Between the lines...

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NEW DELHI | MUMBAI | BENGALURU

January, 2021

Key Highlights

I. Supreme Court: Proceedings under Section 34 of the Arbitration and Conciliation Act, 1996 not maintainable against foreign award

The Supreme Court (**"SC"**) has in its judgment dated November 26, 2020 in the matter of ***M/s Noy Vallesina Engineering SpAv. M/s Jindal Drugs Limited and Others [Civil Appeal No. 8607 of 2010],*** held that proceedings under Section 34 of the Arbitration and Conciliation Act, 1996 (**"ACA"**) are not maintainable against a foreign award.

Facts

M/s. Noy Vallesina Engineering SpA (**"Appellant"**), is a company incorporated under Italian laws involved in the setting-up and construction of plants for production of synthetic fibres, polymers and ascorbic acid. M/s Jindal Drugs Limited (**"Respondent"**), is a public limited company incorporated under Indian laws. The Respondent had entered into four agreements with one Engineering Chur AG of Switzerland (**"Enco"**) to set up an ascorbic acid plant (**"Plant"**) in India, being; (i) an engineering contract for construction of the plant (**"Plant Contract"**); (ii) a supply contract; (iii) a service agreement; and (iv) a license agreement (collectively the **"other Agreements"**). The aforesaid Plant Contract and other Agreements were executed on January 30, 1995. Under the Plant Contract, Enco agreed to provide the Respondent with technical information and basic engineering documentation for the construction, commission, operation and maintenance of the Plant. In consideration of Enco's obligations, the Respondent was to pay a total fee of Swiss Francs 86,00,000 in the manner provided in the Plant Contract. The Plant Contract and the other Agreements contained an arbitration clause which expressly stated that arbitration would be *"under the Rules of Conciliation and arbitration of the International Chamber of Commerce, Paris and Arbitration proceedings shall be in the English language and shall take place in London."* In March 1995, Enco assigned the Plant Contract to the Appellant with the

consent of the Respondent, pursuant to which all obligations of Enco towards the Respondent were taken over by the Appellant.

However, due to certain disputes arising between the Respondent and the Appellant, the Appellant terminated the Plant Contract claiming damages from the Respondent. Subsequently, on October 31, 1996, the Respondent filed a request for arbitration under the Plant Contract before the International Court of Arbitration, Paris (**"ICC"**) which was followed by the Appellant filing its reply to the Respondent's claim and also making a counter claim. After considering the claims and counter claims, the ICC arbitral tribunal passed a partial award on February 1, 2000, under which the Respondent's claims were rejected and the Appellant was awarded Swiss Francs 44,33,416 (**"Partial Award"**) towards its counterclaims under the Plant Contract. The ICC arbitral tribunal then called upon the parties to present written representations on interest and costs to enable it to frame the final award.

On February 20, 2000, the Respondent filed a petition before the Bombay High Court (**"BHC"**) under Section 34 of the ACA challenging the Partial Award. The petition was admitted for final hearing on March 1, 2000 and notice was issued to the Appellant, the ICC and the ICC arbitral tribunal, whereupon an interim injunction was issued restraining them *"from receiving any further submissions, and/or passing any further direction and/or Ruling and/or Award in the arbitration proceedings…."*. However, the ICC arbitral tribunal held the view that the interim order passed by the BHC was not binding on it and consequently, proceeded with granting its final award on October 22, 2001 (**"Final Award"**). When the Final Award was made, the Respondent's challenge to the Partial Award, and the interim application were both pending before the BHC.

The petition under Section 34 of the ACA challenging the Partial Award was decided by an order dated February 6, 2002 passed by a single judge bench of the BHC (**"Single Bench Order"**), which held that the partial award was a foreign award, and therefore a challenge through a petition under Section 34 of the ACA was not maintainable. Thereafter, the Respondent preferred an appeal against the Single Bench Order before a division bench of the BHC (**"Division Bench"**). During the pendency of the appeal, the Appellant had applied before the BHC for enforcement of the Partial Award and Final Award under Sections 47 and 48 of the ACA. The said petition for enforcement of the Partial Award and Final Award was allowed and the Respondent's objections against enforceability of the two awards were overruled. The single judge who decided the petition held, in a judgment, (**"Enforcement Order"**) that the two awards were enforceable, save and except thatpart of the award which directs payment of Swiss Francs 14,53,316 by the Respondent to the Appellant.

The Respondent subsequently preferred an appeal before the BHC and the Appellant filed a cross appeal thereafter. While these appeals were still pending, the Division Bench, relying on the judgments of the SC in ***Bhatia International v. Bulk Trading S. A. and Another [(2002) 4 SCC 105]*** (**"Bhatia Judgement"**) and ***Venture Global Engineering v. Satyam Computer Services Limited and Another [2008 (4) SCC 190]*** (**"Venture Global Judgement"**) held that the proceedings under Section 34 of the ACA could be validly maintained to challenge a foreign award and set aside the Single Bench Order. The Appellant subsequently preferred the present appeal before the SC, challenging the order of the Division Bench.

Issue

Whether proceedings under Section 34 of the ACA can be maintained to challenge a foreign award.

