SUPREME COURT EXTENDS APPLICABILITY OF CHLORO CONTROLS PRINCIPLE TO DOMESTIC ARBITRATIONS

Ameet Lalchand Shah and Ors. v. Rishabh Enterprises and Anr. (Supreme Court, 03 May 2018)

BRIEF BACKGROUND

Respondent No. 1 ("**Rishabh Enterprises**") entered into two agreements with a M/s Juwi India Renewable Energies Ltd. ("**Juwi India**") for supply of material, and installation and commissioning ("**Agreement 1**" and "**Agreement 2**") of solar power plant at Dongri, Uttar Pradesh ("**Solar Plant**"). An arbitration clause was present in both agreements.

Rishabh Enterprises then entered into a sale and purchase agreement ("**Agreement 3**") with Appellant No. 2 ("**Astonfield**"), for purchasing CIS Photovoltaic products ("**PV products**"), which it further intended to lease to Appellant No. 3 ("**Dante Energy**"). Dante Energy would utilise the PV products at the Solar Plant. Agreement 3 did not contain an arbitration clause. In furtherance of the abovementioned intention to lease, Rishabh Enterprises and Dante Energy also entered into an Equipment Lease Agreement ("**Agreement 4**") for the PV products. Agreement 4 contained an arbitration clause.

It is pertinent to note that Appellant No. 1 ("**Ameet Lalchand**") was the promoter and controlling shareholder of both Astonfield and Dante Energy.

When disputes arose between the parties, the Respondents alleged that Dante Energy had defaulted in rent payments, and that Astonfield had fraudulently induced Rishabh Energy to invest huge sums in the PV products. The Respondents filed a criminal complaint against the appellants, on the basis of which an FIR was registered. They also filed a commercial suit in Delhi High Court ("**Delhi HC**") against all the appellants, seeking recovery of various sums as well as a declaration that Agreements 3 and 4 were vitiated due to fraud.

Meanwhile, Dante Energy invoked arbitration against Rishabh Enterprises under Agreement 4. However, when the appellants received notice of the commercial suit, they filed an application under Section 8 of the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**") seeking for the disputes pertaining to all four agreements to be referred to arbitration as they were all inter-connected.

The Section 8 application of the appellants was dismissed by a Single Judge of the Delhi HC, and thereafter by a Division Bench on the basis of the judgments in *Chloro Controls India Pvt Ltd.* v. *Severn Trent Water Purification Inc.*, (2013) 1 SCC 641 ("**Chloro Controls**"), *Sukanya Holdings (P) Ltd.* v. *Jayesh H. Pandya*, (2003) 5 SCC 531 ("**Sukanya Holdings**"), and *A. Ayyasamy* v. *A. Paramasivam*, (2016) 10 SCC 386 ("**Ayyasamy**").

The Division Bench stated that *Chloro Controls* had not overruled *Sukanya Holdings*, and therefore, in light of the differences between Section 8[1] and Section 45[2] of the Arbitration Act, and since Agreement No. 3 being the 'main agreement' did not contain an arbitration clause, the matter could not be referred to arbitration. It was further held that in view of the holding in *Ayyasamy*, any

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[1] *"**Section 8. Power to refer parties to arbitration where there is an arbitration agreement** - (1) A judicial authority, before which an action is brought in a matter which is the subject of an arbitration agreement shall, if a party to the arbitration agreement or any person claiming through or under him, so applies not later than the date of submitting his first statement on the substance of the dispute, then, notwithstanding any judgment, decree or order of the Supreme Court or any Court, refer the parties to arbitration unless it finds that prima facie no valid arbitration agreement exists.*
(2) The application referred to in sub-section (1) shall not be entertained unless it is accompanied by the original arbitration agreement or a duly certified copy thereof:
Provided that where the original arbitration agreement or a certified copy thereof is not available with the party applying for reference to arbitration under sub-section (1), and the said agreement or certified copy is retained by the other party to that agreement, then, the party so applying shall file such application along with a copy of the arbitration agreement and a petition praying the Court to call upon the other party to produce the original arbitration agreement or its duly certified copy before that Court.
(3) Notwithstanding that an application has been made under sub-section (1) and that the issue is pending before the judicial authority, an arbitration may be commenced or continued and an arbitral award made."

