Between the lines...

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I. Delhi High Court rules against defense of FEMA violations for resisting enforcement of foreign arbitral awards

The Hon'ble Delhi High Court in the case of ***Cruz City 1 Mauritius Holdings vs. Unitech Limited*** (decided on April 11, 2017) dealt with a case for enforcement of a foreign award.

A Keepwell agreement dated June 6, 2008 was entered into amongst Cruz City 1 Mauritius Holdings (**"Petitioner"**), Burley Holdings Ltd. (**"Burley"**), which was a wholly owned subsidiary of Unitech Limited (**"Respondent"**) and the Respondent (the "Agreement"). Disputes arose out of the Agreement and request for arbitration was filed by the Petitioner with the London Court of International Arbitration (**"LCIA"**). An award came to be made by the Arbitral Tribunal constituted under the Arbitration Rules of the LCIA.

The Respondent opposed the enforcement of the award, citing three grounds as noted by the Court:

a) Award included decision on matters beyond the scope of submission to arbitration;

b) The Respondent did not have proper notice from either the Petitioner or the Arbitral Tribunal for responding to the claim for payment against the purchase of shares; and

c) Enforcement of the Award would be contrary to the public policy of India as it violates the provisions of the Foreign Exchange Management Act, 1999 (**"FEMA"**).

The Petitioner had entered into a Shareholders Agreement (**"SHA"**) with Arsanovia Limited (**"Arsanovia"**) an affiliate of the Respondent and Kerrush Investments Ltd. (**"Kerrush"**). The Petitioner and Arsanovia had agreed to invest in Kerrush as per terms of the SHA, which in turn was to invest, through downstream subsidiary(ies), into entities engaged in the establishment, development, construction, management and operation of real estate projects in India. A real estate project was to be jointly pursued by the Petitioner and Arsanovia through their joint venture company Kerrush. The Petitioner was issued and allotted 50% of the share capital of Kerrush and the balance 50% was subscribed by Arsanovia. Although Burley and Unitech were not parties to the SHA, they still signed the SHA with respect to certain obligations accepted by them.

The Agreement was executed simultaneous with the execution of the SHA and in terms of the Agreement, Burley had acknowledged its obligations to make payments in terms of the SHA.

As per the SHA, the Petitioner had the right to exercise a put option and call upon Arsanovia and Burley to purchase all equity shares of Kerrush, which were issued and allotted to the Petitioner and Arsanovia and Burley had agreed to pay the Petitioner amounts payable upon exercise of the put option as per the SHA. It must be noted that Burley and Unitech were not parties to the SHA but they had signed the Agreement and had agreed to be bound by certain clauses of the SHA. The Petitioner exercised its put option in 2010. Notice in this respect sent by the Petitioner was not complied with and therefore arbitration was invoked.

Before the Petitioner issued notice, Arsanovia had issued a Buy Out Notice seeking to acquire Kerrush's shares held by the Petitioner. Important aspect to note here is that the terms/price of purchase under the Buy Out Notice was less favorable to the Petitioner as compared to the price payable as per the SHA. Arsanovia invoked arbitration and claimed that it was entitled to purchase the shares held by Petitioner in Kerrush. The arbitration proceedings lead to publishing of three separate awards including the one sought to be enforced in this case.

The Supreme Court noted that the grounds as set out in Section 48 of the Arbitration and Conciliation Act, 1996 (the **"Act"**) for refusing enforcement of the award were set in broad terms. The Court further noted that it may be imperative to refuse the enforcement of the award in some deserving cases but in other cases, it would be unjust to do so. The Court observed that the New York Convention enabled member states to retain some sovereign control over enforcement of foreign awards in their territory. Further, the Court also made an observation on striking a balance between enforcing a foreign award contrary to the public policy of the land or its outright rejection.

The Court was of the view that the Respondent was duly put to notice regarding the payment of the consideration for the subject shares of Kerrush as the Petitioner had unequivocally demanded the same through notice. According to the Court, therefore, the Respondent had notice of Cruz City's claim for the put option amount.

The Court held that the Respondent had opportunity to meet the case against it and also that the award was within the scope of reference.

