ELP Arbitration: Update

DELHI HIGH COURT REITERATES THAT IF A CONTRACT IS SUPERSEDED BY ANOTHER, THE ARBITRATION CLAUSE WHICH WAS PART OF THE EARLIER CONTRACT ALSO PERISHES.

Sanjiv Prakash v. Seema Kukreja & Ors.[1]

FACTS

- The present petition was filed before the Delhi High Court (**Court**) under Section 11(5) of the Arbitration and Conciliation Act 1996 (**the Act**) seeking appointment of an arbitrator for the purposes of adjudicating the disputes that had arisen between the parties under a memorandum of understanding
- Respondent No. 3 had incorporated a company, which was later renamed as ANI Media Private Limited (**ANI**). The entire paid up capital for ANI was paid by Respondent No.3 from his personal funds. The shares of ANI were distributed by Respondent No. 3 to his family - the Petitioner, Respondent No. 2 and Respondent No. 1 without any consideration (the Petitioner and Respondent Nos. 1, 2 & 3 are collectively referred to as **Family Members**).
- In 1996, a company now known as Thomson Reuters Corporation Pte. Ltd. (**Reuters**), approached the Petitioner for a long term equity investment and collaboration on the condition that the Petitioner would play an active role in the management of ANI.
- Prior to finalization of the transaction with Reuters and, in order to secure the future position of the Petitioner, the Family Members *inter se* entered into a Memorandum of Understanding (**MoU**). The MoU also constituted a special arrangement between the Family Members constituting a succession plan and a management scheme concerning the family shares with respect to ANI.
- The MoU was then acted upon, after which, the Family Members entered into a Shareholders Agreement (**SHA**) and Share-Purchase Agreement (**SPA**) with Reuters. By means of the SHA and the SPA, Reuters acquired 49% shares in ANI. A few terms of the MoU and the SHA were incorporated in the Articles of Association (**AoA**) of ANI by means of an amendment.

[1] Arb.P. 4/2020. Order delivered on 22 October 2020.

- Disputes arose between the parties when in furtherance of his intent to transfer the shares of Respondent No. 3 to the joint ownership of himself and Respondent No. 3, the Petitioner vide his letter of lodgement to ANI attached the duly stamped and certified share transfer forms and original share certificates. The matter was subsequently taken up by ANI's Board Meeting where Respondent Nos. 1 and 2 objected to such transfer and also expressed their desire to transfer the shares of Respondent No. 2 to the joint ownership of Respondent No. 2 and 3. Reuters assented to the transfer of shares proposed by both Respondent Nos. 2 and 3.
- The transfer of shares by Respondent No. 2 to the joint shareholding of Respondent Nos. 1 and 2 was objected to by the Petitioner and the Respondent No. 3. The Petitioner clarified that the MoU was executed between the Family Members prior to the execution of the SHA with Reuters, and was meant to govern their rights, *inter-se*. The purpose of the MoU was to put into effect a succession plan, whereunder the shares of the Petitioner would be entitled to the shares of Respondent Nos. 1 and 2 as their successor.
- After protracted correspondence, the Petitioner ultimately invoked the arbitration clause of the MoU i.e. Clause 12. In response to the notice invoking arbitration, the Respondent No. 3, consented to the arbitrator nominated in the Petitioner's notice of arbitration whereas Respondent Nos. 1 and 2 contended that the MoU had been superseded and was invalidated by the SHA.