[2] *"**Section 45. Power of judicial authority to refer parties to arbitration** - Notwithstanding anything contained in Part I or in the Code of Civil Procedure, 1908 (5 of 1908), a judicial authority, when seized of an action in a matter in respect of which the parties have made an agreement referred to in section 44, shall, at the request of one of the parties or any person claiming through or under him, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed."*

dispute related to serious allegations of fraud could not be disputed.

Thus, the appellants preferred a Special Leave Petition before the Supreme Court ("**SC**").

ISSUES AND FINDINGS

The issues which arose for the SC's consideration were:

i) Whether all four agreements were sufficiently interconnected in a manner so as to allow for parties to be referred to arbitration, even though there was no arbitration clause in Agreement 3?

ii) Whether the allegations of fraud raised against the appellants would be a ground to refuse reference to arbitration, or should the court view the agreements as commercial undertakings 'with a sense of business efficacy' per the *Ayyasamy* case?

As regards the first issue, the SC noted that there could be no doubt that all four agreements were interconnected as they contained references to each other, and were executed with the same ultimate objective in mind: commissioning of the Solar Plant. In the SC's view, it was Agreement 4 which was the main/principle agreement, and the Delhi HC had erred in considering Agreement 3 as the main agreement. Having noted thus, the SC opined that in such a case, where several parties were involved in a single commercial project, all parties could be covered by an arbitration clause contained in the main agreement.

The SC also examined the language of Section 8 of the Arbitration Act as it stood after the amendment of 2015. It was noted that, firstly, for a Section 8 application to be maintainable, it was no longer necessary for the applicant to be a party to the arbitration agreement. The section was now equally applicable to a person claiming "through or under" such party to the arbitration agreement. Secondly, the threshold for referring parties to arbitration upon such application was now a *prima facie* existence of a valid arbitration agreement. Thirdly, it was observed that the Law Commission had itself stated in its 246th Report that the amendments to Section 8 had in fact been proposed in the context of the SC's ruling in *Sukanya Holdings*.

Therefore, although the Delhi HC had found that *prima facie* no valid arbitration agreement existed in Agreement 3, in the SC's opinion it had been regarding the wrong agreement as the primary one. As stated above, the SC found Agreement 4 to be the principal agreement, which did contain an arbitration clause.

Finally, the SC considered the implications in the present case of the allegations of fraud against the appellants, and their effect on the arbitration agreement in light of the *Ayyasamy* case. The SC observed that in the *Ayyasamy* case, it had been laid down that only in cases where 'serious' allegations of fraud had been levelled, would it be inapposite to refer a dispute to arbitration. It had simultaneously been noted therein that the courts should not allow parties to wriggle out of possible arbitrations by making simple allegations of fraud concerning only internal affairs of parties. In *Ayyasamy*, the SC had also opined that *"The commercial understanding is reflected in the terms of the agreement between the parties. The duty of the court is to impart to that commercial understanding a sense of business efficacy."*

In the present case, the SC did not find the allegations of fraud to be particularly egregious in nature, and therefore sought to impart a sense of business efficacy to the commercial matter. Thus, the SC referred all the parties to arbitration, and commercial suit filed by the Respondents was considered disposed of on those terms.

CONCLUSION

The Court has certainly adopted a pro-arbitration approach by deeming agreements to be interconnected on the basis of a common project. However, considering that each of these agreements was between different parties, it remains to be seen whether this approach proves to be a slippery slope and whether this standard truly takes into account the touchstone concept of party autonomy.

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