Arguments

Contentions raised by the Appellant:

The Appellant, *inter alia,* contended that the order passed by the Division Bench of the BHC was not supported by law because a foreign award cannot be challenged under Section 34 of the ACA. It argued that the three-judge decision in the Bhatia Judgment (supra) and the subsequent holding in the Venture Global Judgment (supra) were both held to be incorrect in the larger, five judges ruling in ***Bharat Aluminium Company v. Kaiser Aluminium Technical Services Inc [2012 (9) SCC 552]*** (**"BALCO Judgement"**). Relying on the BALCO Judgement, it was contended that foreign awards, having been rendered outside India under the aegis of the ICC could not be challenged merely because a condition in the underlying contract provided that the law governing the agreement, would be Indian law. It was also argued that the BALCO Judgement clearly enunciated the principle that the seat of arbitration also indicated the choice of the law governing the arbitration basis the *'Shashoua'* principle that states that the designation of a "seat" of the arbitration would carry with it "something akin to an exclusive jurisdiction clause".

Referring to identical terms in the Plant Contract and other Agreements, in the present case, which expressly stated that arbitration would be *"under the Rules of Conciliation and arbitration of the International Chamber of Commerce, Paris and Arbitration proceedings shall be in the English language and shall take place in London."* the Appellant argued that the intention of the parties, expressed unambiguously in the contract, was that the arbitration was governed by the law of the seat, which was UK law. Therefore, the findings in the impugned judgment were clearly untenable. The Appellant also contended that the judgements passed in ***Union of India v. Reliance Industries [2015 (10) SCC 213], Harmony Innovation Shipping Limited v. Gupta Goal India Ltd [2015 (9) SCC 172]*** and ***Roger Shashoua v. Mukesh Sharma [2017 (14) SCC 722]*** (**"Shashoua Judgement"**) have now established that disputes arising prior to the BALCO Judgement involving agreements which stipulated that the juridical seat was in India, and which stipulate or could be read as stipulating that the law governing arbitration would be Indian law, should not be decided basis the BALCO Judgement. However, cases where the juridical seat was not in India, or the law governing arbitration was not Indian law, would be bound by the BALCO Judgement. Therefore, the impugned judgment, which held to the contrary, could not be sustained. Lastly, relying on the judgment passed by the Supreme Court in ***Fuerst Day Lawson Limited v. Jindal Exports Limited [(2011) 8 SCC 333]*** (**"Fuerst Day Lawson Judgement"**) it was contended by the Appellant that basis Section 50 of the ACA *(Provides for a restrictive category of appealable subject matters, and prohibits appeals in other matters),* the order holding that the petition under Section 34 was not maintainable, was not appealable.

Contentions raised by the Respondent:

The Respondent on the other hand contended that the impugned judgment was unexceptionable and not liable to be interfered with, and that Section 34 of the ACA operated in a field different from Section 48 of the ACA. It argued

that the latter enabled the enforcement of a foreign award, and the court could only refuse enforcement, whereas under Section 34 of the ACA, the legality of an award could be gone into and the court had the jurisdiction to set it aside and that this crucial difference was recognized by Indian courts, as was evident from the decisions in the Bhatia Judgment and Venture Global Judgment. Relying on the observations in the BALCO Judgement that arbitration agreements entered into before the decision, and disputes which arose under them, would continue to be bound by the rules set prior to the BALCO Judgement, it was argued that, since, in this case, the agreements were entered into, and awards too were rendered during the prevalence of the principles set out under the Bhatia Judgment, the later decision in the BALCO Judgement or any subsequent judgment could not apply. It was further argued that, though the Plant Contract stated that the arbitration was to be held in London, under the ICC, Clause 12.4.1 of the Plant Contract clearly stated that the contract would be governed by Indian law, which unambiguously pointed to the fact that the parties intended that the law governing arbitration too was Indian law. Therefore, there was no question of the applicability of the ratio under the BALCO Judgement in the instant matter.

Observations of the Supreme Court

The SC observed that the Bhatia Judgment, and later, the Venture Global Judgment, had held that resorting to remedies under Part I of the ACA can be made in respect of foreign awards, despite the clear dichotomy in the enactment between domestic awards covered by Part I and foreign awards covered by Part II of the ACA. This understanding was re-visited in the BALCO Judgement where the SC held that *"the Arbitration Act, 1996 has accepted the territoriality principle which has been adopted in the UNCITRAL Model Law. Section 2(2) makes a declaration that Part I of the Arbitration Act, 1996 shall apply to all arbitrations which take place within India. We are of the considered opinion that Part I of the Arbitration Act, 1996 would have no application to international commercial arbitration held outside India. Therefore, such awards would only be subject to the jurisdiction of the Indian courts when the same are sought to be enforced in India in accordance with the provisions contained in Part II of the Arbitration Act, 1996. In our opinion, the provisions contained in the Arbitration Act, 1996 make it crystal clear that there can be no overlapping or intermingling of the provisions contained in Part I with the provisions contained in Part II of the Arbitration Act, 1996."* Further, it was observed that the principle in the Shashoua Judgement had been followed repeatedly in a series of decisions by the SC, with respect to the law governing the seat as the law of the "seat" where the arbitration had been held. This view was reinforced in ***IMAX Corporation v. E-City Entertainment (India) (P.) Limited [2017 (5) SCC 331].*** Taking into consideration the fact that the parties had expressly chosen to resolve the dispute through the ICC, in the form of a London based arbitration, the SC stated that *"ICC having chosen London, leaves no doubt that the place of arbitration will attract the law of UK in all matters concerning arbitration."*

The SC further observed that even as per the latest decision on this issue in ***Government of India v. Vedanta Limited [2020 SCC Online (SC) 749],*** the dispute arose out of a pre-BALCO Judgement contract on January 18, 2011 where the seat of arbitration was Kuala Lumpur, however, the governing law of the contract, was English law.

The SC, in its three-judge bench decision, held that the law governing the challenge to the award was Malaysian law as the curial law of the arbitration was to be determined by the seat of arbitration.