ARGUMENTS ADVANCED BY THE PETITIONER AND RESPONDENT NO. 3

- On behalf of the Petitioner and Respondent No. 3, *inter alia*, the following contentions were raised:
  - The transaction with Reuters was to govern the relationship between Reuters and the Family Members and not the *inter se* relationship of the Family Members which was governed by the MoU. Arbitration under Clause 12 of the MoU had been invoked since disputes as to the validity and breach of Clause 8 of the MoU had arisen between the parties.
  - As per Section 5 read with Section 11(6A) and Section 16 of the Act and the principle of 'kompetenz-kompetenz', the question of the binding nature of the MoU ought to be decided by the Arbitral Tribunal appointed as per Clause 12 of the MoU. The scope of Court's enquiry under Section 11 of the Act was limited only to examining the *prima facie* existence of the arbitration agreement. In this regard, reliance was placed upon the Hon'ble Supreme Court's judgement in *Mayavati Trading Pvt. Ltd. v. Pradyuat Deb Burman.*[2]
  - Companies Act 2013 did not forbid the shareholders of a private company from entering into any arrangement with regard to their transfer of shares or exercise of voting rights *inter se*. Any arrangement between the shareholders would not be void or non-binding for the reason that the terms thereof were not incorporated in the AoA. In fact, private arrangements amongst shareholders need not be incorporated in the AoA in order to be binding.[3]
  - Respondent Nos. 1 and 2 have received huge benefits under the MoU with the induction of Reuters as a shareholder of ANI. Respondent Nos. 1 and 2 are thus estopped from questioning the MoU and the MoU is binding upon the Family Members.
  - The MoU could not be superseded by the SHA since various clauses of the MoU were incorporated in the AoA after the execution of the SHA by the amendment of the AoA in 1996.

ARGUMENTS ADVANCED BY THE RESPONDENT NOS. 1 AND 2

- The following contentions, *inter alia*, were raised by the Respondent Nos. 1 and 2
  - The SHA was executed between the Family Members and Reuters to govern their *inter-se* relationship as equity shareholders and members of ANI.

[2] (2019) 8 SCC 714. Counsel for the Respondent No. 3 also placed reliance upon *Duro Felguera SA v. Gangvaram Port Limited,* 2017 (9) SCC 729*, Zostel Hospitality Pvt. Ltd v. Oravel Stays Pvt. Ltd., Oriental Insurance Company Ltd. v. Narbheram Power and Steel Pvt. Ltd.* 2018 (6) SCC 534.
[3] In this regard, reliance was also placed upon the proviso to Section 58(2) of the Companies Act 2013 and also the judgements in *Vodafone International Holdings BV v. Union of India,* (2012) 6 SCC 613 and *Russell v. Northern Bank Development Corp Ltd*- [1992] B.C.C. 578.

- SHA was a comprehensive agreement between all shareholders and set out the terms governing the relationship of all shareholders in ANI, along with a separate dispute resolution clause i.e. Clause 16 of the SHA.
- Subsequent to Reuter's introduction to ANI through execution of SPA/SHA, any previous arrangement between the then shareholders was superseded by the SHA in view of the 'entire agreement' provision i.e. Clause 28 of the SHA.
- When a contract with arbitration clause gets novated/superseded, the arbitration clause perishes and the same cannot be invoked. Reliance was thus placed on the judgements in *Union of India v. Kishorilal Gupta*[4], *Young Achievers v. IMS Learning Resources Pvt. Ltd.*[5] and *Samyak Projects (P) Ltd. v. Ansal Housing & Construction Ltd.*,[6] Such an issue was not a preliminary issue and thus could not be within the scope of jurisdiction under Section 16 of the Act.
- The scope of Section 11 of the Act has been expanded by the Apex Court to look into the validity of the arbitration agreement and therefore the fundamental issue of novation/supersession ought to be looked at by the Court.[7]

