Foreign arbitral award allows exit based on put option? "No worries" says Bombay High Court

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Introduction

On 30 April 2020 a single judge of the Bombay High Court passed an order by way of a videoconference in favour of the enforcement of a foreign arbitral award which had been rendered by an arbitral tribunal constituted under the Singapore International Arbitration Centre (SIAC) Arbitration Rules (*Banyan Tree Growth Capital LLC v Axiom Cordages Ltd* (common judgment and order in Commercial Arbitration Petitions 475 and 476 of 2019)). The award upheld the validity and performance of a put option created pursuant to a share subscription agreement and a put option deed, which had provided the petitioner, a foreign investor, with an exit from its investment in an Indian company (the first respondent) on agreed terms and conditions. During proceedings before the Bombay High Court for enforcement of the award in India, the respondents had raised fairly routine objections under Section 48 of the Arbitration and Conciliation Act 1996 (Arbitration Act) – namely:

- the inadequate stamping of the underlying arbitration agreement;
- the illegality of the underlying agreement in terms of the Securities Contracts (Regulation) Act 1956 (SCRA);
- the illegality of the underlying agreement in terms of the Foreign Exchange Management Act 1999 (FEMA); and
- public policy grounds under Section 48(2) of the Arbitration Act.

Facts

Banyan Tree Growth Capital LLC, the petitioner, was a Mauritius-based investment fund. Axiom Cordages Limited, the first respondent, was an unlisted Indian public limited company. Responsive Industries Limited and Wellknown Business Ventures LLP (the second and third respondents, respectively) were Indian promoters of Axiom.

In 2008 Banyan entered into a share subscription agreement with the respondents, whereby it made a capital investment in Axiom. Pursuant to the share subscription agreement, Banyan received a put option which it could exercise within a limited timeframe, as per the provisions of the put option deed. This deed was executed by the parties as a condition precedent to the share subscription agreement, wherein Banyan had the right, but not the obligation, to require Responsive Industries and Wellknown Business Ventures to buy out its shares in Axiom. The put option deed was governed by Indian law and provided for disputes to be resolved by the SIAC in Singapore-seated arbitration.

The target value contemplated by the put option deed for returns on the sale of Banyan's shares was pegged at 15%. However, the put option deed also provided a system of valuation of the shares, such that the fair market value of the shares under the existent FEMA Regulations could be ascertained. Any amount in excess of said value would not be repatriated to Banyan's foreign account but would instead be paid in Indian rupees to its domestic nominee account. This is an example of the hybrid arrangements which were prevalent a few years ago and are now the subject of many options disputes.

In 2015 Banyan wished to exit its investment and exercised its put option under the share subscription agreement and put option deed. However, Responsive Industries and Wellknown Business Ventures refused to effectuate the purchase of Banyan's shares in Axiom on the ground that

the put option deed contravened Indian law (ie, the SCRA and the FEMA). As a result, in December 2015 Banyan initiated arbitration proceedings under the SIAC Arbitration Rules 2013, wherein it claimed damages or, alternatively, restitution from the respondents equivalent to the amount that it would have received had it exercised the put option under the put option deed.

In January 2019 the arbitral tribunal issued the award, holding that the put option deed was valid under Indian law, with specific reference to the SCRA and the FEMA. The award stated that Banyan's performance of the put option deed when it had exited Axiom had been legal. As such, Banyan was entitled to damages from the respondents.

Thereafter, Banyan filed a petition in the court for the award's execution under Sections 47 and 49 of the Arbitration Act.

Grounds of challenge

As a preliminary objection, the respondents claimed that the put option deed was inadequately stamped under the Maharashtra Stamp Act 1958. The respondents further alleged that the put option deed violated the SCRA, which had applied at the time of execution (ie, 2008), because the put option rendered the deed a forward contract or a contract in derivatives and not a contract for spot delivery. It was further alleged that the put option deed violated the Foreign Exchange Management (Transfer or Issue of Securities by a Person Resident Outside India) Regulations 2000 (FEMA TISPRO) because, among other things, it provided Banyan with a fixed return for the sale of securities of an Indian entity. Banyan's rejoinder was that the put option deed rendered the final remittance subject to the applicable FEMA Regulations.

Decision

Inadequate stamping

The Bombay High Court dismissed the respondents' objections on this ground for the following reasons, among others:

- The share subscription agreement and put option deed placed the onus for the payment of stamp duty on Responsive Industries and Wellknown Business Ventures. The respondents could not unjustly enrich themselves by opposing the award's enforcement on this ground, which was based on their own failure.
- Section 35 of the Stamp Act states that parties cannot object to the admission of a document into evidence on grounds of payment of inadequate stamp duty after such admission has been made. The put option deed was governed by Indian law and nothing had prevented the arbitral tribunal from adjudicating on the present question of law. In coming to this conclusion, the court relied on *Javer Chand v Pukhraj Surana* (AIR 1961 SC 1655).
- The court stated that although *SMS Tea Estates Pvt Ltd v Chandmari Tea Co Pvt Ltd* ((2011) 14 SCC 66) and *Garware Wall Ropes Ltd v Coastal Marine Constructions and Engineering Ltd* ((2019) 9 SCC 209) stated that an inadequately stamped arbitration agreement cannot be acted on, they were passed in the context of applications for the appointment of arbitrators under Section 11 of the Arbitration Act. On the contrary, the court could not deny enforcement of a foreign award on this ground.