The SC also noted that the decision in the Feurest Day Lawson Judgement unambiguously ruled out the maintainability of any appeal against an order granting enforcement of a foreign arbitration award. It accordingly observed that in the present case, both the Partial and Final Awards being foreign awards, the provisions of Sections 47 and 48 of the ACA were correctly invoked by the Appellant.

Decision of the Supreme Court

In allowing the instant appeal, the SC did not consider the merits of the substantive challenge to the Enforcement Order, because the parties had not been heard and therefore, it would not have been fair to comment on it. Further, the Respondent had proceeded on the assumption that its appeal to the Division Bench on this aspect was pending. In view of the finding of the court that such an appeal against an order of enforcement was untenable due to Section 50 of the ACA, the merits of the Respondent's objections to the Single Bench Order, were open for it to be canvassed in appropriate proceedings. The SC also held that such proceedings could not also be a resort to any remedy under the Code of Civil Procedure, 1908. In the event the Respondent chose to avail of such remedy, the question of limitation was left open, as the court was conscious of the fact that although the Fuerst Day Lawson Judgment was a decision rendered over 10 years ago, it settled the law decisively and has been followed in later judgments.

VA View:

The SC's judgement in the present matter, highlights the importance of choosing the rules and seat of arbitration and governing law in contracts as per the intended agreement/understanding between parties. In allowing this appeal the SC has yet again clarified its stand on the application of Part I and Part II of the ACA with respect to domestic and foreign arbitration awards.

Parties to contracts having foreign seat of arbitration and Indian law as governing law should therefore be well advised and aware that they can no longer take recourse to the argument that since their contracts were entered into prior to the BALCO Judgement, the pre-BALCO rules would automatically apply to them. Accordingly, the seat of arbitration should be chosen in alignment/consonance with the governing law of the contract if the parties wish to ensure due enforcement of arbitral awards in India.

II. NCLAT: Creditor could not be restrained from simultaneously initiating CIRP against both the principal borrower and the guarantor

The National Company Law Appellate Tribunal (**"NCLAT"**) by way of its judgement dated November 24, 2020 in the matter of ***State Bank of India v. Athena Energy Ventures Private Limited [CA (AT) (Ins) No. 633 of 2020]*** set aside the order passed by the National Company Law Tribunal, Hyderabad Bench (**"NCLT"**) on March 4, 2020. The NCLT had declined to admit the application filed by State Bank of India (**"Appellant"**) in order to initiate corporate insolvency resolution process (**"CIRP"**) against Athena Energy Ventures Private Limited (**"Respondent"**)

Facts

The Appellant had filed an application under Section 7 *(Initiation of corporate insolvency resolution process by financial creditor)* of the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) against the Respondent. The Respondent stood as a corporate guarantor for Athena Chattisgarh Power Limited (**"Borrower"**), which had defaulted in repayment of loan facility provided to it. The Borrower was a joint venture company promoted by the Respondent. The Borrower had availed loan facility from the Appellant and several other banks (being a consortium of banks). When the Borrower wished to avail more funds, the Respondent executed a corporate guarantee in favour of the Appellant and the consortium of banks. The Appellant had sanctioned a total of INR 3069,68,00,000/- and had actually disbursed INR 2769,19,05,767/- to the Borrower. Upon Borrower's default, the Appellant filed an application under Section 7 of the IBC before the NCLT. The said application was admitted on May 15, 2019. Thereafter, the Appellant also filed a Section 7 application against the Respondent that is, the corporate guarantor. The Respondent had then opposed the application on the grounds that it arose out of the same transaction, and therefore the application duplicated the claim of the Appellant, which was not permissible. The Respondent relied on the judgement of the NCLAT in ***Vishnu Kumar Agarwal v. Piramal Enterprises Limited [CA (AT) (Ins) No. 346 and 347 of 2018]*** (**"Piramal Enterprises"**) wherein it had been held that once the petition under Section 7 had been filed against co-guarantor and CIRP had been initiated, the financial creditor could not file another application on the very same set of claims.

Issue

Whether a financial creditor can file applications for simultaneously initiating CIRP against a borrower and a guarantor for the same set of debt and default.

Decision of the NCLT

The NCLT relied on the below portion of the NCLAT judgement in ***Piramal Enterprises:***

"There is no bar in the 'I&B Code' for filing simultaneously two applications under Section 7 against the 'Principal Borrower' as well as the 'Corporate Guarantor(s)' or against both the 'Guarantors'. However, once for same set of claim application under Section 7 filed by the 'Financial Creditor' is admitted against one of the 'Corporate Debtor' ('Principal Borrower' or 'Corporate Guarantor(s)'), second application by the same 'Financial Creditor' for same set of claim and default cannot be admitted against the other 'Corporate Debtor' (the 'Corporate Guarantor(s)' or the 'Principal Borrower'). Further, though there is a provision to file joint application under Section 7 by the 'Financial Creditors', no application can be filed by the Financial Creditor' against two or more 'Corporate Debtors' on the ground of joint liability ('Principal Borrower' and one 'Corporate Guarantor', or 'Principal Borrower' or two 'Corporate Guarantors' or one 'Corporate Guarantor' and other 'Corporate Guarantor'), till it is shown that the 'Corporate Debtors' combinedly are joint venture company."

The NCLT noted that the Borrower and the Respondent could not be called 'joint venture company' as they were independent companies. Further, the NCLT held that since the application was on the same set of facts, claim and

default, for which CIRP had already been initiated and in progress (against the Borrower), the claim of the Appellant had already been admitted. Pursuant to the same, the Appellant's application against the Respondent came to be rejected.

