Between the lines...

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Highlights

I. Disputes relating to trust, trustees and beneficiaries arising out of the Trust Deed and the Trust Act not arbitrable: Supreme Court

Adding one more kind of dispute to the list of non-arbitrable disputes, the Supreme Court of India in the case of ***Shri Vimal Kishor Shah and Ors.*** *(the* ***"Appellants"****)* ***vs. Mr. Jayesh Dinesh Shah & Ors.*** *(the* ***"Respondents"****)* (decided on August 17, 2016) has held that any dispute pertaining to affairs of a trust including the disputes inter se trustee and beneficiary in relation to their right, duties, obligations, removal, etc. cannot be decided by an arbitrator under the Arbitration and Conciliation Act, 1996 (the **"Arbitration Act"**). The Civil Court will have to decide such disputes as specified under the Indian Trust Act, 1882 (the **"Trust Act"**).

The factual matrix of the case goes back to 1983 when one person Shri Dwarkadas Laxmichand Modi had executed a trust deed in relation to his properties. Shri Modi formed the trust in favour of six people (minors at that point in time) who were the beneficiaries under the deed. Dispute resolution mechanism was laid down in clause 20 of the deed which provided for resolution by arbitration.

Disputes started to arise between the beneficiaries from 1989-90 onwards. Exchange of notices, allegations and counter allegations followed. Ultimately, as the disputes remained unresolved and the parties could not agree on appointment of an arbitrator, application under Section 11 of the Arbitration Act came to be filed before the Bombay High Court for referral of all disputes to arbitration. The Appellants had opposed the application before the High Court, arguing that neither the Appellants nor the Respondents were parties to the deed and also they had not signed the deed. Thus, the stance taken by the Appellants was that Appellants and Respondents could not be construed as "party" to the deed and

the deed could not be termed as an "agreement" much less an "arbitration agreement" within the meaning of Section 2(b) and 2(h) read with Section 7 of the Arbitration Act. In a nutshell, according to the Appellants, there was no valid and enforceable arbitration agreement.

The Bombay High Court took the view that beneficiaries could be held as "party" to the deed under Section 2(h) of the Arbitration Act as they had attained majority and had taken benefit under the deed throughout their minority as beneficiaries. Therefore, recourse to proceedings under Section 11 of the Arbitration Act was held to be permissible and a sole arbitrator was appointed.

The apex court considered the rival submissions of the parties, the applicable provisions under the Arbitration Act and the relevant case laws. The Court also examined the scheme of the Trust Act. The Court took note of a case ***(Booz Allen and Hamilton Inc. vs. SBI Home Finance Ltd. and Ors.;*** decided on April 15, 2011), in which, the apex court had laid down a list of six non-arbitrable disputes. The Court added one more kind of dispute to this list by opining that there was an implied bar of exclusion under the Trust Act on applicability of the Arbitration Act for deciding the disputes relating to trust, trustees and beneficiaries through private arbitration. Therefore, cases arising out of trust deed and the Trust Act cannot be decided by arbitration.

The Court concluded by ruling that, *"we hold that the application filed by the Respondents under Section 11 of the Act is not maintainable on the ground that firstly, it is not based on an "arbitration agreement" within the meaning of Sections 2(b) and 2(h) read with Section 7 of the Act and secondly, assuming that there exists an arbitration agreement (clause 20 of the Trust Deed) yet the disputes specified therein are not capable of being referred to private arbitration for their adjudication on merits."*

VA View

The Supreme Court's decision in the instant case clarifies the meaning of the term 'arbitrability' of a dispute. The decision lays emphasis on the fact that though there may be an arbitration agreement between the parties but if the dispute is not arbitrable then the dispute cannot be resolved by arbitration but the dispute will have to be resolved by a civil court or the respective authority conferred with the jurisdiction to do so by the respective statute.

II. Court is required to examine the validity of only the arbitration agreement and not the substantive contract under Section 45 of the Arbitration Act: Supreme Court

The Supreme Court of India in the case of ***Sasan Power Limited*** *(the* ***"Appellant")*** ***vs. North American Coal Corporation India Private Limited*** *(the* ***"Respondent")*** (decided on August 24, 2016) observed that for the purpose of deciding whether the suit filed is maintainable or impliedly barred by Section 45 of the Arbitration and Conciliation Act, 1996 (the **"1996 Act"**), the Court is required to examine only the validity of the arbitration agreement and not the substantive contract.

