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Has the Public Policy Exception Returned to Haunt Indian Courts?

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On 1 November 2017, a division bench of the Supreme Court of India (hereinafter SCI) referred the matter between *Venture Global Engineering LLC and Tech Mahindra Ltd.* to a larger bench, in view of the diverging opinions emerging from the division bench. In substance, the SCI was looking at the legality of the order of the High Court, which reversed the Trial Court's decision to set-aside the award on grounds of violation of public policy of India.

Facts:

Venture Global Engineering LLC (hereinafter VGE), a company incorporated under the U.S. laws; and Tech Mahindra Ltd., formerly known as Satyam Computers Pvt. Ltd (hereinafter Satyam), an Indian Company, entered into a joint venture and shareholder agreement in Oct 1999. Section 8 of the Agreement defined 'events of default', and the rights and obligations of parties upon the occurrence of the 'event of default'. One of the clauses in Section 8 of the Agreement provided that, within 30 days after becoming aware of the occurrence of the 'event of default', the non-defaulting party shall have the option to either purchase the defaulting shareholder's shares at the **book value** or cause the immediate dissolution and liquidation of the joint venture company.

Between March 2003 and May 2004, 21 members of the Group of Companies, of which the VGE was a member, filed for bankruptcy and were declared bankrupt. Bankruptcy, as per Section 8 of the Agreement, was categorized as 'event of default'. Consequently, disputes arose between the parties, and Satyam invoked the arbitration clause that provided for LCIA arbitration, with laws of State Michigan, United States, as the governing law of the agreement. The clause also provided for compliance with the relevant laws of India.

The award was delivered in April 2006, where the arbitrator rejected claims of VGE, and *inter alia*, directed VGE to sell their 50% shares to Satyam at book value. This was followed by litigations both in the U.S. and India.

VGE filed a civil suit in India before the City Civil Court in Secunderabad – where it sought a "declaration that the award is illegal and without jurisdiction", and "a decree for granting of permanent injunction" against Satyam from getting the award enforced. The court granted an *ex parte* injunction order, restraining Satyam from enforcing the award. Satyam challenged the order before the High Court of Andhra Pradesh, where the said appeal was allowed, and the City Civil Court was directed to adjudicate afresh on merits.

Satyam's prayer before the City Civil Court for rejection of the plaint and dismissal of the suit was accepted. VGE's appeal against the order before the High Court was dismissed. VGE approached the SCI, which allowed the appeal (*Venture-I)*; directing, *inter alia*, that VGE was entitled to challenge the award before Indian Courts, as Part I of the Arbitration and Conciliation Act of India (hereinafter ACA) was applicable even to a foreign award according to the law laid down in Bhatia International's case. The SCI, without expressing any opinion on the merits of the claims made by parties, directed that "the Trial Court was at liberty to transfer the case to the competent court to decide the case…". Accordingly, setting-aside proceedings under Section 34 of the ACA were initiated before the Court of 2nd Additional Chief Judge (hereafter Trial Court), Hyderabad, in 2008.

Meanwhile, in January 2009, B. Ramalinga Raju, who was the Chairman and Founder of Satyam, disclosed that balance sheets of Satyam had been manipulated to present inflated profits. Upon this disclosure, VGE filed an application before the court to present additional facts and argued for setting-aside of the award on an additional ground of being against the public policy of India. The Trial Court allowed VGE's application. Satyam challenged the order before the High Court, arguing that application for setting-aside was not filed within the prescribed limitation period under the Indian law, and new ground of challenging the award could not be invoked after the expiry of the limitation period. The High Court allowed the application of Satyam, which led to another round of litigation before the SCI. VGE challenged the decision of the High Court, and the SCI in *Venture II* allowed the appeal – restoring Trial Court's order. The SCI emphasized that the facts revealed after the making of the award are relevant, in order to establish whether the making of the award has been induced by fraud.

Following the *Venture II* SCI judgment, the Trial Court allowed the application of VGE, and set-aside the award. The Trial Court reasoned that the transfer of 50% shares of the Joint Venture Company to Satyam at *book value*, as directed in the award, as against *fair value*, violated the provisions of the Foreign Exchange Management Act, 1999 (hereinafter FEMA) – hence against the public policy of India. It also held that the facts revealed by Ramalinga Raju constitute fraud and misrepresentation on part of Satyam – having a causative link with the facts that formed the basis of the award, therefore against the public policy of India. Satyam challenged the award before the High Court. Allowing the appeal, the High Court reversed the Trial Court's decision. VGE, aggrieved by the decision of the High Court, filed an appeal before the SCI.

Decision:

Justice Sapre observed that the Trial Court correctly found the direction to transfer shares at book value instead of fair value as a violation of FEMA – hence against public policy. He largely relied on the definition of expression 'public policy' discussed in Associate Builders' case. It was held that violating FEMA provisions would amount to patent illegality and, thus, public policy of India was violated. Taking a cue from the findings of the SCI in *Venture I* and *Venture II*, he observed that suppression of material facts on part of Satyam clearly has a causative link inter se the companies involved. He further reasoned that had the facts been brought before the shareholder of the joint venture, VGE would have been able to get first right to terminate the agreement and seek relief against Satyam – as a breach on Satyam's part happened prior to VGE's bankruptcy. Also, as suppression of material fact continued during the arbitration proceedings, the proceedings and the subsequent passing of the award cannot be said to have held fairly or reasonably. Finding that the award was tainted by fraud committed by Satyam, it was held to be against public policy of India

Justice Chelameswar, had a different opinion. In substance, he observed that the Trial Court had failed to provide reasons as to how the award, which directed the transfer of shares on book value instead of fair value, would violate the public policy of India. Criticizing the Trial Court, he observed that in absence of any basis in facts, or identification of the provision of law with which the award is in conflict with, the conclusions drawn cannot legally be sustained. On the issue of the alleged fraud committed by Satyam and its influence on the award, Justice Chelameswar sided with the finding of the High Court that fraud was not proved before any court. He observed that the Trial Court's theory that concealment and misrepresentation of facts by Satyam establish a causative link, making the award opposed to the public policy of India, was also not supported by cogent reasons. He stressed that in *Venture II*, the SCI emphasized only upon the relevance of pleading those 'concealed facts', and did not hold that the 'concealed facts' constituted material facts rendering the award liable to be set-aside. He supported the decision of the High Court, that the appeal be dismissed, and the award restored.

Comment:

Venture III, is a reminder that dealing with the public policy exception continues to be a struggle for the Indian courts. Although the SCI produced diverging opinions in the case at hand, as far as the making of the award being induced by fraud is concerned, one cannot ignore to notice that both opinions agree upon the legal position that if the causative link is proved between the frauds committed and the award rendered, then such an award would be in violation of public policy of India. Justice Sapre's observation that violation of FEMA is contrary to public policy of India takes us back to the same debate as to whether patent illegality, on the face of it, should be taken as violation of public policy of India. It is pertinent to note that the SCI on multiple occasions, for example in Associate Builders, Mc Dermott International, Centrotrade Minerals, J.G. Engineers, has stressed that patent illegality, if of trivial nature, should not be held against public policy. Patent illegality must go to the very root of the matter. The amended version of ACA, in Explanation (2A) of Section 34(2)(b)(ii), also seems to support this proposition. Now that the matter has been referred to a larger bench, it will be interesting to see how the legal issues will finally be settled, and how the decision will shape the approach of Indian courts as far

interpretation of the public policy exception is concerned.

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