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

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DECIDED ON: 28.02.2013

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FAO(OS) 7/2013

MOREPEN LABORATORIES LTD

..... Appellant

Through: Mr. Arvind Nigam, Sr. Advocate
with Mr. Manish Gandhi and Mr. P.K. Singh,
Advocates.

versus

PHAFAG AG AND ORS

..... Respondents

Through: Mr. Dhruv Mehta, Sr. Advocate with
Mr. Karan Luthra, Ms. Noomi Chandra and Mr.
Sameer Abhyankar, Advocates for respondent
nos.1&2.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE SUDERSHAN KUMAR MISRA

MR. JUSTICE S.RAVINDRA BHAT (OPEN COURT)

1. This appeal, under Section 37(1) of the Arbitration and Conciliation Act, 1996 ("the Act") challenges the judgment and order of a learned Single Judge of this Court dated 29.08.2012, dismissing the appellant's objections under Section 34 of the said Act, to an Award.

2. The brief facts are that the respondents (collectively known as "Phafag" in arbitral proceedings, and in the impugned judgment, and referred to as such) entered into two agreements with the appellant (hereafter "Morepen") on 01.07.2002. The first was a Technical Know-how/License

Agreement (“TKHL agreement”) and the second was a Market Services Agreement (MSA). Article 1.9 of the TKHL agreement defined “Products” as the *“medical formulation containing the active ingredient Caroverine.....conforming to the specifications as prescribed by the authorities concerned and such other like items as may be mutually agreed upon between the parties to the agreement”*. The “Technical Know-how” was defined as in Article 1.12 as follows:

“1.12 “Technical Know-how” shall mean the technology techniques drawings, and designs, know-how procedures, process system and other value addition provided by Phafag to Morepen for carrying on the business, such as designs, data, drawing, models, methods, process and material specifications, operational and manufacturing date, machinery specifications.”

3. Article 2 of the TKHL agreement, to the extent it is relevant dealt with the scope of the contract, is extracted below:

*“Article 2
Scope of the Agreement*

2.1 The object of this agreement is to provide basic know-how to Morepen to carry on the registration of the Products, and the business. Phafag shall license its technology relating to the manufacture of the products.

2.2 The scope of this agreement shall inter alia, include provisions of Technical Know-how, advice and support for:

- (i) Registration of the Products;*
- (ii) Manufacture of the Products in bulk;*
- (iii) Packaging, marketing and sale of the products;*
- (iv) Manufacture and production of the relevant packaging*

material.”

4. The conditions with regard to consideration were elaborately dealt within Article 6 which is extracted in full as under:-

“CONSIDERATION

6.1 In consideration of the Technical Know-how and grant of licence. Morepen agrees to pay Phafag a turnover royalty of 5% (five per cent) of the Net Sales Price total revenue of the Products for the manufacture and the marketing of the Products.

The payment of royalty shall be valid for a period of 7 years from the date of commencement of production of the product. The royalty shall be subject to Indian Income-tax and such tax withholding as may be applicable at the time of remittance.

6.2 The royalties payable pursuant to Article 6.1 shall be paid from the Commencement of Commercial Production as follows:

(a) the turnover royalty shall be paid to Phafag on a quarterly basis within forty five (45) days of the closing of the preceding quarter and should be transferred to the designated account of Phafag in Swiss Francs Currency (“CHF”) at the Reserve Bank of India recognized exchange rate prevailing on the day on which the royalty is remitted.

*(b) Within 45 days following the end of the period stated above
(b) during the time royalties are payable under this Agreement. Morepen shall send to Phafag/Geyer production and sales report of the Products as well as the royalty account duly audited by chartered accountants.*

6.3 In addition to the royalty payments as set forth in ArticleXXX (not legible),Morepen shall pay a lump sum in the

total amount of CHF 3.2 million (three million and two hundred Swiss Francs) for the transfer of the initial Technical Know-how. This payment shall be made in equal quarterly instalments, payable always in the middle of each quarter, spread over seven (7) years from the Effective Date. The amount paid in accordance with this provision shall be non-refundable, even if this Agreement should termination for any reason before the contractual term.”

