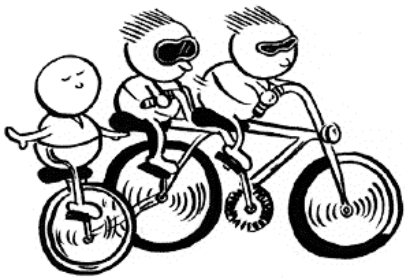
**Volume 5 Issue 2**

# IMC ARBITRATION COMMITTEE

## News Bulletin- Published and circulated periodically

***THIRD WHEEL IN AN ARBITRATION***



In a recent judgment, Hon'ble Justice Alok Aradhe of the Karnataka, has reaffirmed the position in law that an arbitration clause can be invoked by a third party who is not a signatory to the contract.

Reiterating, the position of law laid down by the Supreme Court in the case of ***Chloro Controls India Pvt. Ltd. v. Severn Trent Water Purification Inc.*** [1] **, wherein the Hon'ble Supreme Court held** that arbitration could be possible between a signatory to an arbitration agreement and a third party when the claimant has succeeded by operation of law to the rights of the named party in the contract.

With the introduction of the new Information and Technologies Scheme by the Government of India in 2004, which aimed to improve computer literacy with the younger generation in the country, the Karnataka Government appointed the Karnataka State Electronics Development Corporation

[1] **(2013) 1 SCC 641**

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

Limited (KEONICS) to take the scheme forward in the state. KEONICS was permitted to appoint sub-contractors and consortium partners under the Agreement.

KEONICS floated a nation-wide tender and the bid of one Everonn Education Ltd. was approved along with its then consortium partners. The Agreements between the State Government and KEONICS and KEONICS and the consortium, both provided for any dispute to be referred to Arbitration.

As the State Government rescinded the Contract with KEONICS in 2016, one of the consortium companies approached the Karnataka High Court invoking the writ jurisdiction of the High Court, challenging the termination of the Contract.

After hearing both parties, the Hon'ble High Court noting that the Writ Jurisdiction could not be invoked if there is a disputed question of law and facts that warrants consideration and since there was an Arbitration Clause between the parties, the parties should be relegated to exercise the Arbitration Clause of the Agreement for the adjudication of the disputes between the parties.

The High Court citing the law laid down by the Supreme Court in the case of ***Chloro Controls India Pvt. Ltd. v. Severn Trent***

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

***Water Purification Inc.***[2]**,** gave the Petitioner in the Writ Petition the liberty to take recourse and invoke the Arbitration Clause of the Agreement or such remedy as may be available to the party.

## ‘WIND – UP’ THAT DISPUTE FIRST!

“Great idea to solve the conflict with a water pistol fight!”

An application by an operational creditor to initiate Corporate Insolvency Resolution Proceeding against a Corporate Debtor by the appropriate adjudicating authority is surrounded by certain conditions as provided for under the Insolvency and Bankruptcy Code, 2016. One such condition for the

[2] **(2013) 1 SCC 641**

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

initiation of the insolvency proceedings is there shall be no notice of dispute in any manner whatsoever received by the operational creditor or no record of dispute of any kind in the information utility. The same is indicated more specifically under Section 9(5)(i)(d) of the Code.

It becomes imperative for one to understand the meaning of the word "Dispute" in order to ascertain the maintainability of an application filed under Section 9 of the Code. As per, the Code, the definition of the word "Dispute" shall mean and include a suit or an arbitration proceeding pertaining to (a) the existence or the amount of debt; (b) the quality of goods or service; or (c) the breach of a representation or warranty.

The scope of the word 'Dispute' has been a concern of many in the recent matters of judicial consideration in this context. In the matter of *K. Kishan Vs. M/s Vijay Nirman Company Pvt. Ltd.*, the Hon'ble Supreme Court further widened the scope of the word dispute to include a challenge to an arbitral award passed in a proceeding under Article 34 of the Arbitration and Conciliation Act, 1996.