The Appellant and an American company, namely, the North American Coal Corporation (the **"NACC"**) had an agreement between them for mine and development operations (the **"First Agreement"**). The governing law of the First Agreement was the law of the United Kingdom and provided for resolution of disputes through arbitration by International Chambers of Commerce (the **"ICC"**) with place of arbitration at London. In 2011, an agreement was entered into between the Appellant, the NACC and the Respondent (the **"Second Agreement"**), by which the NACC professed to assign all its rights and obligations to the Respondent.

After disputes started to arise between the Appellant and the Respondent, the Respondent made request for arbitration in 2014. The Appellant went to Court of a District Judge in Madhya Pradesh and sought certain reliefs, including asking for a decree of declaration to hold arbitration request as null and void being contrary to Indian law. An ex-parte order injuncting the ICC from proceeding with the arbitration was passed but was vacated later on an application by the Respondent. When the matter reached the Madhya Pradesh High Court, the High Court was of the view that the parties had to be referred to arbitration and the appeal filed by the Appellant was dismissed. The Appellant preferred an appeal against this decision before the apex Court in this case.

The stance of the Appellant was that parties to the arbitration were two Indian companies which could not have an agreement with foreign governing law as such stipulation was contrary to the public policy and was hit by Sections 23 of the Indian Contract Act, 1872. This was based upon the understanding of the Appellant that by virtue of the assignment under the Second Agreement, the NACC had novated the Second Agreement in favour of the Respondent. Therefore, the Respondent took the position of NACC and the Second Agreement stood between the Appellant and the Respondent, both being Indian parties.

The Court examined the two agreements in detail to come to terms with the nature of the assignment made under the Second Agreement. The transaction under the Second Agreement did not appear to the Court as an assignment as Court noted that the NACC was not discharged from its obligations under the First Agreement. The Court noted that such transaction rather created an agency or was like a sub-contracting or vicarious performance agreement. Therefore, the Court noted that the disputes were between three parties and the stipulation of governing law could not be said to be an agreement between only two Indian companies as the NACC as foreign party was also present.

The pleading of novation was also rejected by the Court, by giving reasons as under:

"(i) There cannot be any novation between the American company and the Respondent because prior to the AGREEMENT-II, there was no agreement whatsoever between them.

(ii) The Respondent cannot be said to have stepped into the shoes of the American company because the obligations under AGREEMENT-I owed by the American company to the Appellant were not discharged by the AGREEMENT-II."

Further, with regards the argument that stipulation of governing law being contrary to the public policy and hit by Section 23 of the Indian Contract Act, 1872, the Court was of the view that even if the submission was accepted, it could not invalidate the arbitration agreement as that was independent from the substantive contract. The Court held that, *"the scope of enquiry under the Section 45 does not extend to the examination of the legality of the*

substantive contract. XXXX For the purpose of deciding whether the suit filed by the Appellant herein is maintainable or impliedly barred by Section 45 of the 1996 Act, the Court is required to examine only the validity of the arbitration agreement within the parameters set out in Section 45, but not the substantive contract of which the arbitration agreement is a part."

The Court finally observed that Section 45 of the 1996 Act made it obligatory on the Court to refer the parties to arbitration after it was clear that the agreement is neither null and void nor inoperative and incapable of being performed. The appeal was dismissed and the order of the Trial Court was modified to the extent of referring the parties to arbitration as mandated by Section 45 of the 1996 Act.

VA View

It may be noted that the decision of the Madhya Pradesh High Court in this matter captured wide attention as the High Court had considered the issue whether two Indian parties could have foreign seated arbitration. However, it is pertinent to note that this issue was not dealt with by the Supreme Court in this case as the Appellant had given up this argument before the Supreme Court and therefore the Supreme Court did not consider this issue in this judgment.

Considering this ruling coming from the apex court, scope of enquiry under Section 45 of the 1996 Act is restricted to determining the validity of the arbitration agreement and a court cannot embark on an adventure to examine the validity of substantive agreement under Section 45 of the 1996 Act, in line with the view that arbitration agreement is independent of the substantive agreement.