5. Morepen, on 01.07.2002, in addition to executing these two agreements also wrote to Phafag that in the event of the agreement not being registered/approved with the Reserve Bank of India (RBI) or the commercial production not being accompanied before 31.03.2003, it (the agreement) would be terminated automatically, unless Morepen were not to prove its best efforts to achieve the deadline by proof of evidence. The deadline could be extended at the latest till 30.09.2003. On 03.09.2002, Morepen informed Phafag's India office that clinical trials of the drug in question were progressing in India and were nearing completion. Concurrently, it is a matter of record that during September-October 2002, Phafag supplied bulk Caroverine to Morepen for formulation development. Morepen was able to manufacture 1000 ampoules. It is also matter of record that in November 2002, Phafag supplied to Morepen, by two e-mails, files detailing manufacture of Spasium ampoules and capsules. The correspondence between the parties placed on the record, suggest that Morepen engaged in communications with Phafag about the clinical drug trials and the adverse comments received from certain experts. Consequently, on 19.09.2003, Morepen wrote to Phafag stating that since adverse drug reactions were reported from patients recruited in the trial, the regulatory authority was not

inclined to grant approval and, therefore, communicated that the agreement of 01.07.2002 (TKHL) agreement stood terminated. In this background, Phafag, on 25.11.2003, demanded US\$ 2 million as technology fee in terms of Article 6.3 as well as US\$ 2.5 million for wrongful exclusion from the Indian market. Eventually, the claim led to arbitration through the aegis of the International Chamber of Commerce (ICC).

6. In the arbitral proceedings, 12 issues were framed. On 24-09-2004, the sole arbitrator in an interim award held that the Indian law governed the contract. By the final award dated 24.03.2005, the arbitrator held in favour of Phafag awarding damages to the extent of US\$ 285,714/- with 6% simple interest per annum on US\$214,285/- from 15.05.2003 till date of award and further amount *inter alia* of US\$ 71,428/- from 15.08.2003 to the date of the award. Thereafter interest at 18% on the amount of the award (US\$ 285,714) until date of payment, besides other interests and costs.

7. In the award, the arbitrator, in para 79 held that the agreement did not stand automatically terminated on 31.03.2003 since both parties were treating it as subsisting and the deadline stood extended. He relied upon the letter issued by Morepen on 19.09.2003 terminating the agreement, by relying on Article 11.2. It was, however, clarified that the condition for operation of that provision had not arisen and Morepen's termination was wrongful. The arbitrator, therefore, held that Phafag were entitled to treat that letter as a repudiation of that agreement and claimed directions for breach.

8. In the discussion on Issue No.5, i.e. entitlement of Phafag to damages to the extent of US\$ 2million under Article 6.3, the award, after discussing the rival submissions held as follows:

“92. Article 6.3 concludes with the words:

“The amount paid in accordance with this provision shall be non-refundable, even if this Agreement should terminate for any reason before the contractual term.”

93. The issue here is whether the clause envisages that the payments would continue to be made in the event of termination of the Agreement, so that in due course the whole sum would be paid, or whether payments should cease on termination.

94. Ms. Anjali Sharma, in a well constructed and sustained argument for Phafag and Geyer, pointed first to the fact that the payment was for the transfer of the “initial” Know-how. Why, she asked forensically, should termination of the Agreement discharge Morepen’s liability to pay for what they had received? Secondly she drew attention to the fact that the payment was expressly described as a lump sum, payable in instalments for the convenience of Morepen. Again, termination of the Agreement should not affect the remaining payments.

95. Mr. Kapur for Morepen submitted that the termination of the Agreement terminated the obligation to pay. He submitted that if the payment was for a definable body of information the parties would not have chosen a vague word such as “initial”. On his construction, the discharge of Phafag and Geyer from their continuing obligations to provide confidential information would be recognised. Moreover it would recognise the fact that, upon termination, the value of the confidential information to Morepen would be exhausted. He also relied on the 2001 Agreement, which was known to both parties, under which the payment for technology was also spread throughout the term.

96. On this issue I prefer Morepen’s submissions. I think it is the plain implication of Article 6.3 that sums not yet paid under that provision do not have to be paid in the event of termination. Under Article 11.4, termination prevents Morepen from making further use of the information, as well as discharging Phafag and Geyer from any further obligations in

relation thereto. In my judgment Phafag and Geyer are only entitled to those payments which had fallen due before 30th September 2003. These are the payments for November 2002 and February, May and August 2003. These will amount to 1/7 of the US\$ 2 million fee or \$285,714.

Issue 6: Has Morepen wrongfully excluded Phafag and Geyer from doing business in India?

