Choice of foreign law (laws of UK) by two Indian parties as the law governing the main contract is enforceable because a foreign element (high seas sale) was involved in the transaction (Delhi High Court)

Update by Editor

Published on 28 November 2020

Dholi Spintex Pvt. Limited v. Louis Dreyfus Company India Pvt. Ltd.

Court: Delhi High Court | **Case Number**: CS (Comm.) 286 of 2020 | **Citation**: 2020 SCC OnLine Del 1476 | **Bench**: Mukta Gupta J | **Date**: 24 November 2020

A. The Context

The concept of freedom of contract is well recognized. It gives the parties to a contract the autonomy to choose the law applicable to their contract[1] and also the forum in which their disputes will be resolved. In international settings, the freedom is more pronounced. The Indian arbitration fraternity has grappled for some time now with two questions relating to freedom of contract (or party-autonomy) concerning all domestic parties.

First, can Indian parties choose a foreign seat of arbitration?

Choosing an arbitral seat X rather than Y has consequences. For instance, in the words of Prof. Born, the courts in the arbitral seat can significantly affect arbitration proceedings when they are commenced or as they proceed. They are competent (usually exclusively competent) to entertain actions to annul or set aside the award.

Recently, a single judge of the Gujarat High Court has ruled in *GE Power Conversion India Pvt. Ltd.* v. *PASL Wind Solutions Pvt. Ltd.* that two (or more) Indian parties can choose a foreign seat. Our Update on this case is available here.

Second—a simple question and yet often confused with the first–can two (or more) Indian parties choose a foreign law, say, the English law, as the proper law of their contract, to determine the substantive rights and liabilities?

This case in its own way answers, yes. The essence of the court's decision is that Indian parties can choose a foreign law to govern their main contract if the contract has a connection with a foreign element. Since the contract at issue was a high seas sale contract, in which the title of the goods transfers to the ultimate buyer at high seas (that is, beyond Indian territory), the requirement of the foreign element was satisfied according to the court.

The reader should also note that the question had arisen in a suit where an application under Section 45 of ACA had been filed. Section 45 gives a judicial authority the power to refer the parties to arbitration unless it

[1]This case chiefly concerns the law governing the main or the substantive contract, and in particular, the question if two Indian parties can choose foreign law to govern the contract. However, while no such question arose, the court has also made a finding in some passages that parties can choose foreign law to govern the arbitration agreement.

finds *prima facie* that there is no valid arbitration agreement.[2] The inquiry under the provision is limited to an examination of the validity of the arbitration agreement. It does not involve examining if the law governing the main contract is void or not. Though the High Court noted this at the end of the judgment, it has examined the legality of the underlying contract in detail. In fact, the entire dispute is about the main contract.

B. The background

B1. The parties chose English law to govern the main contract, and London as the arbitral seat, but also said that only the New Delhi court will have jurisdiction

Two Indian companies–Dholi Spintex ("Dholi or DS") and Louis Dreyfus ("Louis or LD") –contracted for sale and purchase of cotton. Louis trades in imported cotton, which it procures from the overseas suppliers and sells to buyers in India on "High Sea Sales basis"[3]. As the reader will later note, the reasoning of the case turns on this fact.

Their dispute resolution clause provided:

(a) For a resolution through arbitration in accordance with the rules and arbitration procedure of the International Cotton Association ("**ICA**")[4]. [Clause 6]
(b) "Only the courts in New Delhi will have jurisdiction". [Clause 7]

The effect of choosing the ICA rules for arbitration was that the entire body of the ICA Bylaws and rules applied[5] and thus:

(a) English law was the proper law of the substantive contract. Because Bylaw 200 stated that "every contract made under our Bylaws and Rules will be deemed to be a contract made in England and governed by English law."
(b) The seat of the arbitration was in England. Because Bylaw 300[6]said so.

B2. The dispute, the arbitration, anti-arbitration suit by DS, and an application by LD to refer the matter to arbitration

Disputes arose. LD commenced arbitration under the rules of ICA. DS raised objections as to the arbitrator's jurisdiction and commenced a suit in the Delhi High Court for a declaration that Clause 6 was void. It also

[2]Section 45 ACA applies to international commercial arbitration. The parallel provision in domestic arbitrations is Section 8 ACA.

