

# In a landmark ruling, Indian court rejects objections to enforcement of a \$300 million LCIA award

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On 11 April 2017, the High Court of Delhi handed down its decision in the case of Cruz City 1 Mauritius Holdings v Unitech Limited, rejecting objections to the enforcement of a US\$300 million LCIA award.<sup>1</sup>

This decision establishes several significant legal principles in the context of enforcement of foreign arbitration awards in India and structuring of foreign investments in India, including those relating to objections to enforcement based on public policy, violation of exchange control laws, validity of put options with an assured rate of return to foreign investors in case of breach of contract, estoppel based on representations concerning validity of obligations and compliance with foreign exchange regulations under Indian law.

This decision is a robust affirmation of the recent trend in support of enforcement of foreign arbitral awards in India and a clear signal that Indian courts will not allow parties to re-agitate at the enforcement stage disputes which were subject to arbitration. It also demonstrates that Indian courts will take a commercial approach to uphold the bargain between parties.

## Background

In July 2012, following three related London-seated LCIA arbitrations concerning a real estate project in Mumbai, Cruz City obtained a partial final award and a final award (the “**Awards**”) against its joint venture partners, Unitech Limited (“**Unitech**”) and two affiliated companies (collectively the “**Unitech Parties**”). The Unitech Parties were ordered to pay almost US\$ 300 million in return for Cruz City’s shares in the joint venture company, as well as Cruz City’s legal and arbitration costs.

To recover the amount due under the Awards, Cruz City commenced enforcement proceedings in multiple jurisdictions, including the Isle of Man, Cyprus, Mauritius and India.

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<sup>1</sup> Cruz City was advised by White & Case LLP on all cross-border aspects of the original transaction, the arbitration proceedings and litigation in all the relevant countries. On Indian law matters, White & Case and Cruz City were advised by Indian counsel.

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In respect of India, Cruz City commenced enforcement proceedings before the High Court of Delhi at New Delhi to enforce one of the three Awards against Unitech and Unitech objected to such enforcement.

On 11 April 2017, the High Court of Delhi handed down its decision in this proceeding. The Court rejected all the objections against enforcement which had been raised by Unitech, thus paving the way for Cruz City to take steps to execute the Award in India.

## **Judgment**

In its **judgment** (the “**Judgment**”), the High Court of Delhi has established the following significant legal principles in the context of enforcement of foreign arbitral awards in India and structuring of foreign investments in India:

1. Enforcement of an arbitral award in respect of an agreement that is in violation of the Foreign Exchange Management Act, 1999 (“**FEMA**”) is not contrary to the public policy of India.
2. Requirement for an approval from the Reserve Bank of India (“**RBI**”) for remitting funds outside India pursuant to a foreign arbitral award is not a ground for refusing enforcement of that foreign arbitral award.
3. A put option granted to a foreign investor that provides a guaranteed rate of return does not violate RBI’s prohibition on providing guaranteed returns to foreign investors if such put option is exercisable solely in the event of a default or a breach of an undertaking in reliance on which the foreign investor had made its investment.
4. Parties who provide representations or warranties about the validity of foreign exchange transactions under Indian law at the time such transactions are entered into may be estopped from raising a defense in enforcement proceedings that such transactions were in violation of Indian law and may not be relieved from any legal consequences to themselves from entering into transactions in violation of Indian law.
5. Indian courts have the discretion to permit enforcement of foreign arbitral awards even if the specified grounds for refusing such enforcement are met.
6. The findings of a supervisory court in a set-aside proceeding would not necessarily operate as *res judicata* before an enforcement court.

The six key legal principles that emerge from the Judgment are discussed below.

### **i. Violation of FEMA is not a violation of the “public policy of India”**

Under India’s enforcement regime governing foreign arbitral awards, one of the grounds for refusing enforcement is that such enforcement would be contrary to the public policy of India. The Judgment reaffirms that public policy in this context is to be construed narrowly.

Unitech argued that the enforcement of the Award would result in a violation of the exchange control laws of India (i.e. FEMA) since the foreign exchange transactions underlying the Award, as well as the monetary reliefs granted thereunder, were allegedly in violation of the FEMA. Consequently, Unitech asserted that permitting the enforcement of an award which violates the provision(s) of national law – in this case FEMA – would be contrary to the public policy of India.

The Judgment holds that, as a general matter, violation of “*any particular provision or a statute*” would not satisfy the “*narrow width*” of the public policy defense.

Unitech argued that exchange control laws formed part of the public policy of India. In support of this argument, Unitech sought to assert that previously, India’s exchange control law was embodied in the Foreign Exchange Regulation Act, 1973 (“**FERA**”), which expressly prohibited foreign exchange transactions (except for those concluded by authorized dealers). Unitech therefore submitted that the FEMA which succeeded and replaced the FERA, formed part of the public policy disfavouring and prohibiting foreign exchange transactions.

In respect of FEMA, the court found that unlike its predecessor statute, the Foreign Exchange Regulation Act, 1973, FEMA itself neither prohibits foreign exchange transactions, nor does it render them void in case of any procedural non-compliance (such as failure to seek Government/ RBI approval). In fact, FEMA itself permits

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non-compliance to be addressed through compounding (i.e. monetary penalties) as well as granting of permissions/ approvals after the execution of transactions.

In reaching this finding, the Court noted that the expression “fundamental public policy of India” refers to the principles and the legislative policy on which Indian statutes and laws are founded.