Contentions before the NCLAT

Appellant's contentions:

The Appellant contended that under Section 128 (*Surety's liability*) of the Indian Contract Act, 1872, the liability of a principal borrower and guarantor is co-extensive and the creditor is entitled to proceed against either or both and no sequence is required to be followed. Per the definition of 'financial debt', the IBC also treats the principal borrower and guarantor similarly. As per Section 60(2) *(where a corporate insolvency resolution process or liquidation proceeding of a corporate debtor is pending before a National Company Law Tribunal, an application relating to the insolvency resolution or liquidation or bankruptcy of a corporate guarantor or personal guarantor of such corporate debtor shall be filed before such National Company Law Tribunal)* of the IBC, simultaneous application could be filed against the borrower and the guarantor and the same could also be maintained. In ***Piramal Enterprises,*** the judgement was relating to filing of two separate proceedings against two guarantors. Therefore, the judgement could not apply to this case. Further, the Hon'ble Supreme Court (**"SC"**) has directed maintaining status quo in the matter of ***Piramal Enterprises*** and in other matters (which have followed the judgement in Piramal Enterprises) has stayed the judgements of the NCLAT. The 'Insolvency Law Committee Report' of February 2020 (**"ILC-Report"**), had observed that proceedings could be maintained against the borrower as well as the guarantor, and the creditor could file claims in both CIRP proceedings. Under the IBC, the resolution professional only collates claims. The haircut taken by the creditors in the matter of resolution plan is what the Appellant would be able to recover in the resolution plan or liquidation. That can be adjusted in other proceedings, that is, the claims could be reduced and adjusted proportionately in two CIRP proceedings depending on the liability under the guarantee documents.

Respondent's contentions:

The Respondent did not dispute the fact that (i) it was a guarantor,(ii) the execution of documents in respect thereof, (iii) the fact that 'Athena Chattisgarh Power Limited/Borrower' was the principal borrower, or (iv) the issue regarding quantum of outstanding amounts or the Borrower's default. It was argued that the soul of the IBC is resolution of the corporate debtor and to keep the corporate debtor as a going concern to maximise value. The proceedings are not adverse in nature. It was accepted that under Section 128 of the Indian Contract Act, 1872, the liability of surety is co-extensive with the principal debtor and the creditor may proceed against principal debtor, or the surety or both, in no particular sequence in recovery proceedings. However, the said principle is not applicable in insolvency proceedings against the principal debtor and surety, or against more than one surety, for same set of claims, as claims against surety have to be reduced to the extent of claims lodged against the principal debtor. There cannot be two CIRP proceedings, one for the borrower and another for the surety, for the same amount. The

Respondent also referred to 'Halsbury's Laws of England' to argue that it was necessary for the creditor before proceeding against surety, to request the principal debtor to pay or sue him although solvent, unless this was expressly stipulated. Further, it was argued basis the 'The Law of Insolvency' by Ian F Fletcher, that where the creditor had already initiated action against the principal debtor, the liability of the surety is reduced to the amount for which the creditor's debt had been admitted. In the instant case, since the amount claimed against the Borrower and the Respondent was the same, the application against the Respondent could not be maintained.

Observations of NCLAT

In ***Piramal Enterprises,*** the NCLAT dealt with the issue as to whether the CIRP could be initiated against two corporate guarantors simultaneously for the same set of debt and default. It was reasoned therein, that the moment the application against guarantor No. 2 was admitted, the guarantor No. 1 could say that the debt in question was not due as it was not payable in law, having shown the same debt payable by guarantor No. 2, which had already been initiated against guarantor No. 2. The result was that in ***Piramal Enterprises,*** guarantor No. 1 walked away only because CIRP had anyway been initiated against guarantor No. 2. However, the question in ***Piramal Enterprises*** was whether CIRP could be initiated against two corporate guarantors simultaneously for the same set of debt and default and not whether applications could be filed against a principal borrower and a corporate guarantor. The NCLAT then considered Section 60 of the IBC, in respect of which an amendment was introduced by way of the Insolvency and Bankruptcy Code (Second Amendment) Act, 2018. The said amendment was published in the gazette on August 17, 2018. In the erstwhile Section 60(2) of the IBC, the words were *"bankruptcy of a personal guarantor of such corporate debtor".* These words were later on substituted by the words *"liquidation or bankruptcy of a corporate guarantor or personal guarantor as the case may be, of such Corporate Debtor".* The judgement in ***Piramal Enterprises,*** which was passed on January 8, 2019, did not notice the above amendment. Keeping in mind the amendments made to Section 60 of the IBC, it could be said that the IBC has no aversion to simultaneously proceeding against the corporate debtor and the corporate guarantor. If two applications could be filed for the same amount against the principal borrower and the guarantor, the applications against them could also be maintained. The NCLAT found merit in the argument of the Appellant that a creditor could not be restrained from initiating CIRP against both the principal borrower and the surety. The Appellant had also submitted that, when remedy is available against both, application can be maintained against both and it was only at the stage of disbursement that the adjustment may have to be made. The NCLAT noted that arguments made by the Appellant were in line with ILC-Report. Further, the ILC-Report had also referred to the judgement of the SC in ***Edelweiss Asset Reconstruction Company Limited v. Sachet Infrastructure Limited and Others [CA (AT) (Ins) No. 377 of 2019]*** dated September 20, 2019, which permitted simultaneous initiation of CIRP against principal borrower and its corporate guarantors. In that matter, the judgment in the matter of ***Piramal Enterprises*** was relied on but the larger bench mooted the idea of group CIRP.