The brief facts leading up to the dispute are that the Respondent (Vijay Nirman Company Pvt. Ltd.) had entered into a construction agreement dated 01/02/2008 for the widening of a two – lane highway with Ksheerabad Constructions Pvt. Ltd. During the pendency of the agreement and its obligations arising

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

thereof, certain disputes arose between the parties. The said disputes were then referred to an arbitral tribunal on account of the arbitration agreement contained within the said Construction Agreement. The Arbitral tribunal adjudicating over the dispute then passed an Award dated 21/01/2017 allowing in part the claims of the Respondent, one claim for a sum of Rs. 1,71,98,302/- arising out of payment certificates and another claim of Rs. 13,56,98,624/- for higher rates was allowed. All the counter claims made by the Appellant were rejected in the said Award.

On 06/02/2017, the Respondent then issued a demand notice as mandated under Section 8 of the Insolvency and Bankruptcy Code, 2016 for a sum of Rs. 1,79,00,166/- on the Appellant. Within 10 Days, the Appellant tendered a reply stating that the demanded debt amount was disputed and that the same was subject matter of an arbitral proceeding. In pursuance to the foregoing, the Appellant then filed an application under Section 34 of the Arbitration and Conciliation Act, 1996 thereby challenging the Arbitral Award dated 21/01/2017.

The Respondent, during the pendency of the above petition under Section 34 proceeded to file an application for initiation of Corporate Insolvency Resolution Proceedings against the Appellant by filing an application under Section 9 of the Insolvency and Bankruptcy Code, 2016. The nature of claim by the Respondent was that of an 'Operational

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**News Bulletin- Published and circulated periodically**

Debt' under the Code. The National Company Law Tribunal ("**NCLT**") then passed an order admitting the application filed therein by way of order dated 29/08/2017. The same was later upheld by the National Company Law Appellate Tribunal ("**NCLAT**") on the basis that non-obstante Clause contained within Section 238 of the Code would override the Arbitration Act and further that the order of the Arbitral Tribunal adjudicating on the said default claim, would be treated as "a record of an operational debt".

The order passed by the NCLAT later came to be appealed against by the Appellants before the Hon'ble Supreme Court.

The Apex Court then held that the pendency of a challenge to an Award under Section 34 by a Party would constitute a 'dispute' under the Code. It is in this light that an application under the Insolvency and Bankruptcy Code, 2016 is not maintainable as the subject debt is still said to be in dispute by the Corporate Debtor.

It was further held that the prime consideration of a dispute under the Code, by the adjudicating authority regarding an operational debt would be that the same shall not be disputed. Accordingly, it can be said that the pre-existing ongoing dispute between the parties continues and that the conclusion of the dispute would be under sections 34 and 37 of the Arbitration and Conciliation Act,

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**News Bulletin- Published and circulated periodically**

1996. According to the Apex court, since there were cross claims by the Appellant, which were the subject matter of their challenge under the application under section 34 of the Act, and there is a reasonable possibility that the said cross claims may succeed, the operational debt in the said application ought not to be considered as an undisputed debt.

The Supreme Court then went on to reiterate its stand in *Mobilox Innovations Private Limited v. Kirusa Software Private Limited [(2018) 1 SCC 353]* stating that an operational creditor, cannot use the Code to bypass the adjudicatory process of a disputed debt and vitiate from the applicability of other statutes. Further, the Court held that Section 238 of the Code would only be applicable in the event that there was an inconsistency between the Code and the Arbitration and Conciliation Act, 1996. This however, was not the case in the instant matter at hand. As a matter of fact, the challenge under section 34 was an indication that the subject debt was in dispute.

***Mere allegation of fraud simplicitor may not be a ground to nullify the effect of Arbitration Agreement between the parties – Supreme Court of India***

**Parties:**

Rashid Raza was the Appellant and Sadaf Akhtar was the Respondents before the Supreme Court.