[3] High seas are ocean surface and the water column beyond the Exclusive Economic Zones (as defined in the United Nations Convention on the Law of the Sea (UNCLOS) 1982, also known as Law of the Sea). It is considered as "the common heritage of all mankind" and is beyond any national jurisdiction. States can conduct activities in these areas as long as they are for peaceful purposes, such as transit, marine science, and undersea exploration. See, https://www.un.org/depts/los/convention_agreements/texts/unclos/unclos_e.pdf, https://www.drishtiias.com/daily-updates/daily-news-analysis/unclos-maritime-zones. In High Sea Sales, the goods are purchased by the consignee (here, LD) from an overseas supplier to sell it to a third party (here, DS). While the goods are still at high seas, the consignee (here LD) transfers the title in the goods to that third-party buyer (DS).

[4]The International Cotton Association, a group of cotton traders established around 170 years ago in Liverpool, England, has bylaws and rules to help regulate the sale and purchase of cotton.

[5]It is not made clear in the judgement as to why the other provisions of the ICA Bylaws and Rules applied merely because the parties chose arbitration by ICA rules (Clause 6 of the contract). But, it appears to be common ground between the parties and a position accepted by the court.

[6]This was a Bylaw specific to arbitration.

asked an injunction to restrain LD from continuing with the arbitration. LD filed an application under Section 45 ACA to refer the matter to arbitration.

DS' arguments revolved around: –

(a) **The choice of a foreign system of law**– two Indian parties cannot choose a foreign system of law, here the English law, to govern their (main) contract. The choice will violate Section 23 of the Indian Contract Act, 1872 and Section 28 ACA.
(b) **The choice of an unconnected system of law**—Everything about the contract—from execution to performance, to payment–happened in India. In such a contract[7], a foreign law could be chosen only in two conditions: one, where conflict of rules (also, "**CoL**")[8] applied, which gives precedence to choice-of-laws made by parties.[9] And, two, in an international commercial arbitration seated in India.[10]

[7] DS' argument appears to be that where a contract does not have any foreign element, the choice of foreign law is impermissible. This is clear from reading in full of paragraphs 12 and 31.1. If those paras are read in parts, it may appear to the reader that DS' argument was limited to situations "where performance of a contract is in India."

[8] Given the confusion in the minds of several students surrounding the phrase "conflict of law rules" and "choice of law", these terms need to be understood on their own terms aside from how they apply in arbitration. What is "conflict of laws" (also, "**CoL**"), what are the CoL rules, and when do they apply? What is "choice of law", and what is the choice of law rules? Most of what is noted below may well be within quotation marks because it is substantially borrowed from the fifteenth edition of Cheshire, North and Fawcett's Private International Law.
First, as to the nomenclature–the expression "conflict of laws" is also called "private international law" in many jurisdictions. Both terms are inadequate, the latter plainly misleading because there is no involvement of international law (with rare exceptions), and international law is always public.
Second, each country has its own "conflict of laws" or "private international law". CoL is "not a separate branch of law in the same sense as, say, the law of contract or of tort". And yet, it is a distinct unit of law within each country. It is different from say, the property law because CoL is all-pervading. It can spring into question in a case involving property law, or contract law, or tort law, or criminal law, or family law, and so on.
Third, CoL comes into play only when the matter involves a foreign element. Before the court, there must be "some fact, event or transaction that is so closely connected with a foreign system of law as to necessitate recourse to that system". So, "foreign element" signifies a connect with some other system of law than the forum.
Fourth, though CoL does not deal with any specific branch of law, in cases that have a foreign element, it gets involved in three situations only: (i) in the context of jurisdiction. Is the court jurisdictionally competent to decide the case; (ii) in the context of recognition and enforcement of a foreign judgment? Should the court recognize or enforce a judgment passed by a court abroad? (iii) in the context of choice of law. If the court says it has jurisdiction, what law must it apply to determine the dispute? Suppose a UK citizen domiciled in India dies intestate. How must his property be treated by the UK court, and by reference to which law, Indian or English? This is decided by a body of rules, developed and applied, by the courts called the choice of law rules.
Fifth, therefore, in each of the cases referred in the point above, the court applies that part of its body of laws which is called the CoL.
Sixth, (apart from the situation mentioned at the end of the fourth point above) the expression choice of law is used in contracts in a somewhat different sense, that of parties having selected a law to govern any aspect of their contract. It is then said that parties have made a choice of law provision.