Decision of NCLAT

Simultaneous remedy is central to a contract of guarantee and where principal borrower and surety are undergoing CIRP, the creditor should be able to file claims in CIRP of both of them. The IBC does not prevent this. The Respondent had argued that if the debt is the same and claim is made in CIRP against the borrower, the amount must be said to be 'not due or not payable' in the CIRP against guarantor. The NCLAT refused to accept this argument and stated that under the contract of guarantee, it is only when the creditor would receive amount, that the question of no more due or adjustment would arise. It would be a matter of adjustment when the creditor receives debt due from the borrower or guarantor in the respective CIRP that the same should be taken note of and adjusted in the other CIRP. This could be conveniently done, more so when resolution professional in both the CIRP is same. Thereby, the judgment passed by the NCLT was set aside. The NCLT was directed to admit the application against the Respondent and pass necessary orders as per the provisions of the IBC.

VA View:

The NCLAT clearly delineated the difference between the facts in Piramal Enterprises and the present case. In Piramal Enterprises, the primary issue was whether CIRP could be initiated against two guarantors. Further, it has now been clarified by the NCLAT that simultaneous remedy is central to a contract of guarantee. This ruling therefore, makes the position of the guarantor synonymous to the position enumerated under Indian Contract Act, 1872. The fact that creditor can file claims in CIRP against both borrower and guarantor, opens up new risks for the guarantor.

By implication of this judgement, it will have to be understood that the guarantor cannot simply walk away in case of borrower's default. It is material for the guarantor at the time of execution of documents, to re-assess the terms of the guarantee with respect to how much risk, it is willing to take on and/or the extent of protection that can be possibly availed. As far as the creditors are concerned, the judgment definitely offers a new avenue in the sense that they can now go after both the borrower and guarantor. It is very aptly provided that the amounts received by the creditor would only be a matter of readjustment as regards the borrower and guarantor. It would be interesting to study as to how the balance between the creditor's and the guarantor's requirement ultimately plays out in the aftermath of this judgment.

III. Supreme Court: Tenancy disputes under Transfer of Property Act, 1882 are arbitrable except when governed by rent control legislations

The Hon'ble Supreme Court (**"SC"**) has in its judgment dated December 14, 2020 (**"Judgement"**) in the matter of ***Vidya Drolia and Others v. Durga Trading Corporation [Special Leave Petition (Civil) Nos. 5605-5606 of 2019]***, held that landlord-tenant disputes are arbitrable as the Transfer of Property Act, 1882 (**"TPA"**) does not forbid arbitration. However, the landlord-tenant disputes governed by rent control legislation would not be arbitrable since specific court or forum has been given exclusive jurisdiction to adjudicate such cases.

Facts

This Judgement decided the reference made by order dated February 28, 2019 in the case of ***Vidya Drolia and Others v. Durga Trading Corporation*** (**"Vidya Drolia"**) questioning the validity of the ratio laid down in ***Himangni Enterprises v. Kamaljeet Singh Ahluwalia [(2017) 10 SCC 706]*** (**"Himangni Enterprises"**) that landlord-tenant disputes governed by the provisions of TPA, are not arbitrable as this would contravene public policy.

In the instant case, in 2006, the tenants (**"Appellants"**) entered into a tenancy agreement with the predecessor title holder, with respect to certain buildings, with a pre-determined expiry on February 2, 2016. The agreement contained a clause for dispute resolution by arbitration. In 2012, the tenancy was transferred to Durga Trading Corporation (**"Respondent"**). Thereafter, the Appellants started paying monthly rent to the Respondent. The Respondent by letter dated August 24, 2015, sought vacant possession of the property. The Appellants however did not vacate. Subsequently, the Respondent filed a petition under Section 11 *(Appointment of Arbitrators)* of the Arbitration and Conciliation Act, 1996 (**"Act"**) before the Calcutta High Court, which passed an order in favour of the Respondent, by appointing an arbitrator. Aggrieved, the Appellants approached the SC, relying on the ratio of Himangni Enterprises.

The SC in the case of Himangni Enterprises held that though the Delhi Rent Act, 1995 was not applicable, the dispute would be governed by TPA and in cases governed by the TPA, the dispute would be triable by the civil court and not through arbitration.

However, the SC in Vidya Drolia observed that arbitration could be exempted only in cases governed by special statutes, where specific courts are conferred jurisdiction to decide disputes. The SC pointed out that there is no provision in the TPA that negates arbitrability of disputes governed by the Act. Hence it could not be concluded that disputes arising out of TPA are non-arbitrable. The SC was thus of the view that the principle laid down in Himangni Enterprises must be reviewed.

Issue

Whether tenancy disputes are capable of being resolved through arbitration.

Analysis and observations of the Supreme Court

The SC observed that the validity of the legal ratio in Himangni Enterprises cannot be decided without examining when a subject matter or dispute is non-arbitrable. The SC noted that in ***Booz Allenand Hamilton Inc v. SBI Home Finance Limited [(2011) 5 SCC 532]*** (**"Booz Allen"**), non-arbitrable landlord-tenant disputes were confined to those cases that are governed by special statutes where the tenant enjoys statutory protection against eviction and only specific courts are conferred jurisdiction to decide disputes.

Analyzing Booz Allen, which differentiated actions *in rem* from actions *in personam,* the SC noted that while rights *in personam* are amenable to arbitration, rights *in rem* are not, and noted that landlord-tenant disputes governed by rent control legislation, are not actions *in rem,* yet they are non-arbitrable.