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**News Bulletin- Published and circulated periodically**

**Question of Law:**

Mere allegation of fraud simplicitor may not be a ground to nullify the effect of arbitration agreement between the parties

**Factual Matrix:**

The present matter arises out of a partnership dispute in which an FIR was lodged by one of the partners alledging siphoning of funds and that various other business improprieties were committed and the FIR is under investigation.

An Arbitration Petition dated 02/01/2018 was filed by the Appellant before the High Court under Section 11 of the Arbitration and Conciliation Act, seeking appointment of an Arbitrator under the Arbitration Clause found in the Partnership Deed between the parties dated 30/01/2015.

The High Court in its impugned Order dismissing the Petition has cited *A. Ayyasamy v. A. Paramasivam*[3] and held: "The allegation of fraud that was leveled against the appellant was that he had signed and issued a cheque of Rs.10,00,050 on 17th June, 2010 of Hotel Arunagiri in favour of his son without the knowledge and consent of the other partners i.e. respondents. It was a mere matter of account which could be looked into and found out even by the arbitrator. The facts of the instant case however are much more

[3] **(2016) 10 SCC 386**

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

complex as the materials on records disclose. This Court however does not intend to make any comments on the merits of the allegations lest it may prejudice the case of the parties in an appropriate proceeding before competent court. However, considered in totality this Court is of the firm view that the nature of the dispute involving serious allegations of fraud of complicated nature are not fit to be decided in an arbitration proceedings. The dispute may require voluminous evidence on the part of both the parties to come to a finding which can be only properly undertaken by a civil court of competent jurisdiction."

Aggrieved by the aforesaid impugned Order, the Appellant approached the Supreme Court in this Civil Appeal No. 7005 OF 2019 (Arising out of SLP (C) No. 4061 of 2019).

**Judgment:**

The Supreme Court held that the principles of law laid down in this appeal make a distinction between serious allegations of forgery/fabrication in support of the plea of fraud as opposed to "simple allegations". Two working tests laid down in paragraph 25 of the Judgment relied on by the High Court in its Impugned Order are : (1) does this plea permeate the entire contract and above all, the agreement of arbitration, rendering it void, or (2) whether the allegations of fraud touch upon the internal affairs of the parties inter se having no implication in the public domain. Judged by these two tests, it is clear that this

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

is a case which falls on the side of "simple allegations" as there is no allegation of fraud which would vitiate the partnership deed as a whole or, in particular, the arbitration clause concerned in the said deed. The Supreme Court further held that all the allegations made which have been relied upon by the Counsel appearing on behalf of the Respondent, pertain to the affairs of the partnership and siphoning of funds therefrom and not to any matter in the public domain. This being the case, the Supreme Court is of the view that the disputes raised between the parties are arbitrable and further held that a Section 11 application under the Arbitration Act would be maintainable.

The Supreme Court consequently set aside the Judgment under appeal, and with the consent of the parties, proceeded to appoint Justice Amareshwar Sahay, Retired Judge of the Jharkhand High Court as the sole arbitrator to resolve all disputes between the parties.

**Volume 5 Issue 2**

Chamber of Commerce and Industry

# IMC ARBITRATION COMMITTEE

## News Bulletin- Published and circulated periodically

***Parties can be permitted to adduce evidence in proceedings under Section 34 of***

***the Arbitration and Conciliation Act only under exceptional circumstances – Supreme Court***

**BRIEF NOTE**

**Parties:**

Canara Nidhi Limited was the Appellant and M Sashikala and others were the Respondents before the Supreme Court.

**Question of Law:**

Whether parties can adduce evidence in proceedings under Section 34 of the Arbitration and Conciliation Act to prove the grounds specified therein.

**Factual Matrix:**

The Appellant is a financial institution that had advanced a loan to the Respondents and had obtained guarantees from them for the same. A dispute arose when it was alleged that the Respondents failed to repay the loan and discharge their liabilities. The Arbitrator appointed passed an Award directing the Respondents to repay the Appellant along with interest. The Respondents challenged the Award before the District Court. The District Court dismissed an application filed by the Respondents seeking to adduce evidence, holding that the records of the proceedings would be sufficient to decide the challenge under Section 34. When the order was challenged before the High Court of

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

Karnataka, the Single Judge referring to the judgment in *Fiza Developers and Inter-Trade Private Limited v. ACMI (India) Private Limited and another*[4], observed that in order to prove the existence of grounds under Section 34 (2) parties ought to be permitted to adduce evidence and directed the District Court to recast issues and permit the parties to adduce evidence.

