

REPORTABLE

*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

+ O.M.P. No. 374/2006

Date of decision: 8th AUGUST, 2008

UNION OF INDIA & ANR. Petitioners
Through Mr. C.M. Oberoi & Mr. Amitabh
Marwah, Advocates.

versus

M/S SANGHU CHAKRA HOTELS PRIVATE LIMITED
& ANR Respondents
Through Mr. Jayant Nath, Sr. Advocate
with Mr. Rajeev Rufus U & Mr. N.K.
Sinha, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA

1. Whether Reporters of local papers may be
allowed to see the judgment?
2. To be referred to the Reporter or not ? Yes.
3. Whether the judgment should be reported
in the Digest ? Yes.

SANJIV KHANNA, J.:

1. The present petition under Section 34 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as the Act, for short) filed by Union of India and India Tourism Development Corporation challenges and questions the award dated 28th April, 2006. The respondents herein M/s

Sanghu Chakra Hotels Private Limited (hereinafter referred to as Sanghu Hotels, for short) have purchased share holding of the petitioners in Madurai Hotels Private Limited (hereinafter referred to as Madurai Hotels, for short) under the share purchase Agreement dated 31st January, 2002. Madurai Hotels, the respondent No. 2, was incorporated on 23rd August, 2001 with Hotel Madurai Ashok located at Madurai, Tamil Nadu as its asset under the scheme for demerger, which was approved by the Department of Company Affairs on 9th November, 2001.

2. For the purpose of inviting bids and disinvesting Madurai Hotels, balance sheet as on 31st March, 2001 was prepared and the same formed the basis for inviting bids and accepting the offer. What was transferred were the shares held by the Union of India in Madurai Hotels. Liabilities payable by Madurai Hotels continued to be payable and did not extinguish.

3. Sanghu Hotels submitted their tender for acquisition of shares of Madurai Hotels on 6th November, 2001 and their financial bid was approved on 13th November, 2001 and

thereafter on 31st January, 2002, a share purchase agreement was entered into and the entire share holding of the petitioners in Madurai Hotels was transferred to Sanghu Hotels.

4. Madurai Hotels had continued to operate and do business during the period after 31st March, 2001. This obviously meant there would be changes in the balance sheet and the financial position of Madurai Hotels after 31st March, 2001, on the basis of which bids were given and accepted. To deal with this and to neutralize the effect of operations between 31st March, 2001 and 31st January, 2002, the share purchase agreement had Clauses with regard to post-closing adjustments, viz. Clause 2.2 which is as under:-

“2.2 Post-Closing Adjustments

- (a) The purchaser acknowledges and agrees that it has reviewed the balance sheet of the Unit included in the Audited Financial Statements (the “**Last Balance Sheet**”), and that the value of the Current Assets reflected on the Last Balance Sheet is Rs.8,10,894/- (Rupees Eight Lakhs Ten Thousand Eight Hundred and Ninety Four Only) (the “**2000/2001 Net Current Assets Amount**”). The Purchaser further acknowledges and agrees that it has had the opportunity to review and is familiar with the accounting principles and specific

calculations used to prepare the Last Balance Sheet and the 2000/2001 Net Current Assets Amount and accepts as true and correct both the Last Balance Sheet and the 2000/2001 Net Current Assets Amount. As used in this Agreement, the term “**Net Current Assets**” means those current assets of the Company under the accounting principles used to prepare the Last Balance Sheet less those liabilities of the Company reflected on the Last Balance Sheet that constitute current liabilities of the Company under the accounting principles used to prepare the Last Balance Sheet.

- (b) The Purchaser acknowledge and agrees that it has reviewed the Last Balance Sheet and that the value of the debt of the Unit in respect of borrowings from banks, other financial institutions and the Government reflected on the Last Balance Sheet is Nil (the “**2000/2001 Debt Amount**”). The Purchaser further acknowledges and agrees that it has had the opportunity to review and is familiar with the accounting principles and specific calculations used to prepare the last Balance Sheet and the compute the 2000/2001 Debt Amount and accepts the true and correct the 2000/2001 Debt Amount.

