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India's Supreme Court Limits Involvement of Indian Courts in Foreign Arbitrations

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On September 6, 2012, the Supreme Court of India overruled a prior decision and acted to limit the scope of the Indian Arbitration Law and the role of Indian courts in arbitrations where the parties have chosen the seat to be outside of India. This decision, together with recent actions by the Indian government to reduce obstacles to foreign investment in certain sectors of the Indian economy, should further facilitate foreign involvement with India by giving foreign investors confidence that arbitral rulings will no longer be second-guessed and potentially set aside by Indian courts.

The decision of the Supreme Court (India's highest court) in the matter of *Bharat Aluminium Co. v. Kaiser Aluminium Technical Service, Inc*. ("Bharat Aluminium") can be seen as a seminal event, changing the landscape of the Indian Arbitration Law and, in particular, having a significant impact on international transactions related to India. The Supreme Court in *Bharat Aluminium* overruled its previous ruling in the matter of *Bhatia International v. Bulk Trading S.A. & Anr*, (2002) 4 SCC 105 ("Bhatia"), which had been in controversy for the past several years. The Supreme Court's decision *in Bharat Aluminium* comes as a relief for arbitrations involving India that are seated outside of India. In contrast to its ruling in *Bhatia*, the ruling in *Bharat Aluminium* limits the role of Indian courts in cases where the seat of the arbitration proceedings is outside of India (a "Foreign Arbitration").

By upholding the principle of party autonomy and territoriality as under the UNCITRAL Model Law ("Model Law"), this judgment brings the Indian arbitration laws in closer conformity with international norms. However, the non-applicability of this judgment to arbitration agreements that pre-date the judgment places some limitation on its usefulness.

Background: The Indian Arbitration Law Prior to *Bharat Aluminium*

The Indian law on arbitration is codified in The Arbitration and Conciliation Act, 1996 ("Act"). Under the Act, arbitration has been divided into two parts: Part I applies to domestic arbitrations and Part II deals with the recognition and enforcement of Foreign Arbitration awards and incorporates the provisions of the New York Convention.

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The law with regard to the applicability of the Act to Foreign Arbitrations as it stood prior to the ruling in *Bharat Aluminium* was governed by the Supreme Court's decisions in *Bhatia* and *Venture Global Engineering v. Satyam Computer Services*, (2008) 4 SCC 190. In *Bhatia*, the Supreme Court held that Part I of the Act was applicable to all arbitrations, even where the seat of the arbitration was outside India, unless the parties, by agreement, excluded some or all of the Act's provisions. The result of the ruling in *Bhatia* was that parties in a Foreign Arbitration could approach the Indian courts: (i) to claim interim relief under Section 9 of the Act and (ii) to set aside the arbitral award under Section 34 of the Act. Thus, the Indian courts were given wide latitude to intervene on substantive issues even where the parties had chosen a foreign seat.

The Supreme Court's Ruling in *Bharat Aluminium*: Key Highlights and Dissent from *Bhatia*

The facts of the case involved an agreement dated April 22, 1993 between the appellant, Bharat Aluminium Co. ("Appellant"), and the respondent, Kaiser Aluminium Technical Service, Inc. ("Respondent"). Under the agreement, the Respondent was to supply and install a computer-based system for the Appellant. The agreement between the parties contained an arbitration clause that specified arbitration to be conducted in London in accordance with the rules of English Arbitration Law. The substantive law governing the agreement was Indian. Upon a dispute between the parties, an award was rendered by an arbitral tribunal in England. The award was challenged by the Appellant in a district court in India under Section 34 of the Act. On being dismissed by the lower courts, the appeal came before the Supreme Court of India for review.

The core issue before the Supreme Court was to determine whether Part I of the Act applied to Foreign Arbitration awards, thereby permitting the Indian courts to set aside Foreign Arbitration awards or whether Part I and Part II of the Act were mutually exclusive. The Appellants argued that Part I and Part II were not mutually exclusive and that restricting the application of Part I would render Sections 2(5), 2(7), 20 and 28 (1)[1] of the Act redundant. It was further urged by the Appellants that the Act was "subject matter centric," unlike the Model Law on which it was based. It was also contended that limiting the applicability of Part I to domestic awards would restrict the parties from approaching Indian courts under Section 9 of the Act for interim relief, thus leaving the parties, as a de facto matter, without a remedy.

