IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

ARBITRATION PETITION NO.220 OF 2014

Edelweiss Financial Services Ltd. ....Petitioner

vs

Percept Finserve Pvt. Ltd. And Anr. ...Respondents

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Mr. M.S. Doctor, Senior Advocate, a/w. Mr. Dhirajkumar Totala and Ms. Priyanka Shetty, i/b. AZB & Partners, for the Petitioner.

Mr. Sharan Jagtiani, a/w. Mr. Vaibhav Bhure, Mr. Abhishek Kale, Mr. Deepak Deshmukh and Ms. Nisha Kaba, i/b. Naik Naik & Co., for the Respondents.

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CORAM : S.C. GUPTE, J.

DATED: 27 MARCH 2019

(ORAL JUDGEMENT):

. This arbitration petition challenges an award passed by a sole arbitrator in a reference arising out of disputes concerning a share purchase contract.

2. The share purchase contract is contained in a share purchase agreement dated 8 December 2007 as amended by a deed of rectification dated 21 April 2008 and an amendment agreement dated 23 April 2008. (The share purchase agreement, together with its two modifications referred to above, is hereafter referred to as 'SPA'). The Petitioner is a public company carrying on the business of financial services including investment, consultancy, merchant banking, etc. Respondent Nos .1 and 2 are group companies forming what has been referred to by the parties

as 'Percept Group', Respondent No.1, a private company, being one of the promoters of Respondent No.2, a public company, holding about 85 percent of its equity capital. The Petitioner was interested in investing in Respondent No.1 subject to a condition that the Respondents restructure the Percept Group as agreed between the parties *inter alia* by an IPO. The parties accordingly entered into the SPA providing for terms and conditions of the share purchase contract. Under the SPA, the Petitioner purchased 2,28,374 shares of Respondent No.2 held by Respondent No.1 for a total consideration of Rs. 20 crores. One of the conditions subsequent under the SPA, in keeping with the original intention of the parties, required Respondent No.1 to accomplish restructuring of the entire Percept Group not later than by 31 December 2007 and to provide the claimant documents in proof of such accomplishment. It was the case of the Petitioner that the Respondents failed to complete the restructuring of the Group within the period stipulated originally under the SPA or, i.e. by 31 December 2007, or within the period extended by the amendment agreement, i.e. by 30 June 2008, with obligation to provide documentary evidence of such completion not later than by 15 July 2008. In the event of non-fulfillment of this condition subsequent, under clause 8.5 of the SPA, the Petitioner had an option to either re-sell the shares held by it to Respondent No.1, the latter being bound to purchase the same at a price, which would give the Petitioner an internal rate of return ('IRR') of 10% on the original purchase consideration, or to continue as a shareholder of Respondent No.2 subject to certain undertakings from Respondent No.1. It was the case of the Petitioner that in view of breach of this condition subsequent by the Respondents, the Petitioner was entitled to, and did, exercise the

option, requiring Respondent No.1 to repurchase the shareholding of the Petitioner in Respondent No.2 for a sum of Rs.22 crores giving an IRR of 10% on the original purchase consideration of Rs.20 crores. Since Respondent No.1 refused to comply, the Petitioner invoked the arbitration agreement contained in the SPA. By consent of parties, the learned arbitrator was appointed as a sole arbitrator to adjudicate the disputes and differences between the parties. By his impugned award dated 6 June 2013, the learned arbitrator, despite coming to the conclusion that the Respondents had breached their obligations under the SPA, rejected the Petitioner's claim on the ground that the transaction of share purchase option was illegal and unenforceable, being in breach of the Securities Contracts (Regulation) Act, 1956 ('SCRA').

