Indian arbitration law at par with other international jurisdictions. It has eased the difficulties the foreign investors/ players have been facing in enforcing foreign awards in India against Indian parties.

Negatives

The judgment while overruling Bhatia International failed to appreciate an important observation which was made by the Court in allowing the applicability of Section 9 of the Act to arbitrations seated outside India. The Court in Bhatia International had observed that one important reason for allowing the applicability of Section 9 of the Act to arbitrations seated outside India was that interim orders from foreign courts and arbitration tribunals are not enforceable in India and such a situation would leave foreign parties remediless. The Court by not considering this issue has made it very difficult for foreign parties to now seek meaningful and enforceable interim reliefs against Indian parties in arbitration seated outside India.

The judgment also failed to address the issue as to whether two domestic parties could choose a foreign seat thereby excluding the applicability of Part I of the Act. The said issue has been debated extensively in other jurisdictions and also raised by the Appellant herein. The Court inspite of clarifying that Indian substantive law would be applicable compulsorily to all domestic arbitrations and Indian parties where seat of arbitration is India cannot circumvent the application substantive Indian law has failed to discuss the scenario wherein domestic parties opt for a foreign seat.

The biggest negative one can draw from this judgment is its implied adoption of the doctrine of prospective overruling. The Court has made its ruling applicable only to the **arbitration agreements executed (emphasis supplied)** post the present judgment i.e. post September 6, 2012. Though the doctrine of prospective overruling is recognized in India the application of the same in the present situation would lead to more confusion. By pegging the applicability of the present judgment to the execution of an arbitration agreement the court has opened a Pandora's Box of questions. For example: If an arbitration agreement is executed in August, 2012 and the disputes under the same arise in July, 2016 the parties under that agreement would be bound by the rules laid down by *Bhatia International and Venture Global* leading to two sets of jurisprudence running parallel in India. Infact, for the parties, who challenged the law laid down by Bhatia International and have been successful in their challenge, will be still subject to the said law laid down by Bhatia International for adjudication of their disputes pending before the date of this judgment. This is quite an anomaly that has been created.

The Court could have achieved its objective of avoiding confusion due to overruling of *Bhatia International and Venture Global* by restricting the applicability of the Court's decision only to the cases arising in future and prohibiting its applicability to the cases which have attained finality. This would be a more appropriate application of the doctrine of prospective overruling.

STEPS AHEAD

In light of the prospective applicability of the present judgment it is advisable that parties revise their arbitration agreements and re-execute them, if they wish to bring them under the umbrella of the new law.

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You can direct your queries or comments to the authors

¹2004 (2) SCC 105

²2008 (4) SCC 190

³Relevant provisions [attached here](#)

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