(c) Within twenty one (21) days following the Closing Date, the Government and the Purchaser shall jointly select and cause to be appointed an accounting firm from the CAG panel (“**Auditor**”) to prepare and deliver to each of the Purchaser, the Government, and the Company, a statement showing in reasonable detail the computation of the current assets of the Company, the current liabilities of the Company and the debt of the Company in respect of borrowings from banks, other financial institutions and the Government, in each case as of the close of business of the Company on the Closing Date and computed in a manner consistent with the computation of the current assets of the

company, the current liabilities of the Company and the debt of the Company in respect of borrowings from banks, other financial institutions and the Government reflected on the Last Balance Sheet and in accordance with the accounting principles used to complete the 2000/2001 Net Current Assets Amount and the 2000/2001 Debt Amount (the “**Closing Date Statement**”). The sum of the current assets of the Company reflected on the Closing Date Statement less the sum of the current liabilities of the Company reflected on the Closing Date Statement is referred to in this Agreement as the “**Closing Date Net Current Assets Amount**”. The sum of the debt of the Company in respect of borrowings from banks, other financial institutions and the Government reflected on the Closing Date Statement is referred to in this Agreement as the “**Closing Date Debt Amount**”.

(d) The Purchaser shall ensure that the Auditor prepares and finalizes the Closing Date Statement in good faith and submits the statement within 45 days of being called upon to prepare the same by the Purchaser and the Government as contemplated at Article 2.2 (c) above. The Closing Date Statement delivered by the Auditors to each of the Purchaser, the Government and the Company shall, except the errors apparent on the face of records, be final and binding on the Parties to this Agreement. To enable the Auditors to prepare Closing Date Statement, the Purchaser shall cause the Company to, permit the Auditors and the Auditor’s authorized representatives and employees to review, during normal business hours, the books, records, internal management accounts and work papers of the Company. Without limiting the generality or effect of any other provision of this Agreement, the Company shall, and the Purchaser shall cause the Company to (i) provide the Auditors and its authorized representatives and employees access, during normal business hours, to the facilities,

personnel and accounting and other records of the Company necessary to permit the Auditors to prepare the Closing Date Statement as provided in this Agreement; (ii) cooperate with the Auditors and its authorized representatives and employees in the preparation of the Closing Date Statement; and (iii) take such actions as may be reasonably be requested by the Government to close, or to assist the Government in Closing Date, as of the close of business of the Company on the Closing Date, the books and accounting records of the Company.

(e) If the Closing Date Net Current Assets Amount is greater than the 2000/2001 Net Current Assets Amount, the Purchaser shall pay the Government an amount in Rupees by bank draft, equal to the difference between the Closing Date Net Current Assets Amount and the 2000/2001 Net Current Assets Amount multiplied by 89.97%. If the 2000/2001 Net Current Assets Amount is greater than the Closing Date Net Current Assets Amount, the Government shall pay the Purchaser an amount in Rupees, by bank draft, equal to the difference between the 2000/2001 Net Current Assets Amount and the Closing Date Net Current Assets Amount multiplied by 89.97%.

(f) If the Closing Date Debt Amount is greater than the 2000/2001 Debt Amount, the Government shall pay the Purchaser an amount in Rupees, by bank draft, equal to the difference between the Closing Date Debt Amount and the 2000/2001 Debt Amount multiplied by 89.97%. If the 2000/2001 Debt Amount is greater than the Closing Date Debt Amount, the Purchaser shall pay the Government an amount in Rupees, by bank draft, equal to the difference between the 2000/2001 Debt Amount and the Closing Date Debt Amount multiplied by 89.97%.”

5. A bare perusal of the above Clauses discloses that the same were to neutralize the effect of operations and business during the transitional phase between 31st March, 2001 and 31st January, 2002. Adjustments were required to be made with neither party being a gainer or a loser for business operations conducted during this period.

6. To this extent, there is no dispute between the petitioners and the respondents. Dispute between the parties arose on account of liabilities of Rs.26,11,092.85, which were recorded in the books of the corporate office of ITDC as payable by the demerged company Madurai Hotels on account of expenses incurred by ITDC. Before incorporation and demerger, Madurai Hotels was not in existence and profit or losses, assets and liabilities of hotel Madurai Ashok were reflected in the balance sheet and profit and loss account of ITDC. The respondents dispute their liability and submit that Rs.26,11,092.85, as reflected in the books of the corporate office as payable by Madurai Hotels, cannot be taken into consideration and adjusted.

