

Dispute Resolution Hotline

May 13, 2015

SUPREME COURT CLARIFIES VALIDITY OF ARBITRATION AGREEMENTS IN MOUS

- An arbitration clause is a separate and independent agreement.
- The arbitration agreement survives and does not necessarily come to an end even if the MoU does not materialize into a full-fledged agreement.
- Parties are bound to refer disputes arising out of and in relation to the MoU to arbitration if provided in the dispute resolution clause.

INTRODUCTION

The Supreme Court of India (“**Supreme Court**”) in the recent case of *Ashapura Mine-Chem Ltd (“Appellant”) v. Gujarat Mineral Development Corporation¹ (“Respondent”)* has addressed the issue of separability and survival of an arbitration clause contained in a Memorandum of Understanding (“**MoU**”). The Supreme Court held that the arbitration agreement in the MoU was valid as it constitutes a stand-alone agreement independent from its underlying contract.

FACTS

The parties entered into a MoU in 2007 for setting up an alumina plant in Gujarat by way of a Joint Venture with a Chinese company. The MoU provided for an arbitration agreement in the event of parties’ failure to settle disputes amicably. The relevant clause provided that (a) the arbitration proceedings would be held at Ahmedabad; and (b) it would be governed and construed in accordance with the laws of India.

Subsequent to the signing of the MoU, the Respondent decided to approve the MoU subject to certain modifications. After considerable exchange of correspondence, the Respondent sought amendments to the original MoU due to major change in State policy. However, eventually the Respondent cancelled the MoU on the pretext that Appellant had failed to comply with the terms and conditions contained therein.

The parties failed to resolve their disputes amicably and no consensus could be reached on appointment of Arbitrator between them. The Appellant filed an application under Section 11 of the Indian Arbitration & Conciliation Act, 1996 (**Act**) for appointment of Sole Arbitrator.

The Gujarat High Court (“**Gujarat HC**”) dismissed the application for appointment of Arbitrator on the ground that the MoU never resulted in a complete contract, and accordingly held that no enforcement could be sought for the same. The Gujarat HC held that the MoU was “stillborn” as it did not fructify into a joint venture. The present ruling arises out of an appeal from the decision of the Gujarat HC.

ISSUE

The issue before Supreme Court was whether the MoU was a concluded contract, if not, whether the arbitration clause survives and continues to bind the parties being a stand-alone provision.

ARGUMENTS

The Appellant submitted that even if the MoU did not ultimately fructify, the dispute resolution clauses, by virtue of specific terms contained therein, operated as a stand-alone agreement for arbitration with reference to the terms of the MoU. On the other hand, Respondent submitted that due to complete absence of consensus between the parties, even with regard to the MoU, there was no scope for making a reference to arbitration as per certain clauses contained therein.

JUDGMENT

The Supreme Court relying on several judgments including *Reva Electric Car Co. Pvt Ltd. v. Green Mobil²* and *Today Homes and Infrastructure Pvt. Ltd. v. Ludhiana Improvement Trust³* and *Enercon v Enercon⁴* concluded that in addition to the fundamental nature of the separability presumption, the dispute between the parties relates to the relationship created by way of the MoU and so the arbitration agreement contained therein would bind the parties.

The Supreme Court found that irrespective of whether the MoU fructified into a full-fledged agreement, the parties had agreed to subject all disputes, arising out of and in connection to the MoU, to arbitration. Such an agreement would constitute a separate and independent agreement in itself. Since no consensus was reached on the appointment of a Sole Arbitrator, it would be open to the parties to invoke Section 11 of the Act. Based on this ground alone, the Supreme Court set aside the order of the Gujarat HC, and appointed a Sole Arbitrator due to existence of a

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valid arbitration agreement.

ANALYSIS

The position with respect to whether an arbitration agreement contained in a contract is separable is settled law and the separability doctrine is respected by all courts.⁵ However, there continues to be instances where the court finds exception. Such exceptions are often raised in the context of MoUs or agreements claimed to be unconcluded by one of the parties. The contention is essentially that MoU is a contract *non-est* i.e. it is a contract that has not come into existence.

Survivability and separability of arbitration clauses contained in agreements that are novated or superseded by subsequent agreements have also been tested to ascertain their validity. In *Mulheim Pipecoatings v. Welspun Fintrade*⁶, the Bombay HC while dealing with this issue held that the separability presumption enshrined in the Act requires the impugned arbitration agreement to be directly impeached in order to be considered inapplicable. Therefore a superseding agreement not containing an arbitration clause would not invalidate the arbitration clause in the previous one.

However, the Supreme Court in *M/S Young Achievers v. IMS Learning Resources*⁷ gave a completely contradictory view that “an arbitration clause in an agreement cannot survive if the agreement containing arbitration clause has been superseded/novated by a later agreement.” The reasoning of the Supreme Court was that superseded agreements are *void ab initio* or *non-est*. The decision in *Ashapura* might lead the way with respect to issue of separability of arbitration clauses and provide clarity on enforcement of such clauses in MoUs.

– Niyati Gandhi, Payel Chatterjee & Vyapak Desai
You can direct your queries or comments to the authors

¹ 2015 (5) SCALE 379.

² *Reva Electric Car Co. Pvt Ltd. v. Green Mobil*, 2012(2) SCC 93.

³ *Today Homes and Infrastructure Pvt. Ltd. v. Ludhiana Improvement Trust*, 2014 (5) SCC 68.

⁴ *Enercon v. Enercon*, 2014 (5) SCC 1.

⁵ 2014 (5) SCC 1, 2014 (2) ABR 196.

⁶ *Mulheim Pipecoatings v. Welspun Fintrade*, 2014 (2) ABR 196. (See <https://nishithdesai.com/SectionCategory/33/Dispute-Resolution-Hotline/12/57/DisputeResolutionHotline/5586/8.html>)

⁷ *M/S Young Achievers v. IMS Learning Resources*, 2013 (1) SCC 535.

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