On September 6, 2012, the constitutional bench of the Supreme Court ruled in favour of the Respondents and overruled its own decision in *Bhatia,* holding that Part I of the Act was applicable only to domestic awards, i.e., awards rendered within India.

In the *Bhatia* ruling the Supreme Court had, while comparing Article 1(2) of the Model Law with its analogous provision under the Act, i.e., Section 2(2)[2], observed that, the word "only" used in the Article 1 (2) of the Model Law limiting the applicability of such provision to domestic awards was missing in Section 2(2) of the Act. On the basis of this observation, the Supreme Court concluded that the Act did not adopt the territoriality principle and therefore Part I was applicable to all arbitration awards, even outside of India.

The Court in *Bharat Aluminium* rejected the reasoning of the *Bhatia* ruling and recognized the territorial link between the seat of arbitration and the authority of courts at the seat as provided in the New York Convention. The *Bharat Aluminium ruling* stated that the omission of the word "**only**" does not compel the conclusion that Section 2(2) of the Act lacks the territoriality principle recognized in Article 1(2) of the Model Law.

[1] Section 2(5) makes the Act applicable to all arbitrations that are not statutory arbitrations and that do not involve an agreement between India and any other country. Section 2(7) provides that awards under Part I of the Act shall be considered as domestic award. Section 20 allows the parties to agree on a place of arbitration. Section 28 (1) lays down the applicable rules for substance of dispute when the place of arbitration is in India.

[2] Section 2(2) states that Part I shall apply where the place of arbitration is in India.

Along with providing clarity on the aspect that Part I and Part II of the Act are mutually exclusive, the Supreme Court made several significant observations in regard to the involvement of Indian courts in Foreign Arbitration. Among those observations, the Supreme Court commented as follows:

- **No suit for interim injunction under Section 9 of the Act is maintainable in the cases of Foreign Arbitration.** Granting of interim relief in any matter is not isolated and is linked to the final determinative issue. Based on this reasoning, the Supreme Court stated that once the parties chose the seat of arbitration outside of India, they are implied to have understood the consequences of the same, including the fact that Indian courts will not intervene on substantive issues when parties chose a foreign seat. The non-availability of Section 9 of the Act to such parties does not render the parties remediless; but, the remedy for interim measures in such cases would then be available with the courts of the country where such arbitration is seated or the arbitral tribunal itself, once established.

- **The seat of the arbitration, in India or elsewhere, would determine whether Part I of the Act applies, even where the agreement provides that the Act shall govern the arbitration proceedings**. The Court adopted the territoriality principle of the Model Law and clarified that when the parties choose a seat of arbitration outside of India, then the law of such country, unless provided otherwise, is the law that governs the conduct and supervision of the arbitral proceedings. This means that in a Foreign Arbitration, even where the parties' agreement provides that the arbitration would be governed by the provisions of the Act, that would not import the provisions of Part I, which apply only to domestic arbitrations, and from that it follows that the Indian courts would not be authorized to exercise supervisory powers in Part I.

- **The Indian courts do not have the power to vacate an international commercial award made outside of India.** Such annulment powers – also referred to as the power to vacate an award – are applicable only under Section 34 of the Act. As Section 34 is in Part I of the Act, it is applicable only to domestic award. Section 48 (1) of Part II applies to Foreign Arbitration awards, and is meant only for the purpose of enforcement.

Conclusion

The *Bharat Aluminium* judgment settles the question of the applicability of the Act to arbitrations seated outside of India. It defines the powers of Indian courts vis-a-vis foreign awards. However, even though the judgment brings the Indian arbitration law in line with its international counterparts, the judgment applies only to arbitration agreements executed after the date of the *Bharat Aluminium* decision. Therefore, while going forward the parties can choose to limit the involvement of Indian courts by choosing a foreign seat, existing agreements still face the intervention by the Indian courts, unless they exclude the Act or are freshly executed to claim the benefit of the *Bharat Aluminium* decision.

If you have questions, please contact the Pillsbury attorney with whom you regularly work, or the authors:

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