[9] For clarity, this entire argument also needs to be explained. When the concept of party autonomy was developing in international contracts, it was thought that the system of law the parties choose (to govern their main contract) should be connected to that contract in some way or the other; it should not be arbitrary or totally unconnected. What is the basis on which connection was demonstrated? Several factors have been considered including, for example, the place where the contract was executed, or the place of performance of the contract, the nationality of the parties. With the development of the concept of party autonomy, today the selection of a 'neutral' law (and also place) is considered perfectly okay in an international contract. But, is it okay for Indian parties also to choose a foreign law?
DS' argument number 2 was that foreign law can be chosen only where the rules of conflict of laws applied. In other words, parties can choose a foreign law only when the contract has a foreign element. Note DS' argument number 1 that two Indian parties can never choose a foreign system of law.

(c) **Choice of a foreign substantive law makes the arbitration agreement invalid, and incapability of the arbitrator to decide that issue**—The arbitration agreement is invalid because there is initial illegality (that is, choosing a foreign law as the law governing the main contract). The arbitral tribunal would not be able to decide the issue because the tribunal is a creature of contract (the ICA Bylaws) and the Bylaws make the application of English law as substantive law mandatory. So, the tribunal would not be able to apply Indian law even if it was considered non-derogable.

(d) **The interpretation of the arbitration clause**: Even if not Clause 6 is not held void, it should be read harmoniously with Clause 7. Because Clause 7 vests New Delhi courts with exclusive jurisdiction, the only harmonious reading of Clauses 6 and 7 would be to say that Indian laws apply with New Delhi as an arbitral seat.

C. The Court's decision

C1. Indian parties can choose a foreign system of law as the substantive law of the contract

Gupta J began her findings by saying that the issue "is no more res integra[11] having been decided by the Supreme Court, Madhya Pradesh High Court and this court as well", and referred to several judgments.

First, she referred to *Atlas Export Industries* v. *Kotak & Company*, (1999) 7 SCC 61, a decision of a 2-judge bench of the Supreme Court of India, for the point that "an agreement to refer to the disputes to arbitration does not imply that there is an exclusion by the agreement to have recourse to legal proceedings", and because arbitrators are situated in a foreign country is not enough to nullify the arbitration agreement.[12]

Second, Mukta Gupta J referred to the Madhya Pradesh High Court's decision in *Sasan Power Limited* v. *North American Coal Corporation (India) Pvt. Ltd.*, 2015 SCC OnLine MP 7417 and said that the

---

Also, the latter part of the argument is not made clear in the judgment, that is, if the argument referred to that CoL rules which give precedence to the choice of parties, or the argument just assumed that CoL always gives precedence to parties' choice.

[10]Per definition, an international commercial arbitration seated in India will involve a foreign party.

[11]Borrowing from Latin and a phrase very often used by the courts. "Originally: an open question, something which has not yet been determined or resolved. Later: (Law) a case or question not covered by existing law or precedent". See, The Oxford English Dictionary at https://www.oed.com/view/Entry/251719?redirectedFrom=Res+integra#eid.

[12] Atlas (Indian party) had a contract with Oceandale (Hongkong) and Kotak and Co. (Indian) Bombay for the supply of Indian groundnut. The goods were to be supplied to Oceandale through Kotak. The contract was made under the rules of the Grain and Food Trade Association, London (GAFTA). Any dispute was to be settled through arbitration in London. A dispute emerged between Atlas and Kotak. The arbitrators appointed by the parties gave an award under GAFTA rules in favour of Kotak. Atlas resisted enforcement of the award. One of the grounds was that arbitration agreement was opposed to public policy under Section 23 of the Indian Contract Act and void because it compelled two Indian parties to an arbitration by a foreign arbitrator. In answer, the court referred to another provision of the Contract Act, namely, Exception I to Section 28. The section declares that an agreement in restraint of legal proceeding is void, but makes an exception as to arbitration, and says that "this section shall not render illegal a contract …" to refer disputes to arbitration. Lahoti J, writing the judgment for himself and S Rajendra Babu J, said that arbitration does not bar right to legal recourse, just the mode of adjudication is different, and it does not matter if the arbitrators are foreign. The court also (somewhat contradictorily added) that the plea was raised for the first time, hence was not available.
Atlas has been often cited and referred for the proposition that the court allowed two Indian parties to arbitrate at a foreign seat. While it might have been the consequence of the decision, the court did not directly examine the argument of Indian parties choosing a foreign arbitral seat.

court "dealt with the issue raised in the present suit at length". She then simply reproduced 11 paragraphs (paras 46 to 57, omitting para 56) from *Sasan* (HC)[13].