With regard to the claim of FEMA violations, the Court noted that there were certain limbs to the Respondent's challenge to the enforcement of the award on the ground that it violates FEMA and is, thus, contrary to the public policy of India, as under:

a) Award directs Unitech to invest in the shares of Kerrush and therefore violates Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations,2004.

b) The Respondent's obligation under the Agreement is in the nature of a guarantee by the Respondent on behalf of Burley and such guarantee violates the Foreign Exchange Management(Guarantees) Regulations, 2000.

c) In terms of FEMA, the shares of Kerrush are required to be valued and purchase of those shares can only be made at the fair market value of those shares.

d) SHA contemplates an assured exit at a pre-determined rate to the Petitioner in respect of its investment in the project and this violates the mandatory circulars issued by the Reserve Bank of India.

e) SHA is a device to circumvent the provisions of FEMA and the Regulations issued thereunder, which proscribe an assured exit from a foreign direct investment (FDI) at a pre-determined rate.

The Court, after citing several cases, noted that the width of the public policy as a defense to resist enforcement of a foreign award was extremely narrow and could not be equated to offending any particular provision or a statute. The Court was of the view that the contravention of a provision of law was insufficient to invoke the defense of public policy when it comes to enforcement of a foreign award. However, it was noted that any remittance of money recovered from the Respondent in enforcement of the award would necessarily require compliance of regulatory provisions and/or permissions from the concerned authorities.

The Court observed, *"Unitech's contention that structure contemplated under the Keepwell Agreement read with the SHA provided an assured return at a predetermined rate to Cruz City and this was a flagrant violation of FEMA and Regulations made thereunder, is also bereft of merit. The Put Option provided to Cruz City under the Keepwell Agreement could be exercised only within a specified time and was contingent on the Santacruz project not being commenced within the prescribed period. This was not an open ended assured exit option as is sought to be contended by Unitech. Cruz City had made its investment on a representation that the construction of the Santacruz Project would commence within a specified period. Plainly, if the construction of the Santacruz project had commenced within the specified period - that is, by 17.07.2010 - Cruz City would not be entitled to exercise the Put Option for exiting the investment. Further, the Put Option could only be exercised within a fixed time period of 180 days and the said option would be lost thereafter."*

The Court further observed, *"Even if it is accepted that the Keepwell Agreement was designed to induce Cruz City to make investments by offering assured returns, Unitech cannot escape its liability to Cruz City. Cruz City had invested in Kerrush on the assurances held out by Unitech and notwithstanding that Unitech may be liable to be proceeded against for violation of provisions of FEMA, the enforcement of the Award cannot be declined."*

Finally, the Court rejected the objections raised by the Respondent under Section 48 of the Act against enforcement of the award.

VA View

This judgment assumes significance as FEMA related violations are not considered as an impediment to the enforcement of a foreign arbitral award as it being contrary to the public policy of India. Recently the Delhi High Court also rejected the argument which sought non enforcement of the foreign award on the ground of being contrary to the public policy thereby enforcing the USD 1.8 billion award by the LCIA in the Tata Sons-NTT Docomo case. However, remittance of money realized through enforcement may require the approval of the Reserve Bank of India and depends upon the facts of the case.

A new judicial trend can be seen emerging where instead of out rightly rejecting the enforcement of foreign award on account of being in violation of the public policy, the judiciary is keen in enforcing foreign awards in light of the international conventions to which India is a party.

However, a section of legal fraternity has been skeptical of the Court's conclusion in rejecting the intervention of the RBI. Hence, it may be imperative to amend the FEMA provisions to allow exits at pre-determined valuations with a view to facilitating foreign investments.

II. SEBI's Informal Guidance- Confusion galore

The Securities Appellate Tribunal (**"SAT"**) in the matter of ***Arbutus Consultancy LLP vs. the Securities and Exchange Board of India*** (order dated April 05, 2016) decided whether the period of being disclosed as promoter of the target company prior to getting listed could be considered for the purpose of computing the period of three years prior to the proposed acquisition as required under Regulation 10(1)(a)(ii) the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (**"Takeover Code 2011"**). It also commented upon the legal status of the informal guidance issued from time to time by the Securities and Exchange Board of India (**"SEBI"**).