The SC observed that generally non-arbitrability of the subject matter would relate to non-arbitrability in law. Arbitration by necessary implication excludes actions in rem and demonstrates the intrinsic limits of arbitration as a private dispute resolution mechanism, which is only binding on 'the parties' to the arbitration agreement. Arbitral tribunals not being courts of law established under the auspices of the State, cannot affect those who are not bound by the arbitration clause. Arbitration is unsuitable when it has *ergaomnes* effect, that is, it affects the rights and liabilities of persons who are not bound by the arbitration agreement.

The SC observed that in ***N. Radhakrishnan v. Maestro Engineers and Others [(2010) 1 SCC 72]*** (**"N. Radhakrishnan"**), the court had rejected the application for reference to arbitration under the Act on the ground that it would be in furtherance of justice that the allegations as to fraud and manipulation of finances in the partnership firm are tried in the court of law. In the said case, the court while accepting that the dispute may be arbitrable under the applicable mandatory law, held that the dispute would be non-arbitrable on public policy consideration if it relates to serious allegations of fraud.

The SC observed that violation of public policy by the arbitrator could result in setting aside the award on the ground of failure to follow the fundamental policy of law in India, but not on the ground that the subject matter of the dispute was non-arbitrable. Relying on ***Avitel Post Studioz Limited and Others v. HSBC PI Holdings (Mauritius) Limited [Civil Appeal No. 5145 of 2016 decided on August 19, 2020],*** the SC accepted that fraud can be a ground to refuse reference to arbitration only in a clear case where the arbitration clause or agreement itself cannot be said to exist due to the lack of consent of the defaulting party to arbitrate or if allegations of arbitrary, fraudulent, or *mala fide* conduct are made against the state or its instrumentalities which requires a public enquiry.

The SC propounded a four-fold test to determine non-arbitrability of the subject matter of a dispute:

(1) when cause of action and subject matter of the dispute relates to actions *in rem,* that do not pertain to subordinate rights *in personam* that arise from rights *in rem;*

(2) when cause of action and subject matter of the dispute affects third party rights, have *ergaomnes* effect, require centralized adjudication and when mutual adjudication would not be appropriate and enforceable;

(3) when cause of action and subject matter of the dispute relates to inalienable sovereign and public interest functions of the State and hence mutual adjudication would be unenforceable; and

(4) when the subject-matter of the dispute is expressly or by necessary implication non-arbitrable as per mandatory statutes.

As a caveat, the SC stated that these tests are not watertight compartments, they overlap. However, when applied holistically and pragmatically, they will assist in determining with certainty when as per law in India, a dispute or subject matter is non-arbitrable. Only when the answer is affirmative, the subject matter of the dispute would be non-arbitrable.

It further observed that landlord-tenant disputes governed by the TPA are arbitrable as they are not actions *in rem* but pertain to subordinate rights *in personam* that arise from rights *in rem.* Such actions normally would not affect third-party rights or require centralized adjudication. An award passed deciding landlord-tenant disputes can be executed and enforced like a decree of the civil court. Landlord-tenant disputes do not relate to inalienable and sovereign functions of the state. The provisions of TPA do not expressly or by necessary implication bar arbitration. TPA, like all other acts, has a public purpose to regulate landlord-tenant relationships and the arbitrator would be bound by the provisions, including provisions which ensure and protect the tenants. In view of the aforesaid, the SC overruled the ratio laid down in Himangni Enterprises.

The SC further, laid down the scope of the Court to examine the *prima facie* validity of an arbitration agreement to include only:

(1) Whether the arbitration agreement was in writing.

(2) Whether the arbitration agreement was contained in exchange of letters, telecommunication etc.

(3) Whether the core contractual ingredients qua the arbitration agreement were fulfilled.

(4) On rare occasions, whether the subject matter of dispute is arbitrable.

Decision of the Supreme Court

The SC propounded a four-fold test for determining non-arbitrable cases with a caveat. The SC overruled the ratio in N. Radhakrishnan, *inter alia,* observing that allegations of fraud can be made a subject matter of arbitration when they relate to a civil dispute. This is subject to the caveat that fraud, which would vitiate and invalidate the arbitration clause, is an aspect relating to non- arbitrability. The SC overruled the ratio laid down in Himangni Enterprises and held that landlord-tenant disputes are arbitrable as the TPA does not forbid or foreclose arbitration. However, landlord-tenant disputes covered and governed by rent control legislation would not be arbitrable when specific court or forum has been given exclusive jurisdiction to apply and decide special rights and obligations. Such rights and obligations can only be adjudicated and enforced by the specified court/forum, and not through arbitration.

VA View:

The Judgement is a step in the right direction as it has dwelled into various crucial aspects of jurisprudence in arbitration in India and has resolved years of uncertainty. The principle of party autonomy goes hand in hand with the principle of limited court intervention, this is the fundamental principle underlying modern arbitration law. It upholds arbitrability of tenancy disputes, unless governed by special statutes. In a pro-arbitration move, the SC, by this Judgement, elucidated that TPA does not oust the jurisdiction of arbitral tribunals under the Act in case of landlord-tenant disputes, overruling its own judgment in Himangni Enterprises. It also laid down a four-fold test to determine whether a dispute is arbitrable or not and concluded that the arbitral tribunal is the "preferred first authority" to determine and decide all questions of non-arbitrability.