Third, she referred to the Supreme Court's decision in *Sasan Power Limited* v. *North American Coal Corporation (India) Limited*, (2016) 10 SCC 813, and noted that "the Supreme Court did not deal with the said issue as the same was given up by …Sasan Power."[14]

Fourth, Mukta Gupta J referred to *GMR Energy Limited* v. *Doosan Power System India Ltd. and others*, 2017 SCC OnLine Del 11625 and said that following *Atlas* and *Sasan* (HC), *GMR* held that "two Indians can agree to a foreign seated arbitration."[15]

Fifth, she referred to the Supreme Court's decision in *Reliance Industries and another* v. *Union of India*, (2014) 7 SCC 603 and said that it was laid down in the case that "when there is a foreign element to the arbitration three sets of law may apply to an arbitration, that is, proper law of the contract; proper law of the arbitration agreement/lex arbitri; and proper law of the conduct of arbitration/lex fori/curial law."[16]

Sixth, Mukta Gupta J talked about how and the arbitration agreement is independent of the main contract and "may be governed by a proper law of its own which need not be the same as the law governing the underlying contract."

Seventh, she then considered the arguments of the parties about the contract having a foreign element. DS had argued that there was no foreign connection. LD said there was. The court accepted LD's arguments. Gupta J found that:

---

[13]In *Sasan* (HC), the initial agreement was between Sasan (Indian party), North American Coal (USA company). The latter "assigned" the agreement to North American Coal Corporation India Pvt. Ltd. (Indian). The case in the High Court proceeded on the assumption the Indian coal company had stepped into the shoes of the American, and thus the contract was between two Indian parties. The laws of the UK governed the main contract, and the place of arbitration (the seat) was London. If you note counsel's argument set out in the judgment, the question both of foreign seat and foreign law was raised ("…the Arbitration though ICC in United Kingdom, London, that also in accordance to the laws applicable in United Kingdom is not permissible"). The bulk of the arguments from both sides, however, appears to be focused on the seat and so was the decision. The 2-judge bench of the High Court concluded, relying mostly on *Altas*, that two Indian parties can choose a foreign seat. However, see the footnote just below.
Also, it is not right as a matter of law to refer to *Sasan* (HC). It merged into the Supreme Court's judgment and does not exist in the eyes of law.

[14]This is not a correct statement. When *Sasan Power* was considered by the Supreme Court in appeal, it found that there was nothing in the High Court's judgment to indicate that an argument as to Indian parties choosing foreign seat was raised (para 12). The court also noted that the argument was given up by counsel and "the argument before us was confined only to the question whether two Indian companies can enter into an agreement with a stipulation that their agreement …" be governed by a foreign law (para 13). However, this question was not decided because the court found that the assumption that one Indian party had stepped into the shoes of the American party was not correct, and the contract still remained between the original parties ("the question whether two Indian companies could enter into an agreement to be governed by the laws of another country would not arise in this case.").

[15] This is a decision of 14 September 2017 by Mukta Gupta J herself. As she notes herself, she had relied on *Atlas* and *Sasan* (HC).

[16] A point must be made about this passage. This is not an accurate description of what was said in the *Reliance* case. This reference appears to have been taken from the headnote of the publication. The law governing the arbitration agreement has been equated with the *lex arbitri*. The law governing the conduct of arbitration has been equated with *lex fori*, and *curial law*. It is submitted that these terms must be used with care and caution. Using them wrongly, as done in this case, and also for some part in *Reliance*, turn arbitration concepts on their head. The reader would do well, as a starting point, to refer to Alastair Henderson's piece LEX ARBITRI, PROCEDURAL LAW AND THE SEAT OF ARBITRATION available here. More about the concepts later!

(a) The agreement was a high seas sale and the "property in the goods was to pass within ten days prior to the arrival of the goods …in India."[17]

(b) The "complete payment was to be made when the goods were in transit … and not in territorial waters of India."

(c) The fact that the high sea sales agreement did not finally go through because DS did not pay the full consideration and breached the contract does not matter.[18] A subsequent breach does not modify the terms of the contract.