FINDINGS OF THE COURT

- Upon hearing the counsels for the parties, the Court held that:
  - The SHA was executed by all the Family Members in their individual capacity as the shareholders and not by one person representing the family. Clause 16 i.e. the dispute resolution clause under the SHA contemplated resolution of dispute between shareholders. It cannot be said that Clause 16 of the SHA was intended only for disputes between Reuters and Family Members, as the said clause contemplates dispute between 'shareholders' who have been defined as individual shareholders comprising of both the Family Members and Reuters.
  - Clause 28.2 of the SHA, contemplates a situation where the parties agree that SHA supersedes any or all prior agreements, understandings, arrangements, promises, representations, warranties and/or contracts of any form or nature whatsoever, which may have been entered into prior to the date hereof between the parties, except for ancillary agreements and the SPA. A conjoint reading of the Clause 28.2 with the opening paragraph of SHA necessarily means that any kind of agreement as detailed in Clause 28.2, 'between the parties' shall stand superseded as per Clause 28.2.
  - Nothing precluded the Family Members to include a stipulation in the SHA, that the SHA, shall not supersede the MoU, as has been specially stated in Clause 28.2 with regard to ancillary agreements and share purchase agreement.
  - Assuming, clauses *para materia* to the MoU had been incorporated in the AoA, it was only with view to make such clauses a part of AoA but that did not mean that the MoU continued to hold the field.
  - The plea that proviso to Section 58(2) of the Companies Act 2013 recognized private arrangements outside AoA for transfer of shares like MoU, had no relevance to the issue which fell for consideration. In any case, the MoU stood superseded by SHA.
  - To attract the theory of novation as per Section 62 of the Indian Contract Act 1872, there should be total substitution of the earlier contract and its terms and all the terms of the earlier contract should perish with it. The Apex Court in *Union of India v. Kishorilal*[8] has held that the appellants could not refer the dispute to arbitration on the basis of the arbitration clauses under the original contracts entered into between the

[4] AIR 1959 SC 1362.
[5] (2013) 10 SCC 535.
[6] Delhi HC FAO (OS) No. 33 of 2019.
[7] *United India Insurance Company Ltd. & Anr., v. Hyundai Engineering and Construction Company Ltd. & Ors*., 2018 (17) SCC 607; *Garware Wall Ropes Limited v. Coastal Marine Construction and Marine Ltd.*, 2019 (9) SCC 2019.
[8] AIR 1959 SC 1362.

parties due to novation. Similar was also held in *Damodar Valley Corporation v. K.K Kar*[9] and *Young Achievers v. IMS Learning Resources Pvt. Ltd.*[10], (2013) 10 SCC 535.

- An arbitration agreement being a creation of an agreement may be destroyed by agreement. If the contract is superseded by another, the arbitration clause, being a component/part of the earlier contract, falls with it or if the original contract in entirety is put to an end, the arbitration clause, which is a part of it, also perishes along with it. Hence, the arbitration clause of the MoU, having perished with the MoU on account of novation, the invocation of arbitration under the MoU was unjustified.
- In view of the conclusions above, the plea of doctrine of 'kompetenz-kompetenz' and the reliance placed on Section 11 (6A) of the Act was untenable. Thus, the petition filed by the Petitioner invoking the MoU for appointment of arbitrator was held to be not maintainable.

ANALYSIS

The judgement appears to be a sound discourse on the validity of an arbitration clause when the contract containing such clause itself stands novated or superseded.

While the judgment clarifies the effect of novation on an arbitration clause, it must be appreciated that the clarification has been rendered in an application for appointment of an arbitrator under Section 11 of the Act. The exact scope of enquiry under Section 11 thus remains ambiguous. The judgment may erroneously be interpreted by future litigants to have expanded the purview of proceedings under Section 11 of the Act.

Pertinently, the present judgement is presently pending appeal before the Hon'ble Supreme Court and thus, the exposition of the Apex Court in this regard remains to be seen.

[9] AIR 1974 SC 158.

[10] (2013) 10 SCC 535. On similar lines, the Court also relied upon the judgement in *Larsen and Toubro Ltd. v. Mohan Lal Harbans Lal Bhayana*, 2015 (2) SCC 461, where it was held that the arbitration agreement stood modified by the supplementary agreement when the terms of the supplementary agreement changed the entire edifice of the principal arbitration agreement, there could be no arbitration between the parties for the claims raised by the appellant and an application filed under Section 11 would thus be misconceived.