Evolving Arbitration Law: Exclusion or Inclusion of Part I

Introduction

On January 28, 2016, the Supreme Court of India gave its verdict in a case, which is actually a spin-off of the landmark case of Bharat Aluminium Company ("**Balco**") vs. Kaiser Aluminium Technical Services INC. ("**Kaiser**") ("**Balco I**")[1], which overruled Bhatia International vs. Bulk Trading SA.[2] Balco I laid down that Part I of the Arbitration and Conciliation Act, 1996 (the "**Act**") does not apply to international commercial arbitrations held outside India, whereas Bhatia International held that Part I of the Act is also applicable to arbitrations outside India unless it is excluded, impliedly or expressly, by agreement. As Balco I was made prospective, the law laid down in Bhatia International still holds good for all arbitration agreements executed prior to September 12, 2012. The 2016 judgment ("**Balco II**")[3] becomes important for all foreign parties, who want to escape the rigors of Part I by ensuring the seat of arbitration is outside India and where governing law is foreign. Balco II applies to pre September 12, 2012 agreements as well.

This newsletter seeks to analyze the 2016 ruling and suggests the method by which foreign party can avail the benefit of Balco II and Part I.

1. Part I Controversy

The real question is why Part I is so important in arbitration. In this context, it is necessary to examine some important provisions, described in brief: (a) section 9 gives the option to the parties to approach the court for interim relief in order to secure the amount or property in dispute; (b) section 11 gives the parties the right to approach court for appointment of arbitrator in case one party fails to act in terms of the arbitration agreement pertaining to the appointment; and (c) section 27 gives power to the parties to apply to the court for taking its assistance during evidence. Another important provision of Part I is section 34, which has actually been the catalyst for the birth of Balco I and Balco II. Section 34 provides the conditions on the basis of which an award can be set aside. There are several conditions including, amongst others, incapacity of party to execute an arbitration agreement, absence of proper notice of arbitrator's appointment or of proceedings, award is on a subject which cannot be arbitrated and the award is contrary to public policy.

So, why does Part I have so much significance?

As observed from foregoing, despite an agreement to arbitrate, Part I enables parties to approach courts for interim remedies and more importantly, given the plethora of judgments, well reasoned awards have been subjected to challenge under section 34, thereby mocking the entire arbitration process. In contrast, a party can challenge a foreign award in Indian courts under sections 48 and 57 on only two grounds: (a) foreign award is contrary to public policy and/or (b) subject-matter of the dispute was not capable of settlement through arbitration.

[1] (2012) 9 SCC 552
[2] (2002) 4 SCC 105
[3] (2016) 4 SCC 126

In order to minimize challenges to an award under section 34, after Balco I, foreign parties preferred and negotiated to have the seat of arbitration outside India in international commercial transactions. The flip side, of course, was that when Part I was specially excluded, parties were unable to secure any kind of interim relief from Indian courts. By means of the Arbitration and Conciliation (Amendment) Act, 2015[4] (the "**Amendment Act**"), a new proviso has now been added to section 2 of the Act, whereby a narrow option has been provided for a foreign party for availing interim relief against an Indian party even in the foreign seated arbitration. This amendment ensures that contracting parties can carve out an exception to the blanket exclusion of Part I to the arbitral proceedings where the venue is outside India. In effect, this will provide an option to those parties who wish to apply to the Indian courts for interim relief where it is necessary to secure something rapidly.

2. Balco II Facts

Balco and Kaiser entered into an agreement on April 22, 1993 (the "**Agreement**"), whereby Kaiser was required to provide equipment to Balco and to upgrade and modernize its production facilities. As a dispute arose between both the companies, the matter went for arbitration. Dispute resolution clauses in the Agreement, Articles 17.1 and 22, provided as follows: (a) Article 17.1 required parties to try to settle matters amicably and, in case of failure, resolve through arbitration, which was governed by English law; and (b) according to Article 22, the governing law of the contract was Indian, while substantive law of arbitration was English. Thus, seemingly the parties intended to have two different governing laws, one for the contract and the second for arbitration. Pursuant to Articles 17.1 and 22 of the Agreement, the arbitration proceedings were held in London in accordance with English law.