III. Employer cannot enforce covenant in restraint of trade in guise of a confidentiality clause: Delhi High Court

Under the guise of confidentiality covenant, the employer cannot restrain the ex-employees from competing with the employer, held Delhi High Court (**"Court"**) in ***Stellar Information Technology Private Ltd.vs. Rakesh Kumar and Ors.***

The Plaintiff i.e. employer was a private limited company engaged in providing data recovery, data migration and data erasure solutions to clients in India and abroad. The Defendants included (i) past employees of Plaintiff, (ii) spouse of these employees and (iii) a company (**"Techchef"**) wherein spouse of these ex-employees were promoters and directors.

It was Plaintiff's case that Defendants 1 to 3 were ex-employees of Plaintiff and during their employment with Plaintiff, the Defendants 1 to 3 had access to Plaintiff's confidential information, trade secrets, knowhow, client information, etc. (**"Confidential Information"**). The Plaintiff pleaded that although Techchef was run by spouse of these ex-employees, the actual business was being carried on by the ex-employees who were in de facto control and management of Techchef. The Plaintiff further alleged that these ex-employees were using Confidential Information

to conduct business similar to that of Plaintiff and consequently violated the terms of "Employee Confidentiality Agreement" and "Confidentiality and Invention Assignment Agreement".

The Court considered the relevant clauses in the aforesaid agreements and came to the conclusion that contact details could not be said to be confidential, considering it was available in public domain.

In their defense, the Defendants had stated that the 'client information' referred to by the Plaintiff was available in public domain in as much as the names of almost all large customers of Plaintiff were published on the Plaintiff's website and customers who avail such services were known in the market. The Plaintiff countered that unlike names of customers, their contact details were not easily available in public domain. Consequently the Defendants violated their confidentiality obligation by using Plaintiff's client information. The Court did not accept this argument and held that the client contact details could have been found by the Defendants by their own efforts.

Court noted, *"The fact that the Defendants have approached some of the Plaintiff's customers does not in the given facts establish that the Defendants are using any proprietary information of the Plaintiff."*

Court held that by expanding the width of the expression 'confidential information' to include information which is in public domain, the Plaintiff is not seeking protection of proprietary or confidential information, but is essentially seeking a restraint on trade triggering Section 27 of the Indian Contract Act, 1872.

Court observed, *"The contention of the Plaintiff that the restriction to carry on competing business is for a limited time and is therefore, reasonable and consequently, enforceable cannot be accepted. Once it is held that in the guise of a confidentiality clause, the Plaintiff is attempting to enforce a covenant in restraint of trade, the same must be held to be void."*

VA View

These kind of disputes are now very common in India and there have been several decisions on the point of enforceability of non-compete clauses specifically. It may be worth noting that Court in this case observed that if names of clients were available in public domain, such client contacts were not confidential information. In sectors where the client base is largely restricted to few easy identifiable names in the market, employer will face difficulty in contending that an ex-employee violated the confidentiality clause by accessing the client lists or any such database. Further, in such cases, there will be no remedy to stop the ex-employees from approaching the clients or not compete with the ex-employer as the same would be hit by Section 27 of the Indian Contract Act, 1872.

IV. SEBI questions legality of Crowdfunding

The Securities and Exchange Board of India (**"SEBI"**) issued Press Release No. 137/2016 dated August 30, 2016 titled 'SEBI CAUTIONS INVESTORS'(the **"Press Release"**) as a measure to warn the investors and put them on alert against certain practices in the market.

- **Certain schemes/leagues/competitions**

  SEBI has taken note of certain schemes/leagues/competitions unrecognized by SEBI/ recognised Exchanges that are used as a tool to solicit investors. Some of these even offer prize money. SEBI has made it clear that participation in such schemes will be at investors' sole risk and in case of disputes relating to such schemes or enforcement of any related agreement, aggrieved investors of such schemes will not be able to take recourse to the following:

  - Benefits of investor protection under SEBI/ Exchange(s) jurisdiction
  - Exchange dispute resolution mechanism
  - Investor grievance redressal mechanism administered by Exchange(s)

- **Unauthorized Electronic Platforms**

  This is significant in view of the intense debate on crowdfunding doing the rounds in India and considering the fact that substantial chunk of start-up funding comes from crowdfunding. SEBI had also issued consultation paper on crowdfunding in India in 2014.