IV. NCLAT: Reiterated that rent is not to be considered as an operational debt under the IBC

The National Company Law Appellate Tribunal (**"NCLAT"**) has in its judgment dated November 10, 2020 (**"Judgement"**) in the matter of ***Promila Taneja v. Surendri Design Private Limited [Company Appeal (Insolvency) No. 459 of 2020],*** held that rent is not to be considered as an operational debt (**"Operational Debt"**) as defined under Section 5(21) of Insolvency and Bankruptcy Code, 2016 (**"IBC"**).

Facts

The appeal had been filed by the landlady Ms. Promila Taneja (**"Appellant"**) against the impugned order of dismissal of an application filed by her under Section 9 of the IBC, by the National Company Law Tribunal, Chandigarh, (**"NCLT"**). The application was dismissed by the NCLT by relying on the judgement of NCLAT in the matter of ***Mr. M. Ravindranath Reddy v. Mr G. Kishan and Others [Company Appeal (Insolvency) No. 331 of 2019]*** wherein it was held that dues in the nature of rent of immovable property do not fall under the head of Operational Debt as defined under Section 5(21) of the IBC. The NCLT had also held that there was a pre-existing dispute between the parties.

The Appellant had entered into a lease agreement (**"Agreement"**) with a lock-in period of 36 months beginning from February 01, 2016 with Surendri Design Private Limited (**"Respondent"**). The Respondent stated that after renting out the shop premises in the mall from the Appellant it had made huge investments. The Respondent stated that it was running an apparels showroom from the shop premises which was at strategic spot, but due to a liquor shop nearby, and the judgment of the Hon'ble Supreme Court (**"SC"**) in the matter of ***State of Tamil Nadu represented by its Secretary, Home, Prohibition and Excise Department v. K. Balu [(2017) 2 SCC 281]*** wherein it was held that sale of liquor should not be in proximity of national highway, there was change of entry of the mall, which eventually hampered its business.

Therefore, it was stated that the Respondent had suffered losses due to demonetization and change in entry to the mall. The Respondent stated that the Agreement was terminated in July, 2017 due to the said change of circumstances.

Issue

Whether arrears of rent can be considered as Operational Debt.

Arguments

<u>Contentions raised by the Appellant:</u>

It was contended that the conclusion of NCLT that there was a pre-existing dispute, was baseless. It was submitted that, the Respondent had informed the Appellant that it was facing losses and wanted to vacate the premises,

irrespective of the lock-in period in the Agreement. Subsequently, the Respondent had unilaterally stopped making payments of rent. Thus, it was submitted that in the given circumstances it cannot be treated as a pre-exiting dispute.

It was further submitted that subsequent to the judgement of the NCLAT in the matter of Mr. M. Ravindranath Reddy (supra), the NCLAT had in the matter of ***Anup Shushil Dubey v. National Agriculture Co-operative Marketing Federation of India Limited and Others [Company Appeal (Insolvency) No. 229 of 2020]*** held that when the space provided is for commercial purposes, the arrangement has to be treated as services considering the definitions as seen in the Consumer Protection Act and the Central Goods and Services Tax Act, 2017. Therefore, it was submitted that the Appellant should also get relief on parity, considering the view taken in the recent judgement of Anup Shushil Dubey (supra).

Contentions raised by the Respondent:

The Respondent contended that the Appellant was informed by way of an e-mail that the lease deed had already been terminated due to change of circumstances. The Respondent contended that the notice under Section 8 of the IBC was sent on August 06, 2018 and even if it was to be presumed that rent can be considered as an Operational Debt, it shows that there was pre-existing dispute.

Observations of the NCLAT

The NCLAT observed that, in its judgment of Mr. M. Ravindranath Reddy (supra), and basis the reference to the Bankruptcy Law Reforms Committee Report, November 2015 (**"BLR Committee Report"**) made therein, the bench had observed as follows, *"..... Simultaneously, it is also relevant to understand the intention of the lawmakers. The Bankruptcy Law Reforms Committee (BLRC), in its report dated November 2015, states that "Operational creditors are those whose liability from the entity comes from a transaction on operations". While discussing the different types of creditors, the Committee points out that "enterprises have financial creditors by way of loan and debt contracts as well as* ***operational creditors such as*** *employees,* ***rental obligations,*** *..." Further, while differentiating between a financial creditor and an operational creditor, the Committee indicates* ***"the lessor, that the entity rents out space from is an operational creditor to whom the entity owes monthly rent on a three-year lease".*** *Hence, the BLRC recommends the treatment of lessors/landlords as operational creditors.* ***However, the Legislature has not completely adopted the BLRC Report,*** *and only the claim in respect of goods and services are kept in the definition of operational creditor and operational debt u/s Sec 5(20) and 5(21) of the Code.* ***The definition does not give scope to interpret rent dues as operational debt."*** The NCLAT therefore had concluded as follows: *"Therefore, we are of the considered opinion that lease of immovable property cannot be considered as a supply of goods or rendering of any services and thus, cannot fall within the definition or Operational Debt."*

The NCLAT noted that the judgement in the matter of Mr. M. Ravindranath Reddy (supra) was delivered by a 3-member bench, while the judgement in the matter of Anup Shushil Dubey (supra) was delivered by a 2-member bench.