7. Learned Arbitrator in the impugned Award has directed the petitioners to make payment of Rs.14,85,000/- with a direction to pay interest with effect from 26th February, 2003.

8. I have examined the said Award and find that the same suffers from contradictions and, therefore, cannot be sustained. Findings are mutually inconsistent. The net current assets as per balance sheet dated 31st March, 2001 of Madurai Hotels was Rs.8,10,893.91. It is also not disputed that Rs.26,11,092.85 payable by the demerged company i.e. Madurai Hotels to ITDC pertains to the period prior to 31st March, 2001 and does not relate to the transitional period with effect from 1st April, 2001 till 31st January, 2002. These facts are admitted and accepted by the learned Arbitrator in his Award and not disputed.

9. As per the share purchase agreement, audited financial statement as on 31st March, 2001 means the following four documents:-

- (i) Details of advances to employees (page Nos. B-1 to B-3).
- (ii) Audited annual accounts (page Nos. B-4 to B-51).

(iii) Details of balance with Project Division at headquarters (page No. B-52).

(iv) Details of consolidation entries passed at headquarters (page No. B-53).

10. The entry of Rs.26,11,092.85 was included and shown in the project division and in consolidation entries passed by the headquarters at B-52 and B-53. Therefore, audited financial statement included audited financial accounts as on 31st March, 2001 but also the details of balance with project division at headquarters and consolidation entries passed at headquarters of Rs. 26,11,092.85/-.

11. The main contention raised by the respondents-Sanghu Hotels before the learned Arbitrator was that they were never shown and given access to the headquarter accounts and Project Division, i.e. Annexure B-52 and B-53, which included the negative entry figure of Rs.26,11,092.85. Learned Arbitrator has rejected the said contention holding as under:-

“ The above documents were apparently part of Data Room Documents and full reference is made to these documents

in the definition of Financial Statement as stated in the Share Purchase Agreement. Once having signed the Share Purchase Agreement and its Annexures, the Claimants cannot now deny the same. In my opinion, the Claimants were aware of these liabilities at the time of making the bid and these liabilities are to be paid by the Claimants in accordance with the Share Purchase Agreement read with the Scheme of Demerger i.e. these liabilities are to be settled by the Claimants directly. Furthermore, those liabilities were part of the accounts both as at 31-3-2001 and 31-1-2002 and have no bearing, (except as stated below), to the difference of net Current Assets.”

12. I may also note here that the share purchase Agreement itself refers to definitions “Data room” and “Data Room Document” and the same have been defined as all documents relating to the unit. Clause J of the share purchase Agreement dated 31st January, 2002 specifically records as under:-

“J. The Purchaser has conducted a financial, technical and legal due diligence as to the affairs and financial position of the Unit transferred to the Company and in this context has done a complete and thorough review of the Data Room Documents (as defined hereafter).”

13. Learned counsel for the petitioners had drawn my attention to Clause 3.3 (c) of the scheme for arrangement, which reads as under:-

“3.3(c) the debt, liabilities including debts and liabilities lying in the books of accounts of the projects division and corporate office of the Transferor and obligations of the Transferor relating to the Transferred Undertaking, shall, without any further act or deed stand transferred to the Transferee and shall become the debts, liabilities and obligations of the Transferee which it undertakes to meet, discharge and satisfy. All liabilities and obligations arising out of guarantees executed by the Transferor relating to the Transferred Undertaking or any third party/ies shall become the liabilities and obligations of the Transferee which it undertakes to meet, discharge and satisfy on and from the Appointed Date.”

14. The above Clause stipulates that all the debts and liabilities will include debts and liabilities shown in the books of accounts of the projects division and corporate office of the transferor i.e. ITDC and without any further act or deed shall be transferred to the transferee i.e. Madurai Hotels and will become debts and liabilities and obligation of the Madurai Hotels. Thus, the liabilities of Rs.26,11,092.85/-

shown in the project division of the corporate office or head office were to be treated as transferred and reflected in the books of Madurai Hotels.

