

Doctrine of Separability of Arbitration Clause

Separability is a legal doctrine that allows an arbitration agreement to be considered separately from the underlying contract in which it is contained. This is important where there are questions about the enforceability of the underlying agreement.

The Doctrine of Separability of Arbitration Clause has been reaffirmed by the Division Bench of the Bombay High Court in the case of Mulheim Pipecoatings GmbH (Appellant) Vs. Welspun Fintrade Ltd (1st Respondent)& Anr¹

Brief facts of the case

Appellant being a company incorporated in Germany entered into a Share Purchase Agreement “(SPA)” dated 10th December, 2004 with 1st Respondent as ‘Transferor’ and Appellant as ‘Transferee’. A Joint Venture company was promoted inter-alia by the Appellant and the first Respondent and it was proposed to be merged with Second Respondent. Pursuant to the merger, the second Respondent was to issue shares to the shareholder of Joint Venture Company, as per agreed swap ratio. The consideration for acquiring approximately 4.46 Million shares was Rs. 22.80 Million. On 6th October 2009 Appellant issued a notice to the 1st Respondent, intending to sell its shares in second Respondent. On 21st October 2009, the first Respondent informed Appellant that notice of offer is not in accordance with the SPA. The Appellant in reply to the first Respondent’s letter, replied that it was not obliged to explain the reasons for invalidity of notice of offer.

The first Respondent moved an application under section 9 of Arbitration and Conciliation Act, 1996² 21st November 2009 and obtained an ex-parte order restraining the Appellant from alienating the shares in the 2nd Respondent.

Thereafter a Memorandum of Understanding (MoU) was entered on 17th March 2010 between Appellant and first Respondent by which parties recorded a settlement. Out of 8.5 Million shares, the first Respondent was to purchase 5 million shares from Appellant and for the balance 3.5 Million Share, the Appellant could sell in monthly instalments of 1lakh shares over period of 3 years. Upon signing this MoU, the SPA dated 10th December 2004, the SPA stood null and void.

Dispute arose pertaining to tax liabilities in relation to the transfer of 5 Million shares. Appellant moved a Request for Arbitration [RFA] before International Chamber of Commerce, Paris on 25th May 2011, inter alia seeking a declaration to sell shares to any third Party and claimed damages from the first Respondent.

Thereafter the first Respondent filed a suit before the Original Side of Bombay High Court, inter alia praying to declare that SPA stood terminated and to declare the MoU valid and binding over the terminated SPA.

Appellant subsequently moved a Petition under section 45 of Arbitration and Conciliation Act, 1996³ (ACT) inter alia seeking a reference to Arbitration under clause 11.13 of the SPA between the parties to the SPA. The single Judge, rejected the Section 45 Petition and held that parties have substituted the SPA upon the execution of the MoU “in toto by recording fresh terms”.

Thereafter, an Appeal came to be filed by the Appellant wherein the Doctrine of Separability of an Arbitration Clause has been extensively dealt with.

Analysis of the Doctrine of Separability of Arbitration Agreement

The Court while analysing the Doctrine of Separability of an Arbitration Agreement from the underlying contract held that this doctrine was recognised even before the Act came into force. Whenever an arbitration agreement formed part of the contract, it has always stood apart from the rest of the contract. The logic behind the doctrine of separability is that when parties to a business transaction agree to resolve their disputes through arbitration, it would be against the interest of business to assume that despite a binding arbitration agreement as preferred form of dispute resolution, the parties have left some disputes to be resolved by courts.

Relying upon several Judgements of the Supreme Court of India and the English Courts, the court held that the essential features of the Doctrine of Separability can be summed up as follows:-

- The arbitration clause of the contract has nothing to do with the performance of the contract but constitutes the modality for dispute resolution, thereby leaving itself as collateral term.
- The arbitration agreement does not *ipso facto* come to an end even after termination of the contract.
- Survival and Perishment of the arbitration agreement would entirely depend upon the nature of the controversy and its effect upon the existence or survival of the contract itself.
- If the nature of the controversy is such that the main contract would itself be treated as non est in the sense that it never came into existence or was void, the arbitration clause cannot operate, for along with the original contract, the arbitration agreement is also void. Similarly, though the contract was validly executed, parties may put an end to it as if it had never existed and substitute a new contract solely governing their rights and liabilities thereunder. In such a case, since the original contract is extinguished or annihilated by another, the arbitration clause forming a part of the contract would perish with it.
- Depending upon the facts of the case, where either one of the parties or both the

parties of the contract may be discharged from the contract and the contract may come to an end, however, in such cases the arbitration clause would still operate.