The arbitral tribunal passed two awards dated November 10, 2002 and November 12, 2002, (the "**Awards**") which were in favour of Kaiser. Aggrieved by the Awards, Balco filed applications under section 34 of the Act before the district court of Bilaspur, which dismissed them. This dismissal led Balco to file appeals under section 37 of the Act before the High Court of Chhattisgarh, which were also dismissed. Challenging the High Court's dismissals, Balco preferred a special leave petition[5] before the Supreme Court under Article 136 of the Constitution of India.

The main issue to be determined before the Supreme Court was whether parties agreed to exclude application of Part I, wholly or partly, to the Agreement. In effect, the challenge to the award was under section 34 which came within Part I. In order to determine this, the Supreme Court discussed Articles 17.1 and 22 of the Agreement so as to determine applicable governing law for arbitration. It stressed upon the phrase "pursuant to" in Article 17.1 and observed that arbitration is required to be conducted in accordance with English law as the phrase "pursuant to" means "in accordance with" or "in conformity with". Thereafter, it took the position that parties intended to have arbitration governed by English law, which fact was stated both in the arbitral clause and even in the second limb of the governing law clause of the Agreement. It expressly stated:

[4] The Amendment Act introduced some much needed changes to the Act, which came in force from October 23, 2015.

[5] The Indian constitution provides that Supreme Court may permit any person to appeal and challenge any order of the High Court even if the appeal against such order of the High Court is not provided for in any act or law.

"The terms of the contract will have to be understood in the way the parties wanted and intended them to be. In that context, particularly in agreements of arbitration, where party autonomy is the grundnorm, how the parties worked out the agreement, is one of the indicators to decipher the intention, apart from the plain or grammatical meaning of the expressions and the use of the expressions at the proper places in the agreement. Contextually, it may be noted that in the present case, the respondent had invoked the provisions of English law for the purpose of the initiation of the unsettled disputes"

3. Part I: Inclusion or Exclusion

While examining the application of exclusion of Part I, the Supreme Court considered earlier jurisprudence as well. In Videocon Industries Limited v. Union of India ("UoI")[6], the Supreme Court was required to decide whether application of section 9 filed by UoI before the High Court of Delhi was maintainable in view of the fact that governing law for arbitration was English law. This issue was decided against UoI because the court took the view that Part I is excluded as arbitration was governed by foreign law in that case. Similarly, in Yograj Infrastructure Limited v. Ssang Yong Engineering and Construction Co. Limited[7], the Supreme Court took the view that where SIAC rules apply contractually to the arbitration proceedings, parties cannot apply to court for appointment of arbitrator and, therefore, rejected an application under section 11.

In 2014, in Reliance Industries Limited v. Union of India[8], the Supreme Court yet again had to determine the issue of Part I where governing law was foreign law and it observed as under:

"The provisions of the Part I of the Arbitration Act 1996 (India) are necessarily excluded; being wholly inconsistent with the arbitration agreement which provides "that arbitration agreement shall be governed by English law." Thus the remedy of the Respondent to challenge any award rendered in the arbitration proceedings would lie under the relevant provisions contained in Arbitration Act, 1996 of England and Wales"

The above precedents were also followed in Union of India v. Reliance Industries Limited[9]. The Supreme Court observed that when venue of arbitration is outside India and governing law is non-Indian, Part I is excluded. As a consequence, it decided the main issue in favour of Kaiser and held that Balco cannot challenge the award under section 34 before Indian courts for the reason that Part I is impliedly excluded as law governing the arbitration in London was English law.

Conclusion

Flowing from the above it seems that the intent of the highest court is that where the governing law of arbitration is non-Indian and proceedings take place outside India, an award in such cases cannot be challenged under Part I. Where the governing law is Indian and arbitration is conducted outside India, Part I will apply. It is important for contracting parties to take dispute resolution and governing law clauses very seriously and not treat them as boiler plate.

[6] (2011) 6 SCC 161
[7] (2011) 9 SCC 735
[8] (2014) 7 SCC 603
[9] 2015 (10) SCALE 149

At the end, what matters is not to have an award, but to have an enforceable award so that the winning party gets the necessary relief. In a rush to exclude Part I, contracting parties should not disregard where and how enforcement will be speedy. Balco I, Balco II and other judgments discussed above assert the need of specific attention to dispute resolution clauses, which should be drafted with utmost care and after taking various factors into consideration, such as location of movable and immovable properties, including bank accounts.

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