SCRA violations

The Bombay High Court did not entertain this objection for multiple reasons. Rather, it enforced the award even though it specifically approved a contract containing a put option for the following reasons:

- The put option's primary purpose was the creation of a lucrative exit strategy for Banyan and not speculation in securities – a situation which the SCRA attempts to remedy. The put option deed did not fall foul of the SCRA just because it did not operate on a spot delivery basis, as the put option itself had been effected only once Banyan actively exercised it, after which settlement was undertaken by the delivery of shares.
- The 3 October 2013 Securities and Exchange Board of India notification issued under the SCRA legalised, among other things, shareholders' agreements with options in securities, such as the put option in question. Considering the legal developments regarding derivatives, options contracts in securities do not contravene the fundamental policy of Indian law.

FEMA violations

The Bombay High Court held that the put option deed did not violate FEMA TISPRO because, among other things, even if a transaction does not comply with FEMA, that does not render the underlying contract invalid. The legislative intention behind FEMA was only the regulation of foreign exchange transactions and not the voiding of contracts or the rendering of non-compliant foreign awards unenforceable. To conclude that a foreign award cannot be held to be void because of FEMA contraventions, the court relied on the Delhi High Court's authoritative judgment in *Cruz City 1*

Mauritius Holdings v Unitech Ltd ((2017) 239 DLT 649) and the recent Supreme Court judgment in *Vijay Karia v Prysmian Cavi E Sistemi SRL* (2020 SCC Online SC 177), which approved the view taken by the Delhi High Court in *Cruz City*.

Public policy

In rejecting the respondents' challenge on this ground, the Bombay High Court referred to the landmark judgment of *Renusagar Power Co Ltd v General Electric Co* ((1994) Supp (1) SCC 644), as upheld and extolled in *Shri Lal Mahal Ltd v Progetto Grano SPA* ((2014) 2 SCC 433), wherein the Supreme Court stated that the term 'public policy of India' must be interpreted narrowly and more so in the case of foreign awards. It went on to commend the Supreme Court's decision in *Prysmian*, which clearly states that a violation of the fundamental policy of Indian law (the concerned element of a public policy ground) is not a simpliciter violation of a statutory provision. In order to succeed on this ground, the violation must be of a provision or principle "so basic to Indian law that it cannot be compromised". Violations such as FEMA contraventions, which were never intended to void the underlying contract and are rectifiable, cannot be considered to be core values of Indian law and consequently do not meet the threshold espoused in Section 48(2) of the Arbitration Act.

Comment

This judgment aligns with the judiciary's general pro-enforcement attitude towards foreign awards. This usually entails minimal interference in an award or over-analysis of the facts of the dispute, as well as a general disinclination towards granting too much leeway to the oft-cited yet rarely justified ground of a public policy contravention. However, in *National Agricultural Cooperative Marketing Federation of India v Alimenta SA* (22 April 2020, Civil Appeal 667/2012) the Supreme Court declined to enforce a foreign award (albeit on different grounds) while also taking significant cognisance of the facts underlying the concerned dispute. Therefore, the standard of exactly how much the courts must relitigate or re-examine when determining a public policy challenge appears to remain in flux.

Regardless, the present judgment adds significant authority to the oft-used argument that FEMA provisions do not form part of core Indian legal policy, as exhibited in the recent cases of *Prysmian* and *Cruz City* and the earlier case of *NTT Docomo Inc v Tata Sons Ltd* (2017 (4) ArbLR 127 (Delhi)).

In a similar vein, a partial award passed by the Court of Arbitration of the International Chamber of Commerce dated 30 April 2019 dealt with the legality of put options under the FEMA and Reserve Bank of India circulars passed thereunder. The arbitration in question was Singapore-seated but pertained to a share subscription and shareholders' agreement governed by Indian law. The arbitral tribunal therein stated that the put option contained in the agreement was legal under Indian law and went so far as to provide for alternate relief in the event that an Indian court or tribunal ruled that it was unenforceable. This partial award was challenged before the Singapore International Commercial Court, which passed an order on 3 March 2020 upholding the partial award and ruling in favour of the legality of the put option and the alternative relief in case an Indian court denied the enforcement of the partial award (*BYL v BYN* ([2020] SGHC(I) 6)).

The Bombay High Court's judgment is also indicative of the judiciary's general willingness to create a pro-investment environment in India. By enforcing foreign awards which allow for relatively hassle-free exits and interpreting Indian securities laws in a manner which makes exits based on call or put options fairly non-controversial, the court has indirectly indicated that investors in private equity funds need not be unduly concerned about unforeseen complications arising at the time of exit or the Indian courts' unwillingness to enforce awards that favour this pro-investment approach.

Lastly, this judgment provides significant authority for litigants which wish to refute objections to the enforcement of foreign awards for procedural reasons such as inadequate stamping of an arbitration agreement. This ground has been used to disallow the appointment of arbitrators in domestic arbitration agreements, but the Bombay High Court has made it clear that the same will not stand for foreign awards. Notably, in *M/s Shriram EPC Ltd v Rioglass Solar SA* (AIR 2018 SC 4539), the Supreme Court declared that stamp duty need not be paid on a foreign award. Its rationale was that a foreign award is not a document specifically included in the Stamp Act, which is in any event applicable only in India.

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