3. The learned arbitrator raised various issues/points for determination. These were of three categories. The first category involved questions of merits as also of the arbitrator's jurisdiction to consider the same. In particular, these issues bore on the alleged breaches of the Respondents and non-fulfillment of the conditions subsequent referred to above resulting therefrom. The second category of issues concerned the legality or enforceability of the contract for repurchase of shares contained in the SPA. The third involved actual orders to be passed on the basis of the tribunal's findings on the other two categories of issues. These bore on the liability of the Respondents towards repurchase of the Petitioner's shareholding. The learned arbitrator unequivocally held that the Respondents were in breach of the condition subsequent contained in the SPA. The arbitrator held that it was clear, on a conspectus of evidence laid before him, that Respondent

No.1 was not in a position to complete restructuring of Respondent No.2 and bring out the IPO on the due date despite such date having been extended from time to time. The excuse of Respondent No.1 that it had almost completed restructuring, that is to say, to the extent of about 80%, and the delay in issue of IPO was on account of advice of the merchant banking division of the Petitioner about unfavourable market conditions, was not accepted by the arbitrator as a satisfactory explanation. The arbitrator held that the SPA required 100% restructuring by a given date; that date was extended by mutual consent upto 30 June 2008; and it was no excuse to say that restructuring was done upto 80%. Want of 100% restructuring was, thus, treated by the arbitrator as a breach of the Respondents' obligations under the SPA. On the issue of legality or enforceability of the transaction of repurchase contained in the SPA, however, the learned arbitrator held against the Petitioner. The learned arbitrator, firstly, held that clauses 8.5 and 8.5.1, which gave an option to the Petitioner to demand repurchase of its shareholding in Respondent No.2 by Respondent No.1, were illegal because they constituted a forward contract prohibited under Section 16 of SCRA read with the circular dated 1 March 2000 of SEBI issued thereunder. The learned arbitrator, secondly, held that these clauses were also illegal because they contained an option concerning a future purchase of shares and were, thus, a contract in derivatives and not being traded on a recognized stock exchange, were illegal under Section 20 of SCRA (Section 18-A, sic?). For both these reasons, the learned arbitrator held clauses 8.5 and 8.5.1 of SPA to be unenforceable. Having, thus, held against the Petitioner on the question of legality or enforceability of the share purchase option exercised by it, the learned

arbitrator decided the third category of issues bearing on the reliefs to be granted in the reference either against the Petitioner or as inconsequential in view of his findings on the legality and enforceability of clause 8.5 or 8.5.1 as above.

4. Mr. Doctor, learned Senior Counsel appearing for the Petitioner, submits that the arbitrator's conclusion that the share purchase option contained in clauses 8.5 and 8.5.1 was illegal and unenforceable, being a forward contract prohibited by Section 16 of SCRA, read with the circular issued by SEBI thereunder, is clearly untenable. Learned Counsel submits that the finding is an impossible finding, as it is directly contrary to the law stated by a Division Bench of our Court in the case of **MCX Stock Exchange Ltd. vs. SEBI**[1]. Learned Counsel also submits that the contract between the parties, contained in clauses 8.5 and 8.5.1 of SPA, cannot be said to be a contract in derivatives prohibited by Section 18-A of SCRA. Mr. Jagtiani, learned Counsel appearing for the Respondents, does not particularly join issue with the statement of law contained in the Division Bench judgment in **MCX Stock Exchange Ltd.** Learned Counsel, however, submits that the proposition of law stated in **MCX Stock Exchange** does not apply to the option contained in clauses 8.5 and 8.5.1. Learned Counsel also submits that the contract contained in clauses 8.5 and 8.5.1 is even otherwise clearly prohibited under Section 18-A of SCRA. Since these are contracts in derivatives and not having been traded on a recognized stock exchange or settled on the clearing house of any recognized stock exchange or between parties and on terms specified by the Central

1 Judgment of Division Bench (Chandrachud and Mohta, JJ.) of Bombay High Court dated 14/03/2012.

Government by notification in the official gazette, in accordance with rules and bye-laws of any recognized stock exchange, these are prohibited by Section 18-A of SCRA.