- The doctrine of separability requires, for the arbitration agreement to be null and void, inoperative or incapable of performance, a direct impeachment of the arbitration agreement and not simply a parasitical impeachment based on a challenge to the validity or enforceability of the main agreement.

Conclusion

The doctrine of separability which now is an established part of Indian law has, also has been statutorily codified in Section 7 of the Arbitration Act of 1996 in the U.K. The Indian Courts have time and again reaffirmed the Doctrine of Separability and held the validity of one agreement from being affected by the arbitration clause, reinforces the full autonomy of an arbitration agreement and the integrity of the arbitral process. Nonetheless, the two should be evaluated together.

Upholding the Doctrine of Separability of an arbitration clause, the Division Bench of the Bombay High Court set aside the order of the single Judge and relegated the parties to Arbitration.

1. Appeal (L) No. 206 of 2013 in Arbitration Petition No. 1070 of 2011
 2. Interim measures by Court
 3. Power of Judicial authority to refer parties to arbitration.
-

ECB allowed for general corporate purpose from the foreign equity holder

The Reserve Bank of India *vide* its circular A.P.(DIR Series) Circular No. 31 dated September 4, 2013 permitted eligible borrowers to avail ECB under the approval route from their foreign equity holder company for general corporate purposes subject to the following conditions:

- Minimum paid-up equity of 25 per cent should be held directly by the lender;
 - Such ECBs would not be used for any purpose not permitted under extant the ECB guidelines; and
 - Repayment of the principal shall commence only after completion of minimum average maturity of 7 years
-

Shield For The Medical Professionals

In the case *A.S.V. Narayanan Rao v Ratnamala & Another* ⁴, respondent's husband died as the appellant was unsuccessful in performing angioplasty operation. The Supreme Court of India, relying upon the opinion given by Andhra Pradesh Medical Council and the Medical Council of India pertaining to the treatment of the deceased, held that appellant had made an attempt to do his best to save the deceased and hence, he was not liable for the offence of negligence. Shielding the medical professionals from frivolous cases of medical negligence filed under section

304A IPC, the Court relying upon and quoting from *Jacob Mathew v. State of Punjab*, (2005) 6 SCC 1, said that the doctors are not immune from legal proceedings and hence, in the event of medical negligence while discharging their professional duties, it is necessary to protect doctors from frivolous and unjust prosecution, therefore, a private complaint would only be entertained when there are prima facie evidences before the court in the form of a credible opinion given by another competent doctor to support the charge of rashness or negligence on the part of the accused doctor. Adding to this, the Court said that the investigating officer before proceeding against the accused doctor should obtain an independent medical opinion from a qualified doctor in government service. It was also held that the accused doctor should not be arrested unless his arrest is necessary for furthering the investigation or for collecting evidences or the investigating officer is satisfied that the doctor would not make himself available to face the prosecution.

4. Criminal Appeal No.1433 Of 2013 (Arising Out Of Special Leave Petition (Criminal) No.649 Of 2011)

Arbitration Agreement must be in writing

The Bombay High Court in the case of *Yashvant Chunilal Mody v. Yusuf Karmali Kerwala Arbitration Application (L.) No.859 Of 2013*, has considered the requirement that an arbitration agreement must be in writing. Whilst analyzing section 7 of the Arbitration and Conciliation Act, 1996, the Court held that section 7 not only imposes a requirement that the arbitration agreement must be in writing; but also provides for the exclusive modes of proving the existence of the written agreement.

In the said case, the arbitration agreement itself was not annexed to the petition; but it was maintained that the existence of a written arbitration agreement would be proved by oral evidence in accordance with the doctrines contained under section 63 of the Evidence Act which provides that oral accounts of the contents of a document given by some person who has himself seen it are considered to be secondary evidence.

The Hon'ble Bombay High Court rejected the said application filed under section 11 of the Arbitration and Conciliation Act and opined that "*Section 7 (4) is exhaustive... It does not contemplate that an oral account of a document signed by the parties would also be an arbitration agreement... An arbitration agreement is in writing only if it falls within sub-section a, b or c of s. 7(4)...*"

News 10 @ a glance

**RBI Amends Guidelines on
Downstream Investment**

Vide the notification published on September 6, 2013 and the A. P. (DIR Series) Circular No. 42 dated September 12, 2013 the RBI has amended its FDI Regulations. By this amendment the use of internal accruals for downstream investments is now permissible for all companies and is not restricted to investment holding companies. The necessary conditions on entry, compliance with sectoral caps, approvals, would however need to be adhered to as earlier.