15. Here it may be appropriate to refer to another finding given by the learned Arbitrator to the effect that the scheme of demerger/arrangement as approved by Department of Company Affairs forms part of the share purchase agreement. A scheme for demerger under Sections 391-394 of the Companies Act, 1956 has statutory force. Learned Arbitrator in the award has observed as under:-

“The respondents have also emphasized that the Scheme of Demerger as approved by the Department of Company Affairs forms part of the Shares Purchase Agreement and all documents which come within the definition of Audited Financial Statements in the Share Purchase Agreement are to be taken into account for computing the net current assets. To this extent I am in agreement with the Respondents.”

16. In the light of the above observations made by the learned Arbitrator it is difficult to appreciate the reasoning and grounds on which the claim made by the respondents

herein has been accepted. The reasoning given by the learned Arbitrator in this regard is as under:-

“It is obvious that the Share Purchase Agreement by clause 2 seeks to compare the figures of net current assets in order to ensure that any change in net current assets in the period between the two Balance Sheet dates is brought out and the Claimants are not put to disadvantage; any liability which has accrued and was part of the documents on the date of executing the Share Purchase Agreement cannot be now shown as Current Liabilities and taken advantage of. The net current assets comparison must take place between equals and the difference must represent the transactions which took place during the relevant period.”

17. I have quoted Clause 2.2 of the share purchase agreement and referred to the purpose behind the said clause to neutralize the effect of business operations during the period 31st March, 2001 till 31st January, 2002, as bids were given and processed on the basis of balance sheet and accounts for the period ending 31st March, 2001. The first sentence, therefore, of the above reasoning is correct and justified. The clause prevents any disadvantage to both the purchaser and the seller. The clause operates both ways. However, this hardly helps the claimant. The reasoning also

does not notice the fact that the liability of Rs.26,11,093/- pertains to the period prior to 31st March, 2001 and, therefore, Clause 2.2 is of no relevance because it deals with profit and loss, assets and liabilities, which have accrued between the period 31st March, 2001 and 31st January, 2002. Similarly, the last sentence of the reasoning is inconsequential. The said sentence correctly records that the effect of Clause 2.2 is to make comparison of current assets between equals and to take into account difference, which had taken place in the interregnum i.e. between 31st March, 2001 and 31st January, 2002. The only reasoning given by the learned Arbitrator is in the middle portion of the said paragraph and reads “any liability which has accrued and was part of the documents on the date of executing the share purchase agreement, cannot now be shown as current liabilities and taken advantage of”. The said reasoning cannot be accepted and is totally contrary to the scheme of demerger, which has been held by the learned Arbitrator as a part of share purchase agreement and the findings given by the Arbitrator quoted above with reference to Annexure B-52, B-53. Secondly, Rs.26,11,092.85 is not a liability which

has accrued after 31st March, 2001. It was certainly part of the data room documents on the date when share purchase agreement was executed. Learned Arbitrator while holding that liability of Rs.26,11,092.85 was not part of liabilities has contradicted himself, as he has accepted the petitioners' case that documents B-52 and B-53 were shown to the respondents and the same formed part of the financial statement. Thirdly, Rs.26,11,092.85/- is not being included in the list of current liabilities for the first time as on 31st January, 2002. The said amounts were reflected in Annexures B-52 and B-53 and as per the scheme for demerger, Clause 3.3 quoted above was deemed to be part of the current liabilities as on 31st March, 2001. This is in view of the finding of the Id. Arbitrator that scheme of demerger is a part of Share purchase agreement. Lastly, Id. Arbitrator has himself allowed balances of project division to "creep in" as they fall within the wider definition of Audited Financial Statement. By the same reasoning B-53 falls within the wider definition of Audited Financial Statement but has not been allowed to "creep in" for the reason:-

“Any amount accounted for under net current assets which is not an asset or liability pertaining to the intervening period i.e.; 01-04-2000 to 31-01-2001 cannot now be allowed to creep in. The above liabilities admittedly were merely transferred from Sources of Funds (01-04-2000) to Current Liabilities (31-01-2001) and must not be accounted for in computing the net current assets for the purpose of Clause 2 of the share purchase agreement”.