Background

India Bulls Real Estate Limited (**"IBREL"**) was incorporated on April 04, 2006 and listed on the Bombay Stock Exchange Limited (**"BSE"**) and National Stock Exchange of India Limited (**"NSE"**) on March 23, 2007 whereas its wholly owned subsidiary- Rattan India Infrastructure Limited (the **"target company"**) was incorporated on November 09, 2010. The target company was demerged as a separate undertaking through a scheme sanctioned by the Delhi High Court on October 17, 2011, subsequent to which it was listed on the BSE and NSE on July 30, 2012. Laurel Energetics Pvt. Ltd., one of the co-promoter of IBREL and the target company acquired various quantities of equity shares from other co-promoters in July, September and October 2014. On October 28, 2015, Arbutus Consultancy LLP along with other persons acting in concert (the **"Appellants"**) made a public announcement for acquisition of equity shares of the target company and filed the draft letter of offer with the SEBI on November 10, 2015. The SEBI passed an order dated May 05, 2016 whereby the Manager to the open offer was directed to revise the open offer price since the inter-se promoter transfer of shares of the target company was not exempted from the open offer obligation under the Takeover Code 2011. In addition to this, the acquirers were to pay a simple interest of 10% p.a. from the trigger dates to those shareholders in the target company whose shares were to be accepted in the open offer. An appeal was preferred by the Appellants. The first question to be determined was whether the inter-se promoter transfers made prior to completion of three years of listing the target company are eligible for general exemption and the second question to be determined was in relation to the legal status of informal guidance given by a department of SEBI.

Arguments of the parties

The Appellants in the first issue contended that the promoters of IBREL and the target company have been the same and consistent in their composition since 2009-10; information of which was in the public domain, thereby safely concluding that there is no violation of Takeover Code 2011. They relied on the report of the Takeover Regulations Advisory Committee dated July 19, 2010 while amending the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (**"Takeover Code 1997"**) in 2011 which was in favour to continue exemption among qualifying parties and curbing the 'alien entities'. The Appellant contended that a constructive reading of Takeover Code 1997 and Takeover Code 2011 suggest that the three years promoter holding period should not necessarily be subsequent to listing. The Appellant while making its case relied on the informal guidance issued by SEBI on October 25, 2012 to Weizmann Forex Ltd. (**"Weizmann"**). While addressing the second issue, the Appellant submitted that the SEBI cannot deny the statutory value of the informal guidance issued by it as they are the clarifications on regulations issued by the same regulator.

The Respondent in its submission stated that a simple straightforward reading of the Regulation 10 of the Takeover Code 2011 leads to a clear meaning. For availing exemption in inter-se promoter transfers, the mandate is a minimum three year condition after listing and not a declaration to the effect that the same promoters continued prior to and post listing. In the second issue, it was argued that the informal guidance can never act as an estoppel against the law. It was substantiated that the SEBI official erred in the Weizmann guidance by being oblivious of the changes which happened in 2011 amounting to be a bad precedent. SEBI in all its subsequent informal guidance along with its guidance on December 05, 2012 in Commercial Engineers and Body Builders Company Ltd. (**"Commercial Engineers"**) insisted that the target company has to complete a minimum period of three years. The Respondent heavily relied on the case of ***Deepak Mehra vs. SEBI*** (dated August 28, 2009) wherein it was held that the informal guidance were views of a department of SEBI and cannot be construed as law and are not amenable for appeal.

Observation of SAT and its decision

SAT while deciding the first issue stated that the wordings of the Regulation 10(1)(a)(ii) of the Takeover Code 2011 are clear and unambiguous to suggest that in order to be eligible for exemption from making an open offer, the inter-se transfers of shares amongst promoters should not be for less than three years prior to the proposed acquisition. The argument that this three year period should not necessarily be subsequent to the listing agreement cannot be accepted as that will lead to a situation where any company which is listed today with an unchanged promoter holding for more than three years prior to listing would become eligible for exemption as soon as tomorrow which cannot be adduced as the intention behind the amended law. The SAT also observed that the compliance of the law should be starting point and not the end result, thereby stating that the Appellants should not be benefited just because no 'alien entity' has come in as the promoter in the target company. It was observed that it is irrelevant whether the same promoters were holding the same shares for over a long period either in the target company or in the parent company or both, prior to listing the target company. The only relevant factor is date of listing the target company and the promoter holdings filed by the target company as part of the listing agreement.