97. The essence of the Agreement between the parties was that Morepen should have an exclusive licence in respect of the specified formulations of caroverine in return for the payments specified.

98. In my judgment Phafag and Geyer have not been wrongfully excluded from doing business in India. The only breach of the Agreement which is identified is Article 6.3. The payment which Morepen must make under Article 6.3 up to the point when the Agreement would lawfully have come to an end is a payment in respect of exclusivity. Phafag and Geyer would not have been entitled during that period to enter the market in India in competition with Morepen. They are therefore not, in my judgment, entitled to be compensated further.

99. Quite apart from this fundamental objection in the claim under this head, Phafag and Geyer have not adduced any evidence to show the quantum of this claim.

100. Phafag and Geyer also refer to Article 19, under which Morepen had a right of first refusal in respect of other formulations. Morepen was never asked whether it would consent to other formulations being offered elsewhere. I cannot see this as any basis for the further claim either.”

9. Morepen, in its petition under Section 34, contended that the arbitrator travelled beyond the terms of reference and answered issues which had not been referred for adjudication. It was also contended that the award had to

be set-aside under Section 34(2)(a)(iii) since the effective opportunity of presenting the defence had not been given to Morepen. It further argued that in awarding damages, the arbitrator overlooked the principles embodied in Section 73 of the Contract Act and ignored that Phafag had not led any evidence to prove its claim. The Single Judge, in the impugned judgment, rejected Morepen's contentions, evident from the following findings:

“29. Once the conclusion was reached that there was a transfer of the technical know-how for the purposes of Article 6.3 from Respondents 1 and 2 to the Petitioner, then the Petitioner has necessarily to make payment of the fee as set out in the TKHL Agreement. The learned Arbitrator has gone by the wording of Article 6.3 which envisages the payment having to be made in equal quarterly instalments spread over more than 7 years. He has awarded only 1/7th of the total technical fee of USD 2 million to the Respondents 1 and 2.

30. It was vehemently argued by Mr. Kapur, learned counsel for the Petitioner that if one reads para 91 of the Award, it is apparent that the learned Arbitrator has in fact assessed and awarded ‘damages’ to the Respondents 1 and 2. He points out that in para 116 of the Award while summarizing the Award, the learned Arbitrator terms the award of USD 285,714 as “damages for breach of contract”. The award of 6% simple interest is termed as “interest on damages”. According to Mr. Kapur what has been awarded by the learned Arbitrator under Issue (8), is damages. This was not within the scope of the reference and in any event contrary to Section 73 of the Indian Contract Act, 1872. There was no proof of any loss suffered by the Respondents 1 and 2 and therefore, the Award was contrary to the public policy of India.

31. The above submissions proceed on a misconception that the learned Arbitrator has in fact awarded ‘damages’ to Respondents 1 and 2. Although, in para 91 of the impugned Award, the learned Arbitrator states that Respondents 1 and 2

are entitled to 'damages' and to be placed in the same position they would have been if the contract had been performed, what he in fact awarded them in para 96 is only a pro-rata technical know-how fee, i.e., 1/7th of the total fee of USD 2 million. This was become the TKHL Agreement would in any event have come to an end on 30th September 2003 and by that date, commercial production could not have commenced. The use of the word "damages" by the learned Arbitrator in the operative portion, para 116, of the impugned Award cannot dislodge the fact that what was actually awarded to the Respondents in para 96 was not 'damages' at all but only a pro-rata technical know-how fee. Significantly, the learned Arbitrator had rejected the claim by the Respondent Nos.1 and 2 for USD 0.25 million under Issue (10) renumbered by the learned Arbitrator as Issue (7). Consequently, the question of the Respondents 1 and 2 having failed to prove the actual loss suffered by them for the purpose of Section 73 of the Indian Contract Act, 1872 did not arise at all.

32. In the considered view of the Court, the learned Arbitrator has not decided any issue or awarded any amount beyond the scope of his jurisdiction. The ground under Section 34(2)(a)(iv) of the Act is not made out. Consequently, the ground under Section 34(2)(b)(iii) of the Act is not made out either."