18. I am conscious of the fact that this Court has limited jurisdiction to interfere and set aside awards under Section 34 of the Act. However, the Supreme Court has outlined certain situations that would warrant interference in the arbitral award by the courts. The decision of the Supreme Court in the case of ***Oil & Natural Gas Corpn. Ltd. versus Saw Pipes Ltd.***, reported in (2003) 5 SCC 705, dwells on the issue of setting aside of an arbitral award on account of the same being against “public policy”, the Court noted that the word “public Policy has not been as such defined in the Arbitration Act and hence it would require interpretation by the Court, the Court proceeded to observe as under:

“16. The next clause which requires interpretation is clause (ii) of sub-section (2)(b) of Section 34 which inter alia provides that the court may set aside the arbitral award if it is in conflict with the “public policy of India”. The phrase “public policy of India” is not defined under the Act. Hence, the said term is required to be given meaning in context and also considering the purpose of the section and scheme of the Act. It has been repeatedly stated by various authorities that the expression “public policy” does not admit of precise definition and may vary from generation to generation and from time to time. Hence, the concept “public policy” is considered to be vague, susceptible to narrow or wider meaning depending upon the context in which it is used. Lacking precedent, the court has to give its meaning in the light and principles underlying the Arbitration Act, Contract Act and constitutional provisions.”

19. In the case of ***Hindustan Zinc Ltd. versus Friends Coal Carbonisation***, reported in (2006) 4 SCC 445, the Supreme Court referred to the decision in the case of ONGC (Supra) and gave the broad contours of what would qualify as a decision against “public policy”. The Court observed as under:

“13. This Court in *ONGC Ltd. v. Saw Pipes Ltd.* held that an award contrary to

substantive provisions of law or the provisions of the Arbitration and Conciliation Act, 1996 or against the terms of the contract, would be patently illegal, and if it affects the rights of the parties, open to interference by the court under Section 34(2) of the Act. This Court observed: (SCC pp. 718 & 727-28, paras 13 & 31)

“13. The question, therefore, which requires consideration is—whether the award could be set aside, if the Arbitral Tribunal has not followed the mandatory procedure prescribed under Sections 24, 28 or 31(3), which affects the rights of the parties. Under sub-section (1)(a) of Section 28 there is a mandate to the Arbitral Tribunal to decide the dispute in accordance with the substantive law for the time being in force in India. Admittedly, substantive law would include the Indian Contract Act, the Transfer of Property Act and other such laws in force. Suppose, if the award is passed in violation of the provisions of the Transfer of Property Act or in violation of the Indian Contract Act, the question would be—whether such award could be set aside. Similarly, under sub-section (3), the Arbitral Tribunal is directed to decide the dispute in accordance with the terms of the contract and also after taking into account the usage of the trade applicable to the transaction. If the Arbitral Tribunal ignores the terms of the contract or

usage of the trade applicable to the transaction, whether the said award could be interfered. Similarly, if the award is a non-speaking one and is in violation of Section 31(3), can such award be set aside? In our view, reading Section 34 conjointly with other provisions of the Act, it appears that the legislative intent could not be that if the award is in contravention of the provisions of the Act, still however, it couldn't be set aside by the court. If it is held that such award could not be interfered, it would be contrary to the basic concept of justice. If the Arbitral Tribunal has not followed the mandatory procedure prescribed under the Act, it would mean that it has acted beyond its jurisdiction and thereby the award would be patently illegal which could be set aside under Section 34.

* * *

31. ... in our view, the phrase 'public policy of India' used in Section 34 in context is required to be given a wider meaning. It can be stated that the concept of public policy connotes some matter which concerns public good and the public interest. What is for public good or in public interest or what would be injurious or harmful to the public good or public interest has varied from time to time. However, the award which is, on the face of it, patently in violation of statutory

provisions cannot be said to be in public interest. Such award/judgment/decision is likely to adversely affect the administration of justice. Hence, in our view in addition to narrower meaning given to the term “public policy” in *Renusagar case*, it is required to be held that the award could be set aside if it is patently illegal. The result would be—award could be set aside if it is contrary to:

(a) fundamental policy of Indian law; or

(b) the interest of India; or

(c) justice or morality; or

(d) in addition, if it is patently illegal.

