Arbitration clauses and "implied" exclusion of Indian courts

Introduction

India is progressively opening its boundaries to foreign trade and both inbound and outbound investment and trade has increased. With the change in business dynamics, the need of a speedier method of dispute resolution was imperative. The Arbitration and Conciliation Act, 1996 (**"Act"**) provides for arbitration as an alternative dispute resolution mechanism. The Act applies to both domestic as well as international arbitrations and includes provisions that ascertain the substantive and procedural rights of parties.

The Act has often been criticized as it allows the interference of courts at various stages of arbitration. It consists of two parts wherein Part I applies to domestic and international arbitrations and Part II applies to enforcement of foreign awards as per the New York Convention (**"NY Convention"**). There have been instances where courts have applied provisions of Part I even though no specific reference to the Act has been made in the arbitration agreement/clause. While the law has evolved with time, certain ambiguities continue to remain. The present newsletter highlights those specific instances wherein courts have "impliedly" applied provisions of the Act even though there was no express agreement between the parties and instances where courts have refused the application of the Act due to a foreign governing and curial law.

1.0 Extended scope of Part I of the Act

1.1 Most arbitration clauses have certain key ingredients such as venue and language of arbitration, procedural law to be followed during the arbitral proceedings, reference to an arbitral institution such as Singapore International Arbitration Center (**"SIAC"**), American Arbitration Association (AAA), Indian Council of Arbitration (ICA), if applicable, etc. There are often instances where the law governing the arbitration proceedings is different from the governing law of the contract. In fact, parties also have the option to remain silent on the law governing the arbitration. Such contractual provisions have led to Indian courts determining an important question vis-à-vis the Act, i.e. can parties to an arbitration agreement be bound by Indian law if they have neither specifically excluded nor included reference to the Act in their arbitration agreement.

1.2 In *Bhatia International v Bulk Trading SA,*[1] the Supreme Court of India (**"SC"**) enhanced the scope of Part 1 of the Act and applied it to international commercial arbitrations held outside India even when parties did not specifically refer to the provisions of the Act in their contract. The SC held that Part I of the Act would apply even when the parties have agreed to submit to international commercial arbitration held outside India, unless the parties had, by express or implied agreement, decided to exclude the applicability Part I of the Act in their

[1] AIR2002SC1432

contract. This judgment generated some much expected anxiety amongst foreign companies contracting with Indian companies as they feared that Indian companies may have recourse to challenge the arbitral award in India even though the contract/arbitration clause may not expressly provide so. Further, the interpretation of the SC went one step further and also allowed parties to seek interim relief in India, even though arbitral proceedings were held on a foreign territory.

1.3 The result of the judgment in *Bhatia International v. Bulk Trading SA* was also contrary to the spirit of the NY Convention as awards that would ordinarily classify as "foreign awards" could be challenged under Part I of the Act instead of Part II. In order to bypass the judicial interpretation, contracts specifically excluded the application of Part I of the Act even if the governing law of arbitration as well as the contract was a foreign law and the venue of the proceedings was outside India.

1.4 Similarly, in *Venture Global Engineering v Satyam Computer Services Ltd,*[2] arbitration was conducted by the London Court of International Arbitration and the applicable law to the contract was the law of the State of Michigan, United States. The SC held that a party could seek recourse under section 34[3] of the Act (*which falls under Part I*) to challenge an arbitral award passed against it in an international commercial arbitration proceedings held abroad, unless there was an express or implied agreement between the parties to exclude the applicability Part I of the Act. Thus, the judicial principle that evolved was that by merely specifying the law governing the rights and obligations of the contracting parties to be a non-Indian one, parties will not escape the jurisdiction of Indian courts. This naturally resulted in excessive judicial intervention in almost all arbitral proceedings where at least one party was Indian.

2.0 Judicial relief: upholding the spirit of arbitrations

2.1 Pursuant to some recent judgments by the SC, courts have now recognized and upheld the intent of the parties and attempted to "impliedly" exclude the application of Part I to allow minimum judicial interference in arbitral proceedings. One such landmark judgment is that of the SC in *Dozco India Private Limited v Doosan Infracore Co. Ltd.*[4] where the governing law of the contract was that of South Korea and the seat of arbitration was Seoul. While adjudicating upon an application filed under Part I of the Act for appointment of arbitrators, the SC held that since the parties had already decided on Seoul as the seat of arbitration, the curial law determining the procedural aspect in question was to be determined by the laws of South Korea, and accordingly, the provisions of Part I of the Act stood impliedly excluded. The SC finally dismissed the application on the ground of not being maintainable.