The Court distinguished the violation of a provision of a statute from a violation of a national (legislative) policy and held that the expression “fundamental policy of (Indian) law” must be interpreted to mean only the “fundamental and substratal legislative policy” **and not** “a provision of any enactment”.

Consequently, the Court refused to decline enforcement of a foreign award on the ground of any purported regulatory non-compliance or violation of a provision of FEMA.

**ii. Need for RBI approval for remittance of amounts offshore is insufficient to deny enforcement on grounds of public policy**

Unitech contended that an RBI approval would be required for remitting funds under the Award and RBI was not likely to grant such approval, and therefore enforcement of the Award should be declined.

The Court acknowledged that a party may be required to seek permission from the RBI for remittance of funds outside India. India’s exchange control policy, the Court explained, was not designed to prohibit the flow of foreign exchange but to facilitate the flow of foreign exchange subject to reasonable restrictions (such as seeking the RBI’s permission).

While noting that such considerations could be relevant at the time of remittance of funds, the Court stated that it would lean in favor of a course where public policy considerations could be addressed without refusing enforcement and held that the necessity to seek prior RBI approval before remitting funds offshore from India is insufficient to refuse the enforcement of a foreign award.

**iii. A put option that provides a guaranteed return in the event of a default/ breach does not violate RBI’s prohibition on guaranteed returns**

RBI regulations prohibit guaranteed returns to foreign investors on their equity investments in Indian companies. Unitech relied on this prohibition to resist enforcement—it argued that the agreements between Cruz City and Unitech were structured to assure a predetermined return on equity and therefore violated FEMA. Any arbitral award enforcing such agreements, Unitech contended, was therefore contrary to the public policy of India.

The Court rejected Unitech’s objection and highlighted that the put option in this case was not an “open-ended” assured exit option but could be exercised *only* within a particular time limit **and** *only* in case of a default/ breach of the underlying undertaking in reliance on which the foreign investor had made its investment..

Accordingly, the Court held that a put option seeking to recover a specified rate of return in the event of a breach of contract would not offend the general rule prohibiting guaranteed returns to foreign investors on their equity investments.

**iv Estoppel on parties from raising certain defenses in enforcement proceedings**

Unitech also argued that the enforcement must be refused because the underlying transactions in relation to which the Award had been rendered were allegedly concluded in violation of India’s exchange control laws.

Unitech raised this argument at the enforcement stage even though Unitech had, at the time of undertaking the transactions, expressly represented and confirmed that the transactions were valid and in compliance with Indian law.

The Court ruled that an enforcement proceeding was not the appropriate forum for raising such arguments, as these should ordinarily have been raised before the arbitral tribunal. To accept these arguments at the enforcement stage would result in an abuse of process, and accordingly Unitech was *estopped* from raising these issues at the enforcement stage.

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Additionally, the Court observed that a party which seeks to rely on the alleged incompatibility of the underlying agreement with exchange control regulations may nevertheless be liable for violating the Indian law but “cannot escape its liability” under the arbitral award.

**v. Indian courts have discretion to order enforcement even when certain grounds under Section 48 of the Act are met**

The Court also addressed the scope of an Indian court’s power to refuse enforcement of a foreign award under Section 48 of the Act.

The Court underscored that Section 48 states that a court “may” refuse the enforcement of a foreign award. A court may, therefore, enforce an award “even if one or more of the grounds” in Section 48 are established.

The Court noted:

“[W]hilst there is no absolute or open discretion to reject the request for declining to enforce a foreign award, it cannot be accepted that it is totally absent. The width of the discretion is narrow and limited, but if sufficient grounds are established, the court is not precluded from rejecting the request for declining enforcement of a foreign award.”

**vi. Applicability of the doctrine of *res judicata* in enforcement proceedings**

The Court also examined the applicability of the doctrine of *res judicata* in enforcement proceedings.

The Court noted that a foreign award may be amenable to two types of resistance—*first*, before the supervisory court in proceedings to set-aside the award (which in the present case was England, the seat of arbitration); and *second*, before other courts where the award is sought to be enforced. The subject-matter of set-aside proceedings and enforcement proceedings is distinct. While an enforcement court may be guided by the findings of a set-aside court, it may not necessarily be bound by it. Therefore, the findings or reasoning in a set-aside proceeding would not necessarily operate as *res judicata* before the enforcement court.

Specifically, the Court observed:

“[T]he question whether the award will be recognised and enforced in India, cannot be adjudicated by the arbitral tribunal, the Courts in United Kingdom or for that matter any other country; only the courts in this country are competent to consider whether the award is to be recognised and enforced in this country. The principle of *res judicata* is applicable only where the issue/controversy is finally decided by a court/forum of competent jurisdiction ...”

## **Comment**

The reasoning of the High Court of Delhi reflects the increasingly pro-arbitration approach adopted by Indian courts. This decision should help shift the interventionist perception that has dogged the Indian judiciary. Indian courts, as this decision shows, are increasingly following international best-practices in considering challenges to enforcement of foreign arbitral awards.

The restrictive reading of the scope of ‘public policy’ is also consistent with the legislative intent to reform the international arbitration landscape in India. Additionally, the Court has laid down key principles relating to the applicability of *res judicata* to enforcement proceedings and the relevance of exchange control regulations. These principles are a positive development for international investors looking to invest in India.

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