**Judgment:**

The Supreme Court observed the judgment in *Fiza Developers*, and took note of the amendments to Section 34 under the Arbitration and Conciliation (Amendment) Act 2015, and the report of the Justice B N Srikrishna Committee which pointed out that the opportunity to furnish proof in proceedings under Section 34 led to inconsistent practices, and the judgment in *Emkay Global Financial Services Limited v Giridhar Sondhi*[5] which observed that the judgment in *Fiza Developers* must be read in light of the amendments to Section 34, and clarified that evidence in proceedings under Section 34 should not be allowed unless absolutely necessary. The Supreme Court also took note of the further amendments to Section 34 under the Arbitration and Conciliation (Amendment) Act 2019 wherein the words "*furnishes proof that*" were replaced by "*establishes on the basis of the*

[4] **(2009) 17 SCC 796**

[5] **(2018) 9 SCC 49**

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

*record of the Arbitral Tribunal that*". Observing thus, the Supreme Court observed that no grounds were made out by the Respondents in their application to show why additional evidence was necessary, and held that it is only in exceptional circumstances that parties can be permitted to adduce evidence in proceedings under Section 34 of the Act and set aside the judgment of the High Court.

**Power under Section 11-Appointment of an Arbitrator**

The Supreme Court has held that, after introduction of Section 11(6A) to the Arbitration and Conciliation Act, the jurisdiction of the Supreme Court / High Court, while considering a petition to appoint arbitrator, is confined to the examination of existence of an arbitration agreement. ***In Mayavati Trading Pvt Ltd Vs Pradyuat Deb Burman***, the three bench Judge overruled a judgment that had held that the appointment of an arbitrator is a judicial power.

In ***Duro Felguera Vs Gangavaram Port Ltd***, it was held that after 2015 amendment, the power of the court to appoint an arbitrator under section 11 has been narrowed down to expressly state that the Court need only examine the existence of an arbitration agreement – nothing more, nothing less. The 246th Law Commission Report dealt with

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

some of these judgments and felt that at the stage of a Section 11(6) application, only "existence" of an arbitration agreement ought to be looked at and not other preliminary issues.

Prior to introduction of section 11 (6A), the case law under sec 11(6) of the Arbitration Act, as it stood prior to the Amendment Act, 2015, has had a chequered history. The seven- bench judgment in ***SBP Vs Patel Engineering (Supra)*** **(2005)** had overruled that the power to appoint an arbitrator under sec 11(6) of the Act is judicial and not administrative.

It is now clear that the law prior to the 2015 Amendment that has been laid down by the Supreme Court, which would have included going into whether accord and satisfaction has taken place, has now been legislatively overruled with the introduction of section 11(6A) of the 2015 Amendment Act.

**Jurisdiction Issue in Earnest Business Services vs The Government of the State of Israel**

The Petitioner filed the case under section 34 of the Arbitration and Conciliation Act,1996. The Arbitrator granted an award in favor of the respondent, directing the petitioner to pay an amount of Rs.1,17,00,000/- along with interest @ 12% p.a. The Court passed order dismissing a plea filed by *Earnest Business*

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**News Bulletin- Published and circulated periodically**

*Services Private Limited*, challenging an arbitral award passed last year.

The Respondent and the Petitioner got into two separate agreements, one for business service and the other for Business Centre Facility. The Israel Government had deposited an interest-free refundable security deposit with the petitioner under two agreements. The Israeli Government on contrary continued occupying the rented office space even after the expiry of the contact. The rental services were extended later by a subsequent agreement. The petitioner contended that before the extension, the Israeli Government owed money for possessing the office space for 5 months.