5. The learned arbitrator's conclusion that the purchase option contained in clauses 8.5 and 8.5.1 was illegal and unenforceable, being a forward contract, is clearly an impossible view. The judgment of our Court in **MCX Stock Exchange Ltd.**, which was cited before the learned arbitrator, squarely deals with a purchase option, such as the present, where the purchaser of securities requires the vendor to repurchase them on the occurrence of a contingency. Our Court in that case referred to the decision of a Division Bench of our Court in **Jethalal C. Thakkar vs. R.N. Kapur**[2] (Per Chagla C.J. speaking for the Court), where the Division Bench drew a clear distinction between a case where there was a present obligation under a contract, but the performance of which was postponed to a later date and a case, where there was no present obligation at all but the obligation arose by reason of some condition being complied with or some contingency occurring. The Court, relying on that decision, in **MCX Stock Exchange Ltd.** held that a contract giving an option to a purchaser to require repurchase of securities by his vendor fell in the second category of cases, where there was no present obligation at all and the obligation arose by reason of a contingency occurring. The Court held that on the date when the contract was entered into, there was no contract for sale or purchase of shares; a contract for sale or purchase of shares would come into being only at a future point of time in the eventuality of the party, who is granted such option, exercising it in future on the occurrence of a stipulated contingency. As in the case of

2 AIR 1956 Bom 74

MCX Stock Exchange Ltd., even in our case, there is indeed no contract of sale or purchase of shares at a future date. The contract would come into being, if at all, at a future point of time, when two conditions are satisfied, namely, (i) failure of condition subsequent attributable to Respondent No.1 and (ii) exercise by the Petitioner of its option to require repurchase of shares by Respondent No.1 upon such failure. It is only after the Petitioner exercises such option that the contract is complete. The arbitrator has committed a clear error in reading the judgment of **MCX Stock Exchange Ltd.** The law stated in it is plain and clear, and having regard to it, the arbitrator's view that the contract in the present case was a forward contract, can certainly be described as an impossible view; it is a view arrived at by practically disregarding the law stated by our Court in **MCX Stock Exchange Ltd.**

6. Mr. Jagtiani seeks to distinguish the facts in **MCX Stock Exchange Ltd**. from the facts of our case on the ground that in **MCX Stock Exchange Ltd.**, the Court had expressly found that once an option was exercised by the party, the contract would be completed only by means of a spot delivery or by a mode, which was considered lawful. Learned Counsel submits that in our case, there was a postponement of purchase of shares even after exercise of the option by the Petitioner and coming into being of the contract of share purchase. Learned Counsel relies on para 6 of the Petitioner's letter of 30 December 2008, by which the Petitioner exercised its option and required repurchase of shares by Respondent No.1. Para 6 invokes the Petitioner's right under clauses 8.5 and 8.5.1 and calls upon Respondent No.1 to act on the clauses either with immediate effect, or, in any case, before 12 January 2009. Relying

on this clause, it is submitted that inasmuch as this exercise of option demands repurchase on or before a future date, it is not a contract excepted by the circular of SEBI dated 1 March 2000. There is no substance in the contention. Spot delivery is a delivery of shares against payment of price. Just because the original vendor of securities is given an option to complete repurchase of securities by a particular date, it cannot be said that the contract for repurchase is on any basis other than spot delivery. There is nothing to suggest that there is any time lag between payment of price and delivery of shares. There is nothing to suggest that the shares would be delivered first and the price demanded later or vice versa. There is, accordingly, no distinction to be drawn here. The statement of law in **MCX Stock Exchange Ltd.** squarely and fully applies to the facts of our case.

7. That brings us to the second leg of the arbitrator's award on illegality or unenforceability of the share purchase option contained in clauses 8.5 and 8.5.1, on account of breach of Section 18-A of SCRA. (The arbitrator refers to breach of Section 20, which had stood deleted around the relevant time and replaced by Section 18-A; learned Counsel for the Petitioner accepts that this may be treated as a mere oversight not bearing on the validity of the award.) Section 18-A is quoted below :

> **18-A. Contracts in derivative.-** Notwithstanding anything contained in any other law for the time being in force, contracts in derivative shall be legal and valid if such contracts are -
>
> (a) traded on a recognized stock exchange;
>
> (b) settled on the clearing house of the recognized stock exchange; or

> (c) between such parties and on such terms as the Central Government may, by notification in the Official Gazette, specify,
>
> in accordance with the rules and bye-laws of such stock exchange.