In paragraph 17 of the judgment of Anup Shushil Dubey (supra) it was observed as follows: *"17. The Hon'ble Supreme Court in Mobilox Innovations Private Limited V/s. Kirusa Software Private Limited (2018) 1 SCC 353 in Para 5.2.1 observed as hereunder; "5.2.1 Who can trigger IRP? Here, the code differentiates between financial creditors and operational creditors. ... Operational creditors are those whose liability from the entity comes from a transaction on operations. ... Similarly, the lessor that the entity rents out space from is an operational creditor to whom the entity owes monthly rent on a three-year lease. ...".*

Further in the said judgment of Anup Shushil Dubey (supra), there is reference to the definition of "service" under the Consumer Protection Act, 2019 and "a list of activities" which are treated as supply of goods or services under the Central Goods and Services Tax Act, 2017, referring to which in the paragraph 22 of the said judgment, it was concluded as follows, *"Therefore, keeping in view, the observations made by the Hon'ble Supreme Court in Para 5.2.1 of Mobilox (Supra), and having regard to the facts of the instant case this Tribunal is of the earnest opinion that the subject lease rentals arising out of use and occupation of a cold storage unit which is for Commercial Purpose is an 'Operational Debt' as envisaged under Section 5(21) of the Code."*

The NCLAT noted that for the above reasons, the bench had taken a contrary view in the judgment of Anup Shushil Dubey (supra).

The NCLAT in the instant Judgement distinguished the precedents and upheld the view taken in the judgment of Mr. M. Ravindranath Reddy (supra) for the following reasons:

1. Misinterpretation of the precedents:

The NCLAT went through the original judgment in the matter of ***Mobilox Innovations Private Limited v. Kirusa Software Private Limited [(2018) 1 SCC 353]*** and noted that in the original judgment, the SC had reproduced portions from paragraph 5.2.1 of the BLR Committee Report. The NCLAT observed that such paragraph 5.2.1 of the BLR Committee Report has been recorded in paragraph 17 of the judgment of Anup Shushil Dubey (supra) as if it is an observation of the SC. The NCLAT noted that this was apparently not correct. The reproduced portions of the BLR Committee Report were only to gauge the legislative intent and were not the opinion of the SC in the matter of Mobilox Innovations Private Limited (supra).

Further, the SC in the case of Mobilox Innovations Private Limited (supra), held that at the time of admitting application under Section 9 of the IBC, all that the adjudicating authority is to see is whether there is plausible contention which requires further investigation and that the "dispute" is not a patently feeble legal argument or an assertion of fact unsupported by evidence. The NCLAT noted that the learned counsel for the Appellant did not show that the SC in the case of Mobilox Innovations Private Limited (supra), had held rent to be Operational Debt. Therefore, NCLAT upheld the opinion arrived at in the judgment of Mr. M. Ravindranath Reddy (supra).

2. Legislative intent and interpretation of the IBC:

The NCLAT observed that the words and expressions used in the IBC which have not been defined under the IBC, but have been defined in the acts mentioned under Section 3(37) of the IBC, can be directly imported from them. Section 3(37) of the IBC mentions various legislations, however, the NCLAT noted that the Consumer Protection Act, 2019 and the Central Goods and Services Tax Act, 2017 have not been covered under the said Section 3(37) of the IBC. Therefore, the NCLAT observed that the reference to the definition of "service" and "activities" to be treated as supply of service cannot simply be lifted from the said legislations and applied in the IBCas has been done in the case of Anup Shushil Dubey (supra).

The NCLAT observed that the definition of 'financial debt' under Section 5(8)(d) of the IBC, includes the following: *"(d) the amount of any liability in respect of any lease or hire purchase contract which is deemed as a finance or capital lease under the Indian Accounting Standard or such other accounting standards as may be prescribed".* The NCLAT observed that, the legislature was conscious regarding liabilities arising from lease but only for particular types of leases, as mentioned in Section 5(8)(d) of the IBC, and that the legislature made specific provision to even consider it as financial debt, but while dealing with Operational Debt, there is no such provision that has been made. Thus, the NCLAT observed that, even on the parameters of interpretation of statutes, the rent due could not be treated as Operational Debt.

The NCLAT further noted that even if the rent was presumed to be Operational Debt from the e-mail sent by the Respondent, it is clear that the Respondent had referred to financial stress and terminated the Agreement that had a lock-in period. Therefore, the NCLAT observed that the issue whether the said termination of Agreement was legal would be an issue of trial between the parties.

Decision of the NCLAT

The NCLAT dismissed the appeal and reiterated that rent is not to be considered as an Operational Debt, thereby relying upon the judgement of Mr. M. Ravindranath Reddy (supra). The NCLAT also upheld the observation of the NCLT that there is a pre-existing dispute between the parties.

VA View:

The NCLAT in this Judgement, while upholding the view of the NCLT in the impugned order, has looked into the parameters of interpretation of statutes as well as the precedents, thereby crystallising the scope of Operational Debt as limited to goods and services and that dues in the nature of rent of immovable property are not within the scope of Operational Debt as defined under the IBC. Further, the NCLAT has also limited the scope of reference for determining the meaning/definition of terms to legislations as mentioned under Section 3(37) of the IBC.

Furthermore, the NCLAT analysed in detail the precedents and clarified that in the case of Anup Shushil Dubey (supra) the bench had misinterpreted the reference to BLR Committee Report 2015, as the opinion of the SC in the judgement of Mobilox Innovations Private Limited (supra). The NCLAT has over-ruled the judgement of Anup Shushil Dubey (supra) which was *per incuriam* of the decision of the larger bench that is, Mr. M. Ravindranath Reddy (supra). The bench in the case of Anup Shushil Dubey (supra)should have followed the general rule of either accepting the ratio as laid down by the larger bench, or while considering a different view should have made a reference to a larger bench to decide the matter. Therefore, the NCLAT by this Judgement has laid straight the matrix of scope of Operational Debt and settled the issue whether arrears of rent can be considered as Operational Debt, in the negative.

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