10. Sh. Nigam, learned senior counsel for Morepen contended that the learned Single Judge fell into error in refusing to exercise jurisdiction under Section 34 and interfere with the award as regards the findings of Issue No.5. He emphasized the arbitral tribunal's observation in Para 96 that "*the plain implication of Article 6.3 that sums not yet paid under the provisions do not have to be paid in the event of termination*". He proceeded beyond the terms of reference and also acted contrary to law in holding that the amounts were payable on a proportionate or pro-rata basis. It was contended

that the combined effect of the relevant provisions, i.e. Article 11.4 (which envisioned “termination of the agreement”); Article 1.3 (which defined “business”) and Article 1.12 (which defined “technical know-how”); Article 2 which defined the scope of the agreement and Article 6.3 which was the relevant provision with regard to payment of additional license fee, showed that the parties intended that Morepen’s obligations to pay amounts to Phafag were to arise only in the eventuality of the Drug Controller approving its applications after clinical trials. It was further emphasized that the materials used during the clinical trials were separately imported upon payment of consideration. In these circumstances, Morepen did not gain anything out of the arrangement nor was Phafag put to any loss. Consequently, without proving its claim for damages through any credible material, Phafag could not have been awarded any amounts, much less amount of US \$ 285,714/-.

11. Learned counsel contended that once the arbitrator concluded, as it did, in Para 96 of the award that Morepen’s argument on Article 6.3 was reasonable and had to be accepted, the question of its liability for paying any amounts, by whatever nomenclature, could not have arisen. It was argued that the amount contemplated under Article 6.3 was for payment in the event of the agreement being worked-out and not for the contingency of the agreement actually maturing after the Drug Controller’s approval. Any other meaning, submitted learned counsel, would lead to absurdity as Morepen would be saddled with liability in respect of something which it never took advantage of.

12. It is evident from the above discussion that the Arbitral tribunal, in this case, granted a part of Phafag’s claim. Morepen’s submission is that in

terms of Article 6.3 of the TKHL agreement, the question of payment of lump sum license fees, was for “*transfer of the initial Technical Know-how..*” It is further contended that such occasion never arose, because the Drug Controller never approved the manufacture and marketing of the formulations that were the subject matter of the two agreements. This argument overlooks that the consideration agreed upon by the parties, was split into two parts. The first was limited to production levels (“*a turnover royalty of 5% (five per cent) of the Net Sales Price total revenue*”) to be achieved by Morepen in the event of commercial production. Clause 6.3 talked of a different kind of fee, independent of production and net sales, or revenues; it is in “*addition to the royalty payments as set forth*”. The latter part of the clause (Article 6.3) is categorical, in that it records the agreement of the parties that the amounts paid are non-refundable : “*The amount paid in accordance with this provision shall be non-refundable, even if this Agreement should terminate for any reason before the contractual term.*”

13. The Arbitral Tribunal no doubt rejected the submission of Phafag that the entire amount was payable in terms of Article 6.3. However, at the same time, the Award relied on the materials on record that payments for November 2002 and February, May and August 2003 were due to Phafag. He no doubt adverted to Articles 11.2 and Article 1.3 of the TKHL agreement. But that did not, in itself mean that the license fee was payable only in the event of the commercial production beginning or taking off, pursuant to the Drug Controller’s approval. The amount payable under Article 6.3 was an additional lump sum license fee, spread over a period of seven years; it was towards access to the technology and process provided for by Phafag. In that sense, it was part of the larger claim for damages, as

held by the learned single judge, a “*pro-rata technical know-how fee.*” This Court holds that the argument that the claimant did not prove loss, and the award being consequently vitiated is without substance and merit. Likewise, it is held that the Arbitral tribunal did not exceed jurisdiction, or the terms of reference, as contended by Morepen.

14. This Court is conscious of the limited jurisdiction it possesses, while exercising appellate review over the judgment of a learned single judge who decides objections under Section 34 of the Act. The Division Bench, as an appellate forum would intervene only if the single judge’s determination about the Award’s exceeding jurisdiction, or being manifestly contrary to Indian law or substantive provisions, is erroneous. Short of such threshold, this Court, as an appellate court would not substitute its opinion to another plausible one, adopted by the court of first instance. On application of such standard, this Court discerns no infirmity or error in the approach or judgment under Appeal.

15. The result of the above discussion is that the appeal necessarily fails; it is accordingly dismissed, without any order as to costs.

**S. RAVINDRA BHAT
(JUDGE)**

**SUDERSHAN KUMAR MISRA
(JUDGE)**

FEBRUARY 28, 2013