Illegality must go to the root of the matter and if the illegality is of trivial nature it cannot be held that award is against the public policy. Award could also be set aside if it is so unfair and unreasonable that it shocks the conscience of the court. Such award is opposed to public policy and is required to be adjudged void.”

14. The High Court did not have the benefit of the principles laid down in *Saw Pipes*, and had proceeded on the assumption that award cannot be interfered with even if it was contrary to the terms of the contract. It went to the extent of holding that contract terms cannot even be looked into for examining the correctness of the award. This Court in *Saw Pipes* has made it clear that it is open to the

court to consider whether the award is against the specific terms of contract and if so, interfere with it on the ground that it is patently illegal and opposed to the public policy of India.”

20. As mentioned earlier the Award of the learned arbitrator suffers from inherent inconsistencies and self contradictions and for that reason, I deem it appropriate to set aside the said Award. Reliance for the said purpose can be placed upon the decision of the Supreme Court in the case of ***K.P. Poulose versus State of Kerala*** reported in (1975) 2 SCC 236, the said case the Court held as under:-

“6. Under Section 30(a) of the Arbitration Act an award can be set aside when an arbitrator has misconducted himself or the proceedings. Misconduct under Section 30(a) has not a connotation of moral lapse. It comprises legal misconduct which is complete if the arbitrator on the face of the award arrives at an inconsistent conclusion even on his own finding or arrives at a decision by ignoring very material documents which throw abundant light on the controversy to help a just and fair decision. It is in this sense that the arbitrator has misconducted the proceedings in this case....” (emphasis supplied).

21. In the case of ***Union of India versus Pundarikakshudu and Sons***, reported in (2003) 8 SCC 168, the Supreme Court dealt with the question of award of damages by the arbitrator and held that the decision to award damages against one party would suggest that the said party was guilty of breach of contract, any finding to the contrary would make the award bad in the face of it on account of inconsistent findings. The aforesaid view has been reiterated by the Supreme Court in the case of ***Seth Mohanlal Hiralal versus State of M.P*** reported in (2003)12 SCC 144.

22. A mutually contradictory award will be contrary to public policy as it suffers from patent illegality and is unjust.

23. No doubt, figure of Rs.8,10,894/- finds mention in Clause 2.2 (a) of the share purchase agreement but this figure is taken from the balance sheet of the respondent No. 2 as on 31st March, 2001. The contention of the petitioners, on the other hand, is that the audited financial statement as defined in the agreement and as per Annexure-B or the Financial Statement should be made basis for computing the amount payable in Clause 2.2 (e) and (f). The petitioners

also rely upon the definition of the term data room and the data room documents in support thereof. To be fair to the respondents, the aforesaid contention of the petitioners is debatable in view of Clause 2.2 (a), (b) and (c) in which reference has been made to the balance sheet of the company as on 31st March, 2001 and figure of Rs.8,10,894/- is stated. The finding of the Id. Arbitrator that the scheme of demerger is also part of the share purchase agreement is debatable in view of clauses 8.4 and 8.10 of the share purchase agreement. However, in the present case I am not required to go into this controversy and go into these questions as the award is liable to be set aside as the reasoning given by the Id. Arbitrator is self contradictory, if not mutually destructive. While deciding this appeal under Section 34 of the Act, I am concerned with the Award and the reasoning given by the learned Arbitrator. The Award cannot be re-written by giving entirely new reasons. I cannot substitute the reasons given by the learned Arbitrator and uphold the claim of the respondent for entirely different grounds and reasons. The role of this Court is limited to examine grounds and reasons mentioned in the award and

whether the award can be set aside as being contrary to public policy under Section 34 of the Act.

24. As already held above, it is difficult to sustain the award on the reasons mentioned by the learned Arbitrator, which are mutually self contradictory. It is, however, clarified that this Court has not expressed any opinion on interpretation of Clause 2.2 and whether the balance sheet of the company, respondent No. 2, as on 31st March, 2001 alone can be taken into consideration for the purpose of the said clause. These questions are left open and undecided. No costs.

(SANJIV KHANNA)
JUDGE

AUGUST 08, 2008.

VKR/P