(d) When the parties entered into a contract on 30 May 2019, it was their intention to perform a high seas sale.

Eighth, thus, Gupta J concluded that:

(a) Because an arbitration agreement is independent of the main contract and parties can choose a different law governing the arbitration, two Indian parties can choose a foreign law as the law governing arbitration.[19]

(b) Since there was clearly a foreign element to the contract, two Indian parties "could have agreed to an international commercial arbitration governed by the laws of England", and hence Clause 6 was not null or void.

C2. London was the arbitral seat. The clause which vested New Delhi courts with exclusive jurisdiction would be relevant if parties decide to settle their disputes via courts and not arbitration

As noted in the background section, Clause 7 of the contract said that the New Delhi courts have jurisdiction. On the other hand, the arbitral seat of any arbitration conducted under the ICA Bylaws is mandatorily at England.

DS argued that even if Clause 6 is not held void, it should be read harmoniously with Clause 7, after striking down the illegal portion of Clause 6.[20] DS further said that the only harmonious reading of Clauses 6 and 7 would be to say that Indian laws apply with New Delhi as the arbitral seat.

Mukta Gupta J referred to two decisions of the Supreme Court, *BGS SGS Soma JV* v. *NHPC*, 2019 SCC OnLine SC 1585 and *Mankastu Impex (P) Ltd.* v. *Airvisual Ltd.*, (2020) 5 SCC 399, and ruled that:

(a) By agreeing to conduct the arbitration through the ICA, the parties have agreed that the seat of arbitration is London. This is irrespective of the fact that the expression venue has been used (in

[17] This is a basic consequence of a high seas' sale. *See* footnote 3.

[18] *See* footnote 3. LD bought the cotton from overseas suppliers. Ideally, if the contract had gone through when the cotton was sent by the suppliers, and it was still at high seas, LD would have transferred the title to DS and received payment. This did not happen. Gupta J also rejected an argument, made citing a Calcutta High Court judgment, that what parties had done was to enter into an agreement to agree, which was unenforceable.

[19] The question parties can choose a foreign law to govern the arbitration agreement was not directly raised in the case.

[20] DS relied on the "blue-pencil" test referred to in *Shin Satellite Public Co. Ltd.* v. *Jain Studios Ltd.*, (2006) 2 SCC 628, a Section 11 ACA application decided by CK Thakker J.

Clause 6), or that under Clause 7, the substantive law of the contract is Indian law[21], and the New Delhi courts have exclusive jurisdiction.

(b) Clause 7 would be relevant if by an agreement both parties decide not to settle their disputes through arbitration.

C3. When deciding an application under Section 45 ACA, the court only has to see prima facie if the arbitration agreement is valid. In this case, it is, and other matters are for the arbitrator

Gupta J framed "issue no. 3" to ask of the suit was "maintainable in terms of requirement of Section 45 … i.e. whether it is for this Court of the Arbitrator to determine whether the agreement between the plaintiff and defendant is a high seas sale agreement or not or whether any foreign element is involved or not in the agreement between parties".

She then referred to Section 45 ACA and the case-laws on the scope of the court's power[22] and concluded that:

(a) The scope of interference by the Court in an International Commercial Arbitration is limited to the Court determining, whether a valid arbitration agreement exists between the parties".

(b) The court cannot enter into a full-fledged inquiry on merits of the matter as only a prima facie finding is required to be arrived at.

(c) Indubitably, an arbitration agreement exists, and the court has already held that it is valid (neither null nor void, nor inoperative, nor incapable of being performed).

The suit was then lastly dismissed as not maintainable concluding that the parties "having chosen a foreign system of arbitration with open eyes …", the agreement cannot be held invalid.

[21] This is an erroneous statement. Clause 7 only said that "only the courts in New Delhi will have jurisdiction." It does not say anything about the substantive law is also Indian. In other words, courts in India are competent to decide a dispute under foreign law, and vesting jurisdiction with an Indian court does not automatically mean the substantive law of the contract is also Indian law.

[22] *Sasan* (Supreme Court); *WPIL* v. *NTPC Ltd. and others*, 2009 (108) DRJ 404, *McDonalds India Pvt. Ltd*. v. *Vikram Bakshi and others* (DB), 2016 SCC OnLine Del 3949; *Devender Kumar Gupta* v. *Realog Corporation*, 2011 SCC OnLine Del. 3050.