As a reaction to this, the petitioner withheld the refundable security deposit making claims that the Israel Government was yet to pay charges for the additional 5 months that it occupied the office space. It claimed that it was the legal obligation of the Israel Government to pay compensation of ₹58,500 per day, in addition to the business center charges.

After taking up arguments of both the Counsels, the Court eventually ruled in the Israel Government's favor, finding that that the sole arbitrator had rightly allowed the claim for refund of security deposit of ₹1.17 crore since the respondent had handed over the possession before the due date.

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**News Bulletin- Published and circulated periodically**

The Court also took note of contractual provisions conferring Courts in Mumbai exclusive jurisdictions over disputes arising between the two parties.

## RECENT NEWS AND DEVELOPMENTS

### *Section 87 of the Arbitration Act amendment and effect*

In a Petition filed by Hindustan Construction Company Limited, which challenged the constitutionality of the amendment to Section 87 of the Arbitration and Conciliation Act, introduced by the 2019 amendment, Justice R.F Nariman observed that the amendment virtually set at naught the judgment of the Supreme Court in BCCI vs Kochi Cricket Private Limited passed in 2018 which decided the applicability of the 2015 Amendment Act to pending arbitration proceedings. The Hon'ble Supreme Court of India observed that the amendment goes against the decision rendered in Kochi Cricket Private Limited. By the insertion to Section 87, the 2015 amendment will not apply to court proceedings arising out of or in relation to arbitral proceedings whether such proceedings were commenced prior to or after the commencement of the Act of 2015.

The Supreme Court of India held that the insertion of Section 87 would result in delay in disposal of arbitration proceedings and an

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**IMC ARBITRATION COMMITTEE**

**News Bulletin- Published and circulated periodically**

increase in interference of Arbitral Awards by courts.

***Ensuring Confidentiality in Arbitration Proceedings***

A high-level committee led by Justice B N Sri Krishna (Retired) has made suggestions to enhance, strengthen and improve institutional arbitration proceedings in India, by making it mandatory on the parties to the proceedings, the counsels for the parties and the Arbitral Tribunal to ensure confidentiality of proceedings and to protect information disclosed in such proceedings unless disclosure is directed by an order of the court.

While parties themselves enter into agreements to make the proceedings confidential and adopt their own institutional rules, Section 42A of the Act further makes it mandatory to ensure confidentiality unless any other law provides otherwise.

***Inordinate Delay in Passing of an Award***

The High Court of Madras has ruled that an unexplained and inordinate delay in passing of an Arbitral Award is contrary to the public policy of India and the same is liable to be set aside. It was held that unjustified delay would run contrary to the intent and purpose of providing for the mechanism of resolution of disputes through arbitration which in itself would render an Award liable to be set aside under Section 34 of the Act.

**Volume 5 Issue 2**

# IMC ARBITRATION COMMITTEE

## News Bulletin- Published and circulated periodically

***Applicability of Section 14 of the Limitation Act to Arbitration Applications***

In an Application under Section 34 of the Act filed by an Insurance Company seeking to set aside an Arbitral Award, the Applicant filed an Application under Section 14 of the Limitation Act, 1963, before the District Court of Jodhpur, to exclude the time spent in filing its original Application under Section 34 before a court having alternate jurisdiction. The District Court dismissed the Application, and the order of dismissal was confirmed by the High Court. The Supreme Court of India held that an Application under Section 14 of the Limitation Act, to condone the delay of time spent in prosecuting a matter before an alternate forum would be maintainable only in the event the original Application under Section 34 is filed within the period of limitation as provided under Section 34(3) of the Arbitration Act.

(*Please send in your entries to legal@imcnet.org.*)

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**Note from the editorial:** Credits to all the members for encouraging and offering suggestions for this bulletin. Thank you for making this possible.

**Committee Member for Bulletin:**

**Prashant Popat**

**Volume 5 Issue 2**

Chamber of Commerce and Industry

# IMC ARBITRATION COMMITTEE

## News Bulletin- Published and circulated periodically