It is, firstly, to be noted that Section 18-A of SCRA does not purport to invalidate any contract. It is a non-obstante clause having overriding effect over any other law for the time being in force and what it does is making contracts referred to in clauses (a) to (c) thereof as legal and valid. Notwithstanding anything contained in any law for the time being in force, contracts in derivative which are either (a) traded on a recognized stock exchange; or (b) settled on the clearing house of a recognized stock exchange; or (c) are between such parties and on such terms as the Central Government may, by notification in the official gazette, specify, and are in accordance with the rules and bye-laws of such stock exchange, are to be treated as legal and valid. That is the mandate of Section 18-A. It does not, by its own force, make any particular contract illegal or invalid. For such illegality or invalidity one has to look outside Section 18-A. Mr. Jagtiani submits that such illegality is to be found under the SEBI circular of 1 March 2000, but, as we have noted above, the circular of 1 March 2000 has nothing to do with a contract such as the one we are concerned with in the present petition, the reason being that such contract is no contract for sale or purchase of securities. The circular prohibits forward contracts for sale or purchase of securities and, as we have seen above, the option contained in clauses 8.5 and 8.5.1 does not come within that prohibition, since it does not amount to a contract for sale or purchase of shares.

8. Secondly, and at any rate, the option contained in clauses 8.5 and 8.5.1 cannot be termed as a contract in derivative. Mr. Jagtiani refers to the definition of 'derivative' contained in clause (ac) of Section 2 of SCRA, which was inserted by Act No.31 of 1999, i.e. the same amending Act, which introduced Section 18-A in SCRA. The definition is as follows :-

> "2(ac) "derivative" includes-
>
> (A) a security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security;
>
> (B) a contract which derives its value from the prices, or index of prices, of underlying securities;
>
> (C) commodity derivatives; and
>
> (D) such other instruments as may be declared by the Central Government to be derivatives."

9. Learned Counsel refers to the definition of 'option in securities' contained in clause (d) of Section 2. Clause (d) provides that "option in securities" means a contract for the purchase or sale of a right to buy or sell, or a right to buy and sell, securities in future, and includes a teji, a mandi, a teji mandi a galli, a put, a call or a put and call in securities. Learned Counsel relies on the Supreme Court judgment in **Securities And Exchange Board of India vs. Rakhi Trading Pvt. Ltd.**[3] Relying on this judgment, it is submitted that the contract in the present case contains a put option and is, thus, an option in securities. No

3 (2018) 13 Supreme Court Cases 753

doubt, there is a put option in the present case, which the original purchaser may or may not exercise. But the real question is whether such option or its exercise is illegal. The Supreme Court in **Rakhi Trading** was explaining the meaning and content of the terms 'derivatives', 'futures', and 'options'. Derivatives, as explained by the Supreme Court, are a form of financial instruments which are traded in the securities market and whose values are derived from the value of the underlying variables like the share price of a particular scrip in the cash segment of the market or the stock index of a portfolio of stocks. Derivative trading is governed by Section 18-A of SCRA. There are two types of derivative instruments, namely, “futures” and “options”. A future or future contract is an agreement between two parties to buy or sell an asset at a certain time in future at a price agreed upon on the date of the agreement. An option, on the other hand, is a contract between a buyer and his seller, which gives a right, but not an obligation, to buy or sell the underlying asset at a stated price on or before a specified date. What the buyer of an option buys is his right to exercise the option, often with a premium; his counter-party, who gives him such option, receives the option premium and in consideration thereof, is obliged to buy or sell the underlying asset against the option exercised by the buyer. Options are, as the Supreme Court explained, either of “call” or “put”, call option giving the buyer a right to buy and put option giving him a right to sell, in both cases without an obligation, the underlying asset at a given price on or before a given date. Clauses 8.5 and 8.5.1 give the Petitioner the right, though not the obligation, to sell the shares purchased by it under the SPA to Respondent No.1, its vendor, who is obliged to buy the same in case the right is exercised by the former. Though it is very much