[2] AIR2008SC1061
[3] Section 34 of the Act enumerates various grounds for challenging an arbitral award.
[4] (2011)6SCC179

2.2 In *Videocon Industries Ltd. v Union of India,*[5] the SC gave some relief to foreign parties and held that courts do not have power to entertain applications pertaining to international commercial arbitrations where the intent of the parties was never to provide recourse under the Act, even if such recourse was not contractually barred, as required under the *Bhatia International v. Bulk Trading SA* and *Venture Global Engineering v Satyam Computer Services Ltd* judgments. In this case, a production sharing contract was entered into between the Indian government and a consortium of four companies consisting of Oil and Natural Gas Corporation, Videocon, Cairn Energy of United Kingdom and Ravva Oil of Singapore. The contract was for exploration and mining of hydro carbon resources in the territorial waters and exclusive economic zones of India. Certain disputes arose between the parties over cost recoveries and profit and they were referred to an arbitral tribunal which was to sit in Kuala Lumpur. Due to an epidemic in Malaysia around the same time, the arbitral proceedings were first shifted to Amsterdam and then to London. The Indian government requested the tribunal to shift the proceedings back to Kuala Lumpur, but this request was rejected. Thereafter, the Indian government approached the Delhi High Court under section 9 of the Act. The Delhi High Court assumed jurisdiction and accepted the Indian government's request. On appeal, the SC ruled that the Delhi High Court had no jurisdiction in this international agreement. It observed that the law governing the parties was Indian law, the law specifically governing the arbitration was English law and the seat of arbitration was outside India. Based on these contractual provisions, the SC concluded that even though the law governing the rights and obligations of the parties was Indian law, since the parties to the commercial contract had chosen English law as the law governing the arbitration, Indian courts will not have any jurisdiction. The SC held that there was an implied exclusion of Part I of the Act even though it was not specifically excluded in the arbitration agreement.

2.3 Clearly, the judgments of the SC in the Videocon and Dozco case have further evolved the principles laid down by Bhatia International and Venture Global Engineering. Specific exclusion of Part I of the Act is no longer necessary to be incorporated in the contract as the governing law of the contract, the governing law of the arbitration and the seat of arbitration can now assist in determining whether the application of Part I can be "impliedly" excluded. Any "implied" exclusion of Part I by referring to foreign governing laws and an international seat of arbitration will also ensure that interim reliefs are not available from Indian courts. This will work in the interest of foreign contracting parties who do not want to get entangled in the long drawn litigation system of India, but at the same time want to ensure that the law governing the contract is Indian law so that sufficient contractual protection is offered in India and any enforcement proceedings can be decided by the Indian judicial system.

3.0 Legal principles and their impact

3.1 The aforesaid judgments have facilitated in establishing some key principles in the field of Indian arbitration. These principles guide the courts in determining what law to apply and also to protect the overall interest of the parties.

[5] AIR2011SC2040

3.1.1 Governing law of the arbitration proceedings: Pursuant to the judgment of the SC in the Videocon case, preference shall be given to any specific law agreed by the parties to govern the arbitration proceedings. In case no law has been contractually provided for, the law governing the contract shall apply to the arbitration proceedings as well.

3.1.2 Seat of arbitration: In absence of an express choice of curial law in the contract, the curial law that would be applicable to the arbitration proceedings would be the law of the place where the arbitration is conducted i.e. the seat of arbitration.[6]

3.1.3 No governing law of contract: In case the commercial contract is silent on the law governing the contract, the legal system with which the transaction has its closest and most real connection would be the proper law of the contract.

3.2 Based on the aforementioned principles, it is highly recommended to always provide for a detailed arbitration clause while negotiating agreements, especially those that are multi-jurisdictional. In case the governing law of the contract and seat of arbitration is outside of India, and no specific reference to Indian law or the Act has been made, there shall be an "implied" exclusion of Part I of the Act. In the event the parties have agreed to an Indian law governing the contract (*which is often recommended of the subject matter of the contract is located in India*), a foreign law governing the arbitration and an international venue, Part I will again be impliedly excluded. Of course, if the arbitration agreement specifically excludes the jurisdiction of Part I of the Act, the same shall not apply.

Conclusion

In light of the above decisions, parties should carefully draft and negotiate the arbitration clauses after assessing how such clauses may be interpreted by Indian courts. Foreign contracting parties can now allow the subject matter of the contract to be governed by Indian law and yet choose to apply rules of an arbitral institution or their local law to the arbitration, keep a foreign seat of arbitration and yet operate outside the ambit of Part I of the Act. This gives them some flexibility while negotiating the contract with an Indian party. In case parties wish to state only the law governing the contract and the seat of arbitration in their contract, they should specifically exclude the application of Part I of the Act to eliminate the risk of any judicial subjectivity. From the perspective of Indian parties, the above mentioned judgments set forth clarity on how arbitration clauses will be interpreted by courts to allow or disallow the application of Part I of the Act. These judgments can provide a benchmark to Indian parties while negotiating contracts in order to best determine whether they will retain the right to approach Indian courts or not.

[6] In Yograj Infrastructure Ltd v. Ssang Yong Engineering & Construction Co. Ltd, JT2011(10)SC588 the SC held that where the seat of arbitration was Singapore, rules governing the arbitration were of SIAC and the substantive law of contract was Indian law, then Part I of the Act was "impliedly" excluded. Rule 32 of the SIAC rules provides that in case no governing law and seat of arbitration is provided in the agreement, the law of arbitration will be the International Arbitration Act, 2002, and the seat of arbitration will be in Singapore.

Nevertheless, through the *Videocon Industries Ltd. v Union of India* and *Dozco India Private Limited v Doosan Infracore Co. Ltd.* judgments, the SC has upheld the spirit of arbitration and attempted to minimize the risk of judicial intervention by Indian courts, which otherwise could potentially act as a hindrance for a foreign party initiating arbitration against its Indian partner. Arbitration clauses, if chosen as a mode of dispute resolution, are extremely critical while drafting and negotiating contracts, and should always be negotiated and reviewed in view of their overall impact on the rights of the parties.

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