  In the Press Release, SEBI has noted that certain unrecognised electronic platforms are becoming a source for raising fund online, similar to stock exchanges. It is pointed out that such investment happens in the form of private placement with companies in blatant violation of the Securities Contract (Regulation) Act, 1956 and the Companies Act, 2013 and that therefore, the investors should be wary of such dealings which violate the law.

- **Un-registered investment advisers and research analysts**

  Many times, investors rely, to make their market strategy, on casual advice/updates given by fake advisors in the market. SEBI has advised the investors to be cautious in dealing with unregistered investment advisers / research analysts and to not rely on their advice given now a days through text messages and other media.

VA View

As per SEBI, only recognised stock exchanges can provide electronic platforms where equity and other corporate securities could be listed and traded. As the startup activity in India gathers momentum, major equity crowdfunding platforms (ECP) players like Grex, LetsVenture, Termsheet, Equity Crest and Tracxnfor funding startup companies have emerged. SEBI is worried about small investors getting sucked into unknown, illiquid companies marketed by ECPs.

Start-up funding may take a hit as SEBI seems to take a stringent approach to stop the trend which is not in compliance with the current legal and regulatory framework. On the one hand the Government is serious about having a startup ecosystem in India, however with this press release by SEBI, concerns over this funding route for Indian start-ups, remain.

V. Union Cabinet approves liberalisation of FDI norms for NBFCs

As per the press release dated August 10, 2016, issued by the Press Information Bureau, Union Cabinet has given its approval to amend regulation for foreign investment in the Non- Banking Finance Companies (the **"NBFCs"**), a much needed move on part of the Government after signals of such policy change were given earlier in the year when the same was mooted by the Hon'ble Union Finance Minister in his budget speech for 2016-17. Under the current regime on foreign direct investment as per the Consolidated Foreign Direct Investment Policy 2016 (the **"FDI Policy"**), foreign investment in NBFCs is allowed under the automatic route in only the following eighteen activities:

(i) Merchant Banking

(ii) Under Writing

(iii) Portfolio Management Services

(iv) Investment Advisory Services

(v) Financial Consultancy

(vi) Stock Broking

(vii) Asset Management

(viii) Venture Capital

(ix) Custodian Services

(x) Factoring

(xi) Credit Rating Agencies

(xii) Leasing & Finance

xiii) Housing Finance

(xiv) Forex Broking

(xv) Credit Card Business

(xvi) Money Changing Business

(xvii) Micro Credit

(xviii) Rural Credit

Such investments are also subject to minimum capitalisation norms as one of the conditions laid down in the FDI Policy.

Coming to the proposed changes, approval has been given for:

- Amendment in the existing Foreign Exchange Management (Transfer or Issue of Security by the Person Resident outside India) Regulations, 2000 on the NBFCs which will pave the way for inflow of foreign investments in "Other Financial Services" (other than the eighteen activities mentioned above) on automatic route.

- However, such services should be regulated by any financial sector regulators like the Reserve Bank of India, Securities and Exchange Board of India, etc. or government agencies. Foreign investment in services which are not regulated by any regulators or government agency would be under the approval route.

- Further, minimum capitalisation norms under the current regime have been eliminated considering the fact that regulators prescribe their own minimum capitalisation norms.

VA View

This policy trend of the Indian Government of liberalizing the FDI norms is here to stay. Government has again eased the FDI norms, this time for NBFCs.

Foreign investment in NBFCs will come under the automatic route provided they are regulated by any of the financial sector regulators. But entities not regulated by any of the regulators will need approval from the Foreign Investment Promotion Board (FIPB). Easing of minimum capitalization norms is a welcome move.

Once it comes into force, this is sure to give a major boost to the investments in the sector.

Contact Details :

www.vaishlaw.com

NEW DELHI
1st, 9th & 11th Floor
Mohan Dev Bldg. 13 Tolstoy Marg
New Delhi - 110001, India
Phone: +91-11-4249 2525
Fax: +91-11-23320484
delhi@vaishlaw.com

MUMBAI
106, Peninsula Centre
Dr. S. S. Rao Road, Parel
Mumbai - 400012, India
Phone: +91-22-4213 4101
Fax: +91-22-4213 4102
mumbai@vaishlaw.com

BENGALURU
Unit No. 305, 3rd Floor
Prestige Meridian-II, Building No. 30
M.G. Road, Bengaluru - 560001, India
Phone: +91-80-40903581/ 88 /89
Fax: +91-80-40903584
bangalore@vaishlaw.com