doubtful if this type of option was in contemplation of the legislature when it enacted Sections 2 (ac) and 18-A to be read with Section 16 of SCRA (the latest circular, i.e. SEBI Circular of 3 October 2013, in fact making it clear that it was not), it may be technically possible to treat it as an option in securities, and as such, a derivative. So far so good. That, by itself, however, does not make it bad in law or impermissible. What the law prohibits (Section 16 read with the SEBI Circular of 1 March 2000) is not entering into a call or a put option *per se*; what it prohibits is trading or dealing in such option treating it as a security. Only when it is traded in or dealt with, it attracts the embargo of law as a derivative, that is to say, a security derived from an underlying debt or equity instrument. As such derivative, no one can trade or deal in it or make a contract in respect thereof except on a recognized stock exchange or as settled on the clearing house of a recognized stock exchange or as between parties and on terms which the Central Government may specify, in accordance with the rules or bye-laws of such stock exchange, in keeping with the three categories referred to in clauses (a) to (c) of Section 18-A. In other words, any and every trading in such put option is illegal or unenforceable under Section 16 read with a notification issued under that Section, and will not be saved under Section 18-A unless it falls within either of the categories mentioned in Section 18-A. That is all that is meant by Section 18-A read with clauses (ac) and (d) of Section 2 and Section 16 of SCRA read with the notification issued thereunder. The arbitrator has completely gone wrong on these fundamental aspects. He held the exercise of the put option to be illegal because of the provisions of Section 18-A. Merely because the contract contains a put option in respect of securities, the contract cannot be

termed, as explained above, as a trade or contract in derivatives. And simply making a put option concerning a security cannot be termed as illegal and that too under the provisions of Section 18-A of SCRA.

10. Mr. Jagtiani submits that the SEBI Circular of 3 October 2013 saves a contract for purchase or sale of securities in exercise of an option contained in a shareholders agreement; it does so for the first time; meaning thereby that but for this saving, the law always prohibited such contract. Learned Counsel submits that the same notification makes it clear that it does not validate any contract entered into prior to its date. In the first place, the subsequent notification (i.e. notification dated 3 October 2013) is not a saving notification; it is really a prohibitory notification. It prohibits all contracts save the ones which are excepted in it. Secondly, and more importantly, if a contract is no contract for sale or purchase of securities, but merely an option which the promisee may or may not exercise and entering into such option does not amount to making of a '*contract in a derivative*', as explained above, there is no question of saving of such a contract. It is not, and was never, prohibited in the first place.

11. Having failed in justifying the award on either of the two issues on legality considered by the learned arbitrator, learned Counsel for the Respondents seeks to rely on the submissions contained in his affidavit in reply, which are termed as cross-objections. Relying on these objections, learned Counsel seeks to sustain the award challenging its other findings, which are against the Respondents. I am afraid, it is not open to a respondent in an arbitration petition under Section 34 of the