CBDT Notifies General Anti-Avoidance Rules

After being first introduced by the Direct Tax Code in 2009 to tackle the 'Impermissible Avoidance Agreement' for avoidance of tax, The General Anti-Avoidance Rules have now being notified vide Notification SO 2887 (E) dated 23rd September 2013.

The GAAR Provisions would come into effect with 1st April 2005 (Financial Year 2015-2016) as a part of Income Tax Act, 1961. The GAAR Rules have provided for monetary threshold, non-applicability of the GAAR to the FII's which do not take the treaty benefit and protection of investments made before 30 August 2010. The Rules cast an obligation on the AO to undertake thorough exercise before initiating the GAAR proceedings and provides for an opportunity to the taxpayer to prove that the arrangement is not an IAA. The

Rules also provide for definite time limit for conclusion of the proceedings.

RBI Eases Norms on Investment made by Non-Residents

Removing the restriction on only allowing FIIs, NRIs and QFIs to acquire shares of an Indian Company listed on recognized stock exchange, the RBI on 6th September 2013 decided to open up the FDI policy to allow non-residents including NRIs to acquire shares of such companies on recognized stock exchange, but only through registered broker and provided the non resident investor has already acquired and continues to hold control in accordance with the SEBI Takeover Code.

Private Placement Norms to be stricter in New Company Law

The first big change in the draft rules on new company law, is that private placement of unlimited size can now be done to qualify the institutional buyers as well as employees. The qualified institutional buyer bit will be a big beneficiary for companies who wish to do Qualified Institutional Placements (QIP) as they would have had to do it only to 49 Institutional buyers but however now it can be done to many more. A private placement can be done to investors numbering up to an aggregate of 200 people in a year. This may be done through one offer

or upto four offers in a year and each one of those 200 people can transfer those securities to 20 people in a quarter which comes up to 16000 investors in all.

NGOs Funded by Government fall within RTI ambit

The Supreme Court in Thalappalam Ser. Coop. Bank Ltd. and others vs State of Kerala and others has held that the term “Non-Government Organizations” (NGO), as such, is not defined under law. But, over a period of time, the expression has got its own meaning and, it has to be seen in that context, when used in the Right to Information Act. Government used to finance substantially, several non-government organizations, which carry on various social and welfare activities, since those organizations sometimes carry on functions which are otherwise governmental and falls within the ambit of right to information.

Date of cause of action in Cheque Bounce Cases clarified by Supreme Court

In a landmark judgment the Supreme Court of India, in Econ Antri Ltd v. Rom Industries Ltd passed on 13th September, have deliberated on the calculation of period of one month u/sec. 142(b) of Negotiable Instruments Act when filing a complaint u/sec. 138(c) of the Act for cases of cheque bounce . The court while distinguishing and

reconsidering its earlier decision in *Saketh India Ltd. v India Securities Ltd*, held that for calculation of a limitation period of one month u/sec. 142(b) the period has to be reckoned excluding date on which case of action arose. It observed that phrases such as 'from such day' and 'until such day' are equivocal and do not make clear inclusion or exclusion of either the first day or the last day.

Government Servants cannot be prosecuted without prior permission

The Supreme Court in *Anil Kumar & Ors. vs M.K. Aiyappa & Anr.* has opined that in order that the public servant may not be unnecessarily harassed on a complaint of an unscrupulous person, it is obligatory on the part of the executive authority to protect him. If the law requires sanction, and the court proceeds against a public servant without sanction, the public servant has a right to raise the issue of jurisdiction as the entire action may be rendered void ab-initio.

Final Safe Harbour Rules Notified by CBDT

The draft safe harbour rules were placed in public domain along with Central Board of Direct Taxes (CBDT) Press Release on 14th August 2013 seeking comments of various stake holders. The comments received from various stake holders have been considered

and necessary modifications have been made to the draft rules. The finalized safe harbour rules are being notified separately. Section 92CB of the Income-tax Act provides for framing of safe harbour rules.

The Pension Fund Regulatory and Development Authority bill, 2013 notified

The Pension Fund Regulatory and Development Authority Bill, 2013 has received the assent of the President of India. It has now been published in the Gazette of India, Extraordinary, Part-II, Section-1, dated the 19th September 2013 as Act No. 23 of 2013

Unlisted Companies can raise capitals abroad

The Government of India has enabled unlisted Indian companies to raise capital and list overseas without the requirement for a primary listing in India. This will increase the breadth of choices for unlisted Indian companies to raise capital. The new scheme has been introduced on a temporary pilot basis for 2 years after which it will be reviewed.