While addressing the second issue, it is pertinent to note the following clauses of the Securities and Exchange Board of India (Informal Guidance) Scheme, 2003:

"12. A no-action letter or an interpretive letter issued by a Department constitutes the view of the Department but will not be binding on the Board, though the Board may generally act in accordance with such a letter.

13. The letter issued by a Department under this scheme should not be construed as a conclusive decision or determination of any question of law or fact by SEBI. Such a letter cannot be construed as an order of the Board under section 15T of the Act and shall not be appealable."

SAT observed that the Weizmann guidance was not a correct interpretation of law applicable as on that date, however, a wrong interpretation given by an official cannot be used as a shelter in interpreting the provisions of law. It upheld the ratio of the order given in Deepak Mehra's case.

SAT held that in the instant matter the appeal had failed and directed the Appellant to deposit with SEBI the amount of INR 115 crores with interest at 10% p.a. from July, 2014 till March 31, 2017 within four weeks of the order, subject to which SEBI was directed not to enforce the impugned order so as to allow the Appellant to prefer an appeal.

VA View

SAT has stressed upon the fact that literal interpretation of the Regulations issued by SEBI should be taken when it does not lead to any ambiguity. Under Regulation 10(1)(a)(ii) of the Takeover Code 2011, the exemption could be availed only if all the compulsory conditions were duly fulfilled. One of the prescribed conditions is that the earlier exemption can be availed by the promoters desirous of transferring shares inter-se is after three years of listing of the target company. This interpretation is in tune with the intention behind the amendments and should be followed.

Regarding the legal status of the informal guidelines, SAT has made it clear that they are the view of the concerned department and is non-binding and that SEBI/SAT can divert in its stance from such guidance. Primacy and legality should be given to the existing provisions in law which should not be allowed to be undermined by such guidance. Therefore, it can be concluded that in a situation where there exists a difference in the interpretation amongst the two, the interpretation naturally flowing from the existing law should be adhered to.

III. Supreme Court on exclusive jurisdiction of seat in domestic arbitration

The Supreme Court in its decision of ***Indus Mobile Distribution Private Ltd. vs. Datawind Innovations Private & Ors.*** (Civil Appeal Nos. 5370-5371 of 2017, dated April 19, 2017) decided upon an important issue that when the parties agree to the exclusive jurisdiction of any Court in their arbitration agreement, will they be allowed to proceed for relief to the other Courts where the cause of action arises as per their convenience.

Background

Indus Mobile Distribution Private Ltd. (the **"Appellant"**) and Datawind Innovations Private & Ors. (the **"Respondent"**) entered into a Retail Chain Partner agreement on October 25, 2014 under which the Respondent had to supply mobile phones, tablets and other accessories to the Appellant. The agreement had reference to dispute resolution mechanism between the parties wherein the disputes between the parties were to be finally settled by arbitration conducted under the provisions of the Arbitration and Conciliation Act, 1996 (**"the Act"**) subjected to the exclusive jurisdiction of the Courts of Mumbai only. The Respondent had its registered office in Amritsar whereas the Appellant was supplied the goods in Chennai via Delhi.

A dispute arose between the parties and the Respondent filed two petitions in the High Court of Delhi. The first petition was for seeking interim relief to restrain the Appellant from alienating, transferring or creating any third-party interests in respect of a certain property in Chennai which was allowed and the second one was for appointing an arbitrator. The Appellant contended that the Delhi High Court has no jurisdiction over the matter as it could be taken up only in the Courts of Mumbai.

Decision of the High Court of Delhi

The Court held that only the Courts of Amritsar, Chennai and Delhi would have jurisdiction over the matter and not Mumbai as the cause of action arose only in these cities. The Court further stated that it was the Delhi High Court which was approached first and hence, only it would have the jurisdiction, exercising which, it confirmed the interim order passed by it on September 22, 2015. The Appellant approached the Supreme Court through a Special Leave Petition.