Act to rely on any cross-objection for setting aside the award (i.e. its reasons), or, indeed, for sustaining it (i.e. its operative part) when the challenger is able to justify his challenge. Mr. Jagtiani relies on a judgment of a learned Single Judge of our Court in **Satpal P. Malhotra vs. Puneet Malhotra and Others**[4]. In this case, the learned Judge held that the provisions of the Code of Civil Procedure, including Order 41 Rule 22 thereof, which provide for cross-objections, would apply to arbitration appeals filed in Court under Section 37 of the Act. The learned Judge was of the view that Section 37 has to be read with the provisions of Civil Procedure Code and in particular Order 41 Rule 22 thereof; it is not inconsistent with these latter provisions. While rendering this view, the learned Judge relied on a Supreme Court judgment in the case of **ITI Ltd. vs. Siemens Public Communications Network Ltd.**[5] In this judgment, what the Supreme Court held was that merely because the Act does not make CPC applicable, by reference, it should not be held that CPC is inapplicable. In particular, the Court held that a revision against an order passed by a civil court in a first appeal under Section 37 lied before the High Court under Section 115 of CPC; merely because a second appeal is barred under sub-section (3) of Section 37 of the Act, the remedy of revision could not be said to be unavailable. The court held that since Section 37 of the Act provides for an appeal to the civil court and the application of CPC is not expressly barred, the revisional jurisdiction of the High Court under CPC would get attracted to any appeal before a civil court under Section 37 and, if that be so, the bar under Section 5 of the Act will not be attracted. This view of the Supreme Court in **ITI Ltd.** is dissented from by it in the later case

4 Judgment of R.D. Dhanuka, J. of Bombay High Court dated 6/5/2013
5 (2002) 5 Supreme Court Cases 510

of **Mahanagar Telephone Nigam Ltd. vs. Applied Electronics Ltd.**[6] Since, however, the **ITI Ltd.** decision was of a coordinate bench, the Supreme Court in **Mahanagar Telephone Nigam** referred it for reconsideration to a larger bench. Be that as it may, we are not concerned here with an appeal under Section 37 of the Act. What we have here is a challenge petition under Section 34 of the Act. Section 34 of the Act cannot be described as anything but a complete code on an application for setting aside an arbitral award. Recourse to a Court against an arbitral award may be made, by virtue of sub-section (1) of Section 34, **only** by an application for setting aside the award made in accordance with sub-sections (2) and (3) of Section 34. Such application cannot be termed as an appeal from the award and, if that is so, there is no question of importing the provisions or, indeed, the principle, of Order 41 Rule 22 into it on an analogy of an arbitration appeal under Section 37 of the Act. Anomalous consequences would follow, if we were to do so and allow the opponent to a challenge petition under Section 34 to raise cross-objections to an arbitral award, whether towards its reasoning or its operative part, in the event the challenger succeeds in his challenge under Section 34. First of all, that would require us to read Section 34 in an unnatural way. We would have to hold that a cross-objection is not a recourse to a Court against an arbitral award. Section 34, in its very opening line (sub-section (1)), provides that recourse to a court against an arbitral award may be made **only** by an application for setting aside such award in accordance with sub-sections (2) and (3). On the other hand, the right to take a cross-objection under Order 41 Rule 22 is nothing but an exercise of the same

6 (2017) 2 SCC 37

right of appeal which is given to an aggrieved party. Secondly, one would be at a loss to find applicable grounds which can be taken in such cross-objections, though, in the absence of any other indication, and also logically, it would have to be supposedly the same grounds which are provided for an application for setting aside an award. Thirdly, there is no provision in law for making such cross-objections in any particular form. If there is no form unlike the one provided in Order 41 Rule 22 and the objections in a challenge petition could be in the form of a reply to the petition, there is no indication how such objections are to be treated in case the challenge petition under Section 34 is rejected. Should a cross-objection be nevertheless heard and determined in that case, just as a cross-objection would under sub-rule (4) of Order 41 Rule 22. Then there is the unanswered question of time of such cross-objections. A strict time-line is provided for a challenge petition under Section 34. Should there be no time for cross-objections and should there be any consequences for non-filing of such objections within that time. We are driven to find out these answers outside Section 34, and that too when the Courts are unanimous that it is a complete code!

12. In that view of the matter, this Court is not inclined to consider the cross-objections stated by the Respondents in their reply to the arbitration petition for sustaining the final award by impugning its reasons.

13. In the result, the petition succeeds and is allowed by setting aside the impugned award.

14. In the facts of the case, there shall be no order as to costs.

(S.C. GUPTE, J.)