Decision of the Supreme Court

The Supreme Court observed that the arbitration is governed by the party autonomy and that the provision in Section 2(1)(e) should be construed keeping in view the provisions in Section 20 of the Act. It stated that ordinarily the Courts of Mumbai would not have had the jurisdiction over the matter as no cause of action arose in Mumbai, but it is necessary to give clauses 18 and 19 of the Retail Chain Partner agreement a meaningful interpretation. It held that seat of arbitration as per the agreement is Mumbai and the exclusive jurisdiction clause has left no doubt that only the Courts in Mumbai, for all purposes in relation to the agreement, would have exclusive jurisdiction. It stated the decided juridical seat is equivalent to the legal place of arbitration and after its finality, it is neither necessary for any cause of action to have arisen at the neutral venue, nor would any of the provisions of the Code of Civil Procedure, 1908 be attracted thereof.

The Court heavily relied upon its earlier judgments in ***Bharat Aluminium Co. v. Kaiser Aluminium Technical Services Inc.*** (2012) 9 SCC 552, and subsequent judgments to it, such as, ***Reliance Industries Ltd. v. Union of India*** (2014) 7 SCC 603, ***Harmony Innovation Shipping Limited v. Gupta Coal India Limited and Another*** (2015) 9 SCC 172, ***Union of India v. Reliance Industries Limited and Others*** (2015) 10 SCC 213, and ***Eitzen Bulk A/S v. Ashapura Minechem Limited and Another*** (2016) 11 SCC 50, where it had substantiated the fact that once a seat of arbitration is chosen, by necessary implication, the Courts of that country would have supervisory jurisdiction over that arbitration for all the matters arising out of the arbitration and related ancillary matters. It is akin to a clause of exclusive jurisdiction. The Supreme Court admitted the Special Leave Petition and set aside the decision of the Delhi High Court.

VA View

In light of the aforementioned judgment, it is important for the parties to mutually agree and carefully pick an arbitration seat in their agreement as once the seat of arbitration is agreed to by the parties, the Courts of such seat will exercise exclusive jurisdiction in respect of the proceedings arising out of or in connection with the arbitration even if they do not enjoy such jurisdiction on account of the cause of action not arising in its jurisdiction.

IV. Rules for cross border mergers notified

The Ministry of Corporate Affairs (**"MCA"**) has amended the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016 (**"Rules"**) by the Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2017 (**"Amendment Rules"**). Amendment Rules have inserted new Rule 25A to the Rules. Highlights of the amendment are captured below.

a) A foreign company incorporated outside India may merge with an Indian company and an Indian company may merge with a foreign company incorporated in any of the specified jurisdictions after obtaining prior approval of Reserve Bank of India (**"RBI"**) and in compliance with applicable legal provisions.

b) The transferee company is required to ensure that valuation is conducted by valuers who are members of a recognized professional body in the jurisdiction of the transferee company.

c) Valuation should be in accordance with internationally accepted principles on accounting and valuation. A declaration to this effect is required to be attached with the application made to the RBI for obtaining its approval.

d) After obtaining approvals as covered above, application must be filed before the National Company Law Tribunal (**"NCLT"**).

VA View

The MCA notification in respect of cross border mergers provides a green signal for mergers of Indian companies into foreign companies but at the same time it is fraught with various challenges.

Such cross border mergers may facilitate consolidation of holdings, innovative structuring, diversifying ownership base, exercising control over intellectual property, raising capital through various means and foreign investment.

One of the strongest influencing factors in these mergers is that it would need approval from RBI, NCLT and other relevant regulatory authorities before consummation of such mergers thereby ensuring their legality, transparency of operations and credibility.

The Amendment Rules does not allow fast track mergers as per Section 233 of the Companies Act, 2013 and therefore the parties will have to undertake the entire formalities as provided for under Sections 230- 232 of the Companies Act, 2013.

A major limitation of cross border mergers is that the Indian companies can only merge with foreign companies in certain specified jurisdictions, namely, those whose securities regulator is a member of the International

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Organization of Securities Commissions (IOSCO) or has a bilateral memorandum of understanding with SEBI, those whose central bank is a member of the Bank for International Settlements (BIS), and those who have not been identified in the public statement of the Financial Action Task Force (FATF) as regards to certain specified matters.

Further, there is ambiguity on the process to be followed in case of a demerger, that is, when the foreign company demerges its business undertaking to an Indian company or when the Indian company demerges its business undertaking to a foreign company. Some clarity on this issue is needed.

Since it is a novice concept in India, the international practice will be a helpful guide for RBI for framing rules of approval and for NCLT to take an informed decision in the matter.

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